CHAPTER I

Early Measures (mainly Pre-war)

From about the beginning of 1937 the Bank may be said to have almost given up hope that war could be averted, and as early as February the Treasury had sent a questionnaire to the Bank concerning the various measures which might have to be taken before its outbreak. The Bank had also been busy summarising and pondering the steps taken in 1914 and during the later years of the first world war. The first communication of the Bank's views to the Treasury is in a long letter from the Deputy Governor, dated 8th July 1937. Preparations in consultation with the Treasury, so far as the files show, do not seem to have gone much further before the Spring of 1938, after which there was great activity.

It will be convenient to group together a number of subjects all of which had to be dealt with once and for all before the beginning of the war, or which were finished with soon after.

There were, of course, others some of much greater importance (such as foreign exchange control), discussions on which began two or three years before the war and on which various decisions were taken. But discussion of these subjects developed continuously over the whole period, from pre-war to post-war, and is not very suitable for breaking up into what would be, in their case, arbitrary time divisions. Thus, sections on certain pre-war committees, on gold, on silver, and on the arrangements made by the Bank of England for additional premises and air raid precautions and other matters, will be found else-
where. An exception has been made for the Money Market, parts 1
of the arrangements for which extend well beyond the outbreak of war.

This chapter, therefore, contains only the following:

1. Suggestions from the Bank of England to the Treasury
2. Currency Advances
3. P.O. and Scottish and Irish Notes
4. Press Censorship
5. Money Market

Certain

Certain proposals by Sir Henry Clay* of measures which the Government might take in the economic (and financial) field are of interest, as they are likely to have reached the Treasury in one form or another. The substance of his memorandum of 3rd April 1939 undoubtedly was passed on by the Governor to the Treasury, in the form of a set of "Queries", dated 6th April:-

1. Assuming H.M.G.can borrow £350 million in the year, what assurance is there that its expenditure will produce increased output and not merely force up wages and prices in the armament industries?

   Can output of aircraft be increased without compelling manufacturers of cars to reduce output and release labour? (e.g., by special taxation of cars)?

   Are any steps being taken to stiffen the conditions on which Unemployment Insurance Benefit and Assistance are given, in order to force unemployed workers to move to munitions centres?

2. In case of war the two dangers of an inflationary rise in prices are -

   (a) rise in wages due to "labour-stealing", increase in cost of living, etc.: and

   (b) rise in prices due to impact of civilian spending on reduced output of consumers' goods.

   Could H.M.G.forestall the former by -

   (a) promising to keep cost of living of essentials down:

   (b) throwing on contractors the onus of resisting demands for wage-advances by informing them that there will be no reconsideration, on the ground of increased wage-costs, of contract prices once fixed?

   And the latter by -

   (a) announcing at once that Income Tax is to be raised, collected quarterly wherever possible, and assessed on the current year's income instead of on the past year's: and

* Created a Knight 12. January 1946.

and (b) clapping heavy excise and import duties on all articles that do not enter into the cost of living of the lower-paid worker?

3. Compulsory service on military lines, although it could not be applied to industry at the outset, would be a useful power to have in reserve. Should not powers be taken immediately, even if they are not utilised immediately?

Other memoranda and notes by Sir Henry, all dated between 3rd April and 15th May 1939, are reproduced as Appendix No.I. Appendices I(C) and I(D) - 15th May - are comments on an undated paper, apparently a memorandum by the Chancellor for the Cabinet, which refers to the overwhelming demands for expenditure which were being made upon him. He feared that in another six or nine months new methods for financing (other than inflation) would become necessary, and suggested that proposals involving the expenditure of, say, £500,000 or more should be examined by a Committee of three or four members of the Cabinet.

In these memoranda Sir Henry covered a wide field of measures which might be adopted to meet the inevitable further increase in government expenditure foreseen; these writings of Sir Henry seem to indicate a foresight of the scale and rate of growth of wartime expenditure not perhaps generally shared. Among other things, he gave his views on mobilisation of resources; curtailment of private expenditure; control of prices and commodity rationing; taxation to absorb war gains, including a suggestion to impose a differential rate for increases over 1937-38 income.

He was particularly insistent on the importance of the priority principle......."since the Government's demands are illimitable and private demands cannot be reduced beyond a substantial amount".....and considered that the department charged with the preparation and enforcement of priority lists would be the most important in the Government's organisation.

Particularly

Particularly clear was his warning of the inflationary effects of Government expenditure beyond the point at which the absorption of physical resources hitherto unemployed (and the safe financing of this much by Treasury Bills) would come to an end.

More specifically, he recommended that the Committee suggested by the Chancellor should consist of:

A Cabinet Minister, as Deputy to the Prime Minister and as head of the working organisations;

A good business-man industrialist as No.2;

A Treasury official as secretary;

A first-rate industrialist economist, experienced in investigating stocks, consumption, output and equipment.

Currency Advances to Banks (Ref C.C.P. 354)

Little advantage of this arrangement was taken by the banks in 1914, and in the event almost none in 1939, but it was thought well to provide the banks with facilities for obtaining currency to meet their depositors' demands without impairing liquidity. In 1914 banks were allowed to obtain advances of notes, up to 20% of their deposit liabilities, from the Bank of England under a Treasury guarantee, against security. On this occasion there would be no difficulty about supplying notes, as there was power to increase the fiduciary issue under the Currency and Bank Notes Act of 1928.

The Bank raised the question first on 8th July 1937, and received a reply from the Treasury that there need be no formal limit on such advances this time, nor would a Treasury guarantee be likely to be required.

