OSMANIA UNIVERSITY LIBRARY

Call No. 332.5/C95D Accession No. 8546

Author Cross, J. B

Title Domestic & Foreign Exchange.

This book should be returned on or before the date last marked below.

DOMESTIC AND FOREIGN EXCHANGE

THE MACMILLAN COMPANY
NEW YORK · BOSTON · CHICAGO · DALLAS
ATLANTA · SAN FRANCISCO

MACMILLAN & CO., LIMITED
LONDON · BOMBAY · CALCUTTA
MELBOURNE

THE MACMILLAN CO. OF CANADA, LTD.
TORONTO

DOMESTIC AND FOREIGN EXCHANGE

THEORY AND PRACTICE

BY

IRA B. CROSS, PH.D.

PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA

New York

THE MACMILLAN COMPANY

1923

All rights reserved

COPYRIGHT, 1923
BY THE MACMILLAN COMPANY

Set up and electrotyped. Published January, 1923.

Printed in the United States of America

TO THE MEMORY OF A WONDERFUL
FRIEND AND COLLEAGUE
CARLETON HUBBELL PARKER

PREFACE

In writing this volume I have sought to prepare a book on the exchanges which would be simple and adequate in its treatment of the subject, and suited to the needs alike of college students and the younger men engaged in actual exchange operations. In my class room work I have used practically all the volumes thus far published and have felt the need of a book that would be neither a banker's manual nor a brief and inadequate treatment of the more complicated phases of exchange operations. I appreciate the difficulties of others who, as beginners, delve into the intricacies of the field, and have tried to keep their interests continually in mind, even to the extent of being guilty at times of obvious repetition. It is also partly, but not solely, because of them that I preface the discussion of foreign exchange with a survey of the practices and forms commonly found in the domestic field.

There has been much needless mystery about the workings of the exchanges, especially of foreign exchange, due undoubtedly to the stress laid by early writers on the theoretical aspects of the subject. In the chapters that follow, I have interwoven the more important parts of the theoretical with the practical so as to present as complete a treatment as is possible within the limits of one volume. I have frequently questioned the validity of certain commonly accepted theories as tested out in practice, and have urged the advisability of avoiding the customary rigid and dogmatic application thereof to the field of the exchanges. Much still remains to be done not only in this connection but also in the realm of general economic theory. It is my sincere hope that the economists of the future will completely shake off the influence of the past and formulate a group of theories that will be more fully in accord with Twentieth Century conditions.

Some progress is already being made in this direction by our younger writers.

Throughout the volume I have not only dealt with the exchanges as they are supposed to function normally, but have continually referred to those abnormal developments occurring both in times of peace and war which call for a closer and more searching examination of exchange practices and rate fluctuations and necessitate the adoption of unusual methods to meet unusual circumstances.

Many of the details of the practical side of exchange transactions cannot be dealt with in writing, but must be learned solely "on the job" behind the exchange counter. I have, however, given considerable space to the more important features of the technique of exchange operations so as to place before the student the fundamentals of, and the reasons for, some of the more customary practices of the business.

In preparing this work, I have incurred many obligations. I am deeply indebted to those banks and exchange dealers which have so graciously allowed me to reprint their exchange forms and documents, viz., The Guaranty Trust Company, the Irving National Bank, the American Express Company, all of New York City; the Anglo and London Paris National Bank, the First National Bank, the International Banking Corporation, the Crocker National Bank, and the American National Bank, all of San Francisco; and the Merchants National Bank of Los Angeles. The Guaranty Trust Company has also permitted me to reprint some of the forms appearing in its pamphlet, "How Business with Foreign Countries is Financed," and also a photograph of its trader's room, while the Irving National Bank has granted me a similar courtesy in connection with certain forms relating to export credits appearing in its monograph "Trading with the Far East." I am especially eager to make acknowledgment of the aid given me by those good friends and co-workers who have read all or parts of the manuscript and who have made numerous helpful suggestions, viz., Mr. Harry Coe, Vice President of the Anglo and

London Paris National Bank and Manager of its Foreign Department; Mr. C. S. Reuter, Assistant Manager of the Foreign Exchange Department of the Merchants National Bank of Los Angeles; Dr. H. H. Preston of the Department of Economics of the University of Washington; Dr. F. Fluegel and Mr. W. R. Robinson of the Department of Economics of the University of California; Dr. M. W. Dobrzensky of the School of Jurisprudence of the University of California, and Mrs. E. D. Wilkie of the University of California Press. Mr. J. G. Schaffer, Teaching Fellow in the Department of Economics of the University of California, has assisted me in checking many of the exchange calculations appearing in the volume. My greatest debt of gratitude is to Mr. Max Rosenberg, a dear good friend, without whose sincere interest and encouragement this volume would not have been written.

IRA B. CROSS.

Berkeley, California,
January, 1923.

CONTENTS

CHAPTER		PAGE
I.	Introductory	1
II.	Inter-Bank Relations	6
III.	Domestic Exchange	22
IV.	Indorsement, Acceptance, and Liability	79
V.	Exchange Dealers	94
VI.	Principles of Foreign Exchange	116
VII.	Fundamentals of Foreign Bills of Exchange	137
VIII.	Types of Foreign Bills of Exchange	171
IX.	Import and Export Credits	234
X.	Rates of Exchange	300
XI.	Gold and Gold Movements	370
XII.	Exchange Relations with Silver Standard, Gold Exchange, and Paper Standard Countries	427
XIII.	Investment, Speculation, Arbitrage	487
XIV.	The World War and the Exchanges	527

APPENDICES:

I.	A Typical Correspondent Relations Agreement	555
II.	Values of Foreign Coins	557
III.	Methods of Conversion	559

INDEX 567

FORMS

FIGURE		PAGE
1.	Application for domestic money order	23
2.	Domestic postoffice money order	24
3.	Domestic express money order	27
4.	Application for domestic telegraphic transfer	28
5.	Notice to payee of telegraphic transfer	29
6.	Application for bank telegraphic transfer	30
7.	Bank's receipt for telegraphic transfer	31
8.	Bank check	38
9.	Availability schedule for Seattle branch Federal Reserve Bank of San Francisco	42
10.	Bank draft	46
11.	Book of traveler's checks	50
12.	Front page domestic circular letter of credit	52
13.	Second page domestic circular letter of credit	53
14.	Letter of indication	54
15.	Part of correspondent list	55
16.	First page of bank's signature sheet	56
17.	Second page of bank's signature sheet	57
18.	Sight draft	60
19.	Ninety day sight draft	61
20.	Date draft	61
21.	Trade acceptance	68
22.	Domestic commercial letter of credit	71
23.	Certificate of elegibility of banker's acceptance	76
24.	Crossed check	87
25.	Protest blank	91
26.	Notice of protest	92
27.	List of offerings of bankers' acceptances by discount house	101
28.	Diagram showing theory of foreign payments	124
29.	Diagram showing theory of foreign payments	124
30.	Diagram showing theory of foreign payments	125
31.	Typical list of foreign money prices	129
32.	Instructions accompanying a foreign bill of exchange	141
33.	Instructions accompanying a foreign bill of exchange	142
34.	Instructions accompanying several bills of exchange	143
35.	General letter of hypothecation	153
36.	Draft drawn by exporter on importer	156
37.	Steamship bill of lading	159
38.	Insurance certificate	164
39.	Invoice	166

FIGURE PAGE
40. Consular invoice 167
41. American Express Company limited check 175
42. Foreign exchange rate list of American Express Company 176
43. American Express Company postal remittance 177
44. Postal remittance issued by bank through American Express Company 178
45. Postal remittance issued by bank 180
46. Advice to foreign correspondent in connection with bank post money order 180
47. Advice to jobbing bank in connection with bank post money order 181
48. Original and duplicate bank drafts on foreign account 183
49. Application for bank draft on foreign account 184
50. Advice of issuing bank to foreign bank 185
51. Advice to correspondent of foreign correspondent 186
52. Advice to issuing bank by foreign correspondent 187
53. Exchange rate sheet 189
54. Type of four-part form of bank draft 190
55. Type of four-part form of bank draft 192
56. Advice to correspondent of foreign correspondent 193
57. Type of five-part form of bank draft 194
58. Receipt for letter of delegation 195
59. Application for cable transfer 197
60. Old form of foreign traveler's check 219
61. New form of foreign traveler's check 220
62. American Express Company's franc traveler's check 221
63. Foreign circular letter of credit agreement 225
64. First page foreign circular letter of credit 226
65. Second page foreign circular letter of credit 227
66. Advice of letter of credit 228
67. Application for commercial letter of credit 237
68. Agreement signed by applicant for commercial letter of credit 238
69. Dollar import letter of credit 240
70. Trust receipt (documents for warehousing) 245
71. Trust receipt (goods to be held or sold by importer) 246
72. Trust receipt (for delivery to purchaser) 247
73. Bailee receipt 248
74. Sterling import letter of credit 256
75. Draft with interest clause 267
76. Draft with colonial clause 271
77. Confirmed export credit 281
78. Unconfirmed export credit 282
79. Authority to purchase (letter of guarantee) 294
80. Authority to draw or advice of authority to purchase 295
81. Weekly statement of foreign accounts 522

CHARTS

CHART		PAGE
I.	Highest and lowest quotations for sight sterling per month, 1907, 1910, 1913	320
II.	Spread of sterling rates, 1907	362
III.	Spread of sterling rates, 1913	363
IV.	Relation between cable spread and deposit allowance rate in London	364
V.	Maximum and minimum spread of sixty day D/A commercial bills and bankers' bills at varying rates of discount in London, 1913	365
VI.	Gold movements and wholesale prices, United States, 1890–1921	422
VII.	Price of silver in the United States and wholesale price index, November, 1918–April, 1922	437
VIII.	London quotations of telegraphic transfers, Shanghai, Hongkong, and Calcutta, and of price for spot silver, 1914–1921	443
IX.	High rate for sight drafts on Argentina, Brazil and Chile in New York, 1914–1921	471
X.	Wholesale commodity prices in the United States, England, France, and Italy	477
XI.	Commodity price indices and New York exchange rates on England, France, Italy, and Germany	483
XII.	Purchasing power parity of sterling, francs, lire and marks, 1917–1921	484
XIII.	Exchange rates in New York on belligerent countries, June, 1914–July, 1918	540
XIV.	Exchange rates in New York on neutral countries, June, 1914–July, 1918	541
XV.	Exchange rates in New York on England, France, Germany, Italy, Netherlands, Argentina, and Japan, November, 1918–December, 1921	544

ILLUSTRATIONS

Gold shipment from China being received at San Francisco 385
An exchange trader's room 524

DOMESTIC AND FOREIGN EXCHANGE

DOMESTIC AND FOREIGN EXCHANGE

CHAPTER I

INTRODUCTORY

To the layman and to the student enrolled in university classes in finance, the field of Domestic and Foreign Exchange appears at first sight to be but a mass of incomprehensible details, complicated and therefore meaningless documents, mystical and magical practices concerned with creating funds out of "the wind" and shifting such funds, figuratively speaking, almost by wave of hand from one place to another for the purpose of making a profit thereon, and last, but by no means least, endless columns of figures and tables of mathematical computations which further serve to heighten the foreboding character of the subject.

Up to within very recent years there has been good reason for the extent of ignorance and the lack of interest which has existed among us Americans regarding exchange matters, especially as to that part of the subject which deals with the principles and practices of foreign exchange. Prior to the World War we were not vitally concerned with foreign trade; our national task appeared rather to be the caring for our domestic requirements. Trafficking with other nations was carried on only by fits and spells and as the occasion or the situation required. A very small number of American banks had exchange departments, and in the few which did, the work of such departments was practically a closed book even to the rest of the staff of the bank. Our federal and state banking laws were not adapted to the financing of foreign trade,—indeed, they were none too satisfactory even for the needs of domestic trade. Practically all of the small amount of foreign trade that we had was financed through our banking connections in European countries, chiefly in England. Few articles and governmental reports and still fewer American books on foreign trade and foreign exchange were available to those desirous of learning the technique and the practices involved. Foreigners, mostly of English

or German birth and training, dominated the field in the United States. Both England and Germany were competing for the mastery of the seas. Their exporting and importing firms and their banking houses had connections and branches in all parts of the world. Goods had to be paid for, credits had to be established, gold and silver had to be shipped about from one country to another;—in short, trade had to be financed in the most profitable and easy manner, so that it was to be expected that expertness in the handling of exchange transactions would characterize English and German bankers. The World War, however, literally forced us into the field, and our expanding foreign trade, coupled with our more extended international relations, compelled our bankers, import and export managers, investors and speculators, to learn something of the intricacies of foreign exchange methods. Today increasing numbers of American young men are training for a career in the realm of foreign trade and its financing; universities are offering courses in various phases of the subject; books[1]

[1] For many years the only outstanding volume on foreign exchange was "The Theory of Foreign Exchanges," by Viscount George J. Goschen, published in 1861. It has run through many editions and has been widely translated. It is still the classic treatise on the subject, especially on the theory of the exchanges. Another standard English volume, likewise of many editions, is "The A B C of the Foreign Exchanges," by George Clare (London, 1892). Mr. Clare is also the author of "A Money Market Primer and Key to the Exchanges" (London, 1891). Both of these volumes are excellent though brief. "Money Changing" (London, 1913) and "War and Lombard Street" (London, 1915) by Hartley Withers are undoubtedly the best available popular discussions of the field by an Englishman. "Foreign Exchange and Foreign Bills" (London, 1915), by W. F. Spalding presents a most complete and satisfactory treatment of the subject. Mr. Spalding's "Eastern Exchange, Currency and Finance" (2d edition, London, 1920) is also to be highly recommended as is also T E. Gregory's volume on "Foreign Exchange before, during, and after the War" (London, 1921).

American publications have been much later in appearing. In 1902 the Financier Company of New York issued a small volume entitled "Foreign Exchange." It was not a very successful attempt to cover the fundamentals of the subject. "International Exchange," by A. W. Margraff (Chicago, 1903) and "Foreign Exchange Textbook," by Howard K. Brooks (Chicago, 1906) long remained the standard American volumes. "The Elements of Foreign Exchange," by Franklin Escher (New York, 1910) was the first satisfactory attempt with us to popularize the subject. In 1917 Mr. Escher published another small volume, "Foreign Exchange Explained" (New York). Both of these discussions are excellent, but naturally, being popular in character, they do not go deeply into the subject. Approximately one-half of "International Trade and Exchange," by H. G. Brown (New York, 1914) is devoted to foreign exchange, and has been subsequently reprinted under the title of "Foreign Exchange" (New York, 1915). The treatment is scholarly but extremely brief for the student or layman. A much more satisfactory textbook is "Domestic and Foreign Exchange," by E. L. S. Patterson (New York, 1917), although again the treatment is necessarily too brief. By far the best volume on the subject is "Foreign Exchange," by A. C. Whitaker (New York, 1919). It is scholarly, practical, and clearly written. Other volumes that may be mentioned are "Foreign Exchange, Theory and Practice," by T. York (New York 1920), "Problems in Foreign Exchange," by J. M. Shugrue (New York, 1920), and "Modern Foreign Exchange," by V. Gonzales (New York, 1914, revised, 1920). Tables which may be used for figuring foreign exchange rates, may be found in Brooks, "Foreign

and articles are being published, lectures delivered, and governmental documents issued as never before, so that to the observer foreign trade and foreign exchange appear to be riding on the crest of a wave of popularity. American exporting firms have added exchange experts to their staffs. Banks that never before thought of foreign exchange transactions now advertise in their local papers that they are able to furnish exchange on almost any part of the world. The larger metropolitan banks have established branches abroad or have arranged a far-flung system of correspondents, so that they are able to reach practically all corners of the globe for the purpose of putting through almost any sort of moneyed transaction. Local newspapers carry exchange quotations while the more important and serious financial journals publish columns of exchange rates with complete analyses of the exchange market. National and state banking laws have been modified so as to enable both domestic and foreign trade to be financed in an up-to-date and much more satisfactory manner than was formerly possible. We hear much of the United States becoming a creditor nation. The balance of trade, the payment of international debts, the importation of gold, the development of a discount market in the United States, and many similar subjects have become topics of current comment, even in circles outside of the banking and trading worlds. Because of these things there has arisen a real and sincere demand for the diffusion of information concerning exchange matters. Therein alone lies the justification for the publication of this volume.

Foreign exchange has always seemed to be shrouded in mystery. The possible reasons are two. One is that the average student or man of affairs who strays into the field is ignorant of ordinary credit transactions and knows nothing or practically nothing as to how claims are settled between creditor and debtor without the use of money.

Exchange Textbook"; Margraff, "International Exchange"; Gonzales, "Modern Foreign Exchange"; E. D. Davis, "Foreign Exchange Tables" (Minneapolis, 1912); J. H. Norman, "Norman's Universal Cambist" (London, 1897); C. A. Stern, "Arbitration and Parities of Foreign Exchange" (New York, 1902); and Tate's "Modern Cambist" (there are several editions of this, one by H. Schmidt, London, 1903, still another by H. T. Easton, 24th edition, London, 1908). No mention need be made of the large number of volumes issued in foreign languages.

Many American banks have published pamphlets and shorter studies dealing with the financing of foreign trade. These are for the most part fleeting documents and need not be listed.

The *Commercial and Financial Chronicle* and the *Annalist*, both of New York, contain weekly summaries and analyses of the exchange markets.

The other is that foreign exchange implies a knowledge of the monies of foreign nations,—for one no longer talks of dollars and cents but of pounds sterling, francs, yen, marks, etc. If one first becomes acquainted with the practices and devices employed in paying bills at home by means of credit transactions, and then applies those same principles to the foreign field, and if at the same time he merely translates dollars into the money of the foreign country concerned, he will have no serious difficulty in treading the devious trails of the field of foreign exchange. The principles that underlie both domestic and foreign exchange are the same, although at times the practices followed and the instruments employed are decidedly different in character.

In line with the suggestions just outlined, I shall first discuss in a general manner the fundamentals or bases of credit transactions as they facilitate the payment of bills between individuals, business firms, or banks located in different communities in one country. I shall then take up in greater detail the numerous practices and principles involved in settling such obligations. When a man pays a grocery bill or buys a new suit of clothes from his local dealer, he is not concerned with the practices of domestic exchange. But when a man in San Francisco wishes to pay a bill in New York, or when a bank in Seattle desires to pay a debt in New Orleans, or to collect money owing it by a Boston firm, or to establish a deposit or credit with a Baltimore bank, then the question arises "How shall it be done?" It is this sort of financial transaction, involving the use of credit arrangements or the shipment of gold or money, with which domestic exchange is concerned.

After a discussion of domestic exchange I shall pass on to the question of how creditors in one country and debtors in another settle their financial obligations. Suppose that an American owes a bill in England, or desires to get funds with which to travel in France, or wishes to speculate in the exchanges of foreign countries, or plans to import goods from abroad, or to collect money owing him by a resident of Brazil, or suppose that a bank wishes to engage in financial deals of various sorts in other countries or with citizens or banks of those countries,—how are all of these and similar transactions carried through? What are the mechanism, the practices, the underlying principles, and the theories involved? These are matters lying within the province of foreign exchange. By approaching the discussion of

foreign exchange in this manner I hope to make it possible for the reader to understand the fundamentals of the subject more easily than is usually the case.

The details of the technique of domestic and foreign exchange are so numerous, and in some connections so complicated, that it is practically impossible at times to discuss certain phases of the subject without using terms that have not previously been defined or mentioned in the text. It will frequently be necessary to state that certain matters will be more fully discussed in a later portion of the volume. An effort has been made, however, to develop the subject logically and in such a manner that a minimum of confusion may arise in the mind of the reader.

CHAPTER II

INTER-BANK RELATIONS

Ordinarily Jones in Chicago who owes $1,000 to Smith in Los Angeles will not ship actual money, either paper or metallic, to meet his obligation. Once in a while a person paying a small domestic debt will place paper money or a still smaller sum of metallic money in an envelope and mail it to his creditor. As a rule, however, a credit instrument of some sort will be used. Again, if Jones in Chicago owes £50 to Pratt in London, he will not ship fifty pounds sterling of gold to Pratt, nor will he send him fifty pounds sterling's worth of American money. He will be compelled to resort to some kind of credit instrument with which to make the payment. It is not surprising, therefore, to learn that we finance or pay for about ninety per cent of our domestic trade by means of credit instruments, while practically all of our international payments are so made. The first matter therefore that has to be clearly understood concerns the arrangements that exist by means of which Jones may be supplied with or make use of such credit instruments.

The bulk of domestic and foreign payments could not be made were it not for the accommodations provided, and for the services rendered, by our banking and other financial institutions. These services are made possible by extensive and sometimes very complete and detailed relationships which banks and exchange dealers of all kinds establish with one another. Banks in Minneapolis must have representatives in New York to handle New York deals for them. Likewise banks in New York or Seattle must have representatives in Chicago, San Francisco, and other important centers to do many things for them. American banks must make arrangements with banks abroad so that their foreign financial interests and operations may be satisfactorily handled and cared for. Sometimes these relationships are of a purely reciprocal character, i. e., what one bank agrees to do for another without charge, the latter agrees to do for the former without charge. More frequently, however, slight charges are made for services rendered. These bank inter-relationships constitute what

is known as a system of "bank correspondents." The details of such correspondent relationships and their effect on exchange transactions will be discussed in detail in subsequent pages.

Thus it is that our large banks and financial houses have correspondents in practically every city of consequence in the United States and also in foreign countries. Some also have their own foreign branches. At this writing (May, 1922) the American Express Company, besides having about 75,000 agencies and offices in the United States, has thirty-five foreign branch offices and subsidiaries as well as more than 10,000 banking and shipping correspondents elsewhere throughout the world. The National City Bank of New York, with its subsidiary, the International Banking Corporation, has 83 foreign branches and more than 3,000 foreign correspondents. Other large financial concerns such as The Guaranty Trust, The Bankers Trust Company, The American Foreign Banking Corporation, J. P. Morgan and Company, The Equitable Trust Company, The Asia Banking Corporation, The Mercantile Bank of the Americas, and many others have branches in foreign countries,[1] to say nothing of their hundreds or even thousands of correspondents, which form a network of relationships reaching the more important countries and facilitating transactions of all sorts concerned with foreign financing. Likewise, European banks have their branches and correspondents in various places. English and German owned banks have been especially active in this regard, some having as many as a thousand or more branches in addition to several thousand correspondents.[2] It is this system of branch banking that has been of such vital importance in obtaining for England her control over foreign trade. And in passing, it may not be out of place to remark that if the United States wishes to make real progress in building up its foreign trade, it must make it both possible and profitable for American banks to establish branches abroad. Some steps have already been taken in this direction through the revision of our state and federal banking laws.[3]

[1] Quite a number of these branches were discontinued in 1920–21.

[2] Cf. footnote 1, p. 112; footnotes 3 and 4, p. 113.

[3] The revision of state and federal banking laws since 1913 has made possible the use of the bank acceptance in the financing of foreign trade. The establishment of the Federal Reserve system enabled an open discount market of growing proportions to be brought into existence. The Federal Reserve Law also permits national banks under certain conditions to establish foreign branches. The passage of the Edge Act by Congress (December 24, 1919) provided for the organization of corporations which may engage in foreign trade and undertake the long-time financing thereof through the issuance of securities based upon acceptances, collateral trust notes, etc. Other changes in state and national

Banks in our smaller cities arrange with banks in the more important financial centers to make use of the latter's correspondents to a limited, sometimes to an unlimited, extent in connection with either domestic or foreign transactions. The usual requirement is that the former must keep an account or deposit with the latter, either large or small as the case may be. Ordinarily an interest rate of about two per cent is paid on the average balance so maintained. The interest rate on the balances kept by American banks with European correspondents varies, usually in accordance with the discount rate of the central bank of the foreign country.

A bank in St. Louis, for example, wishing to have the facilities which come from a system of domestic and foreign correspondents, makes arrangements to that end with a bank in New York. It agrees to keep an account or deposit with the latter and to notify the latter by means of "advices" of all transactions which it puts through. An "advice" is merely a printed or written statement showing what has been done, which is sent to the correspondent bank as a notice or notification of the transaction. Advices are widely used in connection with all sorts of domestic and foreign exchange operations. Copies of typical advices will appear in subsequent pages. The relationship entered into gives the St. Louis bank exchange connections with a large group of American and foreign banks, but always through the agency of the New York bank. The New York bank, in its turn, keeps accounts with certain banks in the more important cities in the United States and in foreign countries, and when it draws on its accounts for exchange purposes it likewise uses advices to notify the bank drawn on as to the details of the transaction.

The question that immediately arises is, "How are such accounts established, and how are they replenished from time to time so as to enable banks to make use of their correspondent relations in transacting their exchange business?"

It would, of course, be expensive and risky for banks to send actual money or gold to each other in order to create or replenish their exchange accounts, although this is sometimes done, as will be noted later. It is not customary, however, and occurs only when banks find it cheaper to ship gold or money than to use various forms of credit instruments.

banking legislation have made it possible for banks to take a much more active part in the financing of foreign trade in various ways that were formerly prohibited.

Today, if a buyer wishes to pay a bill of ordinary amount to a party located in another section of the country, he will as a rule merely draw a personal check on his bank account and forward it to his creditor. The latter cashes it or deposits it to the credit of his account with his local bank. In order that the check may be collected and the amount actually deducted from the bank account of the buyer, it is necessary that the check find its way back to the bank upon which it has been drawn. Thus, if Jones of Chicago draws a check for $1,000 on his account with the Chicago State Bank and sends it to Smith in Los Angeles, Smith may deposit it with the Los Angeles National Bank and be credited with that sum or be given the $1,000 in actual cash. The Los Angeles National Bank, let us say, has an account with the San Francisco Commercial Bank, which it desires to replenish. It forwards the check to the latter with the request that it be credited with that sum. The San Francisco Commercial Bank then credits the Los Angeles National Bank with $1,000, making it possible for the latter to draw drafts on the account or to use it in any manner that the Los Angeles bank may desire. In its turn the San Francisco Commercial Bank may send the check to the Continental Bank of Chicago. The Continental Bank of Chicago will collect the $1,000 from the Chicago State Bank and credit the San Francisco Commercial Bank with that sum. Finally the Chicago State Bank will deduct $1,000 from the account of Mr. Jones and return the canceled check to him. Thus it is that the Los Angeles National Bank has added $1,000 to its account with the San Francisco Commercial Bank, and the San Francisco Commercial Bank has added $1,000 to its account with the Chicago Continental Bank. Both of these banks may use their accounts built up in this manner for the benefit of themselves or to satisfy the needs of customers who may at any time desire to obtain any of a number of different kinds of exchange instruments.

Another typical method of creating or replenishing such accounts is the following:—Let us say that Andrews of Los Angeles has sold a bill of goods to Sargent in Boston. He draws a draft on Sargent, attaches his shipping documents,[1] and sells the bill of exchange to the Los Angeles National Bank. The Los Angeles National Bank may then send the draft and documents to the Boston State Bank for collection and credit. The Boston State Bank collects the amount

[1] Draft and shipping documents constitute what is known as a documentary bill of exchange.

of the draft from Sargent and credits the sum to the account of the Los Angeles National Bank which may use it as desired. The employment of drafts in such connections will be more fully explained later.

It is by such simple means that funds are shifted about from place to place, and accounts are created for exchange and other purposes.

The same principles apply in building up foreign accounts. Let us say that the Old Colonial Bank of New York desires to create or to build up an account with Barclay's Bank of London so that it may have the use of the latter in accordance with the terms of the correspondent agreement entered into by the two banks. Suppose that Mr. Andrews of New York has sold a bill of goods to Mr. George in London amounting to £500 and has drawn a demand draft (a draft payable at sight) on him for that sum. Andrews may sell that draft and the accompanying shipping documents to the Old Colonial Bank of New York, which in its turn transmits them to Barclay's Bank of London for collection and credit. The draft will be collected by Barclay's Bank from Mr. George and the sum placed to the credit of the Old Colonial Bank of New York. The latter may then use the account thus built up by selling exchange against it.

In foreign exchange, as well as in domestic exchange, the most customary method of creating and replenishing accounts is through the forwarding of checks, drafts, and other bills of exchange for collection or discount.[1] Other methods are employed, but they are of minor importance and will be discussed incidentally in subsequent chapters. If at any time a bank finds that it can shift its funds or build up its accounts by cheaper methods than the ones usually employed, it does so. It must be remembered that in all exchange transactions, both domestic and foreign, the bank is in business to make profits for its stockholders. It is this fact that accounts for many of the practices followed by means of which a slight saving of interest or of funds may be accomplished. It is this fact also which accounts for the continued improvement in exchange methods and the development of new ways of handling the various operations.

Having briefly reviewed some of the practices followed in building

[1] "Thus an active bank at any given date may have hundreds or even thousands of outstanding loans on foreign trade transactions, some of which are due and paid every day, and, in consequence, afford a renewed supply of funds for new transactions." F. H. Sisson, *Annals of the American Academy of Social and Political Science*, March, 1921 (vol. XCIV), p. 150.

up accounts and in establishing correspondent relations, we may now sketch the fundamental methods employed in making use of such relations. Reverting again to our example of the St. Louis and New York banks, let us say that the St. Louis National Bank is approached by a customer who desires to obtain a draft on a New York bank with which to pay a bill in that city. The St. Louis bank merely draws a draft on its account with the New York bank, say the Guaranty Trust Company, and hands the draft to its customer, who mails it to his creditor in New York. The creditor presents it to the Guaranty Trust Company or cashes it at his own New York bank, which in its turn presents it to the Guaranty Trust Company, and the account of the St. Louis National Bank is debited with the amount of the draft, the canceled draft thereupon being returned to the St. Louis National Bank.

Let us now say that the Guaranty Trust Company has established correspondent relations with Barclay's Bank in London, and that a customer desires to pay a bill of £500 in London. The Guaranty Trust Company will draw a draft in pounds sterling, not in dollars, for £500 and sell it to the customer for a certain sum of American dollars. If the price of the pound in New York (the sterling rate of exchange) on that day happens to be $4.86, the customer will have to pay the Guaranty Trust Company the sum of $2,430 (4.86 × 500). The draft will be made payable to the London creditor, who, when he receives it from the American debtor, will cash it at his own bank or at Barclay's and receive £500 therefor. The London account of the Guaranty Trust Company will thereupon be debited with that sum.

Thus far the procedure appears to be fairly simple; but let us go a step farther and have a customer ask the St. Louis National Bank for a draft for £100 with which to pay a bill in London. Suppose that the St. Louis bank has no account in London, but that it has arranged with the Guaranty Trust Company to use the London account of the latter, which is on deposit with Barclay's Bank, London, for all sterling exchange purposes. The Guaranty Trust Company will have furnished the St. Louis bank with the required printed forms. It also keeps the St. Louis bank advised daily as to the rates it will charge the latter for all exchange drawn. Thus daily either by mail or by wire it sends to the St. Louis bank a list of the different rates of exchange at which it is authorized to draw against the foreign accounts of the Guaranty

Trust Company. Suppose that the rate on the list for sight drafts on London happens to be 4.87. The St. Louis bank may charge the customer $4.88 for every pound purchased or a total of $488 for the £100 draft. The customer will mail the draft to his creditor in London, who will cash it at his bank and receive his £100. When the draft reaches Barclay's Bank, it will be paid out of the account of the Guaranty Trust Co. When the St. Louis bank hands the £100 draft to the customer, it sends an "advice" to the Guaranty Trust Company stating that on the day in question it sold a £100 draft on Barclay's Bank, payable to a certain party, whose name is given, and that the rate at which the draft had been drawn, as per the rate list furnished by the Guaranty Trust Company, was 4.87. The Guaranty Trust Company is not interested in the rate that the St. Louis bank charges the customer—but only in the fact that the St. Louis bank draws on it at the rate of 4.87. When the advice reaches the Guaranty Trust Company, the account of the St. Louis bank is debited to the extent of $487 ($100 \times 4.87$). The rate of exchange quoted the St. Louis bank includes a profit for the Guaranty Trust Company, so that the New York account of the St. Louis bank is debited only to the extent of $487. The Guaranty Trust Company then sends an advice to Barclay's Bank that the draft in question has been drawn, that it will soon appear for payment, and that Barclay's is to pay it and debit the London account of the Guaranty Trust Company with the sum of £100. This is the more customary procedure, although sometimes the New York bank authorizes the drawing bank (in this case the St. Louis bank) to notify the foreign bank directly as well as to send a copy of the advice on to New York.

The above pages briefly describe in a general manner the methods employed in building up and in making use of correspondent relations in exchange transactions. Many details remain to be explained but they will be taken up as the discussion proceeds. For our immediate purposes this birdseye view of the situation is sufficient.

The exact terms of the agreements under which the correspondent relations are carried on are sometimes embodied in a several page, printed or typewritten, document which holds until amended or changed by subsequent instructions. Especially in the field of foreign dealings does such a document play an important part because of the distances separating the correspondents and the time that it takes to get in touch with one another concerning any financial matter. The

following is typical of such agreements between American and foreign correspondents:—

CONDITIONS FOR THE ACCOUNT OF THE BOSTON STATE BANK, BOSTON, MASS.

with the

PROVINCIAL BANK, ANTWERP, BELGIUM

ACCOUNT. Commission Franco.

INTEREST. Credit: until further notice 3%.
Debit: 1% over the National Bank Rate. Min. 5%.

COLLECTIONS. Clean Bills:
Antwerp, Brussels, Ostend } Franco. Value day of payment.
Other towns in Belgium: fr. 0.50 per bill.
Value 3 days after payment.
Documentary Bills:
Antwerp, Brussels, Ostend } ¼ o/oo. Min. frs. 2.50. Value day of payment.
Other towns in Belgium: ½ o/oo. Min. frs. 2.50.
Value 3 days after payment.
A special commission may be charged on bills on out-of-the-way places.

DRAWINGS. On our offices or on our agents: Franco. Value date of receipt of advice. See list of correspondents attached.

PAYMENTS. Clean:
Antwerp, Brussels, Ostend } At our offices.
To banks or large mercantile houses: Franco.
To private parties at their domiciles: ½ o/oo.
Documentary:
Antwerp, Brussels, Ostend } ½ o/oo. Min. frs. 2.00.
Under travelers' letters of credit:
Expressed in currencies other than Belgian francs: Franco.
Expressed in Belgian francs: 1/8%. Min. fr. 1.

CREDITS.	Sight: See clean payments.
	Documentary: See documentary payments.
	Confirmed: ½ o/oo. Min. frs. 2.00, additional.
ACCEPTANCES.	For your account:
	¼% for 3 months. (Subject to arrangements.)
VALUE DATES.	Payments to your account:
	Same day if effected before noon.
	Monies paid to the debit of your account:
	Same day.

The above agreement covers the conditions of an account which the Boston State Bank has opened with the Provincial Bank of Antwerp, Belgian. The account is in terms of the money of that country, i. e., Belgian francs. The Boston bank is to receive an interest rate of 3 per cent until further notice on its balance or account with the Antwerp bank. This interest rate varies with the official discount rate [1] of the central bank (the National Bank of Belgium). If perchance the Boston bank overdraws its account, it will be compelled to pay a minimum charge of 5 per cent on such overdrafts, but a charge of at least one per cent over the central bank's (the National Bank of Belgium) official rate of discount.

In choosing a correspondent abroad, bankers deem it advisable to select a bank that has a large number of branches and whose correspondents make the least charges, not a bank that allows the greater rate of interest on credit balances.

If the Boston bank send bills of any sort to be collected by the Provincial Bank, they will either be clean bills, i. e., having no documents attached [2] or documentary bills, i. e., having documents attached.[3] For example, the Boston bank may have a customer who has presented to it a bank draft, received from a Belgian debtor, for 1,000 francs drawn on a bank in Brussels. The Boston bank may have paid the customer a certain number of American dollars for that franc draft. It forwards the draft to the Provincial Bank of Antwerp, which collects from the Brussels bank and credits the Boston bank's account with the amount of the draft. The Boston bank may receive a number of similar bills to be collected from Belgian banks. For all clean bills drawn in francs to be collected from banks in Antwerp,

[1] Cf. pp. 402–406 for discussion of official discount rate of the Bank of England.
[2] Cf. pp. 63, 139 for discussion of clean bills.
[3] Cf. pp 61–62, 140 for discussion of documentary bills.

Brussels, and Ostend, the Provincial Bank makes no charge for collection and credits the account of the Boston bank as soon as the bills are collected, i. e., "value day of payment." On other towns, clean bills are collected at the charge of a half franc per bill and credit given the Boston bank three days after payment. Documentary bills are collected on the three cities mentioned at a charge of 1/40 per cent of the face value of the bill (1/4 per mille), with a minimum charge of 2 1/2 francs, and credit given on day of payment. On other towns the charge is 1/20 per cent with the same minimum charge and with credit three days after payment. In the case of out-of-the-way places, a higher charge may be imposed.

The Boston bank is authorized to draw franc drafts on any of the offices of the Provincial Bank of Antwerp or its agents, and its (the Boston bank's) account is debited upon the receipt of the advice relating to the transaction.

If the Boston bank draws clean bills on the Provincial Bank, they will be paid in Antwerp, Brussels, or Ostend and to banks or large mercantile houses without the deduction of exchange charges, but if made payable to private parties in cities where the bank has no branches, an exchange charge of 1/20 per cent is made to the Boston bank for the service rendered. Documentary bills drawn against the Provincial Bank will also be charged against the account of the Boston bank at the rate of 1/20 per cent with a minimum charge of 2 francs. There is no charge for travelers' letters of credit [1] issued by the Boston bank on the Provincial Bank, provided they are issued in terms of foreign currency because the Provincial Bank in those cases will make a profit in cashing the drafts drawn in foreign monies. But if travelers' letters of credit are drawn in Belgian francs, the Provincial Bank is compelled to pay the full amount of the drafts and will therefore get its commission or profit by charging the account of the Boston bank 1/8 of 1 per cent (minimum charge of 1 franc) on the face value of each draft cashed. For "confirming" a commercial letter of credit [2] a charge of 1/20 per cent is made plus a minimum additional charge of 2 francs. For assuming the responsibility of accepting drafts drawn against it under commercial letters of credit, it will charge the Boston bank, on the average, 1/4 per cent on three months' drafts. This rate may be modified under certain conditions. Some of these

[1] Cf. pp. 223–233 for discussion of foreign travelers' letters of credit.
[2] Cf. pp. 257, 284–287 for discussion of confirmed letter of credit.

terms may be confusing to the beginner but all of them will be more fully defined and described in later pages.

Finally, when items come to the Provincial Bank to be credited to the account of the Boston bank, the latter is given credit on the same day if they arrive before noon; if not, on the next day. In the case of items being presented for payment from the account of the Boston bank, the Provincial Bank debits the account of the Boston bank with those amounts on the day when paid.[1]

The commissions charged American banks by foreign correspondents are a matter of negotiation, the rate usually varying "with the volume and the nature of the transactions—the larger the account the cheaper the rates." The customary scale of charges imposed by London banks will approximate the following: handling documentary bills, about 1/40 of 1 per cent; cashing drafts drawn under travelers' letters of credit, about 1/40 of 1 per cent; accepting drafts drawn under commercial letters of credit, about 1/16 of 1 per cen per month of usance; confirmation of commercial letters of credit, from 1/8 to 1/20 of 1 per cent; accepting long bills drawn by the American bank, about 1/16 of 1 per cent per month of usance. Instead of a commission being charged on each item handled for the American bank, a flat commission may be levied on all items credited or debited to the account of the latter, excluding only acceptances. Such flat rates vary from 1/40 to ¼ of 1 per cent. Or still another form of "arrangement is for the American bank to pay a lump sum periodically for the total service; this arrangement makes for simplicity, frees the business from special commission charges, eliminates the clerical work of recording in detail the different commission charges, gives the American bank interest on its full balance, and saves correspondence over petty details. This lump charge varies, of course, with the average volume of business that the account occasions, and is accordingly readjusted from time to time by contract." [2]

Agreements covering correspondent relations between domestic banks contain clauses of the same general nature as those that are found in the foreign field. The following is typical and needs no explanation:

[1] Cf. Appendix I for another form of correspondent relations agreement.
[2] Westerfield, R. B., "Banking Principles and Practice," New York, 1921, p. 1138.

CONDITIONS OF ACCOUNT
WITH
THE MERCHANTS NATIONAL BANK OF LOS ANGELES
LOS ANGELES, CALIFORNIA

WE DEBIT YOU:

ACCOUNT: Free of commission.

INTEREST: 1% above Federal Reserve Bank rate, minimum 6%.

DRAWINGS: On Us and Our Correspondents by you and your friends:
In Dollars: Free of commission, value date of payment.
In Other Currencies: Free of commission. In reimbursement will draw on you or as you may instruct otherwise, with canceled vouchers attached. Drafts must bear the clause: "At drawee's buying rate for bankers checks on....."

PAYMENTS: *Under Telegraphic or Mail Advices:* To Banks, Mercantile Houses and Private Parties throughout the United States, free of commission, value date of payment, plus actual costs.
Against Documents or under Unconfirmed Credits: 1/16%
And Acceptances under Confirmed Credits: Sight 1/16%
30 days 1/8%
60 & 90 days 1/4%
Under Travelers' Letters of Credit: Both Dollars and Other Currencies, free of commission.

COLLECTIONS: *Clean and Documentary:*
On Los Angeles, free of commission.
On Other Cities, at actual cost to us.

TRANSFERS ON BOOK: Free of commission.

WE CREDIT YOU:

INTEREST: 2½% per annum, on average daily balances, credited monthly, until further notice. (Excepting items under deferred credits.)

REMITTANCES: *Clean and Documentary:* Items payable in Los Angeles if received before 3 P. M. will be credited the same, otherwise the next day.
Items drawn on other places will be credited on a deferred basis ranging from two to ten days (San Francisco 2 days, Seattle 3 days, Chicago 4 days, New York 5 days, etc.)

SPECIAL CONDITIONS AND REMARKS:

INTEREST ON TERM ACCOUNTS: 3% if left for three months, 4% if left six months.

DISCOUNT: Of fine long bills payable in the United States at best rate.

FOREIGN EXCHANGE TRANSACTIONS: We are constant buyers and sellers of foreign exchanges at best rate obtainable.

INFORMATION: Regarding the credit standing of firms and individuals, free of charge.

ACKNOWLEDGMENT: Of remittances is made each time by letter and statement of account is furnished at the close of each month.

The larger metropolitan bank or exchange dealer, whose domestic or foreign accounts are used by correspondent banks for exchange purposes, usually issues a set of instructions to the latter as to just how drawings are to be made. These instructions are frequently of a very detailed character, being necessarily of that nature because of the lack of information and training concerning exchange matters which characterizes bankers and bank employees in our smaller towns. The following is typical of such documents:

THE MERCHANTS NATIONAL BANK

of Los Angeles

GENERAL INSTRUCTIONS

FOR DRAWINGS UNDER OUR PROTECTION

Draft Form 1. The Merchants National Bank of Los Angeles will furnish you upon application books containing drafts and bank post remittance forms with your own title printed upon them. Checks are to be drawn by you over your own signature and for your own account, as we simply act as agents in transmitting funds abroad.

On account of the still existing inefficient postal service abroad and in order to insure prompt payment, our foreign drafts are in duplicate form, either of the instruments being negotiable, which enables the sender to dispatch duplicate by next mail boat or upon advice that the original has not been received by the payee, without further inconveniencing the issuing bank for the issuance of a duplicate.

Drawing Places 2. We urgently request that drawings be confined to the principal cities of the country on which drawn unless the pur-

chaser insists upon having a check drawn direct upon one of the smaller places, in which case you are at liberty to draw on any one of the banks mentioned in this book.

Foreign Currency

3. Drafts should be issued only in the currency of the respective foreign country and in a manner indicated at the head of the various countries.

Post Remittance

4. We recommend the use of bank post remittance in all cases where a remittance is desired payable at a place in Europe without proper banking facilities. Under this system the payee's name, address, and amount advised is forwarded to our correspondent, who, in turn, remits the money in banknotes by registered and insured mail. When sending a bank post remittance to Italy it is necessary to indicate also the father's name of the payee with the prefix "DI" if living and "FU" if dead. Example: "Luigi Angello di Abbateccola" or "Luigi Angello fu Abbateccola."

Rate Sheets

5. Quotations are mailed daily on numbered rate sheets. Always use the last rate sheet on hand. For all drafts in excess of our rate sheet limits, special rates will be supplied by us by phone or wire.

Advice

6. Advice stubs must be mailed to us on the same day the drafts are issued, as our correspondents abroad will honor drafts only upon receipt of our advice.

We acknowledge all advices received. If acknowledgment is not received say within 10 days of date of mailing, inquiries should be made.

Settlement

7. Indicate on the advice whether you are enclosing check or wish to have amount charged to your account.

Spoiled Drafts

8. Drafts spoiled should be returned to us marked "Cancelled."

Repurchase of Drafts

9. In case a draft is to be cancelled or refunded after payment has been made to us, refund will be made only upon surrender of both the original and duplicate at the prevailing rate of exchange and not at the rate issued. All drafts sent us for purchase must bear your guaranteed endorsement signed in ink by an officer duly authorized to sign.

Dollar Drafts

10. All drafts drawn in Dollars on points outside of the United States, or in Pound Sterling on points outside of England, Ireland, and Scotland, or in Francs on points outside of France, are to be marked on their face "PAYABLE AT THE DRAWEE'S BUYING RATE FOR DEMAND DRAFTS (ON NEW YORK) (ON LONDON) (ON PARIS)" as the case might be.

In remitting us for Dollar drafts, please include a charge of one-quarter of one per cent commission. Minimum twenty-five cents.

Cable Transfers

12. Our facilities to effect quick payment by cable in all parts of the world and especially Europe are equal to those of any of the great financial institutions in this country. Whenever the matter is urgent or when transferring large sums of money, we recommend the use of cable (use Special Foreign Money Transfer Blanks).

In selling cable transfers, be governed by the following:

(a) Send us order by telegraph or mail.

(b) Remit cover at the cable rate quoted on your last rate sheet, plus cable charges which we will assume to be on the average of $4.50 for England, France, Belgium, Holland, and $5.50 for other European countries; $7.50 for countries in South America, and $10.00 for oriental points.

(c) All cable orders reaching us before 4 p.m. Los Angeles time will be attended to the same day.

Foreign Deposits

13. In the past two years we have opened accounts in foreign currencies abroad for thousands of our clients to the entire satisfaction of every one of them. You are at liberty to call upon us for similar services in behalf of your clients, enclosing in each case three specimen signature cards. Usually it takes about two months to receive a receipt or pass-book from abroad. When the depositor chooses to open an account with our correspondent abroad, then make checks payable to: "Drawee Bank, Account Mr. X. X." If he chooses some other bank, say for instance Hypotheken Bank, München, then make drafts read, "Pay to Hypotheken Bank, München, Account Mr. X. X." If the draft is already made out in the individual's name, have him make a special endorsement reading: "Pay to Société Générale, Paris for credit of my account. Signed X. X." In case a check is lost in the mails, unauthorized individuals are not able to cash it if made out in the above described manner.

Withdrawal of such accounts can be effected in the following manner:

(a) A personal check may be drawn against the account abroad.

We shall forward such check for collection abroad and make settlement at the current rate of exchange on day advice of credit reaches us.

(b) We will purchase same outright if same bears the endorsement of the bank, at the prevailing market. It is prudent but not essential that the drawer present some evidence that he maintains sufficient funds abroad to cover the withdrawal.

Letters of Credit

14. Our Commercial and Travelers' Letters of Credit are well known throughout the world. We will gladly furnish your clients upon request with such Letters of Credit upon cash payment or under your guarantee, in Dollars, for a nominal charge of 1/8 of 1%, or in other currencies at a fixed rate, or at the current rate of exchange upon receipt of payment advice.

Correspondence Facilities

15. All correspondence relative to foreign exchange service should be addressed to the Foreign Exchange Department.

16. Owing to the fact that our sphere of activity is confined only to some 250 banks located in the great Southwest, we are in position to render to country friends, using our facilities, prompt and efficient service.

Our connections are very extensive, our operations complete, and you may safely entrust us with any foreign exchange transaction that may come up.

THE MERCHANTS NATIONAL BANK
OF LOS ANGELES
FOREIGN DEPARTMENT

The terms of the above agreement are self-explanatory. If it becomes necessary at any time to modify the terms of either domestic or foreign agreements, notices of the changes are sent by mail or by wire.

Naturally it is impossible for a bank to have a correspondent in every city in which it may have to put through some sort of financial transaction or on which it may have to provide exchange. Banks have correspondents only in those cities with which they have the greater part of their outside business relations. But if a bank does not have a correspondent in a certain town, either at home or abroad, and finds it inconvenient or impossible to use one of its already authorized correspondents, it is customary to wire or write a bank located in the city in question, and ask it to act in the desired capacity. In this way it is possible for a bank to arrange financial connections in practically every country and important city of the world.

CHAPTER III

DOMESTIC EXCHANGE

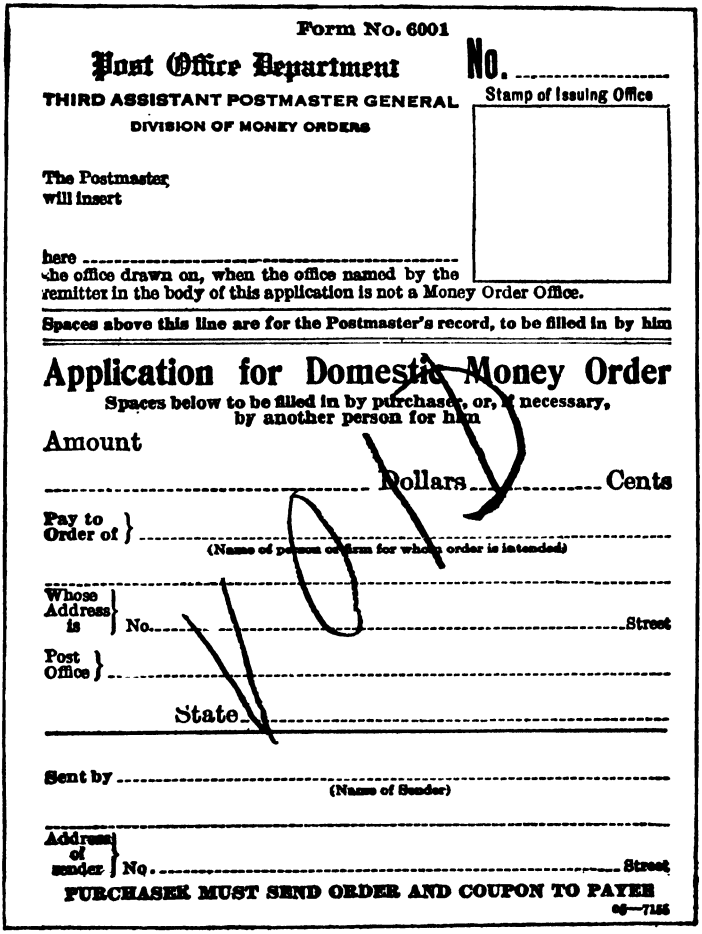
Domestic exchange concerns itself with the instruments, practices, and principles involved in making payments between creditors and debtors in different communities of the same country. It is sometimes known as "inland" exchange, and the instruments with which it is concerned are frequently called "inland bills of exchange." *Legally*, however, an inland bill of exchange is one that is drawn and payable within the same state. Under our "Uniform Negotiable Instruments Law," a bill drawn in New York and payable in New York is an inland bill of exchange; if it is drawn in New York and made payable in St. Louis, it is a "foreign" bill. In this volume, however, I shall use the terms "domestic exchange" and "domestic bills" in the sense employed in the opening statement of this chapter, and the terms "foreign exchange" and "foreign bills" as referring to exchange relations between parties in different countries.

