FINANCING THE ROYAL NAVY, 1905-1914: SOUND FINANCE IN THE DREADNOUGHT ERA

by

TODD CHRISTOPHER CAMPBELL

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Department of History

The University of British Columbia
Vancouver, Canada

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ABSTRACT

The theory of sound finance which dominated British fiscal ideology in the Victorian and Edwardian periods hindered Britain's ability to respond decisively to the German challenge to Royal Navy supremacy from 1905-1908, as the then Chancellor of the Exchequer, Asquith, concentrated on reducing the National Debt and retrenchment of naval expenditure. This was a mistake as it encouraged Germany's naval ambitions. The Government, constrained by the ideology of sound finance, did not realize the enormous resources available to it by shifting the focus of taxation to direct sources of revenue through the income tax and death duties. As Royal Navy supremacy had to be maintained regardless of the cost and the Liberal Government was committed to social reform, a reform of the fiscal system was necessary. Lloyd George fully exploited the fiscal system in his "People's Budget" of 1909, relying heavily on innovations previously introduced by Asquith, and it fulfilled the Government's revenue requirements admirably up to the outbreak of war in 1914. The Liberal Government was able to finance both the supremacy of the Royal Navy and costly social reforms, in the process introducing the era of both modern Government finance and the welfare state in Britain.
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To my Grandparents
The keeping of the sea I reckon not among the ordinary charges, how it be the charge thereof is yearly borne because it is not estimable, and the King hath therefor the subsidy of poundage and tonnage. Nor the less by that reason poundage and tonnage may not be reckoned as parcel of the revenues which the King hath for the maintenance of his estate, because it ought to be applied only to the keeping of the sea. And though we have not always war upon the sea, yet it shall be necessary that the King have always some fleet upon the sea, for the repressing of rovers, saving of our merchandise, our fishers, and the dwellers upon our coasts; and that the King keep always some great and mighty vessels, for the breaking of an army when any shall be against him upon the sea. For then it shall be too late to do make such vessels. And yet without them all the King's Navy shall not suffice to board with carracks and other great vessels, nor yet to more break a mighty fleet gathered of purpose.

Sir John Fortescue, The Governance of England, ca 1470
INTRODUCTION: THE ROYAL NAVY AND SOUND FINANCE

The theory of sound finance which dominated British fiscal ideology in the Victorian and Edwardian periods hindered Britain's ability to respond decisively to the German challenge to Royal Navy supremacy from 1905-1908, as the then Chancellor of the Exchequer, Asquith, concentrated on reducing the National Debt and retrenchment of naval expenditure. This was a mistake as it encouraged Germany's naval ambitions. The Government, constrained by the ideology of sound finance, did not realize the enormous resources available to it by shifting the focus of taxation to direct sources of revenue through the income tax and death duties. As Royal Navy supremacy had to be maintained regardless of the cost and the Liberal Government was committed to social reform, a reform of the fiscal system was necessary. Lloyd George fully exploited the fiscal system in his "People's Budget" of 1909, relying heavily on innovations previously introduced by Asquith, and it fulfilled the Government's revenue requirements admirably up to the outbreak of war in 1914. The Liberal Government was able to finance both the supremacy of the Royal Navy and costly social reforms, in the process introducing the era of both modern Government finance and the welfare state in Britain.

The naval arms race between Britain and Germany prior to the First World War was, at the time, unprecedented in scale and scope and came to define the relationship between the two countries which culminated in that war. This arms race required an extraordinary commitment of technical and financial resources by each side, as well as the concurrent political will to provide them. Strategic imperatives necessitated that Britain respond to any and all challenges
to the Royal Navy's supremacy, and in accepting the challenge posed by Germany's navy the arms race ensued. The limits to this naval arms race were essentially technical/industrial and economic, the former determined by each nation's shipbuilding capacity and the latter by its ability to finance that shipbuilding. These limitations were necessarily interdependent and required the political will of government to initiate and carry them out, and for this popular support was required, especially in Britain.

The expenses of the Royal Navy were funded out of the British Government's general tax revenues, although in the event of shortfalls in revenue short term loans would be arranged. Prior to the First World War British budgets tended to be balanced, as "...Victorian policy insisted that the Chancellor must always plan for a balanced budget, save in the most severe emergency."1 The budget itself was presented in the spring estimating the Government's revenue and expenditures for the following fiscal year. In cases where unforseen revenue shortfalls or expenditure increases occurred short-term borrowings would fill the gap, although extraordinary events such as the Boer War required long-term borrowing: in the 1900-01 budget "...out of the total cost to date [£69,323,000], £25,460,000 had come out of taxation and £43,863,000 from loans."2 It was generally believed that such an unusual situation must be put right at the first opportunity so as to return to the conditions of the balanced budget. Tax revenues were provided by a mixture of direct and indirect taxes, the latter more important than the former at the beginning of this period. In 1895 the Chancellor of the Exchequer, Sir William Harcourt, estimated expenditure

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of £95,981,000 which was “...roughly an additional £2,000,000 on 1894-5, for which the Naval expenditure ... was chiefly responsible.” This estimate would be very close to the actual revenue in that year due to the important principle of the balanced budget in which surpluses were almost as deplorable as deficits.

The largest component of government expenditure in the years prior to 1900 was military spending, of which the navy had the biggest share, and the next most important was payments to the National Debt. “...[I]n the decade 1890-9, for example 40 per cent of government expenditure (£36.4 million annual average) went to the armed forces, and 26 per cent (£23.6 million annual average) went to pay National Debt charges, which were themselves the result of past wars.” The interest charges on the debt were paid out of tax revenues from a fixed sum provided in the Budget, while the principal of the debt would be gradually paid by means of a sinking fund when money was available for it. Social spending grew rapidly until the First World War especially after the Liberals came to power in 1906 and introduced old age pensions, national health insurance and vastly increased expenditure on education. At the same time as social spending was increasing naval expenditures also rose; from £21.8 million in 1897-98 to £38.3 million in 1904-05.

The specifics of financing the Royal Navy were quite straightforward, although the fact

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3Ibid., p.99.


6“Central government expenditures had risen by 630 per cent between 1888 and 1913, admittedly from a very low base.” Kennedy, p.356.
that it took anywhere from one to three years to construct a battleship required considerable long-
term planning to make sure the necessary funds would be available for the construction of each
ship through to its completion. The Navy Estimates, the money to be made available to the Navy
in a given fiscal year, were provided in the Budget estimate after being,

...beaten out in the Committee of Imperial defence after extensive reviews by interested
departments. In the Cabinet, the Chancellor would name an appropriate allocation for the
services and his colleagues would consider both the sum and the policy proposals in the
light of the current diplomatic, financial, and domestic situations. All deliberations were
carefully vetted by the Treasury. 7

In the case of cost over-runs in a ship-building programme that surpassed the Navy Estimates set
out in the Budget, supplemental Navy Estimates would make up the difference. This was, next
to actual revenue shortfalls, the likeliest reason for government expenditure to exceed what was
indicated in the Budget, and guaranteed the Chancellor some heckling from the Opposition. 8 The
following gives an indication of the scale and scope of Naval expenditures in the nine years
between 1899-1900 and 1908-09: “...the Admiralty had given out £150 million for shipbuilding,
repairs and maintenance, £30 million for naval armaments and £15 million in works and building
at home and abroad.” 9 This does not include payroll costs which were a significant portion of
Naval expenditures. Nonetheless, the Government hesitated to resort to borrowing, with the
exception of the loans mentioned previously, to finance the increasing costs of the Navy. This
fact was a source of pleasure to those “economists” who believed in the prudential management

7 C. Trebilcock, “Legends Of The British Armaments Industry, 1890-1914: a Revision.”,
Journal of Contemporary History vol.5, no.4 (1970), p.12. The C.I.D. was a recent innovation
[1904], prior to which the Cabinet provided the battle ground.

8 See, for example, Mallet, p.128.

9 Kennedy, p.300.
of government expenditures and balanced budgets. To this philosophy every Chancellor at least paid lip service, as the following from the Budget speech of April 13, 1899 shows:

Sir Michael Hicks-Beach justly took credit for the fact that British naval and military expenditure was, unlike that of our competitors, met out of the annual revenues of the country, and that even such permanent works as harbours, dockyards, and barracks were provided for by loans for short periods and not by additions to the debt.¹⁰

Nonetheless, this borrowing, however favourably it might compare with that of Britain's rivals, did not appeal to the Liberal opposition who eschewed even loan finance of that nature. Their objection was that such loans, besides increasing the state's indebtedness, removed expenditure from the overview and scrutiny of Parliament, thus encouraging extravagant expenditure. This fiscal philosophy was best described as the theory of sound finance.

Except for the Boer War years, when the Army expenditure was higher, the Navy was the largest single spending department of the British government. The First Lord of the Admiralty presented the Navy Estimates to Parliament each spring. The Estimates provided a detailed breakdown of anticipated Naval expenditure for the upcoming year and preceded the Government's budget by about a month, although they were prepared in consultation with the Cabinet and the Chancellor of the Exchequer. Britain constructed twenty-six battleships following the Naval Defence Act of 1889 and before 1899, at an average cost per ship of £957,172. A further sixteen battleships were built or laid down for construction between 1900 and 1905, at an average cost per ship of £1,339,448. Naval expenditure had risen substantially during the Boer War, from £23,880,875 in 1898/9 to £31,003,977 in 1902/3, and to £36,859,681

¹⁰Mallet, p.136.
in 1904/5.\footnote{The Economist, Nov. 19, 1910 p.v} These rapidly rising costs put enormous pressure on the Treasury, and some fiscal innovations were necessary, such as the Naval Works Act of 1896 whereby surplus government revenue was used to finance "...capital expenditure in connection with the dockyards and naval ports."\footnote{Mallet, p.103.} Previously it had gone into the sinking fund for long-term debt reduction. The construction of larger ships required upgrading of harbour facilities and the Naval Works Act was designed to pay for this. New taxes were also required so that "...in introducing the new scheme of death duty taxation in 1894, the Government had in their minds the prospect of a largely increased Naval expenditure, and had looked to these new taxes to produce a sum to meet the additional demand."\footnote{Ibid., p.100.} This new tax was not only progressive, but an unqualified success as indicated by the following:

...the vast sum of £900,000 in death duties having come from the estate of one gentleman known to fiscal fame as "Chicago Smith", who lived on 15s. a day in a London Club. That one person had contributed to the Exchequer "more than the cost of an ironclad [battleship]."\footnote{Ibid., p.161.}

Limited steps towards government financial reform could cope with the pressures of financing the Royal Navy in the absence of a serious challenge to its supremacy, but were insufficient when such a challenge came in combination with the technical change which increased costs immensely.

The Royal Navy was the guarantor not only of Britain's security but also of the Empire's and the inter-Empire trade and international commerce upon which it was based. The navy had

\footnote{The Economist, Nov. 19, 1910 p.v}

\footnote{Mallet, p.103.}

\footnote{Ibid., p.100.}

\footnote{Ibid., p.161.}
the supreme role in maintaining Britain's security, as befits an island state. It was British policy to maintain a naval superiority over her rivals, and it was a constant concern of the Admiralty to anticipate and calculate which of Britain's rivals presented or would present such a threat, and its extent. The need to maintain naval supremacy was accepted not only in the Admiralty and government, but generally unquestioned by the public at large. It was a principle of British foreign policy: "[naval supremacy] was the one issue over which British statesmen, who so often were (or posed as being) flexible, cool and full of aristocratic disdain for dogmatism were always adamant."

Overseas commerce and trade were important to Britain and its merchant navy was far and away the largest in the world. This preoccupation with naval superiority led to the formal declaration of the "two-Power standard," Royal Navy equality with at least the next two naval powers, in March of 1889. This policy was enunciated at a time when the German threat had not yet manifested itself, but it did indicate quite clearly the British commitment to Royal Navy superiority, for the consequences of failure were well understood.

As Selborne argued, "our stakes are out of all proportion to those of any Power. To us defeat in a maritime war would mean a disaster of almost unparalleled magnitude in history. It might mean the destruction of our mercantile marine, the stoppages of our manufactures, scarcity of food, invasion, disruption of Empire. No other country runs the same risks in a war with us."

The Royal Navy's superiority was threatened or at least rivalled by France and Russia before 1905 and by the Imperial German Navy after that time. The threat posed by the combined

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15Kennedy, p.416.

16"Between 1901 and 1913 the German merchant marine rose from 1,941,000 to 3,153,000 net tons, the British from 9,608,000 to 12,119,000 net tons." Ibid., p.302.


18Kennedy, p.416.
French and Russian navies\textsuperscript{19} was based on calculations of their capabilities to disrupt Britain's mercantile marine, and the danger posed by the French diminished as relations with Britain improved. The Russian threat ceased to exist after the destruction of its Navy in the Russo-Japanese War in 1905.\textsuperscript{20} The challenge posed by the Imperial German Navy was much more credible because of Germany's commitment to naval expansion. The appointment of Rear Admiral Tirpitz to State Secretary of the Navy on June 18, 1897\textsuperscript{21} set in play the naval arms race that was to follow as “It was Tirpitz who fashioned the Kaiser's general wish for more warships into a specific shape, producing a North Sea battle fleet deliberately aimed at one potential opponent above all others [Britain].”\textsuperscript{22} Germany possessed the economic power and industrial capacity to build a navy capable of challenging the British, provided it could muster the political willpower to follow through with it. Kaiser Wilhelm and Tirpitz provided the political ambition, and military strategic considerations, along with German desire for colonies, provided the rationale so that,

Germany's calculated risk in challenging unilaterally the British naval supremacy in the North Sea in order thereby to wring from London colonial concessions and possibly an alliance, stampeded the major powers into a naval arms race that has found its equal only

\textsuperscript{19}Sumida, p.11.


\textsuperscript{21}Holger H. Herwig, \textit{Luxury Fleet: The Imperial German Navy, 1888-1914} (Boston, 1980), p.32.

\textsuperscript{22}Kennedy, p.408.
in the recent Soviet-American arms race.\textsuperscript{23}

In challenging the supremacy of the Royal Navy, Germany was threatening the very heart of British national security, more so as the British did not see a need for a powerful German navy.

But geographical proximity caused Germany's maritime expansion – into the North Sea – and her probable military conquests – into western Europe, in accordance with the Schlieffen Plan – to become a substantial infringement of what was held to be British national security.\textsuperscript{24}

Such a threat had to be met head on by Britain, for vital national interests were at stake, but in rising to this challenge another threat to the supremacy of the Royal Navy arose: that the financial burden of the naval arms race would be too great for Britain to bear.

The financial limits of British military spending were determined by the Government of the day, and while the Royal Navy was popular, spending money was not. There were two pressures operating against increased expenditures on the Navy: the concept of sound finance and Radical left/Liberal pressures for social spending in competition with navy claims on the public purse. The advocates of sound finance believed in balanced budgets, debt reduction and economical government. They were sometimes referred to as "economists" and the Chancellor of the Exchequer, if not one himself, had at least to appear concerned about extravagance and big spending in government.\textsuperscript{25} The Naval Estimates, as one of the largest components of government spending and one particularly susceptible to cost over-runs, were often blamed for unbalancing the budgets. In combination with the increased expenditure on social programs the

\textsuperscript{23}Herwig, p.3.

\textsuperscript{24}Kennedy, p.456.

\textsuperscript{25}"[Sir Michael Hicks Beach in his April 18, 1901 budget speech] was forced to the conclusion that there was 'no party or section of a party in the House that is in favour of economy for economy's sake'" Mallet, p.169.
revenue sources of government had to be increased.

Sound finance was a "political economy" theory of the Victorian and Edwardian periods which demanded meticulous standards of public accounting with an emphasis upon balanced budgets. The roots of this concept were almost as old as the Liberal party itself, and evolved along with the growth of the state and finance.\textsuperscript{26} Developed, introduced and refined by Gladstone\textsuperscript{27} in his capacity as Chancellor of the Exchequer and Prime Minister, it required that the Government's finances be run in a prudent, conservative and, with respect to bookkeeping, transparent manner.

There was also an additional justification for the theory of the everbalanced budget which in the mind of Gladstone in particular assumed very great importance. This was concerned with what is now generally called 'accountability control' of the public departments: securing that the sums voted by Parliament for particular purposes should not be over­spent and should be applied only to those purposes for which they had been voted.\textsuperscript{28}

Emphasizing thrift and frugality, it was the fiscal orthodoxy of its time. Its outlook was definitely not Fabian which was the political economy ideology overtaking it from the left. On the right was Joseph Chamberlain's doctrine of Tariff Reform or Imperial Preference, modelled on the German system of tariffs.

Sound finance was concerned not only with balancing the budget but also with the manner in which that goal was accomplished. Levels of taxation were not to be onerous (because it was

\textsuperscript{26} "[I]n 1830, [the Liberals] remained committed to economical, efficient government, and continued to work in harness with radicals, though the latter were much more thoroughgoing in their attacks on the principal objects of expenditure: defence and officeholder's pay." Parry, The Rise And Fall Of Liberal Government In Victorian Britain (New Haven, 1993), p.14.

\textsuperscript{27} "Other Chancellors were naturally not always able to set out their Financial Statements with Gladstone's mastery; but a standard had been set and any serious weakening from it provoked immediate and scathing comment." Hicks, p.150.

\textsuperscript{28} Hicks, p.144.
believed that would cripple the economy) and certain forms of taxation, such as the income tax, were to be reserved for dire emergencies, that is, for war. "...In the interest of safety and security it is equally important to be strong in financial strength, as well as naval armament...financial reserve is essential in time of danger to back up your naval reserve."\(^{29}\) High peace time taxes destroyed that reserve.

The Victorians tended to regard taxes as a useful moral discipline in making the taxpayer recognize his responsibilities as a member of the body politic.[Their] remedy for the restrictive effect of taxing was to keep down expenditure, effectively to plan the budget on the revenue side, limiting expenditure to what could be covered by acceptable taxes, and especially to avoid those which fell directly on any part of the productive process.\(^{30}\)

This fiscal philosophy found its expression under the free trade system, cherished by the Liberals and challenged by Joseph Chamberlain's proposed Tariff Reform which sought to impose protective tariffs on imports and, in its most ambitious form, to unite the whole of the Empire under a system of Imperial Preference.

Founded in 1843, \textit{The Economist}, or to give it its full name: \textit{THE ECONOMIST, Weekly Commercial Times, Banker's Gazette and Railway Monitor: A Political, Literary, And General Newspaper}, was a liberal leaning business weekly with more influence than circulation. Its circulation at the beginning of this period was 3,500 and, at the end, 4,500.\(^{31}\) It campaigned tirelessly against what it perceived to be bloated and extravagant naval expenditure. \textit{The Economist} deplored both the overall increase in public expenditure and the increasing antagonism

\(^{29}\)\textit{The Economist}, Jan. 28, 1911, p.158

\(^{30}\)Hicks, p.71.

in Anglo-German relations. It felt that both problems could be remedied, to an extent, by reinig in the Navy's expenditure and ambitions. It was the standard bearer for the fiscal orthodoxy known as sound finance.

The restrictions of sound finance had necessarily to be abandoned during the Boer War as wartime fiscal measures came into force. Both the British government and public were unprepared for the extent and duration of sacrifice of these principles, let alone the huge cost in lives and misery. If the British public suffered a blow to their military pride at the effort required to subdue the woefully underestimated Boers, a similar blow awaited their government which had to pay for all of this suffering. The huge and unexpected cost of the Boer War was met by increased taxation and through debt finance. The former was a sacrifice to be expected in time of war while the latter caused a suspension of the Sinking Fund, a fall in the price of Consols and of course an increase in long-term government debt which, prior to the war, had been at its lowest point since the Napoleonic wars.\(^{32}\) The taxpayer was hit directly and indirectly as

Expenditure by the national government, including subsidies to local government, leapt from £117,600,000 in 1898/9 to £205,200,000 in 1901/2, and Exchequer revenue from £117,800,000 in 1898/9 to £161,300,000 in 1902/3. Income tax was raised in stages from 8d. in the £ to 1s. 3d., additions were made to the charges on beer and spirits, the duties on tobacco and tea were increased, and three former taxes were revived, an import duty on sugar, an export duty on coal, and a registration duty on imported corn and flour.\(^{33}\) The fiscal legacy of this war was threefold: the wartime level of taxation in peacetime, the colossal additions to the National debt, and continued extravagance in military expenditure which

\(^{32}\)The British National Debt was £628,021,572 during the fiscal year 1899-1900, and increased to £770,778,762 by 1903-4. Mallet, p.495.

was in 1905 still some £20 millions higher than in 1898. This legacy would haunt the Unionist administration.
Nineteen hundred and five was a watershed year for the Royal Navy: it marked the accession of Sir John Fisher to the post of First Sea Lord of the Admiralty and, intimately connected with him, the introduction of the revolutionary Dreadnought type battleship. It was also a year of political transition and change with the Conservative-Unionist party making way for the Liberal party in December of that year, with an election in January 1906. The Conservatives began the year with electoral prospects on their minds and their Naval Estimates and Budget reflected this, in that they seemed to anticipate the Liberal election cry of “Peace, Retrenchment, and Reform.”

