Chapter IV

FLOATING DEBT

In the first World War, between the two wars and for nearly a year of the second, the Floating Debt consisted of Treasury Bills (much the greater part) and Ways and Means Advances. The latter were either surplus funds of certain Government Departments temporarily lent to others or - the possibly inflationary part - direct advances from the Bank of England to the Treasury to meet its immediate obligations, such as the payment of interest. By the outbreak of the second World War, borrowing from the Bank had all but disappeared: funding operations and a succession of balanced budgets had rendered them all but unnecessary. With the War, however, and the larger figures involved, demands on the Bank of England re-appeared with greater frequency, though the amounts (on weekly accounting dates) were only on half a dozen occasions as much as £50 million.

The very real inflationary possibilities of Bank of England Ways and Means advances not re-absorbed by some means when disbursed by the Government were taken care of in the 1914-18 War by the borrowing of the banks' surplus funds ("Bank borrowings"), the precursor of Treasury Depo~~sits~~sit Receipts, a new element of Government borrowing in the second World War, introduced at the end of June 1940 (see ~~further in Chapter~~ below .....). In the 1914-18 War there existed also for a time a form of deficit financing called "War expenditure certificates".

The following figures will illustrate on broad lines changes in the composition and size of the Floating Debt over the past 35 years. Dates in the earlier years are chosen partly because figures for them are readily available, but the second and third dates because they define fairly closely the limits of the war period.

Floating

clear that this was not an idea of the New Government's but would probably have taken much the same shape if the previous Chancellor of the Exchequer had stayed in office". . . .

Floating Debt

£ million

	Total Floating Debt	Treasury Bills	Ways & Means Advances: By Public Depts.	Ways & Means Advances: By Bank of England	War Expenditure Certificates	Treasury Deposit Receipts
1 Aug.1914 1st Aug	16	15	1		-	-
31 Aug.1914 31st Aug	44½*	43*	1½*	-	-	-
31 Oct.1918 31st Oct	1,472½*	1,129*	196*	145*	2½*	-
31 Dec.1935 31st Dec	936	866	33	37	-	-
1938	1,037	986	46	5	-	-
1939	1,535	1,470	61	4	-	-
1940	2,626	2,152	85	51	-	338
1943	4,948	3,115	367	65	-	1,401
1945	6,294	4,226	423	9	-	1,636
1948	6,355	4,579	265	-	-	1,511

*Figures supplied confidentially by H.M.Treasury.

TREASURY BILLS

The war of 1914-18 saw a great decline in the Commercial Bill, and its replacement in large measure as the main short-term investment of both banks and Discount Market firms by the Treasury Bill. Treasury Bills outstanding increased from a total of £15 million only in August 1914 to over £1,000 million in the autumn of 1918. Ten years after the end of the war there were still over £600 million.

In the first few years after the first war, generally speaking the largest holders of Treasury Bills were the home banks (Clearing and Scottish), certain foreign Central Banks, Government Departments, and the Banking and Issue Departments of the Bank of England. This was also true of later years, when the Issue Department was itself classified as a Government Department, and other Government Departments and quasi Government Departments became important holders in the recent war, when also holdings of foreign Central Banks increased greatly.

Statistics published by the (Macmillan) Committee on Finance and Industry, which reported in 1931, showed that in January 1919, just after the first World War the (10) London Clearing banks held £225 million Treasury Bills and (6) Scottish banks £29 million, or between them about a quarter of the total. During the next ten years (1919 - 1928) the holding of these two main groups of banks amounted on an average to about 20% of the total Bills outstanding. Between 1919 - 1928 clearing banks' holdings averaged £227 million and varied between £69 million (April 1920) and £228 million (November 1921) - the extreme range therefore occurring within seven months, while those of the Scottish banks were over £17 million and ranged between £6 million (March 1926) and £50 million (September 1921). Both groups of banks therefore held their (monthly averages) maxima within two months of one another, though their minima occurred six years apart.

Seasonal

Seasonal contraction in the total of Bills outstanding normally occurred with collection of revenue in the early part of the year; and reduction in the banks' holdings partly with the seasonal contraction in the total of Bills outstanding, but also as total Government borrowing by this means was funded or paid off.

In the next ten years (1929 - 1938), leading up to the Second ~~recent~~ War, the clearing banks held an average of rather more than £180 million Treasury Bills while Scottish banks' holdings fell away to £5 million or less in the latter half of that period.

In 1921/2 and again in 1932/33 - periods when conversion operations were active - clearing banks took up large quantities of Treasury Bills and their ratios were temporarily high. (12.8% in 1921; 13.8% in 1932 and again in 1933).

Treasury Bills having thus to be regarded from at least two points of view, i.e. as instruments of Government borrowing and as desirable investments for the banks and Discount Houses, holdings by the banks, the most important section of the Market in its wider sense, during the war years* (say, between August 1939 and August 1945) can claim to be examined against such a background as the foregoing.

The earlier financing of the more immediate needs of the Government by means of Treasury Bills was supplemented by two other forms of short borrowing, viz. Treasury Deposit Receipts (June ~~January~~ 1940), an improved version of the first world war method of borrowing the banks' surplus funds, and Tax Reserve Certificates (December 1941) which were designed to anticipate receipts from taxation which would fall due in not less than two months nor more than two years, from banks and other companies, and so immobilise funds which might otherwise find their way into enterprises which would not serve the Government's purposes. Meanwhile they yielded their holders 1% interest free of tax. At the end of 1945 there were £800 million Certificates outstanding. Special sections of this chapter are devoted to descriptions of these forms of borrowing.