Suppose that Jones of Chicago buys $100 worth of toys from Smith in New York. How will he pay for the goods? He may use one of a number of methods. He may place $100 of paper, silver, or gold money in a package and send it to Smith by registered mail or by express. This is very unsatisfactory, unsafe, unnecessarily expensive to the sender, and is seldom employed. Usually a credit instrument of some kind will be used. Credit instruments are commonly known as "bills of exchange." A bill of exchange is defined by the Uniform Negotiable Instruments Law [1] as being "an unconditional order in writing addressed by one person to another, signed by the

[1] Negotiable instruments, such as checks, drafts, acceptances, etc., play an important part in our commercial and financial activities. The laws of the forty-eight states of our nation dealing therewith were so confusing and diverse, that the American Bar Association drew up a Uniform Negotiable Instruments Law, somewhat similar to that of England, and presented it for adoption to the various state legislatures. It has been adopted, with but slight modification, by all divisions of our country except Georgia, Hawaii, the District of Columbia, and the Philippine Islands. It establishes uniform regulations regarding the use of negotiable instruments and has been an invaluable aid in facilitating credit transactions in all parts of our commonwealth. More detailed reference is made to it in Chapter IV.

person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer."

The means of creating domestic (as well as foreign) exchange may be divided into two general groups: (1) those in which a third party, such as the postoffice, banks, express companies, telegraph companies, etc., supplies the debtor thereby enabling him to satisfy his obligations



Form No. 6001

Post Office Department

No. _____

THIRD ASSISTANT POSTMASTER GENERAL

DIVISION OF MONEY ORDERS

Stamp of Issuing Office

The Postmaster will insert

here _____

the office drawn on, when the office named by the remitter in the body of this application is not a Money Order Office.

Spaces above this line are for the Postmaster's record, to be filled in by him

Application for Domestic Money Order

Spaces below to be filled in by purchaser, or, if necessary, by another person for him

Amount

_____ Dollars _____ Cents

Pay to Order of } _____

(Name of person or firm for whom order is intended)

Whose Address is } No. _____ Street

Post Office } _____

State _____

Sent by _____

(Name of Sender)

Address of sender } No. _____ Street

PURCHASER MUST SEND ORDER AND COUPON TO PAYEE

05—7155

FIGURE 1

Application for domestic money order

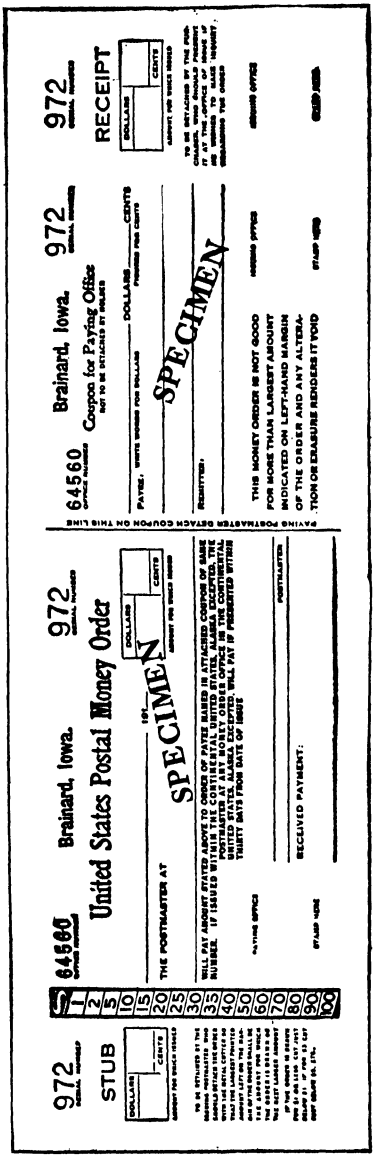


FIGURE 2
Domestic postoffice money order

to his creditor, and (2) those which are created or brought into existence by the creditor himself by which he satisfies his claims upon the debtor. In the first case, the buyer or debtor remits or sends a bill of exchange of some kind to the creditor which the latter may cash at a bank, postoffice, express company, or telegraph office, or which he may sell to another person for money. In the second case, the seller or the creditor draws a draft or an order upon the debtor or his agent and either sends it forward for collection or sells it to an exchange dealer. If sold to an exchange dealer, it will be forwarded and collected by the latter or his agent from the debtor. Under the first group come such kinds of domestic exchange instruments as postoffice and express money orders; telegraphic transfers made available by telegraph companies, banks, and Federal Reserve banks; checks, bank drafts, and certificates of deposit provided by banks; and finally travelers' checks and travelers' or circular letters of credit issued both by banks and by express companies. Under the second group comes the ordinary or individual draft, as distinguished from the bank draft, drawn by the creditor upon the debtor or upon the financial agent of the latter, usually a bank, with which the debtor has

made the necessary arrangements. All these kinds of domestic exchange will be described in this chapter.

Postoffice Money Order. A commonly used type of domestic bill of exchange is the postoffice money order. Jones of San Francisco, wishing to send $100 to Smith in New York, goes to his local postoffice and writes out an "Application for Domestic Money Order" (Fig. 1). The postoffice clerk thereupon fills out the regulation money order form which is of three parts (Fig. 2), (a) the stub of the agent of the selling office, kept for record, (b) the receipt which Jones may keep for future reference, and (c) the order itself which directs the New York postoffice to pay $100 to Smith upon identification. Jones sends the order to Smith who presents it at the postoffice and gets his money, or indorses it and cashes it at his local bank. He may not indorse it to another person. Only his own indorsement and that of a bank are permitted by the rules of the postoffice money order department. In fact, the indorsement of the bank is not legally an indorsement, but is looked upon as being the identification of the signature of the payee. This naturally limits the negotiability of the order and makes it far from satisfactory under many conditions. The order may be cashed at any postoffice within thirty days after being issued, but after that time it is necessary for Smith to cash it only at the office upon which it was issued, i. e., the New York office. Postoffice money orders are used primarily for small sums because of their expense.[1] They are seldom used by business men and are usually employed only by those who do not have banking accounts. They are bothersome because the sender has to go to the postoffice and personally fill out the application blank. If the recipient of the order cashes it at the postoffice, he has to be identified, which is frequently no easy matter because usually he is not acquainted with the clerk in charge of the money order department. The maximum amount for which an order may be issued is $100, so that if one desires to send more than that sum he must obtain additional orders.

The order itself, as may be noted from Fig. 2, is made up of two parts. Once a week the various postoffices cut their cashed orders

[1] The costs are as follows:

From $0.01 to $2.50	3 cents	From $30.01 to $40.00	15 cents
" $2.51 to $5.00	5 cents	" $40.01 to $50.00	18 cents
" $5.01 to $10.00	8 cents	" $50.01 to $60.00	20 cents
" $10.01 to $20.00	10 cents	" $60.01 to $75.00	25 cents
" $20.01 to $30.00	12 cents	" $75.01 to $100.00	30 cents

in two, keep one part for record, and send the other to Washington where the receipts and expenditures of the various postoffices are checked up and balanced. England inaugurated her postal money order business as early as 1839, but it was not until 1864 that the United States put its system into operation.[1] During the first year our postoffice department sold $1,360,122.52 worth of domestic orders. By 1920 this sum had grown to $1,333,045,947.73. For the year 1914 [2] the excess of revenues over cost of operation amounted to $10,296.05, which, when added to the proceeds obtained from the cancellation of unclaimed orders more than a year old ($580,888.85), netted a total profit to the government from the sale of domestic money orders of $591,184.90.

Express Money Order. A much more satisfactory and commonly used form of domestic exchange is the express money order issued by the offices of the American Railway Express Company and by banks, business firms, etc., acting as agents of the American Express Company. This form of money order was introduced in 1882 by the American Express Company. It consists of an agent's stub, a receipt for the sender, and the order itself which is sent to the creditor (Fig. 3). The rates for an express money order are slightly higher for smaller sums and slightly lower for larger sums than those charged for a postoffice order.[3] An express money order is much easier to obtain than a postoffice order because the company's office or branch office is usually more conveniently located than is the postoffice. In applying for an express money order, it is necessary to tell the agent only the name and address of the party to whom you wish to send the money and the amount to be sent. There is no application blank to be made out by the sender. The order will be handed to the customer as quickly as the agent can fill in the blank spaces. Single orders may be issued for any sum up to $50. If a customer wishes to send a larger sum he must purchase two or more orders. Express money orders may be cashed on the usual identification in any place and at any time, and do not have to be cashed at the office upon which drawn. They may

[1] The practice of issuing foreign or international money orders, to be discussed later in detail, was begun September 1, 1869.

[2] No later data appear available.

[3] Rates for Express Money Orders:

Not over $2.50 ..... 5 cts.	Not over 50.00 ..... 15 cts.
" " 5.00 ..... 7 "	" " 75.00 ..... 18 "
" " 10.00 ..... 10 "	" " 100.00 ..... 20 "
" " 25.00 ..... 12 "	Over $100 at above rates.

be indorsed any number of times and passed from person to person or deposited with a bank. In case of loss or theft, the receipt, as in the case of the postoffice money order, guarantees the sender against monetary loss.

Telegraphic Transfers. At times a need arises for a more rapid transference of funds or payment of money than is afforded by the use of postal or express money orders. Recourse may then be had to a telegraphic order. It is as easy to send money by telegraph as it is to send a message by wire. Practically any part of the United States may be reached in this manner. Telegraphic exchange may be purchased either through the regular telegraph offices or through banks. The principle involved is merely the sending of a telegram to an agent or correspondent requesting him to pay over to a designated party a certain sum of money. The details of the procedure will be brought out in connection with the description of a telegraphic exchange transaction, first of an express company and second of a bank.

Jones of San Francisco desires to wire $500 to Smith in New York. He goes to the telegraph company's office and fills out an application for a domestic money transfer order (Fig. 4). He may require positive evidence of identification from the person to whom the money is to be paid or he may waive that formality. In the latter case the company will have to use due diligence and precaution to see that the payee (the one to whom the money is to be paid) is the proper party. If it uses such diligence it cannot be held liable for

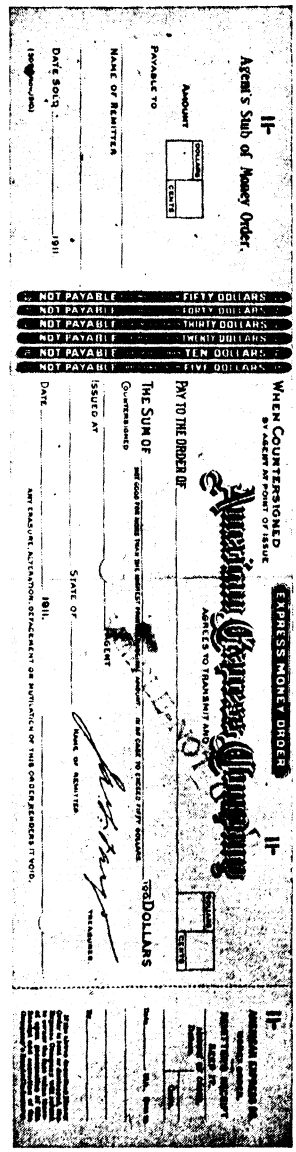
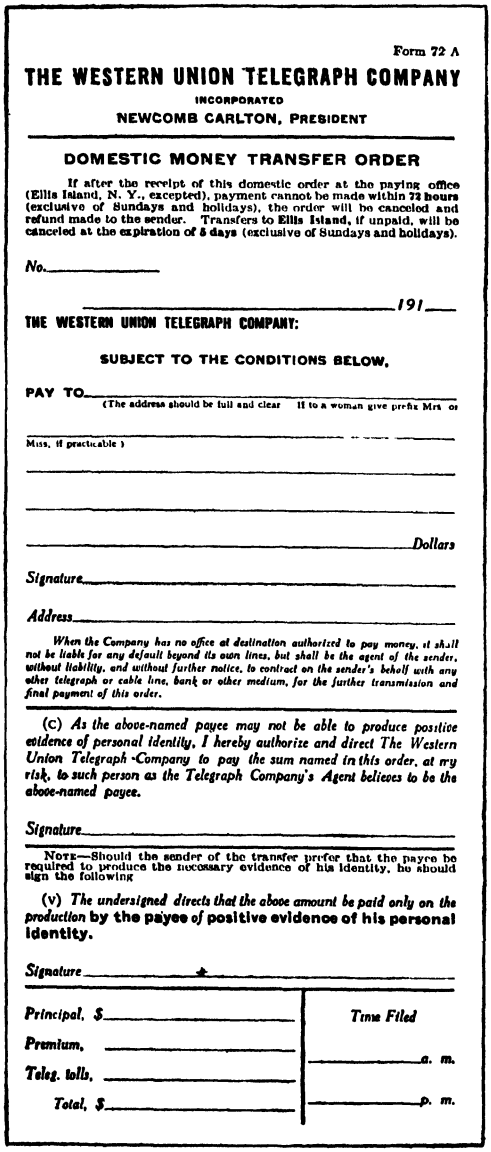


FIGURE 3
Domestic express money order



Form 72 A

THE WESTERN UNION TELEGRAPH COMPANY

INCORPORATED

NEWCOMB CARLTON, PRESIDENT

DOMESTIC MONEY TRANSFER ORDER

If after the receipt of this domestic order at the paying office (Ellis Island, N. Y., excepted), payment cannot be made within 72 hours (exclusive of Sundays and holidays), the order will be canceled and refund made to the sender. Transfers to Ellis Island, if unpaid, will be canceled at the expiration of 5 days (exclusive of Sundays and holidays).

*No.*_____

_____ *191*____

THE WESTERN UNION TELEGRAPH COMPANY:

SUBJECT TO THE CONDITIONS BELOW.

PAY TO_____

(The address should be full and clear If to a woman give prefix Mrs or Miss, if practicable)

_____

_____

_____

_____ *Dollars*

*Signature*_____

*Address*_____

When the Company has no office at destination authorized to pay money, it shall not be liable for any default beyond its own lines, but shall be the agent of the sender, without liability, and without further notice, to contract on the sender's behalf with any other telegraph or cable line, bank or other medium, for the further transmission and final payment of this order.

(C) *As the above-named payee may not be able to produce positive evidence of personal identity, I hereby authorize and direct The Western Union Telegraph Company to pay the sum named in this order, at my risk, to such person as the Telegraph Company's Agent believes to be the above-named payee.*

*Signature*_____

NOTE—Should the sender of the transfer prefer that the payee be required to produce the necessary evidence of his identity, he should sign the following

(V) *The undersigned directs that the above amount be paid only on the production* **by the payee of positive evidence of his personal identity.**

*Signature*_____

*Principal, $*_____	*Time Filed*
Premium, _____	_____ *a. m.*
Teleg. tolls, _____	
*Total, $*_____	_____ *p. m.*

FIGURE 4

Application for domestic telegraphic transfer

wrong payment. If the company has no office in the town of the payee, it agrees to act merely as an agent of the sender and to be held liable only for any default that may occur in connection with its having acted as the sender of the message.

Upon filling out the required application blank, the sender is given a receipt. The cost of the telegraphic transfer includes the cost of the telegram (known as "the telegraphic toll" and varying according to the distance the telegram is to be sent), and the premium costs. The percentage charge for the amount remitted becomes less as the sum sent becomes larger. The premium costs are the same for all offices and range somewhat as shown on opposite page.

In sending telegraphic transfers, codes are used in order to prevent the message being intercepted and payment being made to

the wrong party. The sum that may be sent by one order is usually limited, depending upon the classification of the city. Offices located in large cities are allowed to handle larger amounts than offices in smaller cities. As a rule orders addressed to cities of minor importance are sent through a larger city nearby ("transfer cities"), thus minimizing the confusion that would result from having too many sending and receiving offices with thousands of sending codes.

TELEGRAPHIC TRANSFER PREMIUM COSTS

Up to $25.00	$.25
$26.00 to $50.00	35
51.00 to 75.00	.60
76.00 to 100.00	.85
For each additional $100 up to and including $3,000	$.25
For each additional $100 over $3,000	.20

When the telegram reaches the receiving office, the latter sends out a notice (Fig. 5) to the payee, asking him to appear at the company's

Form 75

THE WESTERN UNION TELEGRAPH COMPANY

INCORPORATED

25,000 OFFICES IN AMERICA CABLE SERVICE TO ALL THE WORLD

GEORGE W. E. ATKINS, Vice President NEWCOMB CARLTON, President BELVIDERE BROOKS, Vice President

MONEY TRANSFERRED BY TELEGRAPH

NOTICE TO PAYEE OF MONEY TRANSFER

_____ 191__

To_____

_____

A telegraphic order to pay you a sum of money has just been received and we shall be glad to make the payment if you will call at the office No._____

If not paid within 72 hours (exclusive of Sundays and Holidays), the order will necessarily be canceled and the amount thereof returned to the sender.

Satisfactory evidence of identity will be required.

MONEY TRANSFER AGENT

BRING THIS NOTICE WITH YOU

FIGURE 5

Notice to payee of telegraphic transfer

office to identify himself positively or to the satisfaction of the company's official, depending upon whether or not the sender has demanded positive identification, and to receive the sum remitted.

It is frequently necessary for banks to forward sums of money to

their correspondents without loss of time. They also send telegraphic orders for their patrons. Let us say that Jones of San Francisco wants to telegraph $1000 to Smith in Boston. He goes to his bank and makes his request. The bank clerk hands him an application blank (Fig. 6), or the clerk may write out the application for the customer as the latter dictates the required data. The clerk gives the customer a receipt (Fig. 7), and also keeps a record of the transaction for the bank's files. The bank may, if it desires to do so, send the transfer through the telegraph company, which will take care of it in the manner described above. As a rule, however, the transfer will not be made in that manner. Almost every bank has a copy of the telegraphic code of the American Banker's Association. The forwarding bank will usually send a message in code direct to a bank in Boston, with whom it may or may not have an ac ount, requesting it to pay $1000 to Smith. If it has an account with the Boston bank, the code message will order that the account be debited to the extent of $1000. If it doesn't have an account with the Boston bank, the message will state that remittance to cover is being forwarded by wire or by mail. In the latter case the Boston bank will lose interest on $1000 for a few days,

The Anglo & London Paris National Bank
of San Francisco

TELEGRAPHIC TRANSFER

To be placed to the Order of

Address

At

For Acc't of

Amount - - $

Premium - $

Telegram - - $

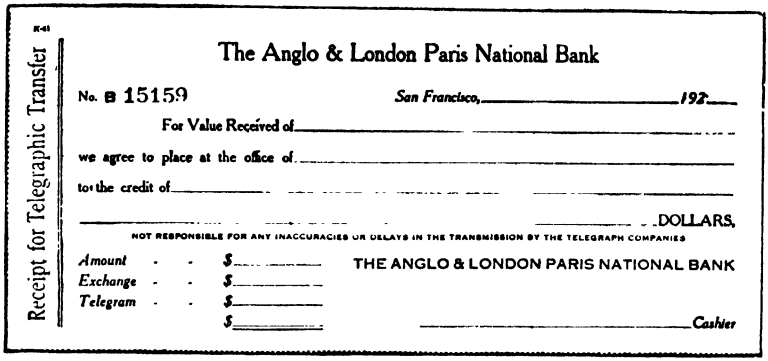
Total - - - $

San Francisco, 192.

Purchased by

No.

FIGURE 6
Application for bank telegraphic transfer



R-41

Receipt for Telegraphic Transfer

The Anglo & London Paris National Bank

No. B 15159 San Francisco, _____ 192__

For Value Received of _____

we agree to place at the office of _____

to the credit of _____

_____ DOLLARS,

NOT RESPONSIBLE FOR ANY INACCURACIES OR DELAYS IN THE TRANSMISSION BY THE TELEGRAPH COMPANIES

Amount - - $_____ THE ANGLO & LONDON PARIS NATIONAL BANK

Exchange - - $_____

Telegram - - $_____

$_____ _____ Cashier

FIGURE 7

Bank's receipt for telegraphic transfer

but such courtesies are usually granted by domestic banks to each other. The San Francisco bank will also mail an advice to the Boston bank notifying it of the details of the transaction. This is merely for confirmation and for the purpose of checking up on the transaction to see that it goes through satisfactorily. The Boston bank will in its turn forward an advice to the San Francisco bank informing the latter that it has followed the telegraphic instructions and has paid the sum of money to the party designated.

The charges for telegraphic transfers between banks vary with circumstances. In addition to the principal sum sent and the regular tolls of the telegraph company, the charges will include an "exchange" charge varying with conditions. If the sum sent is large, the rate per hundred dollars will be less than if it is small. Some banks charge $.50 per $100, others $.75. For large amounts it is not unusual for a bank to charge as low as $.04 a hundred. If the bank is "long" on funds in the payee's city and wants to transfer some of its money to its own vaults at home, it will sell telegraphic exchange, as well as other kinds of exchange, at lower rates than if the reverse condition existed. By selling exchange, it gets cash in hand, and loses that amount from its balance with the bank upon which the exchange has been sold. Suppose that a bank in Denver is running short of funds in its own vaults, or suppose that it has a chance to invest its money at home and receive a larger return upon it than it is receiving on its balance deposited with the Old Colonial Bank of New York. It will telephone to other local banks asking them if they are in the

market for telegraphic exchange on New York, and may find several which are short of funds in New York, but long on funds at home. To these, it will sell the necessary amount of telegraphic exchange, for cash. Then it has only to send a telegram to the Old Colonial Bank in New York, advising it to turn over to the New York banks designated by the buying Denver banks, the sums of money represented by the amounts of exchange sold. The Old Colonial of New York debits the account of the selling bank, and pays the sums requested to the designated New York banks for the account of the buying Denver banks.

The rates for telegraphic transfers are always higher than rates for other kinds of domestic exchange. If the customer sends a sight draft, the bank has the use of the money until its account with the bank upon which the draft has been drawn has been debited with the amount of the draft. But in the case of a telegraphic transfer, it takes only a few moments for the telegram to reach its destination, so that the bank gets practically no use of the customer's money, and consequently has to charge a higher rate for such kind of exchange.

With the introduction and extension of the Federal Reserve System, the activities of local banks in handling telegraphic transfers for large amounts have been greatly modified, in fact revolutionized. The change has come about through the use of the Gold Settlement Fund of the Reserve System for telegraphic transfer purposes. The Fund was established at Washington in May, 1915, by the Federal Reserve Board, and is operated directly under its supervision and by its appointees. Each Federal Reserve bank was required to deposit $1,000,000 gold or gold certificates with the Fund, to be used for the purpose of clearing obligations and items of one Federal Reserve bank upon another, thus making it unnecessary to ship gold, exchange, or money back and forth across the continent in the settlement of balances between the Federal Reserve banks. The Fund has increased rapidly since its establishment and on January 19, 1922, held a balance of $468,174,000 for the twelve Federal Reserve banks and their branches.[1] The regulations governing the operation of the Fund have been changed from time to time. At present clearings are made daily between Federal Reserve banks and sixteen out of their twenty-three branches by messages that are sent over their own leased wires.

[1] It is held by the Treasurer of the United States. It also constitutes part of the gold reserves of the Federal Reserve banks.

Every evening the Federal Reserve banks and their branches wire to the Fund stating the amounts due them from the other Federal Reserve banks and their branches. A settlement of obligations is effected merely by book entries, usually within an hour's time after the receipt of the information, and a telegram is then sent each Federal Reserve bank or branch advising it as to the extent of its favorable or unfavorable balance as a result of the day's clearings, and the balance which it has in the Fund.

The Federal Reserve Board early saw the possibility of using the Fund in connection with the telegraphing of money from one section of the country to another and introduced a system of telegraphic transfers. As a consequence the whole field of domestic exchange, as it formerly existed, has been revolutionized, especially in connection with the transference of large sums of money, even for banks that are not members of the Federal Reserve System. The plan that was adopted is based primarily upon the *Giro Conto* Transfer System of the Imperial Bank (*Reichsbank*) of Germany. The *Reichsbank* has branches in practically every important city in Germany. If a merchant having a deposit with the Hamburg branch of the *Reichsbank* wishes to pay a firm in Berlin, he merely requests the branch to debit his account for a certain sum and to transfer that amount to the credit of the Berlin firm on the books of the Berlin branch. This the bank does by mail free of charge, but if done by telegraph a small fee is charged. Transfers under the Federal Reserve System are made by telegraph only and are sent free of charge but only at the request of banks that are either "member" banks or "non-member clearing" banks. Member banks are those that are stockholders in the Federal Reserve bank of their district to whom all privileges of the Federal Reserve System are accorded. "Non-member clearing" banks are those that are not stockholders, but that maintain a balance with the Federal Reserve bank of their district so as to enjoy some of the advantages of the Federal Reserve System. They are allowed to have such privileges as sharing in the par-collection of checks,[1] the collection of non-cash items, the use of the telegraphic transfer system, etc. Then there are also those banks that are not members of the Federal Reserve System and that do not keep any balance with the Federal Reserve bank of their district, but which nevertheless agree to remit at par for checks on themselves forwarded to them by a Federal Re-

[1] Cf. pp. 39–44.

serve bank. Finally there are those non-member banks that are not even on the par-list. Only the first two groups of banks are allowed to share directly in the use of the Federal Reserve telegraphic transfer system, although indirectly, as we shall see, the others may use it by having a bank in either of the first two groups act for them. Inasmuch as the Federal Reserve banks hold only the accounts of banks, the transfers must be made by and through banks and not by or through individuals.

Today, if the San Francisco National Bank, a member of the Federal Reserve System, wishes to telegraph $1,000,000 to the National City Bank of New York, it may merely notify the Federal Reserve Bank of San Francisco to send the necessary wire. The Federal Reserve Bank of San Francisco deducts $1,000,000 from the account which the San Francisco National Bank has with it, making no charge for the service which it performs for the latter. It then sends a code message to the Federal Reserve Bank of New York, notifying that bank to pay $1,000,000 to the National City Bank for the credit of the San Francisco National Bank. The National City Bank, being a member of the Federal Reserve System, will have an account with the Federal Reserve Bank of New York and the latter pays the sum as requested by merely crediting the account of the National City Bank with that amount, and notifying the National City Bank that it has done so at the request of the San Francisco National Bank. The San Francisco National Bank thus has its account at the Federal Reserve Bank of San Francisco debited $1,000,000, while its account with the National City Bank is credited with a like sum. The claim of the Federal Reserve Bank of New York for $1,000,000 against the Federal Reserve Bank of San Francisco will b settled through the Gold Settlement Fund. Possibly on that same day, banks in the New York Federal Reserve district may telegraph $3,000,000 to banks in the San Francisco Federal Reserve district through the agency of the Federal Reserve banks, while the latter may forward $5,345,000 to the former in the same manner. The balance for the day is settled by wire through the agency of the Gold Settlement Fund at Washington in the manner already described.

Not only do the Federal Reserve banks supply telegraphic exchange for "member" banks and for "non-member clearing" banks, but they also afford the same service indirectly to the customers of those banks. If Stephens in Sacramento, California, desires to send

$5,000 to Reilly and Company in New York, whose bank is the National Bank of Commerce, he merely pays his local bank, if a member or a non-member clearing bank in the Federal Reserve System, $5,000 and requests it to make the transfer for him. The local bank then advises the Federal Reserve Bank of San Francisco, by wire, to debit its (the Sacramento bank's) account with $5,000 and to transfer that sum of money by telegraphic order to Reilly and Company through the National Bank of Commerce in New York. The Federal Reserve Bank of San Francisco wires the Federal Reserve Bank of New York to pay the sum to Reilly and Company through the National Bank of Commerce. The latter bank will be credited on the books of the Federal Reserve Bank of New York with the $5,000, and may receive that sum in actual funds or let it stand to its account. The National Bank of Commerce credits Reilly and Company with $5,000, and the latter likewise may either cash against that sum, or let it stand to their credit on the books of the National Bank of Commerce. If the banks make no charge to correspondents or customers, the Federal Reserve banks make no charge for the service rendered.

Another interesting angle of the situation is the possibility of a bank that is not a member of the Federal Reserve System, or a "non-member clearing " bank, or a customer of such a bank, securing this same service free of charge. This may be accomplished in the following manner: Let us say that the Emporium Department Store of San Francisco has an account with the Union Trust Company of that city. The latter is not a member of the Federal Reserve System, but has as its local agent, or is financially connected with, the Wells Fargo Nevada National Bank, which is a member of the Federal Reserve System. If the Emporium wishes to send $500,000 to Reilly and Company in New York and asks the Union Trust Company to do so for it, the Union Trust Company will request the Wells Fargo Nevada National Bank to put through the transaction just as though the Emporium were a customer of the Wells Fargo Nevada National Bank. The Emporium pays the Union Trust Company $500,000, by check or cash. The Union Trust Company may send cash, a check, or a draft for $500,000 to the Wells Fargo Nevada National Bank, either directly or through the clearing house. The Wells Fargo Nevada National Bank then requests the Federal Reserve Bank of San Francisco to forward $500,000 telegraphic exchange to the National

Bank of Commerce for the account of Reilly and Company. This would be done, as in the above example, through the Federal Reserve Bank of New York.

It is also possible for a member bank to telegraph funds to a non-member bank by means of this system. Let us say that the Wells Fargo Nevada National Bank of San Francisco wishes to remit $10,000 to the Milwaukee State Bank. It requests the Federal Reserve Bank of San Francisco to send the telegraphic transfer. The latter wires the Federal Reserve Bank in Chicago, which in turn notifies a member bank in Milwaukee, let us say, the First National Bank of Milwaukee, that $10,000 has been credited to it for the account of the Milwaukee State Bank. The First National Bank then turns over $10,000 to the Milwaukee State Bank. It should be noted, however, that the Federal Reserve banks will forward telegraphic transfers directly for member and "non-member clearing" banks acting either for themselves or for their customers, when the transfers are to be sent to or through member or "non-member clearing" banks. Banks that are neither members of the Federal Reserve System nor "non-member clearing" banks cannot transmit funds directly through the Federal Reserve banks, nor will any Federal Reserve bank accept transfers to be sent directly to them. They may, however, as we have seen, send transfers through member or "non-member clearing" banks, and on the other hand transfers may be sent to them only through such banks.

Thus far the Federal Reserve Board has left to the individual Federal Reserve bank the decision as to the minimum sum that will be transferred in the manner above described. One Federal Reserve bank has fixed the minimum amount for customers' telegraphic transfers at $1,000, another at $2,500. This rather high limit was decided upon in order to prevent the already crowded telegraph wires of the Federal Reserve System being swamped with an unlimited number of small $100 or $200 transfers for customers of member and "non-member clearing" banks. The Federal Reserve bank that has the $2,500 limit for customers' transfer, however, permits member and "non-member clearing" banks to send transfers for themselves, not for customers, for as low an amount as $1,000.

Some banks make use of the telegraphic transfer system of the Federal Reserve banks for the purpose of earning a day's interest on funds thus transferred. This is done as follows: Let us say that the

Fourth National Bank of San Francisco has payments of $1,000,000 to make to various firms in New York, either for its own account or for the accounts of its customers. It instructs the Federal Reserve Bank of San Francisco to wire that amount to the Chase National Bank of New York. The Federal Reserve Bank of San Francisco does so. At the same time the Fourth National Bank wires the Chase National Bank that a telegraphic transfer is being sent it through the Federal Reserve banks of San Francisco and New York, and that the sum is to be paid out in designated amounts to different parties. When the Federal Reserve Bank of New York notifies the Chase National that the latter has been credited with $1,000,000, it is, to the Chase National Bank, the equivalent of having $1,000,000 in its own vaults. It therefore proceeds to draw checks on itself (cashier's checks) and mails them to the parties designated by the Fourth National Bank of San Francisco. Or if the sums are to be paid to banks which are members of the Clearing House of New York, the checks will be sent to them that day through the Clearing House. The checks that are sent out by mail will be received by the customers possibly on that same day, but will be presented to the Chase National through the Clearing House the next day. Consequently the Chase National Bank will have the use of the $1,000,000 for a day. The account of the Fourth National Bank of San Francisco with the Chase National Bank will be credited with that sum and will receive a day's interest thereon (usually at the rate of about 2 per cent).

A bank sending a telegraphic transfer through the Federal Reserve banks to another bank usually itself wires the "advice" as to the amount, for whose account, etc., or it may send such an advice by mail. This is done for the purpose of confirmation, and to avoid any possible mistake or error.

Telegraphing money is safe, quick, and a very simple and effective method of transferring funds or making payments between distant communities. It is being more and more widely used by all classes of people and by financial institutions. In 1915 the Western Union forwarded $30,000,000 in this manner. No data are available as to the extent that banks employ telegraphic transfers either by means of the service afforded by the Federal Reserve banks or by the telegraph companies themselves.[1]

[1] Some idea of the extent of the total amount of telegraphic transfers sent in 1920 by

Checks. A person owing a sum of money to another in a distant city usually forwards his personal check for the amount. A check (Fig. 8) is an order upon a bank by a depositor requesting the bank to pay a certain sum of money on demand to the depositor himself, to the bank itself, or to a third party who is sometimes designated as the "bearer." Most frequently the check is made out to a third party "or order." The recipient of a check either deposits it at his own bank and receives actual cash or an addition to his deposit account, or he indorses it and passes it to another person who in his turn cashes it, or indorses it and passes it on to another. Ultimately, it is

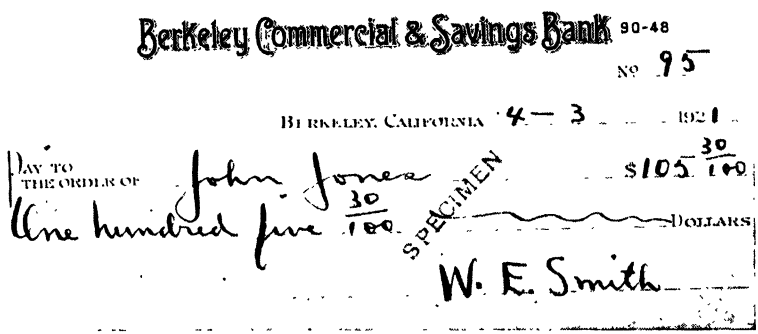


FIGURE 8
Bank check

presented to the bank upon which it has been drawn, is paid, the sum deducted from the account of the drawer, and the check cancelled and returned to the drawer.

The party who draws the check seldom appreciates or knows anything about the complicated machinery of banking relations that lies behind its collection. Until 1915 there was no system of national extent nor was there a central directing force or scheme to be found in connection with the collection of checks. A check might wander

the Federal Reserve banks may be gained from the following data covering only five of those institutions:

	Items	*Amount*
New York	147,302	$17,021,509,734
Philadelphia	9,832	625,338,000
Richmond	21,836	1,246,861,158
St. Louis	32,068	1,225,250,058
San Francisco	29,291	3,043,193,000

over the greater part of the United States before reaching the bank upon which it had been drawn. Jones in Chicago, for instance, might draw a check on the Commercial National Bank of that city and forward it to Smith in Los Angeles. Smith would cash it at his bank, but not at its face value. The bank would make what was called an "exchange charge," varying from five cents to twenty-five cents, for its services in connection with the collection of the check. The Los Angeles bank might then send the check to the New Orleans State Bank for the purpose either of building up its account with that bank or of settling some obligation which it owed that bank. The New Orleans bank might then forward the check to the Liberty Trust Company of New York for similar reasons. The Liberty Trust Company might send it to the Plymouth National Bank of Boston, which in its turn might forward it to a bank in Minneapolis, and so on, the check passing through a number of other banks until it would be returned finally to the Chicago Commercial National Bank. The check might be out on the road, in "float" as it is called, for several weeks. It might crisscross back and forth across its own path several times. Each bank would make an exchange charge for the costs of bookkeeping, handling, mailing, etc. Any day ten banks in a city might have a large number of items on the same banks in other cities and send them out along any number of separate paths for collection. Merchants were harassed by the collection charges imposed by banks for the cashing of these so-called "country" or out-of-town checks, losing from five to twenty-five cents on the face value of each check. Outside of the establishment of a few "country" or "regional clearing houses" for the more economical and efficient collection of such items, nothing had been done up to 1915 to remedy the situation. These regional clearing houses, which had been established at Boston, Kansas City, and a small number of other cities, had reduced the time of collection about 25 per cent and had saved their members about 50 per cent in the expense of handling such checks. But most banks were not willing to join in the organization of regional clearing houses, and as a consequence the antiquated system of collecting checks, in spite of its deficiencies and shortcomings, remained practically unchanged until 1915.

When the Federal Reserve law was passed in 1913 it contained a provision (Section 16) to the effect that the Federal Reserve banks, if directed by the Federal Reserve Board, were to act as clearing houses

for the collection of checks for their members, while the Federal Reserve Board itself was authorized to act as a clearing house for the Federal Reserve banks or to require one of the Federal Reserve banks to act for it in that capacity. The Federal Reserve Board considered this to be one of the most important responsibilities with which it was charged under the Act and early began to prepare a series of regulations designed to carry out the provisions of the law. First of all, in May, 1915, it established the "Gold Settlement Fund" as above described.[1] Next, in order to educate the bankers of the country to appreciate the advantages of the par collection of country checks, the Federal Reserve Board in 1915 authorized the Federal Reserve banks to establish a voluntary check collection system. The scheme did not work out satisfactorily, chiefly because it was a voluntary system and few banks joined in it, so on July 15, 1916, the Federal Reserve Board inaugurated a compulsory par collection system. The essence of the plan was that all member banks should pay the checks drawn on them, when presented by a Federal Reserve bank, without deducting any exchange charge, i. e., they were to remit the full face value of the check to the Federal Reserve bank which presented the check for payment. Member banks were still allowed to send checks through the old channels if they desired, and to make such charges as they wished, but not to exceed ten cents on the $100; but if checks were sent through the Federal Reserve banks for collection, no such deductions could be made. To make the system effective it was necessary to induce or compel the non-member banks to enter the check collection system either as "non-member clearing" banks or as banks that would agree to remit at par. As we have seen in the last section, they did not have to become stockholding members of the Federal Reserve System to be a part of the par collection system. As "non-member clearing" banks they kept funds or balances with the Federal Reserve bank of their district, while as "par list" banks they agreed only to remit at par, i. e., to make no exchange charge, for all checks presented to them for payment through the mails or otherwise by the Federal Reserve bank of their district.

Great opposition was shown by many of the member banks, and especially by the non-member state banks. However, when a member bank in a city, compelled as it was by the rules of the Federal Reserve Board, remitted for its checks at par, other banks who were non-mem-

[1] Cf. pp. 32–33.

bers immediately found their checks at a disadvantage in the local market. Also, again and again, when a non-member bank refused to remit at par, the Federal Reserve bank presented the check to the bank through an express company or some other agency and compelled it to pay the same at par over its counter, even though the costs to the Federal Reserve bank in pursuing this method of collection were at times greatly in excess of the small collection or exchange charge that would have been made by the non-member bank. The par collection system spread rapidly, however, and on January 1, 1922, included all but about 2,000 banks in the United States.[1] The magnitude of the operations of the Federal Reserve banks in this connection is shown by the fact that, in 1921, 522,665,000 items, totalling $118,844,391,000, were collected through this agency.

Charges varying from 1 to 1½¢ per item, imposed by the Federal Reserve banks during the first few years, were abolished in 1918, and all checks and drafts are now collected free of charge when passed through the par collection system. In June, 1920, the Federal Reserve banks also established a collection department for the collection of maturing notes, bills, and other collection items. Credit is given only when these items have actually been paid. The Federal Reserve banks impose no charge for the collection of the latter group of items except to cover any "collection charges made by the collecting bank and for registration, insurance or express charges on negotiable securities (coupons, etc.) payable out of the Federal Reserve city." [2]

The Federal Reserve banks and their branches have in this way become a great collecting agency for the systematic and efficient handling of the collection of checks, drafts, and other similar items. By means of the arrangements provided it is possible for banks to build up their accounts with the Federal Reserve bank of their district, to shift funds about the country as desired, to collect moneys owing them in a minimum of time, to say nothing of the various other services provided, and all this is performed free of charge, except in the case of the collection of maturing notes, bills, and similar collection items, which is done at cost.

The par collection system gives immediate credit to the depositing bank on all items deposited, but the proceeds do not become available for the use of the depositing bank until actually collected or until a

[1] There were about 31,000 banks in the United States on that date.
[2] Circular 101, Federal Reserve Bank of San Francisco.

certain number of days have elapsed if perchance the item has not actually been collected by that time. Each Federal Reserve bank or branch has an "Availability Schedule" which fixes the number of

AVAILABILITY SCHEDULE FOR DEPOSIT OF CHECKS AND DRAFTS WITH SEATTLE BRANCH, FEDERAL RESERVE BANK OF SAN FRANCISCO

For Availability Schedule of Items "Direct Routed" to other offices of this bank, see their respective schedules.

SUBJECT TO FOLLOWING AVAILABILITY	DEPOSITED IN SEATTLE ON				
	12TH DISTRICT				OTHER DISTRICTS
Immediate	Seattle United States Treasury Warrants Drafts on Federal Reserve Bank of San Francisco—Head Office and Branches				
1 Day....	Portland, Spokane				
2 Days...	Washington—Seattle Zone, excepting places noted in 3-day division				
3 Days...	Salt Lake City, San Francisco Washington—Seattle Zone, the following places: Black Diamond, Raymond, South Bend, Wilkeson, Langley, Snoqualmie, Toledo				
4 Days...	Los Angeles Oregon—Country Washington—Portland Zone Washington—Spokane Zone				Chicago Denver Kansas City Minneapolis Omaha St. Louis
5 Days...	Idaho	Atlanta Baltimore Birmingham Boston Buffalo	Cleveland Cincinnati Dallas Detroit El Paso	Little Rock Louisville Nashville New York City New Orleans	Memphis Philadelphia Pittsburgh Richmond
6 Days...	California—Country Nevada Utah—Country	Houston Jacksonville	Illinois Indiana Iowa	Michigan Minnesota	Missouri Wisconsin
7 Days...	Arizona—12th District	Arkansas Colorado Connecticut Delaware Kansas Kentucky Maine	Maryland Massachusetts Montana Nebraska New Hampshire New Jersey	New Mexico—10th District N. Y. State North Dakota Ohio Oklahoma Pennsylvania	Rhode Island South Dakota Tennessee Vermont Virginia Wyoming
8 Days...		Alabama Arizona—11th District	Georgia Louisiana Mississippi	New Mexico—11th District N. Carolina	S. Carolina Texas West Virginia
9 Days...		Florida			

FIGURE 9

Availability schedule for Seattle branch Federal Reserve Bank of San Francisco

days that must elapse before the items deposited are available for use by the depositing bank. The following schedule (Fig. 9) of the Seattle branch of the Federal Reserve Bank of San Francisco is typical of lists issued by Federal Reserve banks and their branches.

If, for instance, the Tacoma National Bank deposits with the Seattle branch a check for $500 on a Los Angeles bank, the funds that the check represents become available for the use of the depositing bank on the fourth day, no matter whether or not the check has actually been paid by the Los Angeles bank. If the check is on the First National Bank of Jacksonville, Florida, the funds become available after nine days have elapsed. In the case of the Florida check, the method of procedure would be somewhat as follows: The check would be deposited with the Seattle branch of the Federal Reserve Bank of San Francisco, which would enter on the account of the Tacoma National Bank a deferred credit of $500 to become available nine days hence. The Seattle branch would then send the check to the Federal Reserve Bank of Atlanta, which would credit it with that sum. The Atlanta institution would then forward the check to the Jacksonville bank. The Jacksonville bank would remit $500 in gold or paper money other than National Bank notes to the Federal Reserve Bank of Atlanta, the costs of the shipment being borne by the Federal Reserve Bank of Atlanta. The Federal Reserve Bank of San Francisco, being the head office of the Seattle branch, would have $500 coming to it from the Atlanta Reserve Bank and its claim would be cleared through the agency of the Gold Settlement Fund without the necessity of shipping any exchange, gold, or money from Atlanta to San Francisco. All branches of a Federal Reserve bank transact their business in the name of the head office.

If, in order to save time, banks in the clearing system desire to send their items for collection direct to a Federal Reserve bank or its branch located outside of the district in which the banks are located they may be authorized to do so and may receive credit at the office of the Federal Reserve bank with which they are affiliated, but ordinarily they will clear checks and other items directly through the Federal Reserve bank of their district.

The par collection system, therefore, has made the check a much more useful means of payment than ever before. It has saved time, labor, and much expense. Each bank now sorts its items according to banks and cities and reserve districts. These bundles of checks flow into the Federal Reserve bank of the district, which gathers all the checks on one bank into one package, and all the checks on banks in one district into a still larger package. The checks that are to be cleared through the Federal Reserve Bank of Chicago go to that

institution; those that are to be cleared through the Federal Reserve Bank of New York go there—the idea being to collect items directly and with the least expenditure of time, expense, and energy. As noted above, the balancing of credits and debits between the various Federal Reserve banks that arise in this and in other connections is made through the Gold Settlement Fund at Washington.

The results of the clearings and collections obtained thus far through the activities of the Fund have been truly surprising, while the costs have been extremely slight. Combined clearings and transfers through the Fund during the year 1921 aggregated $68,223,882,000 as compared with $92,625,805,000 for 1920, $73,984,252,000 for 1919, $50,251,592,000 in 1918, $27,154,704,000 in 1917, $5,533,966,000 in 1916, and $1,052,649,000 in 1915, making a grand total of $318,826,850,000 since the inception of the Fund on May 20, 1915. "When it is considered that these enormous transfers are made almost instantly by means of the leased wire system without involving the physical movement of a dollar, it will be seen that that arrangement has been of incalculable value to the Government, the banks and the public." [1] The total expense of operations for 1921, including the entire cost of the leased wires and salaries of accountants, was approximately $485,000. This represents the basic cost of effecting domestic exchanges between the several Federal Reserve districts. A charge of 10 cents per $100, if generally imposed, would have involved an expense to the Treasury and the commerce of the country of $68,223,000 for the transfers made during 1921.

The large sums representing the combined transfers and clearings effected through the Gold Settlement Fund, averaging about $1,500,000,000 weekly, have been due to the heavy movements of funds by the Government (the Federal Reserve banks now being authorized to act as the fiscal agents of the Government because the subtreasuries have been abolished), and to large transfers for the accounts of member banks in connection with telegraphic exchange, the collection of country checks, and other items.

Bank Drafts. The existence of the Gold Settlement Fund also makes it possible for the Federal Reserve banks greatly to simplify the means by which member banks in any part of the country may provide themselves with "New York exchange," to be availed of by

[1] Annual Report of the Federal Reserve Board, 1920, p. 71.

drafts on their accounts with New York banks whenever desired either for their own needs or for those of their local customers.

Bank drafts on New York still bulk very large in domestic exchange transactions, although they are by no means so important as before the introduction of the Federal Reserve System of telegraphic transfers and the par collection of checks. They are still used for small sums up to $1,000 or more by customers of member banks and of course for even larger sums by customers of non-member banks unless the latter have an arrangement with a member bank or a non-member clearing bank whereby telegraphic transfers may be procured through a Federal Reserve bank.

It is not strange that New York exchange should still be the most important kind of domestic exchange remitted by mail. New York is the financial center of the United States. Banks all over the country have either direct or indirect connection with financial institutions in that city. There is also some Chicago, St. Louis, and San Francisco domestic exchange (bank drafts on those centers) demanded by customers, but the great bulk of bank draft exchange is on New York. If a man in Seattle wishes to pay a bill in Chicago, his bank will sell him a draft on its account with a New York bank. If a man in Denver wishes to pay a bill in Mobile, or Los Angeles, or Boston, it is more than likely that his local bank will provide him with a draft on its account with a New York bank. The reason for this is simply that all banks have a continual demand for exchange of some sort or other on New York. They must build up their accounts in that city with which to meet this demand. When a customer deposits a draft on a New York bank, the local bank sends it on to be collected and credited to its New York account. The demand for New York exchange in connection with domestic financial affairs is as widespread as is the demand for exchange on London in the field of international financial operations.

If Baker in San Francisco has purchased $1,000 worth of goods from Foster in Boston, he goes to his local bank, say, the First National Bank, and asks it for a bank draft for that sum on its New York correspondent, say, the Chase National Bank. The San Francisco bank builds up its account by sending various items to the Chase National Bank for collection. These items may be on New York firms or banks, or on firms or banks located elsewhere in the East. The First National Bank is a member of the Federal Reserve System, and

may also at any time replenish its account by having the Federal Reserve Bank of San Francisco telegraph the needed funds to its correspondent in New York in the manner described above.[1]

As will be noted from the accompanying bank draft (Fig. 10), the name of the remitter does not appear on its face. A bank draft is merely an order from one bank to another requesting the latter to pay a certain sum to a third party and to debit or charge the account of the drawing bank which is on deposit with the paying bank. If the drawing bank does not have sufficient funds on deposit with the paying bank at the time when it draws the draft, it is necessary for it to

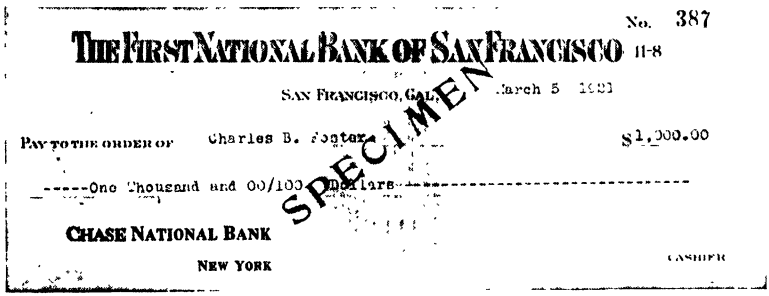


FIGURE 10
Bank draft

provide such funds by remitting telegraphic or other exchange to meet the payment of the draft when it is presented.

The First National Bank will provide Baker with a draft on the Chase National Bank for $1,000. Whether it will charge him more than $1,000 for the draft, i. e., whether it will make an "exchange" charge, depends upon certain circumstances which will be discussed later.[2] Baker mails the draft to Foster, his creditor, in New York. Foster deposits it to his account in his local bank, let us say, in the Irving National Bank. The Irving National Bank collects it from the Chase National Bank through the clearing house or by messenger. The Chase National Bank deducts the amount of the draft from the account of the First National Bank on deposit with it and sends an advice thereof to the latter.

In connection with the issuance of such drafts, several technical

[1] Cf. pp. 34–37.

[2] Cf. p. 48.

terms arise that must be kept clearly in mind throughout our subsequent discussion, because we shall use them constantly. The party that draws the draft, in the above case the First National Bank, is known as the "drawer"; the party upon whom the draft is drawn, in this case the Chase National Bank, is known as the "drawee"; the party to whom the draft is made payable, in this case Foster of New York, is the "payee"; the party that pays the draft, i. e., the Chase National Bank, is the "payer."

The essential difference between a check and a bank draft is that the former is an order of an individual or firm, not a bank, to a bank ordering the latter to pay a certain sum of money to a third party from the account of the party that drew the check. A bank draft is an order drawn by a bank on another bank ordering the latter to pay a certain sum of money to a third party out of the account of the drawing bank.

Sometimes banks make arrangements whereby they are permitted to draw directly upon a New York bank even though they have no account with the latter, the agreement being that the drawing bank shall remit immediately to cover the amount of the drafts issued.

Up to the time of the inauguration of the telegraphic transfer system of the Federal Reserve banks, rates of domestic exchange, telegraphic and mail, were quoted as commonly as foreign exchange rates are quoted today. The following is typical of the weekly announcements that formerly appeared in the *Annalist* of New York:

DOMESTIC EXCHANGE RATES

> The week's range of exchange on New York at Chicago last week was from 25c @ 10c discount, closing at the former; at Boston it stood at par all week; at St. Louis it was 25c @ 15c discount, closing at the former, and at San Francisco it was 30c premium all week.

