Canadian Federal Finance During the Great War —

by

Leslie Thomas Fournier

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CANADIAN FEDERAL FINANCE

DURING

THE GREAT WAR.

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CONTENTS

CHAPTER I.

CANADIAN METHODS OF FINANCE BEFORE THE WAR.

The purpose of this thesis is to present a survey and appraisal of Canada's financial policy during the Great War; and to point out some of the problems of the post-war budget. In the introductory chapter an attempt will be made to outline federal methods of finance before the war, for the reason that Canadian War finance policy can best be examined in the light of previous finance methods.

The British North America Act allows the Dominion Government to levy both direct and indirect taxes, while it limits the Provincial Governments to direct taxation. This distinction between direct and indirect taxation is one which economists commonly make, when classifying taxes; - direct taxes, being those collected from persons who are expected and intended to bear them; and indirect taxes, those collected from persons who are expected to pass them on by charging higher prices for the objects taxed. Before the war, the federal government obtained practically all its tax revenue by means of import duties and excise taxes; that is, by indirect taxation. The only form of direct taxation was a head tax on Chinamen coming into Canada.

The distinction between direct and indirect taxes has psychological importance, because the individual, being taxed indirectly, does not always realize, in the first place, that he is being taxed and if he does, he is ignorant of the amount of the tax. Very often he is unaware that a large part of his grocery and drygoods bill is really a payment to his government plus the merchant's profit for advancing the amount of the tax. This psychological distinction is well illustrated by the fact that the Canadian tax payer before the war did not make the outcry about his tax bill that the Englishman made about his, and yet the average Canadian was taxed more heavily than the resident of the United Kingdom. Professor O. D. Skelton has compared the relative tax burdens in the United Kingdom and Canada for the year 1912-13.(1) His figures are compiled from British and Canadian blue books. Throughout his comparison he takes account only of taxes in the strict sense of the term,- receipts from State railways and the post office, which represent voluntary payments for specific services, are not included for either country. Nor is account taken of the burden thrown on the tax payer by the higher prices charged for protected goods manufactured in Canada; only the taxes paid into the Treasury are included. His conclusion is that the resident of Canada was taxed more than twice as heavily as the resident of the United Kingdom. And yet immigrants have long been attracted to Canada because of "our singularly light taxation"! In fact, on more than one occasion

(1) Federal Finance, pp. 3 and 4.

in the House of Commons during the early part of the war, the finance minister in opposing the adoption of a federal Income tax, spoke of the adverse effect it would have on Canadian immigration.

The Canadian system of public finance is similar to that of the British in having a Consolidated Fund to which are credited and out of which are paid the revenues and expenditures properly relating to each fiscal year ending March 31st. There are also miscellaneous accounts dealing with loans, debt-redemption, railway administration, capital expenditure on public works, and a variety of other subjects. A consideration of federal revenues and federal expenditures in the period from 1891 to 1914 will illustrate pre-war methods of finance in Canada. The main sources of revenue of the federal government of Canada from 1891 to 1914 are given below in tabulated form (see Table I).+ The net debt and the chief objects of expenditure for the same period are summarized in Tables II and III.+

In the cost of every branch of administration it will be seen there was more or less rapid growth. Of the items of ordinary or current expenditure charged to Consolidated fund, the chief increases were in subsidies paid to the provinces and in public works, with military and naval expenditure coming next. The expenditure for post-office and government railways showed a rapid increase, which was however more than offset by the gain in

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+ See pp. 3a. and 3b.

TABLE I.

Sources of Revenue, Dominion of Canada, 1891-1914.

(Millions of Dollars)

	1890-1	'95-6	1900-1	'05-6	'10-11	'11-12	'12-13	'13-14
Customs	23.3	19.7	28.2	46.0	71.8	85.0	111.7	104.6
Excise	6.9	7.9	10.3	14.0	16.8	19.2	21.4	21.4
Chinese Head Tax	.1	.1	.1	.01	1.1	1.5	1.7	1.3
Dominion Lands.	.2	.1	1.5	1.6	3.1	3.7	3.4	3.0
Post Office	2.5	2.9	3.4	5.9	9.1	10.4	12.0	12.9
Railways & Public Works	3.7	3.6	5.7	8.3	10.8	11.6	13.1	14.2
Other Sources	1.8	2.3	3.3	4.3	5.1	4.7	5.3	5.7
Total	38.5	36.6	52.5	80.1	117.8	136.1	168.6	163.1

TABLE II.

Debt of Canada
(In Millions.)

	1890-1	'95-6	1900-1	'05-6	'10-11	'11-12	'12-13	'13-14
Net Debt	237.8	258.4	268.4	267.0	340.0	339.0	314.3	335.9
Interest on Debt	9.5	10.5	10.8	10.8	12.5	12.2	12.6	12.8

TABLE III.

CHIEF OBJECTS OF EXPENDITURE, 1891-1914
(In Millions of Dollars)

Consolidated Fund	1890-1	1895-6	1900-1	1905-6	1910-11	1911-12	1912-13	1913-14
Debt Charges	11.7	12.8	13.4	13.4	14.1	13.8	14.4	14.7
Subsidies to Provinces	3.9	4.2	4.2	6.7	9.0	10.2	13.2	11.2
Public Works	1.9	1.3	3.3	7.4	8.6	10.3	13.4	19.0
Railways and Canals	4.5	3.8	6.3	8.7	11.1	12.3	13.7	14.9
Post Office	3.1	3.6	3.9	4.9	7.9	9.1	10.8	12.8
Militia and Defence	1.3	1.1	2.0	4.2	6.8	7.5	9.1	11.1
Naval Service	...	...	...	...	2.2	1.9	2.0	2.0
Civil Government	1.3	1.4	1.4	1.9	4.4	4.7	5.1	5.6
Legislation	.6	.9	1.1	1.3	1.6	2.4	1.3	1.4
Agr. and Statistics	.1	.2	.6	.6	1.3	2.7	2.6	3.2
Collect., Customs and Exchange	1.3	1.0	1.5	2.1	2.8	3.1	3.9	4.7
Dominion Lands	.1	.1	.1	.4	1.8	2.2	2.4	3.2
Immigration	.1	.1	.4	.8	1.0	1.3	1.2	1.9
TOTAL	29.9	30.5	35.2	52.4	72.6	81.5	93.1	105.7
Canals	1.2	2.2	2.3	1.5	2.3	2.5	2.2	2.8
Intercol. and P.E.I. Rly.	1.2	1.3	4.1	3.9	.8	1.8	2.5	4.5
Transcontinental Rly.	...	...	...	1.8	23.4	21.1	13.7	12.6
Hudson Bay Rly.	...	...	...	...	.1	.1	1.1	4.5
Welland Ship Canal	...	...	...	...	...	...	...	.9
Public Works	.5	.1	1.0	2.3	3.7	4.1	6.0	10.1
Railway Subsidies	1.2	3.2	2.5	1.6	1.2	.8	4.9	19.0
TOTAL	4.1	6.8	9.9	11.1	31.5	30.4	30.7	56.4
GRAND TOTAL (Including other items not here tabulated.)	40.7	44.0	57.9	83.2	122.8	137.1	144.4	186.2

receipts. Of the lesser items the increase in civil government or civil service expenditure was most noteworthy. It was, however, the increase in capital expenditures that accounted for much of the advance on the debit side of Canada's national accounts during this period. It will be noted that in no year did expenditure on consolidated account come near exceeding total receipts. When a Canadian finance minister announced a surplus, as was done every year from 1898 to 1914 and a good many years before 1898, he meant that the total receipts exceeded expenditure on consolidated account. The fact that the Canadian national debt (net) increased in spite of this apparent annual surplus was because consolidated and capital expenditure taken together exceeded total receipts each year following Confederation, with eight exceptions.(1) In the fifteen years from 1900 to 1914 there was spent on capital account nearly three hundred million dollars. Yet the net debt had increased during this period by only seventy million dollars and interest on debt by only two millions a year.

Canadian finance ministers have always regarded expenditure on capital account as extra-ordinary expenditure and have justified borrowing for that purpose. In this connection Professor Skelton says:- "Assuming that the expenditures charged to capital fund are really for permanent objects there seems to be no good

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(1) 1871, 1882, 1900, 1903, 1904, 1907, 1912, 1913.

reason why they should not be so differentiated from current outlay as they would be in the case of a private corporation and why, further, the bulk of such expenditure should not be borrowed if need be and the difference between receipts and consolidated fund expenditure be accounted the proper surplus or deficit. The bulk of such expenditure only - for in addition to the sinking fund, at least so much should be provided from current revenues as would correspond to the allowance a private company makes for its depreciation. That much posterity may reasonably ask from us; if we do more, and pay for all our capital expenditures as well out of current taxes, posterity will bless us more abundantly, even though recognizing that our generosity was not intentional but was due to the quasi-automatic increase of revenue, following increase of imports."(1)

An immediate effect of the war on Canada was to wipe out this annual "surplus" over and above current expenditure. From 1914 onwards the all important task was,- that of making ends meet on current expenditure. Even for a year or two before the war, it was evident that the margin between current income and current expenditure was becoming a narrow one. With the closing of the great railway construction period, and the collapse of the land boom which accompanied it, imports declined and customs revenues fell away. Indeed, for the first seven months of 1914, (calendar year) federal revenues were 20% less than for the same

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(1) Federal Finances, O. D. Skelton, p. 11.

period in 1913. Then came the war, on the one hand cutting down revenue still further by the disturbance to shipping and financial arrangements, while, on the other, increasing expenditure tremendously through the instant determination of the people of Canada to strain every nerve in the struggle for the liberties of the world.