The Naval Estimates for 1905-6, Lord Selborne’s last before being succeeded by Lord Cawdor, were presented to Parliament on March 2, 1905 and introduced in the Commons on the 6th of that month by the Secretary to the Admiralty, Mr. Pretyman. The most significant feature of these Estimates was that they showed a decrease from £36,889,500 the previous year to £33,389,500 and this was due to a number of circumstances, the most important being the elevation of Sir John Fisher to First Sea Lord, in which post he began his work of increasing the

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34The date was 21 October, 1904. “In effect, if not in fact, he was the Board of Admiralty between October 21st., 1904, and January 25th, 1910.” A.J. Marder, ed., Fear God And Dread Nought, The Correspondence of Admiral of the Fleet Lord Fisher of Kilverstone volume 2, Years of Power, (London, 1956), p.15.

efficiency of the Royal Navy. A number of obsolete and inefficient ships were scrapped or mothballed in order to concentrate resources, manpower particularly, in the most efficient fighting ships. There was a significant decrease in the money provided for new shipbuilding in Vote 8, from £12,098,092 the previous year to £9,566,000.\textsuperscript{36} The biggest losers under this particular head were the private shipyards which bore the largest part of the reduction, from £8,066,634 in 1904 to £5,361,604. There was a marked change in the programme of construction, for while twelve battleships were authorized or under construction in 1904,\textsuperscript{37} only one battleship and four armoured cruisers were authorized in the 1905-6 Estimates. Of course, that one battleship was the revolutionary \textit{Dreadnought}.

The British battleship \textit{Dreadnought} was laid down in the fall of 1905 and completed October 2, 1906, the quick construction being due to special efforts to complete it within one year.\textsuperscript{38} The \textit{Dreadnought} was the brainchild of Admiral Sir John Fisher, and what made it revolutionary was its greater armament of twelve-inch guns, an increase from ten-inches, in superfiring turrets (turrets which could swivel both to the port and starboard sides of the ship, and therefore deliver a much increased weight of shell in firing a broadside), greater armoured protection, and faster speed due to the use of turbine engines.\textsuperscript{39} The above improvements came at the price of greater expense, "...£1,813,100, as compared with the roughly [£1,652,693] for a \textit{Lord Nelson} [previous generation battleship which was itself £200,000 more expensive than its

\textsuperscript{36}Ibid., p.3.

\textsuperscript{37}Five in government dockyards and seven contracted to private yards.

\textsuperscript{38}Sumida, p.37.

\textsuperscript{39}Ibid.
although it was anticipated that they would in the long-run prove economical because,

...the increase in fighting power were great enough to reduce the number of ships that would have to be built to counter foreign conventional battleships, which would result in savings that outweighed the increases in the cost per unit. The committee noted, therefore, that besides the “fighting arguments in favour of the new design, the purely financial side of the question is the most important.”

The net effect of the *Dreadnought* design was to make all battleships of previous design obsolete, for the superior armament provided by twelve-inch guns would outrange the opposition while the superior speed afforded by turbine propulsion would, in theory, allow the *Dreadnought* to stay out of range of their guns. With this design the Royal Navy had achieved a technical lead over its rivals and increased the financial stakes for any one attempting to match it.

The presentation of Naval Estimates to the House of Commons was traditionally a less partisan affair due to the esteem in which the Navy and the Admiralty, as a professional service above the fray, were held to be by all parties. Hence the sobriquet, “the Silent Service”. Despite Mr. Richard Haldane's kind words memorialising Lord Selborne's current Estimates and prior work as First Lord there were “economists” within the Liberal party ranks who continued to feel

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40 Ibid., p.69.

41 Ibid., p.57.

42 “What could the *Devonshire* do, or a number of *Devonshires* in point value equal to the *Dreadnought*? There is about one chance in a hundred of a torpedo hit, which would in all probability do no harm. Similarly it may be asked what the *Majestic* could do. It is difficult to see how half a dozen of them could prevent the *Dreadnought* from steaming out of effective range of their guns and sinking them one by one.” *Jane's Fighting Ships*, 1906/07, p.9.

43 He was the future Secretary for War in the Liberal Cabinet.
that Naval expenditure was excessive\textsuperscript{44} and, given a lack of perceived enemies, could be reduced still further. "After all, real economy in the Navy lay with the House of Commons, and when the laxity of the House in dealing with these Estimates disappeared they would see the end of all this extravagance."\textsuperscript{45} And it was these people who would soon find themselves on the Government side of the House responsible for such matters.

The non-partisan nature of the Naval Estimates certainly did not apply to Budgets, which exemplified the fiscal philosophy of the Government of the day and demonstrated its competence in administering the public purse. It was unfortunate for Balfour's Conservative-Unionists that they had more to fear from the doctrinal squabbles within their own camp than from the Liberal partisans opposite them in the House. The great question of Tariff Reform, or Imperial Preference, versus Free Trade was wrenching both their party's platform and unity and would be the cause of Balfour's abandoning the Government in favour of the Liberals that December. Their 1905 Budget, presented by Austen Chamberlain\textsuperscript{46} on 10 April 1905 was his second and their last before the war. Despite his own filial and personal leanings towards the cause of Tariff Reform he presented a conventional free trade Budget and was aided in balancing it by the reduced Naval Estimates of that year.

According to Treasury classification, in 1905/6 roughly equal amounts were raised by direct and indirect taxes. The direct taxes, the property and income tax, the house duty, the land tax, estate duties, stamps, and excise licences and railway passenger duty,

\textsuperscript{44}"...[T]he Government, while expending the taxpayer's money with a lavish hand, has not given the country in return anything like the value of twenty shillings for every sovereign disbursed." \textit{The Economist}, 4 March 1905, p. 344.

\textsuperscript{45}Mr. Lough (Islington W.) speech 14 March 1905 in, \textit{Parliamentary Debates} (Commons), 4th. ser., vol. 142 (1905), col. 1141.

\textsuperscript{46}Son of Joseph Chamberlain, the driving force behind Tariff Reform.
accounted for 50.3 per cent of the revenue raised by taxation, and the indirect taxes, which were all the customs and excise duties excepting licences and railway passenger duty, accounted for 49.7 per cent.\textsuperscript{47}

He estimated revenue for that year of £144,004,000 against expenditure of £141,032,000 which would leave a balance of £2,072,000.\textsuperscript{48} This fiscal situation was so favourable for the Chancellor of the Exchequer that he could allow for a diminution in the tea duty which would, it was hoped, be of particular benefit to the working classes who were taxed predominantly on the basis of consumption. Whether this benefit would be sufficient to gain their goodwill in an upcoming election would remain to be seen. But one journal at least was prepared to damn with faint praise, “Although it cannot be said to give evidence of the possession by its author of any real financial ability Mr. Austen Chamberlain’s second Budget can, at any rate, lay legitimate claim to the merit of being sound, straightforward and honest.”\textsuperscript{49}

The general election of January 1906 returned a Liberal landslide, which it was expected would form a Ministry of “all the talents”\textsuperscript{50} pledged to “Peace, Retrenchment and Reform.” The Budget and Estimates of that Spring would give the Liberal party an opportunity to put its pledge into practice and hopes were especially high that H.H. Asquith, the new Chancellor of the Exchequer, would maintain the Free Trade principles of the Liberal party and the retrenchment of government expenditure that doctrines of sound finance required.

The conflict has lain in a very marked degree between Protection and Free-Trade. The

\textsuperscript{47} Murray, p.93.

\textsuperscript{48} The revenue for 1904-5 was £143,370,000 against expenditure of £141,956,000.

\textsuperscript{49} The Economist. 15 April, 1905, p.615.

fiscal policy of the last 60 years has been enthusiastically challenged and enthusiastically defended, and the new Government will do well to bear this fact in mind when they are shaping their programme.\textsuperscript{51}

Unfortunately the actual expenditure Estimates for the upcoming year had for the most part been put together by the Unionists before their abdication from office and so denied the new government a free hand in constructing them. This was especially the case for the Navy Estimates which Lord Tweedmouth, the new First Lord of the Admiralty, had to present.

The Cawdor Memorandum was a parting gift from the Conservative Unionist government to the new Liberal regime. Although dated November 30th, 1905 it was not published until early that December and was for the most part a state of the Navy address. In it Cawdor explained that the reduced Estimates of the previous year and the concurrent reforms were "...all related and interdependent, and have their foundation in the reorganization of the personnel and in the redistribution of the Fleet..."\textsuperscript{52} In it he also elaborated the current and anticipated future building requirements of the Navy,

At the present time strategic requirements necessitate an output of four large armoured ships annually, and unless unforeseen contingencies arise, this number will not be exceeded. The period of building is to be two years, and therefore four ships will be laid down each year, and there will be eight ships in the course of construction in any one year in the dockyards or by contract... the public cannot rely on this reduction being continued in future years if foreign countries make developments in their shipbuilding programmes which we cannot now foresee, but the programme of shipbuilding we have in view for future years, and have provided for, will in the opinion of the Board of Admiralty meet all the developments which the resources of foreign countries seem at present capable.\textsuperscript{53}

\textsuperscript{51}The Economist. 20 January 1906, p.74.

\textsuperscript{52}From, J. Leyland and T.A. Brassey, eds., The Naval Annual, 1906, (Portsmouth, 1906), p.353.

\textsuperscript{53}Ibid., p.360/1.
This was a cautious manifesto of the Navy's requirements to fulfill its role as the shield of Empire.

This document certainly anticipated the possibility of a Liberal victory at the polls but by emphasizing the economies already achieved along with a minimum yet measurable annual construction programme it sought to deflect any wild calls for retrenchment in the Navy. In fact Fisher's propaganda campaign had already begun.

In December 1905 Fisher was busily advertising his excellence as an economist to them [the Standard] implying that by his astuteness he had actually squared the financial circle and achieved more for the navy by paying less... In one year he had saved ten million pounds yet "left the Fleet immeasurably stronger and more efficient." Gwynne [Standard ed.] thought it more likely that Fisher had given in to the dictates of politicians. Maxse, [of the National Review] in his inimitable style, was already bellowing that Sir John had become "'he willing instrument of a cheese-paring Cobdenite Cabinet.'”

Fisher was sincere in his desire to obtain economy, which he equated with efficiency, and he believed he had a responsibility to the taxpayer to ensure that his Navy achieved both.

The 1906-7 Navy Estimates were presented to the House of Commons on March 7, 1906 by Mr Edmund Robertson, the Secretary of the Admiralty. The trend of retrenchment was continued from the previous year as the total was £31,869,500, a decrease of £1,520,000 on those of 1905-6. The provision for new construction also showed a reduction, of £250,000 to £9,250,000, an amount insufficient to embolden him to claim any credit. He insisted that the role of the Conservative-Unionist party in framing them ought to be acknowledged and prevailed finally in having Mr. Arthur Lee, Civil Lord in the previous Ministry, agree to share in the responsibility for them. “We have only been in office a few weeks. But there are some mitigating

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circumstances. The Navy Estimates, although they are usually the largest, most complicated, and, I think, the most important of all the Estimates, are usually the most non-contentious.\[^{56}\] There would be six battleships under construction during this year, one of which was the *Dreadnought*, but none were included in the new programme of construction for 1906. Instead there were three battlecruisers, a design just as revolutionary as for the *Dreadnought*. They were the *Invincible*, *Inflexible*, and *Indomitable*. So while new construction was only slightly reduced in money terms the programme of brand new construction for 1906 was considerably inferior to its predecessors. This was not, however, sufficient to quell the cries from the Liberal backbenches for further retrenchment despite or in spite of the Unionist culpability in framing the Estimates. In this they had the ear of the Chancellor of the Exchequer.

The summer of 1906 was a summer of “Radical-economist” discontent with the spring’s Navy Estimates. While the Government had initially accepted the Cawdor programme of construction its backbenchers,

...all good Gladstonians to a man, were greatly alarmed at the prospect of heavy expenditure on armaments in peacetime. They saw no reason why Britain should embark upon a large and expensive program of shipbuilding, especially when money was needed for schemes of social reform, and on June 21st a deputation of 120 Liberal M.P.s urged Campbell-Bannerman to reduce the programme for the current year.\[^{57}\]

This was certainly not something the Sea Lords, Fisher in particular, were happy to undertake but because Britain’s foreign competitors had not yet come up with a response to the *Dreadnought* it could be done without imperiling the two-Power standard. Pragmatism prevailed

\[^{56}\text{Ibid., col. 1326.}\]

\[^{57}\text{Rowland, p.185.}\]
and "...the four Sea Lords agreed to limit the 1906-07 programme to three ships...," the key factor in their acquiescence being that they could do so without affecting the supremacy of the Royal Navy.

Asquith presented his first Budget to the House of Commons on 30 April 1906 in which much of the spending, estimated at £141,786,000, had already been formulated by His Unionist predecessor and for which he refused to take responsibility. "Coming into office, as we did, in the Month of December, and much occupied during January with the general election, my colleagues presiding over the spending departments could not, with the best will in the world, do much to recast the expenditure of the country." Unable at this stage to grapple with the evils of excessive expenditure he steeled himself to deal with the danger of debt.

The revenue of the 1905-6 financial year amounted to £143,978,000 with an expenditure of £140,512,000 yielding Asquith a surplus of £3,466,000, which he applied to the "old" sinking fund for 1905-6. The greatest part of his Budget speech was devoted to an explication on the substantial increase in government debt which the Unionist ministry had presided over. This, next to the expenditure problem which could not at this time be addressed, was to be the highlight of his Budget. "Second, and second only to the duty of reducing expenditure, is that of making a more adequate provision for the reduction of debt." Asquith took pains to differentiate

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58 Sumida, pp. 60-1.


60 Ibid., col. 278.

61 Ibid., col. 288.
between the two categories of National Debt, firstly the dead-weight debt “...consisting of Consols, terminable annuities, and unfunded or floating debt,” 62 and “other capital liabilities created of late years by various Acts of Parliament and incurred for the most part in respect of naval and military works.”63 Both forms of indebtedness had been utilized by the previous Conservative-Unionist administration.

The dead-weight debt has risen in ten years from £648,000,000 to £743,000,000, an increase of £95,000,000, of which no less than £55,750,000 is due to the growth of the unfunded or floating debt. The whole increase in the dead-weight debt was caused by the war. The “other capital liabilities” have risen in ten years from £4,000,000 to £45,770,000 - that is to say, they have been multiplied by something like eleven times. By far the greater part of this increase has taken place in the last five years.64

Although it was convenient from Asquith's point of view that the fault for this indebtedness lay with his predecessors, it was now nonetheless his problem to deal with.

The doctrines of sound finance, insofar as Asquith under-stood them, held unfunded debt to be a two-fold evil.

In the first place, it must be obvious to everybody that it would seriously hamper our borrowing powers if a sudden emergency arose for which temporary provision had to be made by way of loan. And, secondly, ...it means that the Government is competing for and locking up funds that might otherwise be available for commercial and industrial purposes. The speedy contraction in this floating debt is, in my opinion, a matter of urgent necessity, even if it calls for some self-denial on the part of the taxpayer. 65

As it was in his power so it was to be, £13,500,000 was applied to reducing the dead-weight debt.

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62 Ibid.
63 Ibid.
64 Ibid., col. 289.
65 Ibid., col. 294.
debt while the evil of "other capital liabilities" was remedied by eliminating this source of finance. "...[T]he principle has been laid down that new naval works are not to be commenced with borrowed money." In this way he had at least tackled head on that aspect of Unionist fiscal policy which his party found so distasteful, the profligate utilization of debt finance while reserving for the next year's budget the problem of finding economies in expenditure. This still allowed some room for manouevre in imposing the new government's philosophy on the existing system of taxation.

Under the system of taxation which he had inherited from Austen Chamberlain the Chancellor of the Exchequer estimated revenues of £144,860,000. As this sum was greater than anticipated expenditure Asquith was able to give the long suffering taxpayers some redress. For income tax payers he had only sympathy, "...income-tax of a uniform rate of 1s. in the pound at a time of peace is impossible to justify." Aside from the burden borne by the taxpayer this rate of tax was open to the same objection as the floating debt, "...it tends to destroy, or at any rate to contract, a most readily available reserve on which the State can draw in a sudden and unforseen emergency." It was also viewed as a war measure which was unacceptable in peacetime. However, the cost of reduction in the income tax was more than he could afford, and so income tax payers would have to be content with Asquith's promise to appoint a Select

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66Ibid., col. 291.
67Ibid., col. 286.
68Ibid., col.299. A tax of one shilling in the pound represents a marginal rate of five percent.
69Ibid.
Committee to “...inquire into the practicability of graduation and differentiation [of the income
tax].” The relief of the taxpayer would have to found not in direct taxes but on those of an
indirect nature. The duty on stripped tobacco, a very minor item, was to be reduced to a rate
1/2d. greater than that on leaf and the existing coal duty, which was an export tax in function and
so by its very nature offended the sensibilities of free traders, was to be repealed entirely at a
cost of £1,000,000. The most notable gain for the average taxpayer, and this was significant
because the vast majority were taxed indirectly, on their consumption, was a reduction in the tea
duty of one penny from 6d. to 5d. It was estimated to cost £920,000 to the Exchequer revenue
which Asquith felt,

...not unsatisfactory to be able to show that a small, but at least a substantial, reduction
on tea is possible without attempting or contemplating any revolutionary change in our
system of free trade and without requiring the consumer to submit to a more than
countervailing sacrifice or added tax upon some other necessity of life such as corn or
meat.71

This then was his effort to reward the lower, that is consuming classes for their electoral support
while at the same time promising those taxed directly that their claims would be investigated. But
he had to match revenue to expenditure and so could not back off on the one without attacking
the other. In fact his means of reconciling the two was to be, for its time, revolutionary.

The Naval Estimates for 1907-8 represented the apotheosis of sound finance and also the
nadir of naval expenditure in this period. Although Tweedmouth's second they were in fact the
first for which the Liberal Government was entirely responsible, and in this respect he found that
his sternest adversaries were within his own party and amongst his Cabinet colleagues. The year

70Ibid., col. 300.
71Ibid., col. 306.
also marked a more partisan Parliamentary debate as the opposition, aided and abetted by the Liberal Carlyon Bellairs, sought a government commitment to the two-Power standard in response to Campbell-Bannerman's musings in *The Nation*72 about his Government's hopes for armament reductions at the upcoming Hague Peace Conference.

Tweedmouth was under considerable pressure to reduce the 1907-8 Naval Estimates by a greater margin than even the previous two years. As the first truly Liberal estimates it was expected that they would live up to the ideals of “Peace, Retrenchment and Reform,” from the election campaign. Of immediate concern to Asquith was that he had to reduce expenditure in order to reduce the tax burden and deliver on the expected social reforms. As the largest spending department the Navy was an obvious and tempting target. Retrenchment there had to be, but Tweedmouth was torn between party obligations and his responsibility, as head of the Board of Admiralty, for the Navy's ability to defend the nation and uphold the two-Power standard. He had been forced to give way once before on the previous year's Estimate and was in no mood to do so again. Asquith was not amused.

Surely the time has come for a complete review of the whole naval situation (before we accept these estimates) either by the Cabinet or a Cabinet Committe. I confess that after a year's experience, I have very little confidence in the present lot of Sea Lords, who chop and change as the whim which suits them. Our naval supremacy is so completely assured - having regard to the sketchy paper programmes and inferior shipbuilding resources of the other Powers - that there is no possible reason for allowing ourselves to be hastily rushed into these nebulous and ambitious developments.73

It was not simply that these higher than expected Estimates would upset his considerable plans for the upcoming Budget, but that Asquith knew there would be considerable pressure from the

72The March 2, 1907 inaugural edition.