According to this announcement, Chicago banks apparently had a considerable supply of funds in New York which they were willing to dispose of by means of New York drafts at from $.10 to $.25 discount on $1,000. In Boston the supply of exchange on New York about balanced the demand for such exchange, so that the Boston banks were willing to sell it at par, making no charge and taking no discount. In San Francisco, however, the demand for New York exchange was heavy and the banks were having a hard time to get an adequate amount, so they were charging $.30 premium, i. e., a New

York draft for $1,000 would cost $1,000.30. Frequently the rates would be published as "Domestic exchange [meaning on New York] 2¢ premium regular," [1] which would signify that a draft on New York would be charged at the rate of $.02 per $100. It was not unusual to charge a sliding rate which would decrease with larger amounts, e. g., 5¢ up to $25, 10¢ for $25 to $100, 50¢ per $1,000, etc.

The basic rates of domestic exchange used to vary from day to day, and would experience the same general tendencies in their swing upward or downward as foreign exchange rates, depending in general upon the same factors that influence foreign exchange rates. In the late summer and fall of the year when the West was shipping the East a large amount of goods, countless drafts would be drawn on eastern consignees, thus creating a large supply of exchange and consequently tending to weaken exchange rates on New York and other eastern centers. In the spring and early summer the West would be buying more heavily from the East, and exchange rates would then tend to rise. As is true also in the field of foreign exchange,[2] the limits within which domestic rates on New York would fluctuate were determined by the cost of shipping gold. It cost normally about $.50 to ship $1,000 in gold from New York to Chicago, $.60 to St. Louis, $.75 to New Orleans, and $1.50 to San Francisco. If a banker in Chicago had to pay more than $1,000.50 for a $1,000 draft on New York, he preferred to ship gold instead of purchasing a bank draft because he could do so at a profit. Likewise if a shipper in Chicago had to accept less than $999.50 for his drafts on New York consignees, he preferred to send his bill to New York for collection and to have gold or currency sent him. If Chicago banks were forced to sell bank drafts on New York for less than $999.50, it would pay them to have gold shipped to them from New York.

The old system and the old methods were revolutionized by the practices inaugurated by the Federal Reserve System. Today the applicant for New York drafts is usually not charged any exchange for the service that is accorded. But if he asks for too large an amount, or if he is a stranger at the bank, or if he asks daily for a large number of drafts on New York, the bank may make what it calls a "service charge," usually rather small in amount. Domestic exchange rates no

[1] Drafts on New York banks were called "regular exchange" so as to differentiate them from "telegraphic exchange."

[2] Cf. Chapter XI, Gold and Gold Movements.

longer fluctuate as they used to, nor do banks ship gold from one to another. Gold is transferred through the Federal Reserve banks without charge. If a San Francisco bank desires to pay $100,000 in gold to a New York bank, it may send the gold to the Federal Reserve Bank of San Francisco, charges collect. The latter then wires the Federal Reserve Bank of New York to pay out that sum in gold to the designated New York bank. No charges for this sort of service are made to member banks or to non-member clearing banks.

It is not possible for all banks to keep accounts with correspondents in New York. Arrangements are therefore made with banks that do keep such accounts whereby banks without correspondents are authorized to draw drafts on New York by means of a system of "advices." If the State Bank of Madison, Wisconsin, has made arrangements with the Chicago Commercial Bank to draw on the latter's New York correspondent, say the Chase National Bank, it can sell a draft to its customer on the Chase National Bank, drawing the draft on blanks furnished by the Chicago bank. The drafts bear the monogram or mark of identification of the Chicago bank, so that the Chase National Bank knows through which one of its correspondents the draft has been drawn. An advice is sent by the Madison bank to the Chicago bank notifying it of the sale, to whom payable, the amount, date, etc. The latter then debits the account of the Madison bank and sends an advice to the Chase National Bank. When the draft reaches the Chase National Bank either over the counter or through the clearing house of New York, it is paid and the amount deducted from the account of the Chicago Commercial Bank.

Traveler's Check. All the forms of domestic exchange discussed in previous pages deal with a situation in which the debtor stays at home and forwards exchange with which to meet his obligations. But if he were traveling from place to place and desired to have available the wherewithal to pay bills as he goes, it would not be advisable for him to carry cash. To carry cash, either metal or paper, in large amounts is bothersome and extremely risky. As long ago as 1891 the American Express Company devised a most satisfactory substitute, viz., the "traveler's cheque" or the "traveler's check." Other express companies followed the example of the American Express Company, until with their amalgamation into the American Railway Express Company all express offices now issue only the American Express Company's traveler's checks. Somewhat later,

the Bankers' Trust Company of New York obtained permission from the American Bankers' Association to issue what are known as the "A. B.A. Cheques" to any bank that desired them for the accommodation of its customers. Subsequently several other large banks in New York notified their correspondents that they too would issue traveler's checks under conditions similar to those of the Bankers' Trust Company. At present traveler's checks may be obtained from practically any bank and from all express company offices in the United States as well as from many hotels, stores, etc.

Traveler's checks may be issued in terms of dollars or in terms of

FIGURE 11

Book of traveler's checks

both dollars and the more commonly demanded foreign moneys, such as sterling, francs, etc. Before 1914 the latter was the more customary form, and when foreign exchange rates again return to normal it will undoubtedly come back into general use. The World War, with its wide fluctuations in the exchange rates on foreign countries, brought into existence a form of traveler's check payable in the United States and Canada in dollars and in foreign countries in terms of foreign money at the banker's selling rate for sight drafts on New York. In the present section we shall confine ourselves to a description of the traveler's check as employed in domestic travel.

Say that the traveler goes to his bank or to the express company office and asks for a book of traveler's checks (Fig. 11) amounting

in all to $1,000. He may have them in various combinations of denominations, inasmuch as they are issued in denominations of $10, $20, $50, $100, and $200. The printed blanks are supplied the agent by the main office of the express company, the Bankers' Trust Company, or the issuing New York bank. The clerk fills out the blanks, each one of which has been numbered before being sent out by the issuing office. The clerk, or one of the officials of the bank, signs his name in the lower right-hand corner of the check. The purchaser signs his name in the upper left-hand corner. The clerk then collects $1,000 from the purchaser plus a commission of $.75 per $100 or $1,007.50 in all. The selling bank or hotel retains two-thirds of the commission ($5.00) and remits the principal ($1,000) plus the remaining one-third of the commission ($2.50) to the issuing company. The purchaser takes his book of checks and departs. When he wishes to cash one of the checks, he presents it at a hotel, bank, express company, or store, and usually has no difficulty in cashing it. To make the check negotiable, he merely signs his name in the lower left-hand corner of the check. The party cashing the check compares the signature at the top of the check with the one at the bottom and if they are the same, the money is paid to the traveler. This method of identification obtains the world over.

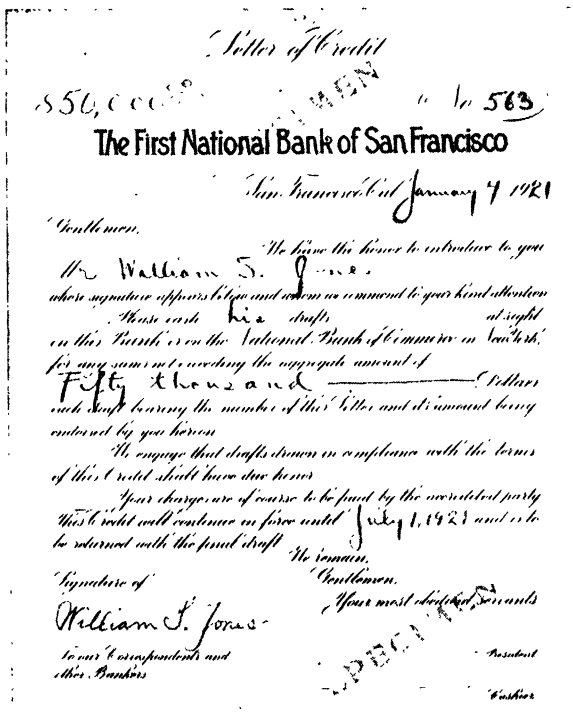
A.B.A. traveler's checks are sold only by banks, but the American Express Company traveler's checks may be purchased at hotels, stores, express offices, banks, etc., under the same conditions and terms as hold in the case of the A.B.A. checks. The American Express Company and the large New York banks that issue traveler's checks give the selling agent the greater portion of the commission because they get the use of the principal until the checks are finally paid by them. In some extreme cases this has meant the use of the principal for ten or twenty years, but usually for several weeks or months.[1]

The advantages of traveler's checks are many. They are issued in a neat leather folder convenient to carry. They are easily cashed and do not require the identification necessary in case of personal checks or drafts. They are cashed for their face value, no discount being charged. If lost, the traveler gives due notice to the bank or express company upon which they have been drawn, and after he signs

[1] During the Yukon gold rush in the 90's a large number of the gold seekers took traveler's checks with them. Many were cashed years afterwards, and some have not yet been cashed.

certain protective forms, his money is refunded. Notices are then sent out cautioning all parties not to cash the lost or stolen traveler's checks, which can be identified both by their number and by the signature of the traveler. They cannot be cashed unless properly countersigned, and few forgers are able to execute another person's signature in the presence of the cashing agent. It is not necessary to cash them at a bank. This is a decided advantage because banks are open only during certain hours of the day and only on banking days, while the traveler sometimes needs funds on a holiday or when in a small town which has no bank.

Travelers' or Circular Letters of Credit. Domestic travelers' letters of credit, frequently known as "circular" letters of credit, are also used by those who travel, but are more commonly employed where



Letter of Credit

No. 563

The First National Bank of San Francisco

San Francisco, Cal. January 7 1921

Gentlemen,

We have the honor to introduce to you Mr. William S. Jones whose signature appears below and whom we commend to your kind attention.

Please cash his drafts at sight on this Bank or on the National Bank of Commerce in New York for any sums not exceeding the aggregate amount of Fifty thousand ——— Dollars each draft bearing the number of this Letter and this amount being endorsed by you hereon.

We engage that drafts drawn in compliance with the terms of this Credit shall have due honor.

Your charges are of course to be paid by the accredited party.

This Credit will continue in force until July 1, 1921 and is to be returned with the final draft.

We remain,

Gentlemen,

Your most obedient Servants

Signature of

William S. Jones

To our Correspondents and other Bankers

President

Cashier

FIGURE 12

Front page domestic circular letter of credit

the traveler wishes to carry a large purchasing power which may be required for needs other than the costs of traveling, such as the purchase of supplies, stocks of goods, etc. They are issued by banks, exchange dealers, and express companies.

Let us say that Jones of San Francisco is to take a three months' trip during which time he is to make a number of purchases for his

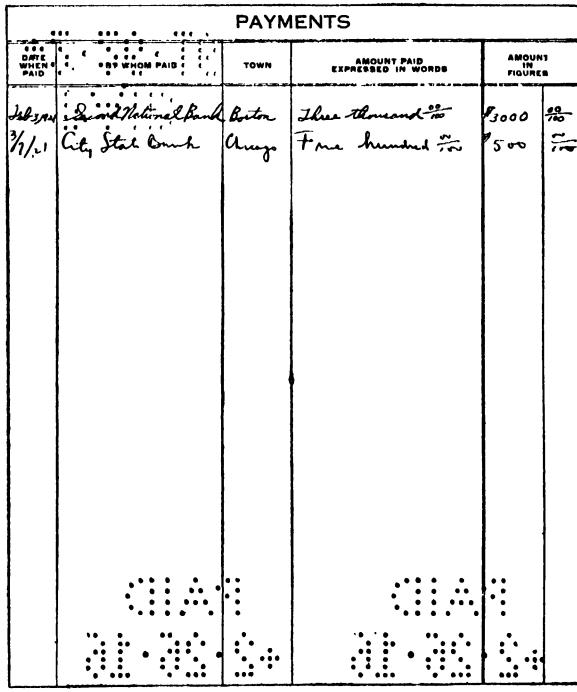


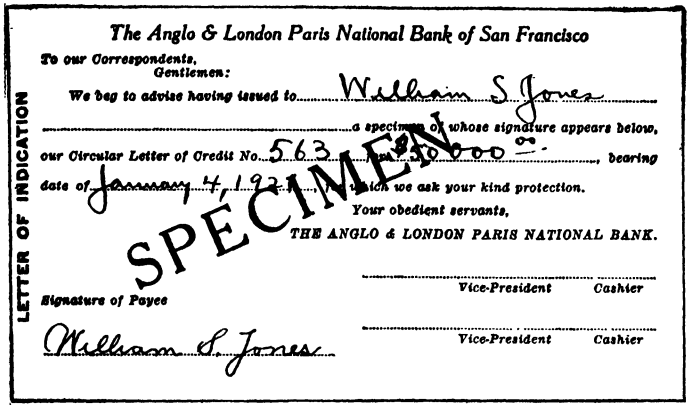
FIGURE 13

Second page domestic circular letter of credit

store. He must be provided with a safe and convenient means of carrying $50,000. His bank, the First National Bank, recommends a traveler's letter of credit because traveler's checks for that amount would make a rather bulky package. The bank clerk fills out a traveler's letter of credit for $50,000, dates it, gives it a number, and also writes in the date on which it is to expire, say three months hence (Fig. 12). Jones signs his name in the lower left-hand corner of the

page or on the front page of a small pamphlet known as a "letter of indication" [1] (Fig. 14).

The proper officials of the bank sign their names to the letter of credit and Jones is prepared for his trip. A small pamphlet is also given him containing a list of the correspondents of the issuing bank located in all parts of the country (and also, frequently, in foreign


LETTER OF INDICATION

The Anglo & London Paris National Bank of San Francisco

To our Correspondents,
Gentlemen:

We beg to advise having issued to William S. Jones

a specimen of whose signature appears below,

our Circular Letter of Credit No. 563 *for* $ 1,000.00 *, bearing*

date of January 4, 1921 *which we ask your kind protection.*

Your obedient servants,

THE ANGLO & LONDON PARIS NATIONAL BANK.

SPECIMEN

Vice-President *Cashier*

Signature of Payee

William S. Jones

Vice-President *Cashier*

FIGURE 14
Letter of indication

countries) at which Jones may cash drafts drawn under his letter of credit.

The letter of credit itself is a four page document, usually 8½ x 10½ inches in size. Printing appears only on the first two pages. The first page is a printed communication addressed to the correspondents of the bank, requesting them to honor the drafts of Mr. Jones when drawn in accordance with the terms of the credit. When Jones is in need of funds, he looks in the book of correspondents to see what bank in the city in which he is staying is a correspondent of his home

[1] Banks pursue different policies in connection with this matter. Some banks issue traveler's letters of credit with the signature of the traveler appearing on the letter itself Other banks do not have the traveler sign the letter but furnish him with a letter of indication on the first page of which he signs his name. The traveler is advised to carry the letter of credit and the letter of indication in separate pieces of his luggage so that if one is lost the other will not be, thus guarding a little more securely against the possibility of forgery It usually happens, however, that the traveler carries both in the same place, so that really nothing is gained by the latter method. The letter of indication almost always is in the form of a pamphlet and, with the exception of the first page upon which the traveler's signature appears, contains a list of the bank's correspondents.

bank (Fig. 15). He then presents himself and his letter at the exchange window of that bank and states that he desires to draw $3,000 against his letter. The clerk looks over the letter and compares it with the set of blank forms which the issuing bank has furnished his bank at the time when correspondent relations were established. If the letter is in the proper form, he compares the signatures of the bank's officers appearing on Jones' letter with their signatures appearing on a "signature sheet" which the issuing bank has also forwarded to all of its correspondents (Fig. 16). When new officials of the issuing bank are appointed, or when a new style of form is adopted, new signature sheets and copies of the new forms must be sent to all the correspondents. If everything seems to be satisfactory, the clerk draws a draft on the First National Bank of San Francisco for $3,000 and on the draft states that it is being "Drawn under Letter of Credit No. 563" (the number of the letter of credit which has been issued to Jones). He then passes the draft to Jones to sign. Jones signs the draft and hands it back to the clerk. The clerk compares Jones' signature on the draft with his signature on the letter of credit or in his letter of indication, and if they are identical, cashes the draft, handing Jones $3,000 minus any charge that the correspondent bank may make for rendering such service. Frequently no commission

LIST OF CORRESPONDENTS

UNITED STATES OF AMERICA

INDIANA

EVANSVILLE	Old State National Bank.
FORT WAYNE	First and Hamilton National Bank.
INDIANAPOLIS	Indiana National Bank.
LA FAYETTE	First-Merchants National Bank.
SOUTH BEND	First National Bank.
TERRE HAUTE	McKeen National Bank.

IOWA

BURLINGTON	National State Bank.
CEDAR RAPIDS	Cedar Rapids National Bank.
DES MOINES	Iowa National Bank.
SIOUX CITY	Security National Bank.

KANSAS

LEAVENWORTH	Leavenworth National Bank.
TOPEKA	Bank of Topeka.
WICHITA	Kansas National Bank.

KENTUCKY

COVINGTON	First National Bank.
FRANKFORT	National Branch Bank of Kentucky.
LEXINGTON	First and City National Bank.
LOUISVILLE	American Southern National Bank.

LOUISIANA

BATON ROUGE	Louisiana National Bank.
NEW ORLEANS	Citizens Bank & Trust Co. of Louisiana; New Orleans National Bank.
SHREVEPORT	First National Bank.

MAINE

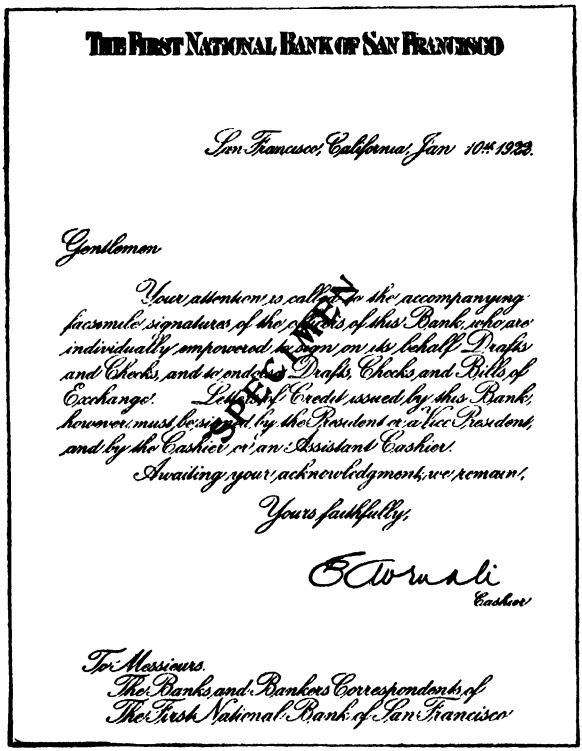
AUGUSTA	First National Granite Bank.
BAR HARBOR	First National Bank.
BATH	First National Bank.
PORTLAND	Portland National Bank.

MARYLAND

ANNAPOLIS	Farmers National Bank.
BALTIMORE	Farmers & Merchants National Bank

FIGURE 15
Part of correspondent list

will be charged, and where charged it is usually of small amount. When the clerk cashes the draft he enters on the second page of the letter the amount, the date, by what bank it was cashed, and hands the letter to Jones. The paying bank then sends the draft to the First National Bank of San Francisco through the Federal Reserve check



THE FIRST NATIONAL BANK OF SAN FRANCISCO

San Francisco, California, Jan 10th 1922.

Gentlemen

Your attention is called to the accompanying facsimile signatures of the officers of this Bank, who are individually empowered to sign, on its behalf, Drafts and Checks, and to endorse Drafts, Checks and Bills of Exchange. Letters of Credit issued by this Bank, however, must be signed by the President or a Vice President and by the Cashier or an Assistant Cashier.

Awaiting your acknowledgment, we remain,

Yours faithfully,

Cashier

To Messieurs.
The Banks and Bankers Correspondents of
The First National Bank of San Francisco

SPECIMEN

FIGURE 16

First page of bank's signature sheet

collection system or in any other manner that it may desire. If Jones uses up all of his $50,000, the letter of credit is attached to the draft that exhausts the credit and both are returned to the First National Bank.

Large banks issue their own travelers' letters of credit, while smaller banks which are not so well known and which cannot afford to establish a list of correspondents throughout the country make arrangements

with the former whereby they may issue letters of credit on them. The small bank will be furnished with all the necessary blanks, together with a set of regulations and directions governing the issuance of such letters of credit. The blanks will bear the name of the smaller bank, but the letter itself will contain instructions to the correspondents that the drafts are to be drawn on the larger bank. When the

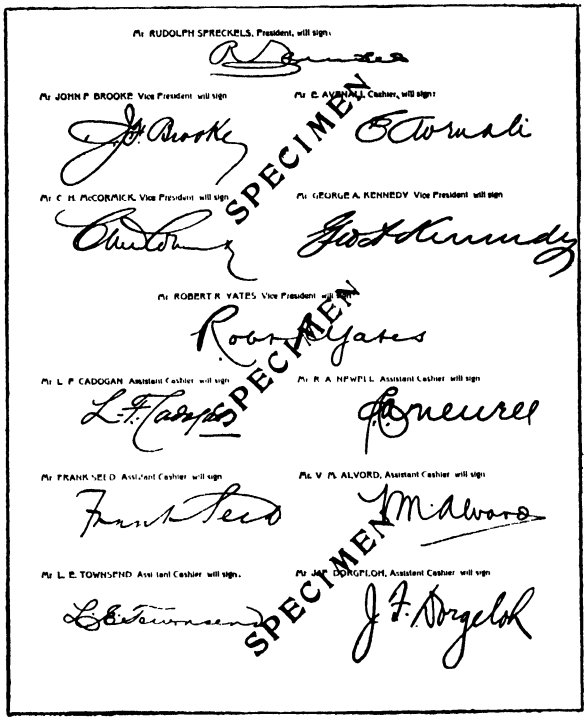


FIGURE 17

Second page of bank's signature sheet

smaller bank issues the circular letter of credit, it notifies the larger bank of that fact and informs it of the amount, the person to whom issued, the date of expiration, and the number of the credit. As the drafts are drawn against the letter by the traveler, they are sent to the larger bank, which deducts the amounts for which they have been drawn from the account of the smaller bank and advises it to that effect.

The charges made by the issuing bank to the customer vary accord-

ing to circumstances. If the traveler is a depositor of the bank, and gets a letter of credit for a rather large amount, paying for it in advance, he may obtain it free of charge, because the bank will have the use of the money, which he pays for it, during the time that the letter is in effect; or he may have to pay a commission varying from 1/8 per cent to 1/2 per cent. If he is a stranger, or asks for a small amount, or if he doesn't pay for it in advance but asks that the drafts as they come in be deducted from his account on deposit with the issuing bank, he will usually be charged a commission of from 1/8 per cent to 1/2 per cent. Where the letter is purchased outright, the larger the amount for which it is issued and the longer the period for which it is to run, the lower the commission will be. This is because the issuing company will have the use of a larger sum of money or will have the use of the principal for a longer time. Thus a letter for $50,000 might be sold at a commission of 1/4 per cent, while one for $100,000 for the same length of time might be sold for 1/8 per cent. One for $100,000 running for 30 days might cost 1/4 per cent, while if it ran for six months it might cost only 1/8 per cent.

The circular letter of credit is the favorite method of carrying large sums while traveling. It gives greater distinction to the traveler in his dealings with banks than do traveler's checks. It serves as an identification of his credit standing because the correspondent that cashes his checks knows that if he has received his letter under a guarantee, his credit at the bank is satisfactory, while if he is a stranger to the issuing bank he has had sufficient funds to pay for it in cash. It usually costs less than traveler's checks. The traveler deals with the correspondents of the issuing bank, with whom the latter has already established connections, thus making it possible for him to receive more courteous treatment than is usually the case when one attempts to cash a traveler's check at any place other than at the office of the agent of the issuing company. It has the disadvantage, however, of compelling the traveler to cash his draft at a bank, and banks keep short office hours and observe legal holidays, thus occasionally putting the traveler to some inconvenience.

Individual or Ordinary Drafts. Excluding the check and the bank draft, the individual or ordinary draft undoubtedly plays the most important part in domestic exchange transactions.

A draft, as noted earlier, is an order by the first party upon a second party (whether it be a bank, business firm or individual), to pay a

certain sum of money either at sight (on demand) or after a certain length of time, to a designated party or to his order. This designated party, the one who is to receive the money or who may order it paid to still another party, may be a bank, a business firm, or an individual. It may even be the party who has drawn the draft.

It will be noted from the above and from what was said regarding a check, that the only differences between a check and a draft are (a) that a check is always drawn on a bank, while a draft may be drawn on a bank or on other parties; (b) that a check is drawn by the debtor to pay his obligation to a creditor, while a draft may be drawn by the creditor to collect funds from the debtor; and (c) that a check is payable always "at sight" (on demand) while a draft may be payable "at sight" or a certain number of days "after sight" or a certain number of days "after date."

A draft is drawn for the collection of money already due or to become due at some future date. It may be used in any of a number of financial transactions and in many different ways, but it is always drawn by a creditor on a debtor or on the debtor's bank or financial agent. It is usually drawn with the consent of the debtor, although at times it is drawn by the creditor without the knowledge or consent of the debtor and for the purpose of forcing payment from him. In the latter case, let us say that for many months Robinson has been waiting for Stockard to pay him for a shipment of goods. He has written frequently requesting payment but with no results. Finally he decides to draw a draft on Stockard for the amount in question and gives it to a bank for collection. The latter sends it to its correspondent bank in the city where Stockard is located. The correspondent bank presents it to Stockard for payment, who may or may not pay the draft. He is under no legal obligation to do so. If he does pay it, the correspondent collecting bank will deduct its collection charges and forward the remainder to Robinson's bank. The latter deducts its charges and credits Robinson with the proceeds or pays him in cash. Thus a draft is sometimes, not frequently, used in domestic transactions for the purpose of compelling debtors to pay their bills.

The draft is more customarily used, however, with the consent of the debtor. If Robinson sells a $1,000 shipment of goods to Bates in a distant city, Bates will usually advise Robinson as to how the draft is to be drawn, or will advise Robinson that he will agree to the draft being drawn according to the terms already specified by Robinson

in earlier correspondence. Thus when Bates wrote or wired Robinson regarding the terms upon which he wished the goods to be forwarded, he may have specified that the draft was to be drawn on him at thirty days' sight or thirty days from date; or he may have sent a commercial letter of credit [1] authorizing Robinson to draw on Bates' bank or financial agent at thirty days' sight, or at thirty days from date, or for any other length of time. In all cases where the draft is drawn with the consent of the debtor the terms of the sale have been agreed upon beforehand.

Individual or ordinary drafts are practically always collected through or handled by a bank or financial agency as will be seen from our subsequent discussion of trade acceptances and bankers' acceptances.

Drafts may be sight or time drafts, and clean or documentary (collateral) drafts. A sight draft is one which is drawn "payable at sight" or "on demand," i. e., when presented for payment (Fig. 18).

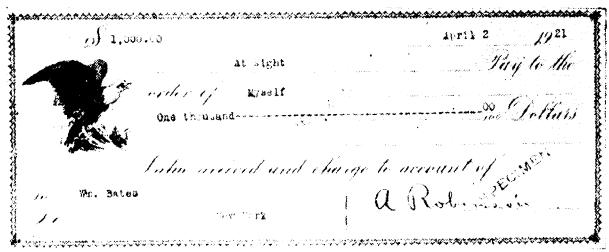


FIGURE 18
Sight draft

A time draft may be made payable at so many days "after sight," i. e., so many days after it has been "accepted" or honored (Fig. 19), or it may be drawn payable so many days "after date," i. e., after the date appearing on the date line of the draft (Fig. 20). When the party upon whom a draft has been drawn payable say thirty days after sight, desires to honor it and agrees to pay in accordance with the amount and terms stated on its face, he "accepts" or honors the draft by writing across its face the word "Accepted," and the date, his name, and also at times the place at which or the bank by which the draft will be paid. The draft then becomes an "acceptance" and the

[1] Cf. pp. 70-73 for discussion of commercial letter of credit in domestic trade.

drawee becomes the "acceptor." This type of time draft is far the more common, in fact it is the usual type employed in financing both domestic and foreign trade.

Clean drafts, more commonly known, both in domestic and in foreign exchange transactions, as "clean bills," are those bills or drafts

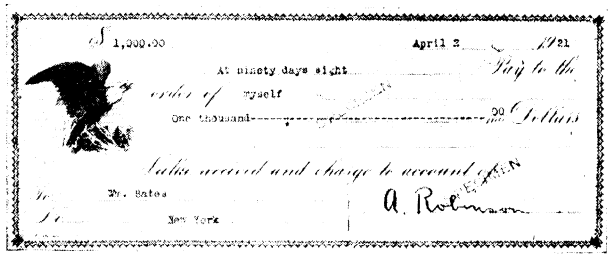


FIGURE 19
Ninety day sight draft

which have no documents attached. When Robinson drew on Stockard to compel him to pay, Robinson simply drew a draft to which nothing was attached. This was a "clean" draft or a "clean" bill. However, when he shipped goods to Bates and drew his draft on Bates, or on Bates' bank or financial agent, he most likely attached

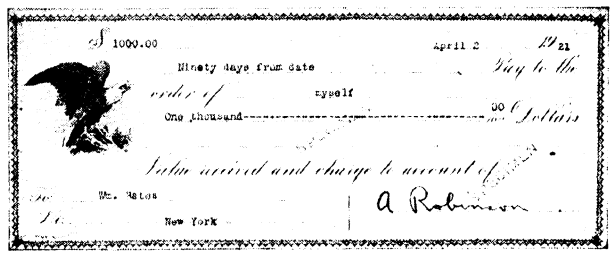


FIGURE 20
Date draft

shipping or other documents which carried title to the goods. We shall later discuss this practice and the reasons therefor. The attaching of documents to a draft makes it a "collateral" draft, or, as it is more commonly known, a "documentary" draft. The documents act as security or as collateral for the draft. Documentary bills of

exchange play an extremely important part in the financing of domestic and foreign trade, being the most common form of exchange used in that connection. We shall henceforth know this class of drafts as "documentary bills." When a thirty or sixty day sight draft has been accepted and the documents have been turned over to the acceptor, the draft will then have no documents attached, and will thus become a "clean" draft.

An interesting practice has grown up in connection with the use of the draft in the sale of stocks and bonds, both in domestic and foreign transactions. A customer in Chicago will instruct a firm in New York to buy for him a certain amount of stocks or bonds and to draw on him for the amount covering their cost plus the commission of the agent. The agent fulfills the engagement and draws on the buyer as requested. He attaches the draft to the stocks or bonds with the instructions that they are not to be turned over to the buyer until the latter has paid the draft. The draft and the securities are given to a bank for collection, or are sold directly to a bank, the attached stocks or bonds acting as "backing" or security for the draft. Such a draft, however, is technically known as a "collateral" draft, not a "documentary" draft. Stocks and bonds are not "documents" which give possession to property being shipped by another route; they are themselves the property involved in the transaction.

The use of the draft in domestic business relations is a most interesting study, and it is regretted that it is not possible in this volume to enter into a detailed discussion thereof. The most important phases only will be sketched, in order to show the part which the individual draft plays in the financing of our domestic trade.

Trade Acceptances. For many years it has been customary for the American business man to sell goods to his customer and merely enter the amount of the sale on his books as charged to the account of the buyer. This is known as the "open book account" method. When the goods are shipped, the seller sends a bill to the buyer with a statement that if paid at once or within a period of ten days the buyer will receive a deduction or rebate of one, two, or possibly as high as five per cent of the amount of the bill, an effort thus being made to induce the buyer to remit cash upon receipt of the bill. This deduction or rebate is known as a "cash discount."

On the face of it, it would appear that the buyer would be eager to remit cash in order to obtain the discount, but in actual practice, on

the contrary, it has been customary for the buyer to wait until he is "good and ready" before remitting for the goods purchased. One two, or three months, or possibly a longer period may elapse before payment is made. In reality, the seller finances the business of the buyer, supplying him with goods to sell and then waiting for him to remit. Under such conditions the seller at times has been placed in a very unsatisfactory financial position. It might happen that he would have on his books a large number of "accounts payable." He might need funds with which to conduct his own business, and yet find himself unable to collect from his customers. He has received nothing from them in the shape of a promissory note or an accepted draft to show just when they would pay. Consequently if he wished to obtain additional funds for his business he might have to do one of three things: (a) sell his accounts outright to the bank, which would charge him a high commission for receiving them because it would have to assume the risks attendant upon their collection; (b) use them as security in applying for a loan, assigning them to the party loaning him the money. This again is unsatisfactory because the margin of safety required by the lender would be rather large since there is no way of knowing just what percentage might be realized on the accounts in case the borrower could not meet his loan when it fell due. (c) Or the seller might place the accounts in the hands of a collection agency, which would undoubtedly lose him the business of his customers. This system of book accounts has been productive of bad debts, undue extension of payments, cancellation of orders, slow collections, and losses, all entailing heavy burdens upon business operations. It has, also, naturally resulted in higher prices to the buyer. Book accounts are not the proper kind of short time investments for banks. In fact, practically nothing good can be said of the system of open book accounts.

For a long time there has been a demand that American business men develop and use the "trade acceptance" for the financing of domestic trade. The reason why no progress was made in that direction until after the enactment and amendment of the Federal Reserve law was because there was no open discount market in the United States. There was no place where banks could take the commercial paper which they had discounted or bought from their customers and sell it, i. e., rediscount it. Such a discount market has existed in the European countries which for years past have financed their internal

trade to a very large extent by means of the trade acceptance.[1] But American banks had not been educated to an appreciation of the practice and advantages of rediscounting bills. If they got hard pressed for funds and sold some of their first class discounted commercial paper to a friendly bank, it was felt that such an action was evidence of the financial weakness of the banks resorting to it. The enactment of the Federal Reserve law, its amendments, and the regulations of the Federal Reserve Board, have done much to remove the "stigma which may have attached to rediscounting in the past" [2] so that today a very considerable progress has been made in the use of both trade and bank acceptances in financing domestic business.

In general an acceptance may be defined as a bill of exchange, payable at a fixed or determinable future date, the obligation to pay being acknowledged in writing on the face of the bill either by the person to whom it is addressed or by some other party. This is usually done by writing the word "Accepted," also the date, followed by the signature of the acceptor, although legally the signature and date only on the face of the draft are sufficient. Frequently the acceptor will designate the place at which or the bank by which the acceptance is to be paid. When the draft is drawn by the seller upon the buyer and accepted by him (or by some other party "for honor" [3]) it is known as a "trade acceptance." Bank acceptances will be discussed in the next section of this chapter. To be eligible for rediscount at a Federal Reserve bank, the acceptance must bear on its face the words "The

[1] The following, from the New York *Times* of July 27, 1919, is of interest in connection with the methods now being followed by English firms in financing their internal trade:

"At a time when so much is being done in the United States to stimulate the use of the trade acceptance in domestic business it may be of interest to know what British practice is in this regard.

" 'The domestic trade acceptance,' explains Trade Commissioner Henry F. Grady, 'was very generally used thirty or thirty-five years ago, but its use has since been practically discontinued. The bank acceptance is used universally in foreign business, but in domestic business the banks make advances and permit overdrafts as the accredited method of financing trade.

" 'The five large joint-stock banks which have branches throughout the United Kingdom and control about 70 per cent of the banking business of the country use the overdraft very extensively. The overdraft is used particularly in the case of the very large firms. It does not follow, of course, that advances made in this form are unsecured. The custom is to keep with the bank as a reserve against which to secure advances, a certain amount of securities, this being true whether the advance is to be an overdraft or a loan. To obtain an overdraft the firm calls on or writes the bank and advises it that it wishes to overdraw its account for a prescribed amount, and the bank then honors checks against it for approximately that amount—the sum is never rigid, and the extent of the overdraft is left to the requirements of the firm.' "

[2] Holdsworth, J. T., "Money and Banking," New York, 1917 ed. p. 268.

[3] Cf. pp. 86–87.

obligation of the acceptor of this bill arises out of the purchase of goods from the drawer," or it must be accompanied by a certificate bearing a statement to the same effect. Federal Reserve banks rediscount acceptances only for member banks.[1]

Trade acceptances arise in the following manner: Robinson of New York sells Stockard of New Orleans $5,000 worth of steel. He takes the steel to the railroad company for shipment and receives a bill of lading. The bill of lading is a receipt from the carrier stating that it has received goods from the shipper for transport to a certain point. If a bill of lading is made out showing that the goods are consigned or destined to a certain party, it is known as a "straight" bill of lading. If, on the other hand, it is made out showing that the goods are consigned to the order of a certain party, usually the seller, it is known as an "order" bill of lading. A straight bill of lading is normally not negotiable, i. e., not capable of being indorsed and delivered to another person (as a check would be under ordinary circumstances), thereby transferring title to the goods. Usually the shipper has the railway company make the bill of lading out to himself "or order," which means that the title to the goods rests with him until he transfers it to another person by writing an indorsement across its face. An "order" bill of lading is negotiable and is the form ordinarily met with in both domestic and foreign trade. In domestic trade, however, the straight bill of lading is frequently used in connection with trade acceptance transactions.

Robinson, having received his order bill of lading from the shipping company, attaches an invoice, which is simply a statement of the goods shipped, and draws a draft on Stockard. Let us say that it is a thirty day sight draft. Robinson pins the three documents together, thus constituting what is known as a "domestic documentary bill of exchange." Sometimes, but not frequently, the documents are drawn in duplicate as a precaution against loss in the mails. If Robinson has faith in the credit standing of Stockard, he may send the docu-

[1] It is not deemed necessary or advisable to present a discussion of the rules and regulations of the Federal Reserve Board regarding the eligibility of commercial paper for rediscount or the extent to which member banks may engage in the acceptance business. Such matters may be easily found by consulting any standard book written since 1917 dealing with the subject of Banking or the Federal Reserve law. Cf. Holdsworth, J. T., "Money and Banking"; Willis, H. P., "The Federal Reserve Act"; Kemmerer, E. W., "The A. B. C. of the Federal Reserve System," etc. Cf. also the *Federal Reserve Bulletin* and the annual reports of the Federal Reserve Board.

In 1920 the Federal Reserve banks rediscounted $192,157,000 in trade acceptances for member banks and purchased $74,627,000 worth of them in the open market.

mentary bill (with a straight bill of lading) direct to him, ask him to accept the draft, and to return the accepted draft. Robinson may hold the accepted draft until about the time of its maturity and then hand it to his bank for collection, or he may sell it to his bank (discount it) at any time before maturity. During the last few years many firms have been attempting to induce their customers to adopt the trade acceptance practice by sending the bill to them in two different forms accompanied by a straight bill of lading. One form embodies the old idea of the open book account method, being just a statement of the amount of money due the seller and a note to the effect that if paid at any time within ten days a discount of a certain percentage will be given the purchaser. The other form is in the shape of a trade acceptance to be accepted by the purchaser, payable, say, at the end of thirty days. The customer thus has the alternative of resorting to either the trade acceptance or the open book account method.

In Robinson's case, above, it may be that after preparing his documentary bill of exchange he asks his bank to purchase it (discount it) before acceptance by Stockard, or to take it for collection. If the bank discounts it for him, it may pay him immediately, or it may wait until it has been notified by its New Orleans correspondent of Stockard's acceptance. When the bank discounts the bill for Robinson it will pay him a sum of money slightly less than the face value of the draft. The bank has really purchased his claim to $5,000 thirty days hence, and, having to wait that long for its money, it imposes a small charge for the accommodation rendered. If the market rate of discount prevailing at that time is 6 per cent for bills of the kind under discussion, the bank will charge a sum equal to 6 per cent for thirty days on $5,000, i. e., $25, and will hand Robinson the remaining $4,975. If the bank takes the draft for collection, however, Robinson will get his money after it has been collected, i. e., thirty days hence, less the bank's collection charges. Or Robinson may hand the documentary bill to his bank to be presented to Stockard by the New Orleans correspondent merely to secure Stockard's acceptance. After having been accepted, the draft in this case will be returned to Robinson for his keeping, or, if he desires, it may be retained by the New Orleans bank until paid, or until Robinson orders the New Orleans bank to discount it, the funds to be remitted to him through the New York bank or to be credited by the New Orleans bank to his account.

Among bankers, discounting is commonly looked upon as "taking out interest ahead of time" or "taking interest in advance." They purchase commercial paper which is due and payable at a certain future date, thus advancing the money prior to the time when it is actually due. It is necessary for them, therefore, to calculate the present worth of the future payment. The amount that is deducted from the face value of the bill is known as the "discount." The "rate of discount" is the percentage per year relation which the amount of the discount bears to the sum that is to be collected by the discounting bank at the maturity of the discounted paper. "Re-discounting" is merely discounting again, i. e., the act of either selling or buying a bill which has already been discounted. The verbs "to discount" and "to re-discount" apply to the action of either the buyer or the seller of the bill. You "discount" your commercial paper at the bank, and the bank "discounts" it for you. A bank "rediscounts" its discounted bills at the Federal Reserve bank, and the Federal Reserve bank "re-discounts" them for the bank.

If you draw a sixty day draft for $1,000 and present it immediately to the bank for discounting, and if the bank buys it at a discount rate of 6 per cent, it pays you $990, which is the present worth of $1,000 sixty days hence. Six per cent on $1,000 for a year is $60. Sixty days is one-sixth of a year, taking 360 days to the year, which is the customary American practice. One-sixth of $60 is $10, the discount deducted by the bank. The bank, of course, collects the full sum of $1,000 sixty days hence when the draft matures. On the other hand, if you were to borrow $990 from the bank as an ordinary loan, agreeing to pay six per cent on the loan at the end of sixty days, you would pay back to the bank the sum of $999.90, or slightly less than the bank would have received had it discounted a $1,000 commercial bill. Discounting at the same rate that prevails for the loaning of money at interest really nets the bank a slightly larger return.

If the bank holds your sixty-day draft for thirty days and then presents it to a Federal Reserve bank for rediscounting, the latter will have to carry the unpaid claim for the remaining thirty days. If, to make our problem simple, the rediscount rate of the Federal Reserve bank happens to be the same as the discount rate of your bank (which supposition is seldom true), the Federal Reserve bank would pay $995 for your draft, thus obtaining $5 on its investment for

thirty days and at the same time giving your bank its discount for the thirty days during which it had carried the claim.[1]

Reverting to our example of Robinson and his documentary bill of exchange, let us say that he sells it to his New York bank. He indorses the draft on the back; he also indorses the bill of lading but by signing his name on its face. He then turns all the documents over to the bank, thus transferring title and claim to the goods to the buying or discounting bank. The bank indorses the documents and sends them to its correspondent in New Orleans. The New Orleans bank presents the draft to Stockard for his acceptance. He accepts the draft by writing across the face of the draft the word "Accepted," and signs his name and the date, or he may omit the word "Accepted" and merely sign his name and the date. In either case the draft has become a "trade acceptance" (Fig. 21). Stockard, after accepting

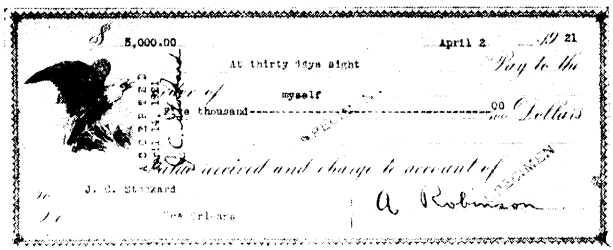


FIGURE 21
Trade acceptance

the draft, hands it to the bank clerk, and the bank turns over to him the bill of lading, the invoice, and any other documents that may have accompanied the draft. The New Orleans bank, acting under instructions received from the New York bank, may or may not take from him security in the form of stocks, bonds, mortgages, or any other

[1] It is the policy of the European central banks, the most important rediscounting agencies in their respective countries, to keep their rate of discount (or rediscount) above the market rate for money, otherwise they would be overwhelmed with offers of bills for rediscount. The Federal Reserve banks, however "have adopted the policy of keeping their buying rates more closely in line with the rates at which bills were offered in the open market by purchasing only at or slightly below those rates." (Sixth Annual Report, Federal Reserve Board, 1919, p. 23.) In 1921 they even scaled down their discount rates in advance of the declining market rates. For example, the Federal Reserve Bank of New York adopted a 4½ per cent rate of discount when the market rates for prime commercial paper, short-dated time paper, and longer dated maturities were respectively 5–5¼ per cent, 5–5¼ per cent and 5¼–5½ per cent.

kind of security so as to protect the New York bank in case of non-payment. In the absence of instructions, it is required by law to turn over the documents upon acceptance. The New Orleans bank holds the draft subject to the orders of the New York institution, and may hold it until maturity at which time the New Orleans bank will present it to Stockard for payment. When paid, the funds are credited to the account of the New York bank or remitted to it, depending upon the instructions received from the latter. Let us say that when Stockard accepted the draft he made it payable at his bank, the Cotton National of New Orleans. The draft would then be presented to the Cotton National Bank on the day of its maturity, and would be paid by that bank out of the deposit account of Stockard without his giving the bank any further order than that authorized by his having written the words "Payable at the Cotton National Bank" on the face of the draft.[1]

Let us say that ten days after Stockard accepts the draft, the New York bank notifies its New Orleans correspondent to take the draft to the New Orleans branch of the Federal Reserve Bank of Atlanta and have it rediscounted. The New Orleans branch of the Federal Reserve Bank of Atlanta rediscounts the draft and credits the discounting bank with the discounted face value of the draft, or, acting upon orders from the latter, it may transfer the funds to the New York bank by means of a telegraphic transfer. The discounted bill may then be used by the Federal Reserve Bank of Atlanta, the parent of the New Orleans branch, as partial security behind the issuance of Federal Reserve notes, provided it desires to do so. When the draft falls due, the New Orleans branch of the Federal Reserve Bank of Atlanta will

[1] The report of the Acceptance Committee of the American Bankers Association (May 2, 1921), comments as follows on this point:

"One of our greatest problems is to bring about a clearer understanding on the part of bankers as to what the trade acceptance is, its proper use, true method of operation and particularly its final disposition when made payable at a bank. Judge Thomas B. Paton, General Counsel of the American Bankers' Association, in a recent decision, the full text of which appears on page 684 of the April "Journal of the American Bankers' Association," stated: 'Where the drawee of a trade acceptance makes it payable at a bank, it is equivalent (except in certain States) to an order to the bank to pay, and there is no need of express instructions as to prerequisite to payment. A bank which refuses payment having sufficient funds of its customer would be liable to him for injuring his credit.'

"Section 87 of the Negotiable Instruments Act, as operative in all States except Illinois, Kansas, Minnesota, Missouri, Nebraska and South Dakota, provides that when an instrument is made payable at a bank it is equivalent to an order on the bank to pay the sum for the account of the principal debtor thereon, which in the case of trade acceptances is the acceptor. If banks would observe this rule of law, the handling of trade acceptances would be greatly facilitated and many complaints and disputes would be obviated."

collect the draft from Stockard just as the New Orleans correspondent would have done had it held the draft until maturity.

The advantages of a trade acceptance over the old open book account system are evident. Robinson can get his money whenever he wants it by discounting the draft either before or after acceptance by Stockard. He can keep his assets in more liquid form and his business in better condition. Banks are provided with a means of investing their funds for short time periods and receive therefor the discount at the rates charged. If they are pressed for funds at any time they may easily rediscount acceptances, if in proper form, at a Federal Reserve bank or its branch. They can therefore keep themselves in a much better financial condition than might otherwise be the case. Stockard by his acceptance definitely agrees to pay the draft when it falls due and is thereby enabled to obtain better prices from Robinson. The Federal Reserve banks also are supplied with satisfactory commercial paper to use as partial security for the issuance of Federal Reserve notes with which to supply the fluctuating needs of business. From the point of view of all parties concerned, therefore, the trade acceptance is superior to the open book account system.

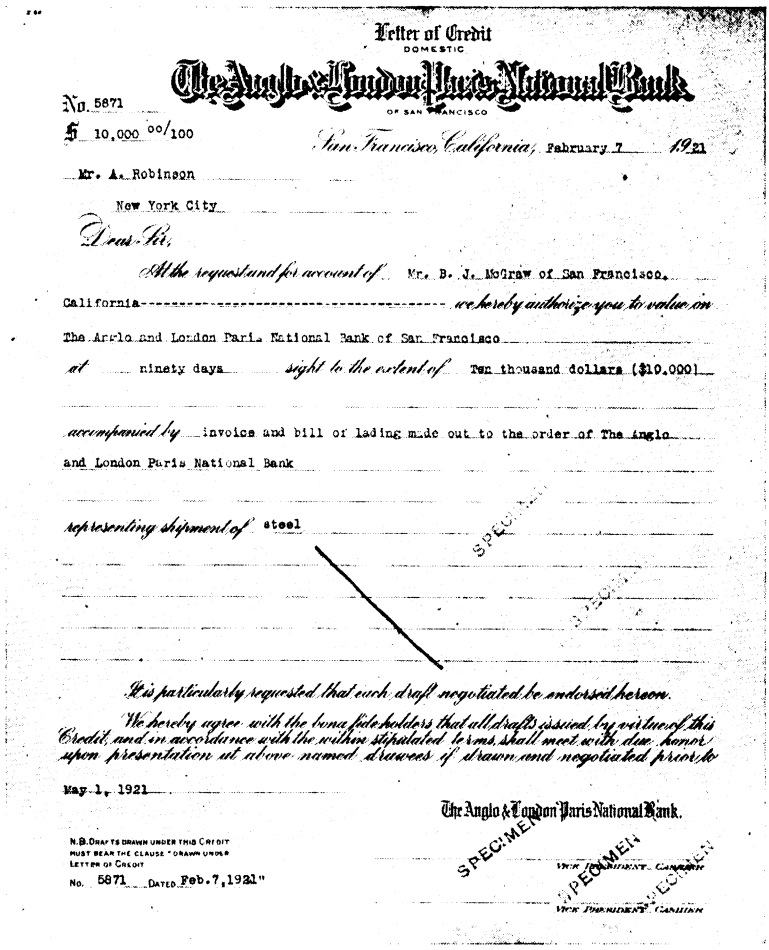
It has been very difficult to induce the American merchant to use the trade acceptance method of financing domestic trade although there has been much propaganda toward that end. National associations of merchants and bankers have gone on record as favoring it and have spent much time and money in furthering its cause. A "National Trade Acceptance Council" has also been established whose object is to popularize the use of the trade acceptance. State and national banking laws have been modified to encourage its development. The results thus far obtained have indeed been very satisfactory.[1]

Bank or Bankers' Acceptances. Closely akin to the trade acceptance is the bank or bankers' acceptance. A bank acceptance may be

[1] A recent report of the Acceptance Committee of the American Bankers' Association contains the following statement:

"In 1916 the known users of trade acceptances in America numbered 185. In October, 1921, the list exceeded 20,000. The number has grown steadily and now includes practically every line of business that makes sales on the time basis. Where the trade acceptance has been properly and legitimately used, the results have been eminently satisfactory. It has shortened the credit period, it has made collections more certain; it has enabled an equal amount of capital to do a greater amount of service; it has eliminated many troublesome claims and disputes; it has reduced the expense of operation both for the buyer and seller; it has stabilized the businesses involved and has produced a character of strictly liquid paper."

defined as a bill of exchange or draft, payable at a fixed or determinable future date, upon the face of which has been acknowledged in



Letter of Credit

DOMESTIC

The Anglo & London Paris National Bank

OF SAN FRANCISCO

No. 5871

$ 10,000 00/100

San Francisco, California, February 7 1921

Mr. A. Robinson

New York City

Dear Sir,

At the request and for account of Mr. B. J. McGraw of San Francisco, California---------- we hereby authorize you to value on The Anglo and London Paris National Bank of San Francisco at ninety days sight to the extent of Ten thousand dollars ($10,000)

accompanied by invoice and bill of lading made out to the order of The Anglo and London Paris National Bank

representing shipment of steel

SPECIMEN

It is particularly requested that each draft negotiated be endorsed hereon.