* And also at other times!

With the

With the further decline in the Commercial Bill in the last war there was all the more reason behind the banks' desire to acquire Treasury Bills. The clearing banks' "liquid" ratio of Cash plus Call Money plus Discounts to deposits, traditionally maintained at about one-third of their deposits, though enormously increased (maximum 60% in 1945) if Treasury Deposit Receipts are included, fell to little more than a half the pre-war figure (minimum 17.3% in March 1944) when only holdings of the original three "liquid" assets were (properly) admitted, and particularly as the proportion of Treasury Bills was not maintained. The conception of this ratio of four assets (including T.D.R.'s) as "liquid" was, in fact, never really accepted. T.D.R.'s seemed to have gradually assumed an unmerited quality of liquidity. There was, of course, always the facility to discount T.D.R.'s (at a penal rate) to back the argument, but this privilege was only invoked by one (Scottish) bank.*

Treasury Bills were also suitable short investments for Government Departments, some of whose holdings increased greatly during the war.** Bills were transferred to the Issue Department in September 1939 in exchange for £263 million gold (at 158/6d. per fine ounce).*** Treasury Bills were held as the main backing for the Note issue, which expanded by about £900 million between 1938 - 1947 when notes began to return from circulation; and Bills in the Issue Department rose from about £200 million just before the war to over £1,300 million in the autumn of 1946. Further large holders were overseas Central Banks, whose large increase in funds sought investment which would be liquid whilst still earning some return. Central Banks' demand for Bills was exercised -

(a) Directly by commissions to invest their funds in Bills to be held for their account (i.e. any excess over an agreed Drawing Office balance, which varied from bank to bank and was a matter of private arrangement).

(b) Indirectly through Bills held by the Bank of England (Customers' Money) in which Central Banks' funds were invested

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*Commercial Bank of Scotland (4 times January - February 1942).
**e.g. Ministry of War Transport (War Risks, Marine); Board of Trade (War Risks, Commodities); Custodian of Enemy Property.
*** The last occasion on which the Issue Dept. transferred gold, leaving a negligible holding.

invested at a rate of interest (varying with the tender rate)* which allowed a small margin for the Bank's services. In practice, anything above a comparatively small agreed working Drawing Office balance up to an agreed maximum is transferred to Customers' Money, adjustments to this figure being made weekly. Any balance above this ~~is~~ was invested directly in Treasury Bills, for which the Bank tenders.

For many years before the second world war the amount offered at the weekly tenders varied between £30/50 million. (About two-thirds of the offers were between £35 mn. and £45 mn.), but was occasionally as low as £25 mn. and for four weeks, from 27th January to 17th February 1939, £20 mn. After 7th September 1939 the figure was never lower than £50 mn.

Such was the competition for Bills as the demand o/a Central Banks** and others increased, and as the banks' deposits expanded, that several times a case had to be made out for the Market (banks), who grew short of Bills. The first recorded occasion was on the 18th March 1941, when it was agreed that the weekly tender, which had been unchanged at £65 mn. since the 10th May 1940, should be increased to £70/£75 mn.

The most important principle governing the figure offered ~~has been~~ was the percentage (Discounts to Deposits) shown to be handled from month to month by the Clearing Banks. They - and the Bank on their behalf - like to see a percentage around 15: thus 15% Discounts + 10% (~~now~~ later 8%) Cash + 5% (~~now~~ later 7%) Call Money ~~go~~ went to make up their traditional and desirable 30% liquidity.

Two years later the question again arose, and with the

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*The nearest eighth below the average tender rate, less a quarter(¼). Commission ~~is~~ was deducted at the rate of 1/16th when the Customers' Money rate ~~is~~ was below 2% and 1/8th when above. A typical current rate (May 1949) works out thus: average tender rate 10/2.83d.: the nearest 1/8th below = ½: less ¼ and commission 1/16th = 3/16% net.

**e.g. between 25.5.40 and 15.2.41 Central Banks' holdings increased from £103 mn. to £185 mn. at the expense of home banks and the Discount Market. (Memo.18.3.41, C.C.P.361).

On both these questions see also Part IV Chapter I. "Banking Department Securities".

Treasury's agreement the maximum weekly tender was raised to £90 mn. on This limit was held (with exceptional offers of £100 mn. for four weeks in October 1943) for a year. From April 1943 the limit was raised by degrees until, in December 1946, it reached £170 mn.: at which level, with occasional seasonal increases (to £180/£190 mn.) or decreases (to £160/£150 mn.) it ~~has since~~ remained.

On the 17th August 1944 the Deputy Governor was asked by representatives of the Discount Market whether Bills of £25,000 could in future be issued instead of the existing £10,000 Bills; for all practical purposes £25,000 was the smallest loan which Market firms could obtain from the banks. It was decided to issue Bills in the extra denomination of £25,000, and on and after 18th September either tap or tender Bills were available in five denominations, viz. £5,000, £10,000, £25,000, £50,000 and £100,000.