The subject dropped until April 1938, when the Bank wrote to say that if there were a scramble for liquidity on the outbreak of war, additions to the Cash Base would be necessary and would not be inflationary in effect.

> "One of the methods of adding to the Cash Base would no doubt be advances to the Joint Stock Banks, and we must be prepared for circumstances in which a Government guarantee of these advances would be desirable although......the necessity for such a guarantee may be unlikely to arise."

In May

In May and June the Bank discussed with the Treasury similar advances to the National Debt Commissioners for account of the Post Office Savings Bank and Trustee Savings Banks. The C.R.N.D. feared advances might be needed by them a week or so before the relevant Act was passed, but the Bank reassured them by saying that in such an event their needs could be met by selling securities to the Bank.

The Treasury expressed some anxiety lest advances to the banks might be used for improper purposes or for longer periods than was necessary, and suggested that the Treasury should have power to vary the rate of interest charged. (Incidentally, the banks should not be asked, except orally, not to press for repayment of loans, etc., as, at some time during the war this lenient policy might become undesirable.). On 28th May the Treasury agreed to a draft notice which kept the limit of advances to 20% of deposits. Interest was to be "at a rate to be fixed from time to time by the Bank of England in consultation with the Treasury; until further notice.......Bank Rate varying." Advances would be a floating charge, ranking in priority to all other floating charges on the assets of each borrower: this followed the 1914 precedent. Later, the Treasury stipulated that the application forms should specify that the advance was for a stated period not to exceed three months (renewable).

A draft was then shown to the bankers, who had no comments. The Treasury next mentioned the case of the Birmingham Municipal Bank, which had about £26 million of deposits and little available cash. The Bank hoped that, if need arose, the Birmingham Bank could borrow from their own bankers, but thought that if they approached the Government or the Bank of England for assistance they would have to be given the same facilities as the other banks. At the instance of the Joint Stock Banks, the case of the Building Societies and Co-operative Societies was also considered. In the Bank's opinion nothing, in advance of an emergency, needed to be done about the former. The Co-operative Societies might need help, which should not be given under the scheme for bankers, but could take the form of

advances

advances by the Bank on account of the Government to the Wholesale Society (as bankers to the movement) against gilt-edged securities, of which some £90 million were held. Instalment financing was also mentioned, but the subject was not pursued.

Arrangements with the C.R.N.D. were taken up again in September, when the Bank, at the instance of the Ministry of Labour, apparently agreed that advances might be needed for the Unemployment Fund. The C.R.N.D. also suggested an extension of advances to all their accounts but the Treasury and the Bank thought this would be an undesirable complication.

In mid-September the Treasury forwarded a statement showing that the Post Office might need, in the first week of an emergency, about £18½ million of currency. This was shown divided between eight districts, London being put down for £8.8 million. The Bank replied that their stocks were already spread more widely than usual and that, combined with a Clearing Banks' decision (15.9.1938) to supply currency to each other in case of need and to re-issue soiled notes, the situation seemed to be well in hand.*

It may be mentioned in this connection that the Midland Bank had suggested that the Bank should issue non-negotiable certificates for blocks of notes held at the Bank of England. The Bank indicated that, as they were anxious that the reserve of notes in the country should be widely distributed, anything which tended to centralisation did not seem to be desirable.

In September 1938 also, the question came up whether Bank of England currency advances would come under a Treasury guarantee or would be Government money. The Bank understood that,

*At the time of the Munich crisis the Bank had decided to deposit about £12 million of small denomination notes with the commercial banks in the Provinces and the Suburbs and to increase in the London store small notes from a three-months' to a six-months' normal supply. At the country branches there was to be a six-months' supply of every denomination of high sum note and an increase to three-months' supply of small sum notes at Manchester, Liverpool and Leeds. This arrangement was not disturbed in 1939.

that, as with advances to acceptors, Government money would be used: It was taken from the Paymaster-General's account, as required.

There seem to have been no further negotiations and the Notice to Bankers of 3rd September 1939 read as follows:

> "The Bank of England give notice that they will be prepared to make temporary advances to approved banks in order to enable the latter to meet demands for currency made by their customers.
>
> Applications for advances must be made on the forms supplied for the purpose and advances will be subject to the following conditions:-
>
> (i) the amount of advances for currency purposes outstanding at any time in the case of each bank will be limited to an amount to be fixed by the Bank of England and in no event to be greater than a sum equivalent to 20% of the total liabilities of the borrowing bank on deposit and current accounts, as shown in the monthly statement dated immediately prior to the date of this Notice;
>
> (ii) advances will constitute a floating charge in favour of the Bank of England ranking in priority to all other floating charges on the assets of each borrower;
>
> (iii) interest on advances will be at a rate to be fixed from time to time by the Bank of England; until further notice the rate has been fixed at Bank Rate varying."

In the application form the banks undertook to use the advance for no other purpose, and agreed to repay by a specified date, the period not to exceed three months.

The Currency (Defence) Act of 1939; Section 3, provided for the floating charge on the banker's assets.

£450,000 was advanced to the Bank of Scotland on 8th September and repaid three days later. No other advances were taken by the banks; and neither the Birmingham Municipal Bank, the Building Societies, Co-operative Societies nor the National Debt Office required assistance from the Bank.