We hereby agree with the bona fide holders that all drafts issued by virtue of this Credit and in accordance with the within stipulated terms shall meet with due honor upon presentation at above named drawees if drawn and negotiated prior to May 1, 1921

The Anglo & London Paris National Bank.

SPECIMEN

VICE PRESIDENT. CASHIER

SPECIMEN

VICE PRESIDENT. CASHIER

N.B. DRAFTS DRAWN UNDER THIS CREDIT MUST BEAR THE CLAUSE "DRAWN UNDER LETTER OF CREDIT No. 5871 DATED Feb. 7, 1921"

FIGURE 22—Domestic commercial letter of credit

writing the unconditional obligation of the bank or other financial agent on which it is drawn to pay the same at maturity.[1] In this

[1] The Federal Reserve Board has defined a bankers' acceptance as "a draft or bill of exchange, whether payable in the United States or abroad, and whether payable in dollars

case the seller draws his draft on a bank, not on the buyer. To do this, the buyer gets from his bank a document known as a "commercial letter of credit." This is usually in the form of a printed letter (although sometimes it is typewritten), with the necessary blanks filled in on the typewriter or in ink, advising the seller that he is authorized to draw on the bank for a certain sum of money, the draft to run for a certain number of days, etc. The letter contains full and complete instructions to the seller informing him how many and what kind of bills of lading he must get from the carrier, what documents he must forward and how they are to be drawn and indorsed, before what date the draft must be drawn and the shipment made, etc. Let us say that McGraw of San Francisco desires to have Robinson of New York ship him $10,000 worth of rope. Robinson doesn't know McGraw or his credit standing and would hesitate to draw a draft on him or to give him open unsecured credit. So McGraw goes to his San Francisco bank, let us say the Anglo and London Paris National Bank, and obtains from it a commercial letter of credit addressed to Robinson (Fig. 22). A commercial letter of credit is usually a four page letter with printing appearing only on the first page. As will be noted from the accompanying form, it authorizes Robinson to draw on the Anglo and London Paris National Bank of San Francisco up to the sum of $10,000, before a certain date, and advises him as to how the shipment is to be made, what documents must be provided, etc.

McGraw sends this letter to Robinson, or may instruct the bank to forward it. McGraw also instructs Robinson regarding how the rope is to be sent, over what transportation lines, etc. Robinson packs the rope, gets the necessary documents from the shipping company, and draws his draft not on McGraw but on the Anglo and London Paris National Bank of San Francisco. He may then sell the draft to his New York bank or it may be handled by him in any of the methods mentioned in connection with our description of the trade acceptance. Let us say that the New York bank discounts the draft. It pays a little higher amount for such a draft, i. e., it charges a lower rate of discount, than it would for a trade acceptance, because it is a draft on a bank, not on an individual, with consequently less risk of non-payment. The documentary bill is then sent to its San Francisco

or some other money, of which the acceptor is a bank or trust company, or a firm, person, company, or corporation engaged generally in the business of granting bankers' acceptance credits." Regulations A, Series 1920, VI, B.

correspondent with the request that it be presented to the Anglo and London Paris National Bank for acceptance. The latter will accept the draft and the documents will be turned over to it without its furnishing any security. Its acceptance is sufficient. Instructions as to just how the transaction is to be handled are always sent to the correspondent bank by the discounting bank. Let us say that the San Francisco correspondent bank, acting on instructions from the New York bank, discounts the acceptance at the local Federal Reserve bank.

The Anglo and London Paris National Bank notifies McGraw that it has the documents covering the shipment. He comes to the bank and receives the documents upon furnishing the proper security, or if he has excellent credit, he is given the documents without furnishing any security, although he would normally be required to execute a trust receipt in favor of the bank.[1] He then gets his goods and pays nothing until the draft falls due. A day or so before the draft matures, he "puts the bank in funds," i. e., he gives the bank the money with which to pay the maturing draft plus the commission (usually about ¼ of one per cent) charged by the bank for the service rendered. On the day of the maturity of the draft, the Federal Reserve Bank of San Francisco presents the draft to the Anglo and London Paris National Bank for payment. The latter will pay the face value of the draft, McGraw, in the meantime, as has been noted, having "put the bank in funds."

The Guaranty Trust Company of New York in one of its pamphlets on this matter, summarizes the numerous advantages of the bank acceptance as follows:

(1) Bank customers can ordinarily borrow by this means more cheaply than by their straight note.

(2) The use of acceptances makes it possible for banks and trust companies to properly and conveniently finance legitimate business transactions of their customers without using any of the bank's funds or the use of any additional funds.

(3) Banks having surplus money which cannot be readily employed at the time can invest it in prime acceptances, which can either be held until maturity or sold in the open market, should such action be found necessary. It is obvious that prime bank acceptances, backed as they are by well-known banks or trust companies, and readily rediscountable, can find eager

[1] Cf. pp. 245–250 for an extended discussion of the trust receipt.

purchasers by virtue of their high intrinsic security as the most liquid form of investment for banking institutions. Aside from cash in the vault nothing is so rapidly liquidated, especially in view of the existing Federal Reserve system.

(4) Acceptances of well-known institutions will more and more be sought as short-term investments and will be especially valuable for such a purpose, principally on account of their ready marketability.

(5) Banks and trust companies can accept for a commission the paper issued by their best customers and sell it in the open market, thus adding to their business another feature which can be a source of definite profit.

(6) The presence of the name of the accepting bank makes prime to the extent of the credit of the accepting bank the paper on which it appears. This at once eliminates the necessity and bother of checking the drawer or several indorsers upon paper, as the primary responsibility rests with the accepting bank. If this is in good credit all other names on the papet become proportionately of less interest.

(7) With the development of the use of bank acceptances, the knowledge of the relations that the borrower has with other institutions, which the credit-extending banks will thus have, will create a condition of almost automatic registration of paper; thus more than ever protecting the banks as well as the borrowers from the evil results of the over-extension of credit.

The buyer advances no funds, but finances the transaction through the credit advanced by the accepting bank. The seller knows that he is sure of his money, because the draft is drawn on a bank. He does not know the buyer or his credit standing, but the substitution of the banks' credit for that of the buyer makes him willing to sell without any hesitancy. The drawer is also able to realize a little higher amount on a draft drawn under a commercial letter of credit because the discounting bank will charge a little lower rate of discount for a bank acceptance than for a trade acceptance. Likewise in the past the rates of rediscount charged by the Federal Reserve banks have been slightly lower for bank acceptances than for trade acceptances,[1]

[1] The rates of rediscount charged by the Federal Reserve banks on March 25, 1921, were as shown on opposite page.

"Note: Rates shown for St. Louis and Kansas City are normal rates, applying to discounts not in excess of basic lines fixed for each member bank by the Federal Reserve Bank. Rates on discounts in excess of the basic line are subject to a ½ per cent progressive increase for each 25 per cent by which the amount of accommodation extended exceeds the basic line, except that in the case of Kansas City the maximum rate is 12 per cent."

It will be noted that in the case of eight banks out of the twelve the rate of rediscounting trade acceptances was higher than that charged for rediscounting bank acceptances.

although at the time of this writing (April, 1922) the same rediscount rates apply to both kinds of paper.[1]

Federal Reserve banks are authorized to rediscount bank acceptances of member banks or to purchase them in the open market [2] (with or without their bearing the indorsement of a member bank), from banks, firms, corporations, or individuals, provided they fulfill all the requirements for eligibility prescribed by the Federal Reserve Board. As eligibility for rediscounting at the Federal Reserve banks has an important bearing on their marketability, we find such bills classified into three groups: (1) "Eligible bills of member banks," (2) "Eligible bills of non-member banks," and (3) "Ineligible bills," with different rates of discount applying to each class. Some of the more important requirements concerning eligibility are to the effect that the acceptance must have a maturity of not more than three months,[3] exclusive of days of grace, and must have been drawn to

"DISCOUNT RATES OF THE FEDERAL RESERVE BANKS IN EFFECT MARCH 25, 1921

	Discounted bills maturing within 90 days (including member banks' 15 day collateral notes) secured by			Bankers' acceptances disc'ted for member banks	Trade acceptances maturing within 90 days	Agricultural and live-stock paper maturing 91 to 180 days
	Treasury certificates of indebtedness	Liberty bonds and Victory notes	Otherwise secured and unsecured			
Boston	5½	6	7	..	7	7
New York	6	6	7	6	7	7
Philadelphia	*6	5½	6	6	6	6
Cleveland	6	6	6	6	6	6
Richmond	6	6	6	6	6	6
Atlanta	6	5½	7	6	7	7
Chicago	6	6	7	6	7	7
St. Louis	6	5½	6	5½	6	6
Minneapolis	5½	6	7	6	6½	7
Kansas City	*6	6	6	5½	6	6
Dallas	6	6	7	6	7	7
San Francisco	6	6	6	6	6	6

"* Discount rate corresponds with interest rate borne by certificates pledged as collateral with minimum of 5 per cent in the case of Kansas City and 5½ per cent in the case of Philadelphia.

[1] On April 1, 1922, the rates of rediscount for all kinds of paper were 4½ per cent for the Federal Reserve banks of Boston, New York, Philadelphia, and San Francisco, and 5 per cent for the other Federal Reserve banks.

[2] During 1920 the Federal Reserve banks discounted $187,162,000 worth of bankers' acceptances for member banks and purchased $3,143,737,000 worth in the open market.

[3] On May 6, 1921, the Federal Reserve Board issued what were taken to be temporary regulations, permitting Federal Reserve banks to purchase bankers' acceptances with six months maturities growing out of foreign trade transactions. The regulation was to re-

finance the foreign or domestic shipment of goods, or the storage of readily marketable staples,[1] or to create dollar exchange.[2] Evi-

At the time of acceptance, this bill was accompanied by shipping documents evidencing the

(*name of commodity*)

domestic shipment of.....

(*point of shipment*)

from.....

(*place of destination*)

to.....

No.....$.....

A C C E P T E D

(*date of acceptance*)

.....

PAYABLE AT

(*name of bank*)

.....

(*date payable*)

.....

(*name of accepting bank*)

.....

(*Vice President*)

.....

(*Assistant Cashier*)

.....

FIGURE 23

Form of statement approved by the Federal Reserve Board to be stamped or printed on bank acceptances covering domestic shipments, or to appear on an accompanying certificate. Similar statements are used in case of warehoused goods.

dence of eligibility indicating the character of the transaction must appear on the face of the acceptance or on an accompanying certificate (Fig. 23).

main effective "until further notice" and was designed for the purpose of trying "to widen the acceptance market" and "to provide more ample facilities for financing import and export trade."

[1] "A clothing manufacturer, for example, desires to carry his stock of wool through the use of bankers' acceptances. He places the wool in a warehouse, draws a draft on his bank

[2] Cf. p. 135.

The bank acceptances of member banks are classed as "eligible" provided the requirements of the Federal Reserve Board have been fulfilled. Non-member banks and bankers may make their acceptances "eligible" and thus purchasable by the Federal Reserve banks in the open market by filing with the purchasing Federal Reserve bank a statement of financial condition in the form approved by the Federal Reserve Board. They must also agree in writing to inform the Federal Reserve bank upon request concerning any transactions covered by their acceptances. Other bank acceptances which the Federal Reserve banks cannot purchase or rediscount are called "ineligible." The first group commands the best or lowest rates of discount in the open market, while the "ineligible" bills command the highest or least satisfactory discount rates, as is shown by the following table:

BANK ACCEPTANCE DISCOUNT RATES IN OPEN MARKET, NEW YORK, MARCH 21–26, 1921

	Ninety Days	*Sixty Days*	*Thirty Days*	*Delivery within 30 days*
Eligible bills of member banks	6-1/8 @ 6	6 @ 5-7/8	5-7/8 @ 5-¾	6-¼ bid
Eligible bills of non-member banks	6-½ @ 6¼	6¼ @ 6	6-1/8 @ 5-7/8	6-5/8 bid
Ineligible bills	7 @ 6¼	7 @ 6¼	7 @ 6¼	7 bid

As yet bankers' acceptances are not used to any extent in domestic trade because other satisfactory means are provided for its financing. In Chapter IX we shall discuss in detail their use in foreign trade. One reason why they have not been more widely used in domestic circles is that until lately national banks and the banks of practically all states have not been allowed to accept drafts arising out of either domestic or foreign trade. The Federal Reserve Act of 1913 au-

for the value of the wool, attaching the warehouse receipts as collateral. The draft, after acceptance, is returned to him to be sold, the warehouse receipts being retained by the bank. The wool must be stored in a warehouse which is independent of the manufacturer; that is, the manufacturer must not have any control of the wool as long as the warehouse receipts are outstanding. It is, of course, possible to secure possession of the original warehouse receipts by substituting other warehouse receipts for wool, but if the manufacturer desires to take down wool without substitution he should give the bank the cash value of the wool taken, for the bank should be secured either by warehouse receipts or cash all the time its acceptance is out." National City Company, Pamphlet on Acceptances, November, 1920, p. 4.

thorized national banks to accept drafts only in connection with the financing of foreign trade. It was not until 1916 that that law was amended so as to permit national banks to accept drafts arising out of domestic transactions. During the last few years, however, the laws of the more progressive states have not only greatly widened the powers of state banks in this respect, but they have also aided in the development of the use of both trade and bankers' acceptances by permitting state banks to invest their funds in such acceptances.

Until 1921 the open discount market in the United States had not progressed sufficiently to take care of the business that was actually available, as a consequence of which it was greatly dependent upon the Federal Reserve banks. This is clearly evident from the following table showing at various dates the percentage of the total bills outstanding which the Federal Reserve banks had to purchase from member banks and others unable or unwilling to carry them to maturity:

Date	1 *Owned by Reserve Bank New York*	2 *Owned by All Reserve Banks*	3 *Estimated Amount Outstanding*	*Per Cent of Column 2 to Column 3*
Dec. 31, 1916....	$ 41,457,000	$127,497,000	$ 250,000,000	51.0
Dec. 31, 1917....	148,125,000	275,366,000	450,000,000	61.2
Dec. 31, 1918....	69,323,000	303,673,000	750,000,000	40.5
Dec. 31, 1919....	191,312,000	585,212,000	1,000,000,000	58.5
Dec. 31, 1920....	109,902,000	255,702,000	1,000,000,000	25.6
Mar. 25, 1921...	39,386,000	123,056,000	1,000,000,000	12.3

The Royal Bank of Canada in a pamphlet issued in 1921 entitled "Financing Foreign Trade" (p. 63) states that "..... the open market now existing in New York for this class of paper [acceptances] is probably second only to that of London." Nevertheless, our bankers and exchange dealers, as well as our business men, still have much hesitancy regarding the advantages that would accrue from the use of trade and bank acceptances in financing domestic and foreign trade.[1]

[1] For more detailed discussion of trade and bank acceptances, see the annual reports of the Federal Reserve Board, the *Federal Reserve Bulletin*, the publications of the National Trade Acceptance Council, and "Acceptances, Trade and Bankers," by P. Mathewson (Appleton and Company, New York, 1921).

CHAPTER IV

INDORSEMENT, ACCEPTANCE, AND LIABILITY [1]

Before going farther into the subject it is advisable that certain matters relating to the acceptance and indorsement of bills of exchange and the liability of the parties concerned be more fully discussed, because of their great significance in practically all exchange transactions.

All bills of exchange that are negotiable are made payable either (a) to a certain party "or order," or (b) to "bearer." In the case of "order" bills, the party in whose favor they are drawn, or in the case of "bearer" bills, the bearer, may indorse them and pass them to another party. Bills of exchange brought into existence by a party other than the debtor or his creditor, such as bank drafts, express and postoffice money orders, etc., are usually drawn payable to the creditor or to his order. The debtor purchases such kinds of exchange from a bank, postoffice or express company in order to make payment to his creditor. In the case of bills drawn by the creditor on his debtor or on the latter's financial agent, the drafts are usually made payable to the creditor or to his order, in words similar to the following: "Pay to ourselves or order, the sum of, etc., etc." In the first case, when the creditor receives the instrument of payment through the mails from his debtor he indorses the bill by writing his name on the back of the document and hands it to another party, receiving his money therefor or asking the other party to collect it for him. In the second case, i. e., where the creditor draws the draft payable to himself or order and sells it, i. e., discounts it, at the bank, he likewise indorses it on the back and receives payment from the

[1] While this chapter deals with certain matters that relate in a way to negotiable instruments as a whole, I have felt it advisable to confine the discussion solely to matters affecting those bills of exchange that are commonly used in domestic and foreign exchange transactions. It must not be overlooked by the reader that the principal kinds of negotiable instruments are bills of exchange, both domestic and foreign; promissory notes, including notes and certificates of deposits; checks or orders by depositors on their banks to pay money to a third party, and bonds or promises to pay in a special form by corporations or the government. (Cf. Huffcut, E. W., "The Elements of Business Law," 1917 ed., pp. 159–160.)

bank. If he has drawn the draft on his debtor and has made it payable to a third party or order, he merely delivers it to the party named as payee, no indorsement being necessary. In case of indorsement, the one who indorses is known as the "indorser" and if when indorsing he makes the bill payable to a certain party, that party is known as the "indorsee." If under any circumstances the bill should be made payable to "bearer," it would be possible for the drawer or the holder of the bill to deliver it to another party without indorsement, provided the other party were willing to accept it without indorsement. The party who delivers a negotiable instrument without indorsement, i. e., by delivery, is known as the "vendor," while the person to whom he delivers the bill is known as the "vendee." The person who transfers the instrument to another by indorsement or delivery is also known as the "transferor"; the person to whom the instrument is transferred is known as the "transferee." As noted in previous chapters, the party who draws the draft is the "drawer"; the party upon whom the draft is drawn is the "drawee"; the one who pays is the "payer," and the one who is paid is the "payee."

According to the Uniform Negotiable Instruments Law, which has been adopted with but slight variations by all states except Georgia,[1] a bill of exchange is negotiated when it is transferred from one party to another in such a manner as to constitute the transferee the holder thereof in due course.[2] If the instrument has been drawn payable to bearer, or indorsed to bearer or "in blank," it may be negotiated merely by delivery, while if it has been drawn payable to a certain party or his order it is negotiated by the indorsement of the party who legally holds it, followed by its delivery to the transferee.

Indorsement

Indorsement is made by the holder of the bill signing his name on the back of it, with or without additional words which convey instruc-

[1] In the following pages the wording of the Uniform Negotiable Instruments Law has been very closely followed.

[2] "A holder in due course is a holder who has taken the instrument under the following conditions:

"(1) That it is complete and regular upon its face;

"(2) That he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such was the fact;

"(3) That he took it in good faith and for value;

"(4) That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it." (Uniform Negotiable Instruments Law, California Civil Code, Sec. 3133.)

tions or qualify his liability. If the bill has been covered with indorsements a slip of paper, known as an "allonge," may be pasted on its back, on which extra indorsements may be written.

A commonly accepted rule of law is that a person cannot transfer any title or right which he does not possess. There are two general exceptions, however, namely, negotiable paper and money. If I lose $100 which Smith finds and spends at his grocery store, I have no action at law against the grocery store to recover my money. The grocery store receives a title or right to the money which Smith did not possess. The same exception to the general rule holds true in the case of negotiable paper. Suppose that Smith steals from Jones a negotiable instrument made payable to bearer and that Smith indorses it and delivers it to Robinson. If Robinson has received the instrument before maturity, for value, in good faith, and without knowledge of the defect in Smith's title to it, Robinson is a "holder in due course" and Jones cannot defend himself against payment by claiming that Smith got possession of the instrument by fraud or without consideration. Thus while Smith's title would not be good as against Jones, Robinson would receive title to it under the circumstances stated because the instrument is "negotiable." [1] As Huffcut says: "Negotiability carries with it the following results: (a) the transferee gets a legal title and can sue in his own name; (b) if the transferee is a holder for value and without notice of defenses and obtains title before maturity of the instrument, he is free from the defenses that might have been set up against his transferor, except those that operate to destroy the contract altogether. He is not subject to the personal defenses of fraud, duress, want of consideration, want of title in the transferor and the like, but is subject to the absolute defenses of forgery, alteration, infancy of the maker, that the statute declares the instrument void (as it does in a gambling contract), etc." [2]

If the instrument has been drawn in duplicate or triplicate, the indorser must be careful not to indorse the copies to different parties, otherwise he will be held liable on each so indorsed.

Indorsements may be "special," "in blank," "restrictive," "quali-

[1] "A holder in due course holds the instrument free from any defect of title of prior parties, and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon." (Uniform Negotiable Instruments Law, California Civil Code, Sec. 3138.)

[2] *Op. cit.*, p. 162.

fied," or "conditional." A "special" indorsement (sometimes known as an indorsement "in full") specifies the person to whom or to whose order the bill is payable, and the indorsement of that person is necessary to further negotiate the instrument. The following is an example of such indorsement:

Pay to John Jones or order
Wm. Smith

In this case the bill could not be passed to another party without the indorsement of John Jones. An indorsement "in blank" specifies no party to whom or to whose order the bill is payable. A bill indorsed in blank is really payable to bearer and may be negotiated by delivery without further indorsement. Such an indorsement is found in those cases where the indorser merely signs his name, with no qualifying words of any sort. Thus if William Smith above had signed his name on the back of a bill of exchange, such an indorsement would have been an indorsement "in blank." Bills that bear a special indorsement or an indorsement in blank may be indorsed by the holder as he wishes, that is, he may put his indorsement in any form that he desires. If a bill has been made payable to himself or order (i. e., a special indorsement), he may indorse it in blank, or he may make his indorsement restrictive, qualified, or conditional. Also when he has been handed a bill which has been indorsed in blank, he may make his own indorsement "special," "qualified, ' "restrictive," or "conditional." A holder may convert the indorsement in blank of the previous holder into a special indorsement by writing over the latter's signature any contract consistent with the character of the indorsement. Thus, if Wm. Brown desires to protect himself from the risks of carrying a check or draft indorsed to him in blank by Andrew White, he may write above White's signature the words, "Pay to Wm. Brown or order." Bills of exchange, as well as the accompanying documents that require indorsement, are frequently indorsed "in blank."

An indorsement is restrictive when it limits further negotiation, or constitutes the indorsee the agent of the indorser, or vests the title in the indorsee in trust for or to the use of some other person. Thus, "Pay to John Jones only" is a restrictive indorsement and prevents further negotiation. But "Pay to John Jones," the word "only" being omitted, is not a restrictive but a special indorsement. "Pay to John Jones or order for collection for my account," or "Pay to

the First State Bank for the benefit of John Jones," are also forms of restrictive indorsement. Such form of indorsement confers upon the indorsee the right to receive payment of the bill, to bring any action in connection with the same that the indorser could bring, or to transfer his rights as such indorsee when the form of the indorsement authorizes him to do so, but all later indorsers acquire only the rights and title of the first indorsee under the restrictive indorsement. Another form of a restrictive indorsement is found in what is called a "Restricted in trust indorsement," such as "Pay to the First National Bank for account of William Smith." Such indorsement passes title to the bank for the benefit of William Smith, and is the form used when a deposit is made for the account of one who cannot make proper indorsement in person because of absence, age, incompetence, etc.

A qualified indorsement is one which is made by adding to the indorser's signature the words "without recourse" or words to the same effect. Such an indorsement does not guarantee the payment of the bill nor does it impair its negotiability. It merely limits the liability of the indorser who under such circumstances becomes what is technically known as an assignor, whose liability will be more fully discussed later.

A conditional indorsement is one where some condition is added to the indorsement, such as "Pay to John Jones or order on the completion of his contract to build my house." If such a condition had appeared in the body of the bill itself it would have made the bill non-negotiable, because the date of payment is not "determinable," but its appearance as part of the indorsement has no such effect. Any bill that is originally negotiable continues to be negotiable until it is restrictively indorsed or discharged by payment or otherwise. Only a restrictive indorsement nullifies the negotiability of a bill that has previously been negotiable.

At times an indorsement is used waiving the right to be notified in case the instrument is protested either for non-acceptance or for non-payment. An indorsement "waiving protest" would be as follows:

Protest and notice of protest waived
John Jones

Such an indorsement, however, does not relieve the indorser from any liability to the holder of the bill. It merely notifies the holder that

the indorser will consider himself liable as an indorser without the necessity of being notified that the bill has been protested.[1] Some banks consider such an indorsement as being merely a waiver of the indorser's right to be notified in case of protest and require the indorser to indorse in blank before he indorses "waiving protest."

ACCEPTANCES

Indorsements always appear on the back of a bill of exchange. An acceptance, however, usually appears on the face of the bill, never on the back, written either directly or diagonally across the bill. In England the acceptance has to be on the bill itself but in the United States it may be made on a separate sheet. The customary form of acceptance is made by writing the word "Accepted," the date and the acceptor's name on the face of the bill, although the date and the acceptor's signature alone are sufficient without the use of the word "Accepted." Under the Uniform Negotiable Instruments Law, the holder of a bill may require that the acceptance be written on the face of the bill itself and if his request is refused he then has the right to treat the bill as dishonored. However, if he consents, the acceptance may be written on a piece of paper other than the bill itself, but in such cases the acceptor is bound only to the person to whom it is shown and who, on faith, receives the bill as an accepted document. An unconditional promise to accept the bill, given even before the bill has been drawn, is deemed to be an actual acceptance. Bills drawn payable at sight are presented for payment only. Bills drawn payable a certain number of days from sight must be presented for acceptance and run the designated number of days following the presentment for acceptance. Bills drawn payable a certain number of days from date run from the date the bill is drawn, and may be presented for acceptance at any time or not at all. The drawee has twenty-four hours after the bill is presented to him in which to accept, but the date of the acceptance is as of the day of presentation. If he destroys the bill or refuses to return it to the presenter within the twenty-four hour limit, or within any period that the presenter or holder may allow, he is deemed to have accepted the bill.

An acceptance is merely the act of acknowledging in writing that

[1] The process of protesting and the liability of the parties concerned will be discussed in a later portion of this chapter. Cf. pp. 88-90.

the obligation or debt is honored and will be paid at maturity. The word "acceptance" is also used as referring to the instrument after it has been accepted, as well as to the words that constitute the acknowledgment. If a draft has been drawn in duplicate or triplicate, the drawee should accept but one copy. If he places his acceptance on more than one copy, and if the copies have by chance been indorsed to different parties, the acceptor becomes liable on each such acceptance.

According to the Uniform Negotiable Instruments Law an acceptance (the act of accepting) may be either general or qualified. A general acceptance acknowledges the obligation without any qualification whatsoever. The usual form is as follows:

Jan. 1, 1921
Accepted
John Jones

It is also possible to designate the place at which the instrument is to be paid, as:

Jan. 1, 1921
Accepted
Payable at the First National Bank,
Berkeley, Cal.
John Jones [1]

On the other hand, a qualified acceptance varies the effect of the bill in some particular. It may be conditional, partial, local, qualified as to time, or it may be the acceptance of one, or some, but not all of the drawees. A conditional acceptance imposes certain conditions which must be met before the bill will be paid, such as the following:

Jan. 1, 1921
Accepted provided shipping documents
are turned over to me
John Jones

A qualified acceptance may be "partial," i. e., be an acceptance of only a part of the face value of the bill. Thus if the draft has been

[1] Cf. footnote p. 69 as to the legal interpretation of this kind of acceptance.

drawn for $1,000 and the drawee accepts for only $800, such an acceptance would be "partial." If the acceptance designates the place at which and only at which the bill will be paid, it is a "local acceptance."

Jan. 1, 1921
Accepted
Payable only at the First National Bank,
San Francisco, Cal.
John Jones

If the draft is drawn payable at sixty days sight, and the drawee accepts but makes the bill payable at a shorter or longer length of time, then the acceptance is qualified "as to time." It is not unusual to have a draft drawn against two or more parties. If all of the parties do not accept the draft when presented to them, the acceptance is "qualified." The holder of a draft may refuse to receive a qualified acceptance and may proceed to have the bill protested if he wishes to do so. Where the holder consents to a qualified acceptance he releases the drawer and the indorsers of the bill unless they have expressly or impliedly authorized him to take such an acceptance. If the holder notifies the drawer and the indorsers that he has seen fit to take a qualified acceptance, they must individually notify him of their dissent within a reasonable time, otherwise they will be deemed to have given their consent to the same.

There is also an "acceptance for honor." This occurs where a bill of exchange that is not overdue has been protested for non-acceptance or for better security, and some party, other than a person already liable on the bill, intervenes and accepts the bill "supra protest" for the honor of any party liable on the bill. He may accept for the honor of any one of the parties already liable as drawer or indorser, or for the honor of the drawee himself.[1] In his acceptance he mentions the party for whose honor he is accepting. The bill under such cir-

[1] In foreign exchange transactions it is not unusual for the drawer to realize that difficulty may be met in connection with the matter of acceptance or payment. To avoid delays, loss of interest, etc., he will therefore designate some party in the town of the drawee to whom the holder of the bill may have recourse in such a case. He will designate such a party on the face of the bill or on the instructions that accompany the bill. In case the drawee refuses to accept or to pay, the holder then goes to this party, who is known as a "referee in case of need," who in his turn may accept the bill for the honor of the drawer, or who may serve in other ways as the agent of the drawer so as to save the latter any unnecessary expense.

cumstances runs from the date of presentment to and non-acceptance by the drawee, and not from the date upon which it is accepted for honor. The acceptor for honor agrees to pay the bill at maturity provided that at its maturity it is presented to the drawee for payment, refused payment, i. e., dishonored, formally protested for non-payment, and a formal notice of such dishonor given to him (the acceptor for honor). Payment for honor must be made before a notary and attested by him, the attest to be appended to the "protest" or made an extension of it.[1]

Crossed Checks. In handling sterling exchange one frequently runs across an interesting practice found only in England known as "cross-

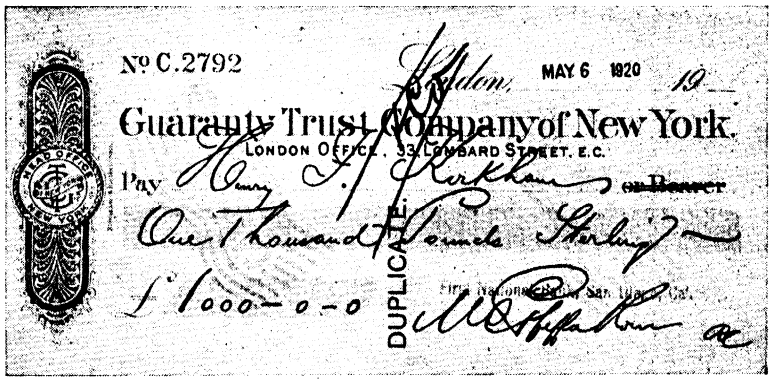


FIGURE 24

Crossed check

ing" a check. A crossed sterling check is one that is made payable to bearer or order which has the name of a banker or two parallel lines and the abbreviation "and Co." written or printed across its face. (Fig. 24.) The effect is to direct the bank upon which the check has been drawn to pay it only when it is presented by some other bank. The purpose of crossing a check is to provide an additional safeguard against wrong payment. Under the English Bills of Exchange Act of 1906, a crossed check can only be credited to a customer's account or paid to another banker. It cannot be paid in cash to the customer.

[1] Cf. p. 91.

Liability of Parties [1]

In discussing the liability of the parties who are interested in the kinds of negotiable instruments with which this volume deals, it is necessary to distinguish between parties *primarily* or unconditionally liable and those *secondarily* or conditionally liable. The Uniform Negotiable Instruments Law declares that "The person 'primarily' liable on an instrument is the person who by the terms of the instrument is absolutely required to pay the same. All other parties are 'secondarily' liable." It has often and incorrectly been said that the drawer of a bill is primarily liable, that he is "absolutely required to pay the same," but according to the terms of the Uniform Negotiable Instruments Law he is not bound to pay *unless* the bill has been presented to the drawee for acceptance or payment, as the case may be, and has been dishonored by the latter, following which due notice of such dishonor has been sent to him (the drawer). Unless these three things, i. e., proper presentment, dishonor, and notice of such dishonor, have been done in accordance with the terms of the law it is not possible to hold the drawer liable. Even an acceptor "for honor," as has been noted above, is not liable as an acceptor unless the bill has been presented for payment to the drawee, dishonored, protested, and a notice of such protest sent to him (the acceptor "for honor "). It should also be made clear that the drawee is not liable in connection with a bill of exchange before he has accepted it even though he legally owes the drawer the sum of money in question. A written promise to accept, appearing on a separate piece of paper, given even before the bill has been drawn, is looked upon by the courts as a regular acceptance, even though the drawee when the draft is presented to him for acceptance refuses to place his acceptance on the face of the bill. After the drawee has accepted the bill he is the only person primarily liable and absolutely bound to pay the same when presented to him for payment at maturity. The situation is the same as though the acceptor were the maker of a promissory note and the drawer were the first indorser thereof. The drawer and the various parties who indorse either before or after the acceptance of the bill, together with the acceptor for honor, are liable *only* when the bill has been presented for payment, dishonored, and a notice of such dishonor (or protest) sent them. Consequently they (the

[1] See Whitaker, *op. cit.*, pp. 29–38, for an excellent discussion of this matter.

drawer, the indorsers, and the acceptor for honor) are secondarily liable, that is, liable on condition that a certain legal procedure is followed for the purpose of holding them liable before the law.

Presentment for acceptance must be made to the drawee, while presentment for payment at the maturity of a bill must be made to the "acceptor." Presentment, either for payment or for acceptance, must be made by the holder of the bill at a reasonable hour of the business day and at a proper place, otherwise the drawer and the indorsers will be discharged from their liability. When the place is specified in the bill itself presentment must be there made. For example, if the drawee's acceptance has stated that the bill is to be paid at a designated bank or address, presentment must be made accordingly. If no place is designated, then it must be made at the place of business of the drawee or at his residence. Presentment for payment must be made upon the date of the maturity of the bill, although in some states and in some European countries the payer is allowed a few days extra (days of grace) after the presentment of the bill in which to arrange for payment. In the United States and in European countries days of grace are not allowed as a rule.[1] Great Britain, however, permits three days of grace; Canada does likewise. Among South American countries days of grace vary from six to fifteen. If the bill is payable at sight there is no need of acceptance because it must be paid at once inasmuch as days of grace do not ordinarily run in the case of such bills.

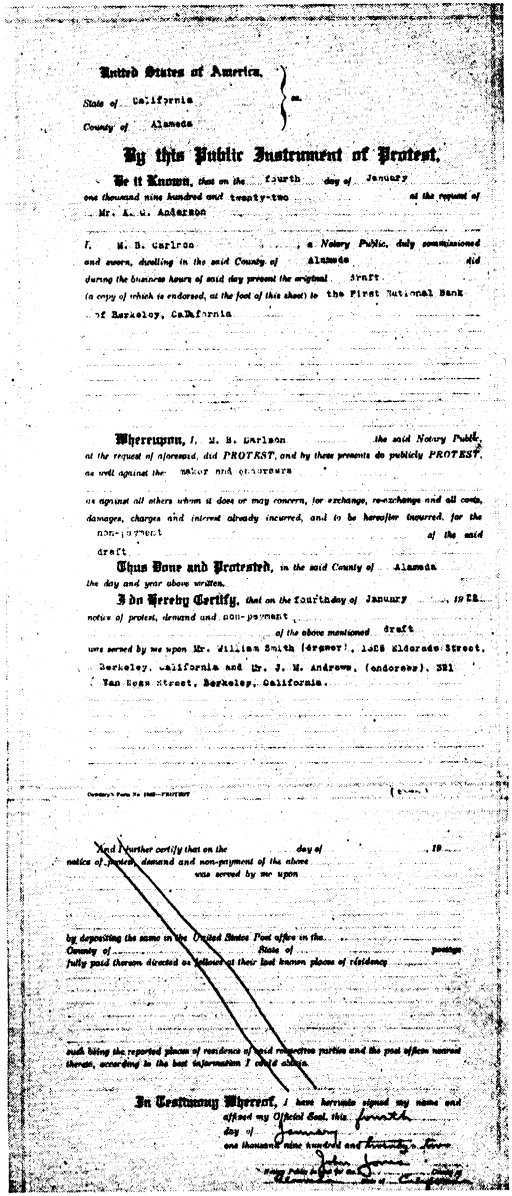
If the drawee refuses to pay a sight bill upon presentment it must be protested at once. If the bill has been accepted and at maturity the drawee refuses to pay, then after the allowable days of grace have run, and payment is still not forthcoming, the bill must be protested. Protesting arises only in case of failure to accept or failure to pay and is made for the purpose of protecting the interests of the holder of the bill by taking certain required legal steps which are necessary in order to hold the drawer and the indorsers liable for payment. Failure to protest, however, does not free from liability the party or parties primarily liable. When the drawer draws the draft he, according to the law, agrees to pay the amount thereof to the holder or to any subsequent indorser who may be legally compelled to pay it, provided presentment, dishonor, and notice of dishonor take place. The

[1] Huffcut, *op. cit.*, p. 162, states that days of grace are allowed in Mississippi, Texas and Wyoming on all classes of bills; in Massachusetts and North Carolina on sight bills only, and in Alaska only on paper payable at a future date.

drawer, however, may insert a stipulation in the bill negativing or limiting his own liability to the holder. Unless such stipulation is inserted the liability of the drawer ceases only with the payment of the bill, not with its acceptance. When the drawee accepts the bill he agrees to pay at maturity. An acceptor for honor agrees to pay at maturity provided pre entment to drawee, dishonor, and notice of dishonor take place. When a party indorses a draft, either before or after it has been accepted, he agrees to pay the instrument provided it is not paid by other parties who are liable and also provided presentment, dishonor, and notice of dishonor occur. Notice of such protest must be sent to all those who have not by their indorsement waived the right of demanding such notice by indorsing "Protest and notice of protest waived" or words to a similar effect. Any party negotiating a bill merely by delivery or by qualified indorsement warrants that the instrument is genuine and that it is in all respects what it purports to be, that he has good title to it, that all prior parties had capacity to contract, and that he has no knowledge of any fact that would in any way impair the validity of the bill or render it worthless. In other words, the liability of such a party is merely that of a seller. His guaranties or warranties extend only in favor of the immediate transferee, i. e., the person to whom the instrument is passed by him, and not to subsequent holders of the bill.

Protest is necessary only in the case of "foreign" bills, i. e., those that have been drawn upon a party residing in another state or country, but is not required where the bill has been drawn in one state and made payable by a party in that state. Protest is usually made by a notary public, although it may be made by any respectable person in the presence of two or more creditable witnesses. It must be made on the day the bill has been dishonored, unless delay be excused, and must be made at the place where it has been dishonored. The protest blank or document is a formal notice which is either appended or attached to the bill itself, specifying the time and place of presentment, stating that the bill has been dishonored by non-acceptance or by non-payment, and that the parties concerned, mentioned by name, are therewith notified of such dishonor and will be held liable in their respective capacities (Fig. 25). When a bill has been handed to a notary for protest, he presents it to the drawee for acceptance or for payment as the case may be, and upon the refusal of the latter to accept or pay, makes a notation to that effect in his protest book.

This is called a "notation of protest." He must thereupon promptly notify the drawer and indorsers of such dishonor or the holder will lose his legal claim against them. If possible protest notices (Fig. 26) must be presented in person to the parties concerned, but if such cannot be done, they may be mailed by depositing them in the postoffice, in a branch of the postoffice, or in a letter box under the control of the postoffice department. Mailing must take place on the day following the day of protest, or, if there is no mail service at that time, then on the first mail thereafter. Notice is deemed to have been given even though there is a miscarriage of the mails. If the notary does not have the addresses of all the indorsers and the drawer, he need only send the notices of



United States of America,
State of California } ss.
County of Alameda

By this Public Instrument of Protest.

Be it Known, that on the fourth day of January one thousand nine hundred and twenty-two at the request of Mr. A. G. Anderson

I, W. B. Carlson, a Notary Public, duly commissioned and sworn, dwelling in the said County of Alameda did during the business hours of said day present the original draft (a copy of which is endorsed, at the foot of this sheet) to the First National Bank of Berkeley, California

Wherefore, I, W. B. Carlson the said Notary Public, at the request aforesaid, did PROTEST, and by these presents do publicly PROTEST, as well against the maker and endorsers as against all others whom it does or may concern, for exchange, re-exchange and all costs, damages, charges and interest already incurred, and to be hereafter incurred, for the non-payment of the said draft.

Thus Done and Protested, in the said County of Alameda the day and year above written.

I do Hereby Certify, that on the fourth day of January 1922, notice of protest, demand and non-payment of the above mentioned draft was served by me upon Mr. William Smith (drawer), 1258 Eldorado Street, Berkeley, California and Mr. J. M. Andrews, (endorser), 321 Van Ness Street, Berkeley, California.

And I further certify that on the day of 19 notice of protest, demand and non-payment of the above was served by me upon

by depositing the same in the United States Post office in the County of State of postage fully paid thereon directed as follows at their last known places of residence

such being the reported places of residence of said respective parties and the post offices nearest thereto, according to the best information I could obtain.

In Testimony Wherent, I have hereunto signed my name and affixed my Official Seal, this fourth day of January one thousand nine hundred and twenty-two

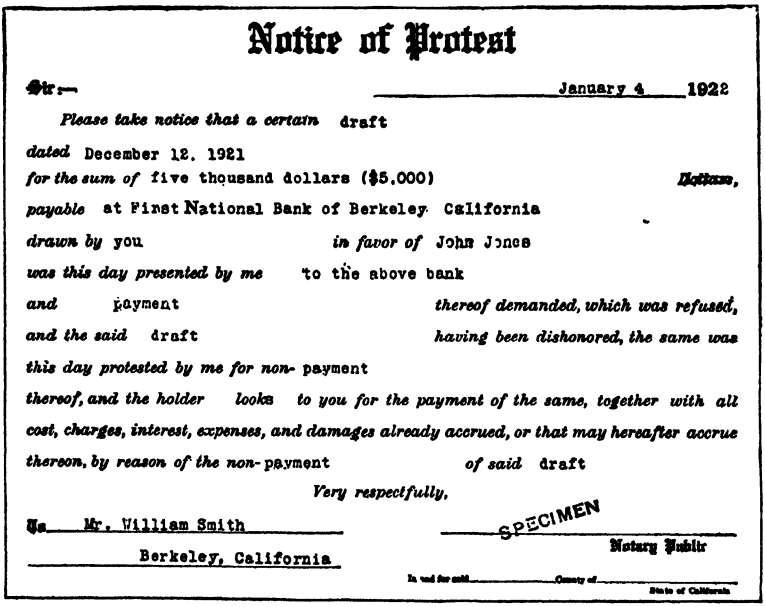
Notary Public in and for the County of

FIGURE 25—Protest blank

protest to the party from whom he received the bill, and this party to protect himself forwards them to the prior indorser, and so on, until all have been properly notified.

The protest fees of the notary public vary from place to place, and are usually fixed by the notaries themselves.[1] The fee is added to the amount of the draft and has to be paid by the party who is finally liable.

The notice of protest is merely a legal notification that the bill in question has been dishonored and that the indorsers and drawer are



Notice of Protest

Sir:— January 4 1922

Please take notice that a certain draft

dated December 12, 1921

for the sum of five thousand dollars ($5,000) *Dollars,*

payable at First National Bank of Berkeley California

drawn by you *in favor of* John Jones

was this day presented by me to the above bank

and payment *thereof demanded, which was refused,*

and the said draft *having been dishonored, the same was*

this day protested by me for non- payment

thereof, and the holder looks to you for the payment of the same, together with all cost, charges, interest, expenses, and damages already accrued, or that may hereafter accrue thereon, by reason of the non- payment *of said* draft

Very respectfully,

To Mr. William Smith

Berkeley, California

SPECIMEN

Notary Public

In and for said County of

State of California

FIGURE 26

Notice of protest

to be held liable for its payment. Indorsers are liable in the order of their indorsement. To get his money out of the bill the holder may sue any one of the indorsers that he chooses, but a suit against any indorser frees all subsequent or later indorsers. The indorser who has been sued and has paid may in his turn sue the drawer or any of the prior indorsers. An acceptor for honor is liable to the holder of the bill and to all parties to the bill subsequent to the party for whose

[1] They range from $1.25 to $7.50.

honor he has accepted. When a bill which has been accepted for honor has been paid, all parties subsequent to the party for whose honor the bill was accepted and was paid are discharged.

When a bill which has been accepted by the drawee is presented for payment and is dishonored and then protested for non-payment, any person may intervene and pay the bill for the honor of any person liable thereon or for the honor of the person for whose account it was drawn. This is called "payment for honor supra protest." Such payment must be attested by a notary public and the attest appended to the instrument or made a part of it. The attest must contain the name of the party for whose honor the payment is made. Payment for honor frees all parties subsequent to the party for whose honor the bill has been paid, and gives the payer for honor all the rights and duties of that party for whose honor he has paid the bill. He can, therefore, proceed to collect from any indorser prior to the party for whose honor he has paid the bill, or from the drawer.

CHAPTER V

EXCHANGE DEALERS

A. In the United States

The exchange market in the United States is unlike the stock and produce markets in that the exchange dealers of a city are not organized into a central trading body like a Stock Exchange or a Board of Trade. The exchange market is what is generally known as an "open" market. There is no designated place or time at which buyers and sellers come together for trading purposes, and there are no sets of rules and regulations by which the dealers abide. During the so-called Greenback period (1862–1878), when our nation had suspended specie payments, gold was bought and sold on the New York Stock Exchange because of the fluctuating premium which it commanded. During the World War when the price of silver was changing daily, almost hourly, it also was quoted on the Exchange. In 1921 it was proposed that foreign exchange should be dealt in on the floor of the New York Stock Exchange, following the example of some of the European stock exchanges, but thus far (April, 1922), no action thereon has been taken by the committee to which it was referred.[1] All transactions in exchange are carried on "over the counter" directly between buyer and seller or thru exchange brokers. The market is "open" and any person who wishes may enter for trading purposes. In London until 1920, the situation was slightly different,[2] but even there the market is now an "open" one.

The metropolis of a country is usually the center of the exchange activities for that country—London for England, Paris for France, Berlin for Germany, etc. In the United States, New York is the center for all the exchanges, European, South American, and Oriental.

[1] Some of the American writers follow Escher ("Foreign Exchange Explained," p. 54), in stating that "Years ago bills of exchange were traded in on the New York Stock Exchange." I have carefully checked this matter through various channels, especially through the Secretary of the New York Stock Exchange, who very kindly interviewed some of the oldest members about it, but nowhere have I been able to verify the statement as made.

[2] See pp. 105–107.

Chicago, New Orleans, San Francisco, and other large cities transact a great deal of foreign exchange business, but for the most part it is not of an independent character, all of the markets in the United States being dependent primarily upon the New York market. A large share of the bills purchased from exporters by banks in cities outside of New York is handled through New York, and the greater part of the bills that are sold by them are also drawn upon banks and financial houses in the latter city. Dealers in all parts of the nation make the rates for the day almost solely on the basis of the quotations received from New York. Even in the matter of rates on the Orient, San Francisco does not independently arrive at its own quotations but bases them upon telegraphic advices from New York.

In the foreign exchange market, there is a variety of dealers, just as is the case in the produce or clothing or hardware markets. It may not be amiss to warn the student of the exchanges that bills of exchange, both domestic and foreign, so far as the marketing of them is concerned, are very much like any other commodity. Those who are concerned with them may be roughly grouped into buyers and sellers, or again into manufacturers, wholesalers, jobbers, brokers, retailers, and customers. A party may be in the market both as a buyer and a seller at the same time. He may be buying the same sort of exchange that he is selling or he may be buying a kind of exchange that he may need a few hours or a few months later. He may also be a wholesaler and retailer, or a jobber and retailer, at the same time. This analogy will be made a little clearer as the discussion proceeds.

First of all, we have the very prominent banking and financial houses of New York, including the head office of the American Express Company,[1] which are vitally interested in practically every phase of

[1] The wide range of activities of some of the large New York houses is surprising. The American Express Company, for instance, advises the public that it offers the following services:

"For the importer, the American Express Company: locates foreign dealers in the commodity desired, or sources of raw material; obtains prices and credit report; procures samples for examination; arranges a proper introduction between the foreign dealer and the American purchaser; executes buying orders for account of accredited importers; insures and ships the goods, advising as to freight rates and steamship routes and sailings; finances the shipment completely; arranges for clearance at the seaboard or ships the goods in bond; warehouses or forwards the shipment wherever desired; makes arrangements with the foreign dealer for payment by cable transfer, foreign draft, commercial letter of credit, acceptance credit, collection of draft or invoice, or any other approved banking method preferred by the importer. Other incidental services of the American Express organization are at the disposal of the importer as occasion may arise.

"For the exporter, the American Express Company: locates the names of foreign prospects; reports on their financial standing and responsibility; reports on conditions of foreign

the exchange field, both domestic and foreign. These five or ten prominent dealers are in the market every day as buyers and sellers of large amounts of exchange, their daily transactions reaching into the millions of dollars. These concerns have accounts with correspondents in the more important cities of the world and some have two or more correspondents in each of the financial centers of Europe, as well as one or more correspondents in every large city in the United States. Within the last decade or so several of these dealers have established their own branches in London, on the continent, and in the Orient. Other cities like Chicago, New Orleans, Boston, San Francisco, support three or more large dealers, but none so important as those of New York, who likewise have their accounts and correspondents abroad although not to the same extent as do the leading New York houses.

This first group of dealers carry on an ordinary retail business in the sale of exchange in small amounts to their customers over the counter. They also do a wholesale business in that they sell millions of dollars worth of exchange to other banks or to importing firms which have to meet their commitments abroad. They buy equally large amounts from exporters and from banks and dealers. They also do what might be termed a jobbing business. They stand ready to take care of the requirements of their domestic correspondents for such exchange as may be requested by the latter or their clients. They are in close touch with a large number of smaller dealers scattered all over the country who buy and sell exchange through them. As has been stated in Chapter II, banks in small towns, and also frequently banks in large cities, have no accounts or correspondents abroad, yet their customers continually demand exchange or have exchange to sell. The needs of the customers must be taken care of, so these banks make arrangements with the larger dealers whereby they are able to sell exchange

markets as to demand, competition, prices and other details; advises about the better markets as conditions vary; provides direct introductions and references for prospective customers abroad; recommends as to packing, marking, invoicing and shipping; advises as to steamship lines and freight rates; offers assistance in dealing with foreign languages, weights and measures, currency and foreign exchange, postal requirements and similar local problems; explains unfamiliar technicalities; establishes credit anywhere, provides a Commercial Letter of Credit, or arranges a foreign checking account, or any other approved or preferred banking accommodations; receives the shipment in the United States for export; insures and ships the goods by the most advantageous route; finances the shipment while in transit; arranges for customs house clearances, domestic and foreign; sees the goods delivered to the buyer abroad, or, if desired, warehoused or reshipped; even sells the goods on the shipper's order, if necessary; and finally, handles collections completely, not only of current accounts but of old accounts as well, making returns to the shipper."

on foreign countries, or to buy the exchange offered by their customers. The larger banks furnish the needed forms or blanks to the smaller institutions and advise them, either daily or weekly, as to the rates at which and for what amounts the latter may draw, and also as to the rates at which the larger banks will purchase exchange from them.

Many of the banks in Chicago, New Orleans, San Francisco, etc., which have a few accounts abroad, would not be able to traffic in bills of exchange except on the few countries in which they happen to have their own foreign accounts, unless they, too, made arrangements with the large New York houses similar to those described above in the case of small town bankers. This group of banks in their turn, as has been noted in Chapter II, may likewise become jobbers in exchange, selling to a large list of small correspondent banks in their individual territory, handling the business through their own foreign accounts or through the larger New York banks.

A number of foreign banks have branches in the more important cities of the United States. These branches conduct a general business in foreign exchange and also act as agents through which American banks may purchase or sell exchange on foreign countries.