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CHAPTER II.

A SURVEY OF THE ANNUAL FINANCIAL CONDITION OF CANADA FROM 1914-1919. WITH PARTICULAR EMPHASIS UPON THE VARIOUS MEASURES ADOPTED BY THE GOVERNMENT TO RAISE MONEY FO[illegible]ING WAR EXPENDITURES

When the war broke out Canada was experiencing a business reaction which had been in evidence for some months. This came in part as a result of the effect of the Balkan struggle on the London money market. Then with the cessation of intercourse with the enemy countries, the interruption of trade with Great Britain and her Allies, the demoralization of the exchanges, the requisitioning of shipping for war purposes, the restrictions placed by the Allies on exports and imports and the closing of the London money market,- the external trade was thrown into confusion. To such an extent was this the case that from April 1st, 1914, to the following January, the customs duties showed a falling off to the extent of nearly thirty millions.(1)

With the public revenues declining and the London financial market closed, the question of raising money for Canada's capital expenditures and above all for her military effort was a most serious one. So much so, that the Minister of Finance, Sir Thomas White, wrote in the latter part of August, 1914, to the Prime Minister, the Ministers of Railways and Public Works, urging

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(1) House of Commons Debates - 1915 - Budget speech.

that only the programme of public works which was under way be proceeded with, and pointing out the serious financial condition with which Canada was confronted in having to provide in addition to her other expenditures on consolidated and capital account, war expenditures of 50 millions for the remainder of the fiscal year.[1]

At this time Canada's military expenditure was mainly abroad so it was deemed advisable to borrow money from the British Government. This policy was a sound one, since it would have been a mistake at the outset of the war, with exchange adverse to Canada, to raise money in Canada to finance military expenditures in Great Britain and on the continent. Furthermore Canada's bank deposits were fully employed in meeting commercial requirements. The large Canadian loans which were floated during the last years of the war were made possible by the increased production within the country, promoted by the high prices and large profits. These profits were available for war loans, the proceeds of which were all expended in Canada in the financing of further production. Accordingly, for the period from September to the end of March, 1915, British Treasury advances to the Canadian Government totalled twelve million pounds sterling. "Indeed, Canada's whole financial fabric as a nation depended at the outbreak of the war upon conditions in London and upon the policy of the British Administration."[2]

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(1) House of Commons Debates, 1915, Budget speech.

(2) The Story of Canada's War Finance, p.

With regard to Canada's contribution in men, it was thought by many public men that a maximum of 25,000 in the first contingent with an additional 25,000 later on, would be a mighty achievement on the part of the Dominion and likely more than would be necessary. It was felt that with Britain in the war, the central Empires must speedily be crushed. In the light of these expectations, expressed in many quarters at the time, it is interesting to observe the actual figures of Canada's war army. The total number of men enlisted in Canada from the beginning of the war to November 15, 1918, was 595,441, out of which 418,052 had gone overseas in the Canadian Expeditionary Force.[1] Until the winter of 1917-18 the Canadian Expeditionary Force was recruited by voluntary enlistments. During the winter the Military Service Act which had been passed the previous July came into operation, and after that time 83,355 were obtained for the force.[1] These were partly men who were drafted and partly men, in the classes called out, who reported voluntarily. The movement of troops overseas by years was as follows:

Before December 31, 1914	30,999
Calendar Year 1915	84,334
" " 1916	165,553
" " 1917	63,536
January 1-November 15, 1918	73,630
TOTAL	418,052

(1) "Canada's Part in the Great War" - Govt. Statistics - Sage.

I have said that when the Special Session of Parliament met in August of 1914, the financial prospect for the immediate future was none too bright. Moreover, all the elements contributory to a panic were then present in Canada, as elsewhere. It required but the slightest sign in high quarters to spread a lack of confidence, to cause a run on banks and to bring the country to financial and business disaster. The manner in which the government and the bankers handled the situation and their repidity of action was notable. It drives home the fact that Canadian executives have the British way of refusing to be stampeded in times of crises. It is instructive to observe the manner in which the financial aspect of the war situation was handled. For this purpose I have summarized the financial measures passed by the Special War Session of 1914:

(1) The Dominion Government stood ready to issue Dominion notes to such an amount as was necessary against securities deposited by the banks and approved by the Minister of Finance.[1]

This legislation was intended by Parliament "to enable the banks of Canada to extend in this time of stress such credit facilities to the community as may be proper, having regard to prevailing conditions and the observance of sound banking principles".[2]

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(1) The Finance Act, 1914 - Statutes of Canada.

(2) House of Commons Debates - Sir Thomas White.

So we see that the finance department was authorized to make advances to the chartered banks by the issue of Dominion notes upon the pledge of securities, deposited with the minister of finance, of such kind and amount as might be approved by the treasury board, which was appointed for this purpose of advising the finance minister as to the securities to be accepted. Such advances were to be repayable at such times as the board might determine, with interest at a rate likewise to be determined by the board but not less than five per cent per annum. This legislation helped the banks considerably in financing the operations of railroads, provincial governments, municipalities and corporations, while it also facilitated the financing of the crop movement.

(2) The government authorized the chartered banks of Canada to make payments in bank notes instead of in gold or Dominion notes until further official announcement in that behalf.[1] "This action will tend to preserve the Canadian gold supply against demands from foreign sources."[2] This was in keeping with the policy of the Imperial Government to conserve the commercial and financial interests of the United Kingdom. The total amount of the notes of any chartered bank in circulation at any time was not to be in excess of the amount of its notes issuable under the provisions of the Bank Act.

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(1) Statutes of Canada - The Finance Act, 1914.

(2) Statutes of Canada - Order in Council, August 3rd, 1914.

(3) The redemption in gold of Dominion notes was suspended.[1] The purpose of this law was similar to that of the one just described.

(4) The government authorized the chartered banks to issue excess circulation to an amount not exceeding 15% of the combined unimpaired paid up capital and rest or reserve fund of the respective banks. Interest not exceeding 5% was to be paid on the excess circulation.[1]

(5) The Governor-in-Council was authorized to proclaim a montorium if necessary.[1] Fortunately the necessity for the proclamation of a moratorium by the Dominion Government did not arise.

(6) An act respecting Dominion notes was passed, authorizing the finance minister to issue Dominion notes and to hold gold as security for their redemption to the amount of 25% of Dominion notes issued up to 50 million dollars. As security for the redemption of Dominion notes issued in excess of fifty million dollars, the Minister was to hold an amount in gold equal to such excess.[2] The effect of this act was to change the previous Dominion Notes Act whereby a margin of 25% gold might be held as security for an issue of thirty million dollars. The notes outstanding at the end of June, 1914, were $114,182,098 with

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(1) Statutes of Canada - The Finance Act, 1914.

(2) Statutes of Canada - The Dominion Notes Act, 1914.

a gold reserve of $92,663,575 so that the uncovered issue amounted to $21,518,523 and the percentage of the reserve to notes in circulation was 81.[1] The minister of finance soon found it necessary to issue twenty-six millions of Dominion notes, but was unable to comply with the section of the act regarding security.[2] Consequently legislation was passed on this occasion confirming and authorizing these issues of Dominion notes. At the end of June, 1915, the notes outstanding amounted to $152,120,734, with a gold reserve of $89,573,041, so that the uncovered issue amounted to $62,547,693 and the percentage of the reserve to notes in circulation was 59. These figures remained substantially unchanged till the end of June, 1917. By the end of June, 1918, the ratio of the gold reserve to the notes outstanding had fallen to 41% and to 33% in 1920.

(7) A war appropriation of 50 millions was voted for the remainder of the fiscal year ending March 31st, 1915. This was appropriation, as was likewise the case with each succeeding one, was issued for the following purposes:[3]

(a) the defence and security of Canada;

(b) the conduct of naval and military operations in or beyond Canada;

(c) promoting the continuance of trade, industry and business communications whether by means of insurance or indemnity against war wisk or otherwise; and

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(1) Canada Year Book.
(2) Statutes of Canada (1915), An Act respecting certain issues of Dominion Notes - April, 1915.
(3) Statutes of Canada (1915), An Act for granting to His Majesty aid for military and naval defence, April 1915.

(d) the carrying out of any measures deemed necessary or advisable by the Governor-in-Council in consequence of the existence of a state of war.

(8) Tariff legislation was passed involving new taxation to increase revenues. This special war taxation chiefly affected the rates of duties of customs and excise upon coffee, sugar,spirits and tobacco, and was estimated to bring an extra revenue of $7,200,000 for the remainder of the fiscal year to end March 31, 1915.

The opening of the year 1915 found Canada with her first contingent overseas and with 50,000 men in training at home. It was clear that she must raise additional revenues. Industry and general business were still feeling the effects of depression; and customs returns were showing heavy declines. Canada was obliged to depend upon the British Treasury in order to meet not only her war expenditure in England and in Canada, but a part of her public works and railway expenditure as well. Since London exchange was at a premium the British Treasury was quite willing to lend to the Dominion even for expenditure other than war expenditure in Canada. The situation in this respect, however, gradually underwent a change, owing to the immense expenditure by Great Britain in the United States for munitions, foodstuffs, steel and other manufactured products. Thus by June, 1915, exchange had become unfavorable to Great Britain and the problem of finding funds to purchase in constantly increasing amounts in the United States and Canada became a vital one for the British Treasury. It was this that led to the many issues of British Loans in the United States.