Liberal backbenches for greater reductions. For his part Tweedmouth had pressures and obligations of his own to contend with, not the least being his personal credibility at the Admiralty which was under attack for the reductions of the previous years. In the person of his First Sea Lord, Sir John Fisher, he had an ally of considerable capacity and influence. It is probable that the First Lord was afraid of his nominal subordinate!

The Naval Estimates were presented to Parliament by Secretary to the Admiralty Mr. Edmund Robertson on 5 March 1907. They showed a reduction in both personnel and cost on the previous year by 1000 men and £450,000, the third consecutive year of retrenchment. In fact these Estimates would have shown an even greater reduction except that the use made in previous years to loans for Naval Works had been forbidden for the current and future years by the Chancellor of the Exchequer.

While, therefore, the total estimate of 31,419,500l., compared with last year's total of 31,869,500l., shows a reduction of only 450,000l., the actual reduction of the board of Admiralty have been able to effect in their Estimates for Naval expenditure for the coming financial year amounts to 1,427,091l.

New construction was provided for to the amount of £8,100,000: £7,340,000 for current ships already authorized and £759,382 for the newly authorized ships of the 1907-8 programme year. Four battleships would have been completed by 31 March 1907, including “... H.M.S.

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74 An example of which is the following letter from Hardinge, of the Foreign Office to the King's Secretary, Lord Knollys dated 23 October 1906: “The only explanation of the scheme is economy and Fisher's desire to truckle to the Liberal party.” The scheme referred to was the use of nucleus crews for the Home Fleet, from A.J. Marder, From The Dreadnought To Scapa Flow, vol. 1, Road to War, 1904-1914, (London, Oxford University Press 1961), p.73.

Dreadnought which was commissioned on the 11th December, 1906, 14 months after being first laid down.\textsuperscript{76} The 1907-8 Estimate year would have, by 1st April 1907, five battleships, seven armoured cruisers\textsuperscript{77}, and thirty-seven smaller craft under construction. It was also planned to “...include two or, unless an understanding between the naval powers be arrived at by the Hague Conference, three large armoured vessels of the Dreadnought type.”\textsuperscript{78} That was an increase in battleships, if successful at the Hague, well below the standard set out in the Cawdor Memorandum. There was a considerable reduction to Ordnance under Vote 9, reduced by £637,300 to £2,348,700, an indication of the length gone to by the Admiralty to get the Estimates down.

The Parliamentary debate on these Estimates was significantly more partisan in nature, and from the Liberal point of view represented something of an internecine struggle. The Secretary to the Admiralty, Mr. Edmund Robertson, sought to head off critics within and without, first by emphasizing the substantial reductions which had been achieved yet obscured by the new practice of not paying for naval works from loans. He was pleased to point out that the greater part of the savings came from reductions in Votes 8 and 9, which affected new construction.

It is nearly nine years since the provision for new construction in the Navy Estimates was so low as it is this year. Inasmuch as these reductions relate to new construction, and new construction carries with it all other Votes in the long run, if these reductions can be maintained they give promise of other reductions in the future, and we hope to see, not

\textsuperscript{76}Ibid., p.15. The other three Battleships were: Africa, Britannia and Hibernia of the King Edward VII. class.

\textsuperscript{77}Included in which were “...three large armoured cruisers Inflexible, Indomitable, and Invincible were laid down in February, March and April, 1906, respectively,” Ibid., p.30.

\textsuperscript{78}These were the ships of the Bellerophon class. Ibid., p.14.
automatic increases, but automatic decreases.\textsuperscript{79}

While these reductions and the promise of more in the future might play well to the Liberal benches he knew that they would arouse concern about the maintenance of the two-Power standard, and so enunciated the situation as the Government saw it with respect to other naval Powers. His conclusion was that "...hon. Members who are nervous about the two-Power standard may possess their souls in patience for the next three and a half years."\textsuperscript{80} This statement by no means satisfied the naval critics of the Unionist Party, nor some of his fellow Liberals.

Mr. Arthur Lee, the opposition spokesman on naval matters, pointed out that the Votes for new construction could be reduced only due to the continued good fortune in having their naval competitors being uncertain as to how to respond to the \textit{Dreadnought}. He questioned the Government's commitment to the two-Power standard, accusing them of concocting "...an entirely new definition of the two-Power standard, and introduced into it the fatal elements of uncertainty, fluctuation, and dependence on diplomacy."\textsuperscript{81} This attack on his government was too much for the Prime Minister to ignore and he defended the goals of the Hague Conference generally and his government's specific participation in it, which for him was simply an affirmation of common sense in the face of militarism and the intolerable burden of armaments. He agreed "...with the two-Power standard, as [he] said last year, as a rough-and-ready method by which we can test our naval strength."\textsuperscript{82} This was exactly the opening that the leader of the opposition was looking

\textsuperscript{79}Parliamentary Debates (Commons), 4th ser., vol. 170, 5 March 1907, col. 656

\textsuperscript{80}Ibid., col. 659.

\textsuperscript{81}Ibid., col. 967.

\textsuperscript{82}Ibid., col. 674.
for, and he sallied forth with a splendid rhetorical defence of the two-Power standard, its historic virtue and present corruption.

[Campbell-Bannerman] still holds that the two-Power standard does not mean, as it has always been thought to mean on both sides of the House, a strength in our Fleet which would enable us to engage with good hope of success the fleets of any two Powers that might be arrayed against us - or, in other words, that our Fleet should be, not only equal to, but have a margin of safety beyond, the strength of the fleets of any two other Powers.\(^{83}\)

Thus he concluded in assailing the Government's commitment to maintaining Royal Navy supremacy and making these Estimates a matter of partisan party warfare which hitherto they had not been.

Asquith's second Budget was the first he had an entirely free hand in constructing and for which he and his party were entirely responsible, was presented to Parliament on 18 April 1907. He was pleased to be able to report that the previous financial year had produced a surplus of £5,399,000, a figure produced by revenue exceeding that estimated by £2,059,000 and expenditure £3,006,000 less than estimated to which must be added the £334,000 in contingencies he had provided for in that year. Asquith attributed the cause of this fiscal windfall to a year in which the nation's trade was "... rarely more active or more flourishing."\(^{84}\) This good fortune allowed him to make a substantial assault upon the National Debt, which he as Chancellor was ever eager to do.

...[T]here was an actual realised reduction on the Unfunded Debt during the year of no less than £9,000,000 sterling. The permanent reduction, as the Committee will see, effected during the course of the year 1906-7 in the National Debt was £13,714,000.\(^{85}\)

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\(^{83}\)Ibid., col. 676.

\(^{84}\)Parliamentary Debates (Commons), 4th. ser., vol. 172, 18 April, 1907, col. 1175

\(^{85}\)Ibid., col. 1183.
This deed in itself stood as a repudiation of the previous administration’s policy and profligacy in accumulating such an increase in debt.

Having explained the past the Chancellor of the Exchequer could now anticipate the financial future, which he believed would be promising. On the expenditure side he took pains to point out that things were more promising than they appeared, for the estimated £140,757,000 was a reduction of more than £1,664,000 on the prior year because, “...we have borne on the Army and Navy Votes for the current year sums amounting to £1,019,000, which under the pre-existing system would have been borrowed and charged to capital account.” While these reductions were modest the figures were nonetheless significant, as the greater part of the reductions had come out of military expenditure which ought to have pleased his party’s adherents in the Commons. More important and of greater significance were his plans for debt reduction in this Budget: “... the estimated sum available during the current year for the diminution of the gross liabilities of the State is £13,400,000.” For the second year in a row the most notable feature on the expenditure side of Asquith’s Budget was an unprecedented attack on the indebtedness of the nation which he had inherited from his predecessors and fiscal opponents. But it was on the revenue side of the ledger that the notoriety of this particular Budget would be established.

The revenue that Asquith counted on receiving in the 1907-8 financial year was £144,190,000, “...a diminution as compared with the preceding year of £624,000.” This revenue

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86Ibid., col. 1181.
87Ibid., col. 1185.
88Ibid., col. 1182.
can be divided into two categories, that derived from taxation and non-tax revenue. It was the former which was most important, comprising the following main sources: Customs (£31,740,000), Excise (£30,600,000), Estate duties (£13,600,000), and the Property and Income tax (£32,500,000). The total estimated tax revenue was "... £119,040,000, or a diminution as compared with the tax revenue of last year of £790,000."\(^{89}\) The non-tax revenue was made up of such sources as post office revenues, telegraph profits, revenue from crown lands and the Government's Suez Canal shares which Asquith estimated would yield an increase over the previous year of £166,000 to produce £25,150,000. All in all he thought this a bounty sufficient to provide him with a surplus of £3,233,000\(^{90}\) at year end. What then, shall he do with it?

Although the Liberal party had not pledged itself to any specific social reforms during the election the Government was being pressured by the Labour party to do something on this front and there were some among its own membership who were even more clamourous. As Chancellor Asquith made the self-evident statement, "Social reform may be regarded, according to the point of view from which you look at it, as a luxury or as a necessity, but in any case it is expensive."\(^{91}\) Having reminded his listeners that his problem was with the paying for it, he conceded that the state ought to do something for the very young and the very old. The former it already did by way of education which cost £25,144,000 for "...the State to recognise its duty to the children of the community."\(^{92}\) At the other extreme, where the State provided nothing but

\(^{89}\)Ibid., col. 1182.
\(^{90}\)Ibid., col. 1183.
\(^{91}\)Ibid., col. 1189.
\(^{92}\)Ibid., col. 1190.
the poorhouse, the cry was for Old Age Pensions, on something like the German or New Zealand model. This he regarded as the "... most serious and the most urgent of all the demands for social reform." But it was not a demand to be heeded at any price.

We are a free-trade Government. This is a free-trade House of Commons. Whatever new resources we can provide for any purpose I have indicated are subject to that governing condition. In any sense of course that involves a limitation of the area. ...for us, I say, free trade is the breath of life, and there is no social reform that would not be dearly purchased by its sacrifice.

The Conservative-Unionist opposition had always proclaimed that free trade finance had reached its limits and would be unable to pay for any such anticipated social reforms. They had lost the last election on this point. Asquith had now to show how it could be done.

I repeat if we are to have social reform we must be ready to pay for it, and when I say "we" I mean the whole nation - the working and consuming classes as well as the wealthier class of direct taxpayers.

However, it was the latter class who would be most burdened by the cost of reform.

After exploring and then abandoning the possibility of repealing or reducing the duties on cocoa, tea and sugar, Asquith turned to the income tax, "...one of the most productive, ...and delicate parts" of his fiscal machinery which had raised approximately £32,000,000 the past year. The Select Committee that had been appointed, in May of 1906, to investigate the practicability of the income tax being differentiated or graduated reported that both were practical

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93Ibid., col. 1191.
94Ibid., cols. 1191/2.
95Ibid., col. 1192.
96Ibid., col. 1198.
measures. Given this encouragement he proceeded with a revolutionary change to the British fiscal system by making the income tax permanent.

The income tax is really a twofold tax, it is a tax on property and a tax on earnings. I start with this proposition, and a most important proposition it is, that it must now be regarded as an integral and permanent part of our financial system.

This was a radical departure from precedent, as the income tax had always been thought of as an extraordinary measure to be reserved for emergencies such as war. In fact it was perceived to be a war tax, first introduced by Pitt in 1798 and not repealed until 1816, when in Parliament a Mr. Brougham “…moved that all the records of the tax should be burnt or destroyed, in order that posterity should never know that such a tax had existed.” Although later revived by Sir Robert Peel and subsequently Gladstone, both had imposed the tax temporarily. Its present existence was due to the costs associated with the Boer war and now Asquith proposed that the war tax should outlive the financial legacy of that war. He did, in the interests of his middle class constituents, modify its worst features.

Where previously the income tax had been applied at a uniform rate to all income Asquith now would differentiate between earned and unearned income. By way of example he compared “Mr. A,” whose income was derived entirely from a safe investment in the funds, and “Mr. B,” who earned the “…same nominal sum by personal labour of some arduous and perhaps precarious profession….”

To say that those two people are, from the point of view of the State, to be taxed in the same way is, to my mind, flying in the face of justice and common sense. ... For a tax

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97Murray, p.100.

98Parliamentary Debates (Commons), 4th ser., vol. 172, (1907), col. 1199.

99Ibid., col. 1199.
whose effective continuance involves the annual perpetration of a gross injustice is a tax which ought to be reserved, at any rate, for great and pressing emergencies.\textsuperscript{100}

So as to remove the injustice from this now permanent tax earned income would be taxed at lower rate of 9d. in the pound (4\%) while unearned income would continue to be taxed at a rate of 1s. in the pound, which is 5\%. In both cases the taxpayer could avail himself of an abatement on his first £120 of income.\textsuperscript{101} For the time being Asquith rejected the idea of graduating the rates of taxation because of perceived taxpayer hostility to the concept and he felt that differentiation was, on its own, complex enough for one year's budget. And he still had the death duties to deal with.

The death duties had been imposed by Sir William Harcourt in 1894, in the face of gloomy predictions of capital flight which had never materialized. They had always been an uncertain source of revenue for any Chancellor of the Exchequer because he could not count on a good crop of millionaires dying in any particular year. But by increasing the estate duties he could at least make the most of the current year's grim harvest, and that was what he purposed to do.

The unfortunate man who is unable to leave more than £150,000 will remain in exactly the same position he is in today. But when the principal value of the estate exceeds £150,000 and does not exceed £250,000, I propose that the rate of duty shall be 7 per cent. instead of 6 1/2 per cent.; ...and when the estate exceeds £1,000,000, 10 per cent. on the first million. And here I introduce a new element, or what is called, in another connection, a super-tax. ... When a man's estate which passes at his death exceeds £1,000,000, but does not exceed £1,500,000,... 10 per cent. on the first million, and an additional 1 per cent., or 11 per cent. in all, upon the remainder...[and so on until] and above £3,000,000 everything in excess of the first million (which will still bear 10 per

\textsuperscript{100}Ibid., col. 1200.

\textsuperscript{101}Ibid., col. 1208/9.
With these increases in the death duties he estimated an additional £1,200,000 in revenue.

The revolutionary nature of these reforms was not immediately realized, particularly in regard to the income tax. Although the revolutionary part consisted in turning an extraordinary measure into an ordinary and permanent part of the fiscal system, the promise of old age pensions for the next year aroused greater interest than the permanent entrenchment of the income taxes which would help pay for them. For despite their reputation as a war tax, Asquith had merely confirmed a long standing practice and sweetened it by the differentiation which would so benefit the middle classes. This was the free trade response to tariff reform/Imperial Preference and it marked, truly, the genesis of the welfare state. It was the existence of this remarkably efficient and bountiful means of revenue gathering which would allow for future great enterprises of the State merely by increasing the marginal rates of taxation. And the Liberal government would need to resort to these means in the near future, and not, as it was expected, to pay for the cost of social reforms, but to meet the burden of military expenditures and particularly those of the Navy.

The year 1908 proved transitional for the Liberal government and ended the Campbell-Bannerman era. His serious illness progressively worsened and Asquith assumed most of his leadership duties in the House. He relinquished his Prime Ministership to Asquith on April 3rd and died on the 22nd. The party began the year feeling the burdens of office and was under constant attack from its own supporters on the questions of expenditure and retrenchment. Campbell-Bannerman, according to Rowland, was the glue that held the Liberal party together.

102Ibid., col. 1209.
as he was held in particular esteem by the backbenchers and most especially those who could be described as "Radicals" or "economists." He was able personally to reconcile the competing claims of the Liberal Imperialists on the right with the reformist "Radicals" on the left while reassuring the "economists" that the extravagence of both would be kept in check. With him ended the hopes of the economists that expenditure could be restrained and their particular brand of naive idealism was doomed by the "realpolitik" of the Imperialists. The economists continued to demand retrenchment without actually changing government policy; and in 1908, perhaps realizing this, they began their great and futile assault upon "Armaments," and in effect, their own ministry. Their influence upon government policy steadily declined as they were overtaken by events which, if Great Britain was to maintain her pre-eminence as a Sea Power, undermined the logical foundations of their arguments for naval retrenchment in particular. With the loss of their champion, Campbell-Bannerman, their arguments lacked force and their numbers influence. Had he survived none of this would have changed.

The controversy over the 1908-9 Naval Estimates began in the Cabinet and Board of Admiralty where considerable discussion resulted in stalemate by November of 1907. According to Marder the "...Sea Lords looked upon the increase of a million and a quarter as 'most moderate,' particularly since the originally proposed increase of £2,150,000 had been trimmed in November to appease the shocked Chancellor of the Exchequer."\(^\text{103}\) The Cabinet insisted that the 1907-8 Estimates not be exceeded and put Tweedmouth under great pressure,\(^\text{104}\) and by 16

\(^{103}\)Marder 1961, p.137.

December he declared that the Cabinet position was unacceptable to the Board.\textsuperscript{105} The Cabinet had to consider for their part that there was considerable backbench unrest over the level of military expenditure despite their party's pledges of retrenchment in this area. When the Cabinet met to discuss the Navy Estimates again on 21 January 1908 the attitudes of the Radicals had hardened, Lloyd George, Harcourt, Burns, Morley and McKenna threatened resignation if no reduction were forthcoming from the Admiralty, and were encouraged to hear that Mr. Murray MacDonald would introduce a motion of censure in the House, with considerable Liberal backbench support, against the Government's failure to reduce armaments expenditure.

The Cabinet now resolved to reduce the Estimates, which had previously received Cabinet approval, by £1,340,000 below the 1907-8 amount.\textsuperscript{106} Messrs. Harcourt and Lloyd George took on the unenviable task of convincing Admiral Fisher to give way by conceding that he could have his own sum next year. But if he didn't back down Admiral Beresford, his arch enemy and more than bitter rival, would be given his job and cut £2,000,000 from the Estimates. Here they were overmatched by their opponent. Fisher was prepared to resign and take the Board of Admiralty with him, but not before playing all the cards up his sleeve. His resignation would certainly damage the Government, but he must have felt that it would harm the Navy much more, and the thought of Beresford as First Sea Lord, was unthinkable! He went straight to the top, to the ailing and uninvolved Prime Minister.

F[isher] asked Robertson (Sec. of Admiralty), a great friend of the Prime Minister, to go and see him (P.M.), and to explain the situation, and, if necessary, to go through every vote showing how impossible it is to cut the Estimates any finer. C-B listened to all he

\textsuperscript{105}\textsuperscript{Rowland 1968, p.193.}

\textsuperscript{106}\textsuperscript{Ibid.}
had to say, and then sent for the Ch. of the Ex. He very shortly gave Asquith the gist of what Robertson had said, in Robertson’s presence, and added, “I have decided that the Navy Estimates are to stand. Haldane will take £300,000 off his instead.” [Haldane’s Army Estimates].

Fisher had won his battle with the Cabinet, but the backbench unrest was undiminished. “The majority of the Cabinet represents an insignificant fraction of the Liberal party. The party is pledged to economy, the Cabinet favours military and naval expansion. The only way in which the House of Commons can save the Budget is by voting for substantial reductions of the Estimates.”

The Naval Estimates for 1908-9 were £32,319,500, an increase of £900,000 on the previous year and the first such increase since 1904. The First Lord was at pains to point out that if this increase looked bad it was in fact “… 13,984l only in excess of that for 1907-8.” That disclaimer aside, “Parliament and the Board are faced with automatic or uncontrollable increases which make any reduction of the total Estimates impracticable.” Although numbers of seamen to be provided for on Vote A were unchanged at 128,000 the wages were to be increased by £260,000 to £7,129,700. The most notable increases were in Vote 8 for Shipbuilding, Repairs, Maintenance, &c.: increases of £386,300 under Section I. - Personnel and £1,121,800 under Section II. - Materiel which were offset by a decrease of £425,300 on Section III. - Contract

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108 The Economist February 8, 1908, p.266.
110 Ibid.
111 Ibid.
Work. This brought the total under Vote 8 to £14,313,900, while that under Vote 9 for "Naval Armaments" was reduced by £300,000 to £2,048,700. The only other significant reduction obtained was £451,700 on Vote 10 for Works which now came to £2,306,700.112 This then was the financial state of the Navy on 11th February 1908, the vague promises of the previous year for retrenchment unfulfilled but not for lack of effort. It was due to the fact that "...a variety of unusual causes combine to create an actual increase in the cash provision which Parliament is asked to vote for the Navy, in spite of the fact that the new Building programme put forward by the Admiralty is exceedingly modest."