The exchange dealers have no outside men, i. e., no employés that go from bank to bank or from firm to firm, buying and selling exchange. Their business is transacted over the counter, by mail, by telegraph, or by telephone. They are constantly in touch with the exchange developments in the more important financial cities of the world.[1]

The next class of exchange dealers is composed of the small banks above mentioned, which have no foreign accounts abroad but which are able through their connections with the larger banks to supply the needs of their customers who desire exchange accommodations. As a rule, they are able to sell only ordinary sight drafts on foreign countries and then only for relatively small amounts, unless special permission be obtained from the jobbing bank. Generally they have authority to sell only on the more important European, South American, and Oriental cities. If their customers require traveler's letters of credit, import or export credit, or some more technical form of exchange, the small local bank cannot provide it, and will have to act merely as an agent in getting it for the customer from the jobbing

[1] The details of the work of the foreign exchange department of a bank will be more fully discussed in subsequent chapters.

bank. Jobbing banks usually grant the right to be drawn against only for a certain length of time, commonly for not more than a year. In such cases, the arrangement has to be renewed annually and the amount set for which the small bank may draw. These smaller banks make a practice of engaging in the exchange business only for the purpose of taking care of the immediate needs of their depositors. Ordinarily they do not buy exchange from their customers, but act only as agents in forwarding it to the larger banks. Their exchange business is of the regular routine character and requires no special knowledge of the principles or theories of exchange. They receive their rates daily or weekly from the jobber, add their profit, and charge the customer the resulting amount. They then remit to the jobbing bank at the rate quoted by the latter. They care nothing as to the forces that move the exchange market or as to its more technical or theoretical phases.

The next class of firms in the exchange market is technically known as the "dealers." As American foreign commerce has developed, an increasingly large number of bills has come into the market. Many of these bills have been drawn by exporting firms in cities far removed from New York, which, realizing the importance of the New York market and the fact that they can possibly get a much better rate for their bills in that city than in their home towns, regularly send them to that center to be marketed. They have no banking connections in New York, and consequently make arrangements with exchange dealers to handle the bills for them. These dealers are usually small firms made up of men who are experts in the exchange business. When the bills are drawn by the exporter they are mailed to the dealer, who takes them from bank to bank and markets them at the best obtainable price. Or it may be that the exporting firm has agreed to sell certain goods to some foreign company at a future date, say three months hence. It therefore instructs its New York dealer to get for it the best possible contract price or rate for the bills which it will have for sale three months hence. The dealer therefore goes from bank to bank and secures the best offer that he can for this "future." [1] It is possible for the dealer to act as an agent for scores of firms scattered throughout the country. All sorts of bills may be sent to him by his clients to be disposed of in the New York market. He may personally make the rounds of the exchange houses each day, or he may transact

[1] Cf. pp. 497–501.

a great deal of his business over the phone. As he usually has a variety of bills in his portfolio, he is a welcome visitor at the bank's counter. Each bank is thus enabled to purchase the kind and the amount of exchange that it wants and to keep its foreign accounts in the desired condition. The dealer may also have orders to buy exchange and here again he is able to obtain for his out-of-town clients much better rates than they could get from their local banks. As a rule, the rates in New York vary little from bank to bank, sometimes not at all, but, no matter what the case may be, it is the task of the dealer to take the best possible care of the interests of his clients. At times the dealer may actually have foreign accounts himself, and buy from or sell to his clients just as banks do, but that is not usually the case. The dealer charges his clients a small commission, but his charges are more than offset by the better rates which he obtains for them. In addition to acting for a large number of clients who are either exporters or importers, he also frequently acts as the New York representative of a number of the larger banks in other parts of the country in connection with their purchases and sales of foreign exchange. Often they commission him to keep them advised as to the fluctuations in the exchange rates, and he accordingly wires them at the opening of the day the sight rates for the more important European exchanges. If during the day the rates change noticeably, he immediately wires his client banks to that effect. A client bank in Chicago may find that it needs a certain amount of exchange on London to take care of its obligations; it wires him to purchase the same for its account; or a San Francisco bank may happen to have more franc exchange on hand than it needs and it wires him to dispose of it at the best price. By this means the exchange of the client bank is sold or purchased at much better rates than it itself could secure by trying to sell to or to purchase from some bank in its own community.

With the exception of the above paragraph, the word "dealer" will not be used in this volume in its technical sense. In subsequent pages, as has been true of the earlier ones, the word will be used as referring to all firms, banks, trust companies, financial houses, express companies, etc., which deal in the exchanges.

Among some exchange men and also in the literature on the subject the "dealers" as described above are sometimes known as "brokers." To be strictly technical, however, the broker is a different type of dealer. He is a man, usually without an office, who comes between the buyer

and the seller. As a rule, he trades solely with the larger exchange dealers. Each morning he goes from bank to bank, asking what they have to sell or what they wish to buy, getting their bids and their offerings and very carefully inquiring as to their rates. He may find that one bank wishes to sell some sterling exchange at a slightly lower rate than some other bank is willing to pay. He acts as the go-between in making the transaction and his profit may either be the difference between the purchase price of the one bank and the sale price of the other, or it may be that he receives a commission. A bank may be in the market for exchange on some particular center, and may give him an order to get it at the best possible price. In that case, the broker gets only a commission for his work. Before the wide use of the telephone, the broker was a very useful and necessary person in buying what some banks desired and in selling what other banks wished to get rid of. Today his lot is far from an easy one, because the banks themselves for the most part take care of their needs over the telephone. Before the introduction of the Gold Settlement Fund of the Federal Reserve System the broker was very active in the sale of domestic exchange. But, as noted earlier, that field has been almost completely taken away from him. On foreign deals, the competition among brokers themselves has greatly reduced the commissions. Formerly the average charge was a commission of 1/20 of 1 per cent on the pound sterling, or $5.00 on every £10,000, and about 1/64 of 1 per cent on Continental exchanges, or on francs, for example, $3.00 on a turnover of 100,000 francs. Since the World War these rates have declined to about 1/16 to 1/8 of a cent per £, and to about one point on Continental exchanges, except on marks, where the average rate is about 1/4 to 1/2 of a point.

Lately there has arisen in the United States a new group of exchange dealers, viz., the acceptance houses. This innovation has been made possible through the changes already referred to, resulting in the development of our acceptance market. During the last few years the practice of using the acceptance for both domestic and foreign trade has grown to such an extent as to warrant the establishment of several acceptance houses with headquarters in New York, Boston and other eastern cities. Their primary function is to buy and sell acceptances, i. e., to discount (buy them) at one rate and to sell at another thus making a slight profit. They issue circulars to clients scattered all over the United States telling what acceptances they

have for sale, what the accepting bank is and where located, the amount of the acceptance, the length of time it has to run, and the rate at which it is for sale (Fig. 27).

JONES SMITH AND COMPANY
85 Wall Street

New York City
May 17, 1922

Dear Sirs:

We own and take pleasure in offering subject to prior sale and change in rate all or part of the following acceptances for delivery in New York.

Amount	*Acceptor*		*Days to Run*	*Rate*
$300,000	Chase National Bank	New York	33/47	3 1/8%
200,000	Guaranty Trust Co.	"	48	"
50,000	Huth & Company	"	20/54	"
100,000	Bank of New York N. B. A.	"	85/88	3 1/8%
150,000	BrownBrothers & Co.	"	77/85	"
200,000	Central Union Trust Co.	"	75	"
150,000	Chase National Bank	"	80	"
60,000	Chemical National Bank	"	84	"
200,000	Equitable Trust Co.	"	61/69	"
200,000	Guaranty Trust Co.	"	77	"
150,000	International Acceptance Bank	"	61/78	"
200,000	National Bank of Commerce	"	76/78	"
100,000	New York Trust Co.	"	68	"
200,000	Royal Bank of Canada	"	51/81	"
200,000	Seaboard National Bank	"	84	"
200,000	First National Bank	Boston	61/81	"
250,000	First National Bank	Chicago	79	"
400,000	Merchants Loan & Trust Co.	"	82	"
165,000	First National Bank	Minneapolis	75/83	"
150,000	Merchants National Bank	St. Paul	64	"
250,000	Anglo & London Paris Nat'l Bk.	San Francisco	82	"
150,000	First National Bank	Chicago	174	3 1/4%
200,000	First Trust & Savings Bank	"	174	"

The above bills are eligible for purchase by the Federal Reserve Banks.

Please communicate promptly at our expense, either with us or with our correspondents listed below, in case you care to avail yourselves of the above offering.

Very truly yours,

Telephone Rector 70

FIGURE 27—List of offerings of bankers' acceptances by discount house

Some of these firms also carry on other financial transations of an international nature, such as the establishment of dollar acceptance credits in the United States, the opening of foreign credits on all parts of the world, the negotiating, collecting, and selling of all kinds of exchange, and, generally, the financing of foreign trade upon a reasonably short term basis. The acceptance companies are corporations possessed of large amounts of capital. Some are owned jointly by a number of American banks, others are owned by American banks and foreign banks, while still others are owned solely by individuals. Some are incorporated under state laws; others under the federal laws.[1] If we are to become an international financial power we must develop a system of discounting and accepting houses similar in character and importance to those of London.

About a dozen or more foreign banking corporations have also been organized under the laws of the various states for the purpose of engaging primarily in banking, exchange, and other financial operations in foreign countries. Some of the more important of these are the American Foreign Banking Corporation, the Mercantile Bank of the Americas, the Asia Banking Corporation, the International Banking Corporation, the French American Banking Corporation, the First National Corporation, the Shawmut Corporation, and the Equitable Eastern Banking Corporation.

The purchase and the sale of bank acceptances have become of such importance, especially in New York, that in 1920 a number of brokers began actively dealing in them. Every morning they make the rounds of the various banks with the list of the acceptances that they have for sale, inquiring at the same time as to what the banks themselves have for sale and at what prices. Certain investment houses in the more important cities have also started carrying an assortment of acceptances varying as to maturities and denominations, which they offer to their customers (banks and individuals) as excellent forms of short time investments.

Behind the entire acceptance market, however, stand the twelve

[1] Typical examples of such firms are as follows: The Foreign Credit Corporation of New York City was incorporated under the laws of the State of New York in 1919 with a capital stock of $5,000,000. In 1921 it also had a surplus of $1,000,000. It is owned by two national banks and four state banks. The International Acceptance Bank was also incorporated under the laws of the State of New York. Its capital and surplus in 1921 were respectively $10,000,000 and $5,000,000. It is owned jointly by eleven national banks, seven state banks, trust companies, and investment firms, eleven foreign banks, and two foreign private banking companies. There are other acceptance houses of similar character.

Federal Reserve banks, ever ready not only to rediscount acceptances for member banks, provided such acceptances fulfill the requirements laid down by the Federal Reserve Board, but also willing to go out into the market and buy for their member banks indorsed bills of all kinds and maturities which will be held for such banks, or sold for them as requested, or collected at maturity. This service has been rendered free of charge and has made it very easy for the member banks to keep their excess funds constantly and profitably employed through the continued or occasional investment in prime bills.[1] This service has been performed by the Federal Reserve banks solely for the purpose of acquainting the banks with the advantages of investing in acceptances, thus popularizing the practice and aiding greatly in the development of the discount market. The amount of acceptances bought in the open market by the Federal Reserve banks from 1915 to 1920, inclusive, was as follows: 1915, $64,845,000; 1916, $386,095,000; 1917, $909,301,000; 1918, $1,809,539,000; 1919, $2,825,177,000; 1920, $3,218,364,000. These data, although covering only the amount purchased in the open market by the Federal Reserve banks, clearly show the wonderful strides that have been made during the last few years in the growth of discounting and rediscounting domestic and foreign bills of exchange in the United States.

The Federal Reserve banks do not provide their member banks with any of the ordinary exchange facilities in connection with foreign trade, i. e., they do not issue letters of credit, accept bills, sell drafts on foreign accounts, etc. A Federal Reserve bank, however, is authorized "with the consent of the Federal Reserve Board to open and maintain banking accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may deem best for any purpose of purchasing, selling and collecting bills of exchange, and to buy and sell with or without its indorsement through such correspondents or agencies, bills of exchange arising out of actual commercial transactions." [2] It may also, "under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of all kinds and maturities by this Act made eligible for rediscount, with or without the indorsement

[1] Annual Report of the Federal Reserve Board, 1920, p. 51.
[2] Section 14, Federal Reserve Law.

of a member bank." [1] It is also authorized to deal in gold coin and bullion at home or abroad. On December 20, 1916, the Federal Reserve Board approved the request of the Federal Reserve Bank of New York that it be allowed to appoint the Bank of England as its agent and correspondent, the relation to be reciprocal in character. The arrangement finally concluded on May 3, 1917, was of "a formal character, covered by written agreement . . . covering in detail the basis of the principal operations and making a close, effective and complete agency." [2] During 1917 the Federal Reserve Bank of New York "acting for itself and other Federal Reserve banks, paid for account of certain English banks a loan of $52,500,000 with interest, maturing in New York, and accepted in return earmarked [3] sovereigns of equivalent value in the Bank of England." During 1918 all but a small amount of this gold was either shipped to New York or furnished to the Treasury Department for the use of the United States Government or its allies in Europe. During 1919 the Bank of England handled for the Federal Reserve banks the $173,000,000 of gold paid by Germany to the United States Grain Corporation for food supplies. The Bank of England transferred that sum to London from the Belgian and Dutch banks in which it has been deposited by the German government, and held it subject to the orders of the Federal Reserve Bank of New York. A large proportion of this gold, although on deposit with the Bank of England, was later sold to American banks by the New York institution for export to the Far East. The remainder was brought to the United States in 1920. Arrangements, although not the same in all cases as that described above, were also concluded with the Bank of France, the Bank of Japan, the Bank of Spain, De Javasche Bank (Java), De Nederlandsche Bank (Holland), the Bank of Italy, the Philippine National Bank, the Sveriges Riksbank (Stockholm), the Norges Bank (Christiania), and with the governments of Argentina, Bolivia, Peru, and Great Britain. The greater part of these relations with the foreign central banks and governments are no longer in effect, owing to the passing of the critical conditions in the exchange market which had necessitated their establishment. In all these agency relationships, the other eleven Federal Reserve banks participated with the Federal Reserve

[1] Section 14, Federal Reserve Law.

[2] Annual Report of the Federal Reserve Board, 1918, p. 339.

[3] "Earmarked" means that the sovereigns were counted and actually set aside as being the property of the Federal Reserve Bank of New York.

bank of New York upon the same terms and under the same conditions.

As a result of the situation arising out of our entrance into the World War, the United States government placed all exchange matters under the complete control of the Federal Reserve Board. This was done by Executive Orders issued by the President at various times following September 7, 1917, which orders remained effective until in June, 1919, when practically all of the restrictions were removed. Such control was purely a war-time measure.[1] In normal times it is not intended that the Federal Reserve Board shall function directly as a factor in the foreign exchange market. Its influence, however, can be, and possibly may be, made effective through the various Federal Reserve banks.

B. Foreign Exchange Dealers in England [2]

In England the situation in some respects is different from that which exists in the United States; in others it is similar. The London market is centuries old, interwoven with long-standing customs and traditions, and characterized by practices that have developed as only they could in what has for centuries been the world's center of finance and foreign trade. There the actual trading in bills of exchange, or at least a part of such trading, had, until December 30, 1920, a more formal character than in any other place in the world. Twice a week (Tuesdays and Thursdays) the bill-brokers who had business to transact in foreign bills gathered at the Royal Exchange, and for about an hour the buying and selling of bills took place. Clare in his "A B C of the Foreign Exchanges" [3] describes the Royal Exchange and its activities as follows:

"There is perhaps no public edifice in the City [London], which is better known or less understood than the Royal Exchange. Familiar as its outlines are to the thousands of Londoners who daily pass by it, there is not one in a hundred that can tell why it was erected, or what purpose it serves. Nor,

[1] This will be more fully discussed in Chapter XIV, War and the Exchanges.

[2] The discussion which follows is concerned only with those phases of the London money market that affect the foreign exchange field, and touches only the part which they play in that connection. It is not designed to give the reader a complete survey of the English banking system. For such a survey consult the publications of the United States National Monetary Commission, F. A. Straker, "The Money Market," G. Clare, "A Money Market Primer," A. Andreades, "History of the Bank of England," C. A. Conant, "History of Modern Banks of Issue," and similar volumes pertaining to that subject.

[3] Pp. 37–40.

if they should enter it in quest of information would they be much the wiser, for at times they would find the interior either entirely deserted or only tenanted by a few loungers. It was not always so, however. The Royal Exchange was intended as a meeting place for merchants, and up to a quarter of a century or so ago London merchants actually did meet there, each separate branch of trade collected in its own corner or round its own particular pillar. But, as the various sections grew in numbers, it became more convenient to make homes for themselves in the localities that they specifically affect, and the coal, wood, corn, produce, and other interests now possess their own separate Exchanges.

"One important group still remains true to its allegiance. Twice a week, on Tuesdays and Thursdays,[1] the Royal Exchange wakes up for a brief space. Immediately after luncheon-time, those who have business to transact in foreign bills begin to gather at the eastern end of the courtyard and for about an hour 'Change is held. The assemblage which is not a very large one—not more than perhaps five or six score at the outside—consists of a small number of brokers and of the chiefs of all the great foreign banking houses. Of bankers, in the ordinary acceptation of the term, scarcely one is to be seen, except on rare occasions; London being perhaps the only great capital in the world of which the home-banking interest is not regularly represented on the 'Change. There is an entire absence of noise or excitement. So quietly is the business transacted that it is difficult for the onlooker to believe that anything is going on. Now and again one observes a broker draw a likely buyer aside, covertly exhibit a contract-note and suggest a price in a whisper. A simple nod of the head, almost imperceptible to a bystander, signifies acceptance; the broker scribbles down the rate, passes over the contract, which the banker thrusts unconcernedly into his pocket, and the bargain is complete. In an hour or so all is over, and the broker hurries back to his office to write out his course of exchange, or list of current prices." [2]

The London papers the next morning contained the list of prices or the rates of exchange which had prevailed on the Exchange. This

[1] Note by Clare: "Formerly Tuesdays and Fridays were the only days on which foreign mails were dispatched from London, and on those days alone were foreign bills negotiable on 'Change. It had always been the custom that bills bought on one 'post day' should be paid for on the next; but a notorious case (and not the first) having occurred of a house, that had bought cheques to a large amount, stopping payment before the following post day, thereby involving the sellers in heavy loss, it was arranged in 1879 that, for the future all bargains should be settled the next morning, in order that, if a similar case happened again, the cheques might be stopped by telegraph. At the same time the second day was altered to Thursday, as it was not to the convenience of the great Jewish houses to pay on Saturday."

[2] Cf. Ernest Seyd, "Bullion and Foreign Exchanges," London, 1868, pp. 434–436; Straker, *op. cit.*, pp. 133–135.

list was much less important, and was scanned much less carefully, than the daily table of rates cabled from abroad, because most of the business in which the foreign exchange dealers are interested concerns not the bills drawn *in* London on foreign centers but those drawn in foreign centers *on* London. Nevertheless, the list was of importance as showing the trend of the exchanges.

These semi-weekly meetings of the Royal Exchange were the only instances of the formal marketing of bills of exchange in London. Otherwise the market has always been as open and as informal as it is in the United States.

The reason for the abandonment of the Exchange meetings is nicely summarized in the London *Times* under date of December 24, 1920:

> "An institution which has existed in the City for generations is about to come to an end, owing to the altered conditions existing at the present day. . . . Originally these dealings were chiefly in the form of bills; nowadays, with the telephones and telegraphs in operation, dealings in foreign exchange take place at a furious pace all day long. . . . The necessity for the old post-day meetings has therefore largely disappeared; hence it has been decided for the present to discontinue these bi-weekly meetings after Thursday next."

The agencies that are active in the English exchange market are: (a) the bill-brokers; (b) the discount houses; (c) the merchant bankers and accepting houses; (d) the branches of London offices of foreign and colonial banks and financial houses; (e) the English private and joint stock banks; and (f) the Bank of England. Each plays its part in the daily transactions that arise in connection with the accepting, negotiating, discounting, and collecting of claims for untold millions of pounds sterling arising out of both domestic and foreign trade.

The bill-brokers and discount houses are peculiarly English institutions, only in exceptional cases are they found on the Continent, and, as we have noted earlier, it is only during the last few years that they have appeared in the New York market to perform the same function that they do in London. There are only a few of the "running" bill brokers, i. e., those who do not themselves make a practice of actually purchasing the bills, but who go from bank to bank or from firm to firm, selling and buying for others on a commission and always using funds supplied by their clients. There are about twenty dis-

count houses that are actual dealers in exchange, buying and selling, and having offices and funds of their own. Three of these discount houses, viz., The Union Discount Company, Ltd., The National Discount Company, Ltd., and Alexanders Discount Company, Ltd., are incorporated;[1] the others are private partnerships. Both groups work with their own capital and also with funds which they attract in the shape of deposits from customers (just as in the case of a banking concern). Interest is paid on these deposits, the rate being based on that prevailing in the market, usually at the bankers' seven day rate for ordinary commercial checking deposits or accounts (in England known as "call deposits") and one-quarter per cent additional for time or savings deposits (known in England as "short notice" deposits). It is also the custom of the discount houses to borrow large sums from the private and joint stock banks, and, in times of need, when all other sources fail, to have recourse to the Bank of England where they either borrow for a few days (usually from three to ten days) the sum which they need to care for their business, or else discount (sell) some of their bills and thus put themselves in funds. They also make loans on negotiable securities, buy and sell stocks and bonds, and at times underwrite new issues of corporation securities, but they do not issue letters of credit, drafts, or other forms of exchange instruments.

The principal function of the brokers and the discount houses, both of which are frequently known only as "brokers," is to provide a market for bills of exchange. The running brokers intervene between buyers and sellers and charge a commission for their services, but the discount houses actually buy the bills that are offered for sale. The discount houses keep a considerable portion of these bills until maturity, thus earning the discount thereon. Other bills they sell to banks and investors at a slightly different rate of discount than that at which purchased, and make their profit on the difference between their buying and their selling rates. English and continental

[1] The National Discount Company, Ltd., was established in 1856. It has a subscribed capital of £4,233,325, of which £846,665 is paid up. Its reserve fund is £500,000. In its balance sheet for December 31, 1920, it showed a total of £32,406,636 worth of bills discounted, £12,114,742 of which it had sold to others.

The Union Discount Company, Ltd., was established in 1885. Its balance sheet of December 31, 1920, showed a capital stock of £2,000,000, of which £1,000,000 was paid up. Its reserve fund was £1,000,000. Bills discounted stood at £41,079,452.

Alexanders Discount Company, Ltd., was established in 1810 and incorporated in 1891. Its balance sheet for December 31, 1920, showed a capital stock of £1,000,000, of which £550,000 was paid up; a reserve fund of £270,000, and bills discounted at £18,063,470.

bankers know the advantages of the acceptance as a form of short time investment. They prefer, however, to purchase them from the discount houses rather than to deal directly with the acceptors because the discount houses specialize in that particular class of paper, and know the exact credit status of each acceptor in the London market, the genuineness of the signatures, the amount of the paper which each acceptor is likely to have outstanding, and all other related facts. Discount houses have many sources of information on these matters and keep their data up to date. In the field of foreign trade and finance the standing of a firm may change almost overnight, so that there is constant need of investors being closely in touch with the latest developments. Thus far the banks have seen fit to rely solely upon the discount houses in such matters. Discount houses can provide the banker with just the kinds of bills that he desires, the proper amounts and maturities, so that he can keep his portfolio filled with the right kinds of paper. Many of the banks on the Continent, including the central banks of Germany, France, Italy, Belgium, and Holland, invest heavily in sterling acceptances. They, too, make their purchases primarily through the discount houses. Also, the small English banks outside of London, find that it is not possible to obtain enough, or at times the right kinds, of acceptances from their customers in which to invest surplus funds, so that they, too, have need of recourse to the discount houses to fill their portfolios. These acceptances are looked upon as being the very best kinds of bills for short time investment. If an English bank does not wish to hold the bills until maturity, it may easily sell them again to a discount house, to one of the private or joint stock banks in London, or to the Bank of England itself. In actual practice, however, it is not customary for English banks to rediscount the acceptances which they have purchased for their own needs.

"The function of the discount house is thus of considerable importance in the London money market, because the terms on which they do business may have a considerable effect upon the foreign exchanges and so upon the inward and outward movement of gold. Ultimately and in the long run it is probable that the discount rates current in the London money market are decided by the banks themselves since if the bankers decide that they will not buy below a certain rate that rate is almost certain to become speedily effective. Nevertheless the discount houses may have a considerable effect on the rates current,

since if they take a strong view concerning monetary probabilities in London their sentiment is almost certain to express itself on the rates current for the moment." [1]

It is not usual for the discount houses to indorse the acceptances which they sell to others. It is customary, however, for them to have a standing "guaranty" with the banks to which they sell large amounts, which guaranty is, practically, the equivalent of an indorsement. "In consideration of the bill-broker's guarantee and of having the advantages of his knowledge in selecting and collecting bills, a banker is content to buy bills from a broker at a slightly lower rate than the ruling market rate, usually 1/8th or 1/16th per cent per annum lower. For instance, if bank or first-class paper is quoted in the market at 2 3/8ths per cent per annum for bills due in three months' time, bankers would buy such bills from the broker at 2 ¼ per cent. The broker thus makes a turn of about 1/32nd per cent on the deal, but in active times this 'turn' is often divided with the merchant from whom he buys. This profit may seem small, but when the enormous turnover of a bill-broker is taken into consideration, it is apparent that the total profits derivable from this business are very considerable. This is confirmed by the satisfactory dividends paid by two or three public companies conducting discount business." [2]

The brokers and discount houses are very heavy borrowers from the banks, either at call or at short notice rates. The security for such loans is either "first-class bills or what are known as 'floaters.' 'Floaters' are bearer securities of the highest class, such as Consol certificates, the debentures of certain Indian railways, the bonds of the Corporation of London, and the London City Council. They obtain the name of 'floaters' from the fact that they float from bank to bank, as one bank calls and another lends." [3] When the money market gets tight and the brokers and discount houses have to borrow from the Bank of England (they are then said to be "in the Bank"), the latter charges them a slightly higher rate, ranging from one-half

[1] Withers, Hartley, "The English Banking System," United States National Monetary Commission Reports, 61st Congress, 2d Session, Senate Document No. 492, pp. 62–63.

[2] Straker, *op. cit.*, pp. 108–109. The following dividends were paid for 1920: Union Discount Company, Ltd., 28 per cent; National Discount Company, Ltd., 24 per cent; Alexanders Discount Company, Ltd., 28 per cent on common shares and 12 per cent on preferred shares.

[3] Straker, *op. cit.*, pp. 111–112.

to one per cent higher, than the official Bank rate. Such loans usually run from three to ten days.

From the above discussion it can be readily appreciated that the brokers and the discount houses are a very important and influential factor in the London money market.

The merchant bankers and accepting houses were among the first to specialize in accepting bills for customers. "The importance of the acceptor's name on a bill . . . led merchants of first rate standing to specialize in this form of business. They gradually let off or reduced the amount of their actual mercantile business and confined themselves to accepting bills, for a commission, for others whose credit was less well established. . . . The business of acceptance has thus grown up an important and separate function which is largely in the hands of the leaders among the old merchant firms, whose acceptance of a bill stamps it at once as a readily negotiable instrument. . . . Other functions of the merchant firms and accepting houses are their activity in general finance and in exchange business. Both of these functions arise out of their old business as merchants, which gave them close connection with the governments and the business communities of foreign countries. Their connection with the governments naturally led to their providing credit facilities for them, and to their handling loans and other operations which these governments might have to conduct in the London market. Many of them act as regular agents of foreign governments, making issues of bonds on their behalf, paying their coupons, and conducting amortization and other business in connection with their loans; and their connections with the general business community led inevitably to their doing a considerable exchange business with foreign countries, financing drafts on them for purposes of travel and the innumerable other arrangements which necessitate the transfer of credit from one country to another." [1] It is interesting to note that the board of directors of the Bank of England is chosen mainly from the ranks of the merchant bankers and accepting firms.

There are in London (1921) sixty-eight offices or branches of foreign banks, representing practically every country of the world, many of which act as correspondents for other banks located not only in the home country of the branch or office itself but in other countries as

[1] Withers, H., "The English Banking System," pp. 54–57.

well.[1] These foreign and colonial banks, as can be surmised, are most actively engaged in and concerned with practically all phases of foreign exchange. They issue letters of credit, act as accepting houses, discount bills, and provide exchange facilities for many banks located in their own and in other countries. It was the fact that they were so successful in the foreign exchange field and were, as a result, able to compete with London banks in other lines of banking activities, that finally compelled the private and joint stock banks of England to engage in the foreign exchange business. It was as late as 1905 that the first foreign exchange department was organized by an English joint stock bank, which is now the London Joint City and Midland Bank.[2] At the time this unprecedented action aroused the hostility of English joint stock and private banks, but it has since been widely copied by them. Having once entered the field, it was easy to take the next step, and the private and joint stock banks then undertook to act as accepting firms. In so doing, however, they aroused the opposition of the older merchant accepting houses. The latter claimed that the banks did not have the special training needed to become acceptors, and also that there was an anomaly in their being acceptors of bills of exchange and at the same time guardians, as they necessarily have to be, of the volume of acceptances created by other accepting firms. It was felt that if they became acceptors they would tend to discriminate against the acceptances created by the merchant bankers and the accepting houses. The banks, however,

[1] The *Economist* of London, in its issue of Oct. 22, 1921, gives the following data concerning colonial and foreign banks with branches or offices in London:

Colonial Joint Stock Banks with London Office:

6 African banks with 979 branches elsewhere.
15 Australian banks with 2,364 branches elsewhere.
8 Canadian and West Indian banks with 2,784 branches elsewhere.
4 Indian banks with 94 branches elsewhere.

Total, 33 Colonial joint stock banks with 6,221 branches.

Foreign Banks with London Offices:

17 Continental banks.
5 Asiatic banks.
6 South American banks.
5 United States banks.

Total, 33.

[2] In October, 1907, the *Journal of the Institute of Bankers* (English) stated, "For some time past there have been signs that some of the English joint stock banks favored the idea of getting into their own hands some of the foreign exchange business which has been so largely under the control of foreign banks and firms. An important step in this direction has been taken by the London and County Bank, who announce that they have purchased the business of Messrs. Fredk. Burt & Co., of 80 Cornhill, and that they will from October 1st carry on at that address a Foreign Exchange Branch of the Bank. It will be interesting to see if this example is followed by other banks."

have not allowed these objections to interfere with the development of the acceptance phase of their business.

The joint stock banks are undoubtedly the most important factors in the London money market outside of the Bank of England. Until lately there have also been a number of private banks in England, but since 1896, and especially during and since the Great War, they have been rapidly absorbed by a few of the more important joint stock banks until today (1922) private banks are almost non-existent. Banking in England is now dominated by a few of the joint stock banks (known as "The Big Five": the London Joint City and Midland; Lloyds; London County, Westminster and Parr's; Barclays; and the National Provincial and Union [1]) either through their having combined with or purchased outright a number of other banking institutions, or through control exercised by their owning a large portion of the stock of these latter banks.

The English banks have been very slow to establish branches in foreign countries [2] although in the British Isles themselves branch banking has long been an accepted practice.[3] It has been the foreign banks, colonial and others, controlled by English capital and with their main offices sometimes in London, sometimes not, that have been so active in spreading a network of branches over the face of the earth.[4]

[1] The progress made in the absorption of the private banks and the tendency toward combination of banking resources are shown by the following data:

Private Banks		*Joint Stock Banks*	
Year	*No. of Banks*	*Year*	*No. of Banks*
1895	38	1890	123
1900	19	1895	118
1905	12	1900	96
1910	9	1905	79
1915	7	1910	63
1920	5	1915	55
		1920	37

The control exercised by the Big Five through stock ownership is not disclosed in the above table.

[2] The situation as it applies to the English joint stock banks is aptly characterized by an article which appeared in the New York *Annalist* on March 5, 1917, written by that journal's London correspondent. In part it stated that:

"The number of British banks with direct connections abroad are few. Lloyds Bank has a subsidiary enterprise in France known as Lloyds Bank (France) and the London County and Westminster Bank has a branch in Paris . . . but even bolder is a step just taken by the London County and Westminster Bank. This concern has decided to open a branch in Spain. . . . No other purely British bank is represented in Spain by branch offices."

[3] In 1890, 123 English banks had a total of 3,634 branches. In 1920, 37 banks had a total of 9,452 branches.

[4] As noted above, 33 colonial joint stock banks with London offices controlled a total of 6,221 branches.

The private and joint stock banks do a general banking business, receiving deposits and paying interest thereon, holding the accounts of domestic and foreign correspondents, selling and buying foreign exchange, accepting and discounting bills, etc. They also loan large amounts of money to bill-brokers and discount houses. When they become hard pressed for funds they rediscount some of their bills with the Bank of England, although it is not the practice of the joint stock banks to discount freely with the Bank of England. While the Bank is willing to act as a rediscounting agency, nevertheless, as noted above, it is the custom of the joint stock banks to hold until maturity the bills which they purchase. The banks of France and Germany have much less hesitancy about discounting with the central bank of their respective countries. In fact, with them it is the customary thing, as a consequence of which the "intercourse between customer and bank on the one hand, and the bank and the central bank on the other, is a pretty direct one. While a large business is still done by brokers and consequently in the open market, the majority of the transactions is carried on directly between customer and bank and bank and central bank." [1]

"In England, banks and bankers generally avoid accepting long bills for home customers, whom they prefer to accommodate by cash advances, but they accept very largely for out-of-town customers. The joint stock banks in England make it a rule to accept only against collateral, while important banking firms and banks, which often make accepting their exclusive business, grant uncovered credits to a very large extent. In France and Germany no line of demarcation of this kind exists; banks, large and small, private bankers as well, accept with or without collateral, according to their own best judgment. The aggregate amount that a firm in any of these countries will accept, must, of course, bear a certain relation to its own resources. But this proportion differs according to the character of the general business done by such firm. A bank doing an extensive general banking business will accept to the extent of its capital only, while banks or bankers devoting themselves exclusively to the business of accepting will accept an aggregate amount representing many times their own capital." [2]

[1] Warburg, Paul M., "The Discount Market in Europe." Publications of the United States National Monetary Commission, 61st Congress, 2d session, Senate Document No. 402, p. 18.

[2] *Ibid*, p. 11.

Back of the entire banking and credit structure of the country stands the Bank of England, known familiarly as "The Old Lady of Threadneedle Street." It is a mountain of strength to the banking interests of the British Isles, and while not the largest bank in the world so far as capitalization, assets, etc., are concerned, it is nevertheless the most important financial institution because of its dominating influence in the world's money market. It deals directly with banks, firms, and individuals, holding their deposits, loaning funds, discounting bills, etc. It is not a bankers' bank as are the Federal Reserve banks. English banks may, but are not required to, keep their reserves with the Bank of England. When these reserves fall low, they are readily replenished by the individual bank rediscounting some of its bills with the Bank of England. Such bills, to be eligible for rediscounting, must be presented by a party having a deposit account with the Bank, must not be payable in other countries, and must bear two British names, one of which must be that of a British acceptor.

The Bank of England does not act as the acceptor of bills of exchange, nor does it provide its customers with any of the ordinary exchange facilities. It has no list of correspondents scattered over the world through which to conduct exchange transactions. In connection with the field of foreign exchange it performs three functions. First, it rediscounts bills for its depositors. We have already discussed its activities in that regard. Second, it is an active participant in the gold market, buying and selling that precious metal in large amounts, and regulating, when necessary, its flow into or out of the country, primarily by raising or lowering its rate of discount, known popularly as the "Bank rate." Third, it practically determines the money rates in the London market, and thus incidentally influences the money rates throughout the world, by manipulating its Bank rate. This rate, published in normal times every Thursday morning by the directors of the Bank, and immediately cabled to all financial centers, is the rate at which the Bank will discount prime three months' bills which are presented to it or advance money against the deposit of approved securities. Interest and discount rates in the English market go up and down with the fluctuations in the Bank rate, as will be more fully brought out later. The details of the functioning of the Bank in the gold market and the influence that it wields through its official Bank rate will be dealt with at length in Chapters X and XI.

CHAPTER VI

PRINCIPLES OF FOREIGN EXCHANGE

The origin of foreign bills of exchange is lost in antiquity and will doubtless so remain. We know, however, that they were used during the heyday of the Roman Empire. Cicero, for example, mentions bills of exchange as being in common use in his time and the inference is that they had been in use for many years prior to that date. It is thought by some writers that they were introduced into the northern provinces of Europe by the Jews, as a means of transferring their belongings to foreign countries in a way that would be safe from the demands of the "robber barons" through whose countries they were compelled to travel. We know that bills of exchange began to be rather widely used in France and England during the early part of the twelfth century. Charters given to various cities during the twelfth and thirteenth centuries authorized the cities themselves to deal in such bills. Macleod tells us that the growing power and arrogance of the popes had a great deal to do with the extension of their use. At the "time of the Crusades they [the popes] claimed the right to tax all Christendom for their support. They had their own money dealers, termed *Cambiatores*, who kept tables in the capital cathedrals to exchange the money of foreigners who came to worship. These persons sent their own agents into different countries to collect the Papal tribute. As soon as they had collected a sufficient amount, they sent the Pope bills upon their principals and correspondents for the amount. . . . These bills were naturally in the form of an order upon their principals to pay a certain amount of the money of the country they were in at a certain rate of exchange in Italian money. In the 12th century Florence became especially famous for this 'banking business,' as it was called. Lucca, Siena, Milan, Placentia, and others were also famous." [1] From that time, primarily as a result of expanding commerce and the developing need for a satisfactory

[1] Macleod, H. D., "Theory and Practice of Banking," 3d ed., London, 1875, Vol. I, p. 196. An excellent summary of the early history of bills of exchange, together with examples of such bills, is given on pp. 195–203 of that volume.

method of handling financial transactions between traders living in different countries, bills of exchange became increasingly prevalent.

The principles underlying foreign exchanges are practically the same as those underlying domestic exchange, the most important of which is the settlement of debts without the shipment of gold or silver. Credit instruments are used to an even greater extent than in domestic transactions, although, strangely enough, it more frequently becomes necessary or profitable to engage in the shipment of the precious metals. Because very few business firms or individuals have checking or commercial accounts with foreign banks, the bank check, as we know it in our ordinary domestic business relations, is seldom employed.[1] There is no international clearing house for foreign bills of exchange. Bills provided or created either by a third party or by the creditor play a much more important part in international transactions than do bills created by the debtor. At times the exigencies of the situation necessitate the use of certain kinds of credit instruments totally unlike those found in domestic affairs.

A matter which causes the greatest amount of confusion, especially for the beginner, is the fact that documents and bills of exchange are drawn usually in terms of the money of a foreign country. At home when we ship goods to a fellow-countryman, we charge him dollars and we receive dollars, either in cash or in the form of credit. Our domestic transactions are carried on in terms of our own unit of value, the dollar. When we sell goods to an Englishman, however, we ordinarily charge him so many pounds sterling, although lately the practice has been growing of charging him so many dollars, just as we do with our domestic customers. In the past our foreign bills have almost always been drawn in terms of foreign moneys[2] because "in former years the American Dollar was a pariah among the foreign moneys. There was no market in American exchange other than an arbitrary one and the price was dictated absolutely according to the whims and fancies of the foreign banker. In the event of a merchant desiring to sell an American draft, he was obliged to suffer a discount of from one, two and three per cent and if he wanted to buy a draft, the reverse operation would be put into effect and he had to pay an exceedingly high premium."[3]

[1] Cf. p. 38.

[2] Not always, however, in terms of the money of the customer's country.

[3] Gardin, J. E., Vice-President, National City Bank of New York, in *Number Eight*, August, 1916, p. 3.

Exchange rates on foreign countries were fairly stable, and we knew just about what our bills drawn in foreign money would be worth in the exchange market. Those conditions, however, no longer exist. With the unsettled conditions caused by the World War it was and has been impossible for us to know from day to day the value of any foreign money in terms of the dollar, but we have known that if we drew our bills in dollars, and compelled the foreign customers to pay us enough of their money at the prevailing exchange rates to equal those dollars, we would be fairly certain not to lose on the transaction. At times we have even compelled the foreign buyer to purchase with his own money a draft drawn in terms of dollars and to remit it to us so that we might have the dollars in hand rather than to have the dollars' worth of foreign money added to our accounts in foreign banks. By so doing the American exporter has been able to shift the risks of exchange to the shoulders of the foreign customer. Whether or not, after international relations return to normal, we shall resume our former practice of drawing foreign bills almost solely in terms of foreign currencies is a matter concerning which definite prophecy is impossible, although at the present time (April, 1922) it seems that the pound sterling will, to a considerable extent, regain its dominancy among the exchanges, with the dollar retaining at least some of the importance gained during the last few years, especially in the financing of South American trade.

The elements that constitute the content of foreign trade necessitating the use of exchange instruments are of the same character as those that constitute the content of domestic trade. We have those "visible" items, such as the exports and imports of raw materials and manufactured goods. We also have those "invisible" items, such as the sums remitted or received for the payment of dividends and interest, insurance premiums, ocean freight charges; funds for clients, financial correspondents, friends, and relatives; expenditures of travelers, etc.[1]

Until within the last few years the United States has been classed as a debtor nation, its citizens and firms owing abroad more than was

[1] The case of Greece presents an interesting instance of the really important part played by the invisible items in the foreign trade of some countries. A recent report of the American Consul General at Athens states that remittances (funds sent to Greece) increased from thirty-three million drachmas in 1914 (a drachma is quoted roughly as having a par of $.193) to three hundred and fifty million drachmas in 1919, in the latter year amounting to *seven-ninths* of the total trade balance against that country.

owing to them.[1] The most customary method of paying such an indebtedness is, of course, by the shipment of goods. Before the World War leading authorities agreed that we were compelled to have an excess of exports over imports varying from $400,000,000 to $600,000,000 annually in order to settle our annual foreign indebtedness without being forced to export gold. This excess of exports was required to pay interest and dividends of from $200,000,000 to $300,000,000 on American securities of various kinds held abroad, the expenditures of tourists varying from $150,000,000 to $200,000,000, remittances by Americans to friends and relatives estimated at from $100,000,000 to $150,000,000, and payments to foreign shipowners for ocean freight charges ranging between $20,000,000 and $40,000,000.[2] As a result

[1] In an address delivered before the California Bankers Association in San Francisco, Cal., May 27, 1915, Dr. Ewing Pratt, formerly Chief of the U. S. Bureau of Foreign and Domestic Commerce, stated that at the outbreak of the European War the United States owed no less than £1,500,000,000 (about $6,000,000,000) to Europe, the largest portion of which was distributed as follows:

England	$4,000,000,000
France	1,000,000,000
Germany	1,250,000,000
Holland	650,000,000

Part of this indebtedness was offset by loans which we had made to European countries, and by our holdings of certain European securities, so that it would seem that at the opening of the World War we owed Europe approximately $6,000,000,000. (Proceedings, California Bankers Association, 1915, p. 66.)

[2] Dr. Ewing Pratt, in the address cited above, also discussed our balance of trade and how we met our obligations therefor during what may be called a normal year, the fiscal year ending July 1, 1914. He said: "In order to show this balance clearly it might be worth while to strike a very brief balance-sheet, and to find out exactly where we stood at the beginning of the European War. Our balance of trade, both visible and invisible, during the last fiscal year [1914] would, therefore, be something as follows:

FOREIGN TRADE OF THE UNITED STATES DURING THE FISCAL YEAR 1914

Merchandise		*Remittances*	
Exports	$2,365,000,000	Interest (net)	$250,000,000
Imports	1,894,000,000	Tourist expenditure (net)	170,000,000
Excess of exports over imports	$471,000,000	Remittances to friends (net)	150,000,000
Gold		Freight	25,000,000
Exports	112,000,000		$595,000,000
Imports	67,000,000		
Excess of gold exports over imports	45,000,000		
Silver			
Exports	55,000,000		
Imports	30,000,000		
Excess of silver exports over imports	25,000,000		
Total excess	$541,000,000	Excess of sum remitted over trade balance	$ 54,000,000

"This balance sheet shows that we had payments to make in Europe over and above the total amount of merchandise exported, and this fact means that we were still contracting debts in Europe at the outbreak of this war. But the situation has changed since the 1st of August, 1914."

of the World War, however, the situation has been reversed, and we now find ourselves a creditor nation of surprising proportions. The Federal Reserve Board has estimated that our total unfunded international balance accrued since the Armistice, excluding the war-time debts of foreign countries to the United States (approximately $10,000,000,000) amounted to some $3,000,000,000 in August, 1920,[1] to $3,408,000,000 on October 1, 1921,[2] and to $3,400,000,000 on January 1, 1922.[3] The volume and value of our foreign trade have increased at a rapid rate since 1914. The maximum expansion in volume was attained in 1917 although the maximum value was reached during 1920.[4] Our excess of exports over imports during the period of the war and to the end of 1921 approximated $20,000,000,000.[5] The task of paying for such large amounts of goods has taxed the minds of the world's financiers and has placed an enormous burden upon the purchasing nations. It has naturally involved foreign exchange problems of the most interesting, complex, and varied sort. But as a prominent banker has well said:

"Every exchange transaction is reciprocal: you give something and you get something. You transfer goods or render services to others in return for goods they transfer or services they render to you. And exchanges go on so long as they are mutually profitable. It is 'fair exchange' that

[1] *Federal Reserve Bulletin*, September, 1920, p. 1262.
[2] *Ibid*, November, 1921, pp. 1262–1266.
[3] *Ibid*, February, 1922, pp. 128–129.
[4] The great increase in prices explains the seeming contradiction contained in the above statement.

[5] MERCHANDISE IMPORTS AND EXPORTS OF THE UNITED STATES

1911–1921

(000 omitted)

	Exports	*Imports*	*Excess Exports*
1921	$4,485,000	$2,509,000	$1,976,000
1920	8,288,016	5,278,481	2,949,535
1919	7,920,425	3,904,364	4,016,061
1918	6,149,087	3,031,212	3,117,875
1917	6,233,512	2,952,467	3,281,045
1916	5,482,641	2,391,635	3,091,006
1915	3,550,915	1,778,605	1,772,309
1914	2,114,257	1,789,022	325,235
1913	2,484,018	1,792,596	691,421
1912	2,399,217	1,818,073	581,144
1911	2,092,526	1,582,359	560,167

'is no robbery.' This means that the goods and services that this country furnishes to other countries will represent goods and services of equal value furnished to this country by other countries. Our exports of merchandise will never exactly balance our imports of merchandise, but our exports of merchandise plus the services that we render other countries will equal in value the imports of merchandise plus the services that other countries render to us. There is no escape from such a conclusion unless men are to quit exchanging things of equal value and begin giving things away. We hear a lot about our export trade, but our export trade involves an import trade. The nation that will not buy, neither shall it sell." [1]

Our stupendous favorable balance of trade has been paid for in the first place by huge importations of gold. From August 1, 1914, to December 31, 1921, our excess gold imports totaled $1,542,119,000. We have also loaned huge sums to private parties and to foreign governments. Private loans made by individual citizens through banking and investment houses to foreign political units have amounted roughly to $2,000,000,000. Our government has loaned to foreign nations, both during and after the war, approximately $9,500,000,000. To enable the United States to purchase the needed supplies for our army in Europe, England, France and Italy advanced a sum of their currencies equal to $1,490,557,111. We have repurchased from European holders close to $3,000,000,000 of American securities. We have also invested heavily in ventures of all sorts in various parts of the world, the extent of which it is not possible to estimate with any degree of accuracy.[2] We have sent money abroad to friends and relatives, insurance companies, freight carriers, and to the needy of Europe. The export of American funds in such large amounts and their use in various ways have aided greatly in the temporary settlement of Europe's indebtedness to us arising out of its huge adverse balance of trade. Because it is through foreign exchange transactions that such indebtedness between different countries and the peoples of those countries is cared for, it is not strange that the subject of the exchanges has loomed large in all discussions in financial circles since 1914.[3]

[1] Dwight L. Morrow, *Commercial and Financial Chronicle*, Nov. 6, 1920, p. 1801.

[2] Cf. pp. 332–336.

[3] The following most excellent survey of this unique situation appears in a pamphlet issued by the Guaranty Trust Company of New York City (1921) entitled "Our New Place in World Trade":

"For convenience, we may now sum up the known items, both visible and invisible, of

In normal times and even in abnormal times efforts are made by those dealing in the exchanges to obviate the shipment of precious metals. Claims of the citizens of one country on those of another must be paid, if not by the shipment of goods, the rendering of services, etc., then by the shipment of either gold or silver. While gold cannot correctly be called the "international money," it is nevertheless the most important metallic medium or basis of exchange in all foreign relations. In normal times practically all of the countries of the world are on a gold standard basis, the unit of their monetary system being some sort of gold coin. Other countries, like India, the Straits Settlement, the Philippine Islands, etc., are on what is technically known as a "gold exchange" basis,[1] which means in brief that their coins are exchangeable for a certain amount of foreign exchange payable at a fixed ratio in gold in some designated foreign center. Only a few countries, China being the most important, still remain on a silver basis. Some South American nations are on a paper money basis. Due to the exigencies of the war even the more important

our foreign trade balance during the six and a half years from July 1, 1914, to December 31, 1920.

"A table showing items in our foreign trade balance between July 1, 1914, and December 31, 1920, of known amounts follows:

CREDIT		
Visible		
Exports of merchandise and silver	$39,477,831,159	
Exports of gold	1,429,262,624	
		$40,907,093,783
Invisible		
Interest received on government loans		437,349,431
		$41,344,443,214
DEBIT		
Visible		
Imports of merchandise and silver	$20,528,606,984	
Imports of gold	2,259,323,817	
		$22,787,930,801
Invisible		
Government loans less repayments	$9,466,283,171	
Government purchases of foreign currency	1,490,557,111	
Private loans	1,989,717,727	
		12,946,558,009
		$35,734,488,810
Leaving a debit liquidated by other items of		$5,609,954,404

"The last debit in the table consists of invisible items representing payments for services, etc., the amounts of which can only be estimated."

[1] Cf. pp. 451–465.

European nations, which are normally on a gold basis, are at present (April, 1922) on a depreciated paper money standard. In spite of that fact, however, gold figures solely as the metal that is used in the settlement of trade balances between us and the latter nations because we will not accept either paper money or silver in payment of their obligations to us.[1]

If, when we sold goods to foreigners there were no bills of exchange, they would have to ship us precious metals, and when they sold goods to us we would have to ship precious metals to them, which would result in a great waste of effort and money. We have therefore devised ways and means through the use of bills of exchange whereby such shipments are made only when necessary to pay balances, or to put the exchange machinery back into its normal functioning condition, or to net a profit to exchange dealers. The fundamental principle upon which is based the practice of settling debts without the shipment of the precious metals is as follows:

Let us say that Jones in New York has bought some goods from Pratt in London equal in value to 1,000 ounces of gold. We will use ounces of gold in our illustration so as to obviate the necessity of dealing with pounds sterling and dollars. At the same time Smith in New York has sold goods, likewise valued at 1,000 ounces of gold, to Lloyd in London. Now, if it were possible for all of the parties to know each other personally, inasmuch as the amount of money that Jones of New York owes Pratt in London is the same as that which Smith of New York has coming to him from Lloyd of London, the whole transaction could be settled without any funds crossing the Atlantic Ocean by Pratt telling Jones to pay Smith 1,000 ounces of gold, and by Smith telling Lloyd to pay Pratt the same amount. Each buyer would thus pay the amount that he owed, and each seller would receive the amount that was due. Of course, such a situation could never arise, because the parties could not know each other and also because the sums to be paid and to be received would never be equal (Fig. 28).

