

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM**Office Correspondence**Date August 3, 1942To Chairman Eccles

Subject: \_\_\_\_\_

From C. P. Kindleberger

To supplement my memorandum of July 30 on the Canadian Government Borrowing Program 1941-42, may I call your attention to the announcement in Canada of a new type of security issue for sale to the chartered banks. These are to consist of Dominion of Canada deposit certificates which will be sold from time to time between major Government issues. The certificates will bear interest at  $3/4$  per cent per annum and will mature 26 weeks after issue date. Finance Minister Ilesley, making an announcement of the first issue of \$79 million dated July 29, 1942, said that offerings will be made weekly for some time.

Deposit certificates are analogous in several respects to treasury receipts which have been issued during this war by the British Treasury.

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BOARD OF GOVERNORS  
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FEDERAL RESERVE SYSTEM

# Office Correspondence

Date July 30, 1942

To Chairman Eccles

Subject: The Canadian Government

From C. P. Kindleberger

Borrowing Program 1941-42

Pursuant to your request, relayed to me through Mr. Piser, the following memorandum describes the war finance program followed by the Canadian government during the fiscal year ended March 1942.

## Security Issues

Table I, on the following page, sets forth Canadian government borrowing of new money in Canada. \$450 million of securities issued to the Bank of Canada and the chartered banks to replace maturing obligations held by those institutions are omitted from the table, along with \$33.3 million of special school land debentures reissued each year and regularly maturing Treasury bills. The increase in net debt of the Dominion government is, of course, smaller than this amount because of the redemption of obligations in London and New York.

## Victory Loans

The First and Second Victory Loans were sold through nation-wide campaigns much akin to the Liberty Loan drives of the United States in the last war, with every type of public pressure conceivable being brought to bear to obtain subscriptions. Campaigns were carefully organized several weeks in advance of their opening date, and were continued for a period of three weeks during which books were kept open for subscriptions.

The success of the Victory Loans may be measured to some extent by the number of subscribers:

Issue	Dated	New Money	Number of Subscribers 1/
1st War Loan	Feb. 1, 1940	\$175 million	178,000
2nd War Loan	Oct. 1, 1940	250 million	150,000
1st Victory Loan	June 15, 1941	730 million	968,000
2nd Victory Loan	Feb. 1, 1942	845 million	1,681,000

1/ Including subscribers to conversion portion of issues.

Information upon the composition of the subscribers is not uniform. Statistics on the First and Second War Loans indicate that private individuals initially took 63 and 46.4 per cent of the total issues, respectively, leaving 37 and 53.6 per cent, respectively, bought by corporations and institutional investors. On the First Victory Loan, 861,000 of the 968,000 subscribers bought bonds in denominations of \$500 or lower, aggregating only \$115,000,000, while 656 subscriptions in amounts of more than \$100,000 accounted for \$395,000,000, including conversion purchases. A similar breakdown is not yet available on subscriptions to the Second Victory Loan.

Table I

## CANADIAN GOVERNMENT LOAN FLOTATIONS FOR NEW MONEY IN CANADA

Issue Date	Maturity (Years)	Coupon Rate (%)	Price		Yield at		Amount Issued (\\$)
			To Public (\\$)	To Govt. (\\$)	Public Price (%)	Price to Govt. (%)	
June 15, 1941	5 1/2	2	99.00	97.98	2.19	2.40	151,090,000) <sup>2/</sup>
June 15, 1941	10	3	100.00	97.95	3.09 <sup>1/</sup>	3.21	579,286,250) <sup>2/</sup>
March 1, 1942	2 1/2	1 1/2	100.00	<u>3/</u>	1.50	<u>3/</u> )	
March 1, 1942	6	2 1/4	100.00	<u>3/</u>	2.25	<u>3/</u> )	845,385,300
March 1, 1942	12	3	100.00	<u>3/</u>	3.07 <sup>1/</sup>	<u>3/</u> )	
Various	Due June 15, 1945	Non-inter- est bearing certificates	100.00	100.00	Nil	Nil	4,533,000
Various	7 1/2	War Savings certificates	--	--	3.00 <sup>5/</sup>	3.00 <sup>5/</sup>	79,782,000
Various	--	War Savings Stamps	--	--	Nil	Nil	960,000
							<u>1,661,036,550</u>
			Increase	in short-term	Treasury	bills	<u>40,000,000</u>
							<u>1,701,036,000</u>

<sup>1/</sup> To be redeemed at 101 at maturity.