In fact, to call it modest was to overstate the case. The new construction programme for the year's Naval Estimates comprised one battleship (the *Neptune*), one "Large Armoured Cruiser," six fast protected cruisers (of the *Boadicea class*), 16 torpedo boat destroyers and 500,000l. of submarines. The deficit114 on that which would have begun under the auspices of the Cawdor programme was substantial.

New construction for the year will cost 7,545,202l. as against 8,100,000l. for 1907-8. The continuous fall in the estimate for new construction from the maximum of 11,654,176l. in 1904-5 is thus carried on, and Parliament is asked to vote 4,108,974l. less than it was four years ago. Of this sum of 7,545,202l., 6,795,202l. will be spent on the continuation of ships already under construction, and 750,000l. in beginning work on ships of the new programme.115

112Ibid.

113Ibid., p.5.

114"Expenditures on the construction of battleships and first-class cruisers thus declined substantially, falling from £8.4 million in 1905-06, to £7.9 million in 1906-7, to £6.4 million in 1907-8 and finally to £5.5 million in 1908-9." Sumida, p.186.

The First Lord estimated that between 1 April 1907 and the 31 March, 1908 one battleship (the *Lord Nelson*, a *pre-Dreadnought*) and three armoured cruisers (the *Invincible class*) would be completed and available for service while by 1 April 1908 there would be under construction: "7 Battleships, 4 Armoured Cruisers, 1 Unarmoured Cruiser, 10 Torpedo Boat Destroyers, 20 Torpedo Boats... and 18 Submarines."\(^{116}\) If the economists within the Liberal party were disappointed at the increased Estimates they at least ought to have been pleased at the record low figure for new construction and in particular the very small programme put forward in this Estimate which, if maintained, would lead to even smaller construction Votes in the future.

There was a novel development in the introduction of the Naval Estimates to Parliament as Radical members of the Liberal party introduced a motion to debate the growth of spending on armaments, which took place on 2 March 1908, the day before the scheduled debate on the Navy Estimates. Mr. Murray Macdonald moved

> That, in view of the continued friendly relations with foreign Powers announced in the gracious Speech from the Throne, this House trusts that further reductions may be made in expenditure on armaments, and effect be given to the policy of retrenchment and reform to which the Government is pledged.\(^ {117}\)

This motion was more than just an embarrassment to the Government, it was unacceptable on its own terms as it implied that they had failed to make good on their election pledges and were profligate in their administration of these great spending departments. Asquith, in his role as de facto Parliamentary leader, took it upon himself to reply to the motion with sweet reason. He first pointed out that the Government had always to consider the Empire's defence requirements,

\(^{116}\)Ibid.

\(^{117}\)Parliamentary Debates (Commons), 4th ser., vol. 185, col. 369, 2 March 1908.
and then reminded the House of the burden of profligacy inherited from the Unionist party now in opposition. He then reassured them of his own efforts on behalf of their cause.

...[A]fter more than two years experience in which I can honestly say that almost day and night I have been battling - I will not say with my colleagues, though in that I should not be saying anything far from the truth - in every Department of the State, not merely to bring about reductions, but to prevent increases in expenditure.\textsuperscript{118}

Nonetheless, he felt it imperative to point out that for both Government and Nation, “The command of the sea, however important and however desirable it may be to other Powers, is to us a matter of life and death.”\textsuperscript{119} It was then up to Mr. Edmund Robertson to defend the specifics of the Navy’s Estimates.

His main task was to trivialize the current year’s increase as much less than what the opposition in power would have implemented in the Cawdor programme. The apparent increase was due to a number of unavoidable circumstances such as the “automatic and unavoidable” rise in wages and the necessity for funding works construction out of the Estimates because loan finance was now forsworn. In fact so important were these points that he had gone to the trouble of providing a “Statement showing the Total Estimated Gross Expenditure on the Navy, including Expenditure from Loans from each year, inclusive, from 1905-6 to 1908-9,” along with a breakdown of the “Late Administration’s Gross Naval Expenditure.”\textsuperscript{120} He went further.

To sum up the conclusion on this head, the result of our two years’ administration of the finances of the Navy - first, the total expenditure as shown by this table has been reduced in that time by £1,500,000, or if we compare Estimate with Estimate, by £1,800,000. Secondly, the expenditure on loans has been reduced in the manner I have described by £4,600,000. And thirdly, and most important of all, new construction alone has been

\textsuperscript{118}Ibid., col.371.

\textsuperscript{119}Ibid., col. 376-7.

\textsuperscript{120}Ibid., cols. 203-206, 28 February 1908.
reduced in that period by the very considerable figure of £1,700,000. ...if the Cawdor programme had been carried out, the difference is not £1,700,000 but £2,000,000.\textsuperscript{121}

While the former was intended to mollify the Radicals he was also keen to reassure the Opposition as to the state of the Navy, “I have the authority of the Admiralty for saying, and I think this ought to be sufficient for the House, that the programme now proposed and the provision now made fully maintain the two-Power standard.”\textsuperscript{122} Robertson concluded his and the Government's self-defence with a statement and a plea on his own behalf.

I hope that no hon. friend of mine will go away to-night with the notion that I have ceased to be the economist I once was. I am as strong an economist as ever I was, and I have impressed economy on my colleagues. For many a long weary year I stood almost alone in protesting for economy, not only in naval and military matters, but, what is sometimes too much forgotten, in civil expenditure as well.\textsuperscript{123}

These were hardly the words of a servant happy to bear his burden.

The dissension on the Government side of the House provided the Opposition with an opportunity they did not squander. Mr. Wyndham attacked the Government on their own high ground of finance, asking and then answering his own query.

Is it sound finance to pay only one-tenth on account of a programme which everybody knows to be inadequate, and to defer the completion of that programme to a time when it is absolutely certain that you will be embarking on another and larger programme? ...[It] is not only unsound finance, but it is scarcely honest finance.\textsuperscript{124}

The opposition spokesman on naval matters, Mr. Arthur Lee, was contemptuous of the Radical motion, “If battleships and docks and other requisites of the Fleet and the \textit{personnel}
necessary to man the Fleet could be ordered like a pound of tea at Harrod's Stores, there might be some sense and relevance in the argument. A new Fleet, however, cannot be evolved in less than a decade,". What was more, he kindly pointed out the reason for such a Fleet. "There is no secret whatever that Germany, which already commands the land, is frankly and openly seeking to create a fleet of sufficient strength to imperil the supremacy at sea which we now possess." The naval situation as he understood it, and he understood it perfectly well, did not allow for any of the empty rhetoric which the Government seemed intent upon flourishing.

The Chancellor of the Exchequer in moving that Amendment knows perfectly well, no one can know better, that so far from economies being possible on the present Estimates, he has cut them down to a point where even the very modest programme of this year, if it is not to be a sham programme, will necessitate the bringing in of Supplementary Estimates before the end of the present financial year, and must lead to enormous increases in the next and following years. He knows perfectly well that if he translates his advocacy of the two-Power standard into action, we must lay down next year five "Dreadnoughts" instead of two, as proposed in the programme of the present year. The present Estimates deliberately shirk their fair proportion of the burden of even the modest programme which they announce. Almost every item indicates a policy of deferred expenditure, and consequently the Chancellor of the Exchequer knows perfectly well that no reduction is possible next year in these Estimates, whilst, on the contrary, there must be a large and progressive increase of expenditure. Consequently, the Amendment of the right hon. gentleman is a mere tactical manoeuvre calculated to throw dust into the eyes of the House of Commons.

And all of this before the formal Naval Estimates debate had even begun. It was left to the leader of the Opposition, A.J. Balfour, to set the cleverest trap for the Government, which he did by proposing an amendment to the motion, to read:

That in view of the continued friendly relations with foreign Powers announced in the Gracious Speech from the Throne, this House will support His Majesty's Ministers in such

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125 Ibid., col. 416.

126 Ibid., col. 418.

127 Ibid., col. 420.
economies of naval and military expenditure as are consistent with the two-Power standard of naval strength and the adequate defence of his Majesty's dominions.\textsuperscript{128}

Balfour knew full well that there was no agreement on the Government side of the House as to the necessity or utility of maintaining the two-Power standard while his Opposition were staking much more than the outcome of a Parliamentary debate upon it.

When the formal Parliamentary debate on the Navy Estimates commenced the next day, 3 March, the opposition were relentless in their attacks. The non-partisan tradition of the debate was by now a fiction of the past, and the Unionists were determined to score points for their party. Their attacks were of a two-pronged nature. First they challenged the honesty and financial prudence of the Government in presenting Estimates which were deliberately inadequate and would have to be made up in subsequent years. Second, their key argument was that not only would the two-Power standard not be maintained by these Estimates but in 1911 the Imperial German Navy would possess a greater number of \textit{Dreadnoughts} than the Royal Navy. If the public could be convinced of the latter charge it was political dynamite, and the Unionists were not lacking in Press allies, particularly the Northcliffe Press, which was soon to include the \textit{Times}.

The redoubtable Arthur Lee led the assault upon the Estimates by offering his sympathy to Mr. Edmund Robertson "...in defending these Estimates, because he has undertaken the task of defending the indefensible."\textsuperscript{129} He then accused the Government of being,

...[E]ither not prepared to face the necessary expenditure to keep up the two-Power standard which is generally regarded as being essential to our national security, or that

\textsuperscript{128}Ibid., col. 460.

\textsuperscript{129}Ibid., col. 557.
out of consideration for purely Party exigencies they are postponing the necessary expenditure, and piling up the Estimates for next year to a point where they must swamp any schemes of social reform to which they are committing themselves.  

Their shipbuilding programme, he charged, was inadequate as it would "...fall greatly below the two-Power standard in 1910 and, indeed, that we shall be only just equal to one Power, that Power being Germany." This had not been the case when Mr. Lee had been a member of the Admiralty in the previous administration with his government committed to the two-Power standard. The Cawdor Memorandum was proof enough of this. If the present administration had only adhered to that splendid document it would not have found itself falling behind in an arms race with Germany.

With so much at stake the opposition brought all its big guns to bear, and the most effective was its leader, A.J. Balfour. Following the same line of attack as his lieutenant, he complained first of the financial shortcomings of the Estimates.

"The Estimates before us this year are illusory Estimates from the point of view that they are not specimens of what we must have in succeeding years, if the avowed policy of the Government is to be maintained. They fail and they fail completely.... It is impossible but that your Naval Estimates will rise, and rise immensely."

But the more serious charge, and the one which the Government would find so hard to shake, was that they were failing of their responsibility to maintain the requisite standard of Naval superiority and, indeed, would soon fall behind their most perilous rival.

"If the Germans can build as fast as we can, will they not have, in the autumn of 1911, thirteen ships of the "Dreadnought" and "Invincible" type; and can the right hon. Gentleman show us any possible means by which we, in the autumn of 1911, should also...

\[130\] Ibid., col. 558.
\[131\] Ibid., col. 561.
\[132\] Ibid., col. 601.
have thirteen "Dreadnoughts" and "Invincibles." I understand that we cannot have more than twelve in January, 1911. 133

This was the opening salvo in a political campaign which would be the most effective of any so far in disrupting the Liberal agenda and shaking their unity, a salvo whose ripples would continue to discomfit the Government over the next two years.

Whether it was due to his expertise as a former Chancellor of the Exchequer or to the fact that his ambition for his party's leadership required him to play a more prominent role in this critical debate, Mr. Austen Chamberlain sallied into the ring. As one with extensive Treasury experience, and plans to overhaul and remake the country's entire fiscal system, he was obliged to point out the unfunded naval liabilities which the future had in store for the Government.

With these enormous liabilities in front of you, with these great additional burdens next year and the succeeding year, you must provide new ships and new construction. Therefore, I say that apart from the question of naval safety and the sufficiency of this year's programme, there is here a financial position which is unsound, unthrifty, and is overburdening succeeding years for the purpose of getting a temporary advantage this year.134

If this were true certainly the Government could not admit it. Not to its own supporters not to the public and, above all, not to the Opposition.

In the absence of the Prime Minister due to continued ill health the Chancellor of the Exchequer had to assume responsibility for damage control. This he did by meeting the Opposition's charges head on. He affirmed the Government's commitment to the two-Power standard, displeasing though it must have been to his own Radicals and economists. "...we must maintain the unassailable supremacy of this country at sea; and that for that purpose the two-

133 Ibid., col. 1181, 9 March 1908.
134 Ibid., col. 1191.
Power standard, as it is commonly called—whether a scientific formula or not—is a good practical and workable one.” The politically more dangerous charge he sought to disarm outright, for the arcane squabbles over technicalities inherent in the two-Power standard would not hold the public’s attention like the much more easily grasped notion that Germany was beating Britain in Dreadnoughts.

I will say this without the faintest hesitation, that if we find at that time there is a probability or a reasonable probability of the German programme being carried out in the way the paper figures suggest, we should deem it our duty to provide and we should provide not only for a sufficient number of ships, but for such a date of laying down those ships that at the end of 1911 the superiority of Germany which the right hon. Gentleman [Balfour] foreshadows would not be an actual fact.

And here he hoped that the whole matter would rest.

When Asquith became Prime Minister on 8 April he made a number of changes to his Cabinet, the most important being Lloyd George's assumption of the duties of Chancellor of the Exchequer and Reginald McKenna's replacement of Lord Tweedmouth at the Admiralty. Lloyd George was the rising star of the Liberal Government who wanted the Exchequer not because of any experience, affinity for the post or innate talent for the job, but because it was the natural spot from which to succeed the Prime Minister. It was the promotion which best suited his ambitions. It was also a post from which he could champion social reform - which would indicate that he was concerned with more than the dictates of sound finance - and that it was much more likely that he would change his office than that office would change him.

135Ibid., col. 1336, 10 March 1908.
136Ibid., col. 1338.

[Lloyd George and Churchill's] appointments were seen as reflecting Asquith's concern to preserve the balance of forces and opinion in Cabinet, which might otherwise have been upset with his replacement of Campbell-Bannerman, and together they were expected to serve as the standard bearers of advanced Radicalism in the Cabinet, and the best guarantees of its reformist direction and political resourcefulness.\textsuperscript{138}

Tweedmouth was forced out for a number of reasons, incompetence being just one of them.\textsuperscript{139} It was desirable that the First Lord be in the Commons and, more importantly, the retrenchment of military expenditure was essential if the Government was to achieve its goal of social reform without raising new taxes. Tweedmouth was perceived to be the tool of Fisher, the First Sea Lord, and Asquith desired someone who could impose the Government's will upon the Board of Admiralty.

McKenna, who had some reputation as a Radical, had shown himself intensely conservative on taxation reform when he had served Asquith as Financial Secretary to the Treasury from December 1905 to January 1907. Highly regarded as an administrator, his main public image was that of a strict 'economist,' and he was consequently expected to keep the navy estimates down.\textsuperscript{140}

It was vitally important that the Government regain control over its spending departments, and none spent so much as the Navy or was so politically sensitive. The First Lord of the Treasury did not waste time.

One of the first things that Asquith did when he became Prime Minister in April 1908, was to appoint a Cabinet Committee to consider further military economies. This was a move to compensate the Radicals for their defeat over the Navy Estimates and the members of the Committee were, in fact, the three most ardent Gladstonian economists in the Cabinet at this time: Lloyd George, Harcourt and Churchill. McKenna's

\textsuperscript{138}Murray, p.64.

\textsuperscript{139}Rowland remarks that his downfall was due in part to the fact that "...he owned half the ordinary shares in a firm which supplied the navy with most of its beer." In addition there was the embarassment of the "Kaiser Letter" and the fact that he himself wanted out. See p.152.

\textsuperscript{140}Murray, p.73.
appointment as First Lord of the Admiralty was also a move to pacify the Radicals and King Edward only agreed to it on the condition that Fisher remained First Sea Lord.\textsuperscript{141}

What Fisher would make of his new political master remained to be seen.

The Government's Budget for the financial year 1908-9 was noteworthy on a number of counts: it was the first year of operation of the new system of differentiation for the income tax, it was expected that a scheme of Old Age Pensions would be introduced, and there was the novel circumstance of the Prime Minister presenting the Budget to Parliament. This latter point was due to Asquith succeeding Campbell-Bannerman, who resigned April 3rd and died on the 22nd, as Prime Minister and First Lord of the Treasury on 8 April 1908. Although Lloyd George was now the Chancellor of the Exchequer it was decided that Asquith should make the budget presentation, whose preparation had been his responsibility.\textsuperscript{142}

Asquith made his third and final Budget speech to Parliament on 7 May 1908. As precedent required he began his address with a review of the financial year ended 31 March 1908, in which the Revenue had exceeded that estimated by £3,703,000 to yield £156,538,000.\textsuperscript{143} The main source of this increase was the Income Tax which had raised £32,380,000 or almost twenty-one percent of the Revenue.\textsuperscript{144} He was pleased to point out the breakdown of Revenue by source.

\begin{quote}
[T]he total revenue derived from taxation, ... was £130,320,000 or £268,000 more than
\end{quote}

\textsuperscript{141}Rowland, p.195.

\textsuperscript{142}In fact Asquith had initially thought of keeping the Exchequer in addition to the post of Prime Minister but for reasons of Cabinet balance between the left and right wings of the Liberal party had relinquished the former.

\textsuperscript{143}Parliamentary Debates (Commons), 4th ser., vol. 185, col. 448, 7 May 1908.

\textsuperscript{144}Ibid., col. 450.
the corresponding revenue of the preceding year, and £2,635,000 more than the Budget estimate. The non-tax revenue amounted ... to £26,218,000, being an increase of £1,068,000 over the Budget estimate, and of £1,234,00 over the corresponding revenue of 1906-1907.145

This welcome excess over estimate was further improved by the failure of estimated expenditure to meet its nominal target. The expenditure for 1907-8 was £151,812,000, which was £690,000 below that which had been estimated. The happy result for Asquith was a realised surplus on the year of £4,726,000, his third consecutive surplus as Chancellor of the Exchequer.146 Best of all, from his point of view, was that this sum had to be applied to the Old Sinking Fund for the reduction of National Debt, an end upon which he could not have improved if not required by law to do so anyway.

The reduction of debt was the subject nearest and dearest to Asquith's heart, and he was particularly proud of his achievements towards this end while responsible for the nation's finances. He had applied £29,500,00 towards the nation's indebtedness during the past year resulting in a reduction, after interest charges, of £18,030,000 in the National Debt or, in absolute terms, a £16,839,000 reduction in the aggregate gross liabilities of the State. "This reduction, I need hardly say, is wholly without precedent."147 It may well have been that the key factor in persuading him to present the Budget was the opportunity that it afforded him to point out his accomplishment in this regard. And he made full use of this opportunity to do so.

"I wish hon. members to appreciate how we stand with regard to our financial liabilities

145Ibid., col. 451.

146Ibid., col. 453.

147Ibid., col. 454.
and what has been done in the last three years in that respect." On assuming office at the end of 1905 the Liberal Government had inherited the burden of dealing with the enormous debt load accumulated during the Boer war. This debt load was not confined to the very visible National Debt but included also a number of liabilities entered into as the Conservative-Unionist administration had taken advantage of loan finance to meet the cost of various projects. The first was bad enough but the latter was anathema to the Chancellor, who had a keenly developed appreciation for the principles of sound finance. In order to distance himself from the profligate fiscal record of his predecessors, Asquith reiterated the Liberal Government's record of debt reduction.

I start with the figure showing the total amount of the National, or dead-weight Debt twenty years ago. On 31st March, 1889, the amount of the dead-weight Debt was £697,000,000; ... In 1903, at the close of the South African War that figure had risen from £697,000,000 to £770,700,000. On 31st March 1906, which may be said for all effective purposes to be the time when we first became responsible for the conduct of the financial affairs of the country, two or three months after we came into office, the amount was £743,200,000. On 31st March, 1909, the last year for which I shall have responsibility for national finance, it is estimated that the amount will be reduced to £696,500,000. In other words, the figures will be brought back to what they were twenty years ago. I do not in any way want to depreciate the financial policy of my predecessors, but the figures show that, while from 1903 to 1909 the total reduction was £74,200,000, in the first three years it was £27,500,000, at the rate of about £9,000,000 a year; in the second three years it was £46,700,000, or about £15,500,000 a year. These figures were impressive enough, showing as they did the superiority of a Liberal administration committed to free trade finance, but a much more telling point was provided by the comparison between their efforts and achievements at reducing the State's gross capital liabilities.

On 31st March, 1889, our total capital liabilities amounted to £697,600,000; in 1903 the

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148 Ibid., col. 456.

