

DEBT

BY SMITH W. CARPENTER

THERE is an element of shamefulness in all debt. No matter how sound the borrower, or for what excellent purpose the debt was incurred, it is something to be apologized for, something to be explained and justified. New forms of securities and the exigencies of big business delude us; we have lost our sense of proportion; we fail to adjust modern conditions to the old ideal of a self contained, self financed business; yet that ideal is just as commendable and just as attainable as it ever was. We, more than any other nation, have run riot in borrowing; that is the line of least resistance; the shiftless and the inefficient can borrow when they can raise money in no other way. It is not they whom we would so characterize as a class that I decry, but the element of shiftlessness and inefficiency to be found in the average man of large affairs, and which attains to spectacular proportions in corporation management.

The legitimate function of debt is to tide over an emergency or to take advantage of a temporary opportunity; debt can never be justified as a permanent part of a fiscal system. A stream of emergencies constantly arising is not an emergency; a stream of opportunities constantly arising is not a temporary opportunity; they should not be financed by debt, and no manager should rest content so long as that course is necessary. That doctrine amounts to a law from which there is no exception whether among individuals, corporations, or bodies politic.

We habitually justify our thriftless borrowing by the sophistry that money may be borrowed more cheaply than it can be otherwise obtained. A great American now proposes a further extension of this delusion for the benefit of farmers, to whom he would have the government advance modest loans on produce of certain standard sorts without interest. It is amusing to note the zeal of his opponents in demolishing the fallacy that a loan for so moderate a sum

would help a needy farmer, since from any bank he could borrow at commercial rates more than the government would lend, while his equity of redemption, being back of the government's mortgage, would not be deemed good security for any sum. In establishing that argument they do not discern that they discredit the whole system of corporation finance, with its mortgage bonds of many vintages, its debentures, secured and unsecured notes, and its various preferred stocks plastered on ahead of its common stock. This condition of affairs must not be entirely debited to the promoter; to float his deal he must conform to custom; his stake is so large that he would be a superhuman to refuse to take money any way he can get it. Where abnormal and unhealthful practices are the only ones that investors and financiers are accustomed to they have to prevail. Nor does there seem to be any practical utility in remonstrating; nevertheless one should freely declare the evidences which stand out so patent to his senses.

The corporation manager is charged with a high and holy duty: he is to serve the true and substantial interests of the corporation. By the term corporation you are to understand a public corporation, one whose stock is traded in, not in individual or family affairs such as one organizes to avoid liability. Such corporations are important factors in the economic structure of our nation; they express the genius of America; they possess a soul, a differentiated part of the great soul of the nation. The old concept of a corporation with no soul to save nor anatomy to kick don't apply. In that old day the corporation manager was identified with the insiders, and the corporation was run for their selfish interests, but the modern corporation is more than that; it is more than the interests of the stockholders; it is more than the interests of stockholders and employees combined; even to add the interests of the patrons does not round out the full measure of managerial responsibility. It involves a service so important, yet so sane and free from philanthropic taint, that it is worth much pains to fairly express it.

It is upon the theory of public service that the corporation is suffered to exist; it is the creature of the state, endowed with a part of its own life, and commissioned to carry on a specialized part of the common work of society. Every corporation exercises quasi public function; therefore corporation managers are quasi public officials. The state, or nation, is a composite human being, built up of all its constituent citizens, the state *is* its citizens; all of their interests are the state's interests. We should get it out of our minds that the

state is a political organization only. Political function is in a sense the highest because it directs and controls, but it is not so vital as economic functions, for by that we live. On the economic plane the state, or nation, consists of individuals and corporations, of which the corporations are relatively the more important because they are aggregates of individuals. If we think of the state as a composite human personality, an Uncle Sam, then the corporations become the organs of the composite body, and, as the health of the body depends upon the health of its organs, so does the economic health of the state depend upon the health of its corporations. Of course we would be speaking as truly to substitute the word individual for corporation, but for the purposes of this confab the emphasis should be upon the corporation. The corporation manager as a quasi public official is charged not only with the healthful functioning of the factors within the corporation, but with the equitable co-ordination of the corporation with the whole state. The corporation must render the fullest possible measure of service; to do this it must have the fullest measure of vigor; the vigor of a corporation is declared by its balance sheet; its life blood is profits. That the corporation should be co-ordinated with the state implies an element of restraint, its profits must not be too large, nor its holdings too great; still, if the stock is sufficiently widely distributed there is less to be feared upon this score than we generally fancy. We, the public, are vastly interested in the prosperity of our corporations, for only from prosperous money making corporations can we look for constantly improving service. We have no right to legislate money to a corporation, but we have a certain right to stop the leaks; money wrongfully diverted from a corporation, whether in excessive dividends, excessive salaries, excessive wages—granted that there is such a thing—inefficiency, or plain graft is a concern of the whole people, for whatever impairs the credit or puts an incumbrance upon a corporation lessens the efficiency or increases the cost of its service. It makes no difference at all to the average citizen whether debts accumulate against the state or against its corporations, the burden rests upon the same shoulders.