The two tables to follow will show how the Bills held by the largest holders have varied. In these tables the columns headed "Remainder" include the Discounts of the Bank of England usually a few millions only (maximum £36 mn. in March 1946), Bills held by the Discount Market (brackets) and by sundry other holders of which the Colonial Banks are believed to account for about £40 mn.

TABLE I

DISTRIBUTION OF TREASURY BILLS OUTSTANDING AT THE END OF AUGUST 1939
AND EACH OF THE LAST 10 YEARS

£ millions

	Issue Dept.	E.E. A/c	Other Govt. Depts.	Bank of England Banking Dept.	Customers' Money	Central Banks' Funds etc.** India**, Pakistan & Burma	Central Banks' Funds etc.** Other Countries	Central Banks' Funds etc.** Total	Clearing Banks	Remainder ø	Total
End Aug. 1939											
31 Dec. 1939											
1940	532	618	159	131	64	73	68	141	238	269 (165)	2,152
1941	721	590	132	131	102	168	314	482	153	236 (170)	2,547
1942	890	450	238	162	73	271	260	531	185	304 (212)	2,833
1943	854	255	316	227	116	518	358	876	121	350 (231)	3,115
1944	1,104	160	308	294	154	764	433	1,197	133	456 (344)	3,806
1945	1,052	205	119	354	185	1,066	497	1,563	352	396 (315)	4,226
1946	1,266	75	75	290	195	965	498	1,463	574	657 (491)	4,595
1947	1,174	250	72	285	207	882	624	1,506	706	601 (505)	4,801
1948	1,213	345	61	349	107	637	525	1,162	648	694 (568)	4,579

**Tap and Tender Bills.

øComprises Bills held at the Bank of England and also those held elsewhere by the Crown Agents and the Banking Dept. of the Commonwealth Bank of Australia.
Canada held Bills up to May 1942 (£173 mn.): none thereafter.

Figures in brackets are for the Discount Market on 31 December.

DISTRIBUTION OF TREASURY BILLS OUTSTANDING AT THE END OF AUGUST 1939 AND AT VARIOUS DATES SHOWING MAXIMA HELD BY VARIOUS GROUPS

£ millions

	Issue Dept.	E.E. A/c	Other Govt. Depts.	Bank of England Banking Dept.	Customers' Money	Central Banks' Funds etc.**			Clearing Banks	Total
						India**, Pakistan & Burma	Other Countries	Total		
End of: Aug. 1939	204	448	16	56	16	33	37	70	179	1,093
31 May 1941	617	695ø	148	76	169	70	98	168	158	2,315
27 May 1944	1,036	190	321ø	171	119	606	392	998	161	3,465
31 Dec. 1945	1,052	205	119	354ø	185	1,066	497	1,563	352	4,226
27 Apl. 1946	1,259	160	129	168	206	1,091ø	514	1,605	412	4,522
27 July 1946	1,154	100	93	203	207	1,055	489	1,544	500	4,375
26 Oct. 1946	1,320ø	100	90	249	202	970	514	1,484	447	4,552
22 Feb. 1947	1,286	100	77	217	219	965	502	1,467	620	4,672
26 Apl. 1947	1,289	175	79	272	248ø	962	529	1,491	669	4,882
28 Oct. 1947	1,203	200	73	238	209	903	615	1,518	765ø	4,792
31 Mar. 1948	1,152	255	71	280	174	920	625	1,545	721	4,910ø

**Tap and Tender Bills

øMaximum between August 1939 and December 1948.

Treasury Deposit Receipts

Although there had been some discussion of the scheme and its alternatives with the Treasury a little earlier, specific proposals for this form of borrowing appear first in a memorandum by the Chief Cashier, dated 4th December 1939. Instead of "Bank Borrowings", the method adopted in the past to supplement the sale of Treasury Bills, he suggested that money should be borrowed by the Treasury directly from the Clearing Banks, the Scottish Banks and perhaps Central Banks directly operating in the London Market, viz., the Commonwealth Bank of Australia and National Bank of Egypt; partly at, say, 7 days' notice and partly at 6 months' notice. The rate might be $\frac{3}{4}$-1% for 7 days' money, and 1½% for 6 months. There should be no special rate for foreign money (contrary to arrangements in the first World War).* The Bank would act as agents of the Treasury and merely charge out-of-pocket expenses. In the previous war money had been borrowed for periods of from 3 days to one month and exceptionally for 3 months, and re-lent to the Treasury as Ways and Means Advances at the rates paid (or at a higher figure). Direct borrowings by the Treasury from the Banks would be a considerable improvement, cheaper for the Government and less clumsy.** The Chief Cashier also felt that this method of borrowing would prevent the Bank being placed at the end of the war in the weak position of being owed a vast sum by the Treasury.

Sir F.Phillips, in January 1940, suggested the direct borrowing of Banks' Customers' balances, apparently giving subscribers the option to tender the security at par for subsequent war loans. This was not considered attractive by the Bank (L.26.1.40) and was dropped.

The proposal

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*Special high rates for foreign money were given in the war of 1914/18, — down to October 1919. [redacted].