Postal Orders, Scottish and Irish Bank Notes

Both of these had been made legal tender by the Currency and Bank Notes Act of August 1914 and the precedent appears to have been followed almost automatically. By May 1938 it had been decided that Scottish and Northern Irish bank notes should be made legal tender for any amount in Scotland and

Northern Ireland,

Northern Ireland, respectively. But whereas in 1914 they were not legal tender by the head office of a bank in payment of its own notes, no such qualification was attached on this occasion. And in 1914 postal orders were made payable at the Bank of England in coin, a provision now omitted, doubtless because the orders were themselves intended to alleviate any possible shortage of coin. In September 1938 the Clearing Banks suggested that if for any reason the Mint should be unable to function there should be a replacement of part of the metallic currency by notes of a smaller denomination than 10s. The Bank replied (23rd September) that any increase in the number of denominations of notes would give much extra work....."and as postal orders will become legal tender in the event of war, no serious consequences of the temporary non-functioning of the Mint are to be anticipated".

Both the bank notes referred to and postal orders were made legal tender by the Currency (Defence) Act 2 and 3 George VI chapter 64, which was put in force by an Order in Council as from 3rd September 1939. As regards postal orders, the provisions were cancelled by the Statutory Rules & Orders No.1858 of 20th December 1939; they were thus legal tender for a shorter period than in the first world war, revocation having come then by Proclamation on 3rd February 1915. Scottish and Irish notes ceased to be legal tender in the previous war on 1st January 1920.

Press Censorship (Ref W.141 Vol 2.)

The Bank was consulted on the financial aspects of this question at a time when plans for a shadow Ministry of Information were being considered, in June 1938. By the end of July the form of warning to the Press on this subject had been drawn up. It included a few modifications suggested by the Bank, and covered much the same points as in the last war. It read as follows:

Government

Government Financial measures	No report or statement may be published which is likely to prejudice the success of any financial measures taken, or arrangements made, by the Government in connection with the war.
Notes	Nothing should be published which is likely to undermine public confidence in any notes which are legal tender in the United Kingdom or any part thereof. In particular it should not be stated, except with express official authority, that any series of currency or other notes are forgeries. It is important that no description should be given in reports of trials or otherwise of any process used in forgeries, as such a description might be of service to enemy agents who may be desirous of destroying confidence in the currency.
Loans or securities	No statements about or advertisements of the issue or sale of loans or securities other than those dealt in on the London and Provincial Stock Exchanges should be published except with the express sanction of the Treasury, which will be obtained through the Ministry of Information.
Shipments of bullion, etc.	No reference should be made to shipments of bullion or securities from or to any part of the British Empire.
Currency Speculation	Nothing should be published which is likely to undermine public confidence in British Empire currencies or that of any Allied Country. In particular, opinions that any such currency is over-valued in relation to gold or other currencies (e.g. the U.S.Dollar), or is likely to depreciate or that there has been inflation of currency or credit in British or Allied Countries should not be expressed or quoted.
Statistics	When the publication of statistics relating to trade production, prices, shipping or finance has been discontinued, no attempts to estimate such statistics should be published or quoted.
Shortages	No references should be made to any shortage in supply, rationing, shopping queues, or deterioration in quality of articles available, or to governmental control of imports or exports, of distribution or of scaling in any goods, except as officially published.

Briefer and more generalised versions of these paragraphs were given in the Defence Notices issued during the war by the Ministry of Information, that concerning shipments of bullion and securities being underlined as of special importance. But the files show that information concerning gold shipments sometimes leaked out.

Money Market

The ground to be covered under this heading is fairly wide and it is perhaps best to start with a chronological outline of the steps taken before the war to deal with the anticipated emergency and then to cover in more detail the wartime developments of these and other measures.

Pre-war Measures

In 1914, war found the Market completely unprepared, and business was at a standstill from the 2nd to the 13th August. Commercial bills numbering 80,000 and amounting to £120 millions had to be discounted by the Bank before normal conditions returned. This was the background of the problem in 1939, though its magnitude was then much smaller as the Prime Bank Bills in the Market had fallen from £350 millions in 1914 to about £140 millions in 1936. In that year the first precautionary step was taken by the Governor in the form of measures to reduce those of the outstanding Bills (about £26 millions) which were subject to the German and Hungarian Standstill Agreements. This is dealt with in detail below.

The general discussions with the Treasury started in 1937 and in July of that year the Bank suggested that it would be necessary to have a two or three-day Bank Holiday and then a moratorium on the lines of 1914 for a month, renewable if necessary, with a scheme enabling acceptors of Bills of Exchange to obtain advances under a Government guarantee. The Treasury (3rd September) thought that if there were such a guarantee a moratorium or even a Bank Holiday should be unnecessary. A bill moratorium would be likely to lead to a general moratorium, as in 1914; and the Courts Bill would suffice for postponement, if desirable, of other forms of liability.

The Bank seemed unconvinced, but no progress was made until 29th March 1938 when a meeting at the Treasury, with Bank representatives present, agreed that while a Bank Holiday of, say, three days, might be necessary in which to pass legislation, a general moratorium should be avoided. The Bank drew up a plan for special advances to

acceptors

acceptors based on the 1914 scheme, but with the important difference that the advances were to be made through and on the recommendation of the acceptors' own bankers. This plan was submitted to the Treasury in April.

