

August 17, 1942.

Governor Ransom

British Government Borrowing

Chairman Eccles

I am attaching hereto copy of a memorandum covering British Government borrowing which Mr. Knapp prepared for me at the request of Mr. Piser.

Attachment

MSE:VE:b

(SENT TO EACH BOARD MEMBER INDIVIDUALLY)

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 31, 1942

To Chairman Eccles

Subject: British Government Borrowing

From J. Burke Knapp

JBK

At the request of Mr. Piser, the following memorandum has been prepared to give a summary of the public issues by the British Treasury in the fiscal year 1941-42.

In this fiscal year total expenditure amounted to 4,789 million pounds, excluding the value of lend-lease assistance from this country but including the British Government's expenditures abroad. Total revenue receipts, excluding contributions under the national health and unemployment insurance schemes, amounted to 2,074 million pounds, leaving a net deficit to be covered by borrowing of 2,715 million pounds. The form which this borrowing took may be summarized as follows:

	<u>In millions of pounds</u>
National Savings Certificates (net)	228
3% Defense Bonds (net)	182
2½ National War Bonds	724
3% Savings Bonds	577
Tax Reserve Certificates	192
Total	1903
Floating Debt (net)	499
Treasury Deposit Receipts Issued to Commercial Banks	67
Treasury Bills Issued to the Commercial Banks	-30 (approx.)
Treasury Bills Issued to the Bank of England, Other Government Departments, Foreign Central Banks, etc., plus Advances by Other Government Departments to the Treasury	462 (approx.)
Special 3% Issues to Postal Savings Banks	166
Miscellaneous	147
Grand total	2,715

It may first be remarked that almost all the 500 million pound increase in the floating debt was incurred toward other Government departments, the Bank of England, and foreign central banks (principally the latter). Only a net 40 million of this increase represented increased holdings of short-term Treasury securities by British commercial banks. The special issues to the Postal Savings Banks represent special transactions by which the British Treasury absorbed small savings deposited in these Government institutions, while the "Miscellaneous" item represents principally the British Treasury's loan from the R.F.C. against the pledging of British-owned dollar securities and investments. Thus the

first five issues listed above constituted the great bulk of the Treasury's direct borrowing from the public and the commercial banks during the fiscal year 1941-42.

These five issues may be briefly described as follows:

1. The National Savings Certificates are offered at 15 shillings each and mature in ten years from the date of issue at $20\frac{1}{2}$ shillings and give a yield over their full life of about 3.17% which is free of tax. They may be cashed at any time on a few days notice at a schedule of redemption prices which give the holder a slightly smaller yield than if he had held the certificate for its full life. Holdings of these certificates are limited to 500 per person (maturity value of £512-10-0).

2. The 3% Defense Bonds issued at par plus accrued interest are redeemable at a 1% premium ten years (before September 1941, seven years) from the date of purchase, offering a yield to maturity of slightly over 3% subject to tax. Holders can obtain repayment at par plus accrued interest by giving six months notice, or in case of urgent need within a few days. Holdings of this issue are limited to £1000 per individual subscriber.

3. The $2\frac{1}{2}$ % National War Bonds are marketable securities issued and redeemable at par plus accrued interest and available in unlimited amounts to any subscriber. The first series of these securities, issued in June 1940, had a maturity of five to seven years. As time went on the life of these bonds became shorter until in January 1941 the first series was replaced by a second series maturing in $5\frac{5}{8}$ to $7\frac{5}{8}$ years. A third series was commenced in October 1941, maturing in about $7\frac{3}{4}$ to $9\frac{3}{4}$ years. While the issue price, coupon rate, and redemption price have remained the same for all series, the terms of the issue have gradually been tightened by extending the maturity of the successive series. In this way, the Treasury has been able to stagger the maturity of its obligations. Total subscriptions to the first series in the period June-December 1940 amounted to 442 million pounds. The second series raised 494 million pounds in the period January-October 1941 and the third series brought in 442 million pounds through June 30, 1942.

