## War loans

The government employed a range of borrowing structures in the course of the war to fund its constant need for money. One of the most important was the series of war loans issued in November 1914, June 1915 and January 1917.

Each investor in war loans was effectively lending money to the government. The loans were for fixed periods, during which time interest was paid. Government stock was the securest type of investment, assuming Britain would eventually win the war, and the interest rates were favourable, ranging from 3.5% up to 5%, compared to a normal pre-war rate of 3.25% on government stock. In practice, such profits were more than wiped out by rampant wartime inflation, but nevertheless, war loans were a relatively attractive investment. The government also sought to give the loans a strong patriotic appeal, making investing a national duty as well as a financial opportunity.

For the loans to succeed they had to secure a broad subscriber base, both geographically and across different sectors of the economy. It was here that the commercial banks undertook a vital role. The government recognised the banks' unique position in having connections with millions of potential investors all over Britain, and called upon them to use their influence to encourage the sale of loan stock.

After a slow start in 1914, the banks undertook their task with gusto in 1915 and 1917, filling their banking halls with advertising posters, calendars, counter blotters and leaflets. They wrote and spoke directly to customers, adding a personal dimension to the national marketing campaign. They also – along with post offices and savings associations – took responsibility for processing subscriptions, and themselves bought large quantities of the stock.

Each successive loan offered more generous terms. Investors could roll their existing stock over onto the newer, better terms, which meant that a decreasing proportion of subscriptions to later loans was actually new money.

## The 1914 loan

In the first weeks of the war, the government funded its spending through advances from the Bank of England, but by late autumn 1914 it needed new funds in order to repay treasury bills that were due for redemption. It started planning what would become the first in a series of war loans.

The loan was to be unprecedented in scale, offering £350m of stock. It paid 3.5% interest and was repayable between 1925 and 1928. Stock was issued at a 5% discount, meaning that investors could expect an annual return of just over 4% over the expected lifetime of the loan - a very attractive rate for a government-guaranteed investment. The Bank of England offered loans at 1% below bank rate for the purpose of buying war loan stock, making it financially attractive to borrow money in order to lend it to the government.

Although the government would later broaden its attentions to smaller investors, the first loan was aimed at wealthy people and institutions, who could afford the minimum subscription of £100. The support of Britain's commercial banks would be instrumental in reaching these potential investors. As well as being major investors themselves, they counted among their customers almost all the people the government hoped to attract.

By early November 1914 the banks knew that a war loan was being planned, but did not know exactly what the terms would be, or what involvement would be asked of them. They began internal discussions about how much they might invest, and met with competitors, both formally and informally, to discuss the situation.

On 16 November 1914, the day before the loan prospectus was published, Chancellor of the Exchequer David Lloyd George met with representatives of all the banks in the boardroom of our constituent London County & Westminster Bank. He needed to secure the banks' firm commitment in advance of the launch, because it was essential that the loan should be seen to sell well. Anything less might suggest – to allies and enemies alike – that Britain lacked confidence.

At the meeting, Lloyd George emphasised the patriotic importance of the loan, and asked for the support of all present. He also unveiled the full terms of the loan, prompting a flurry of telegrams as attendees relayed details to their respective head offices and awaited authorisation to participate.

Nearly all the British banks agreed to subscribe 5% of their deposits to the loan and underwrite the same amount again. They promised to encourage customers to invest too. In later years, extensive marketing campaigns would accompany loan issues, but in 1914 the loan was mostly promoted by bank managers writing or talking to customers about the benefits of participating. This was a new departure for bank managers, who were not accustomed to encouraging their customers to withdraw money from the bank and invest it elsewhere. Nevertheless, as a London County & Westminster Bank head office circular explained, 'there are patriotic and other motives to be considered.'

As well as promoting the loan, banks were responsible for handling and submitting applications. In compensation for the administrative costs involved, they received a commission of 1s 8d per £100 subscribed, or 0.08%.

In fact, the loan was not a success. Its scale had been shaped by the government's need, rather than the market's capacity to lend. Its terms were confusing, and it was put together without properly planning the timing or presentation. It only attracted £91m from the general public. The banks were called upon to contribute almost their full underwriting as well their intended investment, bringing their total allocation to £106m. The Bank of England took £40m, but this still left a shortfall of £113m. The Chancellor of the Exchequer announced publicly that the loan had been over-subscribed, and had particularly attracted smaller applicants, but this was far from the whole truth. In fact, a discreet way had been found for two Bank of England officials personally to buy the remaining stock, funded by covert loans from the Bank. The 1914 war loan had been kept from looking like a failure, but in reality it had only raised around half of its nominal target.