√ The story of Canadian finance during the war was briefly as follows:

Britain lent Canada the money in London to pay all her military expenses overseas. She repaid Britain by moneys placed to her credit in Canada, while Britain used these credits to purchase munitions, wheat, flour and other Canadian products. The sale of these products aided Canadians in subscribing to the war loans. In a sentence, Canada paid the cost of her military operations by her production; and Canadian goods and services constituted the price which Canada paid to Britain for providing for her expenditure overseas. Canada, before the end of the war, was to see that not only all her borrowings for this purpose from the British Treasury were repaid, but an indebtedness to her by the British Treasury would arise of 400 million dollars, one half of which would be owed to the Dominion and the other to the Banks.

In his budget presented on February 11th, 1915, Sir Thomas White explained the financial arrangement which Canada had made with the Imperial Government. "We shall pay interest at the same rate as is paid by the Imperial Treasury upon its war loans, from the proceeds of which advances are to be made to us. At such time or times in the future as may be agreed upon by the British Chancellor of the Exchequer and the Canadian Minister of finance, a Canadian war loan or loans will be issued and the borrowing from the British Parliament repaid. It seems to me that no fairer terms could be named than those so generously accorded us by the Imperial authorities."(1) He went on to point out that the expenditure on capital and consolidated account would be some 60 million dollars in excess of the consolidated revenue for the approaching fiscal year. In addition to which, the proposed war appropriation for the year was 100 million dollars. "My proposals for meeting the situation are as follows: So far as special war expenditures are concerned which may reach one hundred million dollars, I should be disposed, if we had not such heavy and uncontrollable capital expenditure to meet, to recommend that we should pay at least a part of it from current revenue. But it is obvious upon a consideration of the figures which I have submitted that we shall not by any reasonable supplemental taxation measures be able to close the gap between revenue and expenditure, much less to pay a part of the principal of our special war outlay. In the circumstances I have no hesitancy in proposing to the House that we shall borrow the full amount required under this heading. Canadian Governments have always justified public borrowing for capital account on the principle that expenditure upon enterprises permanent in their nature, enures to the benefit

(1) House of Commons Debates, 1915.

and advantage of future generations, who may therefore fairly be asked to pay interest on the debt contracted in respect to them. If this theory is correct and so far as I know it has never been challenged seriously, then we need have no reluctance in borrowing to meet the expense of this war, because such borrowing is for the purpose of accomplishing for future generations that which is infinitely more precious than material undertakings, namely the preservation of our national and individual liberty and the constitutional freedom won by our forefathers during centuries of struggle, enjoyed by us to-day, and destined, we believe, to be ours for all time."[1] I will reserve for chapter 4 my criticism of the idea expressed in this quotation.

In order that the country's credit should not suffer it was necessary that an attempt be made to meet at least part of the huge deficit. This attempt resulted in the passing of the Special War Revenue Act of 1915. There were a number of special taxes which, in summary form, included: (1) one percent upon the note circulation of all Banks, upon the gross income derived in Canada by all Trust and Loan Companies, upon net premiums received in Canada by all Insurance organizations other than Life, Fraternal, Benefit and Marine Associations (2) one per cent upon all cable and telegraph despatches originating in Canada with a charge of fifteen cents or over; (3) five cents upon railway and steamboat

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(1) House of Commons Debates - Budget Speech, February 11/15.

tickets purchased in Canada for any part of Canada, New Foundland, West Indies, and the United States, and five cents additional for each five dollars or fractional part of five dollars; (4) ten cents upon every purchaser of a berth in a sleeping car and five cents for each seat in a parlour car; (5) one dollar upon every purchaser of a ticket entitling the purchaser to transportation by vessel to ports or places other than those mentioned above in (3), if the cost exceeded ten dollars; three dollars if it exceeded thirty dollars and five dollars if it exceeded sixty dollars; (6) a stamp tax of two cents upon cheques, receipts, bills of exchange, bills of lading, express and post-office orders; and one cent upon patent-medicines and perfumes of retail price not over ten cents and two cents for over that amount; (7) a stamp tax upon wine, non-sparkling, sold in Canada, of five cents per bottle, one quart or under, and five cents per additional quart; of twenty-five cents per half-pint bottle of champagne and twenty-five cents on each additional pint. From these Sir Thomas White expected to raise eight million dollars at least.

Another fiscal measure was the uniform increase in general customs duties of 7 1/2 per cent and in British preferential rates of 5%. Wheat, flour, tea, anthracite coal and several other items were excepted from the increase. The justification for this unusual mode of raising tariff rates was that revenue was imperatively needed and it was no time in the midst of war to revise the whole tariff, item by item. Under ordinary circumstances, indeed, the flat increase of the preferential tariff by five percent and of the general tariff by seven and a half would be open to grave criticism, and further, the imposition of a tax on all but a few articles in the free list would be indefensible even on protectionist principles. It would appear strange that fifty years' experience of tariffs had not made it possible to discriminate between different schedules, indicating in what cases a higher tariff would yield more revenue and in what cases it would simply prevent further importation. But, as pointed out above, in the early months of the war, immediate revenue was more important than exact justice, and a flat horizontal increase had the possible advantage that it could be repealed en bloc in the future. The new customs and excise taxes imposed in August 1914 were calculated to yield 15 million dollars in a full year and the additional taxes of 1915 twice that sum. "The result of this Customs increase was to almost immediately increase the national revenue and greatly stimulate business throughout the country. It encouraged production both on the farm and in the factory; and assisted in conserving Canada's gold supply and the maintenance of our exchange with foreign nations by tending to reduce our importation of many articles and foodstuffs which we ourselves could produce. My own view is that this increase in customs duties at the beginning of the war was of the utmost value to Canada in maintaining general prosperity and financial stability during the war and in the period succeeding the armistice."[1]

In July, 1915, Canada sold in New York twenty five million dollars of one year five per cent notes at par, and twenty millions of two year notes at ninety-nine and a half with the option to holders of conversion into five per cent twenty year debentures. By using the proceeds for ordinary expenditure thereby releasing the same amount of Canadian revenues for war purposes, the Canadian finance minister took this loan out of the category of war issue. This was the wish of the American Government which at this time was neutral. The first domestic loan was floated in November of the same year. For some months it had been under consideration and it was regarded as a somewhat doubtful experiment. No loan of over five million dollars had ever been subscribed in Canada before and a war issue of less than twenty-five millions would have been hardly worth while. There was, however, the necessity of discontinuing borrowing from the Imperial Treasury for war expenditures in Canada. Exchange with America was unfavorable now to Great Britain. Her purchases in the United States were on a constantly growing scale. Every withdrawal from London by the Canadian Government of funds advanced by the Imperial Treasury aggravated the exchange

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(1) "The Story of Canada's War Finance" - Sir Thomas White, p.18

situation and added to the cost to the British Government of funds with which to make trans-Atlantic purchases. Canada assuredly didn't desire to lean upon the Imperial Treasury more than was absolutely necessary, but up to the spring of 1915, conditions were far from favorable for domestic financing on a large scale. A decided change took place in Autumn. It was the year of the great wheat crop in the Canadian Northwest, and the year in which Canada began to manufacture munitions. Probably the most significant sign of the changed conditions was the alteration of Canada's trade balance. This for years past had been continually adverse. For the three years ending March 1913, the average annual excess of imports was 239,000,000; for the year 1913-14 this excess of imports was 180 millions; by 1915 it had been reduced to 36 millions and in the year 1915-16 the balance was favorable to Canada by an amount exceeding two hundred millions.[1]

This first Canadian war loan was of maturity of ten years. It bore interest at five per cent and sold at ninety-seven and a half. This gave an interest yield of between five and five and a quarter per cent. This rate was considered rather low in comparison to what could be obtained upon other high grade securities and it was issued free of taxation. "This had been insisted upon by the New York interests which floated our earlier loan there and was regarded as a specially attractive

(1) Canada Year Book.

feature by Canadian financial experts."[1] The privilege, also, of converting at issue price into bonds of any succeeding domestic loan, was granted to holders of these bonds. The reason for this was that many investing interests were disposed to hold off until the next loan, believing that it must soon come and that with advancing interest rates it would be offered at a more favorable yield. The objective of the loan was fifty million dollars, toward which the banks promised to subscribe twenty-five millions. This was found unnecessary, however, for the people subscribed slightly over one hundred million dollars. This notable and striking success created a sensation at home and abroad; even more so in fact when it was learned that one half of the proceeds of the loan (i.e., 50 million dollars) was to be loaned to the British Government to enable her to purchase munitions, foodstuffs and other supplies in the Dominion.

This and all subsequent Canadian war loans, with the exception of the third Victory Loan floated in 1919, were issued exempt from taxation. While it is true that the supreme necessity at the time was to raise funds for the vast war expenditures, the question none the less arises whether the exemption privilege was essential to this end. So far as Canadian loans floated in the United States were concerned, the privilege was essential. Yet giving exemption on New York issues did not in the least entail

(1) "The Story of Canada's War Finance" - p. 26.

giving exemption on issues floated at home. Great Britain exempted every loan floated in the United States from British taxation, while at the same time she made issues floated in Great Britain taxable. There are many factors, indeed, making for the success of a war loan aside from tax exemption privileges,- patriotism, organization, rate and conversion privileges. A comparison may be made between the Victory Loans of Canada and the Liberty Loans of the United States. The United States was fresh and unprecedentedly prosperous, while Canada had borne the brunt of the war for many months; on the other hand the Republic was planning a much more drastic tax programme. Patriotism counts in the success of a loan, not with all men, but with most, and surely that factor was as great in Canada as in the United States! It scarcely requires a great amount of patriotism to be induced to accept 5 1/2 percent tax free bonds for one's money on absolutely safe security. The rate counts, and Canada offered 5 1/2 percent, while the United States offered 4 1/2, with not nearly so tempting exemption privileges.