149 Ibid., col. 456.

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amount was £798,300,000; in 1906 it was £789,000,000; and for 1909 it is estimated at £748,000,000. ... in the years between 1903 and 1906 the gross liabilities of the nation were reduced by £9,300,000, or at a rate of £3,100,000 a year, and in the second three years the reduction, in round figures, was £41,000,000, or at the rate of £13,700,000 a year.\textsuperscript{150}

Here then was the proof of Unionist fiscal incompetence and Liberal virtue, for he had made a real reduction whereas the Unionists had squandered their efforts at reducing the National Debt by simultaneously adding further liabilities. And the benefit to the nation of Liberal fiscal stewardship would be lasting, for the permanent interest charges had been reduced.

...[T]he total interest charged on the National Debt on 31st March, 1906 was £18,812,000, and on 31st March, 1909, at the expiration of three years, it will be £17,585,000. In other words, there is a saving, a permanent saving, in the interest to be annually provided for the National Debt of very nearly £1,250,000.\textsuperscript{151}

In making this comparison his primary aim was to show just what free trade and the principles of sound finance could accomplish in the sphere of fiscal activity. The Unionists had been proclaiming since Austen Chamberlain's last budget that tariff reform was inevitable and had drawn their inspiration from the German model. The former Chancellor was able to make an unflattering comparison with that model, but for strictly salutary reasons. "I state these facts, not as affording an opportunity for self-glorification, but to draw a solid lesson from them, a lesson that will bear very much on the finance of future Chancellors of the Exchequer."\textsuperscript{152} There is no doubt, however, that he took great pride in his accomplishment.

Having given the House a treatise on debt management he could now continue with his Estimates for the current Budget year. On the expenditure side he anticipated spending

\textsuperscript{150}Ibid., col. 456/7.

\textsuperscript{151}Ibid., col. 457.

\textsuperscript{152}Ibid., col. 458.
£152,869,000 which was an increase of £1,057,000, "...due almost entirely to the Navy and the Post Office."

The largest source of savings was on the head of "Consolidated Fund Services" or debt service charges because, as he had explained, the amount provided would be reduced by £1,500,000. This did not take into account the new provisions for Old Age Pensions. So here then no comfort was to be provided for those who demanded retrenchment of Government expenditure.

The revenue estimates were much more interesting as they showed an increase of £1,232,000 on the prior year to yield £157,770,000. The reasons for this increase were well distributed amongst his sources of revenue and mostly from the taxation sources. Customs and Excise were expected to yield £32,600,000 and £35,500,000 respectively while the Stamps tax was expected to provide £8,100,000. The two largest sources of anticipated increase were the Estate Duties and the Income Tax. The former was to provide £19,500,000, an increase of £430,000 while the latter tax was relied upon to provide £33,000,000, a gain of £620,000. Taken together Asquith was counting on taxation revenue to provide an additional £980,000.

The non-tax sources of revenue were estimated to yield an almost ten percent increase on 1907-8, amounting to £26,470,000 which, when combined with the £131,300,000 from taxation would at this point provide him with a surplus of £4,901,000, his third such bounty.

Such a surplus allowed him to be more generous than Chancellors of the Exchequer were
expected to be, but then he was now Prime Minister and perhaps could be excused such munificence with the taxpayer's money. He gave up £20,000 in revenue by reducing the "...duty on voyage policies from 3d. to 1d. per cent."\textsuperscript{157} The provision for Old Age Pensions was expected to cost not more than £1,200,000 during the current Budget year, although the anticipated cost of a full year's operation was £6,000,000.\textsuperscript{158} This still left him with a substantial surplus, some £3,700,000. That begged the following question:

Is the Chancellor of the Exchequer justified in all the circumstances in drawing from the taxpayers £3,500,000 of which the State has no immediate need? In our view, the answer to the question, in accordance with the sound traditions and almost unvarying practice of British finance, is in the negative.\textsuperscript{159}

Where to provide the relief? The previous year he had reduced the income tax burden on those with earned incomes, primarily benefitting the middle classes, and he now proposed a relief to those whose tax burden was indirect. His target here was the sugar duty and the lower classes who paid such a disproportionate part of this consumption tax.

The truth is that a sugar duty is one of the most objectionable of all our indirect taxes, because it is at one and the same time a tax upon food and a tax upon raw material. Unfortunately, it is very productive. Last year it brought in £6,700,000. ... We propose to reduce the duty of 4s. 2d. per cwt. to 1s. 10d. ... The total loss to the revenue for the year I estimate at £3,400,000.\textsuperscript{160}

So it was quite obvious that the Liberal party were concerned to provide the lower classes with a beneficial Budget. This combination of tax relief and expenditure reduction had left a balance

\textsuperscript{157}\textit{Ibid.}, col. 462. This would provide a very narrow benefit and convenience to the "Mercantile community."

\textsuperscript{158}\textit{Ibid.}, col. 474-5.

\textsuperscript{159}\textit{Ibid.}, col. 476.

\textsuperscript{160}\textit{Ibid.}, col. 477-9.
of £241,000 in his Budget and for the Opposition he departed with a final taunt.

In my judgment there cannot be a greater mistake than to suppose that a free trade Finance Minister has come to or is nearly approaching the end of his resources in the matter of new taxation. My solitary contribution in that direction during my three years of office has been a comparatively trivial addition to the death duties last year, because, as I have said, I regarded it as my first and main duty to do what I could to reduce the national liabilities. The field is open to my right hon. friend, and I have the most complete confidence in his ability, if he should be in need – I do not know that he will – to make it yield a fruitful and abundant crop.161

The opposition of course begrudged the Liberals their gloating but hardly knew where to begin to criticize a budget which lowered taxes, reduced the debt and introduced a scheme for Old Age Pensions.

Others were more forthcoming with their praise, “A GREAT BUDGET” according to The Economist, “It is to be hoped that the friends of sound and honest finance, both on the Continent of Europe and on the other side of the Atlantic, will rub in the moral for the edification and enlightenment of their statesmen.”162 This Budget was the crowning achievement of Asquith’s political career, at this point at least. He took great pride in the accomplishment. In a letter to the editor of The Spectator he explained his guiding principles as Chancellor of the Exchequer.

I have realized from the first that if it could not be proved that social reform (not Socialism) can be financed on Free Trade lines, a return to Protectionism is a moral certainty. This has been one of the mainsprings of my policy at the Exchequer. I prepared the way by steadily reducing the principal of the debt - at the cost of the taxpayer and by means of the war taxes - till I shall have brought it at the end of this year to the level of 20 years ago... Old Age Pensions were inevitable, I have secured an ample fund to meet them without any extra taxation.163

It was his farewell valedictory to the Treasury and an admission that the principles of sound

161 Ibid., col. 480.

162 May 9, 1908., p.979.

163 Letter dated 9 May, 1908 to Strachey, the Spectator editor., Murray, p.92.
finance need not be abandoned in the cause of social reform. But would Lloyd George take heed?
The concern and interest in naval affairs during 1909 made the shrill debates of the previous spring seem but a pleasant memory for Asquith's Government. The key problem lay in the uncertainty of German intentions coupled with the certainty of German efforts in the sphere of naval construction. The fact was that the intention of Germany was to supplant the Royal Navy and achieve their ambitious dream of Weltpolitik, national dominance on a world stage.  

It is not a surprise then that British efforts to come to an understanding with Germany which would limit their construction and expenditure while preserving Royal Navy supremacy, were unsuccessful. On 6 April 1908 the Reichstag passed a second Supplementary Naval Law which "...established both the policy of three ships per year and a twenty-year service life for every ship. In effect, this meant construction of four ships per year including new projects and replacements."  

The great question for British politics became, could Germany build as many as fast as us? "...[T]here were two supposed dangers: the theoretical possibility of German 'acceleration,' the actual probability of German 'anticipation.'"  

The British Admiralty, Government and Opposition had all come to the conclusion, for varied and different reasons, that Germany could construct Dreadnought type ships in about the same time as Britain - twenty-four

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months. This was the foundation of the 1909 naval scare and *Dreadnought* panic. The fact that the above conclusion was false proved immaterial to the political debate which ensued.\(^{167}\)

As had by now become routine for the Liberal Government, the greatest struggle over the Naval Estimates was waged in the Cabinet, not Parliament. The 1909-10 Estimates were no exception. In light of the reduced construction programmes of the previous three years and the anticipated German efforts the Admiralty initially demanded six *Dreadnoughts* for 1909-10. This was unacceptable to the new Chancellor of the Exchequer, Lloyd George, and his allies in the Cabinet: Churchill, Burns, Harcourt and Morley.\(^{168}\) This was the Radical or Economist faction in the Cabinet and the First Lord, McKenna, had been one of them himself. Lloyd George had very good reasons to oppose the Liberal Imperialists in their “big Navy” demands.

He had allocated £2,000,000 for additional naval expenditure in 1909/10, and was anxious to keep to something like that figure. To give in to Admiralty demands might add substantially to his real deficit, and perhaps even sabotage his design to make his Budget a showpiece of free trade finance.\(^{169}\)

The critical difference was that this year the Admiralty, that is to say Sir John Fisher, had no intention of backing down. The economies of the previous years, whether acceptable or inevitable, had been complied with because the Navy's margin of superiority over rival powers allowed it. Fisher had concluded that enough was enough, that the days of retrenchment in shipbuilding were at an end. As early as December 19th, 1908 he was coaching McKenna, “I hope you will play the game off your own bat, quoting the whole Board as being absolutely with

\(^{167}\)“Without the time allotted for the shakedown cruise, [German]private yards took thirty-six months and the imperial yards an average of forty.” Weir, p.106.

\(^{168}\)Murray, p.128.

\(^{169}\)Ibid., p.125.
you and no compromise possible because we have gone to the very minimum. Indeed, my conversation with Jellicoe makes me most anxious whether we are doing enough in view of German possibilities.\textsuperscript{170} In fact by February of 1909 he had determined that six were insufficient and eight were needed, while concurrently the Prime Minister had engineered a compromise with the help of Sir Edward Grey, the Foreign Secretary. Having been briefed privately by Fisher as to German intentions and capabilities Grey put the case for eight before Asquith, along with a promise to resign if the Radical desire for a small navy prevailed.\textsuperscript{171} Unlike Lloyd George and Churchill, Grey's threat to resign was credible. The Radicals were unlikely to bring down a Government committed to their cause of social reform whereas Grey's resignation in combination with McKenna and the whole of the Board of Admiralty would undoubtably have destroyed not just the Government but the Liberal party also. By 10 March 1909 Fisher could report to King Edward, "Lloyd George and Winston Churchill, bad as they were, fought out in the open. They said they would resign if more than 4 ships — McKenna asked for 6 and we have got 8!...Your Majesty has one splendid servant in the Cabinet — the Foreign Secretary."\textsuperscript{172}

"The Estimates for 1909-10 amount to £35,142,700, as compared with £32,319,500 for the current year."\textsuperscript{173} The increase was much more modest than the reality of the shipbuilding programme that the Government had committed to, as Asquith's compromise meant that only four of the ships would be chargeable to the 1909-10 financial year. But what there was for the 1909-

\textsuperscript{170}Marder, \textit{Fear God and Dread Nought, vol.2}, p.203.

\textsuperscript{171}Morris, \textit{Scaremongers.}, p.180.

\textsuperscript{172}Marder, \textit{Fear God and Dread Nought, vol.2}, p.232.

10 financial year was not inexpensive.

New construction for the year will cost £8,885,194, as against £7,545,202 for 1908-09. £6,599,424 will be spent on a continuation of work on ships already under construction, and £2,285,770 for beginning work on ships of the new programme, for which provision is made in the Estimates as follows:— 4 Battleships (Dreadnought type), 6 Protected Cruisers, 20 Destroyers, and a number of Submarine Boats, for which a sum of half a million pounds is allowed.

In addition to the above provision for ship construction, His Majesty's Government may, in the course of the financial year 1909-10, find it necessary to make preparation for the rapid construction of four more large armoured ships, beginning on the 1st April of the following financial year.¹⁷⁴

Vote 8, for Shipbuilding, Repairs, Maintenance, &c., came to £15,818,300, which along with Votes 9 and 10 for Naval Armaments and Works respectively accounted for 87 percent of the increase in the Estimates. These were the Votes most affected by the economies of the previous years which were now found to be postponements of expenditure only. The First Lord was able to report that the Dreadnought Bellerophon and the pre-Dreadnoughts Lord Nelson and Agamemnon were completed along with the three battlecruisers Indomitable, Inflexible, and Invincible, and the cruiser Defence. There would be, on April 1st, 1909 the following ships under construction: 6 battleships¹⁷⁵, 1 battlecruiser, 2 unarmoured cruisers, 5 second class protected cruisers, 25 torpedo boat destroyers, 6 torpedo boats and 19 submarines.¹⁷⁶ Despite the hardships endured by the First Lord to push them through Cabinet, more was in store on 16 March for the Parliamentary debate.

¹⁷⁴Ibid., p.334.

¹⁷⁵These were the Temeraire, Superb, St.Vincent, Collingwood, Vanguard and Neptune. The battlecruiser was the Indefatigable.

¹⁷⁶Ibid., pp.335-6.
"Not for years had the estimates been anticipated with so much interest." The Government and in particular its First Lord, McKenna, were in the unenviable yet familiar position of defending their Naval Estimates against both their Radical supporters and the Unionist Opposition. This would be the first year that the latter were the more fearsome opponent. It was up to McKenna to walk the tightrope between the two viewpoints.

The policy of the present Government has been declared to be one of Peace, Retrenchment, and Reform. I agree most cordially with that policy, and I can well understand that any addition to the Naval expenditure may be viewed with the gravest alarm by many persons whose political convictions I share, and whose good opinion I greatly value. ... Such proposals cannot fail to be regarded as of exceptional gravity from the financial point of view; a novel but actual and potential programme of shipbuilding which not only throws an additional charge on the Estimates for the coming financial year, but necessarily entails further increase in the year 1910-11. ... No one can suppose that the present government have made themselves responsible for the estimates on such a scale with a light heart. If I may speak of myself for a moment, it would be to say that there is no man in this House who is more earnestly desirous of retrenchment in expenditure on armaments than I am, or more reluctant to have forced upon him by the circumstances of the time so burdensome a programme. My first experience of official life was at the Treasury. In that admirable department I learned the practice and the theory of economy. ... But there are occasions when even the most determined economist is willing to make a sacrifice.

McKenna was willing to sacrifice the cause of sound finance, in all of its Gladstonian glory, and his political career, but he would not sacrifice the supremacy of Great Britain's Royal Navy. Four years of retrenchment in naval expenditure, and in particular the shipbuilding components, had made it possible for Germany to mount a credible challenge to that supremacy. "...[W]e have to take stock of a new situation, in which we reckon that not nine, but 13, [German] ships may be completed in 1911, and in 1912 such further ships, if any, as may be begun in the course of the

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next financial year or laid down in April, 1910." While Britain had hesitated Germany plunged ahead in shipbuilding, and seemed capable of matching Britain *Dreadnought* for *Dreadnought*. In pursuing the Liberal party's vision of social reform and sound financial policy, the Asquith Government had effectively abandoned the two-Power standard which had hitherto been accepted as a national and non-partisan policy apart from political controversy. No longer.

The Opposition reaction was as furious as it was predictable. Balfour denounced the governing Liberals for failing to adhere to the Cawdor programme and for betraying the national trust with respect to the two-Power standard.

I do not mean to compare our strength with foreign nations. That I should do if I were dealing with the pledge of the Prime Minister with regards to the two-Power standard. I regret to say we have reached the point when the matter of debate among us is not whether we are maintaining the two-Power standard, but whether we are maintaining a one-Power standard.\(^{180}\)

To the dereliction of duty in allowing this situation to develop the Unionists added that the Cabinet saving compromise of four contingent *Dreadnoughts* was inadequate.

...[S]urely it is obvious that circumstances demand – certainly the country will not be satisfied with anything less - that the Government should order at once the whole of these eight ships which they have foreshadowed in their programme, and that those ships should be completed at the earliest possible moment. This is not an occasion for panic, but it is an occasion for prompt and resolute action.\(^{181}\)

The financial considerations which so concerned the Government were irrelevant to the Unionists, in fact any fiscal embarrassment the system of free trade finance experienced in meeting the costs of this proposed programme would only serve their interests in promoting tariff reform and

\(^{179}\)Ibid., col. 934.

\(^{180}\)Ibid., col. 946.

\(^{181}\)Ibid., Mr. Arthur Lee, col. 1079, 17 March 1909.
Imperial Preference. The disloyal opposition within the Liberal party, were not so sanguine. Sir John Brunner, intimate and ally of Hirst and his Economist, spoke on behalf of the Radicals.

I wish we could always think of money instead of ships. What do these figures mean? ... What could we do if we had that money to spend among our own people? ... A month hence we shall be discussing not ships but taxation, and I venture to prophesy that there will be from these [Unionist] benches eloquence amounting almost to screaming when my right hon. Friend the Chancellor of the Exchequer makes his proposals.

David Lloyd George would fulfill this prophesy forty-three days later.

The Budget for 1909-10 had to reconcile the conflicting demands of military expenditure, for which the Navy was most responsible, and such social reforms as the scheme for Old Age Pensions. These two items conflicted only in the sense that each made a claim upon the scarce resources of the state, which resources would have to be increased if both were to be satisfied. To Lloyd George fell the task, in his first Budget, of delivering both guns and butter. He was further constrained in that he was expected to do this without abandoning the system of free trade or offending the principles of sound finance. He “...was to establish, once and for all, the resources of free trade finance and give free trade a new popularity against tariff reform.” Fortunately for him Asquith had already laid the foundation, with his innovations to the income tax and death duties, and by his unprecedented reduction of the National debt, for the new


183 Ibid., col. 1101.

184 Asquith had estimated the cost of Old Age Pensions at £6,000,000 for 1909 whereas by March the true figure was greater than £8,000,000, going to 668,201 pensioners. This provided an average weekly pension of 4s. 9d. Murray, p.126.

185 Ibid., p.118.
Chancellor of the Exchequer's fiscal edifice.

Lloyd George faced a deficit, based on the 1908-9 taxation, estimated at £16 ½ million.\(^{186}\) In order to achieve his goal of making this a showpiece budget for free trade, he concentrated on improving the yield of the direct taxes, modifying the excise taxes, and introducing new taxes on land and licences. While the last mentioned were the most controversial it was to the former that his Budget owed its name and success. The income tax was increased, except on earned incomes below £3,000, from 1s. to 1s. 2d. in the pound. The great innovation was the introduction of an “Income (Super) Tax” on incomes over £5,000, but at the rate of 6d. on the amount by which such incomes exceeded £3,000. This was in addition to the regular income tax.\(^{187}\) Asquith had intended to introduce such a supertax on incomes himself but was rebuffed by the Treasury officials. Not so Lloyd George.

Two of the major opponents of the introduction of a supertax, Sir Edward Hamilton and Sir Henry Primrose, had retired, leaving Sir George Murray as the last of the old Gladstonians opposed to a fundamental reform of the income tax, while Chalmers, Blain, and Bradbury supported the principle of a supertax. The way, in short, was open to Lloyd George to proceed with the introduction of a supertax.\(^{188}\) He did not hesitate to do so, knowing that it would fall exclusively upon the very wealthy while sparing the middle classes. Its yield he estimated at £2,300,000. The death duties were to produce an additional £2,550,000, “...[B]ut between £5,000 and £1,000,000 I propose to shorten the steps and steepen the graduation. I do not propose to increase the maximum of 15 per cent., but I

\(^{186}\)\textit{Parliamentary Debates} (Commons), 5th ser., vol. 4, col. 498, 29 April 1909.

\(^{187}\)Ibid., col. 509.

\(^{188}\)Murray, p.101.
propose that it should be reached at £1,000,000 rather than £3,000,000.”

Indirect taxation was to be avoided, the tea and sugar duties were left alone, but the modern precedent of gouging the consumer of spirits and tobacco with sin taxes was established. The former was increased by 3s. 9d. per gallon and the latter by 8d./lb. to a rate of 3s. 8d./lb., the two yielding an expected £3½ million. The most controversial of his proposals were the increase in licence duties which he expected to produce a further £2,600,000, and £500,000 from a new land tax. Following Asquith's suggestion in the last Budget, Lloyd George proposed to reduce the Fixed Debt Charge by £3 million to £25 million. These measures combined to provide the bulk of revenue so that his hypothetical deficit was now replaced by an estimated surplus of £488,000. These measures did not win Cabinet approval without a fight. “To an extent that historians have not appreciated, Lloyd George's Budget was considerably modified during its progress through the Cabinet.” Nonetheless, his arguments were buttressed by the knowledge that extreme measures had to be undertaken in order to procure the revenue for the increased Estimates which he had fought so hard against.