If the parties knew each other the claims of all parties might also be settled in the following manner: Smith in New York who has sold goods to Lloyd in London might draw a draft on Lloyd for the value of the goods and sell the same for 1,000 ounces of gold to Jones in New York who has to pay Pratt in London for the goods which

[1] Cf. Chapter XII.

he has bought from Pratt. Jones might then send the draft to Pratt, who would collect 1,000 ounces of gold from Lloyd. Thus by means of one draft, the claims of all parties against each other would be satisfactorily and completely settled (Fig. 29).

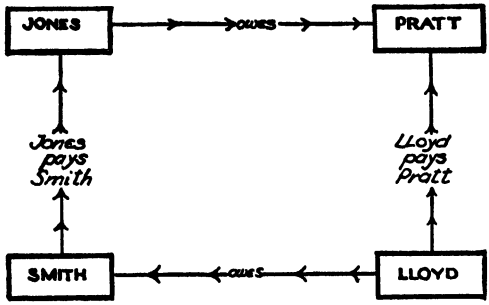


FIGURE 28
Diagram showing theory of foreign payments

What actually happens, however, is that a third party, a bank or an exchange dealer of some sort, comes in between the parties concerned and make the payments more easily possible. Smith of New York has sold goods to Lloyd of London; he draws a draft on Lloyd to the value of 1,000 ounces of gold and sells it to his bank. The bank in New York sends it to its correspondent in London, which collects it from Lloyd. To keep our example as simple as possible, let us say that Jones of New York, having purchased goods from Pratt of London, goes to Smith's New York bank and buys a draft from it on its London correspondent to the value of 1,000 ounces of gold. Jones mails the draft to Pratt. Pratt receives the draft in the mail and takes it to the bank upon which it has been drawn, and gets his money. By this means all parties concerned have paid their bills or have received the money that was due them, and no gold has crossed the Atlantic (Fig. 30).

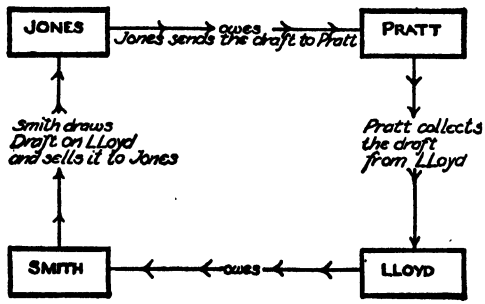


FIGURE 29
Diagram showing theory of foreign payments

The item of discount and the use of the terms "dollars" and "pounds sterling" have been purposely omitted from these preliminary explanations of the fundamental principles that underlie the workings of our foreign exchanges, so as to present the

situation in as simple a form as possible. As has been previously stated, American firms are continually exporting to and importing from various countries. To simplify the discussion somewhat, it is better to limit our illustration to England and the United States. American exporters draw drafts on English firms for the value of the goods that are sent abroad. The drafts are for all sorts of amounts, and also run for various lengths of time, i. e., from sight to six months. American banks and financial houses purchase these bills of exchange and send them abroad for collection. As the funds are collected, they are added to the foreign balances which the banks and financial houses keep with their English correspondents. Those who have bills to pay in England come to these banks and financial houses and buy drafts with which to make such payments. These drafts are also drawn for any sum, and also for various lengths of time, but are usually payable at sight. They are mailed by the American purchasers to the English firms to which they owe money for goods bought, and these firms cash them at their own banks. The latter then present the drafts to the banks upon which they have been drawn, and the accounts of the American banks are debited, or decreased, by the sums which the drafts represent. The banks and financial houses act as the "go-betweens" that make such transactions possible.

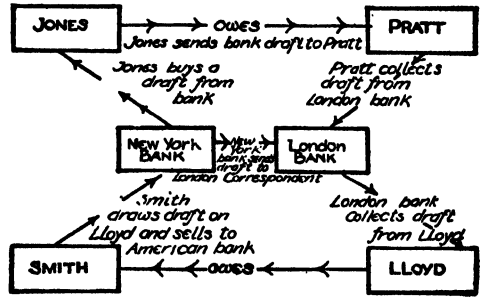


FIGURE 30
Diagram showing theory of foreign payments

If we buy from English merchants more than we sell to them, there is a great demand for drafts on England, which tends to use up the accounts that the American banks have with their correspondents in England. This creates a scarcity of exchange on England, which tends to raise the rate of exchange to levels where it may become profitable to ship gold to England. On the other hand, if we sell to English merchants a much larger amount than we buy from them an over-supply of bills on England is created, which floods the bankers and exchange dealers with bills, and therefore tends to lower the rate

of exchange to such a point that it may become profitable to import gold from that country.[1] Gold will not be shipped, however, unless it becomes necessary or profitable to do so.

In any discussion of the exchanges, one must always keep clearly in mind the fact that banks (and from now on we shall use the word "banks" as referring to all financial houses that deal in foreign exchange) act as both buyers and sellers of exchange. They buy so as to build up their foreign accounts against which to sell exchange of various sorts, and they sell to those who have to make remittances to foreign parties. Banks, therefore, have their buying and their selling rates of exchange. Naturally they aim to buy low and to sell high, or to put the matter in a slightly different form, they aim to sell at a slightly higher rate than that at which they have purchased in order to net a profit. Frequently, however, banks are compelled to take considerable losses owing to adverse fluctuations in exchange rates.

Another matter which the beginner must not overlook is the long standing practice that when we buy goods from Englishmen they expect us to buy a draft and to remit it to them, while when we sell goods to them they expect us to draw a draft on them and realize our money thereon by selling the draft to our banks. The result is that drafts remitted by American buyers and drafts drawn by American sellers both flow toward London. This is quite the practice in the case of all countries that trade with firms in England, although of course English exporters at times do draw on the foreign buyer. Even the astounding developments of the World War have not as yet noticeably affected this long prevailing custom. There are several reasons for the origin and retention of this practice. The American exporter prefers to draw his draft and to get his money immediately by selling his draft to the local bank, rather than to wait for a remittance to come to him from his English customer. American banks readily purchase these bills because there is always an excellent market for them in the discount market of England and also because they must have some means of building up their accounts in England against which to sell drafts to those who desire to remit funds to England or to other countries. On the other hand, the American importer much prefers to remit to his English creditor rather than to allow the latter

[1] The details of gold shipments and the reasons therefor will be more fully presented in Chapter XI.

to draw against him for the goods that the Englishman has purchased. If the American buyer remits, he knows exactly how many pounds sterling he owes the British firm, and he can get the best possible rate for sterling exchange from his local bank with which he has had business connections possibly for many years. Rates charged for exchange are always "shaved" or decreased slightly in favor of a bank's regular customer. Although the English firm has to wait for its money to arrive (in the form of a remittance), nevertheless, in making its prices to the American, it has taken care to include therein an interest charge that will compensate it for the time lost while waiting for the arrival of the funds. If the American did not remit, but allowed the English firm to draw on him, he would most likely have the draft presented to him for payment through a strange bank or broker who would not give him so favorable a rate as would his own banker. One very important reason for the development of the custom of our remitting to England is the fact that before the enactment of the Federal Reserve Law in 1913 there were no facilities in the United States for the discounting of drafts that arose out of our foreign trade. Therefore, if the English firms drew on American firms and sent their drafts to the United States for collection, the bills had to be held until maturity and could not be discounted in the open market. English merchants much preferred to get their money as soon as possible, so they demanded that we remit to them for goods purchased.

The practices employed between American firms and firms in countries other than England ordinarily follow the custom of the exporter drawing a draft against the importer or against some bank with which the importer has arranged some form of credit. Thus when we export we usually draw a draft on the foreign importer or on a bank which he has designated, and when we import, the foreign exporter usually draws a draft on us or on some bank that we designate. The bank, in either case, may be in the country of the exporter or in that of the importer or it may even be in a third country. Paying for imports and exports through a bank as an intermediary will be discussed in Chapter IX.

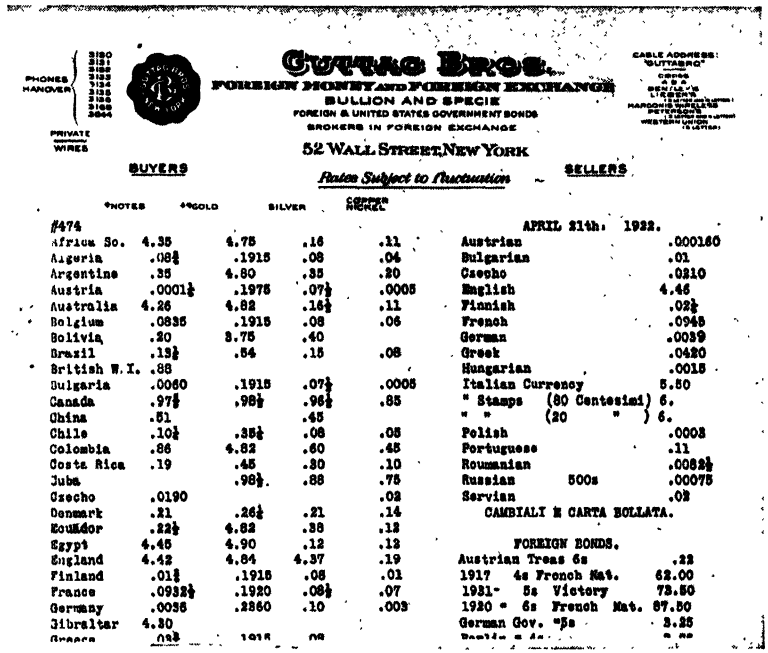
Normally we have in the market at all times large amounts of bills of various kinds drawn against foreign firms and banks and also against domestic firms and banks. Foreign exchange dealers daily traffic in these bills just as other merchants traffic in clothing, farm produce, raw materials, etc. Their stock in trade is, briefly, "claims

to money in other countries." Their customers either have a claim for money against some foreigner which claim they desire to sell to a bank in return for dollars, or else they owe some money to a foreigner and desire to buy from the bank, for dollars, a claim to funds abroad with which to settle their indebtedness. Only occasionally will a bank be called upon to buy or to sell the actual money, either paper or metal, of foreign countries, and only occasionally will even the very largest banks be in the market as buyers or sellers of gold or silver. It is "claims to money in other countries," more commonly called "bills" or "bills of exchange," with which the foreign exchange houses primarily concern themselves.

These bills of exchange are drawn for the most part in the moneys of other countries. A small but increasing proportion is being drawn in terms of dollars. The foreign exchange dealer, therefore, must ever be ready to purchase or to sell foreign bills, but always in return for payment in the money of his own country. In other words, when an American draws a draft in pounds sterling, or francs, or marks, and sells it to his bank, the banker must translate the amount of foreign money, for which it has been drawn, into dollars. How much are the pounds or francs or marks worth in American money? Likewise when an American goes to his bank and purchases a draft for a certain number of pounds sterling, francs, or marks, etc., he pays dollars for it, and the banker is compelled to translate the value of that amount of foreign money into dollars and cents. This translating of the value of one nation's money into the money of another is technically known as "conversion" and will be more fully discussed when we come to a description of the methods and calculations involved in the actual buying and selling of bills of exchange.[1] In the early years of foreign trade and travel before the use of credit instruments developed, the money changer played an important part, sitting in the market place and exchanging the money of his own country for that of the traveler from foreign lands. Today the exchange department of a bank performs the same service, except that for the most part it deals in credit instruments, in bills of exchange, in claims for money, rather than in the actual paper or metallic money of foreign countries. But the clerks in that department are still compelled, as were the money changers of old, to convert the money of one country into terms of the money of another. At times, travelers

[1] Cf. Appendix III.

do come to the exchange department with small sums of foreign monies which they desire to sell to the bank, i. e., to have converted into the money of the United States. It is then that the exchange department becomes an old-fashioned money changer, and the clerk looks up his list of rates for foreign monies, supplied weekly by some large New York dealer, and sets the price at which he will exchange American money for the foreign (Fig. 31).



CUTTING BROS.

FOREIGN MONEY AND FOREIGN EXCHANGE

BULLION AND SPECIE

FOREIGN & UNITED STATES GOVERNMENT BONDS

BROKERS IN FOREIGN EXCHANGE

52 WALL STREET, NEW YORK

Rates Subject to Fluctuation

	BUYERS *NOTES	**GOLD	SILVER	COPPER NICKEL	SELLERS
#474					APRIL 21th: 1922.
African So.	4.35	4.75	.16	.11	Austrian .000160
Algeria	.08¾	.1915	.08	.04	Bulgarian .01
Argentine	.35	4.80	.35	.20	Czecho .0310
Austria	.0001½	.1975	.07½	.0005	English 4.46
Australia	4.26	4.82	.16½	.11	Finnish .02½
Belgium	.0835	.1915	.08	.06	French .0945
Bolivia	.20	3.75	.40		German .0039
Brazil	.13½	.54	.15	.08	Greek .0420
British W.I.	.88				Hungarian .0015
Bulgaria	.0060	.1915	.07½	.0005	Italian Currency 5.50
Canada	.97⅝	.98½	.96½	.85	" Stamps (80 Centesimi) 6.
China	.51		.45		" " (20 ") 6.
Chile	.10½	.35½	.08	.05	Polish .0003
Colombia	.86	4.82	.60	.45	Portuguese .11
Costa Rica	.19	.45	.20	.10	Roumanian .0082½
Cuba		.98½	.88	.75	Russian 500s .00075
Czecho	.0190			.02	Servian .02
Denmark	.21	.26½	.21	.14	CAMBIALI E CARTA BOLLATA.
Ecuador	.22½	4.82	.38	.13	
Egypt	4.45	4.90	.12	.13	FOREIGN BONDS.
England	4.42	4.84	4.37	.19	Austrian Treas 6s .22
Finland	.01¼	.1915	.08	.01	1917 4s French Nat. 62.00
France	.0932½	.1920	.08½	.07	1931 " 5s Victory 73.50
Germany	.0036	.2860	.10	.003	1920 " 6s French Nat. 87.50
Gibraltar	4.30				German Gov. "5s 3.25
Greece	.023	1915	.08		

FIGURE 31

Typical list of foreign money prices

The "rate of exchange" is the price that the buyer has to pay for the particular kind of foreign exchange that he is purchasing. When a traveler from a foreign country asks the clerk in the exchange department, "How much will you give me for the foreign coins that I have brought over with me," the rate is the amount of American money that the clerk will give him for his foreign coins. The rate that will be paid for a foreign bill on the traveler's country may be greatly different from the rate that he will get for his foreign coins or

paper money. In normal times there is a rather close relationship between the two, but in abnormal periods they may be widely apart. In the case of the coins themselves the amount given will be somewhere near the value that we place on their gold or silver content, i. e., the value of the gold or silver bullion which they contain. This is because the coins may be melted and sold as so much bullion in our home markets. Gold coins will be bought usually at a discount of from 1 to 1½ per cent. The value of foreign paper money, naturally, fluctuates much more widely than the value of foreign coins because it is of no value to us in our own country unless we can find some person who is willing to buy it, either as a dealer or speculator, or as a prospective traveler in the country concerned. During the past few years a considerable amount of foreign bank notes has passed through the hands of American banks which have purchased them usually at their buying rates for demand drafts less cost of insurance, which differs with the country, but which has ranged from ¼ per cent to 1 per cent.

Inasmuch as there are different monetary systems in different countries, there must be some basis used upon which to make calculations as to the value of the money of one country in terms of that of another. The basis of the rate of exchange on foreign countries (and in the rest of this volume we shall use the term "exchange rate" as applying solely to the price paid or charged for foreign bills of exchange) is what is technically known as "the mint par of exchange," more commonly as the "par of exchange." This par of exchange is obtained by comparing the relative weight and fineness of the precious metal contained in the standard coin of the respective countries concerned. The standard coin of a country is the unit or basis of its monetary system, in terms of which all things are valued in that country. There can be a mint par between countries that have a gold coin of any sort as their standard coin, but as between a gold standard country and a silver standard country there can be no mint par because there is no fixed ratio between the value of gold and silver. The value of silver in terms of gold fluctuates continually, making a fixed basis of comparison impossible. Nor can there be a mint par of exchange between paper standard countries themselves, nor between them and gold or silver standard countries, because, again, there is no fixed relationship between the value of the paper money of one country in terms of the paper money of another, or in terms of either

the gold or silver money of another. Thus a mint par of exchange, or as we more commonly say, a par of exchange, exists between the United States and only those countries which have a gold coin as their standard, or measuring rod, of value, or more technically, as the basis of their monetary systems. As between the United States and silver or paper standard countries there can be no par of exchange. The paper and silver exchanges as well as the exchange relations with the so-called "gold exchange standard" countries will be discussed in Chapter XII.

There is considerable difference between the weight of the various gold coins which have been adopted by the more important countries of the world as the bases of their monetary standards, although their fineness is almost universally the same, i. e., 9/10 fine. Our own gold coins are 9/10 fine, i. e., they contain nine parts of pure gold to one part of alloy, the alloy being used for the purpose of hardening the metal and making it more capable of resisting wear and consequent loss in weight from constant handling. The same is true of the gold coins of France, Germany, Italy, Belgium, Switzerland, and practically all of the other trading countries. The one notable exception is England whose gold coins are 11/12 fine. To obtain the par of exchange as between countries on the same monetary standard, it is only necessary, therefore, to compare the weight of the pure metal in the standard coin of one country with the weight of the pure metal in the standard coin of another. As between the United States and England, we find the following: Our gold dollar, though no longer minted, is by law decreed to be 23.22 grains of pure gold.[1] The English sovereign contains 113.0015 grains of pure gold.[2] Dividing the latter by the former we find that the pure gold content of the English sovereign is 4.8665+ times as great as that of the American dollar. Therefore we say that the par of exchange between the United States and England is $4.8665+, which is the value of the pure gold in the sovereign as measured in terms of the value of the pure gold in the American dollar.

The smallest French gold coin minted is the five franc piece, which contains a total of 24.8908 grains 9/10 fine, or a content of 22.4018 grains of pure gold. Thus the pure gold in the five franc piece is worth $.9647 of our money; a franc being one-fifth of that amount, the

[1] Being nine-tenths fine, it has a gross or total weight of 25.8 grains.
[2] Being eleven-twelfths fine it has a gross or total weight of 123.2744 grains.

mint par between the United States and France is $.19295. Inasmuch as Italy, Belgium, Spain, Switzerland, Greece, Bulgaria, Serbia, Finland, Venezuela, and certain other countries have as their standard of value a gold coin of the same weight as the franc (known respectively as the lira, franc, peseta, franc, drachma, lev, dinar, markka and bolivar), the par of exchange between the United States and those countries is the same as that for France, i. e., $.19295.

The German crown of ten marks contains 61.4588 grains of gold 9/10 fine, or a pure gold content of 55.3130 grains. Valued in terms of the American dollar it is worth $2.3821, which gives a mint par per mark of $.23821. The par of exchange in terms of the pound sterling between England and Germany is 20.429 marks (commonly known as 20.43), while between England and France it is 25.2215 francs (commonly known as 25.22). Between England and those other countries that use the same weight gold standard coin as France, the par of exchange is naturally the same as that between England and France, viz., on Greece, 25.2215 drachmas; on Belgium, or Switzerland, 25.2215 francs; on Italy, 25.2215 lira; on Spain, 25.2215 pesetas, etc. Between Germany and France, the par of exchange of the mark is 1.2345 francs. It must not be overlooked that in the examples just given we have quoted the par of exchange in only one direction. For example the mint par of the mark in terms of francs is 1.2345 francs, but the mint par of the franc in terms of the mark is approximately .81 marks (to be exact, .8099 marks). The mint par of the mark, the franc, and the dollar in English money is respectively 11.747 pence, 9.515 pence, and 49.316 pence or 4 shillings 1 5/16 pence.

As between countries that have as their standard a coin of the same metal, weight, and fineness, the par is found without any calculation being necessary. The Dominion of Canada has, as its standard coin, the gold dollar of the same weight and fineness as that of the United States. The mint par is therefore one American dollar for one Canadian dollar or vice versa. Rates of exchange between Canada and the United States fluctuate above and below par just as do the rates of exchange between the United States, England, France, or any other country, depending upon certain factors to be later considered.[1]

The pars of exchange for gold standard countries as estimated

[1] See Chapter X, Rates of Exchange.

by the Director of the United States Mint appear in Appendix II.[1]

The mint par expresses only the ratio between the weights of the standard coins of two countries as they are supposed to be minted, not the ratio between their weights as they are found in actual circulation. If a comparison were made between the weight of £10,000 of English gold coin and $48,665 of American gold coin actually in circulation, the ratio would be different from the mint ratio because of loss by abrasion, or because the minting had not been perfect as to weight or as to fineness, or both. As Clare so aptly says, "The Mint Par depends, in short, not on the coin itself, but on the *legal definition* of it; not on the sovereign *de facto*, but on the sovereign *de jure;* and if every gold coin in this country were debased, and every gold coin in France sweated and mutilated, the Mint Par would still remain the same. Unless and until the law is altered the Mint Par cannot alter." [2]

While the market rates of exchange on a country are continually fluctuating above or below the par of exchange, the par itself never changes unless the country itself modifies the metallic content of its standard coin. This has occurred many times in the past as monetary systems have been revised, and naturally necessitates a change not only in the mint par of exchange but also at times in the method employed in quoting the exchanges. In the case of our own country we have from time to time varied the weight and fineness of our standard gold coin and have likewise changed our methods of quoting exchanges on other countries. In our early history the value of foreign monies was quoted in terms of the Spanish dollar, which was then the current standard, the par of the pound sterling being fixed at $4.44 by Congress by Act of July 31, 1789. The law creating our monetary system (April 2, 1792) decreed that the ten dollar gold piece should have a total or gross weight of 270 grains of gold 11/12 fine. This made the pound sterling worth about $4.56½. The law of June 28, 1834, reduced the gross weight of the ten dollar gold piece to 258 grains, still 11/12 fine, making the pound sterling worth about $4.78. On Jan. 18, 1837, the fineness of our gold coins was reduced to 9/10, changing the par of the pound to $4.8665+ where it still remains.

[1] The Director of the United States Mint estimates quarterly the par of exchange between the United States and all gold standard or gold exchange standard countries so that the value of foreign merchandise entering the country may be properly estimated.

[2] "The A. B. C. of the Foreign Exchanges," p. 21.

Up to 1834 the English valued our dollar as being worth almost exactly 4 shillings 6 pence, which they called 100 or par, and we quoted the dollar, as they did, as being either above or below par. However, when it was above par for England it was below par for us. Thus if the quotation were to appear as "Pound sterling—108 1/8" in England it would signify that the pound sterling commanded a premium of 8 1/8 per cent or that it would purchase 8 1/8 per cent more American money than if it had remained at par. With us, conversely, it meant that our dollar was at a discount of 8 1/8 per cent, because at 108 1/8 it would take more American dollars to buy a fixed sum of English money than if the quotation were at 100. From 1834 to January 1, 1874, during which time we made the change in our monetary system above referred to, the London Stock Exchange continued to value the American dollar for trading purposes at 4 shillings 6 pence, which was from 9 to 9 1/2 per cent too high, so that in the field of exchange the accepted par was raised to 109.45 5/8, which par was adopted by the New York bankers. On March 3, 1873, however, Congress fixed the par of exchange of the pound sterling at $4.8665 and in pursuance of that law the method of quoting sterling was altered, the present system going into effect January 1, 1874.

We have also changed our methods of quoting other exchanges. Until 1920 we quoted German exchange on the basis of how much four marks were worth in American money, while French exchange was quoted on the basis of how many francs the dollar would buy. Since 1920, however, we have changed to the basis of quoting what the mark or the franc is worth in American money, i. e., how many cents it takes to buy a mark or a franc.[1]

The exchanges become "favorable" or "unfavorable," in accordance with the nature of their fluctuation. If our own money becomes more valuable as measured in terms of the foreign money, or, more accurately, if our dollar will purchase more pounds, francs, marks, etc., the exchanges are said to be "for us," or are "favorable." If our money will buy less foreign money, the exchanges are said to be "against us," or "unfavorable." When exchanges are "favorable," rates have moved toward the point at which gold will tend to be shipped into our country. This will build up our bank reserves and will tend to make money "easier" or cheaper in the United States,

[1] Our former system of quoting marks and francs will be more fully described in Chapter X.

thereby enabling borrowers to secure loans and discounts from their banks at lower rates. When the exchanges are "unfavorable," rates have moved toward the point at which gold will tend to leave the country, and if gold does leave it will reduce bank reserves and cause money to become "tighter" with the result that the rates charged by banks for loans and discounts will tend to be increased.

Another expression "the commercial par of exchange" is found at times in text-books and sometimes in our financial journals. The more customary statement is that "the exchanges are at par," which signifies that our financial claims on another country are equal to its claims on us. Of course such a situation could but rarely if ever occur. As will be noted later it is the inequality of claims that to a very great extent causes exchange rates to fluctuate above and below par.

In publications and articles dealing with the exchanges and also in current discussion among exchange dealers themselves, such terms as "dollar exchange," "sterling" or "sterling exchange," "the Continental exchanges," "neutral exchanges," "Eastern" or "Oriental exchanges," "South American exchanges," "silver exchanges" and "paper exchanges" are commonly met with. "Dollar exchange" is exchange drawn in terms of dollars. American exporters now draw a large number of bills on foreign firms in dollars; importers also frequently ask that the bills drawn on them by foreigners be drawn in dollars; travelers, both for pleasure and for commercial purposes, take dollar letters of credit abroad, and banks that are members of the Federal Reserve System are authorized, under restrictions imposed by the Federal Reserve Board, to establish dollar exchange in the United States for the use of foreign banks "as required by the usages of trade in the respective countries." [1]

[1] The Federal Reserve Law permits "any member bank to accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations" . . . prescribed by the Federal Reserve Board, by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies, or insular possessions (Sixth Annual Report [1919], Federal Reserve Board, p. 21).

The purpose of the act and the regulations adopted thereunder by the Federal Reserve Board is to provide dollar exchange in countries where the sight draft or cable "is not the current means of remittance in payment of foreign debts, but where the three months' bankers' draft is generally used for that purpose."

The Board has ruled that there is nothing "in the provisions of Section 13 of the Federal Reserve Act which can be construed to permit the acceptance by member banks of drafts drawn merely for the purpose of correcting adverse exchange conditions," or "merely because dollar exchange is at a premium in the country where the drafts are to be drawn."

The countries designated thus far (April, 1922) are: Australia, New Zealand, and other

"Sterling exchange" means exchange on England. The "Continental exchanges" refer to the exchanges of the countries of the European continent. "Neutral exchanges" is a term that is already passing out of use, and arose during the World War to designate the exchanges on the then neutral nations. The term "Eastern" or "Oriental" exchanges applies to the exchanges on Oriental countries including India; "South American exchanges" to the exchanges on South American countries; "silver exchanges" to the exchanges on silver standard countries; and "paper exchanges" to the exchanges on paper standard countries.

The methods followed in quoting the rates on various countries, the system by which the rates progress or advance, the factors affecting the actual rates charged or paid, will be considered in detail in Chapter X. It is sufficient for our present purpose to have learned the meaning of certain technical terms commonly employed in the open market and in the discussion of the exchanges.

Australasian dependencies, Argentina, Australia, Bolivia, Brazil, British Guiana, British Honduras, Chile, Colombia, Costa Rica, Cuba, Dutch Guiana, Ecuador, French Guiana, Guatemala, Honduras, Nicaragua, Panama, Paraguay, Peru, Porto Rica, San Salvador, Santo Domingo, Trinidad, Uruguay, Venezuela, and the French West Indies.

CHAPTER VII

FUNDAMENTALS OF FOREIGN BILLS OF EXCHANGE

Foreign bills of exchange are very much like domestic bills of exchange, the main differences being that, first, the personal bank check drawn in dollars as we know it in domestic trade is never used; second, the draft drawn by the seller upon the buyer, viz., the ordinary trade acceptance, is very seldom found, although now and then it appears for reasons later to be discussed; and third, bills of all kinds, even in spite of the developments during the World War, are still for the most part drawn in terms of a foreign money, although as has been noted there appears to be a growing tendency to finance our foreign trade by means of "dollar exchange." Foreign exchange stresses the part played by banks and other financial intermediaries even more than does domestic exchange.

Practically all foreign trade is financed by means of drafts of some sort or other and cables, although of late there has been a slight development in the use of the ordinary bank check drawn by American importers in terms of foreign money against checking accounts which they have established with foreign banks. Cables, or telegraphic transfers (commonly designated as "T. T." in the foreign exchange lists), are payable immediately upon receipt by the foreign correspondent to whom the cable is sent. Foreign drafts, however, may be payable at sight, i. e., on presentation to the payer or the party upon whom drawn (commonly called "sight" or "demand" bills), or at so many days after sight, i. e., so many days after the draft has been presented for acceptance (commonly called "time" bills), or at so many days from date, i. e., so many days from the date on which the draft was drawn (commonly called "date" bills). Days of grace do not run in the case of sight bills or cables, but they do hold in the case of time bills and date bills, the number of days of grace varying as between different countries. Days of grace are not allowed by European countries as a rule; Great Britain, the most noteworthy exception, allows three days grace. A sixty days draft on London reaches maturity and is payable, not at the end of sixty days, but at

the end of sixty-three days. Short time bills may run three,[1] seven, ten, or thirty days from sight. Many of the shipments sent to Germany from the United States since the World War have been covered by three day sight drafts. Had the drafts been drawn at sight, it might have been difficult for the German importer to have paid the draft on demand, but being allowed three days time in which to make the necessary arrangements with his bank he could much more easily make provision for the payment. Long time bills usually run sixty or ninety days from sight, although some run as long as six or nine months. Date bills drawn in New York on London or nearby European cities frequently run "ten days from date," due to the fact that it normally takes about ten days for a cargo to reach those centers. Such drafts arrive a few days before the goods and before date of payment, but the time that intervenes makes it possible for the importer to get the funds needed for payment. If the draft were drawn at sight, it would necessitate payment by the importer before the goods were received. Importers as a rule do not wish to pay for goods before they are at hand. Date bills may run for longer periods, i. e., thirty, sixty, or ninety days. There has been a growing desire on the part of the exporters to use the date bill rather than the long sight bill, because the former enables them to know exactly when the bill will mature and become payable, while if it is drawn so many days from sight the exporter cannot know definitely just when it is to mature unless the foreign correspondent advises him of the date of acceptance by the drawee. Importers, however, object to the use of the date bill because they feel that the bill is running against them during the days that it is in transit, and that consequently they have a shorter time in which to make payment than would be the case if the draft were drawn payable a certain number of days after sight.

Drafts drawn payable at sight and date bills do not have to be accepted by the drawee as do bills drawn payable a certain number of days after sight. The latter, commonly known as "acceptance bills" or "acceptances," are used in one form or another for the financing of the greater part of our foreign trade. Acceptances that arise out of foreign trade may be classified on the basis of whether or not they are used in paying for exports ("export acceptances"), in paying for imports ("import acceptances"), or in the loaning of money by a foreign bank to or through a domestic bank by means of the latter

[1] In England a three day bill is not classed as a time bill.

drawing drafts against the former (generally known as "finance bills," sometimes as dollar, sterling, mark, or franc loans). Acceptances in the foreign field may also be classified into trade acceptances and bank, or bankers', acceptances. Each of the above forms of acceptance bills will be discussed in subsequent pages.

Foreign bills of exchange may be either "clean" or "documentary." A clean bill has no documents attached relating to the nature of the transaction that brought it into existence. A foreign postal money order, a draft drawn by one bank upon another or by one merchant upon another merchant or by a merchant upon a bank, or a check drawn by an American upon his account with a foreign bank, are all instances of clean bills of exchange. They may be sent by the remitter for the purpose of enabling him to pay for goods, services, securities, etc., already purchased or about to be purchased abroad, or for the purpose of remitting funds to friends, relatives, etc., or they may be drawn by an exporting firm in order to obtain payment for goods that have been, are being, or are about to be, shipped abroad. Such bills are usually sight bills, although they may run from sight to sixty or ninety days. When a "clean" bill has been drawn by one merchant upon another, the bank or exchange dealer purchasing it takes a greater risk than usual because the dealer has no security except the credit of the drawer. The goods, payment for which is represented by the draft, may have been shipped some months before the draft was drawn. Or it may be that the clean bill is not based on a shipment of goods but arises in some other connection. The dealer who purchases a clean bill knows nothing of the details of the transaction which brought it into being. It is because of these facts that clean bills drawn by one merchant upon another are either not bought at all by some banks, or when purchased are paid for at a slightly lower rate than is given for documentary bills. Drafts drawn by a domestic bank upon a foreign bank, or by a merchant upon a bank under proper authorization, do not have to meet the above mentioned objections because of the unquestioned credit standing of the parties concerned, although, as we shall see later, when one bank draws too many drafts on another bank for the purpose of creating "finance bills," the market will even in that case question the worth of the bills and will pay a little lower rate for them.

Documentary bills of exchange, also known as "commercial bills" or "collateral bills," are those which have negotiable documents

attached to the draft, which documents cover the goods that are being shipped.[1] The usual documents are the bill of lading, invoice, and insurance policy or insurance certificate. The invoice is a statement of the character and amount of the goods shipped, their prices, and any additional charges that may be involved. The bill of lading is, briefly, a receipt from the shipping company, and if made out to order and indorsed in blank, gives possession of the goods to the party holding it. The insurance policy or insurance certificate represents insurance coverage for the goods, and, if in proper form and indorsed in blank, awards the insurance money in case of loss to the party that has possession of it. Each of these documents, as well as others that are used under certain conditions, will be more fully discussed later. The number and kinds of documents that are to accompany the draft, the manner in which they are to be drawn and to whom payable, the length of time for which the draft is to run (its "usance"), interest charges, exchange, and all other matters relating to the shipment of the goods, are as a rule fully and completely determined between seller and buyer before the goods are shipped. "In export trade no detail of a transaction should be left vague or undefined. Customers are far distant, mails are slow, cables are costly, and misunderstandings are exasperating and difficult to straighten out. A clear-cut agreement should be reached between buyer and seller as to the way the goods are to be packed and marked, who is to insure them and pay various charges, such as consular fees and other incidentals. The parties to the transaction should assure themselves that they fully understand each other when using such trade terms as F. O. B., F. A. S. and so on, and attach precisely the same meaning to these commercial formulas."[2] It is necessary that the exporter abide by the terms of the contract of sale, otherwise when the goods and documents arrive at their destination the drawee may refuse to accept the draft and thus cause serious loss to the shipper. When a bank buys a bill of exchange, regardless of whether or not it is clean or documentary, or when it takes a bill for collection, it must always be careful to note that any instructions that are attached to the bill accord with the agreement between the drawer

[1] "Documentary bills are those to which are attached negotiable shipping documents which not only constitute the evidence of the shipment but which also carry the right ultimately to control the goods. Of course the documents must be negotiable, otherwise the bill is practically a clean bill." Agger, E. E., in National City Bank Correspondence Course in Foreign Exchange.

[2] "Essentials of Trading with Latin America," pamphlet issued by Guaranty Trust Company, N. Y., pp. 9–10.

January 2, 19 *21*

GUARANTY TRUST COMPANY OF NEW YORK,
140 Broadway, New York City

Dear Sirs:

We enclose for ~~Discount~~ / Collection the undermentioned draft with documents as enumerated. The surrender of documents to drawees is conditional upon fulfillment of instructions as indicated by cross (x) in margin.

DRAFT	NUMBER	DOCUMENTS
No. *298*	*2*	Commercial Invoice
Drawer *John Brown & Co.*	*1*	Consular Invoice
Drawee *Chinese Trading Co.*	*3*	Bills of Lading
City Where Payable *Shanghai, China*	*2*	Insurance Certificate
Date *Aug. 7, 1920*	–	Certificate of Origin
Amount *U. S. $10,342.10*	–	Weight Certificate
Drawn at *120 d/d*	–	Declaration of Shipper

INSTRUCTIONS

☒ Documents against ~~Payment~~ / Acceptance.

☒ Protest for Non-Payment / ~~Non-Acceptance~~.

☒ Permit Drawee privilege inspecting merchandise before accepting draft.

☒ Hold for arrival of goods.

☒ Payable at collecting banks selling Check / ~~Cable~~ rate on New York day of payment.

☒ Payable at Check rate on New York, remitting proceeds by cable, charges for our account.

☒ Interest to be collected at..... *6* ....% from date of issue until approximate arrival cover in New York.

☒ Allow Drawee interest at..... *6* .....% per annum for anticipated payment.

☒ All charges are for account of ~~Drawer~~ / Drawee.

☒ Waive charges if refused by Drawee.

☒ In case of need refer to *American Export Co. Shanghai* and advise immediately by ~~Mail~~ / Cable.

☒ SPECIAL INSTRUCTIONS.

Kindly collect this draft through the Asia Banking Corporation, Shanghai.

Yours truly,

J. BROWN & CO.

FIGURE 32—Instructions accompanying a foreign bill of exchange

and the drawee covering the terms of the transaction, usually to be found in the commercial letter of credit [1] or other document which forms the basis of the transaction. If it is a documentary bill of exchange, the bank must be certain that the correct number of documents accompany the draft, that they are of the designated kind, that full instructions accompany the bill as to how the documents are to be handled by its foreign correspondent, i. e., whether they are to be turned over to the drawee on payment or on acceptance of the draft, and that all other conditions are fully provided for. In addition to the instructions which the drawer may give the bank when he places the bill in its hands, the bank itself may impose certain conditions or add other instructions. These instructions may be a typewritten set of directions, or a small printed blank with the spaces properly filled in, or they may appear on the draft itself or on a detachable stub at the left end of the draft. Figures 32–33 are samples of forms commonly used to convey the necessary instructions to the foreign correspondent.

(3M. sets. 11-6-11)

ORIGINAL

The American National Bank

of San Francisco, Cal.

INSTRUCTIONS PERTAINING TO REMITTANCE NO.

DOCUMENTS ATTACHED

____LETTERS OF ADVICE

____INVOICES

____CONSULAR INVOICE

____CERTIFICATES

____BILLS OF LADING

____INSURANCE POLICIES

DELIVER DOCUMENTS AGAINST_____

IN CASE OF NEED APPLY TO_____

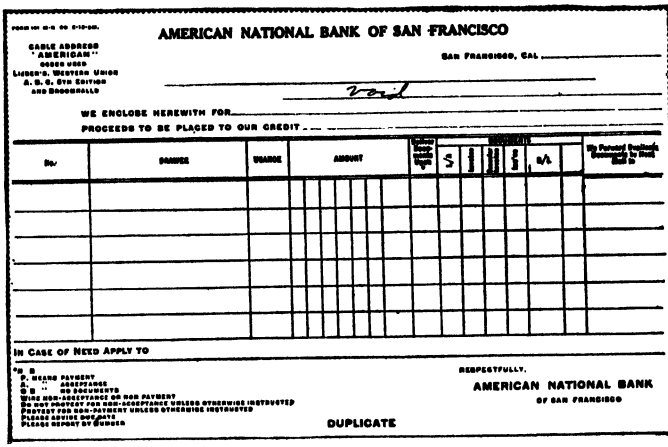
FIGURE 33

Instructions accompanying a foreign bill of exchange

These instructions are drawn in duplicate, sometimes in greater number, one copy always accompanying each complete set of documents. When a number of bills are forwarded at the same time it is customary for the bank to send instructions regarding them on one blank, rather than to attach a separate list of instructions to each set

[1] Cf. Chapter. IX

of documents. In that case the following form (Fig. 34) may be used, the terms of which will be explained later: [1]


AMERICAN NATIONAL BANK OF SAN FRANCISCO

SAN FRANCISCO, CAL. _____

Void

WE ENCLOSE HEREWITH FOR _____

PROCEEDS TO BE PLACED TO OUR CREDIT _____

No.	DRAWER	DRAWEE	AMOUNT	$	¢

IN CASE OF NEED APPLY TO

RESPECTFULLY,

AMERICAN NATIONAL BANK

OF SAN FRANCISCO

DUPLICATE

FIGURE 34

Instructions accompanying several bills of exchange

The draft accompanying each set of documents may be drawn by a merchant (the exporter) against another merchant (the importer), or by a merchant (the exporter) against a bank with which the foreign importer or possibly his bank has made the necessary arrangements.[2] Long bills running from sixty to ninety days are usually, though not always, documentary in character. Documentary bills drawn against shipments of cotton, wheat, corn, and other staples, constitute the bulk of the bills dealt in by the New York exchange market. If the documentary bills are demand (sight) bills, there is of course no need of acceptance by the drawee; he gets his documents and his goods only upon the payment of the draft when presented to him. In case the draft is to run a certain number of days after sight, the documentary bill must be accepted and thus is classed as an "acceptance" bill. If drawn by one merchant against another it is a trade acceptance; if by a merchant on a foreign bank, it is a bank or banker's acceptance. Whether or not the documents will be turned over to the drawee upon his having accepted the draft will depend entirely upon the instructions which accompany the draft. If the instructions are that the docu-

[1] Cf. pp. 159–169.

[2] See discussion of foreign commercial letters of credit, Chapter IX.

ments are to be turned over to him upon acceptance, the drawee receives them immediately upon acceptance. Whether or not he must deposit security with the bank or agent who presents the draft to him for acceptance will also depend upon the instructions which the foreign correspondent has received and which accompany the documents. In the case just described, the instructions would read "Documents on acceptance," or merely "D. A." If the drawer did not wish to have the documents turned over to the drawee upon acceptance but only after he has paid for the goods, the instructions would read "Documents on payment," or merely "D. P." Acceptance does not always give possession of the documents or of the goods. In the latter case, where the instructions are "D. P.", the act of accepting merely sets the date from which the draft begins to run. The acceptor of a "D. P." bill is able to obtain his documents and his goods only after he has paid the draft. He is permitted to pay it any time between the date of his acceptance and the date of the maturity of the bill. In England, if the draft runs for sixty days, he may wait until sixty-three days (three days of grace being allowed) have elapsed before being compelled to pay the bill and before getting his documents, but he may pay it any time after acceptance. If he pays before maturity, he is given a "rebate," i. e., he pays less than the face value of the draft, the amount of his rebate depending upon the discount rate in the market and the number of days the bill is paid ahead of time. "D. P." bills are therefore usually known as "rebatable commercial long bills." The rate of the rebate, sometimes called the "rebate rate," or "the rebate rate of interest," but more correctly the "retirement rate of discount," is fixed by custom in England at one-half of one per cent above the rate of interest that bankers are paying for deposits (usually two per cent under the Bank of England's official rate of discount), or, to put the matter another way, the retirement rate of discount is usually one and one-half per cent below the Bank of England's discount rate. In other European centers the retirement rate of discount is usually fixed at the current rate of discount of the central bank of the country upon which the draft has been drawn. It is an unusual thing for an acceptor of a "D. A" bill to be willing to pay the draft before it is due. If, however, he does pay it before maturity, he is given a rebate at the same rate as for "D. P" bills.

When a "D. A." bill has been accepted and the documents have been handed to the acceptor, the documentary bill becomes a clean

bill, nothing but the draft remaining in the hands of the correspondent. This draft may then be indorsed by the holder and discounted in the open market. There is no need of keeping track of the bill as it passes from one party to another, because the person who holds it on the date of maturity will either present it or have his bank present it to the acceptor for payment. "D. P." bills are not discounted in England, for the simple reason that the acceptor may at any time wish to pay the draft and thereupon obtain his documents so as to have access to his goods. If the bill were discounted and possibly rediscounted a number of times, it would be difficult for him to trace it from bank to bank and locate the person or bank that was holding it. The holder of a number of "D. P." bills, however, may use them as a pledge for a loan, with the agreement, however, that the acceptor may have his documents whenever he is willing to pay the draft and that other bills may be substituted for those that are taken up by the acceptor before the maturity of the loan. In Germany, however, it is not unusual for "D. P." bills to be discounted in the open market. In such cases, the correspondent retains the documents (which give possession to the goods), and sells the draft as a clean bill. The bill then runs to maturity. When the acceptor announces that he is ready to pay the draft less the rebate, the banker receives the money, turns the documents over to him, and guarantees that the draft will be paid in full at maturity.

Where the credit standing of the drawee is not well known or is not considered to be of the very best, or where there is more than ordinary risk involved, or where the commodities shipped are perishable, it is customary to have the documents go forward under "D. P." instructions. It is not unusual, therefore, for trade acceptances to be "D. P." bills. When the draft is drawn against a bank, however, documentary bills are always "D. A." bills, because there is no question involved as to the credit standing of the bank. If definite instructions do not accompany the bills, documents are delivered only against payment in India and other eastern countries and occasionally in Europe, but in some of the South American countries they are turned over to the drawee only upon acceptance. The laws of some of the South American countries accord the merchants the right to demand and to obtain the documents when they accept, regardless of the instructions that may accompany the bill of exchange. The following letter addressed to a bank in the United States by a bank of Lima, Peru, depicts the

attitude of the merchants and banks of that country toward "D. P." bills:

"Dear Sirs:

We beg to confirm our cable of the 5th instant reading as follows:

'REFERRING YOUR LETTER 7TH & 8TH ULTIMO YOUR REMITTANCES 48 TO 53 AND 59 TO 60 DRAWEES DEMAND DELIVERY DOCUMENTS AGAINST ACCEPTANCE—TELEGRAPH INSTRUCTIONS'

which refers to your collections .... all drawn at sixty days' sight.

"Regarding the above transactions, we beg to call your attention to the fact that such drafts, in the form they are issued, i. e., at sixty days' sight, with instructions to deliver documents against PAYMENT and not against ACCEPTANCE cause us a great deal of trouble. The merchants of this country are accustomed since early years, to have surrendered to them, corresponding documents against ACCEPTANCE OF TIME DRAFTS; which means to them to enjoy the privilege of credit for the time at which items are drawn. Furthermore, the Law of this country upholds the merchants in their contentions.

"Time Drafts should come with instructions of delivering documents against ACCEPTANCE and in case of cash payment being desired (that is, documents against PAYMENT) SIGHT BILLS should be drawn.

"We shall be obliged if in future you will bear the foregoing in mind and refrain from forwarding us for collection, TIME DRAFTS with documents to be surrendered only against PAYMENT.

"We trust the above is quite explanatory and shall appreciate your usual good attention to the matter which has compelled us to write this letter.

"Yours faithfully," [1]

[1] The following letter from a bank in Bolivia to a bank in the United States is likewise of interest in the above connection:

"Gentlemen:

Collection ....

"We beg to call your attention to the discrepancy which we note in your instructions given us in reference to the above collection. The draft is drawn at 120 days' sight and you tell us that the documents should be handed against payment. We do not know this way of proceeding and rather believe that this is an error or a ridiculous inconsistency. It is plain to us in this country, that if a drawing is issued at 120 days' sight, with documents, said documents should be deliverable against acceptance of draft and not against payment. If it had been the wish of the Drawers to give instructions to hand the documents against payment, why the draft should simply have been drawn at sight. We fail to understand in this country what benefit a person would enjoy by having drafts drawn on him at 120 days' sight, as in this case, when he is unable to procure corresponding docu-

The instructions that accompany a documentary bill of exchange may contain the designation "D. D.," which means simply that the documents are to be delivered to the party concerned. Such instructions are employed only when goods have been shipped with the understanding that the documents are to be forwarded immediately and that payment may be made at some later date by means of a draft upon the importer or by the latter forwarding a remittance to the shipper. In this case the documents are turned over to the bank as the shipper's forwarding agent.

There often appears on the face of the draft, or more frequently on the instruction blank accompanying the bill of exchange, the phrase "In case of need, with....." or "In case of need, apply to.....," the name and address of some business concern, bank, shipping agency, branch office of the exporter, or individual being inserted. This party, known as a "referee in case of need," is usually located in the country upon which the draft has been drawn and may be called upon by the holder of the bill to straighten out any difficulty that may arise between him and the importer and thus save the expense of delay, cablegrams, protest fees, etc., which would otherwise result. It frequently happens that the importer's "refusal to accept or pay a draft arises from some trivial matter which can be adjusted easily by a tactful intermediary, but which otherwise would involve expensive cablegrams and negotiations at long range. If the 'case of need' succeeds in adjusting the point in dispute so that the drawee becomes willing to complete the transaction, then the matter is closed without material expense to the exporter. Or, failing to arrive at any agreement, the local representative ('case of need') may honor the draft himself or make some arrangement with another importer to take over the goods upon satisfactory terms. On the other hand, it may be that the 'case of need' finds it necessary to make certain concessions to the buyer. The local bank holding the draft then is in the position to cable a concrete proposal on behalf of the purchaser to the American bank which originally

ments without payment. In what manner is he to procure the necessary funds if he cannot take possession and dispose of the relative merchandise and receive the proceeds therefrom?

"With this explanation, we beg to inform you that in future we shall not take upon ourselves any collections that contain such contradictory instructions, and we must again inform you that such proceedings are not known here as they are very evidently absurd.

"Expecting that you will find our remarks in order, we remain,

"Yours very truly,"

started the bill along for collection. If it is desired that the powers and authority of the 'case of need' exceed those described above, then the necessary authorization or power of attorney should be filed both with the 'case of need' and with the bank which negotiates the draft in the United States." [1]

Other terms that appear on the drafts themselves or in the instructions which accompany the documents, such as the "colonial clause," the "interest clause," the phrase "exchange as per indorsement," etc., will be explained in later chapters.

Documentary bills, unlike clean bills, are comparatively safe for the exchange dealer to purchase, because, aside from the liability of the drawer, which, as has been seen, does not cease until payment of draft, the documents normally afford practically complete protection against loss. When prices are falling rapidly, as they did during 1920–1921, bankers and others run great risks through the refusal of the drawee to accept the drafts covering goods contracted for at higher prices, and also through the failure or bankruptcy of the exporting firms from which the bills have been purchased. In normal times, however, documentary bills covering shipments of staple non-perishable products, such as flour, farming implements, canned meats (or fresh meats and provisions when shipped in refrigerator cars and vessels), etc., are comparatively safe because the goods can usually be sold in the market where consigned, if a forced sale is necessary, at prices that will reimburse the bank for its outlay. If a small balance remains unpaid, it can usually be collected from the indorsers or drawer without difficulty, while if a surplus be realized it is returned to the drawer. Cotton bills should be purchased only from well-known and responsible shippers because there are so many grades with a different price for each and because it is so easy to substitute one grade for another. Bills against grain shipments are usually safe provided the grain inspector at the shipping point is of good repute and will not certify a higher grade for a lower. Bills covering shipments of perishable fruits, goods, etc., because of the chance of spoilage, naturally involve more or less risk, as do those covering live stock, because any delay at destination necessitates the expense of feed and attention, or those covering specialties, such as pianos, phonographs, musical instruments, etc., because they can rarely be sold at auction at anywhere near the price at which they have been billed.

[1] Foreign Trade Bulletin of the American Express Company, May–June, 1918.