I conclude this outline of the financial condition of Canada, for the year 1915, with a summary of the revenue and expenditures of the government for the fiscal year ending March 31st, 1916, and of the loans floated during the same period.

Receipts	Expenditures
Consolidated Fund Receipts -	Consolidated Fund Expenditures -
$172,147,483.27	$130,350,726.90
Other Receipts - - - - - - -	
$ 1,555.30	
Sinking Fund - - - - - - - -	Capital Expenditure & Other Exp.
$ 1,773,021.11	$ 43,154,020.12
Net Addition to Debt - - - -	War Expenditure - - - - - - - - -
$165,780,087.81	$166,197,755.47
$339,702,502.49	$339.702,502.49

The loans floated during the year:

(1) Amount - $ 23,332,500 - 5 year - 4 1/2% bonds - March - London

(2) " - $ 25,000,000 - 1 year notes - 5% - July - New York

(3) " - $ 20,000,000 - 2 " " " " " "

(4) " - $100,000,000 -10 " bonds - " - Nov. - Canada.

In his budget speech on February 15, 1916, Sir Thomas White reviewed the war expenditure, which involved appropriations of 50 million dollars in 1914, 100 millions in 1915, and an estimated 250 million dollars for the coming year 1916 –– to meet expenses of troops growing by stages from 50,000 to 100,000, then to 250,000 and with a new authorization in 1916 of a 500000 total. Sir Thomas White, in his 1915 budget speech, had urged strong objections against the adoption of a direct income tax. It will be well before proceeding with the new features of the budget of

1916, to consider this question of the advisability of the adoption of an income tax in Canada in the earlier years of the war. I shall attempt to summarize the arguments both for and against its adoption.

One of Sir Thomas White's objections was the heavy expense which he thought would be incurred in creating machinery for assessment, revision, and collection of the tax, as compared with the amount which would be realized. Using the United States as a basis for his argument, he did not see how Canada could hope to raise a sum in excess of two million dollars. Another alleged feature of the tax which made it appear unsatisfactory was the length of time that must elapse before it would become productive. The chief objection of Sir Thomas White's, however, was that under legislation existing in certain of the provinces, income was already subject to taxation by some municipalities and it was not his wish to enter upon their domain.[1] So far as the immediate necessities of the war budget were concerned, there is no question that the second objection above mentioned was sound. An income tax requires time, time for thorough investigation as to the best form to adopt, time for getting the machinery of assessment and collection in working order. It could not give results as immediate as a customs or excise tax. But the fact that the war lasted longer than was

(1) Budget Speech, 1915.

expected and that it was found necessary in the following year to impose this "much-talked-of" income tax shows that it might have been better to have made earlier provisions for it. As regards the objection that the yield of the tax would be small as compared with the expense of collection it developed that Sir Thomas White's fears were ill-grounded.

His chief objection, however, was the desirability of leaving this and other direct taxes to the provinces. If the municipalities and provinces in question had been using the income tax as the sole or even main basis of their tax systems - the objection might have been valid. More will appear on this subject in a later chapter. It will suffice here to note that the adoption of the income tax in 1917 did not have the serious consequences or disadvantages anticipated by Sir Thomas White.

An important feature of the budget of 1916 was the Business War Profits Act which provided for the taking of a percentage of the profits of persons, firms, and companies carrying on business in Canada.(1) It provided for taxation to the amount of 1/4 of all profits in excess of seven percent upon the paid up capital of imcorporated companies; except life insurance companies and those engaged in agriculture, and in excess of ten percent upon the capital of persons and partnerships engaged in business. It applied

(1) Statutes of Canada, 1916.

only to those firms with capital of $50,000 or over, except manufacutrers of munitions who were taxed under it without respect to capital. Furthermore the tax was made retroactive so as to apply to profits made since the beginning of the war. It will be observed that incorporated companies were taxed upon a higher basis than individuals and partnerships. "The reason for this is that capital in the case of joint stock companies frequently represents intangible assets or capitalized good-will or earning power. It was deemed impossible to ascertain the precise cash value of the assets of companies relative to their capitalized value - hence the higher tax. Provision is to be taken for preventing evasion of taxation by further stock issues or the incorporation of companies for the purpose of taking over existing businesses. Provision is also to be made for preventing the postponement of the taking of profits in orders and contracts wholly or partially performed."[1] Banks and companies already taxed under the provision of the Special War Revenue Act of 1915 were exempt from this taxation to the extent which they were taxed by the earlier Act. The yield of the Business Profit Tax for the year ending March 31/17 was $12,500,000.

The details of national financing during 1916 may be summarized at this point:

(1) Loans in the United States;

(2) Loans in Canada;

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(1) Budget speech - 1916 - February 15th.

(3) Loans to Great Britain for the purpose of purchasing munitions; with a general reorganization of British and Canadian financial relationship.

In March, 1916, a 75 million dollar loan was placed in New York in three portions, at 5%, and bearing five, ten and fifteen year terms. In Canada two war loans were floated during the year; the first issued in September was a loan of 100 million dollars, 5% gold bonds maturing in fifteen years, and the second was issued in March 1917, to the extent of 150 millions for 20 years at 5%. It has already been stated that 50 million dollars of the over-subscription to the 1915 domestic Canadian loan was lent to the Imperial Treasury. This policy was continued, a further advance of 75 million dollars being made out of the proceeds of the 1916 war loan; to this the banks added 25 million dollars, making a total to that time of 150 million dollars loaned by the Dominion Government and Banks to the Imperial Treasury. By the end of the year 1916, this figure had increased to 250 million dollars.

A summary of the revenues and expenditures of the Government for the fiscal year 1916-17 follows:

Consolidated Fund Receipts - $232,701,294.00	Consolidated Fund Expenditures - $148,597,343.23
Sinking Fund - - - - - - - - $ 1,471,690.50	Capital & Other Expenditures - - $ 43,114,960.42
Net Addition to Debt - - - - $264,030,126.78	War Expenditure - - - - - - - - $306,488,814.63
$498,203,118.28	$498,203,118.28

In his budget speech delivered on April 24th, 1917, the finance minister made mention that the policy of the government was "to fund war indebtedness so as to postpone its maturities to periods well beyond the end of the war, and by increased taxation on the one hand, and the reduction of current expenditures on the other, to meet from the annual income all annual outlays, including interest and pension charges, and in addition a substantial amount of the war expenditure itself." There were no tariff changes announced; but the Business Profits Tax Act of 1916 was amended as follows:[1] 50% of all profits in excess of 15%, but not exceeding 20% per annum and 75% of all profits in excess of 20% per annum upon capital. "That is to say, up to 15% the business interests will be liable under the existing legislation and in addition we shall take one-half of their profits between 15% and 20% and three-quarters of their profits over 20%. The increased tax will chiefly affect manufacturers of munitions and other war supplies. While the percentage of excess profits which is taken is large, sufficient is left to provide incentive to effort on the part of all subject to War-tax."[2] The Minister discussed income tax proposals again, but declared that in view of competitive continental conditions in wealth and population, with the balance in favor of the Unived States this taxation should not be resorted to

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(1) Statutes of Canada, 1917.

(2) Budget Speech - 1917 - April 24th.

until absolutely necessary, in order that Canada's immigration might not be affected adversely.

Financial interests were in some measure opposed to this Excess Profits Tax and Sir Thomas White was strongly criticized [1] by the Financial Times of Montreal, in particular, on the ground that (1) the tax was not equitable and discriminated against one small group of citizens; (2) that it would remove the incentive to war activities of an industrial character and restrict production; (3) that it would eliminate the source of large contributions to war loans and war requirements; (4) that it was a tax on enterprise and on special ability, on capital, on efficient production; (5) that the basis of the so-called excess profits was the keeping of capital and labour occupied twenty-four hours a day instead of eight hours and that the profits were not consequently excessive; (6) that war industries required capital, but only for a limited and doubtful period, and that in order to get and keep investments and increasing plants for a temporary business, large profits were essential. The fact that none of these dreadful things happened would lead one to take these arguments for what they are worth. The manufacturers' organ, "Industrial Canada", objected not to the principle, but to its application, and the Legislative Committee of Manufacturer's Association at Winnipeg on June 15th, 1917, claimed that no amount of revenue which the increased taxation of profits

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(1) Canadian Annual Review - 1917 - The financial administration of Sir Thomas White.

could possibly yield would compensate for the detrimental effect of such a tax upon the industrial future of the country.

It seems to the writer that the war profits tax found its sanction in the conviction of patriotic men that no one should profit largely by the war. Apart from the patriotic aspect, however, there was the plain necessity for more direct taxation. Taxes based on consumption, so far as they are based on articles used mainly by the masses, as is often the case, are regressive and therefore undesirable. Taxes such as tariff duties in so far as they are levied on machinery, materials, or semi-finished goods, raise costs all along the line and put home industry at a disadvantage in world markets at least in peace time, when competitive conditions obtain.