Draft Proclamations were discussed during May, some doubts being felt as to whether Bank Holidays were necessary - one day would be sufficient in the Treasury's opinion, and this was agreed to by the Bank (27th May). At the end of the month the Treasury expressed concern about German Standstill Acceptances and even suggested that these should be excluded from the Special Advance arrangement. The Bank pointed out that this would make the negotiation of such bills impossible, and it was eventually agreed that in the case of war with Germany the Standstill bills would have to be taken up as no renewal bills could be drawn. The difficulties would be a direct result of the emergency and the question was whether the market should be maintained or whether the Bank and the Treasury were prepared to see failures. The Treasury then stipulated that there should be a clause giving the Bank a floating charge on the assets of each borrower. (This would have to be mentioned in the Enabling Act). Some consideration was given to the attitude to be adopted to foreign agencies as acceptors. It was agreed that, prima facie, such acceptors were unsuitable for accommodation under the special scheme but that freedom of action should be retained to make advances in special cases. In fact no applications for advances were made by these agencies.

Memoranda on emergency measures were now handed confidentially to the President of the British Bankers' Association, and a meeting with the Clearing Bankers took place on 14th June. At this meeting, in discussions on the scheme for assisting acceptors, the Banks pointed out that the habit of granting non-self-liquidating acceptance credits to inland borrowers by Accepting Houses had grown up, and that in an emergency these disguised overdrafts would become Clearing Bank overdrafts again, thus prejudicing liquidity at a moment of crisis. This fear was to prove unfounded, as the inland borrowers' bills were met or renewed without difficulty.

It also

It also appeared that the banks were afraid that book creditors would suffer hardship unless the acceptance scheme in some way included them. The banks seemed to wish to avoid the burden of supporting their customers, by encouraging small acceptors to utilise the special scheme. The Discount Office thought that the banks should be told that no general application of the scheme to trading acceptors was intended: the offer was designed only to maintain the Discount Market in a healthy condition. This was made clear to the bankers and the draft announcement was made more explicit. On 21st July a Clearing Bank meeting estimated the total number of acceptors who came within the restricted definition at under 2,000 and the maximum amount of bills which these could have outstanding at any one time at between £40 and £50 mn.

Revised forms were sent to banks for consideration on 4th August 1938. By the end of August a one-day holiday only was contemplated, although in June the Banks had thought this impracticable.

Up to the end of September the Bank do not appear to have said anything about these plans to the Accepting Houses Committee. Two of their representatives then called and were told that their possible difficulties were being kept in mind and action to meet any circumstances had been fully considered. The possible evacuation of London was mentioned and the Bank stated that if the City became uninhabitable the Bank of England would move to their Record Office at Roehampton,* and that a building was being set aside in that locality as a centre for representatives of financial institutions. It might be advisable for it to include a representative of the Accepting Houses Committee and Secretariat.

In May 1939 some Accepting Houses were asking the Ministry of Health that certain specified country houses should be reserved for them as emergency quarters, and in June the Committee asked the Bank what their intentions were as regards discounting acceptances. A Sub-Committee was also much exercised

*In June 1939 the Bank told the bankers that they then contemplated moving various services to different centres.

exercised about Accepting Houses continuing business in the City at all, as many of their buildings were old and offered little protection. They wanted a co-ordinated scheme of evacuation worked out between the banks, Accepting Houses and Discount Market. This proposal was not accepted by the Bank of England, who gave the Committee some reassurances but apparently pointed out that circumstances might arise when the Discount Market would temporarily disappear, and added that arranging for the discount of their acceptances is not the proper business of Accepting Houses. If the Discount Market were not available to their customers, the latter should discount the bills with their bankers; it was most unlikely that the Bank of England would be prepared to discount for the Accepting Houses their own acceptances - their own bankers should do this.

In August 1938 Brocklebank & Co. had suggested the issue of certificates of ownership to cover Government Bills or Bonds, the printing of which they thought could then be dispensed with. Owners would be registered, and the certificate, not a document of value, would be made out to the institution concerned and endorsed by it in blank. Bonds and Treasury Bills would thus become, in effect, inscribed stock. Certificates could be in convenient denominations. In use as security against loans, they would be accompanied by a signed blank transfer.

Outstanding Treasury Bills would be made nominal (the form in which they were drawn always permitted this). They could then be endorsed by Clearing and other banks from whom the market borrowed money under powers conferred on them.

All this would avoid the danger of destruction of bills, etc., in transit from one bank to another.

In October the Chief Cashier turned down the scheme because -

(a) it would lead to continual demands for splitting certificates;

(b) it

(b) it would cause confusion and delay when the Bank was doing large open market transactions;

(c) the Treasury Bills would still have to be printed and the issue of certificates would be that much extra work and responsibility.

In June 1939, however, the market were said to be still very concerned for the safety of their securities, and a Sub-Committee of the Discount Market proposed, among other things, that Commercial Bills should be left with banks who might issue transferable receipts against parcels of them. Treasury Bills might also be issued in larger denominations. During July negotiations on various points continued between Committees of the Discount Market, Accepting Houses, bankers and the Bank. It was agreed that commercial bills should be drawn in duplicate, the duplicate being retained by the Acceptor to be issued in case of loss or destruction of the original.

The Bank and the Treasury agreed to the issue (as from 11th August 1939) of large denominations of Treasury Bills (£50,000 and £100,000*) and to replace, at once, lost or destroyed Bills on the indemnity** of the Discount House concerned, provided the Bills were made payable to the order of a Discount House but not endorsed. The Bank and the bankers were ready to lend on Bills in this form if furnished with an undertaking from their customer to endorse the Bills when called upon. Short bonds could be registered and used as security for loans at

Clearing

*As from September 1944 a £25,000 denomination was added.