## The 1915 loan

By spring 1915 the government was planning a second war loan. Unlike the first loan, it was to be marketed heavily to smaller investors. Previously, the minimum investment had been £100, but now people could participate for as little as £5. This lower limit gave access to a much larger pool of potential investors. Furthermore, drawing investment from the broader economy had the benefit of helping to counter domestic inflation, thereby steadying international exchange.

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The details were announced in June 1915. Its term was longer than that of the previous loan, falling due for payment between 1925 and 1945, and the interest rate was higher, at 4.5%. It was issued at par, meaning that investors received no discount at the time of buying their stock.

Unlike in 1914, the government did not consult the banks in advance, perhaps because it knew they would have little choice but to support it. The banks were annoyed, believing they should have been consulted, in view of their twin roles as major buyers and chief salesmen. They later sent a joint letter to the Chancellor of the Exchequer, expressing their dissatisfaction.

On 9 July 1915, after the loan had already been launched, the Chancellor of the Exchequer did hold a meeting with the banks' representatives. Despite feeling snubbed by the lack of consultation and worried about the loan's effect on depositors and customers, the banks were anxious to act patriotically. They agreed to double the amount they had put into the 1914 loan.

As previously, the banks took a leading role in selling the loan to their customers. With the minimum investment set at £5, there were many more potential buyers. Some banks extended opening hours to make it easier for customers to submit applications. They even offered loans at a favourable interest rate, so that customers could borrow in order to subscribe. In recognition of this extra work, and in particular of the high administrative costs of so many small subscriptions, the government paid the banks an increased rate of commission, amounting to 2/6 per £100, or 0.125%.

The smaller minimum subscription also meant that many bank workers were themselves potential investors. Some banks introduced schemes to help staff to club together to buy stock, and pay for it later through monthly salary deductions. London County & Westminster Bank's scheme attracted 142 members, raising £2,725.

When smaller investors participated in the war loan, they tended to find the money by withdrawing it from their bank savings accounts, so banks saw a significant drop in their deposits. In theory, the government would soon spend the loan money on goods, whose suppliers would then put the money back into their bank accounts, stabilising the banks' balance sheets. In practice, however, a large portion of the money was used to repay government debt at the Bank of England, and did not quickly find its way back into the wider economy. In consequence, the 1915 loan left the banks stretched for many months, with depleted deposits on one side and their own sizeable commitments to the loan on the other.

When all the applications were added up, it was found that the 1915 war loan had attracted over a million subscribers. It nominally raised £900m, but more than a third of that total was actually conversion of existing debt. Of the new money, one third was contributed by the banks.

## The 1917 loan

Throughout 1916 the government focussed its domestic borrowing on short-term treasury bills. In January 1917, however, the new coalition government launched the third, and largest, of the British government war loans.

The new loan was offered at a 5% discount on face value, meaning that it cost £95 to buy £100 of stock. The interest rate was 5% per annum, or 4% tax free for 25 years. Holders of existing war loan stock, treasury bills and exchequer bonds could convert to the new issue.

The Chancellor of the Exchequer met with the banks before the prospectus was issued. Like his predecessor at the time of the 1914 and 1915 loans, he outlined the loan's terms, emphasised the role of the banks in its success, and asked for their active support. This time, however, his focus was not on asking the banks to invest directly, but on encouraging them to persuade customers to invest, including by lending them money for the purpose at favourable rates. He also secured agreement from most of them to underwrite the loan to the extent of £150m, if overall subscriptions fell below £620m. In the event this facility was not called upon.

The January 1917 war loan raised £2,127m, but only just over 40% of that total was new money. The rest came from treasury bills, exchequer bonds and previous war loan stock being converted to the more favourable terms. The government continued to pay 5% interest on the 1917 loan until 1932, when – under pressure in the Great Depression – the government encouraged investors to convert their holding into a new 3.5% loan with no fixed maturity date. Most of them did so, and the £2bn that was converted at that time remained outstanding until it was finally repaid in 2015.