**In the Bank Return Bank Borrowings were deducted from Government and/or Other Securities.

The proposal to borrow from the banks was elaborated confidentially in May with Sir Charles (then Mr.) Lidbury of the Westminster Bank (who was at that time Chairman of the Chief Executive Officers of the Clearing Banks). It was agreed that the Treasury Deposit Receipts, as they were by then being called, should be non-negotiable and issued in multiples of £500,000. Holders should be permitted to tender the Receipts to the Bank of England at par, plus accrued interest from the date of issue, in payment for any allotment or instalment, for themselves or their customers, on any public issue of H.M.G.* The deposits should be for six months and the rate 1¼%, subsequently altered by the Governor to 1 1/8%. Sir Charles Lidbury urged that, in order to protect their liquidity, holders should be allowed to discount Treasury Deposit Receipts at the Bank of England, at Bank Rate ruling at the time of deposit; and this concession was granted provided 24 hours' notice was given**.

The scheme, officially communicated to the banks in a letter of 26th June, was introduced on 1st July 1940, when it was realised that, despite the introduction of a "tap" issue a current deficit would from time to time arise***. The 1st July was also the date for the repayment of such amounts of 4½% Conversion Loan as had not been converted into 2% Conversion Stock. An overriding reason for such a scheme, as true then as it was later, was the general convenience for all parties to "pay as you go"****.

Under

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*Except short-term issues such as Treasury Bills. Originally the surrender and subscription had to be made on the same day; later (May 1941) the subscription was permitted on any day in the same week.

**The receipts were to carry the right "of payment at the Bank of England under discount at Bank Rate (ruling at the time of deposit) in order to cover any emergency needs". This right was exercised by one bank only (the Commercial Bank of Scotland) on four separate occasions in January-February 1942.

***3rd July 1940. The Governor acquainted the Committee of Treasury that arrangements had been made for money to be borrowed by H.M.Government for periods of six months from the Clearing Banks, the Scottish Banks and the Central Banks directly operating in London, details of which were laid before the Committee. In this connection the Committee agreed that it would be inappropriate for the Bank to lend money to H.M.Government free of interest.

****The moment would have been inconvenient for the issue of a large public loan: the Issue Department still held £115 million of the 3% War Loan and over £50 million of the 2% Conversion Loan.

Under the scheme the amount to be borrowed in any week was to be decided, so far as possible, and the bankers concerned informed, on the preceding Friday. The loans were to be shown as a separate item in the banks' Balance Sheets. ~~their inclusion with Investments would have involved either an increase in their Cash (in order to maintain the customary Cash Proportion) or the borrowing [illegible] their total surplus funds.~~

In announcing the scheme in the House of Commons, on 4th July, the Chancellor said that instead of financing himself by further sales of Treasury Bills he preferred "a slightly longer security and one that was not negotiable" and claimed that it would provide "a greater control from the centre of the amount of short-term borrowings". The financial Press gave the arrangement a favourable reception.

Separately but simultaneously the Bank arranged with the banks that the maximum rate to be allowed by them on customers' deposits should (with a few small exceptions) be 1% (see chapter on Bank Rate and Market Rates).

The weekly procedure was for the Treasury to estimate their deficit for the following week and to fix, on the advice of the Bank, the maximum sum to be called for from the Bankers during that period. The Bankers were advised of this total and themselves decided how it should be allotted among them. Having received his allotment, each banker had the choice from day to day in the following week as to how much he should pay over according to his cash position. The Banks were under no compulsion to take up the "maximum" or indeed any amount, but in practice the maximum was invariably forthcoming.

Naturally, except to the extent that the Bankers reduced their other assets, their subscriptions to T.D.R.s entailed an appropriate increase in the Cash Base. The Bank, through their management of the Cash Base and their current knowledge of the Bankers' resources, did not ask for sums which would cause inconvenience, and after a little experience the system worked smoothly.

In April it was suggested to both the Commonwealth Bank*

and the

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*The Commonwealth Bank had, in fact, taken up a small amount (£500,000) on 2nd January.

and the National Bank of Egypt that they should take up Deposit Receipts, the motive being to make more Treasury Bills available to the Market: these two banks held nearly £100 million of Treasury Bills between them. As will be seen from the table appended, however, their combined contribution to T.D.R.s did not exceed £20 million until 1943.

During much of the period there were questions in the House of Commons from critics of this form of borrowing. Often they complained that 1 1/8% was too high a rate, some Members of course contending that the subscriptions were created by the banks without cost. A more frequent objection was to the option given to the banks to encash the Receipts for the purpose of subscribing to War Loans; since the latter bore a higher rate of interest, the concession appeared to some Members to be equivalent to giving banks an unearned profit.* The fact that the Receipts could in any case be encashed at maturity and reinvested in such securities did not appear to have occurred to these Members - or perhaps the facility would also have been regarded as objectionable. Occasionally the opinion was expressed that these large borrowings were inflationary. During the course of his replies (which were not always very illuminating) the Chancellor of the time refused to give the names of the individual banks holding the Receipts.

A change in the method (and interval) of making known the amounts encashed before maturity came in for considerable criticism. The Press used to get some partial and not up-to-date particulars weekly from some of the Commercial Banks, which they published until the Chancellor stopped them in April 1942, pointing out that publication was not authorised. At the same time the Treasury began to publish accurate figures monthly.