** In a form drawn up in September 1940.

Clearing Banks and at the Bank, with a similar engagement to perfect the Bank's title to the security, the Principals of the Discount Office acting as attorneys. This arrangement turned out to be very useful. After some encouragement from the Bank large denomination Treasury Bills were readily taken and all bonds were registered, saving many thousand man-hours. Transferable receipts for parcels of commercial bills were not looked upon favourably unless the bills were to be deposited at the Bank of England and eligible for discount there, and nothing came of this idea.

By mid-August alternative emergency quarters in the neighbourhood of Roehampton had been obtained for nearly all Discount Houses. (By June 1940, however, the Bank had almost given up the idea of moving to Priory Lane, and in the event of it being impossible to carry on in London expected to transfer operations to the Midlands - in which case, the Discount Market were told, there would be no place for them at all in a banking structure which would have had to be greatly simplified.

The draft of the Government's announcement on the Discount Market had been settled for some time before the war, and (as has been seen) it had also been agreed that one Bank Holiday would be sufficient, although early in 1939 the bankers were again pressing for more***. On 3rd September, when war was declared, the announcement making Monday the 4th a Bank Holiday made it clear that Banks only, including the Post Office and other Savings Banks, were affected.

Standstill Bills

***The Treasury wished the banks to undertake to pay cash for wages on the Bank Holiday, but the Bank of England resisted this; any formal engagement to do so would, they said, only lead to further insistence on a longer holiday.

Standstill Bills

Bills drawn under the German and Hungarian Standstill Agreements might, and did still in many cases, represent current overseas trade; but it was only the Acceptor's good name and the eligibility of the Bills for discount at the Bank that made them marketable. War with Germany (and/or Hungary) would obviously determine the Standstill Agreements, making the issue of renewal Bills impossible. Funds would have to be provided by the Acceptors, whose chances of ultimate recovery from their debtors would be problematical.

Early in 1936, with a view to lessening the upheaval in the event of war (and incidentally to reduce any call for Government assistance), the Governor decided that the amount circulating in the Market should be reduced as soon as possible by the Acceptors taking up some of the Bills from their own resources and debiting the credit taker in an Advance Account. (There was no objection to the retention of the credits in the form of Bills, provided they were taken into the Acceptors' own portfolios).

In June 1936 the Standstill position of the Accepting Houses was reviewed and a questionnaire circulated to each House. From the answers received it appeared that -

(i) German and Hungarian Standstill acceptances amounted to £26 mn. out of total acceptances of £68 mn.

(ii) Four Houses would be insolvent in a liquidation if all their Standstill assets were reckoned as valueless; the others would suffer a serious loss of liquidity.

In December 1936 the Accepting Houses were informed privately that on and after the 15th July 1937 Bills coming under the Hungarian Standstill Agreement, of which there were some £3.4 mn. in the Market, would not be eligible for discount. At about the same time the Accepting Houses were asked to submit their year-end balance sheets in a standardised form (prepared for the Bank by Deloittes) which would provide exact information in respect of their Standstill commitments. From these it was seen that, as at the 31st December 1936, German Standstill Bills in the Market had been reduced to some £23 mn.

In April

In April 1937 the Accepting Houses, etc., (i.e. Houses who rendered to the Joint Committee of British Short-Term Creditors a return of acceptance credits granted under the German Standstill Agreement) were given oral notice that by the 30th September 1937 the total of their German Standstill acceptances as at 31st December 1936 should be reduced by 30%, leaving £16 mn. With two exceptions (i.e. British Overseas Bank Limited, who were treated as a special case, and Arbuthnot Latham & Company Limited, who cleared up their position by the end of November) the full reductions were made within the time limit. There were no serious repercussions, though two or three Houses may have had recourse to their bankers for temporary assistance.

The Accepting Houses continued to submit special balance sheets and the position was reviewed from time to time. At the end of May 1939 the Acceptors were requested to reduce the amount outstanding in the Market further by taking up an additional 40% of the basic figure of £23 mn., leaving £7 mn. This cut, coming on top of the previous withdrawals of £3.4 mn. Hungarian and £7 mn. German Standstill Bills, resulted in the elimination of certain of the weaker Houses. Thus in two cases (British Overseas Bank Limited and Goschens & Cunliffe) the remaining free assets were insufficient to justify carrying on the business and they went into virtual liquidation. Although in a similar position as regards their acceptance business, Arbuthnot Latham & Company were able, with the support of the Bank, to continue the merchant and agency business which was their main interest. The further loss of liquidity suffered by the remaining Accepting Houses was in one or two cases of such proportions as to make any future expansion difficult if not impossible.

The termination of the Standstill Agreements following the declaration of war compelled the withdrawal of the remaining (i.e. 30%) Bills from the Market; but owing to the steps taken earlier to clear the decks the amount of Government assistance (Special Advances to Acceptors) required to finance this operation was reduced to relatively small proportions, and with one exception (Japhets)

the accommodation

the accommodation was outstanding only for a short time.