The presentation of the Budget to Parliament on 29 April 1909 was different from its immediate predecessors because Lloyd George lacked the lucidity of explication possessed by Asquith. For that he substituted a passionate declamatory style. It was this passion which would get his Budget into trouble with the Lords. He began by excusing himself for the magnitude of expenditure and subsequent taxation. “To what is the increase of expenditure due? It is very well

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189 Parliamentary Debates (Commons), 5th ser., vol. 4, col. 512, 29 April 1909.

190 Ibid., col. 546-7.

191 Murray, p.150.
known that it must be placed to the credit of two items and practically two items alone. One is
the Navy and the other is Old Age Pensions. ... The increased expenditure under both these heads
was substantially incurred with the unanimous assent of all political parties in this House." 192

The Budget statement itself was unprecedented, over four hours in length and requiring an
adjournment due to the Chancellor of the Exchequer losing his voice, and imparting more detail
than his auditors could digest in one sitting. He had high praise for "The income tax, imposed
originally as a temporary expedient, ... now in reality the centre and sheet anchor of our financial
system." 193 And he took satisfaction from the fact that "...under the head of 'Other Capital
Liabilities' the repayments will, in the present financial year, for the first time since the
introduction of the system of naval and military works loans, exceed the new borrowings." 194

This, one of the greatest sins against sound finance committed by the Unionists, had finally been
tamed. The final Balance Sheet for the 1909-10 financial year predicted a revenue of
£162,590,000 and expenditure of £162,102,000 so as to produce a modest surplus of £488,000. 195

My task has been an extraordinarily difficult one. It has been as disagreeable a task as
could well have been allotted to any Minister of the Crown. But there is one element of
supreme satisfaction in it. That is to be found in contemplating the objects for which these
new imposts have been created. The money thus raised is to be expended first of all in
ensuring the inviolability of our shores. It has also been raised in order not merely to
relieve but to prevent unmerited distress within those shores. 196

One could hardly predict, based upon the immediate opposition reaction, the controversy which

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192 Parliamentary Debates (Commons), 5th ser., vol. 4, col. 474, 29 April 1909.
193 Ibid., col. 507.
194 Ibid., col. 499.
195 Ibid., col. 546.
196 Ibid., col. 548.
Mr. Austen Chamberlain, the Unionist spokesman on budgetary matters, had very little to say as he hadn't sufficient time to digest all of its provisions but he did know that the expenditure upon the Navy was insufficient.

Whatever sacrifices we are called upon to make, we do not grudge the money spent in maintaining the defences of this country in a satisfactory condition. The only regret I have to express upon that point is that, after all the brave words of the Chancellor of the Exchequer, after his declaration that to stint the Navy would not be Liberalism but lunacy, he still makes no provision for the battleships which are necessary. The Estimates remain where they were when presented to the House. ¹⁹⁷

Once they had sufficient time to study the Budget the Unionists found plenty to object to. Its passage through the house was tortuously slow, taking "...seventy parliamentary days, with frequent recourse to late night and all night sittings. Of the 895 divisions during the year, 554 related to the Budget."¹⁹⁸ After all of that it was rejected by the Lords on 30 November, thus ensuring its notoriety and their demise.¹⁹⁹ This the *Economist* deemed hypocritical.

...this Budget is not bad in the eyes of the great majority of the peers merely because it does not tax the poor enough. It is doubly bad because it taxes the rich too much. Lord Newbury says the income tax has never been so high. That is an exaggeration. During the Napoleonic wars it was higher. And if Lord Cromer and Lord Rothschild are right the German peril is now as awful as anything we have had to face in our history. The super-tax, then, we should have thought, and the increased death duties, might be set against the super-Dreadnoughts until such time as we come to an arrangement with Germany or take a more moderate view of the premiums which are required to insure us against

¹⁹⁷Ibid., col. 552.

¹⁹⁸Murray, p.200.

¹⁹⁹"It is interesting to note, ... that those Conservative members of the Upper House most strongly opposed to the rejection of the Budget, namely James of Hereford, Balfour of Burleigh, Cromer, Lytton, and St. Aldwyn, were also well-known for their adherence to Free Trade and dislike of Joseph Chamberlain." Rowland 1968, p.229.
invasion.²⁰⁰

The subsequent history of this most famous of all British Budgets is too well known to require explication here excepting its relationship with the Navy's finances. Bruce K. Murray in his definitive study of this budget found that "...it is impossible to conclude that Lloyd George, or any of his major colleagues, intended that the Budget should provoke a final crisis between the Liberal Government and the Lords."²⁰¹ This is not to deny the political motivations behind certain of the Budget provisions, notably the Land valuation and new taxation of licences, but the Liberals just didn't believe the Lords would be foolish enough to reject a money bill. Certainly the Chancellor's subsequent actions did nothing to ease its passage through that Chamber, and his Limehouse speech on 30 July was infamous.

Aside from an opening sally against "the rich" for their disinclination to pay for the Dreadnoughts they had demanded, and a brief statement that the Budget was designed to raise the money for social reform, [his]... speech consisted of a sustained attack on the landlords, their means of wealth, and their opposition to the land taxes.²⁰² Murray concluded by stating that the revenue provisions of the Budget were an unqualified success, "No additions to taxation were required until 1914, despite considerable increases in expenditure."²⁰³ By 1909 the revolutionary changes to government expenditure required a radical change to revenue procurement. If the Free Trade system could not deliver this, then it would be replaced by the Unionist's darling, tariff reform and Imperial Preference. The Liberals were

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²⁰⁰ The Economist, 27 Nov. 1909, p.1082.
²⁰¹ Murray, p.117.
²⁰² Ibid., p.191.
²⁰³ Ibid., p.292.
committed to Free Trade, it was a matter of doctrine and tradition, but it would not ensure maintenance of the principles of sound finance. Their choice was to make drastic changes to increase the yield from direct taxation and so change the ratio and importance of it compared to indirect taxes. In this Liberalism met the constant lurking challenge of tariff reform and countered it with a definitive and exemplary free trade Budget. Hence the opposition Unionist's reacted disastrously in defence of their cherished concept of tariff reform as much as in defence of class privilege. In order to pay for the Navy's arms race, which was unavoidable, and for the nascent social reforms (really income redistribution), which were a policy choice, Lloyd George could extend the innovations already introduced by Asquith. He had merely to ratchet up the income tax and death duties to achieve his revenue targets, and his real fiscal innovations were, for the most part, superfluous. The Unionist demands for Dreadnoughts were being met and paid for out of this Budget and so it seemed fair to associate, as The Economist did, the super-tax with super-Dreadnoughts. The notoriety and controversy of the 1909 'People's Budget' was mostly a product of partisan political gamesmanship, indulged in by the Liberals rhetorically and by the Unionists with fatal reality. The Budget, in and of itself was undeserving of this, but it gave Lloyd George immense political stature. He no doubt intended this result. The last word on the subject can best be left to Murray: "...the 'People's Budget' was an important milestone in the history of British taxation, and together with Harcourt's reform of the death duties and Asquith's differentiation between earned and unearned income for income tax purposes it helped to establish the basic structure of modern progressive direct taxation in Britain."204

The decision to proceed with the contingent Dreadnoughts was made in Cabinet on 21

204Murray, p.302.
July 1909 and explained to Parliament on the 26th of that same month. Besides the German naval programme the paper plans of Austria and Italy to construct Dreadnoughts had the decisive role in the Government's decision. That is to say that it provided the necessary excuse for the decision which could not be avoided. Appearances to the contrary, the promise to build eight had implicitly been made in the March Naval Estimates, the compromise form taken merely a courtesy in which the winners allowed the losers to save face. It was now McKenna's turn to take delivery on that promise.

This novel form has, amongst other advantages, given occasion for the exercise of a considerable amount of wit and ingenuity. We have had the classical couplet [We want eight, and we won't wait.], ... and we have had various epithets ascribed to these four ships, such as “phantom ships,” “hypothetical ships,” and “mythical ships,” which were meant, I think, to cast ridicule upon the method which had been adopted by the Government. ... After very anxious and careful examination of the conditions of shipbuilding in foreign countries, the Government have come to the conclusion that it is desirable to take all the necessary steps to ensure that the second four ships referred to in this year's programme should be completed by March, 1912.

This had been contrived so that the cost of these four ships would not fall upon the 1909-10 fiscal year, but would accrue when their keels were laid down after the 1st of April 1910. The best that Balfour could say was, “Nothing will make me believe the Government have not been guilty of serious laches in what they have not done up to this time, ... I shall support the Government, not because I do not think they have been guilty of the most serious negligence in the past, but on the whole it is clear that their policy is, at all events, much better than the

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205 Morris, Scaremongers, p.182.

206 Marder 1961, p.171.

207 Parliamentary Debates (Commons), 5th ser., vol. 8, col. 855-6, 26 July 1909.
alternative policy [of the Radicals].” That policy was a rhetorical one only. With the approval of the contingent four Dreadnoughts the 1909-10 new shipbuilding programme was now eight, and the costs associated with it would continue well into the future Naval Estimates. The Radical–economists had lost not only the battle over the present Estimates but over the future ones as well. Their only hope was an understanding with Germany to limit naval armaments.

The period from the ‘People’s Budget’ of 1909 to the outbreak of war in 1914 was, despite the vast sums of revenue and expenditure involved, not as interesting or dynamic as the period which preceded it so far as Naval finance is concerned. The British reaction to the German naval challenge which occurred in 1909 was definitive, in that from that point on in the naval arms race Great Britain accelerated away from Germany in both Dreadnought construction and finance. The old Liberal party slogan of ‘Peace, Retrenchment and Reform’ was now but a hollow joke to those who professed themselves economists. Peace levels of taxation were a distant memory while the military policy of the Government seemed to amount to a preparation for war. The principle of retrenchment had been utterly abandoned as both civil and military expenditure were at levels never before known in a time of peace. Reform was the only slogan which had been honoured. The free trade fiscal system had been reformed in order to finance the social reforms desired by the Liberals, and even more importantly, to pay for the huge increases in military expenditure predominantly due to the Navy. This strategy allowed the Liberal-Imperialist wing of the party to be reconciled with the Radicals: the former got their naval

\[208\] Ibid., col. 968.
programme and foreign policy, the latter the costly social programs they so desired. Only the economists were abandoned as their ideology and goal, best defined as sound finance, was simply incompatible with the other two. So abundant was Lloyd George's 1909 Budget that it provided for the expenditure plus a surplus. The only hope for the economist faction in pursuing their ideal of sound finance was an arrangement or understanding with Germany for limiting naval expenditure. That possibility was complicated by the fact that the German price for such an agreement was almost as menacing to Britain's national security as the naval crisis which precipitated it.

The Navy underwent a profound change with the retirement of Sir John Fisher in January 1910.\textsuperscript{208} He was succeeded by A.K. Wilson as First Sea Lord. The Naval Estimates produced the usual Cabinet controversy and threats of resignation as the same factions squared off against each other: Liberal Imperialists versus Radical-economists. Again, the crux of the controversy was the shipbuilding programme, the initial Admiralty demand for four increased to six \textit{Dreadnoughts}, the Chancellor of the Exchequer as usual aghast at the prospect of paying for them. However, their compromise of building five in 1910 and five more in 1911 was less the reason for the huge increase in costs than the previous year's eight \textit{Dreadnoughts}. The real fight was over future costs. The total for the 1910-11 Estimates was £40,603,700, a sum £5,461,000 greater than the year before. More than half of this amount, and almost all of the increase, was accounted for in Vote 8, which stood at £20,453,600, a record figure. “Of this amount £11,850,790 will be spent

\textsuperscript{208}‘Jacky Fisher’ was what the lethargic Navy had been in dire need of. His five years' tenure of the post of First Sea Lord was the most memorable and the most profitable in the modern history of the Royal Navy. He fell on the old régime with a devastating fury.” Marder, \textit{Fear God and Dread Nought}, v.2, p.218.
on the continuation of work on ships already under construction, and £1,429,040 for beginning work on ships of the new programme. The Admiralty anticipated the completion of five Dreadnoughts by 31 March 1910: Temeraire, Collingwood, St. Vincent, Superb and Vanguard along with two unarmoured cruisers, nine destroyers, six torpedo boats and sixteen submarines. What was remarkable was the level of shipbuilding. On April 1, 1910 there were seven battleships, three battlecruisers, nine protected and two unprotected cruisers, thirty-seven torpedo boat destroyers and nine submarines under construction. A unique feature of these estimates was the provision for two additional battlecruisers which were funded entirely by New Zealand and Australia, although the latter was to become part of the Royal Australian Navy.

The 1911-12 Naval Estimates were truly staggering, a total of £44,932,500. Vote 8 amounted to £22,862,200 of which £15,323,522 was for new construction, £13,323,522 on continuation of construction and £1,738,645 for the new programme. The last consisted of five large armoured ships, three protected and one unprotected cruiser, twenty destroyers and six submarines. On 1 April 1911 there were ten battleships, three battlecruisers, seven protected cruisers, three unarmoured cruisers and thirty-two torpedo boat destroyers under construction, a massive number which didn't include the two dominion battlecruisers. The Battleship Neptune and battlecruiser Indefatigable were commissioned the past year bringing a total of twelve

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211 These were the Dreadnought battleships: Neptune, Orion, Hercules, Colossus, Conqueror, Monarch, Thunderer and Battlecruisers Indefatigable, Lion, and Princess Royal.

212 The battleships were: Colossus, Hercules, Orion, Thunderer, Monarch, Conqueror, King George V, Centurion, Ajax, and Audacious. The Lion, Princess Royal and Queen Mary were the battlecruisers.
Dreadnoughts into service. The German Navy at this time consisted of five.213

The naval arms race was reaching its peak in 1911. With thirteen British Dreadnoughts building, and two for the Dominions of New Zealand and Australia, Great Britain was meeting the challenge of Germany but at an enormous financial cost. In addition the new programme of construction called for five more Dreadnoughts. Fortunately Britain could bear this cost, partly through the assistance of the Dominions, but mostly because of the great fiscal reserves which Lloyd George had tapped in 1909. The fact that money was available did not make its expenditure any more agreeable for the Liberal Government which had constantly to deal with economist dissension in its backbenches and within Cabinet itself. Reginald McKenna, First Lord of the Admiralty, was a focus of this dissension because his department was responsible for so much of the Government expenditure which obliterated the economist's goal of retrenchment. It perhaps infuriated them that McKenna was one of their own turned renegade. For McKenna it was not simply a matter of succumbing to Fisher's charm and influence, it was his responsibility to ensure that the Royal Navy met the German challenge, and no amount of Radical-economist opprobrium would persuade him to place their cause ahead of his supreme concern. He battled with Lloyd George over every one of his Estimates and the personal antagonism between them grew. In December of 1908 Lloyd George had written to Churchill to express his thanks for "...the assistance you rendered me in smashing McKenna's fatuous estimates & my warm admiration for the splendid way in which you tore them up."214 It is perhaps surprising then that


the ostensible reason for McKenna's being deprived of responsibility for the Admiralty was not that he failed to rein in naval expenditure as Radical-economists expected him to do, but that he failed to implement a Naval War staff upon the reluctant Admiralty. Insult was no doubt added to injury when he had to relinquish his post to Winston Churchill, whose portfolio as Home Secretary he reluctantly assumed. As First Lord McKenna had fought relentlessly for the Navy and put its interests well before his own, and that was his downfall. He represented the Navy in the Cabinet and what Asquith now desired was someone who would impose the views of the Cabinet upon the Navy. In choosing Churchill over Haldane he thought he had his man.

Churchill had many qualifications for the job: youth, enthusiasm and a keen interest in the Navy which was helped along by a friendship with Fisher, despite their previous differences over the Estimates. His reputation did, however, precede him.

One cannot say that he suffered from any surfeit of public approval. There were serious misgivings in big-navy quarters, and in the Navy itself, on the announcement of the appointment, because of his reputation as a determined, cheeseparing niggardly economist.\textsuperscript{215}

This reputation did not dismay the economist faction, Lloyd George prominent among them. His appointment certainly excited high hopes at \textit{The Economist} which welcomed his appointment on 28 October, 1911.

[T]here has been no such carnival of expenditure as that which was initiated by Mr. M'Kenna at the Admiralty. In three years he added twelve millions to the Navy, taking for that purpose the whole of the enormous additions to the income-tax. Obviously this could not go on, and we are not surprised that, to avoid disaster, Mr M'Kenna has been "promoted." Mr. Winston Churchill's transference is not only a compliment to a great service, but it should prove of enormous benefit to the Government, the Navy, and the country. He has the energy, the resource, and the capacity that should enable him to increase the efficiency of the whole Administration, put spirit and confidence into the service, effecting large retrenchments, and avoiding such fiascoes as airships which cannot fly, and battleships which cannot either get into harbours or fire their own broadsides. The new position will test his character and

\textsuperscript{215} Marder 1961, p. 252.
powers as they have never been tested before. Mr. M'Kenna was also a pledged economist but he went under.\textsuperscript{216}

Such hopes were doomed to disappointment, for the same reasons with Churchill as his predecessor. The British role in the naval arms race with Germany was essentially reactive. It was the German shipbuilding, determined by its Navy Laws, which dictated the British response. In this Churchill could react no differently than McKenna. The only way to accomplish the Radical-economist goal of retrenchment was to reach an understanding with Germany, and Churchill was willing to attempt this.

Churchill's conversion from Radical-economist to Liberal Imperialist involved more than political opportunism and the responsibility of office, for he had come to the conclusion that the German menace was real before then. It was the Agadir crisis in July of that same year which prompted his revaluation of foreign affairs. "If Germany makes war on France in the course of the discussion or deadlock...we shd (sic) join with France. Germany should be told this now."\textsuperscript{217} The crisis made a more profound impression upon Churchill than it did Lloyd George but the effect was to undercut the Radical-economist contention that the German threat was wholly contrived. Nonetheless the diehards who believed in "Peace and Retrenchment" at any price, and the editor of \textit{The Economist}, Francis Hirst was one of them, just could not believe that Germany, or any other civilized state, would start a European war. More importantly he was reluctant to see Britain involved under any circumstances in war, regardless of whether British vital interests were at stake, or there was a risk of German hegemony over the European continent. It was a

\textsuperscript{216} \textit{The Economist}, 28 October, 1911., p. 862.

\textsuperscript{217} R.S. Churchill, op. cit., p.523.
form of pacifism equally principled and naive. The new First Lord was soon to be a target of its wrath.

The German Naval Law of 1912 effectively quashed the possibility of reduced Estimates for the Royal Navy. "[N]ot only were three additional German capital ships to be laid down, but the number of vessels in the active fleet was to be raised substantially, from seventeen battleships and four battlecruisers to twenty-five battleships and eight battlecruisers." This was the catalyst for increased British rates of construction and their efforts to come to an understanding with Germany. This 1912 Naval Law indicated Germany's unwillingness to compromise over naval construction, and their adherence to Tirpitz's "Risk Theory." But the financial pressure on Germany was beginning to tell. The reasons behind this were a combination of national pride, ambition and tragic miscalculation of Britain's motives. According to Langhorne the naval arms race with Britain was the symbol for some Germans of one aspect of their struggle for world power status. It was at the very core of their belief that England stood in their way. For others, it was a more subtle means of pressure whereby England might be induced to abandon her opposition to German continental ambitions. It was this aspect that was prominent between 1912 and 1914. The navy was to be used to extract a pledge of neutrality from England, since circumstances precluded the building up of the fleet into a genuine threat.

This strategy was not supported by their Ambassador in London, Metternich, who believed that it was further antagonising Britain and so ensuring the opposite of its ends. This counsel was not appreciated and Metternich was removed from his post.

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Far more threatening to Tirpitz's grand vision than Metternich's views was the financial crisis that this arms race caused. Germany could no longer continue in this naval arms race without imperilling the Army, which was so much more vital to its security. German finances had neither the strength nor efficiency of the British. German Imperial finance was complex and confused, and throughout the naval arms race had relied extensively on loans.