On the merits of this change Press opinion was divided. The "News Chronicle" called it "another piece of official obscurantism for

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*The Chancellor pointed out that such subscriptions included subscriptions on behalf of the banks' customers as well as those on the banks' own account.

for which no vestige of justification can be advanced"; the "Daily Telegraph", more moderate, admitted that the weekly information "had its limitations, which were well understood", but also its uses as "one of the many guides to money market conditions"; the "Times" was in favour of the change, which was "welcome in that it will supplement the still all-too-scanty information available for the intelligent study of the public finances".

The limitation of the minimum subscription to £500,000 brought a protest from a Scottish bank in June 1940 and an occasional grumble from the smaller banks. At one time the Discount Market suggested the issue of 6 and 2-months' Treasury Bills as more flexible and cheaper. While the size of the minimum subscription was not changed the paper-saving campaign was assisted by the issue of large denomination bills* of £2 and £1 million, and the dimensions of all bills were halved.

In general, however, T.D.R.s were an exceptionally flexible instrument. They were all in a few strong and known hands and their amount could be greatly varied from week to week without causing disturbance to the market. For example, in the three consecutive weeks including and on either side of London's "Salute the Soldier" Week the call was for £80 million, nil and £100 million: thus the large movements caused by the subscriptions of the public were easily offset.

The rate of interest on T.D.R.s was reduced, in conformity with a general lowering of short-term rates which had been the subject of discussion for almost a year, to 5/8% from 22nd October 1945.**

The growth year by year in the amount outstanding was formidable, and constituted a post-war payment and funding problem. In the Summer of 1945 the total outstanding exceeded £2,000 million

for

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*Also from June 1942, by arrangement with the Treasury, by the release for destruction, six months after maturity, of matured and cancelled receipts.

**See further under "Bank Rate and Money Market".

for several weeks, The Clearing Banks held £1,982 million at the end of September, and their ratio of T.D.R.s to Deposits was 40%, with the Advances ratio at under 16%.

After the reduction in the interest rate the total fell by some £5-600 million, rising again in the Autumn of 1946 towards the £1,800 million level. For the next two years the total ranged between about £1,300 million and £1,500 million. A table of quarterly figures is appended.

By the end of 1948 the Clearing Banks had gone a fair way towards re-establishing more normal ratios. Of a total of rather more than £1,500 million T.D.R.s outstanding they held £1,397 million, with a ratio to Deposits of 22.5% (Advances 22.2%).

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The facility of pre-encashment in order to subscribe to "tap" issues etc. undoubtedly helped to make T.D.R.s attractive to the banks. The extent to which they availed themselves of this right is indicated by figures given by the Chancellor in answer to questions (14th and 28th March 1948). These represent pre-encashments from the beginning of the scheme (30th June 1940) to 31st December 1944 for subscription to:-

	£ million
3% Savings Bonds	358
2½% National War Bonds	835
1¾% Exchequer Bonds	6
Tax Reserve Certificates	732
Post Office issues	6