Our great corporations should be generally free from debt; most of them would be free from debt if their affairs had always been administered in a wholly honest manner. Honesty is a relative term and the sort of dishonesty that our corporations suffer from chiefly is one that scarce involves moral turpitude; at least the unethical things that we all do, if we have a chance, are not shocking until

public attention is centered upon them. The day should come when to divert a dollar from any corporation without making a just return therefor would be regarded the same as to steal from the public treasury. Dividends should never amount to more than a going rate of interest on money actually paid into the treasury of the corporation, so long as any unpaid debt remains against it. Note, please, that this excludes money paid to promoters for securities which cost only brain-sweat. No matter how important the services of promoters and financiers may be, their reward should not begin to flow from the treasury of the company as long as unliquidated debts remain against it. Since it is a rare thing to find a corporation whose common stock was not very largely if not entirely promotion profits, it follows that such a rule would be far reaching; yet it would not accomplish full equity, for so many such issues of stock have in various ways been taken up by bonds in later transactions. America will never attain her natural strength or rightful standing until in some manner our corporations can be freed from debt. Neither can labor get its due, nor patrons their just service until the corporation is made financially strong, and heavily buttressed with surpluses and reserves. Neither man nor corporation, bumping over financial rocks, is in any state of mind to consider nice questions of ethics or to exemplify justice or benevolence.

Intelligent self interest requires the discrimination between actual capital and borrowed money as surely as it requires discrimination between capital and profits. It is wrong in principle, and it becomes fatal in ultimate results to borrow permanent capital. It is true that there are compensating advantages that tend to obscure the error of common practice; bonds are popular, they sell readily, and in many cases they provide a given sum of money on easier terms than investors would exact to provide it otherwise; yet if it were the established policy of corporations to finance themselves on stock, that preference for bonds would disappear. Our plethora of bonds is a symptom of disease, and the disease is the failure of corporation managers to live up to a high standard of responsibility. For a strong company, free from bonds there is little even of temporary advantage in issuing them, but when a company has been weakened by over capitalization, especially by the issue of bonds, nothing less than bonds will provide it with funds.

Because of their splendid credit our railroads were able to borrow vast sums; it was the easy, shiftless, thriftless way to get money; perhaps it was the only way to get so much money with so poor ex-

cuse. The nature of debt was forgotten; rather, a new and sophistical theory of debt was invented to excuse it; borrowed money was held to be an integral part of corporation capital, something to be perpetually carried and from time to time renewed, with no provision at all for amortization or eventual retirement, except a vague trust in providence and faith in the continued growth of the country.

One often hears the specious argument that bonds are a good thing because they convert the funds of widows and orphans back into commercial stream. That is quite true, but it butters no shiftless financiering. The exigencies of business justify enough unavoidable bond issues to absorb all the trust funds there are, without issuing them with eleemosynary intent. The widow and orphan and personal interests of all sorts are beyond the purview of the corporation manager; that sophistry being admitted, however, the next step is to issue bonds running for an exceedingly long term, sometimes for more than a hundred years. No such bond is consistent with the interests of the company that issues it, or an adequate security to the person who buys it. A bond is the evidence of debt, and a debt is something to be paid as quickly as possible. To incur a company with debts running longer than need be is a fraud upon all the interests the management is supposed to serve. A bond for which no sinking fund or other definite plan of amortization is provided is inadequately secured, and those that run for long periods are more than likely to see the whole class of service to which they belong superseded before they are due. In the maturity of every bond issue for which no adequate amortization is provided, the company confronts a crisis. We have just seen case after case where railroads loaded for more than they should carry when money ranged around four per cent, were obliged to bid around six to refund it.

Laws afford little hope of relief from the bond distemper; what we need is a clearer understanding of the principles involved, a schooling in accounting science and business management, and more of the grace of God in the business heart. So long as bankers, corporation executives, and departments of public control fail to recognize the nature of debt, fail to distinguish borrowed money from capital, or to frown upon debts for which there is no plan of amortization we have not arrived at a time when remedial legislation would be intelligently enforced. Possibly the logical first move would be to revise the conventional form of the balance sheet by subtracting debts, including redeemable preferred stocks, from assets to show net worth set up against capital stock and constructive liabilities.

The statistics of increasing debt prove that we are riding to a fall. The fallacy of issuing bonds as an integral part of capitalization, with no thought of ever liquidating them, will work out its cure in nature's own hard way. Of course we need not wait for Nemesis with her club; we might read our lesson in the German experience, but we won't. Russia, Austria, and Germany have wiped the slate of public and private debt, but at what a cost! France, Italy, and Greece are likely to go through the same bath. What sort of rod fate has in pickle for the rest of us it would take a brave—should I say foolish?—man to answer. Possession of most of the world's gold makes us feel so secure that we fail to realize that our whole business structure is honeycombed with unpayable debt. We are so loaded that normal prosperity, such as we are now enjoying—save that our tariff robs our unorganized Peters to pay our organized Pauls—seems like hard times.

How can I paint the shame of public debt in this most favored of all nations? Think of all the land of this nation—soil, forests, and mines included—having passed out of public ownership with so little to show for it; then add the franchises and special privileges we have given away. Jefferson used twenty-seven paragraphs to indict King George; it would take that many thousand to list the charges we should bring against our fathers and their children for stupidity and bungling in public finance. Instead of borrowers our bodies politic should be bankers; they should all be rich, so rich that even war and war bonuses would not disturb them. That condition easily might have been so far as the material side of wealth is concerned; but to have been it would have required us to conserve our intelligence. Self interest, there is the squeeze, we are short on intelligence. What passes for intelligence among us is short sighted, greedy, and selfish. It is no part of the purpose of this confab to dig into the question of public finance, save to point out that our very excellent currency system is founded upon debt; were we out of debt we would have no currency. It seems illogical, however, to approach the question of debt from the currency side. We have the public debt, and we would continue to have it whether we used it as a currency basis or not. That the wisdom of this nation should be held not to be sufficient to base its currency upon its assets instead of its liabilities is enough to make the angels weep.