Soon after the outbreak of war a question arose regarding enemy goods, financed by means of Standstill credits, which had been seized and condemned by the Prize Court. The Acceptors were of course still bound to pay the relative acceptances on maturity, but they had relied upon the security of the shipping documents which they held, and these now afforded no protection. The Acceptors were thus left with claims against their enemy debtors which could only be enforced, if at all, after the war. While the action of the Procurator-General could not be challenged on legal grounds (it was established in law that if the legal property of goods at the time of seizure was in an enemy, a pledgee of the Bill of Lading had no rights whatever in the prize) it was felt that in equity the Acceptors had a case. It was strengthened by two additional factors; first, assistance had been freely given to the Ministry of Economic Warfare by the Acceptors in tracing German goods and thus facilitating seizures, and secondly, in 1931 short-term creditors had been asked by H.M.Treasury to "take concerted measures with a view to maintaining the volume of credits they had already extended to Germany". The case put forward by the Joint Committee of British Short-Term Creditors was strongly supported by the Bank (who also pointed out to H.M.Treasury that any relief granted would materially reduce calls for assistance under the scheme for Special Advances to Acceptors.). In November 1939 the Treasury agreed that the Bounty of the Crown should be exercised to meet equitable claims by third parties in respect of property seized as prize. Subsequently, further representations were made asking for similar concessions in cases which were unsupported by Bills of Lading, and in June 1943 the Procurator-General was informed that "in future, applications for the Bounty need not be rejected merely because the applicants do not possess the actual Bills of Lading or other documents of entitlement to the goods". Although no figures are available it seems likely that Acceptors may have recovered some £250,000 through the Prize Courts.

Another

Another point in connection with Standstill Bills concerned the Trading with the Enemy Act, which prohibited the payment by an Acceptor of any Bill arising from a credit granted to the enemy or bearing an enemy endorsement, unless the sanction of the Treasury had been obtained. In order to cover the Standstill Bills in the Market the Treasury agreed that the Bills might be paid if endorsed with a certificate in the following terms:-

> We, the...........Bank certify that this Bill was in our possession at the close of business on the 2nd September 1939 and that it then bore the following endorsements.........

The Bank and any member of the British Bankers' Association or the Accepting Houses Committee were authorised to sign these certificates.

Special Advances to Acceptors

The discussions on this scheme have already been referred to, and by September 1938 details had been settled. The Government announcement was eventually issued on 3rd September 1939 in the following form:-

> "The Chancellor of the Exchequer announces that the following arrangements have been made with a view to maintaining essential financial services in the present emergency. These arrangements apply to approved acceptors whose Bills are normally discounted in the London Discount Market and are intended to supplement the general provisions embodied in the Counts (Emergency Powers) Act 1939:-
>
> 1. The Bank of England will advance, where required, to such acceptors through their bankers the funds necessary to pay at maturity all approved bills accepted before yesterday (September 3rd). This course will release the drawers and endorsers of such bills, from their liabilities as parties to these bills, but their liability under any agreement with the acceptors for payment or cover will be retained.
>
> 2. The acceptors will be under obligation to collect as soon as possible any amounts recoverable by them in respect of the transactions to which the Bills relate and to apply such amounts to repayment of the advances made by the Bank of England. Interest will be charged upon these advances at 2 per cent. above the ruling Bank rate from time to time and in no case less than 6 per cent. The first interest payment will be on March 1st 1940 and thereafter half-yearly on September 1st and March 1st. Interest, if unpaid on the due dates, will be capitalised forthwith and interest thereon will be charged at the prevailing rate for the advance.

3. Advances

3. Advances and Interest will constitute a floating charge on all the assets of acceptors in favour of the Bank of England ranking in priority to all other floating charges whether under Statute or otherwise on their assets. The Bank of England undertake, however, not (except in cases of insolvency or liquidation) to claim repayment of any amounts not recovered by the acceptors for a period of six months after such date as His Majesty may by Order in Council declare to be the date on which a state of war emergency has ceased to exist."

Apart from the published restrictions it was decided to withhold approval from certain other classes of Bills. These were -

(i) Hungarian Standstill Bills (all of which should already have been taken off the Market).

(ii) Such German Standstill Bills as the Acceptors had previously been requested to take up.

(iii) Bills drawn on account of clients resident in the Empire.

Acceptors considered suitable for accommodation under the scheme were members of the Accepting Houses Committee, and persons otherwise known to the Bank of England, or recommended by a Clearing Banker. (A full report of the applicants' standing and details of their latest balance sheet figures were required.)

It was also a condition that the inability of the Acceptor to meet the Bills should be solely due to causes arising directly from the emergency.

Applications had to be lodged through the bank with whom the Bills were domiciled, at least eight days before their due date. Acceptors had to arrange with their bankers to provide the amounts of the Acceptances and to hand the Bills uncancelled to the Bank of England, who then reimbursed the bankers. (In 1914 applications were received direct from the Acceptors). The Bills were to be held at the Bank of England until the whole advance was repaid with interest - a provision not often enforced in practice.

Interest was charged at Bank Rate varying plus 2% with a minimum of 6%. This admittedly penal rate was deliberately imposed to deter Acceptors from continuing the advance longer

than

than was necessary: it was strongly suspected that certain Acceptors had used advances obtained under the 1914 scheme as capital. Open criticism of the high rate was confined to the two Acceptors, S.Japhet & Co.Ltd., and Barton, Thompson & Co.Ltd., Timber Merchants, whose advances were longest outstanding. The latter, on the plea that the virtual closing of their business by the war did not allow them to earn sufficient to pay 6%, paid only 3% simple interest until September 1944 although, under protest, they admitted the full liability and made provision for it in their Balance Sheet. Schröders approached the Bank with the suggestion that they should be allowed a reduction in the event of their lodging gilt-edged security as collateral. The Bank could not agree as the high rate was an integral part of the arrangements. Schröders could repay the advance at any time, and for this purpose might care to take an advance from their own bankers against this security. Such an advance would not offend under the terms of the Chancellor's letter of September 1939 as no new money would be created.