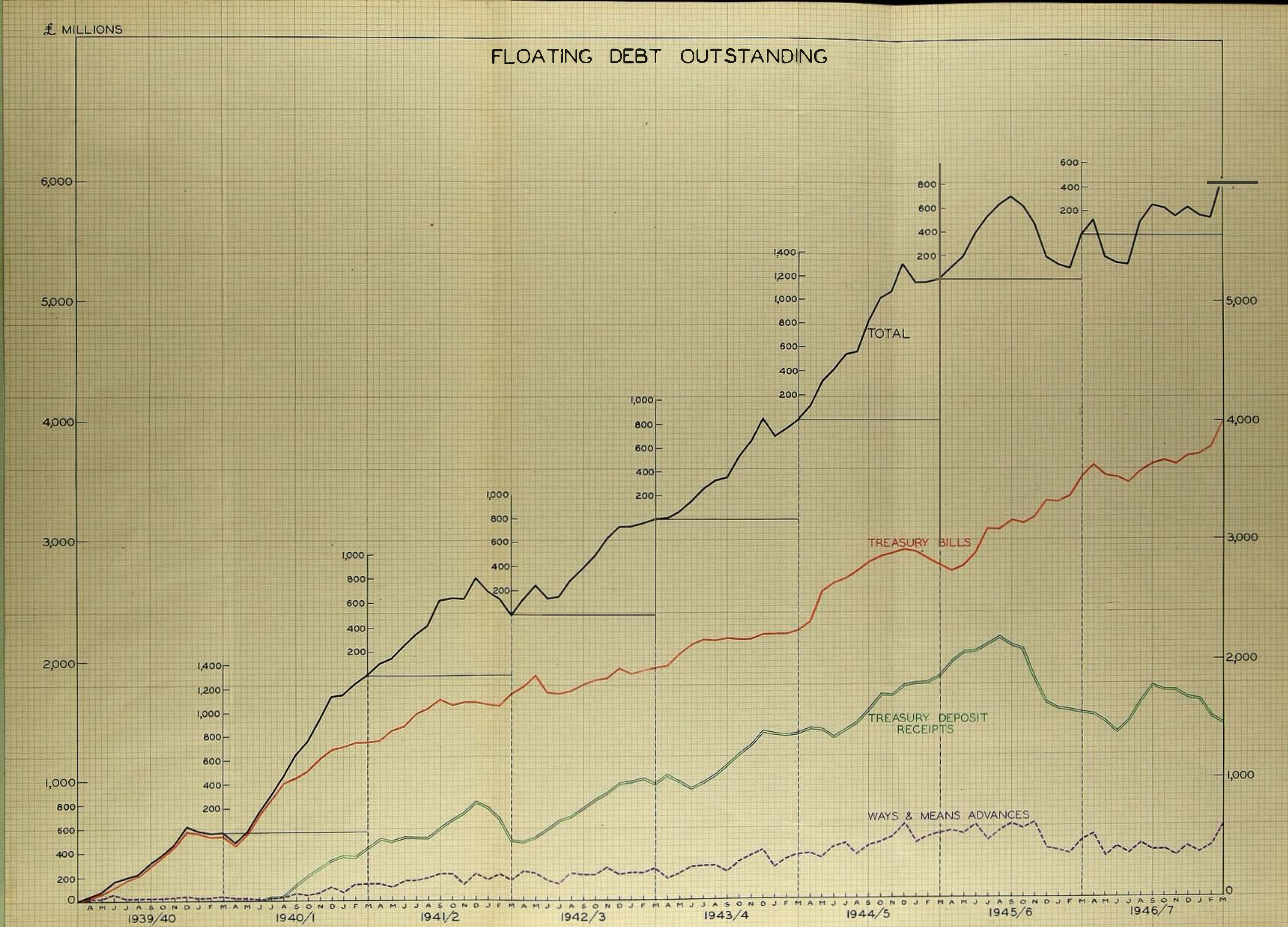
Treasury

Treasury Deposit Receipts Outstanding

(End of Quarter)

£ million

Quarter ended	Clearing Banks	Scottish Banks	Central Banks			Total
			Nat.Bank of Egypt	Commonwealth Bank of Australia	Total	
1940 Sep.30	109.5	14.5	-	-	-	124.0
Dec.31	313.5	24.5	-	-	-	338.0
1941 Mar.31	401.0	28.0	-	.5	.5	429.5
Jun.30	482.0	31.0	3.5	2.5	6.0	519.0
Sep.30	553.0	37.5	5.0	4.5	9.5	600.0
Dec.31	758.0	42.5	5.0	6.0	11.0	811.5
1942 Mar.31	455.5	26.5	9.5	5.0	14.5	496.5
Jun.30	542.5	34.0	10.0	5.0	15.0	591.5
Sep.30	703.0	45.5	7.0	5.0	12.0	760.5
Dec.31	895.5	51.0	15.0	5.0	20.0	966.5
1943 Mar.31	903.5	39.5	21.0	5.0	26.0	969.0
Jun.30	858.5	35.5	26.5	5.0	31.5	925.5
Sep.30	1,029.5	47.5	32.5	5.0	37.5	1,114.5
Dec.31	1,307.0	56.0	33.0	5.0	38.0	1,401.0
1944 Mar.31	1,292.5	54.0	36.5	6.5	43.0	1,389.5
Jun.30	1,245.5	58.0	40.0	7.5	47.5	1,351.0
Sep.30	1,463.0	66.5	43.0	9.5	52.5	1,582.0
Dec.31	1,666.5	73.5	45.0	9.5	54.5	1,794.5
1945 Mar.31	1,728.5	74.5	46.5	9.5	56.0	1,859.0
Jun.30	1,938.5	77.5	50.0	9.5	59.5	2,075.5
Sep.29	1,981.5	83.0	48.0	9.5	57.5	2,122.0
Dec.31	1,523.0	62.5	42.0	9.0	51.0	1,636.5
1946 Mar.30	1,459.0	54.0	38.0	8.0	46.0	1,559.0
Jun.29	1,302.0	50.0	32.0	6.5	38.5	1,390.5
Sep.30	1,670.0	61.0	39.5	8.5	48.0	1,779.0
Dec.31	1,559.5	67.0	41.0	9.0	50.0	1,676.5
1947 Mar.31	1,342.0	60.5	45.5	8.5	54.0	1,456.5
Jun.30	1,329.5	57.0	47.0	8.5	55.5	1,442.0
Sep.30	1,180.5	56.5	47.0	8.5	55.5	1,292.5
Dec.31	1,288.0	58.5	47.0	9.0	56.0	1,402.5
1948 Mar.31	1,187.5	52.0	44.5	7.0	51.5	1,291.0
Jun.30	1,360.5	50.5	49.0	8.0	57.0	1,468.0
Sep.30	1,334.5	55.5	49.0	10.5	59.5	1,449.5
Dec.31	1,397.0	54.0	47.5	12.5	60.0	1,511.0


£ MILLIONS
FLOATING DEBT OUTSTANDING
TOTAL
TREASURY BILLS
TREASURY DEPOSIT RECEIPTS
WAYS & MEANS ADVANCES
1939/40
1940/1
1941/2
1942/3
1943/4
1944/5
1945/6
1946/7
6,000
5,000
4,000
3,000
2,000
1,000
0

33 cm x 37 cm.

A.M.