The second sin against 'sound finance' was being committed on the German side, where the political difficulties of paying for rising public expenditure (especially Tirpitz's navy) by direct taxation had led to a large increase in government borrowing, a steep rise in the National Debt and higher interest rates; so poor was the German government's credit that it could only borrow at much higher rates of interest than those usually available to the French and British governments, and the increases in national indebtedness which followed the 1906 and 1908 Navy Bills were such that some observers began to suspect that the only solution contemplated by the establishment to solve this domestic political crisis was war.221

The construction of the navy was dependent upon loan finance,222 but the huge sums involved meant that the Army was being deprived of funds because the Treasury would not pay for both.223

Von Tirpitz probably faced the greatest challenge of his career in the debate over the 1912 Supplementary Naval Law. The technical and strategic demands posed by his goals for the fleet had become financially oppressive. He came under attack by both the Reichstag and the Imperial Treasury Office. By now, managing the former had become second nature to von Tirpitz. The Treasury presented quite another problem. In the State Secretary of the Treasury Office, Adolf Wermuth, von Tirpitz met his match.224

This was the critical factor because the enormous cost of construction meant that finance was the key to competitiveness in this arms race. The political will to mount the challenge meant nothing without the financial resources to build the ships.

221Kennedy, p.303.

222"...the construction costs of more than half the German all-big-gun capital ships completed before the outbreak of war were covered by loans.” Sumida, p.196.

223Weir, p.120.

224Weir, p.118.
Although the addition of the reserves to the active fleet momentarily obscured it, von Tirpitz's precious building rate fell markedly. From 1908 through 1911 the state secretary built at a tempo of four capital ships per year: three battleships and a heavy cruiser. Now, reduced resources allowed only one of each type for the 1912 budget year, and the Supplementary Naval Law funds increased this by only one battleship in 1913.²²⁵

Thus Germany was in the precarious position of being no longer able to afford the arms race it had initiated while at the same time the strategic reason for the navy had backfired: the naval arms race had succeeded only in alienating and antagonising Britain into a naval construction effort far superior to Germany's.

Troubled or not, the German efforts nonetheless haunted the British Government. That Germany was having difficulties maintaining the pace of the arms race did not change the fact that the costs of sustaining their effort were a burden and plague to the Liberal party. Concentrating the Royal Navy against Germany required reductions in the traditional theatres of operation in the far east and Mediterranean. The treaty with Japan was renewed in 1911, despite colonial unease, "...in the interests of strategy, in the interests of naval expenditure, and in the interests of stability."²²⁶ Great Britain no longer had the resources to maintain naval supremacy in the Pacific. The maritime power of the United States and Japan had to be acknowledged and neutralized, which the Japanese alliance did at the lowest cost. While the decision to do that was relatively costless and pain free, the abandonment of Royal Navy supremacy in the Mediterranean was not. It provoked outrage amongst Imperialists and traditionalists because to them it was *mare nostrum*. To give it up seemed a betrayal of Empire and a renunciation of birthright. What they failed to realize was that the financial resources to maintain naval supremacy in this theatre did

²²⁵Ibid., p.120.
²²⁶Marder 1961, p.238.

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not exist, given the very grave threat which the German Imperial Navy presented. All effort had to be concentrated in the North Sea where the decisive confrontation would take place. Allocation of scarce naval resources for sentimental reasons was worse than foolish, it was dangerous. “Dispersion of strength, frittering of money, empty parades of foolish little ships ‘displaying the flag’ in unfrequented seas, are the certain features leading through extravagance to defeat.”

Meeting the combined Austrian and Italian naval strength would weaken the effort in the North Sea, the decisive theatre. In fact this was another example of cost effective naval calculations, for the Admiralty knew that they could count on French naval support in the Mediterranean, they were all but formerly allied as the French had pledged their Atlantic coast to the protection of the Royal Navy. This dependence on France was a source of outrage to the Radicals inside the Cabinet who...discovered that they were hoist by their own petard. Churchill quietly pointed out that economies in shipbuilding meant numerical weaknesses that could only be compensated for by dependence on France. As they were not prepared to rely on France, then he must ask for more money for more ships. The Cabinet had to give way.

The German menace was preeminent: Britain adjusted her geopolitical strategies and ambitions accordingly. The German failure to grasp this concept was ominous and tragic.

The February 1912 visit to Germany of Lord Haldane was the last best opportunity for the two nations to come to a naval understanding and to reduce the tensions which existed between them. Haldane was the perfect man for the task. Former Army Secretary, something of a Germanophile and German speaking, he had been Churchill’s close rival for the job of First Lord

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228 Morris, Scaremongers, p.318.
and was one of the most capable members of Asquith's Cabinet. There was enormous pressure from within the Liberal party and Cabinet to come to an understanding with Germany so as to reduce the burden of armaments and halt the costly arms race. The Asquith Government had to show that it was making every possible effort in this direction. Haldane's task was to come to a naval understanding with Germany and, most importantly, to impress upon them Great Britain's determination to maintain Royal Navy supremacy. He told Tirpitz and the Kaiser that

Germany was quite free to do as she pleased, but so were we, and we should probably lay down two keels for every one which she added to her programme. The initiative in slackening competition was really not with us, but with Germany. Any agreement for settling our differences and introducing a new spirit into the relations of the two nations would be bones without flesh if Germany began by fresh shipbuilding, and so forced us to do twice as much.\(^{229}\)

This initiative ended in failure because of the incompatability of each side's objectives. British demands for Naval supremacy would not be countenanced by Germany without a political agreement for neutrality or non-aggression which the former would and could not, without negating its Entente with France, adhere to. "The failure of the Haldane Mission and the refusal of the formula of neutrality, which the Germans demanded, shut the door on any return to the policy of isolation."\(^{230}\) Britain's sincerity in pursuing such an agreement need not be questioned, it was to her advantage to reduce expenditure and still maintain Royal Navy supremacy.

The 1912-13 Naval Estimates amounted to £44,085,400, a diminution on the previous year of £847,100.\(^{231}\) There were increases in personnel of 2,000 on Vote A and a consequent rise in


\(^{231}\)This was too good to be true and a Supplemental Estimate of £990,000 was required in March of 1913.
pay. Vote 8, Shipbuilding, Repairs & Maintenance was marginally reduced. New construction amounted to £13,971,527 of which £12,067,727 was for ships already under construction while £1,903,800 was provided for ships of the new programme. That new programme was to consist of four large armoured ships, eight light cruisers and twenty destroyers, the savings on Dreadnoughts made up for by the light cruiser construction. The First Lord was able to report that as of 31 March the following ships were completed and passed into service: the battleships Hercules, Orion, Monarch and Colossus; four protected and two unarmoured cruisers; twenty destroyers and five submarines. The current shipbuilding programme was enormous. As of 1 April 1912 there would be ten battleships, six battlecruisers, eight protected and two unprotected cruisers, thirty-one torpedo boat destroyers and fifteen submarines under construction. This awesome combination of financial and industrial might, together with the redistribution and concentration of fleets in home waters, was intended to dwarf the German challenge. If these actions were not sufficient to gain the German attention, words soon followed.

Churchill presented his first Naval Estimates to Parliament on 12 March 1912, and of even greater interest than the figures was his announcement of the new one-Power standard which replaced the former two-Power standard. While its timing may have been sudden its formulation was not. “A one-Power standard calculated as being a force equal to that of Germany plus a margin of 60 per cent, first appeared officially in April 1909 in a report of the Admiralty’s

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233 The battleships were the Thunderer, Conqueror, King George V, Centurion, Ajax, Audacious, Iron Duke, Marlborough, Delhi, and Benbow. The six battlecruisers were: Lion, Princess Royal, Queen Mary, Tiger, New Zealand, and Australia, the latter two were Dominion contributions and thus not chargeable to the Estimates. Ibid., p.369.
Committee on Manning Requirements." This change in policy, although drastic and an admission that the Unionists were correct about the Liberals not maintaining a two-Power standard of naval supremacy, was more an acknowledgement of the seriousness and credibility of the German challenge than an admission of weakness. It meant that Germany was the only naval rival which mattered, for the United States was presumed friendly, Japan in a treaty of alliance, France in a de facto alliance and Russia, in naval terms, still irrelevant. This left only Germany (with Austria and Italy in the Mediterranean), against which Britain's naval forces were ranged and construction directed. In fact, in terms of *Dreadnought* construction, Britain had not adhered to the two-Power standard since 1909, nor even that of one-Power as defined above.

In both fiscal and calendar years from 1909 to 1912, by the criterion given by the [Department of Naval Intelligence] in 1913 neither the one-Power nor two power standard was achieved in cumulative dreadnought starts, but both standards were closely approximated and even exceeded in terms of cumulative dreadnought launches and completions.\textsuperscript{235}

It was Britain's advantage in speed of construction which allowed her both to close the gap and exceed German *Dreadnought* construction even after effectively spotting her rival a lead. The new one-Power standard was an admission that she could not build against the whole world as well as Germany.

The fact was that Britain could not afford, in financial terms, to maintain a pure two-Power standard against the whole world. Times had changed and the growth of non-European blue water navies had altered the premises which underlay that standard. The new one-Power standard was based on an analysis of risk and the threat posed by Germany. The result was for the Royal Navy

\textsuperscript{234}Sumida, p.191.

\textsuperscript{235}Ibid., p.192.
to shift the focus to her only true naval rival and bring overwhelming force, financial and industrial, to bear upon the German naval challenge. The bankruptcy of Tirpitz's 'Risk Theory' was now more apparent than ever, for not only had it created an implacable foe in Great Britain, it had also alienated almost all probable naval allies from Germany. Germany was in fact more isolated than ever and had virtually guaranteed British hostility in any European conflict.

Churchill's reputation as an economist did not survive his first Estimates. He did not care. His only concern was for an efficient Royal Navy, capable of meeting the German challenge, and he did not stand in the way of technical progress. The ships of the 1912-13 programme were the *Queen Elizabeth* class which were oil fueled and had 15-inch instead of 13.5-inch guns. These technical improvements resulted in “...battleships that were more than 30 per cent more expensive than their immediate predecessors, and some 60 per cent more than the 12-inch gun battleships of the 1909-10 programme.”\(^{236}\) Marder has said that it took courage for Churchill to do this and he is right, but it also required the absolute conviction and faith in himself which Churchill possessed in abundance.\(^{237}\) He also had an ally of sorts in Lloyd George, at least initially, who had to find the money to pay for those innovations. In his Budget speech of 2 April 1912 he explained to the Commons the reason for the Government's great increase in expenditure which now totalled £188,622,000.

Navy, old age pensions,...the exigencies of motor traffic, demands for agricultural development and afforestation, national insurance – these had been responsible for increases of expenditure in the three years of £10,000,200, £17,287,000 and £23,575,000 respectively, one-half of the increase in each year having been attributable to naval expenditure.\(^{238}\)

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\(^{236}\)Sumida, p.193.

\(^{237}\)Marder 1961, p.268.

\(^{238}\)Mallet, p.333.
It was fortunate that his popular fiscal revolution of 1909 was able to meet these increases so handily, because there was to be no slowing down of the pace of expenditure.

The 1913-14 Naval Estimates were for £46,309,300, a sum whose size was not mitigated by the fact that a supplemental Estimate of £990,000 was required for the previous year. There was an increase of 10,000 men on Vote A, with a consequent increase on Vote 1, wages, which was now at £8,399,200. Votes 8 and 9 together came to £26,537,000 which was fifty-seven per cent of the Estimate.

I do not estimate that more than £12,224,000 will be spent on... new construction within the year as compared with £12,067,727 estimated for 1912-13... A sum of £2,052,400 is required for the ... new programme. The total cost of the new programme is £15,958,525 as compared with £13,014,000 in 1912-13.\(^{239}\)

This new programme was to consist of five battleships, eight light cruisers and sixteen destroyers.\(^{240}\) Completed and passed into service by 31 March 1913 were the battleships *King George V, Centurion, Thunderer* and *Conqueror*; the battlecruisers *Lion, Princess Royal*, and the *New Zealand*; five light cruisers, fifteen destroyers and five submarines. There would be under construction on 1 April 1913 eleven battleships, three battlecruisers, thirteen light cruisers thirty-five destroyers and twenty-one submarines.\(^{241}\)

The Estimate did not include the Dominion contributions to the Royal Navy, which were of vital assistance, the more so as Germany could not replicate such sources of funding from her


\(^{240}\)These battleships were the *Royal Sovereign* class which were initially designed to burn coal, but were subsequently changed to oil fuel.

\(^{241}\)The additional battleships were the *Queen Elizabeth, Warspite, Barham, Valiant*, and *Malaya*, the last of which was the gift of the Federated Malay States.
wholly dependent colonies. For Britain these Dominion contributions were not free of complication, as the larger Dominions of Canada and Australia desired a voice in Imperial policy and some control of the ships they were providing. This assistance had begun in 1910 when New Zealand and Australia agreed to pay for the construction of namesake battlecruisers, although the Australia was to be in the Royal Australian Navy. In 1912 Canadian and Malayan contributions were proposed, in the form of fast battleships of the Queen Elizabeth class. While the Canadian contribution was a controversial political issue in Ottawa, Churchill could announce with some relief, especially for the British taxpayer, that

Mr. Borden has since announced in the Canadian House of Commons the decision of his Government to propose the grant to the Crown of £7,000,000 for the immediate construction of three of the most modern type of armoured ships. It is intended to place these ships at the disposal of the Imperial Government for the common defence of the Empire, to be controlled and maintained as part of the Royal Navy.²⁴²

This magnificent gesture did not, however, come to fruition as the Canadian Senate rejected this proposal and so no money was forthcoming. Although a complicated political issue in Canada, it could more generally be described as the first of many occasions where Canada took the economically efficient option of being a “free-rider” with respect to defence expenditure, having realized that the growth of the United States Navy provided an additional source of “free defence.” It was, however, unfortunate for Britain.

The failure of the Canadian project deprived the Royal Navy of units that were to have been deployed in the Mediterranean by 1915, and changes in capital ship design had made it practically impossible for Britain to make up for the shortfall on her own by ordering more than four capital ships per annum.²⁴³

²⁴²Ibid., p.423.
²⁴³Sumida, p.192.
There was in fact still some hope that the Canadian Prime Minister Borden would be able to secure the money and Churchil was still counting on it. Nonetheless the Dominion resources effectively added an additional “...£2 million per annum from 1910-11 through 1913-14” to the Estimates. The problem for Churchill was that he needed it so desperately.

Churchill’s proposal of a naval Holiday in March of 1913 was the last British effort to arrive at some sort of accommodation with Germany so as to reduce naval expenditure. The promotion of good relations between the two was strictly a welcome side effect. The “holiday” proposal was ingenious in its simplicity, as the money would be saved simply by postponing new shipbuilding for one year.

Churchill’s speech in the Commons explaining the estimates, 26 March [1913], branded the race in armaments as sheer stupidity and futility, and renewed his offer of a “naval holiday.” The proposal was that all the powers should delay the commencement of any fresh building, at least in capital ships, for twelve months. Millions would be saved by Britain and Germany, while their relative strength would be absolutely unchanged.

It was also, given Britain’s quicker pace of construction, to her advantage, but this was a marginal consideration. Its chief aim was cost saving, which would go a long way to appease the Radical-economists in his party and thus avoid for him a crisis in the 1914-15 Naval Estimates. This was not to be, Germany rebuffed the proposal and the naval arms race continued unabated. A

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244 Ibid., p.189.

245 “After the spring of 1916 the margin for the whole world service of the Empire would slip to a dangerous low without Canadian help.” Marder 1961, p.313.

246 Ibid.p.313.

247 “At Manchester in October 1913, Churchill had hinted that if his naval holiday initiative was not rejected then there would have to be an increase in the naval estimates.” Morris, Scaremongers, p.349.
reduction, however welcome, was nothing more than a rational effort to save money. It was not a sign of impending weakness, although that may have been the German interpretation. Royal Navy superiority would be maintained regardless of the cost. The proposal was summed up by Sir Edward Grey, the Foreign Secretary.

It may be convenient to sum up here the situation in Europe as it appeared to me in 1914 before the great crisis came upon us. No progress was being made towards reduction, or even towards arrest, of competition in armaments. Churchill's proposal for a "naval holiday," though made in all good faith and good-will on our side, had met with no response.

This was the final effort to come to an arrangement with Germany, its failure was to Britain regrettable but much easier to bear than for Germany, so mired in fiscal and economic difficulties. In fact the German ability to carry on this competition had now entered the stage of bluff.

The Naval Estimates for fiscal year 1914-15 provoked a bitter conflict within the Cabinet of Prime Minister H.H. Asquith and threatened to bring down his Liberal Government. The two key antagonists within the Cabinet were Chancellor of the Exchequer David Lloyd George, leading the Radical-economists opposed to the Naval Estimates, and Winston Churchill, First Lord of the Admiralty. This conflict first came to a head in Cabinet meetings in December of 1913 and thereafter was discussed intermittently in Cabinet meetings during January and February of 1914. The Opposition to the Naval Estimates came on two fronts: first, that the Estimates were in themselves excessive (the position of the "economists"), and secondly, the Radical position that expenditure on naval armaments was wasteful, diverting money from much needed social programs, and morally wrong because naval and other arms races intensified the likelihood

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of war. The position of the Admiralty as represented by Churchill was that the figures of the Naval Estimates represented the minimum amount necessary to maintain adequate naval superiority for Britain.

The crisis over the Naval Estimates of 1914-15 must be considered within the context of the naval arms race that Britain was engaged in with Germany at that time and the fact that the conflict was occurring within the governing Liberal party itself. Opposition to the Estimates was first and foremost ideological in nature, whereas the position of the Admiralty was based upon the carefully calculated requirements of the Navy for the defence of Britain and the Empire. Forced to make a choice between ideological considerations and the harsh imperatives of national security, it is not surprising that the latter took precedence. What is surprising is that the Liberal government came so close to self-destruction in making that choice.

The Naval Estimates for 1914-15 were contentious from the outset:

The Churchill-Lloyd George alliance, under a severe strain since the 1912-13 estimates, now collapsed when Churchill presented the 1914-15 estimates to the Cabinet on 15 December 1913. They amounted to £50,700,000, or, roughly, an increase of £3,000,000 over those voted for 1913-14...249

The above figure represented a record amount of expenditure for the Navy and provided for the construction of four new *Dreadnought* battleships.250 The opposition to the 1914-15 Estimates focused on these but the Estimates were unique for another reason. Churchill “...had now been in charge of the Admiralty for more than two years and these were the first Estimates which were

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249 Marder 1961, p.319.

250 Sumida, Table 3.
entirely his.”

Opposition to the Naval Estimates within the Liberal party was by an alliance of “economists” and Radicals, and often there was so little to distinguish between them that they were referred to as “Radical-economists”. That the “economist” wanted to save money by reducing government expenditure, and in this particular instance naval expenditure, is easy enough to comprehend. The philosophical opposition of the Radicals requires some explanation because,

Their constant preoccupation was with domestic questions. Despite the sinister growth in armaments, there had been unbroken peace for more than thirty years between the Great Powers of Western Europe. There was a widespread, cheerful if illusory, hope that the world would very soon abandon war for arbitration as the means of adjudicating and settling international disputes.

Optimistic or naive, they were against large naval expenditures which additionally diverted money which could otherwise be devoted to peaceful and much needed social expenditures. Their opposition to the Estimates was not long in coming.

On 17 December [1913] Asquith faced an unwelcome deputation of some forty critical backbenchers...They bore a memorandum with almost a hundred signatories, affirming


\[252\] “So far as the balance of factions within the Government was concerned, and as leader Asquith had constantly to bear this factor in mind, [Asquith] could not ignore the possibility that a disgruntled McKenna might return to his first loyalty and be a powerful alloy to the Radical economist group in the Cabinet.” A.J. Anthony Morris, *Radicalism Against War. 1906-1914*. (London, 1972), p.294.

\[253\] Ibid., p.9.
their determination to oppose Churchill's proposals.²⁵⁴

And they were joined in their opposition by the Chancellor of The Exchequer.

It was the natural tendency of Chancellors of the Exchequer to abhor fiscal profligacy and Lloyd George was no exception during his tenure at 11 Downing (although the Tories would never forgive him over the fiscal profligacy of his 1909 “People's Budget”). He had to reconcile the demands for increased social spending, beyond what had already been done, with the financial resources available to him. The record naval Estimates of Churchill were not at all helpful. He did not feel that Churchill was interested in his efforts at economy, and he was ready to help him along in that direction.