In November 1939 the Accepting Houses Committee put forward tentative and somewhat premature proposals to the effect that, under the terms of any Peace Treaty, Acceptors who had taken advances under the scheme should be allowed to claim from their German debtors interest at 6% (plus commission) as against 5% which had been the basis adopted in the Versailles Treaty. This attempt to secure preferential treatment for Acceptors as a class was strongly discouraged and the matter was not raised again.

An essential feature of the scheme was the creation of the statutory floating charge in favour of the Bank of England on the assets of the borrower to cover both advance and interest. This charge, authority for which was given in an enabling Act (Currency (Defence) Act of 1st September 1939) ranked prior to all other charges whether under statute or otherwise. It involved specific mention in any published balance sheet, a fact which probably acted as an added inducement to the early liquidation of the debts. No such charge was created in 1914;

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it was then merely stated that the Bank of England's claim would rank after claims in respect of post-moratorium transactions until the end of one year after the close of the war - a phrase in itself open to uncertainty of interpretation.

In 1939 the money was provided by H.M.Government and the advances, therefore, never appeared in the Bank's figures as they had done in 1914/15.

Applicants were 7 Accepting Houses and 2 Merchants. 1,948 bills were received, 3 refused and 109 withdrawn or not presented. £4,137,000 was advanced on 1,836 bills; £4,083 m. to the Accepting Houses and £54 m. to the Merchants. Of the total advanced £3,726 m. covered German Standstill bills, the balance mainly representing Baltic Timber credits.

More than three quarters of the advances were repaid within about three months; repayments (including interest) amounted to £3,228 m. by February 1940. A further £540 m. were repaid during the following year and £394 m. between March 1941 and the end of the war. The small balance outstanding was finally repaid on 15th January 1946.

Discount Market

It may here be noted that wartime developments in the structure of the market followed the trend of the immediate pre-war years. Since 1931, when there were 23 companies and firms with discount accounts, the Bank had been urging amalgamations. The commodity in which the market primarily dealt, the commercial bill, continued to decline in volume and the business could no longer maintain the large number of full time partners and directors. By September 1939 the number of market houses had declined to 15 and by 1943 had fallen to 11.

This reduction in numbers had been accompanied by a large wartime increase in business, both in Treasury Bills and short-dated Government Securities. In these latter Securities the Bank encouraged the Discount Market to act as jobbers, as the limited resources of Stock Exchange partnerships had proved insufficient to deal with the increased turnover. In

recognition

recognition of their new function the market Houses were in 1944 given Certified Accounts at the Bank in short-term Government Securities, a privilege which the Chief Accountant had previously confined to Stock Exchange dealers.

The increase in the market's general turnover (their "books" increased from £266 million in December 1938 to £555 million in December 1945) led to a number of applications for authority to issue further capital. Between 1941 and 1945 new capital amounting to £3,300,000 was obtained from professional sources, mostly insurance companies but including a large investment by the United Dominions Trust in Ryders Discount Co.Ltd.

British Overseas Bank Limited

It has already been mentioned that one of the Houses seriously involved under the German and Hungarian Standstill Agreements was the British Overseas Bank. In September 1937 the Governor expressed his concern at the large frozen position of the bank to the Chairman of Williams Deacons Bank who, with the Union Bank of Scotland and the Prudential Assurance Company, held the "B" Shares carrying voting control.

Negotiations took place during 1938, and in December it was arranged that special deposits should be made with the British Overseas Bank, ranking after its liabilities to the public. The depositors were the Bank of England £1,000,000, Williams Deacons £750,000, Union Bank of Scotland £250,000. The total of £2,000,000 was certified by the auditors as sufficient to cover the deficiency in liquid assets. The "B" shareholders agreed to hand their shares to trustees who would hold them for the ultimate benefit of the "A" shareholders.

Mr.J.A.Drexel who, at the request of the Governor, succeeded Mr.A.C.D.Gairdner as Chairman, started the task of realising the frozen assets. One interesting point in the negotiations with German banking debtors was the offer for sale in May 1939 of the liners "Bremen" and "Europa", payment to be partly in cash and partly in Standstill claims. Both ships

were

were running at a loss and the shipping companies here to whom the offer was passed were not interested in buying out an unsuccessful competitor.

Liquidations continued after the war began, and in January 1941 the Trading with the Enemy Department authorised a deal with the Dresdner Bank, through a Swiss intermediary, involving repayment at a discount of a substantial amount of that bank's debts. During the same year the premises of the Overseas Bank in Gracechurch Street were sold, and by May 1942 the auditors had agreed that the special deposit might be reduced to £750,000, to which the three depositors contributed equally.

By the beginning of 1944 it became clear that further substantial realizations would have to wait till the end of the war and that in the meanwhile current earnings might well be insufficient to cover expenses. Negotiations with the New Trading Company for the sale of the business as a going concern had broken down, and it was decided to dispose of the current banking business (to Glyns), to sell the Huth produce subsidiaries (to Matheson & Co.) and to leave for the sole benefit of the "A" shareholders the whole of the frozen assets in enemy countries. These moves were completed during the Summer of 1944, and on 15th September the management of the bank was taken over by the Continental Assets Realization Trust Ltd. From the sale of the produce companies and from receipts from Spanish and other debtors repayments were made to the special depositors, whose joint loss, it seemed, might eventually not exceed £250,000.

Louis Dreyfus & Company

This arrangement afforded the first example of effective collaboration amongst credit givers and underlined the advantages of a Credit Register.