<sup>2/</sup> Total subscriptions to the First Victory Loan amounted to \$836,820,250, including \$106,000,000 of conversion subscriptions, of which \$42,196,000 were for the 5 1/2-year maturity and \$64,248,000 for the 10-year.

<sup>3/</sup> Final costs for Second Victory Loan not available as of June 23, 1942.

<sup>4/</sup> Total subscriptions to the three issues amounted to \$997,503,300, including \$152,118,000 of conversion subscriptions. Information at hand does not give us figures for cash subscriptions by issues. The breakdown of total subscriptions by issues is as follows:

1 1/2-year maturity (available only for conversion subscribers)...	\$ 57,160,000
6-year maturity.....	268,924,000
12-year maturity.....	<u>671,410,300</u>
	\$997,503,000

<sup>5/</sup> Yield to investor if held to maturity.

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Method of Selling

The Dominion government pays commissions to individual salesmen, service fees to banks, trust and loan companies, etc., and remuneration to investment dealers and brokers. On the Second Victory Loan, the government paid 3/8 per cent commission on the 6-year issue and 5/8 per cent commission on the 12-year issue, an increase of 1/8 per cent over the scale of commissions on the First Victory Loan. No commissions were paid on the Second Victory Loan, however, on employee subscriptions. The service fee paid to banks, etc., for entering subscriptions and handling the payment and delivery of bonds to purchasers, amounted to 1/4 per cent. A committee consisting of the chairman of the National War Finance Committee, the securities adviser of the Bank of Canada, and the Deputy Minister of Finance arrived at the rate of remuneration to investment dealers and stockbrokers on the basis of the services rendered.

Expenses of selling the First Victory Loan have been revealed as follows:

Preparation and distribution of bonds	\$ 363,921.86
Administration expenses *	769,826.30
Publicity expenses *	1,058,068.98
Commissions to individual canvassers on general subscriptions	1,551,713.80
Remuneration to banks, trust and loan companies -- service fee for handling and delivering bonds	1,750,000.00
Remuneration to investment dealers and stockbrokers re pooled subscriptions	<u>3,293,040.00</u>
	<u>\$8,786,570.94</u>

The Minister of Finance defended these expenses on the ground that they amounted to only 1.09 per cent of the issue (including conversion). He anticipated that total expenses in connection with the Second Victory Loan would represent a slightly lower percentage of the total issue (Debates, March 27, 1942, p. 1854). In a return to Parliament on June 29, 1942 (Debates, p. 4033) it was stated that the total commission paid to salesmen -- presumably individual canvassers -- on the Second Victory Loan amounted to \$1,654,381.58.

In the organization of local Victory Loan Committees, the investment dealers are believed to pay special attention to "special names", i.e., those companies and individuals who may be expected to subscribe \$25,000 or more. Bank accounts are examined to ascertain the existence of large idle deposits available for subscriptions.

\* House of Commons Debates, February 25, 1942, p. 897, gives further details under these items.