On July 25th, 1917, the minister of finance announced a proposed national income tax.[1] The Military Service Act was about to be passed, establishing conscription in Canada, and as a result increased war expenditure was expected. Sir Thomas White, who up to this time had been opposed to the adoption of a federal income tax, was at last obliged to give way. "In view of the financial situation, the increased demands which will be made upon us, and the purpose of the people of Canada in this war, it is manifest to me that the time has arrived when we must resort to this measure."[2]

(1) Statutes of Canada - 1917 - August 29th.

(2) House of Commons Debates - Sir Thomas White - July 25th, 1917.

He went on to state that apart from the necessity of the tax from a financial standpoint, there had arisen both in the House of Commons and in the country a very natural and in his view a very just sentiment that those who were in the enjoyment of substantial incomes should substantially and directly contribute to the growing war expenditure of the Dominion. The adoption of an income tax was an innovation in federal government finance; for apart from the Business War Profits tax which was a measure of direct taxation, although narrow in scope, the government had relied as we have seen chiefly on customs and excise taxes.

The Income War Tax Act which was finally passed on September 20th, 1917, provided for the levy of an income tax of 4% upon all incomes in excess of $1500 per annum in the case of unmarried men and widowers without dependent children, and upon all incomes exceeding $3000 in the case of all other persons; and in addition thereto a supertax of 2% upon the amount by which the income exceeded $6,000 and did not exceed $10,000; 5% of the amount over $10,000 to $20,000; 8% of the amount over $20,000 to $30,000; 10% of the amount over $30,000 to $50,000; 15% of the amount over $50,000 to $100,000; 25% of the amount over $100,000. The tax was to apply to all incomes beginning with year 1917. In framing the act the finance minister had regard to the greatly increased cost of living, the Municipal taxation upon incomes, running in some places as high as 3%; and the income taxes of some of the provinces. Corporations and joint stock companies were required to pay the normal tax of 4% upon income exceeding $3,000 but were not subject to the supertax. Further more they were allowed to deduct from their taxes the amounts paid by them for the year under the Business War Profits Act of 1916 and the special War Revenue Act of 1915. The adoption of an Income Tax was a step in the direction of a sound financial policy and it is to be hoped it will have the effect of making the federal tax system as a whole proportionate and as time goes on progressive.

A notable feature of Sir Thomas White's policy was his continuous financial cooperation with the British Treasury. Substantial sums had already been loaned by Canada to the British Government. In July, 1917, most urgent despatches were sent to the Canadian Government by the British authorities pointing out that it would be impossible for them to continue purchasing cheese, hay, oats and flour from Canada unless Canada provided the credits. As a result, advances totalling one hundred and seventy million dollars were made by the Canadian Government to the British authorities during the next four or five months. I have indicated elsewhere the extent of the indebtedness of the British Treasury to Government and banks of Canada as of March 31st, 1920.

A review of the year 1917 would not be complete without some mention of the flotation of the first of Canada's three Victory loans. These three victory loans were floated in 1917, 1918, 1919 respectively, and raised an aggregate of more than seventeen hundred million dollars. When we consider that this sum was almost twice the amount of all the deposits in all the chartered banks of Canada before the war, we realize why these three victory loans are spoken of as the greatest financial achievement of Canada during the war. As has already been pointed out, the business of Canada literally depended upon her ability to finance a large part of her foreign trade. The people of Canada met the situation by their subscriptions to the three victory loans. These loans were the foundation of the enormous volume of business done by Canada during the last two years of the war.(1) They kept the Dominion Treasury in funds through which it was possible both to meet war expenditures in Canada and supply credits for Great Britain's purchases in Canada. These loans, moreover, enabled Canada to conclude the war with practically no floating debt.

The year 1917 was probably the most trying period of the war. It was a time of deep anxiety and uncertainty as to the outcome. While it marked the entry of the United States on the side of the Allies, it was also the year of Russia's revolution and subsequent collapse. The German submarine campaign was at the height of its destructiveness. It was directed at enemy and

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(1) In the fiscal year 1918 there was an excess of merchandise exports of \$622,637,214; in 1919 the excess was \$349,053,580; and in 1920, \$222,150,586.

neutral shipping alike in the desperate endeavour to starve Britain into submission and bring the war to an immediate end. In order to conserve food and meet as adequately as possible the overseas need, control was established in Canada and the nation put on rations. It was during this year as pointed out that the stress of the conflict and the strength of public opinion in favour of "equality of sacrifice" brought about conscription. In the realm of finance, the sentiment of the public was reflected in a desire for heavier taxation. This desire for heavier taxation resulted in the passing of the revised Business War Profits Act and the Income Tax Act both of which have been described. A statement of the revenues and expenditures for the year follows:

Consolidated Fund Revenue - $260,778,953.	Consolidtaed Fund Expenditure - $178,284,313.
Increase in net debt - $315,455,066.	Capital Fund Expenditure - $ 43,111,904
....	All other civil expenditure - $ 11,000,000
....	War Expenditure - $343,836,802.
$576,233,019	$576,233,019

The Honorable Mr. A. K. McLean, acting minister of finance in 1918, during the absence of Sir Thomas White, described the financial requirements for the fiscal year 1918-19 in his budget speech delivered on April 30th, 1918, as follows:

(1) Obligations to be met during the year:

For the civil budget.............	$230,000,000
For the war budget...............	$425,000,000
For advances to the Imperial Govt.	$325,000,000
TOTAL...........................	$980,000,000

(2) Available for the above purposes:

Revenue.........................	$270,000,000
Advances by Great Britain, to pay for Canadian troops overseas..	$300,000,000
Unexpected balance of 1917 victory loan as of March 31, 1918........................	$130,000,000
TOTAL	$700,000,000

The amount therefore to be obtained by borrowing totalled at least $280,000,000, and possibly a great deal more. It was necessary that taxes be increased, yet as Mr. McLean pointed out, "no taxes should be imposed which would paralyze industry of any kind, hamper enterprise, or breed discontent amongst the people; at the same time none should be avoided which were essential to provide the revenue required and which would distribute the incidence of the burden equitably."(1) He pointed out also that prohibition entailed a yearly loss of over fifteen million dollars in revenue. The Business Profits War Tax Act, under which

(1) Budget Speech, April 30th, 1918.

$12,506,516 had been received in 1916 and $21,271,283 in 1917, and an estimated $25,000,000 for 1918 was to be continued for another twelve months.

The financial measures for the year included an amendment of the Business Profits War Tax Act, in order to tax businesses with capital of $25,000 to $50,000. The tax was 25% of the amount of the profits exceeding 10% per annum. The Income War Tax Act was amended so as to reduce exemptions, and to increase the rates of the supertax; in addition to which there was a new war surtax as follows: upon income in excess of $6,000 but not exceeding $10,000, five percent of the normal tax and supertax payable thereon; upon income in excess of $10,000 but not exceeding $100,000, ten percent of the normal tax and supertax payable thereon; upon income exceeding $100,000 but not exceeding $200,000 fifteen percent of the normal tax and supertax payable thereon; upon income exceeding $200,000, thirty-five percent of the normal tax and supertax payable thereon. The corporation income tax was increased from four percent to six percent. Corporations were, however, not liable to pay the supertax or the surtax. The Inland Revenue Act was amended to provide for increased taxes principally on tobacco and cigarettes. The Special War Revenue Act was also amended providing for an increase in the tax on sleeping car berths and parlour car seats; an excise tax of one percent per hundred matches, of 8 cents per pack of playing cards; a special ten percent on automobiles, jewelry, gramophones, mechanical pianos, when imported or manufactured in Canada; a tax of ten percent on tea with corresponding increases in the taxes on coffee and chicory.

In the summer of 1918 a loan of 65,000,000 was placed in New York, which made a total borrowed there during the war of $285,000,000. The second victory loan was issued in November and realized $681,230,450. Sir Henry Drayton, minister of finance in 1920, in answer to a question in the House of Commons on May 5th, 1920, as to the amount of Canadian government bonds issued in Canada during the war and still outstanding, supplied the following figures:

Date and Maturity	Amount Issued	Outstanding, March 31/20
War loan 1915-25	$100,000,000	$43,246,300
" " 1916-31	$106,706,300	$54,398,700
" " 1917-37	$172,926,800	$92,652,800
Victory loan 1917	$546,148,750	$513,628,150
" " 1918	$681,230,450	$676,938,050
" " 1919	$594,725,200	$566,302,847.42
TOTAL		$1,947,166,847.42

With the exception of the 1919 Victory Loan these bonds were all issued exempt from Federal taxation; so that on March 31/20 the total amount of outstanding bonds which were exempt from the operation of the Income War Tax Act was $1,380,846,000.00.

We may now consider the revenues and expenditures for the fiscal year 1918-19. During the year the expenditure of the Dominion upon account of ordinary services of government amounted to $232,731,282; the outlay upon capital account was $25,031,266; the war expenditure was $446,519,439. On the other side of the account we see total revenues of $312,946,747. Of this total 147,000,000 was received from customs, 30 million from excise taxes; 33 million from taxation under the Business Profits War Tax Act, 10 millions under the Income War Tax Act; 14 millions from other war taxation and 55 millions from miscellaneous sources including 38 millions from railways. The increase in the net debt for the year was $391,345,240.

This concludes the survey of the various financial measures passed by the Canadian government to meet civil and war expenditures. A critical examination of the policies adopted will be found in Chapter IV.

CHAPTER III.

THE COST OF THE WAR TO CANADA.