4. The 3% savings bonds are also marketable securities issued and redeemable at par plus accrued interest and available in unlimited amounts to any subscriber. These securities were first issued in January 1941 to mature in 1955-65. The terms of this issue remained unchanged until April 1942 when a second series was issued with a longer maturity (1960-70). The first series brought in a total of about 710 million pounds, and a further 50 million pounds was subscribed to the new series through June 30, 1942.

5. The tax reserve certificates were first issued in December 1941 and constituted an innovation in British Government finance. As the name indicates, they are certificates which may be tendered in payment for taxes (particularly personal and corporate income taxes including surtax and excess profits taxes) falling due within two years from the date of purchase of the Certificates. When Certificates are so tendered the tax payer is credited with their face value plus interest at the rate of 1% per annum free of tax for each full month that the Certificate has been held. The Certificates are non-transferable but may be redeemed by the holder at par at any time after two months from the date of purchase. The tax-free character of the return on the Certificates makes them extraordinarily attractive to individuals with incomes subject to high surtaxes or to corporations subject to excess profits tax.

Little information is available concerning the identity of the buyers of the securities in these five categories. It is clear that the 400 million pounds of National Savings Certificates and 3% Defense Bonds sold during the fiscal year 1941-42 were taken by individual subscribers while it is likely that the 200 million pounds of tax reserve certificates were taken largely by corporations and to a certain extent by wealthy individuals. The distribution of the remaining 1,300 million pounds of 2½% National War Bonds and 3% Savings Bonds is most difficult to determine. British commercial banks increased their holdings of medium and long-term Treasury securities by some 230 million pounds during the fiscal year and no doubt additional large amounts were taken by insurance companies, building and loan societies, and other repositories of private savings. Industrial and commercial corporations may also have purchased some of these bonds, for example, as an investment for their post-war reserves.

On the basis of data in the British White Paper on War Finance, it appears that personal savings in the United Kingdom including provision for accrued taxation may have amounted to 1,000 million pounds during the fiscal year. Probably in very large part these savings were tapped directly or indirectly by the Treasury. If they were not invested directly in government securities they were probably accumulated in the form of deposits with commercial banks, the Postal Savings Banks, building and loan associations, etc., and were invested by those institutions in Treasury issues. In addition, the Treasury was probably able during the year to reabsorb the bulk of the funds paid to British investors by the Treasury when it requisitioned their holdings of foreign securities for sale abroad. It is estimated that disinvestment abroad by British investors in this manner amounted to several hundred

million pounds during the fiscal year, thus providing a source of funds to the Treasury additional to the accumulation of private savings.

Since June 1940 the British Treasury has relied exclusively upon tap issues for its public medium-term and long-term financing. Subscriptions to these issues, especially by small savers, are sought continuously by members of a nation-wide volunteer organization, the National Savings Movement, headed by Lord Kindersley. This body, organized on the "cell" system, has representatives in every city block and every place of employment. Various group saving schemes are in effect, including wide-spread pay-roll deduction plans in commercial and industrial establishments. There is a steady stream of advertising and other publicity exhorting the public to save more and to invest more in Government bonds.

In addition to this regular nation-wide propaganda, there are periodic "drives" concentrated on some city or area during which the area, with the aid of speeches and demonstrations by national figures in the Savings Movement, attempts within the period of one week to reach a target figure of subscriptions to Government bonds. All the devices of a "community drive" are used to raise subscriptions in the area from individuals, corporations, and even banks. A series of these "Warships Weeks", so-called because the slogan is that subscriptions will serve to finance warship construction, were promulgated in the leading British cities, culminating with a "Warships Week" in London last March. For the big drive in London a target was set at 125 million pounds; actually in that single week subscriptions from residents of the London area were forthcoming in the amount of 150 million pounds. Figures are not available to show the extent of direct bank subscriptions in these drives, or the extent to which the banks financed subscriptions by third parties. In general, however, the latter practice is frowned upon except to the extent that the borrower amortizes his loan within a brief period.