Documentary bills, regardless of the conditions existing, should be dealt in only by those who are thoroughly trained in that phase of foreign exchange, because it means, when the transaction is stripped of all its outward characteristics, the loaning of money upon goods that the exchange dealer has not seen. "The attachment of documents does not enhance the value of the draft in every case. The standing of the drawer is what counts in first instance, as documentary bills are not easily negotiable in the open market and they protect only while documents are attached. The acceptance of the drawee adds usually to the value of the paper, especially when the acceptor is a bank, a banker, or merchant of good standing and reputation." [1] If the drawer and the drawee have excellent financial standing, that of course eliminates the principal source of loss. But even then, great care should be exercised by the dealer in purchasing bills so that no possible difficulty may arise to impair their value. The bank clerk should note whether all documents are drawn in accordance with the terms called for in the letter of credit. He should examine the bill of lading to see that it is correctly dated and corresponds with the shipment made; that it declares that the goods were received in good condition; that it is duly signed by the agent or the proper official of the railway or steamship company; that it corresponds with the insurance certificate or policy in all particulars; that all negotiable copies of the bill of lading are in his possession; and that there are no stamped or printed conditions on it that might render it valueless in case of an emergency. He should know the market value of the goods shipped, so as to be sure that the draft is not drawn for a larger sum than could normally be realized should the goods have to be sold by the bank in order to collect its claim. Information concerning the value of commodities can be obtained from the various trade journals or from local firms dealing therein. The banker should keep continually posted as to the financial standing of the drawer, and if possible of the drawee. If the goods are perishable, he should take care to see that they are to be sent by fast freight or steamer or in refrigerator cars and vessels. If sent from some small inland point where it is not possible to obtain a through bill of lading to the point of destination, he should make the necessary arrangements with a broker or the bank's correspondent at the seaport to have the original bill of lading ex-

[1] Gonzales, V., "Modern Foreign Exchange," N. Y., 1920, second edition, pp. 41–42.

changed for a through bill of lading.[1] In every seaport there are a number of firms that make a business of acting as forwarding agents for inland customers, exchanging bills of lading, arranging for shipment of goods on the proper lines, etc. He should also note whether or not the insurance in effect on the shipment is for the proper sum, whether or not it covers the goods from the time they leave the exporter's hands until they reach the importer, just what length of time and what route the policy covers, and whether there are any clauses in the insurance policy or certificate or attached thereto by stickers that may make it either difficult or impossible for the bank to collect a claim for damages. And in the case of all documents needing indorsements, he should note that the indorsements are in proper form, in order that the documents may be easily negotiated and the bank's interests completely protected. Any error or incompleteness may cause delay and necessitate loss of interest, protest fees, cablegram costs, etc.

Practically all of the important banks (both domestic and foreign) in the United States that are engaged in buying documentary bills of exchange have adopted a uniform set of rules governing payments of commercial credits and the handling or purchasing of documents drawn thereunder, and have notified their correspondents to the following effect:

TO CORRESPONDENTS:

Payments under Export Commercial Credits advised to the undersigned are made in conformity with the following regulations, which are in accord with the standard practice adopted by the New York Bankers Commercial Credit Conference of 1920:

1. We assume no liability or responsibility for the form, sufficiency, correctness, genuineness or legal effect of any documents, or for the description, quantity, quality, condition, delivery or value of the merchandise represented thereby, or for the good faith or acts of the shipper or any other person whomsoever; but documents will be examined with care sufficient to ascertain whether on their face they appear to be regular in general form.

2. We will interpret the terms "documents," "shipping documents" and words of similar import, as comprehending only ocean bills of lading (sailor bill of lading included) and marine and war risk insurance, in negotiable form, with invoices.

3. Unless specifically otherwise instructed, we will accept "received for transportation" bills of lading in the form customarily issued in New York.

[1] Brooks, *op. cit.*, p. 189.

(The steamship lines constituting the Transatlantic Conference state that the customary procedure necessitated by American port conditions, is to issue bills of lading against the receipt of goods into the custody of the steamship owners or agents, for transportation by a named steamer, and failing shipment by said steamer, with liberty to ship in and upon a prior or following steamer. They state that it is not possible here to issue "on board" bills of lading, but have agreed, after the goods are loaded, so far as reasonably practicable, to indorse on the bills of lading, if returned for the purpose by the shippers, a dated clause to the effect that the within goods have been loaded on board, specifying any portion that has been "short shipped." They represent, however, that such procedure will not be reasonably practicable in all trades, nor in any trade at all times, and where used, on account of the delay involved, may result in the merchandise arriving at destination in advance of the bills of lading.) When specifically requested by a correspondent, we will request the "on board" indorsement, and obtain it, where practicable.

4. When the "on board" indorsement is not specifically requested by a correspondent, or it is impracticable to obtain it, the date of the bill of lading will be taken to be the date upon which shipment has been effected. When the "on board" indorsement is obtained, the date of such indorsement will be taken to be the date upon which shipment has been effected.

5. Instructions shall be interpreted according to our law and customs, but in any event, in accordance with the following general rules:

A. Forwarders' bills of lading will not be accepted, unless specially authorized. Railroad through bills of lading will not be accepted, except on exportations to the Far East via Pacific ports, unless expressly stipulated.

B. Bills of lading shall contain no words qualifying the acceptance of the merchandise in apparent good order and condition. If "on board" bills of lading are stipulated, they shall acknowledge receipt of the goods on board a named vessel. Otherwise, "received for transportation" bills of lading, which acknowledge the receipt of the goods into the custody of the steamship owners or agents for transportation by a named steamer, and failing shipment by said steamer with liberty to ship in and upon a prior or following steamer, will be accepted; and insurance certificates, if required, shall cover shipment correspondingly.

C. Documents for partial shipments will be accepted, even if the pro rata value cannot be verified, unless expressly prohibited.

D. The use of "to," "until" "on," and words of similar import, in indicating expiration, is interpreted to include the date mentioned.

E. When the indicated expiration date for payment falls upon a Sunday or legal holiday here, the expiration is extended to the next succeeding business day.

F. The terms "prompt shipment," "immediate shipment," "shipment as soon as possible" and words of similar import, shall be interpreted as requiring shipment to be effected and (if the credit advice is without expressed duration) the stipulated documents presented for payment within thirty days from the date of our credit advice.

G. Our credit advice if without expressed duration, shall not continue in force longer than one year from its date.

H. The stipulated documents must all be presented not later than 3 p. m. (or twelve o'clock, noon, if Saturday) on the indicated expiration date.

I. The terms "approximately," "about," or words of similar import, shall be construed to permit a variation of not to exceed ten per centum.

J. Definitions of Export Quotations will be those adopted by the National Foreign Trade Council, Chamber of Commerce of the U. S. A,. National Association of Manufacturers, American Manufacturers' Export Association, Philadelphia Commercial Museum, American Exporters' and Importers' Association, Chamber of Commerce of the State of New York, N. Y., Produce Exchange, and New York Merchants' Association, at a conference held in India House, N. Y., on December 16, 1919.

6. Correspondents will understand that the above regulations shall govern in all credit transactions in the absence of other specific agreements. If the beneficiary shall make representations, or shall offer security, satisfactory to the bank, that no loss shall result to its correspondent or client by the waiver of any of such regulations or any instruction, the bank reserves the right to make such waiver, and shall recognize no claim in the premises unless substantial direct damage shall be shown to have resulted.

In order to protect themselves against possible losses resulting from their transactions in documentary bills of exchange, bankers take from exporters, whose bills they purchase, a document known as an "hypothecation certificate." In case a large number of bills are to be purchased, a "general letter of hypothecation" (Fig. 35) is taken and retained by the bank, but if only one or a few bills are involved then a separate certificate of hypothecation is taken and attached to the draft along with the other documents.

GENERAL LETTER OF HYPOTHECATION

To the Tenth National Bank, New York.

Gentlemen:—

Having in contemplation transactions with you from time to time in the sale of Bills of Exchange with Shipping Documents for goods or produce attached as collateral security, which documents are to be held by you for the due payment of the same, we hereby declare that upon the sale by us to you of any such Bills of Exchange our agreement with you is understood to be as follows:

You may insure any goods forming the collateral security (if not already insured, and the policy or policies deposited in your hands), from sea risk, including loss by capture, and from fire on shore, and add the premiums and expense thereof to the amount chargeable in respect of the said Bills, but it shall not be imperative upon you to effect any such insurance.

You may sell any portion of the said goods which you may deem necessary for payment of such premiums and expenses, freight, or duties, and take such measures generally, and make such charges for commission, and are to be accountable in such manner, but not further or otherwise as in ordinary cases between a Merchant and his Correspondent.

You may take conditional acceptance to such Bills to the effect that on payment thereof at maturity or under discount the documents handed to you as collateral security shall be delivered to the Acceptors, and this shall extend to acceptances for honor.

In case default be made in acceptance of the said Bills on presentation, we agree immediately on receiving notice from you that you have been advised by telegraph of such non-acceptance, and without waiting for or requiring the protest of the said Bills, that we will pay to you the amount thereof, with all charges of every description incurred by you in consequence of the non-acceptance of the said Bills, or give you a margin which shall be satisfactory to you, either in cash or Securities, and notwithstanding that the goods or produce against which the said Bill is drawn, or the Documents thereof remain in your possession in the United Kingdom or elsewhere; and we hereby agree that your account of the disbursements, commission and charges, incurred by you in consequence of the non-acceptance of the said Bills shall be received by us as sufficient evidence of the amount of such disbursements, commission and charges, and shall not be open to objection of any kind.

In case default be made in acceptance or payment of any of the said Bills, or if the Drawees or Acceptors should suspend payment, or be adjudicated Bankrupt, or execute any Deed of Arrangement, Composition, or Inspectorship or take any other steps whatsoever towards effecting a compromise or arrangements with their creditors during the currency of

the said bills, you may at any time after either of the aforesaid events taking place, sell the goods or any part thereof without notice to or the concurrence of any person whomsoever without waiting for the maturity of the said bills, and either by public auction or private sale, and you may act in all respects as if you had been the direct consignee of the goods, charging such commission as is usual between a Merchant and his Correspondent in ordinary cases, and shall apply the net proceeds of any sale, after deducting any payment made under the powers herein contained, with interest thereon and the usual commission and charges, in payment of the Bills with interest, re-exchange and other charges, and may retain the balance (if any) towards liquidation of any debt or liability of ours to you whether or not the same be then payable or ascertained, it being hereby agreed that the goods themselves until sale shall be liable for and be charged with the payment of all such Bills, with commission, interest, re-exchange, and other charges, debts, or liabilities, and we agree that all account sales and accounts current furnished by you in respect of the said goods shall be received by us as sufficient evidence of the accuracy of the transactions to which they refer, and shall not be open to objection of any kind.

We further authorize you, in case the net proceeds of the sale of such goods shall be insufficient to pay the amount of the said Bills, with disbursements, interest, re-exchange and charges, to draw upon us at the exchange of the day for the amount of such deficiency, and we engage to honor such drafts on presentation, or even without such drafts being sent, to pay you the amount of such deficiency on your informing us of the amount.

In case the aforesaid Power of Sale shall not have arisen during the currency of the said Bills, you may accept payment from the Drawees or Acceptors thereof, and on payment deliver the said Bills of Lading and Shipping Documents to such Drawees or Acceptors.

In case the Drawees or Acceptors should wish to take delivery of any portion of the Goods held as collateral Security against the said Bills before maturity thereof, you are authorized (but not so as to be binding on you) to make such partial deliveries on receiving payment of a proportionate part of the said Bills.

The delivery to you as aforesaid of the above mentioned collateral securities is not to prejudice any of your rights on the said Bills in case of dishonor, nor shall any proceedings taken thereon prejudicially affect your title to the said securities.

All rights, powers, and authorities hereinbefore given to you shall extend to and may be exercised by the holders for the time being of the said Bills and Shipping Documents.

It is understood that in the event of Bills being paid under discount, rebate of interest shall be allowed as follows:—

At one-half per cent per annum above the advertised rate of interest for short deposits allowed by the leading London Joint Stock Banks, if the Bills are taken up in the United Kingdom of Great Britain and Ireland.

At the current minimum rate of Discount of the National Banks of France, Italy, Belgium and Germany respectively if taken up in either of those Countries.

Signed

.....

FIGURE 35

The letter or certificate of hypothecation is merely a rather detailed statement given by the exporter, i. e., the seller of the bill of exchange, to the purchasing bank, containing an enumeration of the powers and privileges of the latter as the buyer of the draft. It recites that the bank has the right to insure the goods against all risks, if such has not already been done; that it may sell all or any part of the goods in order to satisfy its claims for expenses, commission, and principal; that if sufficient funds are not provided by the sale of the goods, the exporter will reimburse the bank for the deficit; and that the bank shall have all authority necessary to enable it to handle the transaction in a manner that will protect its interests. In other words, the letter or certificate of hypothecation represents a rather complete and detailed bill of sale and, while it gives the bank few if any powers that it would not otherwise possess before the law, it does nevertheless clearly set forth those powers in the shape of a formal agreement and thus prevents a controversy arising in the future between the bank and the exporter in case there be non-acceptance or non-payment of the draft.

It is not possible or necessary for us to enter into a detailed discussion of the various papers that must be prepared and handled by an exporter in getting his goods ready for shipment. Anyone interested in the details of clerical work in connection with foreign shipments, such as export licenses, shipping permits, export declarations, dock receipts, etc., will find full explanations of those matters in the many volumes that deal with the technic of foreign trade.[1] In this volume only those papers concern us that are related to the financing of the transaction.

We have seen that a documentary bill of exchange is usually made

[1] Cf. Hough, B. O., "Practical Exporting"; deHaas, A., "Foreign Trade and Shipping," etc.

up of the draft, bill of lading, invoice, and insurance certificate or policy, although there are other documents that may be required under certain conditions and as a consequence of the requirements of the laws of trading countries. We have already referred briefly to some of the documents that are commonly found in the field of foreign exchange, but it is advisable to describe them in more detail than has been done in preceding pages.

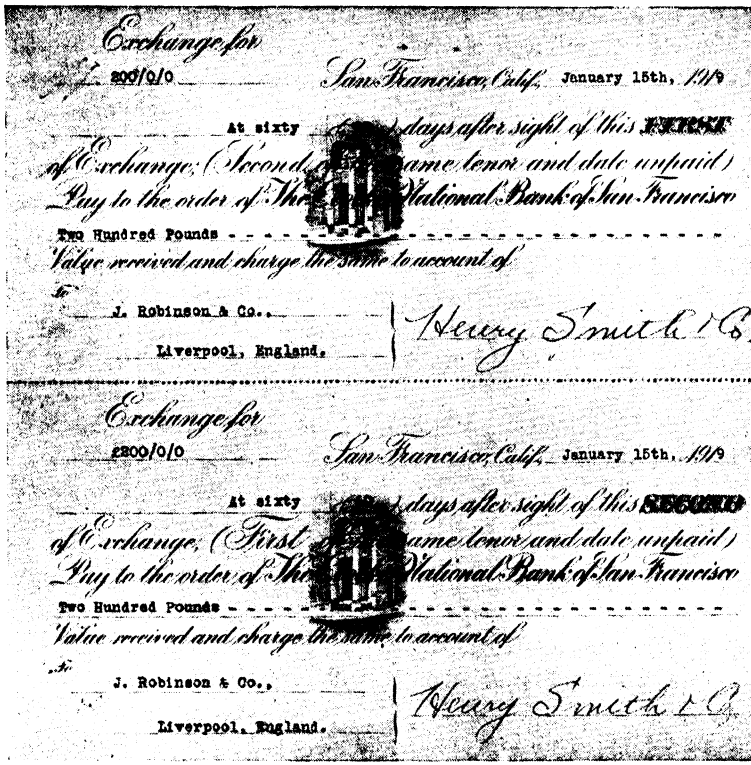

Exchange for
£ 200/0/0 San Francisco, Calif. January 15th, 1919
At sixty days after sight of this FIRST
of Exchange, (Second same tenor and date unpaid)
Pay to the order of The National Bank of San Francisco
Two Hundred Pounds
Value received and charge the same to account of
To
J. Robinson & Co.,
Liverpool, England.
Henry Smith & Co.
Exchange for
£200/0/0 San Francisco, Calif. January 15th, 1919
At sixty days after sight of this SECOND
of Exchange, (First same tenor and date unpaid)
Pay to the order of The National Bank of San Francisco
Two Hundred Pounds
Value received and charge the same to account of
To
J. Robinson & Co.,
Liverpool, England.
Henry Smith & Co.

FIGURE 36
Draft drawn by exporter on importer

As has been noted above, the draft is drawn either by a merchant (the exporter) against another merchant (the importer) (Fig. 36) or by the exporter against a bank or financial agent with which the importer has made the necessary arrangements (to be described more

fully in our discussion of commercial letters of credit).[1] It is usually drawn in duplicate, although at times in triplicate, occasionally in greater number. Each of the copies issued bears its number, i. e., "original" or "first of exchange," "duplicate" or "second of exchange," "triplicate" or "third of exchange," etc. Duplicate or triplicate drafts are drawn, as is the case with the other documents, so that one set of documents may be sent by one steamer, another by a second steamer, etc., as a precaution against loss in transit. The drawer will also usually keep a complete set of documents for his own file ready for future reference. The first complete set of documents to arrive, regardless of whether or not they are the originals, duplicates, or triplicates, are the ones that are used to carry through the transaction. The others become void and are filed away by the correspondent bank or importer. The usance of the draft is customarily thirty to ninety days, although short time bills, and bills for a longer term than ninety days, are not unusual. The usance depends upon the agreement between the seller and the buyer, but the really determining factor is the custom of the trade and of the country to which the goods are shipped.[2] The credit standing of the importer,

[1] Cf. Chapter IX.

[2] A concise and excellent statement of the credit terms in Latin American trade, prepared by the Guaranty Trust Company of New York, is in part as follows:

Custom of many years' standing has made the 90 days sight draft the most generally used instrument of credit in South America. Probably eighty to ninety per cent of the foreign business is done on those terms. The banks even carry their sterling accounts in 90 day bills, checks on which read payable in exchange on London at 90 days after sight.

Another good reason for asking terms other than cash in advance or on arrival of goods is the natural desire of the merchant to get his purchases in his warehouse and examine and list them. Usually, too, it takes quite some time to put them through the customs. Then again the importer may be an agent and the goods may have to go back into the country where transportation is difficult, in which case he himself will have to wait perhaps six months before receiving his final payment.

It is not, therefore, a desire to be financed by the foreign seller that prompts this request for credit as much as the necessity arising from the circumstances of the trade.

The following are the usual terms required:

Argentina: The big houses in Buenos Aires do a large amount of business for cash against delivery of documents, but bills at 60 and 90 days are common. In Rosario and other outlying districts 90 days after receipt of goods is quite generally the custom, and even 120 days in Mendoza and up-country. For textiles 120 days is the usual time allowed for payment and for machinery 150 days may be demanded. Although interest at six per cent is added, it should be included in the face of the draft as only the amount of the face of the draft is legally collectible in Argentina.

Bolivia: Terms are not less than 90 days after sight and range up to 150 days, dry goods requiring 120 days. The rule is to accept drafts only on arrival of goods at customhouse. Documents are very seldom held for payment, being delivered almost in every instance

the length of time that he has been established, the extent of his business, are factors that also enter into the length of time for which

upon acceptance. Transportation is particularly slow and arduous, pack animals being required very extensively.

Brazil: The best houses secure credits at 90 days sight. In the out ports 120 days is quite common, especially for textiles, while heavy machinery frequently requires six to nine months.

Chile: While some business is done on open credit, 90 days after sight is almost universally the custom at Valparaiso, the principal port, while at Iquique it is 90 to 120 days.

Colombia: Buyers require usually from 30 to 60 days after goods pass through the custom house, but six to nine months' bills are quite common. Discount cost plus interest at six per cent is generally added. Discount for cash or prepayment is usually at the rate of five per cent per annum. The custom among wholesalers in Colombia is to allow retailers and agriculturists six months' credit.

Costa Rica: Although many will pay cash for a liberal discount, 90 to 180 days is customary.

Cuba: Credit terms are for three, six and twelve months, according to the commodity, with six per cent interest added. Discounts offered are usually five or six per cent.

Dominican Republic: Generally four to six months credit is granted, plus interest at six per cent.

Ecuador: The rule is 30, 60 and 90 days sight bills, but the up-country trade requires seldom less than 90 days and usually six months to a year, plus six per cent interest.

Guatemala: Ninety days to six months are granted, usually the former, but not infrequently six months after arrival of goods is required, with interest at six per cent.

Haiti: General rule is six months from date of invoice, but quite frequently the time runs from receipt of goods in warehouse, with interest at six per cent.

Honduras: Many leading firms take advantage of discounts for cash, but six months' credit is usual. At Puerto Cortez the prevailing terms are 30, 60 or 90 days, plus six per cent interest or five per cent discount.

Nicaragua: Usual terms six or nine months' bills.

Panama: Usual terms six months.

Paraguay: The general rule is six months after clearance through customhouse, but as officials allow quite long warehousing in bond agreement should be made limiting time for clearance.

Peru: Usual terms 90 days sight, but 60 days, 120, and even 180 days are quite common. Interest is usually at six per cent, and eight per cent for extension. Dry goods require 120 days, and machinery, especially sugar machinery, is sold on long credit, sometimes as much as three years, with a payment of one third in cash on receipt of invoice.

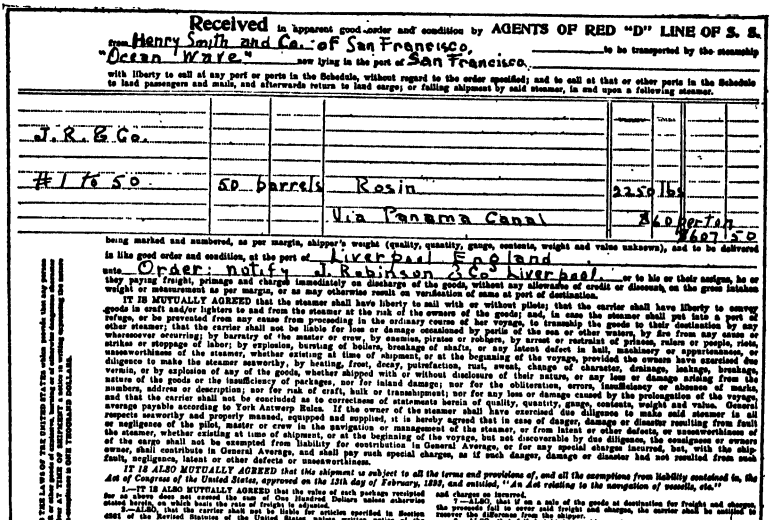
Salvador: Bills at six to nine months, with interest at five to eight per cent, though a liberal discount for cash is usually taken advantage of by the importing houses.

Uruguay: Open accounts are quite generally allowed to well-established Montevideo houses. Otherwise 30 to 60 days sight bills are the rule. Up-country trade requires six months' credit.

Venezuela: Large amount of business is done on open account but usually payment is by bills of three to six months' time. Discounts for prepayment are availed of by many firms. As the consignees named in the consular invoice can always obtain goods from the customhouse without having any papers in his possession, the bills of lading having no standing in Venezuela as commercial documents, the attaching of such documents to drafts affords no security. If acceptance or payment should be required before delivery of goods to purchaser the only way is to invoice the goods to the banking house that is to make the collection.

credit is given and assist in determining the usuance of the draft. The shipper usually indorses the draft in blank when he hands the documents to the bank.

The bill of lading (B/L) is without doubt the most valuable and important of all the documents that accompany the draft (Fig. 37),



Received in apparent good order and condition by AGENTS OF RED "D" LINE OF S. S.
from Henry Smith and Co. of San Francisco,
"Ocean Wave" now lying in the port of San Francisco. to be transported by the steamship
with liberty to call at any port or ports in the Schedule, without regard to the order specified; and to call at that or other ports in the Schedule to land passengers and mails, and afterwards return to land cargo; or failing shipment by said steamer, in and upon a following steamer.

J. R. & Co.

#1 to 50. 50 barrels Rosin 2250 lbs

Via Panama Canal Freight Collect

being marked and numbered, as per margin, shipper's weight (quality, quantity, gauge, contents, weight and value unknown), and to be delivered in like good order and condition, at the port of Liverpool England

unto Order: notify J. Robinson & Co. Liverpool or to his or their assigns, he or they paying freight, primage and charges immediately on discharge of the goods, without any allowance of credit or discount, on the gross inshore weight or measurement as per margin, or as may otherwise result on verification of same at port of destination.

IT IS MUTUALLY AGREED that the steamer shall have liberty to sail with or without pilots; that the carrier shall have liberty to convey goods in craft and/or lighters to and from the steamer at the risk of the owners of the goods; and, in case the steamer shall put into a port of refuge, or be prevented from any cause from proceeding in the ordinary course of her voyage, to transship the goods by their own or other steamer; that the carrier shall not be liable for loss or damage occasioned by perils of the sea or other waters, by fire from any cause or wheresoever occurring; by barratry of the master or crew, by enemies, pirates or robbers, by arrest or restraint of princes, rulers or people, riots, strikes or stoppage of labor; by explosion, bursting of boilers, breakage of shafts, or any latent defect in hull, machinery or appurtenances, or unseaworthiness of the steamer, whether existing at time of shipment, or at the beginning of the voyage, provided the owners have exercised due diligence to make the steamer seaworthy, by heating, frost, decay, putrefaction, rust, sweat, change of character, drainage, leakage, breakage, vermin, or by explosion of any of the goods, whether shipped with or without disclosure of their nature, or any loss or damage arising from the nature of the goods or the insufficiency of packages, nor for inland damage; nor for the obliteration, errors, inadequacy or absence of marks, numbers, address or description; nor for risk of craft, bulk or transshipment; nor for any loss or damage caused by the prolongation of the voyage, and that the carrier shall not be concluded as to correctness of statements herein of quality, quantity, gauge, contents, weight and value. General average payable according to York Antwerp Rules. If the owner of the steamer shall have exercised due diligence to make said steamer in all respects seaworthy and properly manned, equipped and supplied, it is hereby agreed that in case of danger, damage or disaster resulting from fault or negligence of the pilot, master or crew in the navigation or management of the steamer, or from latent or other defects, or unseaworthiness of the steamer, whether existing at time of shipment, or at the beginning of the voyage, but not discoverable by due diligence, the consignees or owners of the cargo shall not be exempted from liability for contribution in General Average, or for any special charges incurred, but, with the ship-owner, shall contribute in General Average, and shall pay such special charges, as if such danger, damage or disaster had not resulted from such fault, negligence, latent or other defects or unseaworthiness.

IT IS ALSO MUTUALLY AGREED that this shipment is subject to all the terms and provisions of, and all the exemptions from liability contained in, the Act of Congress of the United States, approved on the 13th day of February, 1893, and entitled, "An Act relating to the navigation of vessels, etc."

1.—IT IS ALSO MUTUALLY AGREED that the value of such package exceeding Dollars unless otherwise stated herein, on which basis the rate of freight is fixed, is limited to Dollars unless otherwise stated herein.

2.—ALSO, that the carrier shall not be liable for articles specified in Section 4281 of the Revised Statutes of the United States, unless the written nature of the goods is inserted by the owner or value thereof is given at the time of lading and entered in the bill of lading.

3.—ALSO, that shippers shall be liable for any loss or damage to steamer or cargo, caused by inflammable, explosive or dangerous goods, shipped without full disclosure of their nature, whether such shipper be principal or agent, and such goods may be thrown overboard or destroyed at any time without compensation.

4.—ALSO, that the carrier shall have a lien on the goods for all freight, primage and charges, and also for all fines or damages which the steamer or cargo may incur or suffer by reason of the illegal, incorrect or fraudulent marking, numbering or addressing of packages or description of their contents.

5.—ALSO, that in case the steamer shall be prevented from reaching her destination by Quarantine, the carrier may discharge the goods into any depot or hospital, such discharge shall be deemed a final delivery under this contract, and all expenses thereby incurred on the goods shall be a lien thereon.

6.—ALSO, that the carrier may commence discharging immediately on arrival and continue night and day, Sundays and Holidays, any custom of the port to the contrary notwithstanding, the Collector of the port being hereby authorized to grant a general permit for discharge immediately on arrival, and if the goods be not taken from the steamer's tackle on the completion of their report to land the goods, or put them into craft or store at the owner's risk and expense, when the goods shall be deemed delivered and steamer's responsibility ended, but the steamer and carrier to have a lien on such goods until the payment of all sums due thereon.

7.—ALSO, that if a sale of the goods at destination for freight and charges, the proceeds fail to cover said freight and charges, the owner shall be liable to recover the difference from the shipper.

8.—ALSO, that in the event of claims for short delivery when the steamer reaches her destination, the onus shall be the same as part of shipment as when the day the steamer sailed plus freight and insurance.

9.—ALSO, that in the event of the vessel not completing shipment or delivery be at the port of destination, the carrier or manager of the steamer shall be entitled to the proportion of freight pro rata.

10.—ALSO, that in the event of any part of the goods not being found for delivery at any stage of the voyage, or part of destination said goods may be re-warded or replaced at ship's option, but not to exceed the value of the goods.

11.—ALSO, that the carrier shall not be liable for any loss or damage occasioned by delay, whether arising from negligence or otherwise.

12.—ALSO, that in the event of the vessel not completing the voyage, or discharging the goods at the port of destination for any cause, the carrier shall have the option of loading them at any other near port or of bringing them back to port of shipment, at the owner's expense, and in the event of their being brought back to port of shipment the freights for the round voyage shall be due and payable, and the amount agreed upon for outward voyage.

13.—ALSO, that prepaid freight shall not be returned ship lost or not lost.

14.—ALSO that goods transhipped under this bill of lading are subject to all the conditions and exceptions noted above and are at owner's risk while on dock, in store, and at lighters.

IN WITNESS WHEREOF, the Master or Agent of the said steamship hath affirmed to 2 Bills of Lading, all of this tenor and date, one of which being accomplished, the others to stand void.

Dated in San Francisco this 15th day of January 1921

SPECIMEN

For Agents.

ATTENTION OF SHIPPERS IS CALLED TO THE LAWS OF THE UNITED STATES, which provide that any person who shall insert in any bill of lading or shipping document any false statement in any matter relating to the shipment of goods, or who shall be guilty of any fraud or evasion in connection therewith, shall be punished by a fine of not exceeding $5,000, or imprisonment for not exceeding two years, or both, at the discretion of the court.

FIGURE 37

Steamship bill of lading

because it alone gives possession of the goods either to the holder or to the consignee, depending upon whether it is an "order" or a "straight" bill of lading.[1] If the goods have been shipped through to their destination from some interior point, a comparatively large number of copies must be obtained from the railroad, varying from

[1] Cf. p. 65.

three to eleven, and depending upon the needs of the railroad, the exporter, his banker, and the steamship company. If the goods have been shipped from some seaport, the number of copies will be less and will be obtained from the steamship company. Only those that are signed by the proper official of the carrier, usually two or three in number, are "negotiable," and all the negotiable copies must be turned over to the shipper. The number of negotiable copies is entered on the bill itself with the statement that "one of which Bills of Lading being accomplished, the others to stand void." The "non-negotiable" copies are for purpose of record only. The exporter may keep one of the latter for his office records, may send one to the importer, together with a copy of the invoice as an "advice" that the goods have been shipped. One copy goes to the captain of the ship. Some countries require that the negotiable bills of lading covering goods that are being imported must be certified by the consul of that country at the point of export. This is especially true of South American countries.[1] The consul of some countries requires a non-negotiable copy for his files.

Bills of lading are usually drawn "to the order" of the exporter and when indorsed by him, simply by his writing his name across the bill, become negotiable. Some countries, however, forbid the use of the "order" bill of lading (Venezuela, Costa Rica, Columbia, and Panama, for example).[2] In those cases a "straight" bill of lading is necessary and very frequently is made out to a party other than the importer but located in the importer's country, such as the correspondent of the bank negotiating the draft. Order bills of lading customarily bear the clause "to be delivered unto Order: notify——————" (mentioning the name of the consignee). This practice is followed so that the correspondent bank, when it receives the documents, may know to whom the goods are being shipped and thus be able to advise the importer of their arrival. Bills with the "notify" clause do not give the party mentioned any control over the goods until they have presented the properly indorsed bill of lading.[3]

[1] Uruguay, Bolivia, Chile, Costa Rica, Cuba, Peru, Honduras, and San Salvador require that all negotiable bills of lading shall be certified by the consul, while Paraguay requires only one to be certified, Haiti five, and Panama four. Cf. deHaas, *op. cit.*, p. 191.

[2] During the World War the Allies forbade the use of the "order" bills of lading to some ports because they wished to know to whom the goods were actually being consigned.

[3] In 1921 a Brazilian court held that a dual control was created by a bill of lading containing the "notify" clause. It should not appear, therefore, on bills of lading covering

The purchasing bank should make certain that the bill of lading is "clean," i. e., that there is no notation on the bill to the effect that the goods have been received by the carrier in damaged condition. In the latter case the carrying company issues what is called a "foul" bill of lading, which, of course, from the standpoint of the bank, is not a satisfactory sort of security for its investment.

Insurance on land shipments is practically unknown because of the liabilities imposed by state and federal laws upon common carriers, but on sea shipments it is universal, not only because of the limited liability of the steamship company, but also because the possibilities of loss are so much greater. Some of the more important contingencies are:

"(a) Loss of vessel or cargo or damage sustained from stranding, sinking, fire or collision, including salvage and other charges.

"(b) Loss or damage by sea water or from risks on shore while in transit, or awaiting shipment, transshipment or delivery, including those of loading and discharge.

"(c) Loss or damage from theft or pilferage, leakage and breakage, fresh water, sweat, etc.

"(d) War risks, including danger from mines as a result of war-time operations, riots and civil commotion." [1]

The liability of the marine carrier is limited practically to its exercising due diligence in seeing that the ship is seaworthy, "free from all defects, latent or otherwise," [2] and properly manned, equipped, and supplied. If such is the case, neither the shipowner "nor the charterers shall be held responsible for damage or loss resulting from faults or errors in navigation or in the management of the vessel, nor shall they be held liable for losses arising from dangers of the sea, acts of God, or public enemies, or the inherent defect, quality or vice of the thing carried, or from insufficiency of package, or seizure under legal process, or from loss resulting from any act or omission of the shipper or owner of the goods, or from saving or attempting to save life or property at sea, or from any deviation in rendering such service. It is obvious, therefore, that the responsibility for a good many kinds of losses which may be incurred can with difficulty be brought home

shipments to Brazil. Consignments to that country should be made "to the order" of the shipper himself or "to the order" of the bank negotiating the draft.

[1] "Trading with the Far East," published by the Irving National Bank, N. Y., 2d edition, 1920, p. 124.

[2] Hough, "Practical Exporting," 3rd ed., 1919, p. 421.

to the carrier. The shipper's protection against other losses must be secured through marine insurance." [1]

The marine insurance policy usually covers only the loss or damage resulting directly from the "perils of the sea." If a person desires to cover loss from other causes, such as deterioration of the goods in transit, breakage, pilferage, fire, etc., it is necessary to include clauses to that effect and to pay extra premiums therefor. Losses from pilferage were very great during the World War and have continued down to date. It has been estimated by one British shipowner that claims for pilferage have increased about 2000 per cent since 1913,[2] a situation that has naturally tended to increase the premiums on insurance against theft and robbery. Where ordinarily these premiums have been about 5/8 of one per cent on the invoice value of the goods, they are now from three to four times that amount. At present (April, 1922) British and American steamship companies refuse to hold themselves responsible for pilferage where the loss can be covered by insurance, and proof of negligence on the part of the carrier is necessary to obtain damages. Needless to say such negligence is a very difficult matter to prove in court. British and Dutch underwriters have also adopted the policy of covering theft risks up to only seventy-five per cent of the value of the shipment. The ever present danger from floating mines makes it still advisable to carry war risk insurance. Newspapers even yet occasionally report ships being blown up by floating mines in the North Sea and in the Mediterranean.

The insurance policy of today contains many clauses and expressions which appear old-fashioned and, to the uninitiated, also meaningless. Some of the policies issued by American marine insurance companies and by the U. S. War Risk Insurance Bureau [3] during and after the World War have been couched in somewhat more modern terms. The reason for the dominance of the British or old-fashioned form of policy is that, having been in use for centuries, the English courts have established a body of interpretations and decisions covering the various phases of marine insurance, and to change the form of the policy at this late date would raise many questions as to the meaning of the newer statements and necessitate interpretation by the courts.

Prior to the World War, English companies controlled more than

[1] Hough, *op. cit.*, p. 436.
[2] Foreign Trade Bulletin of the American Express Company, March, 1921.
[3] The U. S. War Risk Insurance Bureau insured only against marine war risks, the cargo having to be insured against other risks in approved companies.

two-thirds of the marine insurance business of the United States. There were relatively few American companies operating in the field [1], and those which did reinsured a considerable portion of their business with English companies. In international trade rivalry, marine insurance plays a very prominent part. It is one of the three principal commercial facilities, the other two being an adequate merchant marine, and an adequate banking and financial machinery covering all countries with which we trade. "British commercial interests have long realized the advantages of coöperation between these three complementary factors, since each can be made to serve and hasten the growth of the others." [2] Dr. Huebner estimated that in 1918 foreign companies in the American market collected approximately $71,500,000 premiums on marine insurance, to say nothing of premiums on fire insurance, amounting to approximately $144,000,000 and on casualty, liability, and the various forms of inland insurance, amounting to about $35,000,000, making an annual insurance payment by us to foreign companies of about $250,000,000.[3] During the World War, efforts were made—and met with some success—to increase the amount of marine insurance written by American companies. Since the conclusion of the war, however, American companies have been unable to hold their own in competition with foreign companies, and now find their business slipping away from them. Great changes must come in our insurance laws, in our banking system, and in our foreign trade activities before we can expect to compete successfully with foreign insurance companies.

The marine insurance policy differs from the so-called insurance certificate. The policy is usually a rather lengthy printed document describing in detail just what shipment is insured, the amount for which insured, the length of time the policy is to be in effect, the conditions and circumstances under which the insurer will hold itself liable for loss, the boat on which the goods are to be shipped, etc., and is usually issued in duplicate. The shipper is given a receipt by the

[1] Dr. S. S. Huebner in his Report on the Status of Marine Insurance in the United States, Washington, 1920, pp. 27–33, gives the following reasons for the dominance of the British companies: A world market of long development; a broader spread and broader reinsurance facilities; a close union with banking and shipping interests; freedom to combine or to form communities of interest; permission to write numerous kinds of insurance; a smaller tax burden; ease with which American insurance may be exported abroad; a smaller overhead charge; and support of home merchants and vessel owners.

[2] Huebner, *op. cit.*, p. 10.

[3] *Ibid*, p. 12.

£1700.#

No. 197419

Certificate of Insurance

EFFECTED BY

WILLCOX, PECK & HUGHES

Galveston, Texas May 23rd 1916.

This is to Certify, That on the Twenty third day of May 1916 there was insured with

The American Insurance Company

for account of The Cotton Export Corporation on

One hundred (100) BALES COTTON, valued at sum insured, per A.B.&C.Ry. Little Rock v/s Liberty ——— at and from

Galveston, Texas to Liverpool, England.

It is hereby understood and agreed that, in case of loss, such loss is payable to the order of the Assured on surrender of this Certificate, which represents and takes the place of the Policy, and conveys all the rights of the Original Policyholder, (for the purpose of collecting any claims for loss or damage), as fully as if the property were covered by a special policy direct to the holder hereof, and is free from any liability for unpaid premiums.

ORIGINAL ISSUED AND PUBLICATION OF WHICH IS FORBIDDEN. THE OTHER TO FOLLOW BY VOUCHER.

Not valid unless countersigned by

Countersigned The Cotton Export Corporation

By Authority of the Above Named Insurance Companies

WILLCOX, PECK & HUGHES

Chas. [illegible] PRESIDENT

MARKS AND NUMBERS

ACZ
JB 1/100

CLAUSES

"This certificate is subject to the full terms of the policy in respect of being warranted free of capture, seizure and detention, and the consequences thereof, or of any attempt thereat, and also from all consequences of riots, civil commotions, insurrections, hostilities or warlike operations, whether before or after Declaration of War."

"With the exception of risks in the United Kingdom, no risk is covered hereunder on shore in any European country which is at war at time of shipment."

ON COTTON—To pay particular average on each ten bales as if separately insured, if amounting to three per cent. unless otherwise agreed, and on shipments to Europe to pay on damage pickings claims without reference to series or amount. General Average and Salvage Charges payable according to Foreign Statement or per York/Antwerp Rules, if in accordance with the contract of affreightment.

Also to cover the risk of country damage on shipments insured hereunder to Europe, Japan, China, India or Manila, subject to settlement at destination, in accordance with customs and usages of the port of destination, unless otherwise specified in certificate, but no claim for loss of or damage to cotton picked or reconditioned in the United States nor for any cost or expense in respect of such picking or reconditioning shall be recoverable hereunder. Country damage is not covered on cost and freight shipments and local sales, nor on shipments to points in the United States or Canada or Mexico.

LIMITED, Subject to 3% particular average on each bale, but free from claim for country damage.

Cotton pickings or grabbots, free of particular average unless the vessel be stranded, sunk, burned or in collision.

In the event of loss or damage to the cotton insured hereunder, immediate notice to be given to the companies as named hereon. Including risk of craft, &c., to and from the vessel, each craft or lighter being deemed a separate insurance. Held covered in case of deviation or change of voyage, or transfer to other steamers at a premium to be arranged, provided notice be given on receipt of advices.

This Certificate is issued subject to the terms and conditions of the policy, except so far as herein otherwise provided.

NOTICE—To conform with the Revenue Laws of Great Britain, in order to collect a claim under this Certificate, it must be stamped within Ten Days after its receipt in the United Kingdom.

FIGURE 38—Insurance certificate

insurer showing the essential facts of the transaction. In case of occasional shipments an ordinary policy is issued, but when frequent shipments are made by the exporting firm, an "open" or "floating" policy is customarily obtained. These open policies cover risks amounting to large sums of money and contain clauses which protect the goods under various circumstances as desired by the shipper. They do not contain any data relating to any one shipment, but, as each shipment is made, the insurance company indorses the required information thereon. An open policy runs for a given length of time or until the aggregate values of the shipments amount to the total sum for which the policy has been issued. Open policies are extremely handy for exporters because they enable the shippers to insure their goods without the necessity of continually resorting to the insurance office. When a shipment is ready to go forward, the exporter fills out the necessary blanks, which have been supplied him, just as though he were the insurance agent. These blanks are technically known as "insurance certificates" (Fig. 38). He makes as many copies as he needs for his bills of exchange, usually two, in addition to one copy for his own files and another for the advice of the insurance company. When the latter receives the "advice" copy it indorses the required data on the open policy, and enters the amount of the premium against the account of the exporter. The certificate contains a statement to the effect that a certain specific shipment sent on a certain designated vessel has been insured under a policy of certain number and that losses will be paid on such shipment in accordance with the terms of the original policy. Although much briefer, the certificate has all the force of the policy on which it is based. Special clauses may also be stamped on the certificate. Once a month or thereabouts, the exporter settles with the insurance company and pays the premiums charged against him. Such practice avoids delay in making shipments, since the insurance agent does not have to visit the exporter's plant and write a policy every time a shipment of goods is ready to go forward.

Marine insurance policies and insurance certificates are made out to the shipper or order and as a rule are indorsed by him in blank, just as is done in the case of the other negotiable instruments that constitute a documentary bill of exchange.

It is customary to insure the cargo for from ten to twenty per cent more than the actual value of the goods shipped in order to

cover "the costs of ocean freight, other incidentals, and possibly, sometimes, loss of the foreign importer in the non-arrival of goods on which he was depending." [1] All the various kinds of risks insured against must be mentioned in the policy in order to secure the desired coverage. The cost of insurance depends upon the character of the risks insured, the nature of the goods, the point of destination, the character of the vessel on which the goods are shipped, etc. In normal times the rates will vary from one-quarter of one per cent on the invoice value, provided the goods are being sent to one of the main European ports, to one and one-half or to even two per cent on shipments going to Oriental or tropical ports.

Insurance may be effected by the shipper or by the importer. Very frequently the importer finds that he can obtain marine insurance much more cheaply at home than by allowing the exporter to secure it for him, in which case he notifies the exporter, and the latter, in place of the insurance certificate or policy, includes a declaration to the effect that "Insurance has been effected abroad." [2]

Another important document is the invoice (Fig. 39), which is

HENRY SMITH & COMPANY
San Francisco

To J. Robinson & Co.,
Liverpool, England

January 15, 1919

50 bbls. Rosin 450 lbs. each @ £4 per bbl.
C. I. F. Liverpool £200. 0. 0

Marked J. R. & Co.
Numbered 1 to 50
Per S. S. "Ocean Wave" via Panama Canal

FIGURE 39
Invoice

usually only a statement of the goods shipped, although good commercial practice demands that it contain the name and address of the consignee as well as the name and address of the party to whom invoiced, a full description of the goods, a statement of the number of boxes or packages, the method of packing, the number of articles in

[1] Hough, *op. cit.*, p. 445.
[2] Cf. Chapter IX. The technical details of marine insurance may be learned by consulting any of the standard books on that subject. Cf. Huebner, S. S., "Marine Insurance"; Gow, W., "Marine Insurance"; Winter, W. D., "Marine Insurance," etc.

each container, the marks on the boxes, the weight and dimensions of the cases, the price per unit of measurement, the total price of the shipment, discounts, the name of the steamer and route, the terms of sale, and such other information as may be necessary for the importer to identify the goods when they arrive.[1] Invoices should always be numbered and signed and should include the cable code which the exporter is accustomed to use. It is the practice of some firms to include also a statement of extra charges that the importer is to pay and which have been included in the sum for which the draft has been drawn, but sometimes this latter information appears on a separate form. The number of copies and the language in which the invoice is made out must coincide with the legal requirements of the country to which the goods are being sent.

A consular invoice is very generally demanded, especially by Central and South American countries, Cuba, Mexico, etc. (Fig. 40).

AMERICAN CONSULAR SERVICE
CONSULAR INVOICE

(Place and date.)

Invoice of _____ purchased
by _____, of _____
from _____, of _____
to be shipped per _____

Marks, Numbers, and Quantities	FULL DESCRIPTION OF GOODS (N. B.—Always state the cost of packing, and all other costs, charges, and expenses)	Price Per Unit	Total Amount	Consular Corrections or Remarks

The above invoice is correct and true.
(Signature of purchaser or seller or duly authorized agent of either signing in the name of his principal) _____

[1] Cf. deHaas, *op. cit.*, pp. 180–182.

Declaration of Purchaser or Seller or Duly Authorized Agent of Either

I, We _____

of _____ do solemnly and truly declare that I am / we are the _____

(Purchaser or seller)

of the merchandise in the within invoice mentioned and described; that the said invoice is in all respects correct and true, and was made at the place named therein whence the said merchandise is to be exported to the United States of America; that said invoice contains a true and full statement of the time when, the place where, and the person from whom the same was purchased, or agreed to be purchased and the actual cost thereof, price actually paid or to be paid therefor; and all charges thereon; that no discounts or commissions are contained in said invoice but such as have been actually allowed thereon; that all drawbacks or bounties received or to be received are shown therein; that no different invoice of the merchandise has been or will be furnished to anyone, and that the currency in which the invoice is made out is that which was actually paid or to be paid for the said merchandise.

I / We further declare _____

_____

_____

_____

_____

I / We further declare that it is intended to make entry of said merchandise at the port of _____ in the United States of America.

Dated at _____, this _____ day of _____

(Date)

_____

_____

The signature to a declaration made by an agent should show the name of the principal, the name of the agent, and an indication of the authority by virtue of which the agent acts.

FIGURE 40

Consular invoice

It is similar in its content to the ordinary invoice, but at times contains additional information required by the laws of the importing country. The form is usually obtained from the consular officers. When the necessary number of copies (varying from one to seven) have been filled out, they are certified or sworn to before the consul of the country to which the goods are to be sent. A small fee, either a definite fixed sum, such as $2.00, $2.50, etc., or a percentage fee, such as one or two per cent of the value of the shipment, is paid the consul for certification. Such fees are in reality disguised import taxes. On the other hand, however, consular invoices greatly facilitate the work of the customs officials of the importing country.

A certificate of origin is sometimes met with in handling documentary bills of exchange. It is merely a certified statement showing in what country the goods originated, and also giving the name of the exporter and the consignee, and a description of the goods themselves. In some countries it is necessary for such certificate to be presented in order that the goods may be admitted to the importer's country at a reduced tariff rate. The certificate is viséed for a fee by the consul of the country of destination.

Some countries require an inspection certificate showing that the goods were in proper condition when they left the shipping point. This applies especially to meat and meat food products, processed butter, etc. Some countries (primarily British colonies) also require anti-dumping certificates, which are sworn statements to the effect that the goods are not listed at prices lower than those for which they are selling at home and that no unusual discounts are being given to the importer. Certificates of weight, analysis, etc., are also sometimes necessary.

A documentary bill of exchange comprises one copy of each of the required documents. Care must be taken to have each set complete, free from erasures, corresponding in all details, and properly indorsed. They carry title to the goods, and consequently the banker who buys them must be careful that they contain or omit nothing that will impair the bill of exchange as a negotiable instrument in which he has invested his money.

The above discussion holds true regardless of whether the exporter sells his documentary bill of exchange to the bank or whether he turns it over to the bank for collection. Very frequently the latter practice is followed when the discount rates are unfavorable and the

exporter prefers to wait for the return of the funds after their collection abroad, or when the consignee is unknown, or when the exporter is willing to allow the importer to take a portion of the goods from time to time and to pay for them in pro rata installments, or for some other reason. The bank then acts as a collection agent, and pays the money to the exporter as collected, minus its charges. The instructions given by the exporter to the bank in such cases must necessarily be full and explicit as to just what the bank is to do under any and all circumstances that may arise.

CHAPTER VIII

TYPES OF FOREIGN BILLS OF EXCHANGE

The means that are employed in paying bills abroad or in financing foreign trade or foreign travel may be roughly divided into five groups:

A. Mail remittances, i. e., checks on foreign accounts, postal and express money orders, bank post or postal remittances, and bank drafts.

B. Cable remittances, i. e., cables or telegraphic transfers.

C. Those that arise in connection with the loaning of foreign money or foreign credit in the United States, i. e., the greater part of the so-called bankers' long bills, including those used in connection with (a) currency or dollar loans, (b) loans in terms of a foreign money, and (c) "finance" bills.

D. Those that are used for traveling purposes, i. e., the travelers' check, and the travelers' letter of credit.

E. Those means that enable creditors to draw drafts on debtors for goods sold or services rendered or to collect some monetary claim, i. e., drafts drawn against sales of securities or drawn under a commercial letter of credit, authority to purchase, etc.

A. Mail Remittances

Checks. The ordinary check drawn by the depositor on his banking account in terms of dollars, with which all are so familiar in domestic trade, does not function in foreign transactions. Lately, however, large American importing and exporting firms have developed a decided tendency to establish checking accounts, both demand and time, in foreign countries. This tendency has been encouraged by the very favorable exchange rates that have prevailed during the last few years. Today, when one of these firms desires to pay a bill abroad, it merely draws a check on its foreign account in favor of its creditor, just as it would on its own local bank account for a domestic payment, and forwards the check to the foreign party to whom it owes the money. The check is drawn in terms of the money of the country in which

the firm has its foreign account, and is payable at sight. In the establishment of such foreign accounts, certain of the larger banks and some express companies have given active assistance by selling sight drafts drawn on the foreign accounts of the bank or express company. These drafts the American firm (or the bank or the express company acting on its behalf) forwards to the foreign correspondent along with copies of the signature of the firm, whereupon the foreign correspondent opens the account just as a San Francisco bank under similar conditions would open an account for a New York firm. More frequently the American firm deposits a sum of money with the American bank or express company, together with several copies of the signatures which are to be honored on the firm's checks. The exchange dealer sends the signatures to the foreign correspondent with a request that an account be opened for the American firm and that the stated sum be deducted from the account of the exchange dealer on deposit with the correspondent and transferred to the account of the American firm. The exchange dealer is paid for his services by the profit which he makes in charging the American firm a certain exchange rate for that portion of his foreign account which he has turned over to it, the rate charged being the ruling rate for sight drafts on the center in which the account is established.