Tax Reserve Certificates

Tax Reserve Certificates appear to have been an invention of the American Treasury who, from 1st August 1941, began to sell Certificates which could be surrendered against Income Tax and Excess Profits Tax claims. The rate of interest was about 1.9% for Certificates of small amounts and ½% on large amounts, subject to tax. There was a limit of $1,200 on the holding of these certificates by those with small incomes, but none for those with large incomes. They had a maturity of two years. Interest was payable only if the Certificates were used in payment of taxes, and the buying price included accrued interest: they were not negotiable.

The introduction of some similar instrument in the U.K. appears to have been recommended by Lord Keynes; a considerable public demand also sprang up. The position in the U.K., however, where the greater part of Income Tax is deducted at the source, was rather different from that in the U.S.A. Here the attraction of Certificates would be mainly for companies, etc., paying Excess Profits Tax and for those persons subject to Sur-Tax.

The Treasury and the Inland Revenue favoured some such scheme, and their proposals were also approved by the Bank of England. In October a memorandum by Sir Henry Clay reads:

"On every ground it is desirable -

(a) that firms should reserve profits against liability to taxation on those profits as soon as the profits are earned;

(b) that the Government should get hold of the money represented by taxation on income as soon as possible after the income is earned. We urged on the Treasury early in the war, I think, the desirability of shortening the lag between acquisition of income and payment of tax on income, and the arrangements now in force for deduction at the source cover Schedule E.

The question is whether Tax Anticipation Notes add anything material to the facilities already provided (a) by the discount offered on anticipated payments of Schedule D tax, and (b) by the offer of tap securities of varying maturities from Treasury Bills

upwards

upwards. I think they do for the following reasons:-

1. The discount offered on anticipated payments does not extend to E.P.T. or Sur-Tax where the lag between income and payment of tax is largest. Moreover.....the discount is more expensive than Tax Anticipation Notes at 1% would be;
2. The existing rules as to computation of capital for purposes of calculating liability to E.P.T. constitute a deterrent to the investment of taxation reserves in any existing Government Security. Such investments are deducted from estimated capital and therefore lower the standard income allowed before E.P.T. becomes chargeable.....it would be difficult to change this rule, but not difficult to exclude Tax Anticipation Certificates from it (as the discount on anticipated payments of Schedule D tax is excluded);
3. None of the existing tap securities is devised specifically to meet the demand for a security in which to invest taxation reserves, and it appears in fact that firms prefer to put such reserves on deposit with their banks. A security specially designed seems to be needed if the advantages of transferring to the Government currently taxes on current income are to be secured."

While the main terms of the issue emanated from the Treasury, the Bank did much work on the detailed provisions.

The general lines of the prospectus, issued on 22nd December 1941, followed the American arrangements, but there were some differences. Certificates (for £25 or multiples of that sum) were obtainable without limit. The Certificates could be tendered in payment of Income Tax (except Schedule E Tax)*, Sur-Tax, National Defence Contribution, Excess Profits Tax, Land Tax or Contribution under Part I of the War Damage Act, 1941, provided the Tax was due in not less than two months or more than two years' time from the date of the Certificate. Interest was uniform at 1%, free of Income Tax, Sur-Tax, National Defence Contribution and Excess Profits Tax. As in the U.S.A., Certificates were issued at par, were not negotiable, but

*It was decided at the time of the issue to take powers to abolish the discount of 2½% allowed on Schedule D Income Tax paid in advance of the due date.

but could be repaid without interest at any time.*

The issue was made through the Bank, when applications were received directly or through the bankers named in the prospectus. Payment was required in full on application.

In an explanatory memorandum issued to the public the Treasury pointed out that the Certificates were designed to facilitate the setting aside, as they accrued, of sums ultimately payable in respect of taxes "particularly..... for ordinary trading concerns liable to Excess Profits Tax, since sums held in cash against future payment of taxes may in certain circumstances be legitimately reckoned as 'employed in the business' but lose this status if they are invested in Government Loans".

The memorandum also mentioned as one of the objects of the issue that it would "tend to correct the present position in which the total of bank deposits is swollen by the accumulation of large sums which, from the outset, are destined to be withdrawn after relatively short periods for payment of Taxes".

For the reason stated, these tax moneys would not find their way into "tap" loans, etc., and it was probably this effect which was feared. In any case the offer of Certificates would "tend to even out the flow of funds to the Exchequer" - a factor of some importance in view of the yield on Income Tax, Sur-Tax and Excess Profits Tax (estimated at £900 million or more in the financial year 1941/42).

At the suggestion of the Bank the bankers agreed to handle the issue without remuneration or commission. (At the same time they were warned that the sale of Certificates should not be included in War Loan Week totals, etc.).

Having in mind the essentially complicated nature of the Issue, remarkably few complaints were received and these were confined practically to two points:

(a) that

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*Up to 30th June 1944 only £11,834,000 had been so repaid.

(a) that, because banks were closed on 1st January, it was impossible to obtain Certificates dated 1st January, and accordingly impossible to earn 24 months' interest on a Certificate required for payment of taxes due 1st January two years ahead;

(b) that the provision in the prospectus that no interest would be allowed on Certificates tendered for taxes deemed to be due more than two years after the date of the Certificate reacted hardly in certain cases.