An attempt will be made in this chapter to appraise the direct cost of the war to Canada. The direct money costs of the war may be presumed to consist of the actual cash expenditures incidental to its prosecution. The books of the finance department show a total war expenditure as of March 31st, 1920, of $1,670,410,240. The annual expenditures on war account during the years 1914 to 1920 are given in the following table:(1)

1914-15	$60,750,476
1915-16	$166,197,755
1916-17	$306,488,814
1917-18	$343,836,802
1918-19	$446,519,439
1919-20	$346,616,954
TOTAL	$1670,410,240

The year 1919-1920 is included as a war year because of expenditure incurred in that year for demobilization. The cost of the war to Canada as submitted to the Reparation Commission at Paris were estimated at $1,500,000,000, a figure that is slightly less than that mentioned above.(2)

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(1) Canada's Part in the Great War - p.

(2) Bogart, E. L. - Direct and Indirect Costs of the War - p. 51.

There is reason for believing that the direct cost of the war to Canada was more than is usually represented by the actual expenditures on war account. The estimated annual interest charge on Canada's national debt for instance was on March 31st, 1920 - $107,000,000, whereas in the last pre-war fiscal year, 1913-14, it was but $12,893,534. Furthermore there are the pensions to soldiers and their dependents. For the year 1918-19 the amount paid on this account was $18,282,440 and for 1919-20 - $26,004,461.(1) For a generation or more Canada may look forward to providing say 35 to 40 million dollars per annum for pensions. In addition there has been the annual expense for the maintenance of hospitals, convalescent homes and other services established for the aid and comfort of the soldiers.

Besides the actual money cost, the cost of a war consists in loss of life, destruction of property and loss of economic efficiency. It is impossible to appraise such varied values, for some of them are clearly not reducible to monetary valuation. Accordingly, no attempt has been made to estimate the indirect cost of the war to Canada. Nor in the estimate of the direct money outlay has consideration been taken of the increased expenditure of the federal government on ordinary account since the beginning of the war. On account of inflation in Canada during the war, the ordinary expenditures of the government were in excess of normal

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(1) Canada Year Book, 1920.

years. It is true that revenue increased for the same reason, though it is extremely doubtful whether revenue increased on account of inflation in the same proportion as expenditures. In so far as the excess ordinary cost of government above normal years can be measured (deducting the increase in revenue due to inflation) it is attributable and chargeable to the war.

The total war expenditure of $1,670,410,240 for the six war years has already been set forward. During the same period the expenditure of the Dominion for civil purposes was $1,425,672,150. This includes the expenditure on current or consolidated fund account, capital expenditure, (including construction of railways, and other public works, and railway subsidies) and other minor charges. A detailed statement of the foregoing follows:[1]

Fiscal Year	Consolidated Fund	Capital Exp.	All Other Exp.
	$	$	+ $
1914-15	135,523,206	41,447,320	10,000,000
1915-16	130,350,727	38,566,950	4,000,000
1916-17	148,599,343	26,880,031	16,000,000
1917-18	178,284,313	43,111,904	11,000,000
1918-19	232,731,283	25,031,266	7,000,000
1919-20	303,843,930	69,301,877	18,000,000
TOTAL	1,129,332,802	244,339,348	52,000,000

+(approximately)

(1) Canada's Part in the Great War, p.

The total expenditure for the six fiscal years 1914-20 is therefore as follows:

Fiscal Year 1914-20	- War Expenditure.........	$1,670,410,240
" " " "	- Consolidated Fund Exp...	$1,129,332,802
" " " "	- Capital Expenditure.....	$ 244,339,348
" " " "	- All other Expenditure...	52,000,000
	TOTAL...............	$3,096,082,390

During the same period the consolidated fund revenue, that is, receipts from sources other than loans, and including taxes, and income from lands, public works, post-office, etc. was $1,461,394,649. In the following table, is given an itemized account of the consolidated fund revenue for each year:[1]

(See Table p. 43a.)

It will be noted that in the first year, 1914-15, the revenue, so far from providing a surplus to be applied on war expenditure, did not even cover the civil budget, and that a sum nearly double the amount spent on the war was added to the national debt. In the second year, civil receipts and expenditures balanced leaving the whole war outlay to be met by borrowing. In the third and fourth years, there were substantial surpluses over all civil expenditure, making it possible to apply $41,000,000 in one year and $28,000,000 in the other, to the principal of the war

(1) Canada Year Book.

CONSOLIDATED REVENUE.

(In millions of dollars)

Year ending March 31st

Items	1914-1915	1915-1916-	1916-1917	1917-1918	1918-1919	1919-1920
Customs	75,941,220	98,649,409	134,043,842	144,172,630	147,169,188	168,796,823
Excise	21,479,731	22,428,492	24,412,348	27,168,445	30,342,034	42,698,083
War Taxes		3,620,782	16,302,238	25,379,901	56,177,508	82,079,802
Post Office	13,046,665	18,858,690	20,902,384	21,345,394	21,603,542	24,471,709
Railways	12,149,357	18,427,909	23,539,759	27,172,208	37,967,551	.........(1)
Dominion Lands	2,859,715	2,299,550	4,055,662	4,443,758	3,539,927	4,622,592
Interest on Investments	2,980,247	3,358,210	3,094,012	4,466,724	7,421,002	17,086,981
Other Items	4,518,490	4,504,796	6,351,049	6,629,893	8,725,995	9,990,345
TOTAL	133,073,482	172,147,838	232,701,294	206,778,953	312,946,747	349,746,335

(1) $41,402,061 Railway Revenue was transferred to special account.

outlay. In the year 1918-19, there was a surplus of $61,000,000 over all civil expenditure but in the following year there was a deficit of $48,000,000. Taking the six years of the war together, therefore, we find a surplus of revenue over all civil expenditure of $35,722,499. In other words of the total principal of the war outlay to March 31, 1920, amounting to $1,670,410,240, only $35,722,499, or slightly over 2%, was met out of current revenues. It must, however, be borne in mind that a heavy and rapidly increasing burden of war interest and pensions was met out of current revenue in this period. On the other hand, the civil budget had been relieved of the greater part of ordinary military and naval expenditure, running about $15,000,000 a year in peace time.

It was suggested in 1919 by Sir Thomas White,[1] that all revenues in excess of consolidated fund expenditure should be considered as a surplus applicable on the principal of the war outlay, and that we should consider that a portion of the increased debt has really been incurred for capital expenditure not ordinarily to be met out of current income. There is, of course, a case for the contention that capital, non-recurring expenditure should be met by loans, not from current revenue. When the capital outlays recur year after year, however, this contention loses force. In any case the practical point is that in normal

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(1) House of Commons Debates, June 6th, 1919.

pre-war years only a part or none at all of the capital expenditure had required to be met by loans. Ordinary revenue of late years had covered both current and capital outlays, including the cost of railway construction and sbusidies. The net debt in 1914 was only $100,000,000 more than it was a quarter of a century before so that the annual average shortage was only $4,000,000. This fact indicates, therefore, the basis to be taken in a comparison of war with pre-war Canadian finance.

It would seem that the basis adopted in estimating the proportion of war expenditures which were met out of war revenues is practical as well as fair. Yet it is interesting to note that other bases have been adopted. Mr. Friedman in his book "International Finance and its Reorganization", referring to the ratio of war taxes to war expenditures in the case of United States, Great Britain, France, Italy and Germany, uses the terms war tax and war expenditure to mean the surplus over peace figures. So that the war figures are obtained by deducting from the total figures, the figures of the last peace year multiplied by the number of years of the war period. On this basis he reaches the conclusion that the ratio of war taxes to war expenditures (excluding loans to Allies) in the case of United States was 31.4%; Great Britain, 23.1%; France 1.1%; Italy, 7%; Germany, 4%. Using this same method of comparison in the case of Canada, we discover that the war taxes in Canada bore a ratio of 24% to war expenditures, as shown below:

<u>Ratio of war taxes to war expenditures</u> -

(1) Total expenditures 1914-1920 - - - - - - - - - - $3,096,082,390.

Peace expenditures for six years
6 x $186,000,000 - - - - - - - - - - - - - $1,116,000,000.

∴ war expenditures - - - - - - - - - - - - - $1,980,082,390.

(2) Total revenue 1914-1920 - - - - - - - - - - - - $1,461,394,649.

Peace revenue for six years
6 x $163,000,000 - - - - - - - - - - - - - $ 978,000,000.

∴ war revenue - - - - - - - - - - - - - - - - - $ 483,394,649.

∴ Ratio of war revenues to war expenditure = 24%.

It is evident therefore on this basis Canada does not compare very unfavorably with Great Britain and the United States. However, for the purpose of appraising Canada's war finance policy, it is probable that the former basis suggested is the more useful and satisfactory.

It is pertinent to our study of the state of Canada's federal finances during and since the war to refer to the annual increase in the net national debt. It is customary for the finance department when mentioning the public debt to refer to the net debt, that is the gross debt less certain assets, such as investments and reserves. These assets are both active and non-active; in the figures presented below, the net debt has been calculated by subtracting only the active assets from the gross debt:

(See p. 46a.)

PUBLIC DEBT OF CANADA - 1914-1920.[1]

Year ending March 31	1914	1915	1916	1917	1918	1919	1920
Total debt	554,391,369	700,473,814	936,987,802	1,382,003,268	1,863,335,899	2,460,183,021	3,041,529,587
Total assets	208,394,519	251,097,731	321,831,631	502,816,970	671,451,836	647,598,202	792,660,963
Net Debt	335,996,850	449,376,083	615,156,171	879,186,298	1,191,884,063	1,812,584,819	2,248,868,624
Interest on debt	12,893,505	15,736,743	21,421,585	35,802,587	47,845,585	77,531,432	107,527,089
Interest on investments	1,964,541	2,980,247	3,358,210	3,094,012	4,466,724	7,421,002	17,086,981

(1) Canada Year Book.