Of course I have been too easy during the past two years regarding the Naval estimates. When [Churchill] went to the Admiralty I made a bargain with him about expenditure. He has not kept it. He has been extravagant. Now the feeling against him is very strong. I think, however, he will amend his figures to meet the views of the party.²⁵⁵

There is another aspect to Lloyd George's strong opposition to the Naval Estimates, the possibility of political opportunism. The Chancellor of the Exchequer was well placed within the Cabinet to oppose the estimates and so quite naturally Lloyd George became head of the economists and Radicals against the First Lord of the Admiralty. It was rumoured that “Lloyd George's object in joining the ‘economists’ and ‘malcontents’ to oppose Churchill's estimates was to stake his claim as a radical candidate to succeed Asquith.”²⁵⁶ Such ambitions might explain

²⁵⁴Ibid., p.339.


some of the equivocation of his later behaviour.

Lloyd George did not waste any time in confronting Churchill and on December 16, 1913 during a Cabinet meeting, one day after the Naval Estimates had been presented, he took a hard line with him and suggested a method of cost savings in a note to the First Lord:

I agreed to the figure for this year & I have stood by it & carried it much to the disappointment of my economical friends. But I told you distinctly I would press for a reduction of a new programme with a view to 1915 & I think quite respectfuilly you are unnecessarily stubborn. It is only a question of a 6 months' postponement of laying down. That cannot endanger our safety.\(^{257}\)

Lloyd George was proposing that the construction program be postponed, while those more radical were suggesting that only two of the proposed four battleships be built.

In response to the above criticisms from Lloyd George and others in Cabinet Churchill

...submitted [17 December 1913] a revised estimate of £49,970,000. He had reduced the provision for oil by £400,000, that for the air service by £200,000, and had made a number of smaller economies. The estimates were still £2½ millions over the 1913-14 expenditure.\(^{258}\)

In spite of these proposed measures the "Radical economists" held fast to their demand that only two battleships were required. On that, however, Churchill would not budge.\(^{259}\)

The position of the Admiralty, as represented by Churchill, did not allow for retrenchment on this point, because to do so would have meant abandoning the one-power standard with Germany. That one-power standard entailed equality of Dreadnoughts with Germany plus a


\(^{258}\)Marder, p.320.

\(^{259}\)Ibid.
margin of sixty percent. Churchill articulated the position of the Admiralty (and of himself) explicitly in a letter to Prime Minister Asquith dated 18 December, 1913:

...there is no chance whatever of my being able to go on, if the quota of capital ships for 1914-15 is reduced below 4. Even the Daily News [Radical newspaper] does not expect that. I base myself on 1) my public declarations in Parlt; 2) the 60% standard (see minute of Sea Lords); 3) the Cabinet decision on the Meditn and 4) my obligations towards Mr. Borden [Canadian Prime Minister].

The importance of his Parliamentary statements to Churchill are understandable but it was the latter three points which were important to the Admiralty.

The one-Power standard was both symbolically and technically important to the Admiralty. Symbolically it measured their superiority over the German fleet and could be used to rally public opinion. In technical terms it was the standard which would determine the level of new ship construction with respect to Germany. And this gave it some measure of independence from the politicians. In claiming to uphold the legislated standard of British naval superiority the Admiralty could challenge the Government and to a limited extent so could the Sea Lords [naval officers on the Board of Admiralty] challenge the First Lord [civilian politician] while avoiding the charge of engaging in political activities. In the midst of the Naval Estimates controversy Sir John Fisher, former First Sea Lord and an important advisor to Churchill, wrote to the Second Sea Lord, Jellicoe:

I have been hearing a good deal of the Estimates fight. What I earnestly pray you to bear in mind is the vital fact that the Sea Lords have nothing whatever to do with ‘POLICY’ — that is the sole business and responsibility of Parliament...But when Parliament has laid down the ‘policy’ (whatever it is, whether 2 Keels to 1 or 60 per cent, or any other scale), then the Sea Lords come into business and say that the standard is or not being adhered to.

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Were the Sea Lords ever to “come into business” and state that the standard was not being adhered to the Government of the day would find itself in a first rate political storm. The method by which the Sea Lords would “come into business” was by tendering their resignations.

The second reason for the Admiralty to stand firm was its Mediterranean commitment. The pressure of the German naval challenge had forced the Admiralty to withdraw and consolidate its ships into home waters, leaving a diminished presence in the Mediterranean Sea. This had led to some controversy as it required an understanding with the French, who

...were willing to concentrate their whole battle fleet in the Mediterranean, and, in conjunction with such naval forces as Britain could maintain in the Mediterranean, to safeguard British interests in those waters. This involved exposing their Atlantic and Channel coasts to attack, but it was anticipated that the British Fleet would fill the vacuum.\(^{262}\)

This drawing together of the British and French fleets in the Mediterranean, and closer cooperation in general, was not well received by the Radical faction of the Liberal party who feared that it could entangle them in a European war. For them there was some irony in this situation, for the limitations in the size of the Navy, which they approved of, had required closer military relations with France, of which they did not approve.\(^{263}\) For the Admiralty the logic of this arrangement could not be avoided, it was a matter of allocating scarce resources, the ships of the Fleet. A reduction in the building programme of the 1914-15 estimates would not even allow the maintenance of this diminished presence in the Mediterranean.

Churchill's obligations towards the Canadian Prime Minister, Mr. Borden, were unusually complex. The Committee of Imperial Defence [C.I.D.] had impressed on Borden the pressures

\(^{262}\) Marder, 1961, p.305.

\(^{263}\) Morris, Radicalism p.322.
that the naval arms race with Germany was putting the Admiralty under, particularly with respect
to new battleship construction, or Dreadnoughts. Borden had promised on behalf of the Canadian
Government to contribute three Dreadnoughts towards Imperial defence, on the understanding
that they would be in addition to that required by the sixty percent margin of the one-Power
standard. Despite the setback in the Canadian Senate, Churchill and the Admiralty hoped that
Borden would be able to secure passage of the bill in 1914. The dilemma for Churchill was two­
fold, for if the British Dreadnought construction program was reduced from four ships to two
then the Borden Government would be made to look foolish, for why should Canada contribute
three if Britain could afford to cutback to two? More importantly for the Admiralty, if the hoped
for Canadian ships did not materialize (they never did), then the proposed four Dreadnoughts
were absolutely essential. Churchill would accept nothing less than the four Dreadnoughts
provided for in the estimates.\footnote{The debate had entered the stage where the Admiralty and Treasury were distributing conflicting memorandums to the Cabinet, arguing the relative merits of German and British battlecruisers and pre-Dreadnoughts. For example see, “Memorandum for the Cabinet, circulated by Winston Churchill, First Lord of the Admiralty, January 1914.” in John B. Hattendorf et al., eds., \textit{British Naval Documents 1204 – 1960} (Aldershot, U.K.: Scolar Press for The Navy Records Society, 1993), Document No. 439, p.757.}

Given the positions of the contesting factions within the Cabinet it was unlikely that their
debate would be anything other than rancorous. On Christmas Eve 1913 Lloyd George let it be
known that the Naval Estimates, now at a proposed £49,970,000, would “...lay the Government
peak. Both Churchill and Lloyd George had threatened to resign over the Estimates, but
Churchill's threat was the more credible. He had written to Asquith that if “...the Cabinet decide
to reduce the quota, it wd be indispensable that a new exponent shd be chosen. I have no doubts at all about my duty." And the Sea Lords were with Churchill should he have to resign, as indicated by Jellicoe:

There was great opposition to our building programme, headed, as in 1909, by Mr. Lloyd George, and it looked at one time as if the First Lord would resign, as he insisted, I am glad to say, on the main features of the programme being approved. Had he resigned the Sea Lords would, as in 1909, have followed his example.

The consequence to the Government of such an occurrence would have been calamitous, for it would have exposed the Liberals to the charge of neglect of the Navy. It would likely have brought down the Government as other Cabinet members, such as the Foreign Minister Sir Edward Grey, would almost certainly have supported Churchill. On the other side, "If Lloyd George resigned, a contingency which McKenna thought laughably improbable, then he would have no weighty support." The position of the Prime Minister was unenviable. Asquith supported Churchill but not openly, instead he managed the Cabinet debates "...mainly by skillful adjournments when a crisis seemed to be imminent." By such patient methods he managed to avoid the collapse of his government.

There were certainly Radicals who were prepared to run that risk. Churchill had become as much an object of their wrath as his estimates,

...Mr. Churchill is a wasteful and incompetent administrator, who has egregiously failed to make good the brilliant but empty rhetoric of his past speeches against other folk's extravagance. It is indeed a pity that so much cleverness could not have been conjoined with common sense and with some of the more solid qualities which earn confidence and esteem. Clearly if we are to have value for money and control of our taxes, we cannot afford to let


269Spender and Asquith, p. 76.
Mr. Churchill remain at the head of a spending department.\footnote{The Economist, March 14, 1914 p.648.}

The Attorney General, Sir John Simon, would have been happy to have Churchill resign, as his letter to Asquith of January 1914 indicates,

3. the loss of WC, though regrettable, is not by any means a splitting of party – indeed large admiralty estimates may be capable of being carried only because WC has gone.
4. The party wd feel itself strengthened in its radical element & among the Economists; the feeling that the Cabinet fights for economy but pursues Home Rule [for Ireland] unflinchingly is just what is wanted.
5. A Majority of the Cabinet certainly takes this view.\footnote{R. Churchill, Winston S. Churchill, p.658}

Unfortunately for Simon's position, if his fifth point were correct then it was not an important majority within the Cabinet. By 23 January 1914 Churchill and Lloyd George were close to a compromise, £54,000,000 for the 1914-15 Estimates and the First Lord would try to get the next two years below £50 millions.\footnote{Fry, p.177.} The sticking point was now the years following 1914-15, and Lloyd George wanted a firm promise from Churchill as to those years. Again Churchill stood firm,

\textit{I cannot buy a year of office by a bargain under duress about estimates for 1915-16. No forecasts beyond the year have ever been made by my predecessors; & I have no power – even if I were willing – to bind the Board of Admiralty of 1915 to any exact decision.}\footnote{R. Churchill, Winston S. Churchill – Companion Volume, p.1854.}

Churchill was not prepared to sacrifice the Admiralty for the sake of political expediency, and Lloyd George had started his climb-down.\footnote{Sir John Simon to Lloyd George 26 January, 1914: "...I think it well to write to make plain that I cannot hold myself bound to join you in acquiescing in Winston's figure of £54 millions. Our recent close association began because (as I understood) you sympathized with the criticism directed against so large a figure as £50 millions: the upshot of the crusade for economy is, so
The 1914-15 Naval Estimates were read in the House of Commons by Churchill on 17 March 1914.\textsuperscript{275} “These are the largest Estimates for naval expense ever presented to the House.”\textsuperscript{276} The Navy Estimates amounted to £51,550,000, and included significant increases on Votes 1, 2, 8, and 9, the latter two amounting to £30,908,800. There was an increase on Vote A, numbers of men, to 151,000. “That is a figure greater than was borne on the list of the Royal Navy in the climax of the Napoleonic wars.”\textsuperscript{277} These increased numbers required a corresponding rise in pay, Vote 1 now at £8,800,000. The First Lord had the pleasure of presenting to Parliament a new construction programme of

[F]our battleships, four cruisers, twelve destroyers, a large number of submarines, the usual subsidiary craft, and the sea plane ship. Three of the battleships will be in principle Royal Sovereigns, completing, with the five now under construction, another homogeneous squadron of eight vessels. The fourth battleship will be a faster vessel of the Queen Elizabeth type, and will burn oil only. All these ships will be armed with 15–inch guns.\textsuperscript{278}

The battleships Iron Duke, Ajax, Audacious, and Centurion had been completed and passed into service along with the battlecruisers Queen Mary and Australia, the last for the Royal Australian Navy. There would be under construction during the 1914-15 financial year twelve battleships and one battlecruiser.\textsuperscript{279} Churchill sought to downplay the magnitude of the new construction, particularly that for which he was responsible, and so gave an outline of the total shipbuilding far, an increase of £4 millions: a conclusion at once tragical and laughable.” in R. S. Churchill, Winston S. Churchill, p.655.

\textsuperscript{275}\textsuperscript{Ibid.}, p.663.

\textsuperscript{276}Parliamentary Debates (Commons), 5th ser., vol. 59, 17 March 1914, col.1896.

\textsuperscript{277}\textsuperscript{Ibid.}, col. 1914.

\textsuperscript{278}\textsuperscript{Ibid.}, col. 1921.


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liabilities to the Commons.

The outstanding liability up to the close of this year for new construction under Votes 8 and 9 is £26,069,000; the new programme of commitments ... is £14,817,000. Therefore the total liability will be £40,886,000. The money taken in the Estimates for new construction under all programmes in reduction of this total liability is £18,373,000. The liability remaining at the end of the year will, therefore, be £22,512,000, and the reduction of total liabilities during the year, which will be first for five years in which there has been a reduction, will not be less than £3,557,000. The prospect, therefore, for 1915-16 is now distinctly more favourable than that which now confronts us.

In other words, the cost of shipbuilding had reached its peak and should decrease in the future.

A compromise had been reached between Churchill and Lloyd George and the Liberal Government did not self-destruct. The compromise was in fact a huge triumph for the First Lord and a bitter disappointment for the "Radical-economists". In Churchill's own description the note of triumph is apparent:

In all these months of bickering we had only lost three small cruisers and twelve torpedo-boats for harbour defense. Estimates were presented to Parliament for 52½ millions. We had not secured this victory without being compelled to give certain general assurances with regard to the future. I agreed, under proper reserves, to promise a substantial reduction on the Estimates of the following year. When the time came, I was not pressed to redeem this undertaking.

The economists and Radicals within the Liberal party had picked the wrong fight. The supremacy of the Royal Navy had to be maintained, especially when being challenged by the Imperial German Navy. That was why Churchill abandoned the Radical economist faction when he became First Lord and saw the seriousness of the situation.

Lloyd George, nonetheless, had to pay for it. The Navy was not alone in increasing expenditure, for Old Age Pensions and other social reforms had combined to a total expenditure

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281 Winston S. Churchill, The World Crisis, Volume 1. (London, 1923), p.188. His figure is not exact as it includes the Supplemental Estimate.
of £205,985,000.\textsuperscript{282} He resorted to the by now familiar methods of increasing the income tax and super-tax, the latter now at a maximum rate of 15.3 per cent.\textsuperscript{283} He had in this Budget presided over a significant change in taxation policy, the logical progression from his first one in 1909 in that the indirect taxes now contributed 40 per cent of revenue and direct taxes 60 per cent.\textsuperscript{284} This reflected the conscious decision of the Liberals to reduce the burden on the working classes so as to gain their electoral support.

Yet in 1914, as a consequence of the Liberal determination to reassure the bulk of the middle classes, the large majority of income tax-payers were less heavily taxed, even after Lloyd George's Budget for 1914/15, than they had been when the Liberals assumed office, when the income tax, as yet undifferentiated, had stood at 1s. in the £.\textsuperscript{285}

Not only had the burden of taxation been shifted to the wealthier by means of differentiation and graduation of the income tax, but the assault on the National Debt had continued throughout his tenure as Chancellor of the Exchequer.

We have paid in respect of the indebtedness of this country, since the present Government came into power, £104,000,000. ... By next year... we shall have wiped out indebtedness to the extent of £114,000,000. That is quite without precedent in the history of any administration.\textsuperscript{286}

So much without precedent in fact that he felt confident in reducing the Sinking Fund by £1,000,000 so as to give the taxpayers a break and reward for their past achievements in this field. Despite expenditure more than £40 millions greater than when he presented his first budget in 1909, he had not exhausted the resources of free trade finance. When the competition between

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\textsuperscript{282}Parliamentary Debates\textsuperscript{285} (Commons), 5th. ser., vol. 62, col. 60, 4 May 1914.
\textsuperscript{283}Ibid., col. 86.
\textsuperscript{284}Ibid., col. 93.
\textsuperscript{285}Murray, p. 310.
\textsuperscript{286}Parliamentary Debates\textsuperscript{285} (Commons), 5th. ser., vol. 62, col. 92.
\end{flushleft}
defense and social spending threatened to get out of hand, the Chancellor of the Exchequer inevitably found more money through increased taxation.
The retrenchment of Naval expenditures was never a serious consideration, and in 1914-15 the controversy was over the unprecedented Naval Estimates, not reductions of a radical nature. As the British Government found when financing military expenditure in the First World War, the limits to what was financially possible had hardly been reached. In a review of his Government's pre-war fiscal experience Asquith concluded that "...notwithstanding the heavy demands that had to be met for naval defence and social reform, the financial position of the country at the outbreak of war was one of exceptional strength." His administration had, despite continual difficulty from within and without, managed to deliver both guns and butter: Royal Navy supremacy was maintained and social reforms were implemented. They did all of this while adhering to the broader principles of sound finance, not only balancing the Budgets but substantially reducing the National Debt.

When war was declared in 1914 the German Navy possessed "...13 Dreadnoughts and 3 battle cruisers," compared to the British "...thirty-one modern capital ships: twenty Dreadnoughts and nine battle cruisers, [plus] two Nelsons, with twelve Dreadnoughts and one battlecruiser building." Britain's one-Power standard had been maintained, and the efforts of McKenna and Churchill to get their building programmes through Cabinet and Parliament justified. We know

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288 Herwig Luxury Fleet, p.145.

289 "In addition, two nearly completed Turkish Dreadnoughts building in England were taken over by the Admiralty in August and one building for Chile was requisitioned in September." Marder 1961, p.420.
that, given German military ambitions, Tirpitz's "risk" strategy may very well have been effective had Great Britain continued the small Navy building policy advocated by the Radical-economists. The fiscal and naval policies of Asquith as Chancellor of the Exchequer and Campbell-Bannerman as Prime Minister, encouraged Germany's naval ambitions. In 1907 Lord Ellenborough predicted "We have encouraged Germany in this respect to fresh efforts, and we shall have to meet them with corresponding exertions on our own part. I am afraid that, for every £100,000 we have saved this year we may have to spend £1,000,000 afterwards." Asquith the Liberal Imperialist only emerged as a Prime Minister, prior to which he was a strict Gladstonian who adhered rigidly to the principles of sound finance. Only when he was no longer responsible for the Treasury did his ability to handle his Cabinet and play down dissension work to the benefit of the Liberal Imperialists and ensure that the Admiralty and Foreign Office view prevailed.

When Germany decided to challenge Britain's Naval supremacy Britain had no alternative but accept that challenge. Royal Navy supremacy was fundamental to British and Imperial security and, had Germany pressed even harder in the naval arms race, the British government would undoubtably have done whatever was necessary to maintain that supremacy and security. It has been seen that whenever the financial pressures of the arms race intensified, the Government was able to take the necessary taxation measures to maintain its lead, and this at the same time as social spending programs of truly revolutionary nature were being introduced. Had it been necessary the British government could have increased the tax burden on the economy, for the resources available had by no means been exhausted; or financed the expenditures with borrowings, as its credit was excellent and finance was available. Both of these measures would

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290 Parliamentary Debates (Lords), 4th ser., vol. 172, col. 928, 17 April 1907.
have caused considerable political turmoil, but failing to maintain the one-Power standard and Naval supremacy would have caused considerably more, for opposition to such measures would have come from narrow interest groups whereas Royal Navy supremacy could call upon broader cross party support.

In spite of the magnitude of German naval efforts, the danger to Royal Navy supremacy was more apparent than real. Great Britain, in terms of shipbuilding capacity, could allow Germany to close the gap in *Dreadnought* construction because her financial resources could rise to the occasion and her shipbuilding capacity was unmatched. Once the German challenge was taken up, a two to three year period combined with the Royal Navy's preponderance of *pre-Dreadnoughts* and the huge shipbuilding potential of private and government dockyards, was sufficient to guarantee that no danger zone would exist. The evidence of financial strength is that at no point in this arms race did the Government resort to loan finance, in fact at the peak of the shipbuilding activity the naval loans incurred by the previous Unionist administration were being repaid. For Lloyd George the vital importance of Asquith's work while Chancellor of the Exchequer cannot be overstated. He had provided the foundation for the shift of emphasis to direct taxation and eliminated the greater part of Britain's debt problem, ensuring that it did not exist as a problem when Lloyd George took over at the Treasury. It was that which allowed Lloyd George to present his radical “Admiralty's Budget” in 1909. The shame is that had Asquith spent more on the Navy and less on debt reduction, Lloyd George would not have had to.
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