Some of these complaints arose from the fact that the first subscribers to the Certificates (in December 1941) only later realised that their Certificates were not available, with interest, for payment of taxes due on 1st January 1944, and while many such persons no doubt cut their losses on the original Certificates and took up new ones, others felt - despite the wording of the prospectus - that they had been misled. Other larger tax payers took up Certificates against needs which could only be estimated, whereas their final assessments, often delayed, might well show that they had over-estimated their requirements, with the result that Certificates surplus to their tax payments would have earned nothing for perhaps two years or more.

As a result of complaints and of Questions in the House, the Chancellor of the Exchequer called for a review of the prospectus to eliminate any proved hardships; and the revised version, issued in July 1944, extended the period of availability of the Certificates for tax payments from two to five years, while maintaining the maximum period for interest earning of two years and the proviso that Certificates would not be regarded as "capital employed in the business" for more than two years. This amendment removed a recognised ground for complaint by enabling holders who over-estimated their needs to use their surplus Certificates, with the benefit of interest, for further tax payments. The revised terms were made available retrospectively to Certificates already held by subscribers, and in certain cases to Certificates already surrendered without interest. It was considered that the concession

removed

33cm x 37cm.

removed the grounds of the complaint regarding the refusal to issue Certificates dated 1st January.

One other trouble arose in connection with Tax Reserve Certificates. It was found that, allowing for relief on Bank Interest in respect of Income Tax and Sur-Tax, it would often pay to borrow from a bank in order to subscribe for the Certificates. Where the Bank Interest charged was 4% it was said that the net profit would be 18/-%. A number of accountants pointed out the advantages to their clients.

Under the terms of a Chancellor's letter of 26th September 1939, concerning advances, no bank should have entered into a transaction of this kind, and in January 1942 banks were reminded that they should not make advances for the purpose. In the following month, however, one of the banks asked that the Chancellor should make a public statement to that effect which would strengthen the hands of individual banks. The Bank of England arranged for a Question and Answer in the House of Commons and brought the Chancellor's reply to the notice of a number of Accountancy Institutes and Associations. But as the Press pointed out, it would be difficult for banks in all cases to ascertain how the proceeds of their advances were being used; the advance and the purchase of Certificates might not synchronise. At the end of November 1943 another reminder in the House was judged advisable; but in 1944 there seemed to be prima facie evidence that such borrowings had not been entirely eliminated.

~~The question was raised as to what should be done if persons who had paid taxes in advance before the introduction of the scheme should wish to take advantage of it, and the Chancellor, at the end of March 1944, gave them permission to do so. They were very few in number. A slightly larger fraction of holders took the opposite course of surrendering to the Exchequer the interest they had earned - mostly not large amounts.~~

The reduction in short money rates late in 1945 naturally brought up the question of cutting the rate on T.R.C.'s and the Treasury approached the Bank (L. 8.2.1946) with a view to

settling

settling the date from which the new rate (they proposed to recommend ½% tax free to the Chancellor) should take effect, and suggested that a last-minute rush to buy the old Certificates should be avoided by issuing a new prospectus with only the necessary minimum of notice.

The Bank agreed (pointing out that a new prospectus was not legally necessary, though desirable); but wondered whether the time had not come when the Certificates should be discontinued. There was already a "more than adequate supply of short bonds, the market in which needs the very support which might be forthcoming from those who at present take up these certificates".

The Treasury wondered whether a large proportion of large businesses who had been using the Certificates would go to the trouble of using the market for investing their tax provision money (units of Certificates had been held for an average period of 11 months). The Inland Revenue, moreover, thought that withdrawal of the Certificates, or even drastic revision of their terms would seriously retard collection of revenue and affect ultimate yields; and further that withdrawal at that time would mean that Certificates would cease to be available for payment of taxation at a time of (probable) greater investment activity in industry, which businesses might give priority over payment of taxes.

The Bank would still have preferred to discontinue issue, but agreed that the matter should be "decided in the main by the Revenue Authorities". But in the Governor's opinion the latter's objection to any "drastic revision" of the terms continuance of the issue would "seem to require that the present rate of interest be maintained". (L. 6.3.1946.)

A rate mid-way between the old and suggested new rates was finally decided on (viz. ¾% free of tax). The new issue was announced by the Chancellor on 11th April, in answer to a question. The terms of the Certificates remained in all other respects unchanged.

The following table shews the total of Certificates outstanding at the end of each quarter. The figures illustrate clearly the build-up each year to a maximum holding in December and the

subsequent

subsequent fall in the March quarter, ranging from £27 million in 1943 to £153 million in 1946, with an average of £100 million over six years. The peak holding was in December 1946, at £800 million, just before the cut in the interest rate. The average March-December increase in the previous four years was £200 million: in 1946 it amounted to £21 million only and in 1947 to £14 million.

Tax Reserve Certificates outstanding: end of quarter

£ million

	30 June	30 Sep.	31 Dec.	31 Mar.	Increase Mar./Dec.	Decrease Dec./Mar.
1941-2				191.5		
1942-3	281.1	377.3	470.0	443.1	+ 278.5	- 26.9
1943-4	514.0	582.8	646.5	561.7	+ 203.4	- 84.8
1944-5	624.7	686.8	759.6	682.5	+ 197.9	- 77.1
1945-6	738.1	755.1	800.5	647.7	+ 118.0	-152.8
1946-7	655.8	655.9	668.3	529.3	+ 20.6	-139.0
1947-8	521.4	517.6	543.2	426.4	+ 13.9	-116.8