Thus the increase in the net debt for the six war years in $1,912,871,574. It is almost entirely attributable to war expenditure. This is the financial situation so far as it relates to the national debt. The amount is large, and averages $250 per head of population, and the annual debt charge averages $12.00 per head. However, comparing it with the present national debts of European countries, including Great Britain, who were active participants throughout the war, and having regard to the relation of debt to number of population and to national wealth,(1) we must regard it as distinctly more favorable. It will nevertheless constitute a burden on the people of Canada for generations to come. The proportion which the debt charges now bear to the ordinary expenditures of government and to revenue appears in the following table:

Year ending March 31.	Population	Revenue per Head	Total Expenditure Civil & War per Head	Debt Charge per Head.+
		$	$	$
1914	7,725,000	21.12	24.15	2.00
1915	7,928,000	16,78	31.00	2.32
1916	8,140,000	21.14	42.37	2.93
1917	8,360,000	27.82	60.00	4.52
1918	8,593,000	30.35	67.76	6.00
1919	8,835,000	35.42	79.20	9.08
1920	9,030,000	38.73	82.00	12.00

of management, interest, sinking fund and premium, discount and exchange except for year 1919-20 when sinking made a special account.

Coates, Dominion Statistician, in Journal Associatiation, October, 1919, as $16,000,000,000.

In considering the subject of Canada's national debt, an important aspect from the viewpoint of its bearing on Canada's financial standing and credit is whether it is owed at home or abroad. It is the view of some, including Sir Thomas White, that a national debt, no matter where it is owed, is debt, it does make some difference to national strength, whether it is held in the country itself, that is to say whether the people regarded in the aggregate owe it to individual members of the community, or whether it is owed to citizens of other nations. From a national standpoint it is claimed, a public debt owed to a nation's own people is not nearly so serious an obligation as if owed abroad. The interest paid upon it is disbursed at home and remains part of the national resources. When the principal is paid, there is a transfer of wealth from the government to its own citizens. But if the debt is held abroad every interest and principal payment diminishes the resources of the debtor nation. Before the war, Canada's borrowings for federal, provincial, municipal and industrial purposes were principally in Great Britain and the United States. Therefore, in this respect, the situation as regards Canada's national debt may (not?) be regarded with satisfaction. contradiction On March 31st, 1920, the funded debt of the Dominion government was payable as follows: London.....$336,001,470,

Canada.....$2,066,856,126,

New York...$135,873,000. Besides which there were floating or temporary loans amounting to $88,862,000.

CHAPTER IV.

A CRITICAL EXAMINATION OF CANADA'S WAR FINANCIAL POLICY.

The purpose of this Chapter is to appraise the policy of war finance in Canada in the light of accepted principles of war finance. The fiscal and social considerations to be accounted for in an ideal policy of war finance will be briefly reviewed, followed by a sketch and if possible, defence of the shortcomings of Canada's policy in the light of these considerations.

The greatest problem that faced the finance department of the federal government was that of securing funds to pay for the vast war expenditures. It involved the question as to how far the government should finance the war by taxes and how far by internal loans. Internal loans, be it noted, because it was not possible to borrow externally to any great extent. The loans made by Great Britain to Canada early in the war were but temporary advances to be repaid shortly from the proceeds of Canadian loans. Likewise, Canadian loans floated in New York were all short-time issues with the exception of an issue in March 1916 of $75,000,000 of 5, 10, and 15 year bonds and a rather unsuccessful issue in the summer of 1918 of $65,000,000.

The only other plan available for raising funds on a large scale - manipulation of the currency - has been almost universally condemned. The following table tells the story of Canada's issues of unconvertible Dominion notes:

Year ending June 30th	Notes in Circulation	Specie Reserves	Circulation uncovered by specie.
1914	114,182,098	92,663,575	21,518,523
1915	152,120,734	89,573,041	62,547,693
1916	175,497,175	114,071,032	61,426,143
1917	178,568,009	119,110,113	59,457,896
1918	281,339,514	114,951,618	166,387,896
1919	300,749,844	118,268,407	182,481,437
1920	292,016,290	95,538,190	196,478,100

In respect of the vexed problem of taxes versus loans, let us search out the considerations which determine the proportion of total costs which it is desirable to meet by taxes and loans respectively. In Chapter II, Sir Thomas White was quoted to the effect that Canadian governments had always justified borrowing for capital expenditure on the principle that expenditure upon enterprises permanent in their nature enures to the benefit and advantage of future generations who may, therefore, fairly be asked to pay interest on the debt contracted in respect of them; and that since war expenditure was for the purpose of accomplishing for future generations that which is infinitely more precious than material undertakings, namely the preservation of national and individual liberty, Canada need have no reluctance in borrowing to meet such war expenditure. This statement illustrates a common confusion of thought. It illustrates a belief that in so far as war is financed out of taxation, the economic burden involved in it is borne at the time of the war, whereas, in so far as it is financed out of loans, the burden is thrown forward upon the future. This is a misconception. No doubt when Canada borrowed from the United States the burden was shifted to future tax-payers, but, as pointed out, this course was only possible on a small scale. Practically all Canada's funded debt had to be contracted in Canada. Canada, by borrowing practically her whole war expenditure has simply given individual creditors the right to recoup themselves in the future from individual taxpayers. Such an authority as A.C. Pigou may be quoted to substantiate the theory that "as regards the distribution of war costs between present and future, the influence of the government's choice between taxes and loans is secondary and remote".(1) We therefore may come to the conclusion that the desire to shift part of the financial burden of the war to future generations by a policy of war loans was based upon a misconception.

There are several considerations which should determine the relative reliance upon loans and taxes in the financing of a war. A sound financial program for the conduct of a war requires first that taxation be adequate to meet interest on the growing debt so that the government may preserve its credit unimpaired

(1) The Economy and Finance of the War. - p. 67.

and support the price of its outstanding securities, and second that as much of the extraordinary expenditure of the war as is expedient be met out of war taxation. However, it is agreed on all sides, that during the transition period at the outbreak of war, taxation should not be so increased as to prevent the rapid adjustment of industry to the war-time programme, though subsequently the rates should be increased and new taxes instituted to meet as much of the extraordinary expenditure of the war as is possible, to the limit that war-time production be not curtailed.

The reason why all economists advocate heavy taxation (along the lines which I will indicate) in time of war are readily explained. The most important reason possibly is the unfair distribution of the war burden between people of different grades of wealth which results from a policy of war loans. Mr. Pigou, in his book "The Economy and Finance of the War", explains this point extremely well: "What is the difference", he asks, "between the effects of raising 1000 millions from the better-to-do classes by means of progressive taxation and by means of war loans, which will, as a matter of fact, be subscribed in a progressive sense? As regards immediate effects, there is no difference. These people provide the money more or less in the same proportion which ever plan is adopted. But, as regards aggregate effects, there is a great difference. Under the tax method the rich and moderately rich really shoulder the whole burden of the charge that is laid upon them. Under the loan method, they do not do this; because they are compensated afterwards through taxes laid for that purpose partly on themselves, but partly also on the other and poorer sections of the community. Under the tax method a great deal of money is obtained from the very rich and rich of this generation without compensation. Under the loan method the same amount of money is obtained from them, but a contract is appended to the effect that the poorer classes in future generations shall pay money to their descendants as a reward for their present patriotic conduct. That is the vital difference between the two methods. It follows, that the root principle, in accordance with which the Government should decide how far to finance the war by taxes and how far by loans, is the judgment that it forms concerning the right ultimate distribution of war costs between people of different grades of wealth." A second reason is that loans lead to inflation to a greater degree than does increased taxation. Furthermore there are available during a war, special sources of taxation, such as war profits, which should be largely drawn upon, not only on principles of equity but to avert popular discontent. It is also a cardinal principle of war finance that since inflation inevitably occurs in time of war, it is desirable to meet out of current taxation as much of the inflated costs of the war as possible, because after the war when prices fall the government will be paying back to the privileged holders of war bonds more in commodities (over and above interest payments) than such creditors turned over to the government when they subscribed to the war loans.

It was for these reasons desirable that a large proportion of the costs of the war should have been met out of current taxation. What can Canada actually show in this respect? We discovered in Chapter III that Canada met just slightly over 2% of her war expenditure out of current taxation, using one basis of valuation and 24% when we used another basis. Furthermore but 47% of the total Canadian expenditure during the war was met out of current revenue. More significant are the figures showing that federal government revenue averaged $21.40 per head in 1914 and 38.73 per head in 1919-20. In the meantime, expenditure had increased from 186 millions in 1914 to 736 millions in 1919-20 — that is, four times the pre-war expenditure. Owing to inflation during the war it is difficult to form an accurate conclusion, yet it must be evident that Canada did not pay out of current revenue that proportion of the total war cost which, in the light of the fiscal and social considerations mentioned above, was advisable, and which Canadian war time prosperity would have made possible.