Role of the Banks

The chartered banks in Canada do not subscribe to the large public issues. In addition to their role in handling subscriptions, payment and the delivery of bonds, however, they stand prepared to finance bond purchases by individuals and corporations, and they deal in bonds when these are traded after the subscription books are closed. ✓

Bank loans on the First Victory Loan, dated June 15, 1941, amounted to \$135,978,539 as of June 30, 1941 (Debates, February 25, 1942, p. 896). This amount compares with the total subscriptions for new money of \$730,000,000. The Minister of Finance stated that the rate of interest charged by the chartered banks on these loans was equal to the coupon rate received in the bonds, for a period of six months subsequent to June 15, 1941. We have no knowledge whether the interest rate charged on such loans rises after six months. The banks stand ready, however, to make loans against government bonds at any time, as can be deduced from the following excerpt from the Salesman's Manual for the Second Victory Loan (p. 15):

"A Liquid Asset

"Like a dollar bill, and almost as readily, a Canadian Government Bond is negotiable by its owner. If a man wants to draw money from his savings account, he goes to his bank and signs a cheque. If he holds a Government Bond, and needs money immediately, he can go to his bank and borrow on it. . . ."

Loans by chartered banks to finance the Second Victory Loan amounted to \$209,800,000, out of total cash subscriptions of \$845,000,000, distributed as follows (Debates, May 14, 1942, p. 2630):

Loans as of March 31, 1942

Instalment Subscriptions under the official plan....	\$ 50,594,437
Loans against security of Second Victory Loan bonds.	<u>159,209,496</u>
	\$209,803,933

Under the official instalment plan, individual subscribers are urged to buy bonds and pay for them out of income. Straight loans against the security of the bonds are of two types: loans to finance the purchase of securities, say, by a corporation which has undertaken to deduct instalments for the purchase of bonds by its employees from weekly payrolls, reducing the loan at the bank until the bonds are fully paid for; and loans to individuals who for various reasons have bought more bonds than they can carry and sell these bonds in the market at a later date. We have no information bearing on the rapidity with which these loans are paid off.

In addition to financing the purchase of Victory bonds by others, the banks buy such bonds as investments after trading in the bonds is begun. Information is not available on bank holdings of Dominion bonds by issues, or even of banks holding of Dominion government bonds separately from provincial government issues.

During the fiscal year 1941-42, chartered bank holdings of Dominion and provincial government securities increased by \$117,000,000, made up of an increase of \$133,000,000 in securities having more than two years to run to maturity, offset in small part by a reduction of \$16,000,000 in securities of less than two years. Bank of Canada holdings of Dominion and provincial government securities increased by \$70 million, made of an increase of \$94 million in long-term bonds, offset by a decrease of \$24 million in short-term holdings. The banking system as a whole, therefore, increased its long-term holdings of government securities by \$227 million, and reduced its short-term holdings by \$40 million, for a net increase of \$187 million. Only \$40 million in treasury bills were sold directly by the Dominion government to the banking system during the year.

Per Cent of Total Borrowing Financed by Banks

If the increase in bank holdings of Dominion and provincial government securities be accepted as a rough measure of the change in holdings of Dominion securities, the banking contribution to Canadian government finance during the fiscal year ended March 31, 1942, can be summarized as follows:

Chartered Banks			
Increase in security holdings	\$117 million		
Finance of 2nd Victory Loan	210 million		
Loans still outstanding on 1st Victory Loan on March 31	<u>?</u>		
Total			\$327+
Bank of Canada			
Increase in security holdings	70		
Increase in sterling	<u>207</u>		
Total			<u>277</u>
GRAND TOTAL			<u>\$604</u>

The increase in the Bank of Canada's holdings of sterling exchange is included among the items of banking finance of government expenditure, since it represents one method by which the Canadian government financed the net export of goods and services to the sterling area during the year. Since March 31, 1942, the sterling of the Bank of Canada has been reduced by \$220 million, as the Foreign Exchange Control Board has consolidated its holdings of sterling into a loan for the duration of the war, but the Bank of Canada's holdings of Dominion and provincial government securities have risen by \$244 million over the same period -- to July 22, 1942.

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The figure of \$604 million plus of bank financing during the fiscal year 1941-42 can be compared with the following figures:

	<u>Item</u> <u>(Millions)</u>	<u>Bank borrowing</u> <u>as per cent</u>
Total government borrowing in Canada, plus increase in Bank of Canada's holdings of sterling	1,900	32
Total Canadian government expenditure, plus finance of net British expenditures in Canada	3,400	18
Net national income	7,250	8

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