In 1937 it was estimated that this French firm of grain merchants had commitments in London in the form of acceptances and cash advances amounting to some £9/10 million (the Bank held their drawings to the extent of £¾ to £1 million), although nobody had seen an audited balance sheet; neither did the

shipping

shipping documents pass through the hands of the credit-giving banks. The Clearing Bankers Committee discussed the possibility of taking co-operative action to ascertain Dreyfus's position, but this was opposed by certain interests and the subject was dropped.

In January 1940 it was suggested by the Bank that information on Dreyfus credits should be pooled. This the Clearing Banks agreed to do but asked that similar information should be obtained from other lenders. The totals of limits and availments as at the end of 1938 and 1939 were collected - from the Clearing Banks and Accepting Houses through their respective Committees and from the Eastern, Colonial and Foreign banks individually by the Discount Office. The global figures (which were disclosed to all who had supplied their own figures) showed:-

	Limits	Availments
31st December 1938	£7,855,000	£1,487,000
31st December 1939	£8,483,000	£4,205,000

It was then (March) suggested by the Clearing Bankers that similar figures should be collected at three-monthly intervals and that no action should be taken pending the receipt of the next set of figures (as at 31st March 1940). These showed limits of £7,829,000 of which £4,579,000 had been drawn.

In May, on a request from the Governor, the Clearing Banks agreed to keep within the existing limit (£1,250,000) for acceptance credits. The Accepting Houses were asked to reduce their limits by at least 40% and were told that other acceptors would not grant new acceptance facilities to replace the lines cut by the Houses. The leading foreign banks were advised of these proposals and asked to co-operate, which they were very willing to do. The effect of the proposal was to reduce the existing limits for acceptance credits from £4,850,000 to £3,500,000.

Following the fall of France, the open position of the London branch (which then had a deficit of £1 million, all

owing

owing to London banks, etc.) was financed by the New York branch. Further attempts were made by the London branch to secure credits in London, chiefly against the earmarking of cash in New York. This was not considered a proper basis for acceptance credits, and in August the Governor stated that...."as things stand I do not wish to see any of their drawings in the market".

At the beginning of 1941 a Company, Louis Dreyfus & Co.Ltd., was formed with a capital of £500,000 to carry on the business of the London branch of the firm. All the shares were issued to the Custodian of Enemy Property, whose representative was appointed to the Board. The business of the old firm was restricted, under the supervision of a Controller appointed by the Custodian, to the carrying out of contracts entered into prior to the date on which the new Company commenced business.

Subsequent attempts by the Limited Company to secure "clean" credits in the London market were also frowned upon by the Bank.

Credits to Japan

In October 1937 the Treasury raised the question of possible economic and financial action against Japan, and enquiries were made through the Westminster Bank to ascertain the position in the London Market. It appeared that the limit of short-term facilities (advances, discounts and confirmed credits) amounted to £19/22 million, of which a considerable part had to be covered by gilt-edged securities. Later, more detailed figures were obtained (for January and November 1938) which disclosed that the limit had fallen during the period from £24.6 million to £21.6 million, and actual availments from £6.4 million to £2.2 million. At the latter date Japanese gilt-edged holdings were £8.4 million. It seemed that the earlier estimates had been passed on by the Treasury to the United States Government without the Bank's knowledge and the Treasury were specifically asked not to divulge later figures without consultation.

In July 1939 the Treasury asked the Bank to

ascertain

ascertain the amount of credit facilities given to Japan by banks in Australia, New Zealand and South and East Africa. The figures, obtained through the British Overseas Banks Association, showed that between July 1937 and July 1939 credits had been reduced from £4.7 million to £1.5 million, of which at the later date nearly a half was separately secured. These figures were limits and the amounts actually used were not specified.

The Governor's many warnings coupled with these enquiries had made the attitude of the London Market extremely cautious, and by 1940 Discount Houses had even ceased to take the Yokohama Specie Bank's call money, and Japanese holdings of gilt-edged securities had fallen to under £4 million. Thus when war came in December 1941 there was no financial disturbance of any kind.

Jute

On 17th June 1940 the Bank were approached by the Chairman of the Eastern Exchange Banks' Association regarding Bills, held by his constituents, which were drawn on members of the London Jute Association against jute shipped (or in course of shipment) to France. The matter was of some urgency as the first of the Bills fell due on 24th June, the fall of France appeared to make the receipt of funds from that source unlikely and at least some of the drawees would be unable to meet their commitments.

Dishonouring the Bills would adversely affect the names of the London merchants and there was also the possibility that the Indian drawers to whom recourse might be had would be unable to meet the Bills. There was thus the danger, unless something were done, of serious reactions in the jute trade both in England and India. If the banks took up the Bills they were faced with the prospect of a heavy loss: this would be so even in cases where the jute had not reached France and could be successfully diverted, as the current price of £30 a ton was only about half the invoiced price.

Following

Following an interview with representatives of the Eastern Banks and of the London Jute Association the Governor put the case of the merchants to the Treasury. The following day a Press notice was issued under the joint aegis of the Treasury and the French Embassy stating that arrangements were being made to effect payments due to persons in the Sterling Area by importers in France. This took care of the problem as far as jute delivered to France was concerned. Subsequently it was arranged between the Treasury and the French that cargoes which had been diverted would be taken over by the French Mission in this country at the contract prices; forward contracts were cancelled.

It was suggested by the London Jute Association that the Exchange banks should lodge the documents with the Bank of England, where they would be held while the French examined them. This was agreed to on the understanding that the Bank took no responsibility as to the accuracy of the documents. These were delivered to the Discount Office, where representatives of the French Mission and of the London Jute Association attended.

The amounts involved were approximately £1,500,000 for current shipments and £600,000 forward contracts.