It is the opinion of most economists that not only should as large a proportion of war costs as possible be met out of current revenues, but that a large proportion of whatever revenue is raised should come from taxes levied directly on property or income rather than on expenditure. In this respect Canada has failed dismally as the following table (showing the proportion of direct to indirect taxes in Canada for each of the six years) illustrates;

Year	Taxes on Consumption	Per Cent	Taxes on Property & Income	Per Cent
1914-15	97,800,000	100	none	...
1915-16	128,400,000	99	1,200,000	1
1916-17	160,900,000	92	13,800,000	8
1917-18	173,800,000	88	23,000,000	12
1918-19	189,400,000	81	44,300,000	19
1919-20	227,100,000	77	66,800,000	23
TOTAL	971,800,000	87	149,100,000	13

The demand for progressive systems of taxation is becoming more and more evident in recent years. The principal objection to progressive taxation, if carried out too drastically, is that it would seriously check saving and hamper industry. But the objection is not valid as regards special taxes levied on an exceptional occasion for financing an unprecedented war. Such taxes did not carry an expectation of continuance and did not, therefore, react upon habits of saving and work in the way that taxes levied in the ordinary course of public finance might be expected to do. The general effect of this consideration is to convince us that a very much larger proportion of the financial burden imposed by the war on the community should have been laid upon the shoulders of the very rich and the rich than it would be proper to lay upon them in respect of normal peace expenditure. In other words the ratio in which the war was financed with money borrowed from people with large incomes should have been diminished; and the ratio in which it was financed with money collected from them under some form of progressive taxation should have been much increased.

Canada was distinctly at a disadvantage in the early part of the war in not having a diversified system of taxation. It is a circumstance to be regretted that the finance minister in 1914 and 1915 had no other recourse than to increase the customs and excise taxes on the old lines, except the introduction of a few stamp taxes and taxes on a few classes of corporations. Income taxes, land taxes, and general corporation taxes would all have required some time for investigation and for getting the machinery into play; and time was lacking. Yet there can be little doubt that it would have been possible and desirable to have had a federal income tax earlier than we did. It would then have been possible to have obtained during the war a larger sum than $29,000,000 from this desirable source. In conclusion it may be remarked that the redeeming feature in Canada's war financial policy was that our showing for the last two years of the war was a great improvement over the earlier years.

CHAPTER V.

PROBLEMS OF THE POST-WAR BUDGET.

The Finance Minister, in his 1923 budget speech, told a story of the burden of debt as an aftermath of the war; of a surplus of revenue over ordinary expenditures swallowed up and turned into deficits by expenditure on special accounts and railways. Yet he closed with a buoyant note of optimism, arguing that the period of depression through which Canada has been passing is about over; and with good times, will come balanced budgets and a reduced national debt.

A comparison of the annual federal government expenditure for the three post-war years, 1921, 1922, 1923, with that of the three pre-war years, 1912, 1913 and 1914, indicates fairly satisfactorily the extent of the post-war financial burden. The itemized figures for the pre-war years will be found in Chapter I. It will suffice here to again indicate the totals:

Total government expenditure for fiscal years:

1911-12 - $137,100,000

1912-13 - $144,400,000

1913-14 - $186,200,000

The total government expenditure for the fiscal years, 1920-21, 1921-22, and 1922-23, were:

1920-21 - $418,600,000 + $109,997,000 advances to railways.

1921-22 - $365,700,000 + $ 97,950,000 " " "

1922-23 - $350,600,000 + $ 83,900,000 " " "

The explanation for the vast increase in government expenditure for normal years is to be looked for in an itemized account of the post-war budget. The figures for the fiscal years 1920-21, and 1921-22 are given below.

Consolidated Fund Expenditure - for year ending March 31st

	1921	1922
Charges on Debt	140,653,607	139,357,449
Subsidies to Provinces	11,490,860	12,211,924
Collection of Revenue (including Post Office	43,740,040	49,217,080
Militia and Defence	9,893,863	11,017,533
Pensions	37,420,751	36,153,031
Civil Government	8,784,178	9,968,932
Public Works (Income)	10,846,875	10,574,364
Soldiers Civil Re-Establishment	35,174,788	17,147,651
Other Items	63,113,183	61,913,691
TOTAL	361,118,145	347,560,691
Special Expenditure		
Capital Expenditure	40,012,807	16,295,332
War and Demobilization	16,997,544	1,544,250
Other Charges	492,048	301,518
GRAND TOTAL	418,620,544	365,701,791
Advances to Railways	109,997,655	97,950,645

Canada has built up a very large public debt, so large, in fact, that the interest alone on that debt calls for the payment of a sum of money greater than the total expenditure of the federal government for the fiscal year 1912. In addition, payments for pensions and other obligations incurred as a result of the war, help to swell the total. In addition, the annual deficits of Canada's national railway system is a source of worry to government officials. The advances made since the close of the war have been indicated. They constitute one of the reasons for Canada's increasing public debt, the figures of which are given below:

Public Debt of Canada as of March 31st.[1]

	1921	1922	1923
Total Debt	2,902,482,117	2,902,347,137	2,888,827,237
Total Assets	561,603,133	480,211,336	435,050,368
Net Debt	2,340,878,984	2,422,135,801	2,453,776,869
Interest on Debt	139,551,520	135,247,849	137,892,735
Interest on Investments	24,815,246	21,961,513	16,465,303

The gross national debt of Canada on March 31st, 1914, was 544,391,369 as against assets of 208,394,519, leaving a net debt of $334,996,850. Comparatively small as was this debt, it was a debt incurred almost altogether either for public works of general utility which, like the Intercolonial and Transcontinental railways and the canal system, remained assets, though, perhaps, not realizable assets of the nation; or was expended as subsidies to enterprises which, like the Canadian Pacific Railway, though not government owned, assisted greatly in extending the area of

(1) Canada Year Book, 1923.

settlement as well as the productive and therefore the taxable capacity of the country. Broadly speaking, it was a debt incurred for productive purposes. Also it was held mainly outside the country. Great changes have taken place in Canada's national debt: (1) the extent of its growth has been indicated; (2) as having been largely incurred for war purposes, the gross debt is not represented by corresponding assets; (3) the debt is held mainly in Canada; (4) the average rate of interest paid on interest bearing debt has been considerably increased, namely from 3.52 per cent. as of March 31st, 1914, to 5.120 per cent. as of 1923. Had it been possible to keep down the rate of interest to its pre-war level, the debt charge would be nearly $45,000,000 less than it is. Post-war conversions of debt to lower rates of interest are likely to reduce substantially the annual interest payments within the next few years.

The main problem before the government is to find suitable sources of revenue in order to accomplish the task of reducing Canada's public debt. The desirability that government revenue should be derived mainly from taxes levied directly on property and income rather than on expenditure, has been pointed out in an earlier chapter. The record of Canada in this respect was not all that could be desired until near the conclusion of the war. However, a distinct improvement in methods of taxation was made during the war ans has been followed up in the post-war budgets. In the fiscal year 1919-20 direct taxes constituted

23% of the total tax revenue for the year. The sources of revenue for the fiscal years (ending March 31st) 1921 and 1922 are given below:

Items	Receipts 1921	Receipts 1922
Customs	163,266,804	105,686,645
Excise	37,118,367	36,755,206
War Taxes	168,385,327	177,484,161
Post-Office	26,706,198	26,402,299
Dominion Lands	3,955,326	2,799,450
Interest on Investments	24,815,246	21,961,513
Other Items	12,044,917	11,173,297
TOTAL	436,292,185	382,262,571

It can be seen at a glance that the proportion which the war taxes (Business Profits Tax, Income Tax and special taxes under the heading of the Special War Revenue Act of 1915) bear to the customs and excise tax is distinctly more favorable than in previous years. Of the total war taxes in 1921, the Business Profits Tax yielded $40,841,401, the Income Tax, $46,381,824; and under the heading Inland Revenue comes the remainder. $78,803,099. For 1922 the Income Tax on both personal and corporate income yielded $101,500,000, and Inland Revenue amounted to $75,981,161. The Business Profits War Tax Act took effect only to the 31st December, 1920.

Although the Income Tax was proclaimed a war tax just as the Business Profits War Tax, there can be no doubt but that it is here to stay. The fact alone that it is needed to at least counteract the regressive character of some of the customs duties, is a good reason for giving it a permanent place in Canada's system of taxation. Canada is not likely, within the next few generations, to materially change her tariff system; protectionism is too strongly entranched. Yet the advantages of direct taxation in the federal tax system are now being seen and have become in evidence in recent legislation. In the 1919 session of Parliament the Income War Tax Act was amended so as to increase the general rate of taxation of the earlier act. Under this act all corporations paid 10% of their net income in excess of $2,000 as against 6% under the former act. In respect of individuals, the normal rate of 4% was to be levied on all incomes exceeding 4% but not exceeding $6,000, in the case of unmarried persons and widows or widowers without dependent children; and upon all incomes exceeding $2,000 but not exceeding $6,000, in the case of all other persons, the respective minima being exempt from taxation. A normal tax of 8% was levied on the excess of all incomes over $6,000. The surtax was imposed on a progressive scale on all incomes over $6,000 applying first at the rate of 1% on the amount by which the income exceeded $5,000 and did not exceed $6,000, 2% on the amount by which the income exceeded $6,000 but not $8,000; then at a rate increasing by 1% for each $2,000 increase of income up to $100,000, so that 48% was levied on the amount by which the income exceeded $98,000 and did not exceed $100,000 - then at 52% on the amount by which the income exceeded 100,000 but not 150,000 - 56% on 150,000 to 200,000 - 60%, 200,000 to 300,000 - 63%, 300,000 to 500,000 - 64%, 500,000 to 1,000,000 - 65% on excess over 1,000,000.

In 1920 the Income Tax Act was further amended so as to increase the tax and surtax by 5% on incomes of $5,000 or more. The present Act is essentially as here recorded.