International or Foreign Postal Money Order. A method often employed, especially by foreigners, in sending small sums abroad, is the international postoffice money order sold by the local offices of the U. S. Postoffice Department. The application blank must be filled out by the sender or remitter. The clerk takes the application and from the data thereon fills in the spaces on the money order itself. The money order is of three parts, one being the stub or receipt kept by the issuing office, the second being the receipt given to the remitter, and the third the order itself, which is also given to the remitter. The remitter sends the order to the foreign party, who presents it at his postoffice and receives, in money of his own country, the sum designated. Suppose that the remitter wishes to send ten dollars to his mother in England. He fills out the application, the clerk converts the ten dollars into pounds sterling at the rate fixed by the U. S. postal authorities, and writes out an order for so many pounds, shilling, and pence. The English postoffice, on presentation of the order by the sender's mother, pays the amount designated.

The United States Government in 1920 had direct exchange con-

nections with fifty-three countries and indirect connections with many others. On some it is authorized to draw in the money of the countries concerned; on others it must draw in dollars and cents and the orders are converted by the local foreign postoffice into the money of the paying country.

The postoffice charges a fee for the issuance of the order varying in amount from three cents to one dollar for sums ranging from one cent to 100 dollars, depending upon the amount of the order and also upon the country to which the order is sent. There is a group of countries made up mostly of the smaller West Indian islands, Cuba, Canada, the Philippines, etc., on which the domestic form of money order is issued and for which the domestic rates are charged.[1] On all other countries the international money order form is used and a different set of rates is charged. A single foreign money order cannot be drawn for more than $100 worth of foreign money, although any number of such orders may be issued to a person.

Inasmuch as the money order must be drawn on the more important nations in terms of the money of those countries, dollars must be converted into terms of that money. The postoffice authorities supply the local offices with a conversion schedule of rates. The following rates on the more important European countries were in effect until August 15, 1920:

Pound Sterling	$4.87
Krona on Sweden, Norway and Denmark	.26 9/10
Florin on Holland	.40 1/2
Franc on France, Belgium, Switzerland, and lire on Italy	1.00 for 5.15 francs or lire

During the early days of the World War, the market rates on the above countries, especially on England, reached such high levels that it was possible for bankers, speculators, and others to go to the postoffice and receive, for example, a money order on England at a cost of $4.87 per pound sterling when the cost in the open market was $5.00 or higher. To have continued the unlimited sale of orders at the then existing scale of rates would have meant serious financial loss to the government. Therefore, on August 3, 1914, the Postoffice Department instructed the local offices not to send more than $100 worth of foreign money orders to any one payee. This restriction remained

[1] Cf. footnote, p. 25.

effective until January 21, 1915, by which time the rates in the market had returned to normal. The rates of conversion and the practices of the postoffice then remained unchanged until August 15, 1920, when the following schedule was issued by the Postmaster General, because the rates in the market had declined so greatly:

Pound Sterling	$4.00
Krona on Sweden	.24
Krona on Denmark and Norway	.20
Florin	.38
Franc on France, Belgium, and lire on Italy	1.00 for 10.30 francs or lire
Franc on Switzerland	1.00 for 5.15 Swiss francs

A further revision was made on November 15, 1920:

Pound Sterling	$3.75
Florin on Holland	.35
Krona on Sweden	.22
Krona on Denmark and Norway	.16
Franc on France and Belgium	13 francs for 1.00
Lira on Italy	20 lire for 1.00
Franc on Switzerland	5.15 francs for 1.00

These revisions of the conversion table of the postoffice were necessary because the previous rates had afforded excellent opportunities for speculation and because also serious complaint was being made that the government was charging altogether too much for its money orders. The public until August, 1920, had to pay $4.87 (which rate had been fixed in 1880) plus a ten cent fee for a £1 money order at a time when express companies and banks were charging from $3.20 to $3.50 and were getting the major portion of the business. The high rates, however, enabled the postoffice department to profit greatly, so that, in spite of losses arising out of unfavorable purchases of exchange,[1] it made a profit of $1,242,079.08 on the foreign money order business during the fiscal year ending June 30, 1920. Approximately $33,000,000 worth of orders were sold during that year.[2]

The U. S. Postoffice Department sells more money orders on foreign countries than it is called on to cash against those countries. As a

[1] The total loss amounted to $1,380,224.94.

[2] The extent of the business grew from $22,189.70 in 1870 to a maximum of $97,681,211.85 in 1911. Since 1911 there has been a slight decrease in the amount of orders sold.

consequence it has to go into the open market and purchase exchange to meet its foreign indebtedness thus occasioned.[1] This it does by asking for competitive bids from the exchange dealers in New York. The exchange purchased in this way is then sent abroad to settle the obligations of our postal department to foreign governments.

American Express Company Limited Check. The American Express Company issues through its agents what is known as a "limited check" (Fig. 41). It is a form of three parts, the customer's receipt, the order itself, and the agent's stub. The customer keeps the receipt and mails the order to the foreign party, who merely indorses and cashes it at a bank, hotel, store, or express office. It later finds its way back to the head office of the American Express Company in New York City, where it is finally canceled.

The check is somewhat similar to the postoffice foreign money order and was devised to compete with it. The maximum amount for which the check can be issued is limited to $100, although if a customer wishes to send more than that sum he may purchase as many orders as may be required to do so.

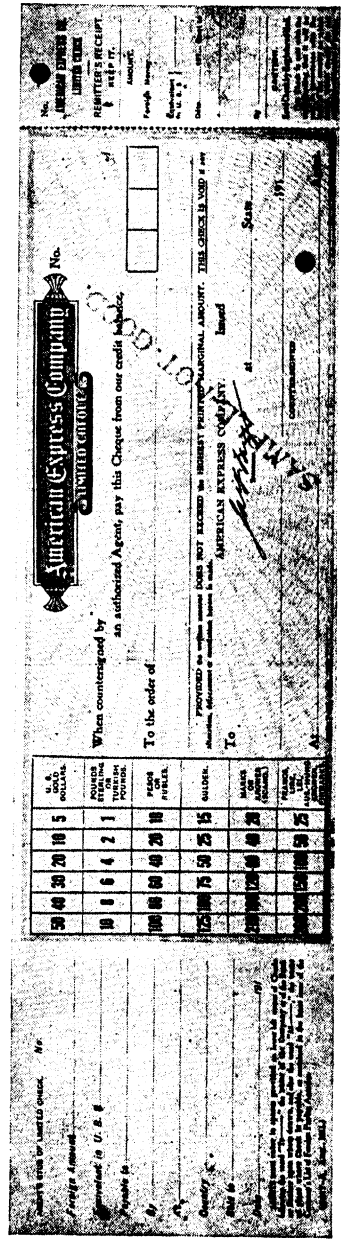


FIGURE 41—American Express Company limited check

[1] During the fiscal year 1920 our indebtedness for foreign countries in this connection amounted to approximately $13,000,000.

The checks are sold at the current rates of exchange, according to quotations supplied the agents (Fig. 42), so that the customer

AMERICAN EXPRESS COMPANY

Foreign Exchange Rates

SAN FRANCISCO

Good Only for Use

May 24th, 1922

Postage applies only on Foreign M/Os

		Checks	*M/Os*	*Postage*
£	England	4.45½		10¢
£	Ireland–Scotland	4.45½		10¢
Francs	France	.0912	.0914	25¢
Francs	Belgium	.0844	.0846	25¢
Francs	Switzerland	.1912		15¢
Lire	Italy	.0523	.0525	30¢
Kroner	Norway	.1840	.1842	15¢
Kroner	Sweden	.2590	.2592	15¢
Kroner	Denmark	.2150	.2152	15¢
Gulden	Holland	.3895		15¢
Finmark	Finland	.0212	.0214	15¢
$ Loc. Cy.	Hongkong	.6035		
Pesetas	Spain	.1605	.1607	25¢
Drachmas	Greece	.0421	.0423	15¢
Marks	Germany	.0038	.0040	25¢
Kronen	Hungary	.0013	.0013½	25¢
Kronen	Austria	.00011	.00011½	25¢
Crowns	Czecho-Slovakia	.0192	.0194	25¢
Kronen	Jugo-Slavia	.0038	.0040	25¢
Lei	Roumania	.0071	.0073	25¢
Yen	Japan	.4875		

FIGURE 42

Foreign exchange rate list of American Express Company

First column of rates applies to express foreign drafts and limited check; the second column to postal remittances; the third column to the postage charge on postal remittances

is always able to purchase his remittance at a much better rate than in the case of the postoffice foreign money order. The offices

of the express company are usually more conveniently situated near the business district of the town than is the postoffice. Further, the express company sells not only through its own offices, but also through branch agents and local exchange dealers, such as banks, steamship companies, etc. It can also furnish orders on more foreign countries than the postoffice because it has thousands of correspondents scattered all over the globe.

Bank Post Money Order or Postal Remittance. Closely akin to the foreign money order is the "bank post money order," or "foreign postal remittance" as it is sometimes called, originated by the American Express Company in 1897. People in the outlying districts of foreign countries are unacquainted with the intricacies of checks, drafts, money orders, indorsements, etc., and much prefer to have the actual money sent them. Banks and express companies have developed a very unique device to make this possible. If the remitter goes to the office of the bank or express company and states that he

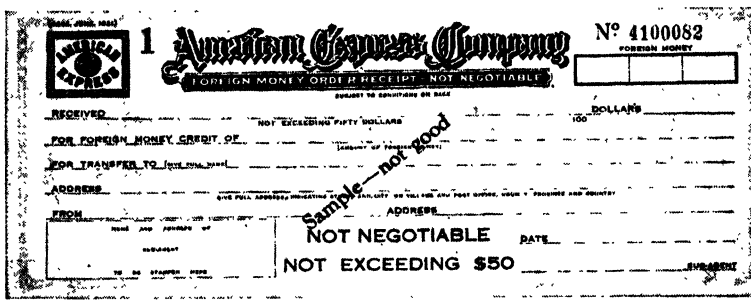


FIGURE 43

American Express Company postal remittance

wishes to put a certain amount of the actual money of a foreign country in the hands of his family or relatives, he will be advised to use a postal remittance (bank post money order). This order is usually of four parts, viz., the remitter's receipt, the agent's stub, the notification to the payee, and the advice to the correspondent of the exchange dealer from whom the order is being purchased. To simplify the description of this interesting foreign exchange device, let us first consider the method and form issued by the American Express Company for which, as it will be remembered, all express offices now act as agents in domestic and foreign exchange matters.

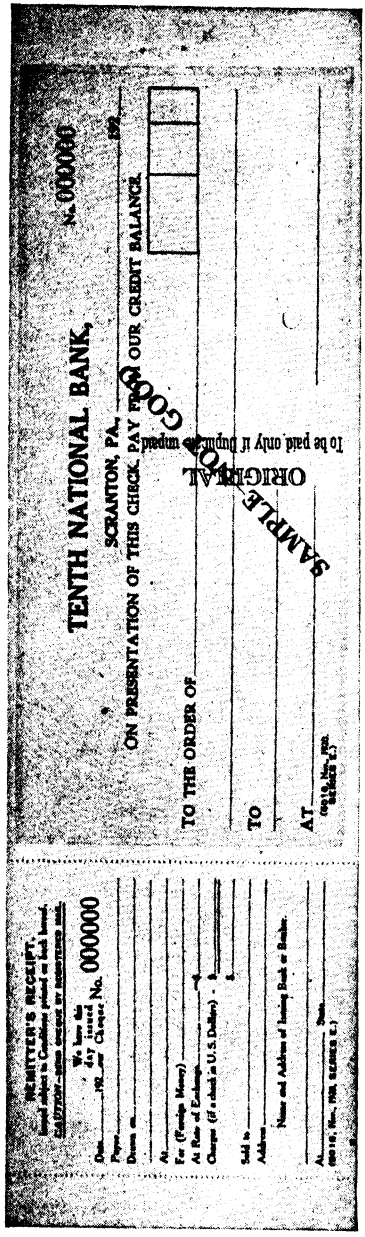


FIGURE 44—Postal remittance issued by bank through American Express Company

The blanks are issued to the agencies in book form, each order being in triplicate and numbered serially. One of these is the remitter's receipt, the second, the agent's stub, and the third, the advice to the Foreign Order Department of the American Express Company. No notification to payee is given to the remitter. The agent fills out the three parts at once by using carbon paper between the sheets. The same data thus appear on each, although each contains a printed heading at its top showing whether it is the stub, receipt, or advice (Fig. 43). He retains the stub, and gives the receipt to the remitter. The remitter keeps the receipt, but if he desires to do so, he may forward it to the payee in the foreign country so as to advise him that the money is being sent. The advice is forwarded by the agent to the head office of the American Express Company in New York, which, in turn notifies its agent or correspondent, located nearest to the payee, to pay to the latter the amount of money designated. The correspondent incloses the exact sum of money in an envelope, registers it, and, through the postoffice or a messenger, sends it to the payee.

Sometimes a local postoffice money order is inclosed instead of the actual money depending upon whatever method the correspondent considers will best serve the interests of the payee. When the payee receives the registered letter he signs a receipt which is generally sent back to the original issuing agent in the United States and through him turned over to the remitter thus assuring the latter that the money has reached its destination.

The forms used by exchange dealers that sell exchange through the American Express Company's service, i. e., banks, steamship companies, etc., have the name of the exchange dealer, instead of the name of the American Express Company, appearing on the blanks (Fig. 44). They consist of two parts, the dealer filling out both parts at once by using carbon paper. The first part consists of the order and the remitter's receipt, while the second part consists of the dealer's stub and the advice which he sends to the American Express Company.

The costs of a postal remittance are higher by two points on the exchange rate than for the limited check, plus postage, which ranges from 10 cents to 30 cents according to the postal rates of the country to which the order is being sent.[1]

If the money is to be forwarded to a country upon which the company quotes exchange rates to its agents and dealers, the sum in dollars that is to be sent is converted into terms of the foreign money on the basis of the conversion table furnished the agent or dealer by the New York office of the company and kept up to date by it.[2] The quoted rate includes a slight profit for the express company. But when exchange rates are not so quoted, the remittance is made out in dollars and is payable in the foreign country at the current rate of exchange for dollars in that country on the day that the remittance is paid, the conversion being effected by the foreign correspondent, who deducts his charges before paying over the money to the beneficiary.

Of late the American Express Company has had to meet the competition of the larger banks and exchange dealers, who have also developed their own system of bank post remittances. The following is typical of the form commonly used by banks and exchange dealers (Fig. 45). It is made out in triplicate and none of the copies is negotiable, just as was the case with the postal remittance of the American

[1] "The system depends for its life upon a facility provided by continental postoffices . . . that of marking the value of the contents of registered letters on the cover, and paying ad valorem postage which automatically insures it." *Guaranty News*, September, 1919, p. 216.

[2] Cf. p. 176.

Express Company. The original is mailed to the payee notifying him that the money will be forwarded; the duplicate is the remitter's receipt, while the triplicate is kept by the issuing bank for its files. The

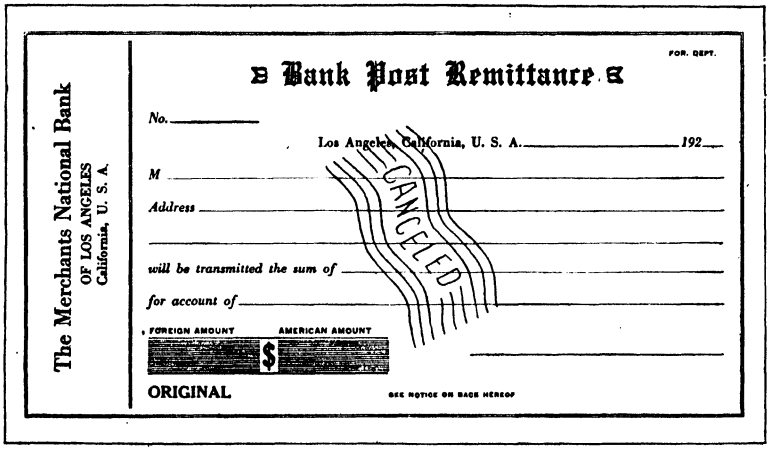


FIGURE 45
Postal remittance issued by bank

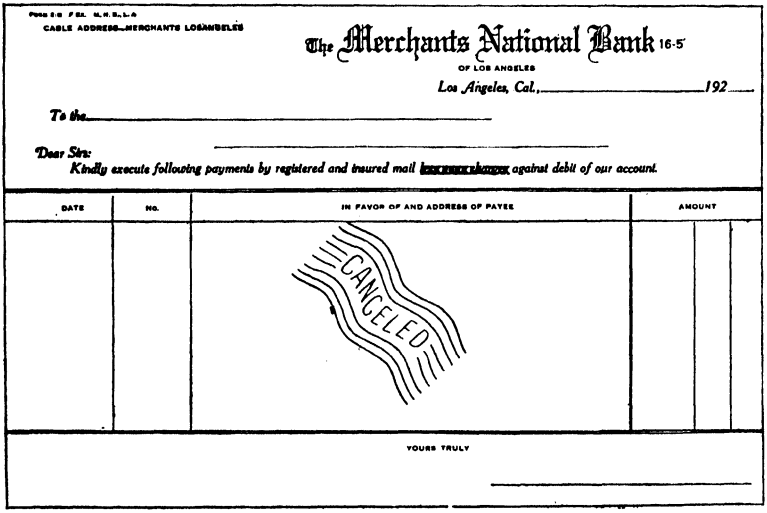
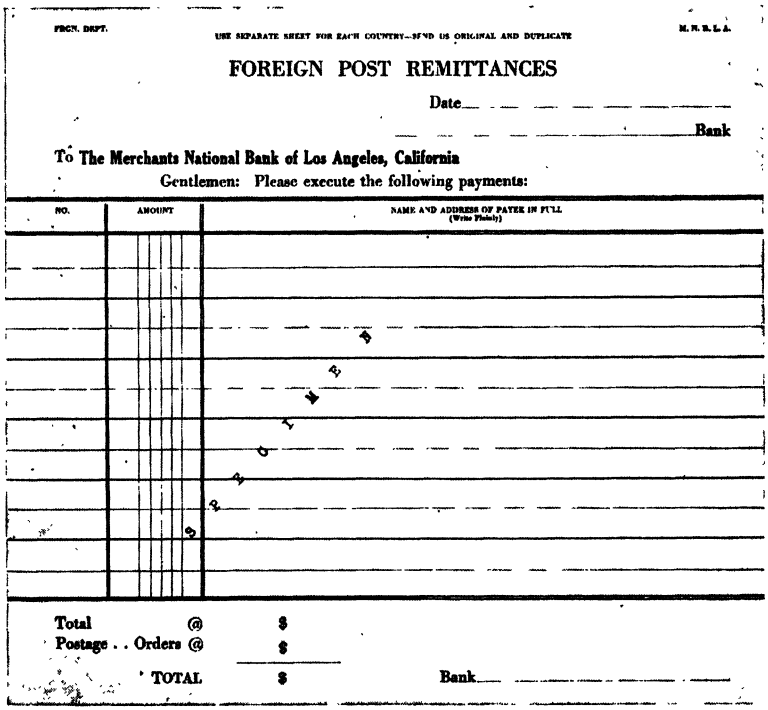


FIGURE 46
Advice to foreign correspondent in connection with bank post money order

issuing bank uses the following form of advice in notifying its foreign correspondent to pay to the designated party, by registered and insured mail, the sum mentioned and to deduct that amount from the account of the sending bank (Fig. 46). When a local country bank issues a postal remittance through another exchange dealer or jobbing bank, it employs the same forms in the same manner as above, but it does not notify the foreign correspondent bank. It notifies the exchange dealer or jobbing bank through which it is issuing the postal remittance and uses the following form for that purpose (Fig. 47):



FRGN. DEPT. USE SEPARATE SHEET FOR EACH COUNTRY—SEND US ORIGINAL AND DUPLICATE M. N. B. L. A.

FOREIGN POST REMITTANCES

Date_____

_____ Bank

To The Merchants National Bank of Los Angeles, California

Gentlemen: Please execute the following payments:

NO.	AMOUNT	NAME AND ADDRESS OF PAYEE IN FULL (Write Plainly)

Total @ $

Postage . . Orders @ $

TOTAL $ Bank_____

FIGURE 47

Advice to jobbing bank in connection with bank post money order

The exchange dealer or jobbing bank uses the same form as above (Fig. 46) in notifying its foreign correspondent of the issuance of the post remittance just as though it itself had sold the remittance to the customer. The larger banks, just as was true of the American Ex-

press Company, act as wholesalers of exchange, while the local banks that draw through them act as retailers. The retailer charges what the traffic will bear, but always buys exchange at the rates sent out daily or weekly by the bank through which it sells.

Before the upheaval and disarrangements caused by the Great War this system of forwarding money to foreign countries was "as nearly perfect as was humanly possible." [1] In normal times hundreds of thousands of such payments were transmitted to Europe weekly. The American Express Company alone in 1919 handled an average of 10,000 such orders per week, while during seasons of heavy business it has been called upon to handle upward of 4,000 remittances daily. The Guaranty Trust Company of New York declares that "We have always felt that the financial regeneration of Italy, which was so noticeable from 1895 onward, was due in no small measure to the continual pouring in to that country in one unending stream of these small remittances which represented the savings of her faithful children who emigrated both to North and South America." [2] It is estimated that at least $100,000,000 was formerly sent annually to Poland by her emigrants, mostly by means of the bank post remittance.

The breaking up of families, the changing of addresses, and all the confusion caused by the World War, greatly upset previous conditions, with the result that it has been difficult and in many cases impossible for the bank and express post remittances to function as satisfactorily as before. Undoubtedly, with the return of normal conditions in the late warring countries, the bank and express post remittances will regain their former usefulness.

Bank Drafts. The two kinds of exchange most commonly purchased by American business firms and others for remitting money to parties in foreign countries are drafts and cables, both of which are sold by banks and express companies. In normal times they are available on any of the important trading countries of the world; war, of course, naturally interferes with customary practices.

Most foreign drafts are drawn payable at sight, but drafts payable a certain number of days after sight or after date are not uncommon. Especially is the latter true of drafts sold by South American banks, usually drawn on correspondents in England payable 90 days after sight and sent by South Americans to their creditors even in countries

[1] *Guaranty News, op cit.* [2] *Ibid.*

other than England.[1] Foreign drafts are usually drawn payable to the order of the foreign party to whom payment is to be made, although they are sometimes drawn to the order of the customer or purchaser who then must add his indorsement before sending them abroad. It is customary to draw foreign drafts in duplicate or even in triplicate, but the former practice is the rule (Fig. 48). The copies are sent by

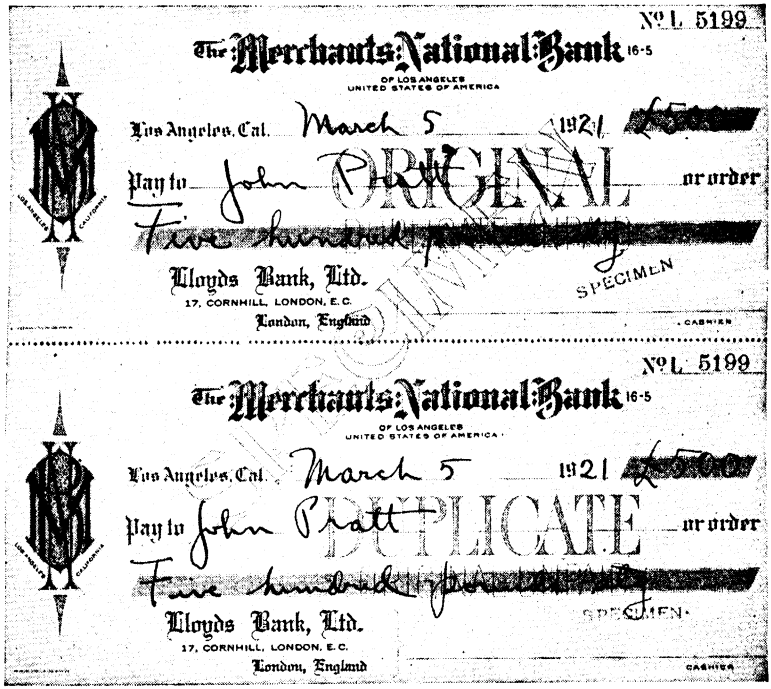


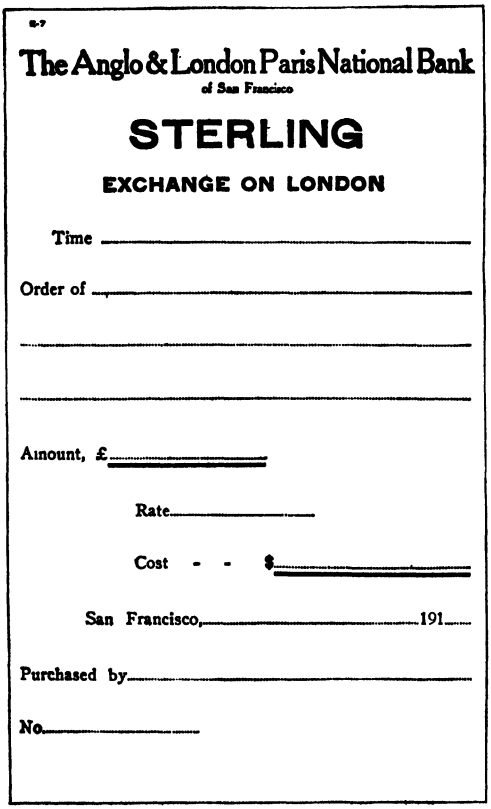
FIGURE 48

Original and duplicate bank drafts on foreign account

separate mails as a precaution against possibilities of loss. The one that arrives first is paid and voids the remaining copy or copies. Foreign drafts are drawn on the foreign account of the issuing exchange

[1] This custom of selling three months drafts instead of drafts payable at sight arose in the South American countries because of the uncertainties of mail connections and the limitations of the foreign exchange market. If South American bankers sold sight drafts they might have great difficulty in finding sufficient cover to forward immediately, while in selling three months drafts they feel fairly assured of being able to forward cover before the drafts fall due.

bank or on the foreign account of some domestic bank which acts as an intermediary for it in various foreign exchange transactions. The details of the practices followed in each case, as well as the forms that are used, differ to such an extent that to avoid confusion, some of the more commonly used forms will be described in detail.



The Anglo & London Paris National Bank
of San Francisco

STERLING

EXCHANGE ON LONDON

Time _____

Order of _____

_____

_____

Amount, £_____

Rate_____

Cost - - $_____

San Francisco,_____ 191__

Purchased by_____

No._____

FIGURE 49
Application for bank draft on foreign account

Considering first the case of the bank which issues drafts on its own foreign account let us say that a customer of a San Francisco bank asks for a sight draft with which to pay his creditor in London the sum of £1,000. The bank may have several accounts in London, but on that particular day it may be drawing heavily on its account with the banking firm of Lazard Brothers in order to reduce its deposit with that company. The clerk asks the customer to fill out a blank (Fig. 49) giving the name of the party to whom the draft is to be made payable, the amount in American or in English money that is to be sent, whether it is to be a demand bill, date bill or payable a certain number of days after sight, and by whom purchased (the customer's name). The clerk then glances at the rate board behind the counter on which the rates for the day are posted and notes that the rate on London which his bank is charging at that moment is $4.87

per pound sterling. If the customer is an old depositor of the bank, and because the sum is a rather large one, the rate will be shaved slightly, and he may get his draft at the rate of 4.86½. He therefore has to pay the clerk an amount of American money equal to $4.86½ × 1000, or $4865. On the other hand, if the customer wishes to send the equivalent of $4865 to his creditor in England, the clerk would calculate how many pounds sterling could be purchased for that sum at a rate of, say, 4.86½. The process would be one of division, i. e., 4865 ÷ 4.865 = £1,000. The customer would therefore be able to obtain a draft for £1,000 in return for $4,865 if the rate per pound were 4.86½.[1]

The draft is drawn on Lazard Brothers in duplicate, and both copies are given to the customer. He sends them by different mails to his creditor, who cashes at his own bank the one first received. This bank then forwards it to Lazard Brothers through the clearing house. In the meantime Lazard Brothers have received a statement or advice

The Anglo & London Paris National Bank
of San Francisco

San Francisco, _____ 192____

Dear Sirs:

We beg to advise that we have drawn the following drafts on you which kindly pay and charge to our account·

NO.	PAYER	AMOUNT	
	SPECIMEN		

FIGURE 50
Advice of issuing bank to foreign bank

[1] The methods followed in converting dollars into English money and vice versa will be presented in Chapter X and Appendix III.

(Fig. 50) from the San Francisco bank advising them that it has drawn the draft in question, and asking them to honor the same and deduct the amount from its (the San Francisco bank's) account. After Lazard Brothers have cashed the draft and debited the account of the San Francisco bank, they notify the latter of that fact.

Sometimes a customer demands a draft on a city in which the American bank has no correspondent. In that case the bank draws a draft on a bank in the designated city, which bank is a correspondent of the American bank's foreign correspondent, and notifies the bank drawn on to present the draft to the latter for payment. The bank

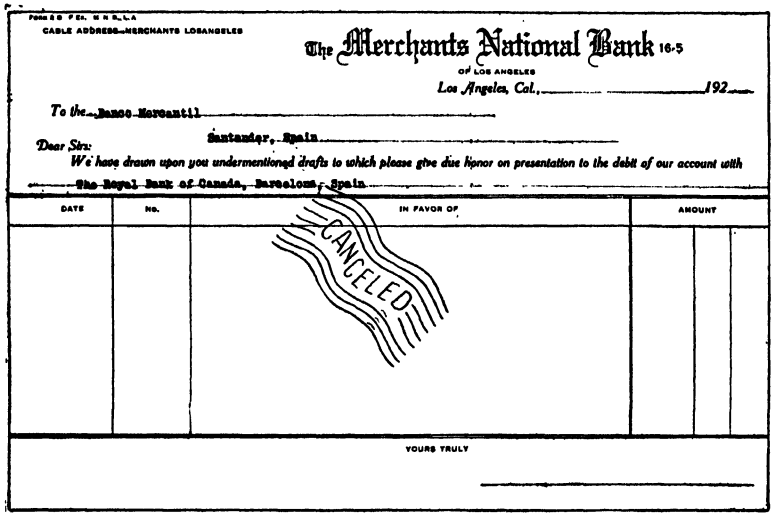


FIGURE 51

Advice to correspondent of foreign correspondent

in such matters merely uses the correspondents of its foreign correspondent. To make the example a little more concrete, suppose a customer of the Merchants' National Bank of Los Angeles asks for a draft on Santander, Spain. The Merchants' National Bank has as its correspondent in Spain the Barcelona branch of the Royal Bank of Canada. The Banco Mercantil of Santander is the local correspondent of the Royal Bank of Canada. The Merchants' National Bank of Los Angeles draws a draft on the Banco Mercantil and hands it to the customer. It then fills out an advice in duplicate, similar to the following (Fig. 51) and sends the original to the Banco Mercan-

til, asking that bank to honor the same and to present it to the Barcelona branch of the Royal Bank of Canada. The duplicate copy of the advice is sent to the Royal Bank of Canada so that it may be

The Royal Bank of Canada

BARCELONA, SPAIN

LP/IS

January 11th 1921

THE MERCHANTS NATIONAL BANK

Of Los Angeles

LOS ANGELES (California)

Dear Sir:

We have debited your account with the following drafts drawn on ourselves or on our correspondents:

DRAFT NO.	BRANCH DRAWN BY	PLACE DRAWN ON	AMOUNT OF DRAFT PESETAS	COMMISSION PESETAS
5013	Yourselves	Barcelona	55,436.65	
4	"	"	38,000.-	
			93,436.65	

CANCELED

Yours truly,

Manager.

FIGURE 52

Advice to issuing bank by foreign correspondent

advised of the transaction. The draft will subsequently be presented to the Banco Mercantil, which will cash it, and then forward it to

the Royal Bank of Canada at Barcelona, where the amount, plus charges if any, will be deducted from the account of the Los Angeles Bank, and the latter advised to that effect. (Fig. 52).

There are two other methods by which a bank may issue a draft on another bank with which it has no account. First: Suppose that Jones in Chicago goes to his bank and asks it to sell him a draft on Rome. It may have no account in Rome, but it has one in London with Barclays, and it also knows that the Banca di Italia of Rome has an account at Barclays. It can therefore sell a draft to its customer in lire drawn on the Banca di Italia of Rome, notify the latter of that fact, and ask it to reimburse itself by drawing a draft covering the transaction on the Chicago bank's account with Barclays. The Chicago bank will also notify Barclays to honor such a draft and deduct the amount from its account. The Chicago bank, however, runs the risk that the dollars it receives for the lire draft on the Banca di Italia may be less in amount than the dollars that will be required to replenish its sterling account at Barclays after Barclays has deducted the reimbursement sterling draft of the Banca di Italia. Second: Say that the Banca di Italia has an account with the Chicago bank, but that the latter does not have an account with the Banca di Italia. Suppose Jones requests that the Chicago bank sell him a draft in lire on Rome. The Chicago bank issues the draft on the Banca di Italia and advises it of that fact, suggesting that it reimburse itself either by drawing a dollar draft on it (the Chicago bank) and selling the draft in the local (Rome) market, thus getting its funds in Rome, or by merely authorizing the Chicago bank to credit its account, on deposit with the Chicago bank, for the amount in question.

When local banks that have no foreign banking accounts or correspondents sell foreign bank drafts through the agency of banks that act as exchange jobbers, the practices followed and the forms used are quite different from those described above. The jobbing bank supplies the local bank with the needed forms upon which the name of the retailing local bank is printed. These forms are bound in a book or pad, are serially numbered, and usually consist of four parts, although at times of two or of five parts. It also supplies a list of the foreign banks upon which drafts may be drawn. Daily or weekly the jobbing bank forwards the issuing bank a rate sheet containing the rates at which the issuing bank is authorized to cover its drafts, i. e., remit to the jobbing bank for drafts which it draws (Fig. 53). If the rates

change noticeably, as has often been the case since 1914, the jobbing

The Merchants National Bank
OF LOS ANGELES
FOREIGN EXCHANGE RATES
NO. 104 GOOD ONLY FOR TODAY DATE May. 5 1922

COUNTRY	PRINCIPAL CITY	CURRENCY	SELLING RATES FOR CHECKS ON Principal City	CHECKS ON Other Places	CABLE* Transfers and M.P.R.	LIMIT † IN THE AGGREGATE
AUSTRIA	VIENNA	Kronen	.013	.013	.013	$ 500
BELGIUM	ANTWERP	Francs	6.45	6.46	6.47	1000
BULGARIA	SOFIA	Leva	.75	.76	.77	500
CZECHO-SLOVAKIA	PRAGUE	Kronen	1.95	1.96	1.97	500
DENMARK	COPENHAGEN	Kroner	21.28	21.33	21.38	2000
FINLAND	HELSINGFORS	Finmarks	2.08	2.09	2.10	500
FRANCE	PARIS	Francs	9.20	9.21	9.22	2000
GERMANY	BERLIN	Marks	.36	.36½	.36½	500
GREAT BRITAIN	LONDON	Pounds	4.44	4.44½	4.44½	5000
GREECE	ATHENS	Drachmas	4.53	4.55	4.57	1000
HOLLAND	AMSTERDAM	Guilders	38.35	38.40	38.45	5000
HUNGARY	BUDAPEST	Kronen	.13½	.13½	.13½	500
ITALY	ROME	Lire	5.37	5.38	5.39	2000
JUGOSLAVIA	BELGRADE	Dinars	1.47	1.49	1.49	500
	ZAGREB	Kronen	.36½	.37½	.37½	500
NORWAY	CHRISTIANIA	Kroner	16.65	16.70	16.75	2000
POLAND	WARSAW	Marks	.02½		.02½	500
PORTUGAL	LISBON	Escudos	6.15	6.20	6.25	500
ROUMANIA	BUCAREST	Lei	.73	.74	.75	500
RUSSIA	PETROGRAD	Roubles		NOT	QUOTED	
SPAIN	BARCELONA	Pesetas	15.60	15.62	15.65	2000
SWEDEN	STOCKHOLM	Kroner	25.90	25.95	26.00	2000
SWITZERLAND	ZURICH	Francs	19.40	19.42	19.45	5000
CANADA	MONTREAL	Dollars	98.35	98.35	98.60	5000
MEXICO	MEXICO CITY	Pesos	49.50	50.00	50.50	5000
CHINA	HONGKONG	Loc. Cur.	57.00		57.50	2000
INDIA	CALCUTTA	Rupees	28.50	28.75	28.75	2000
JAPAN	YOKOHAMA	Yen	47.75	48.00	48.25	2000
AUSTRALIA	MELBOURNE	Pounds	4.44½	4.45	4.45	5000

BUYING RATES: ENGLAND 4.42½ FRANCE 9.05 GERMANY .33 CANADA 97.75

For other Countries quotations furnished on application.

* ADD TO EACH BANK POST REMITTANCE 25 CENTS FOR POSTAGE, AND IN CASE OF CABLE TRANSFER THE COST OF CABLE.

† FOR RATES ON AMOUNTS IN EXCESS OF ABOVE LIMITS, INQUIRE BY PHONE OR TELEGRAPH.

FIGURE 53
Exchange rate sheet

bank may see fit to change its quotations by telegraph. The issuing bank is supposed to draw at the latest quoted rate, although it is not

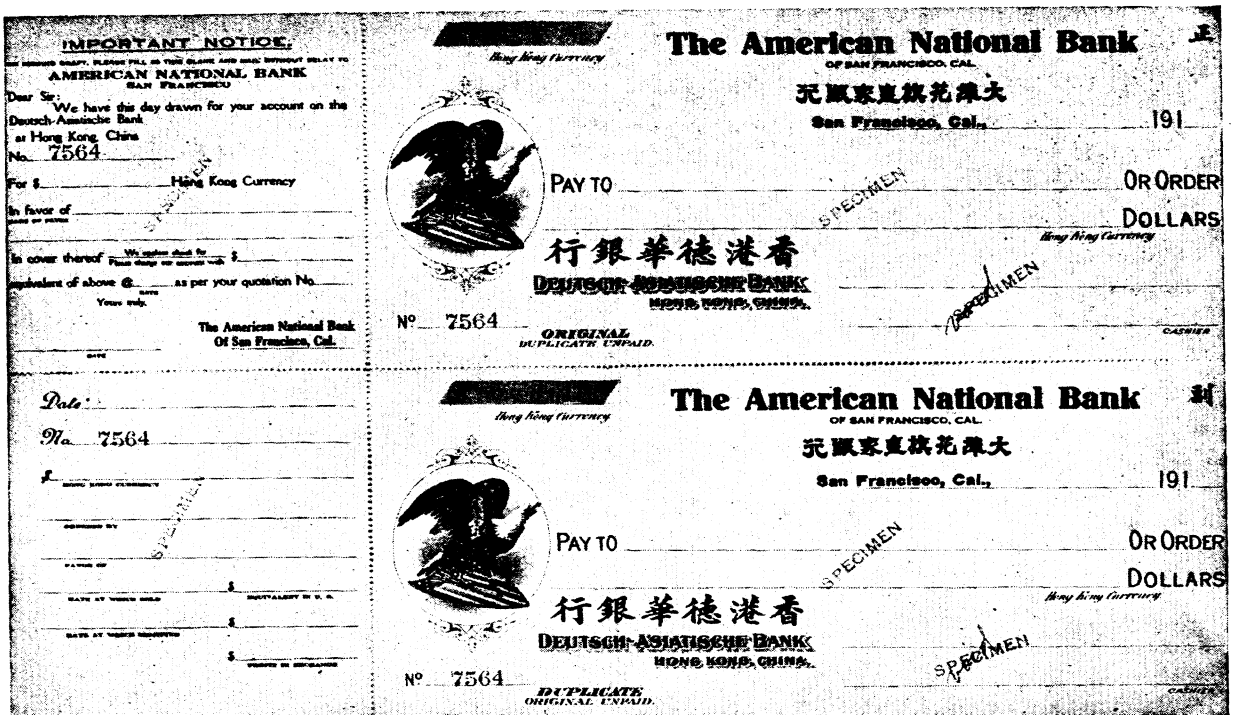


FIGURE 54—Type of four-part form of bank draft

unusual for it to disregard instructions and draw at a previous rate which may be slightly more favorable to it. Disputes frequently arise between the issuing bank and jobbing bank over this matter. The issuing bank on its part may charge its customer any rate that the traffic will bear, merely being certain that the rate charged is above the rate at which it will have to cover with the jobbing bank. It is customary for the issuing bank to charge about one per cent more than the rate quoted by the jobbing bank.

There are a number of different kinds of forms used that are of four parts. The limits of space preclude our discussing any but those that are the most typical. In the form above (Fig. 54) the draft is drawn only on a designated foreign bank and in a designated foreign money. The original and duplicate drafts constitute the right-hand portion of the blank. The name of the issuing bank is not printed on the form, but is stamped in when its officers sign the draft. The lower left-hand portion of the form is retained by the issuing bank as its record of the sale. The upper left-hand portion is the advice which the issuing bank must send to the jobber, notifying it of the amount of the draft, when drawn, the name of the payee, and also as to what rate of exchange and in what manner the issuing bank is covering (paying the jobbing bank), i. e., whether by check or by asking the jobbing bank to debit its (the issuing bank's) account. The jobbing bank in its turn sends an advice to the foreign bank and asks that its (the jobbing bank's) account be debited accordingly.

In another four-part form (Fig. 55), the draft is issued in duplicate and bears on its face the name of the issuing bank and also the emblem or monogram of the jobbing bank. Both of the copies are given to the customer. The lower left-hand portion is the issuing bank's stub or record, while the upper left-hand portion is the advice which the issuing bank forwards to the jobbing bank. The latter notifies the foreign bank by means of an advice as in the examples given above.

Sometimes the issuing bank is asked to sell a draft on a correspondent of the foreign correspondent of the jobbing bank. The practice followed, so far as the issuing bank is concerned, is the same as in the example cited above,[1] but it becomes necessary for the jobbing bank to notify not only the foreign correspondent but also the bank on which the draft has been drawn as to the details of the transaction. To cite an example: Let us say that the First National Bank of Pasadena,

[1] Cf. pp. 188–191.

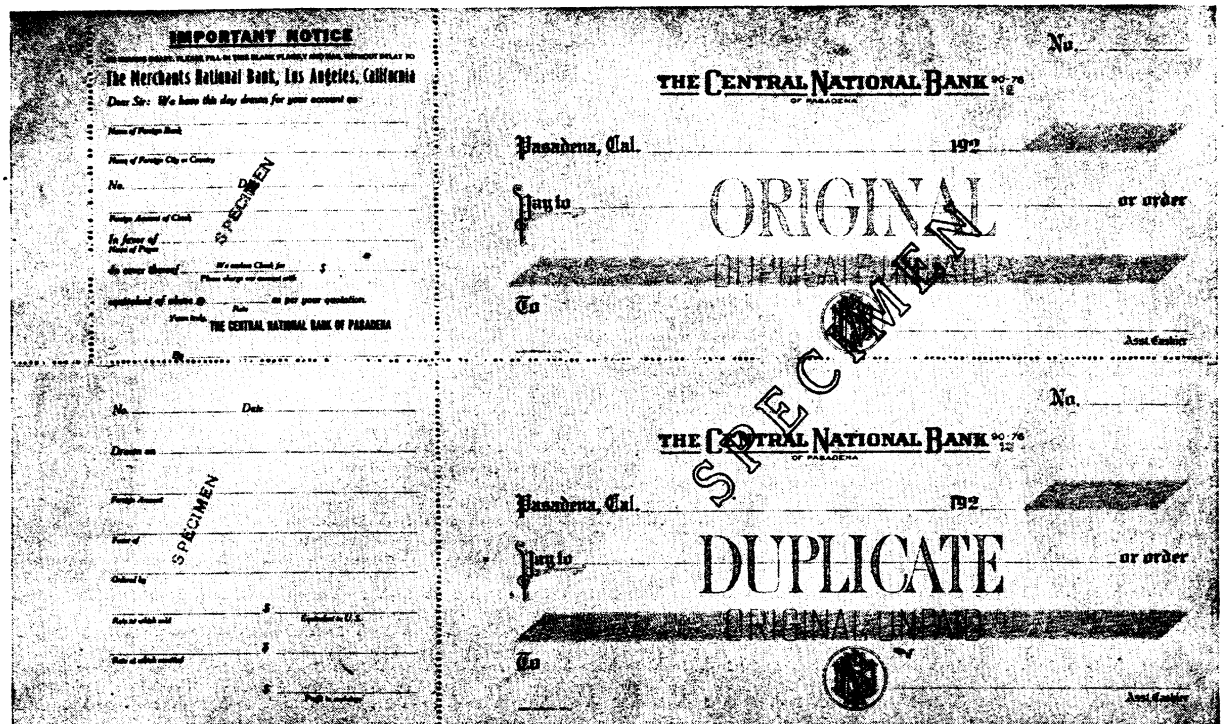
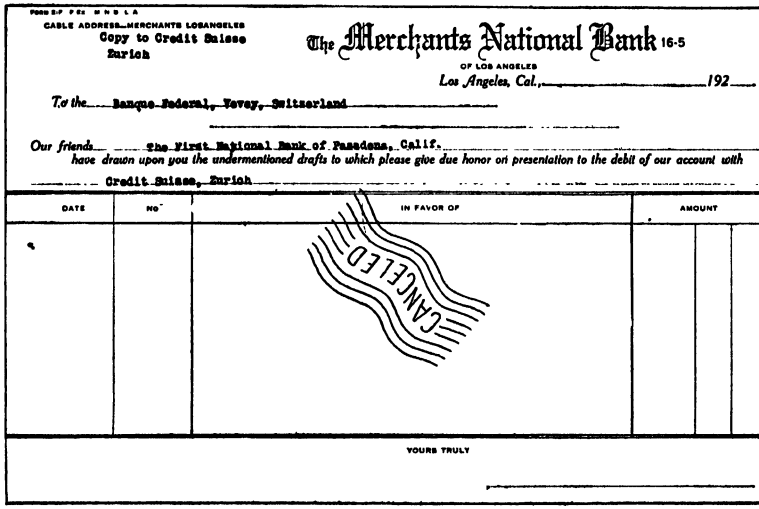


FIGURE 55—Type of four-part form of bank draft

California, has sold a draft through the Merchant's National Bank of Los Angeles on the Banque Fédéral, Vevey, Switzerland. The latter is a correspondent of the Credit Suisse, of Zurich, which in its turn is a correspondent of the Merchants' National Bank of Los Angeles. The First National Bank of Pasadena will, on selling the draft, notify the Los Angeles bank to that effect. The latter will fill out the following form (Fig. 56) usually, though not necessarily different in color


CABLE ADDRESS—MERCHANTS LOSANGELES
Copy to Credit Suisse Zurich

The Merchants National Bank 16-5
OF LOS ANGELES
Los Angeles, Cal., _____ 192__

To the Banque Federal, Vevey, Switzerland

Our friends the First National Bank of Pasadena, Calif.
have drawn upon you the undermentioned drafts to which please give due honor on presentation to the debit of our account with
Credit Suisse, Zurich

DATE	No.	IN FAVOR OF	AMOUNT
		CANCELED	

YOURS TRULY

FIGURE 56

Advice to correspondent of foreign correspondent

from the form above mentioned (Fig. 51). This form or advice will be made out in duplicate, the original being sent to the Banque Fédéral and the duplicate to the Credit Suisse. The Credit Suisse will not wait until the arrival of the draft before debiting the account of the Los Angeles bank, but will debit the latter's account as soon as the above advice is received. The draft may be presented several days or weeks later, so that in the meantime the Credit Suisse has the use of an amount of money equal to the face value of the draft. This is the general custom of all European banks, excepting only a few of the English banks, which debit the correspondent's account only when payment of drafts is made.

Certain of the above forms do not provide a purchaser's receipt.

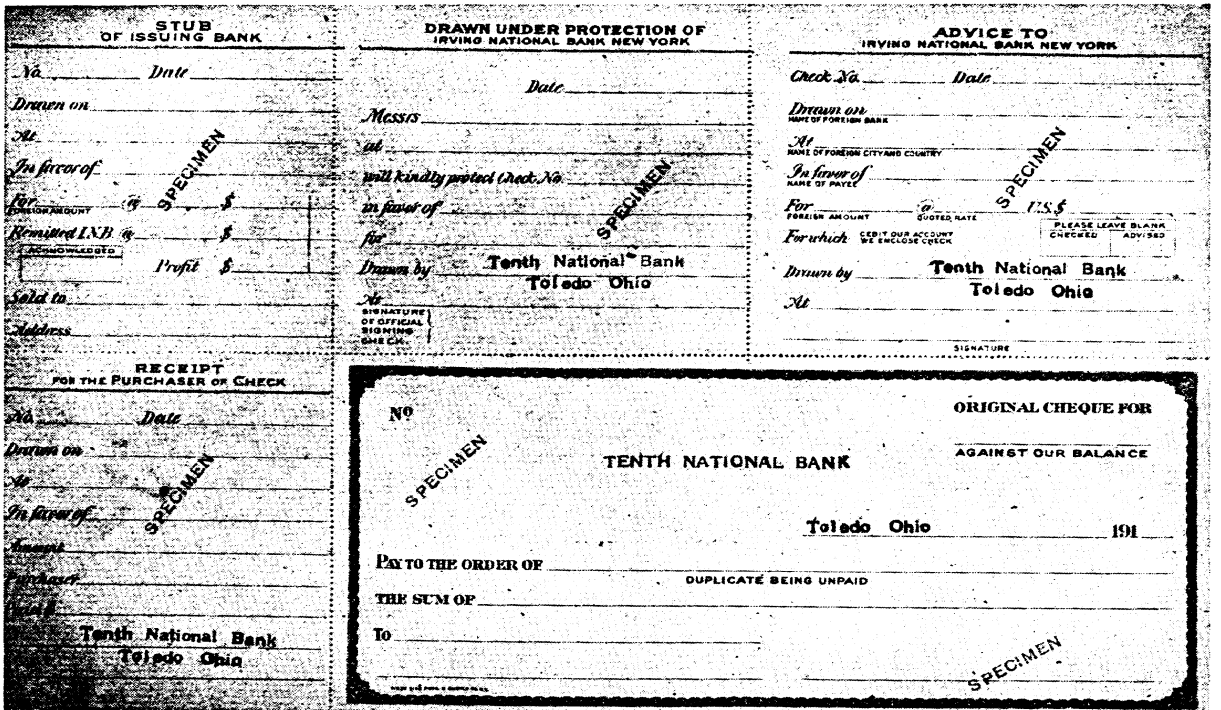
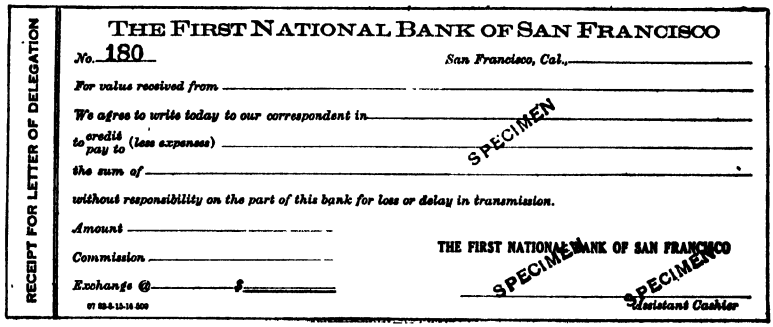


FIGURE 57—Type of five-part form of bank draft

It is the practice of every bank however, to give the customer a receipt, using a printed form for that purpose, stating the name of the payee, the amount of the draft, and other necessary data.

In the case of the five-part form, which has but lately come into use in the foreign exchange field, the form is divided horizontally into two equal parts (Fig. 57). The draft itself constitutes the right-hand portion of the lower half, and the purchaser's receipt the left-hand portion. The draft bears the name of the issuing bank and certain other marks or emblems which enable the foreign bank readily to recognize the identity of the jobbing bank. The upper half of the form is divided into three parts; the left-hand portion is the stub or record of the issuing bank, the middle portion is the advice that is mailed to the jobbing bank, and the right-hand portion is the advice that is mailed by the


RECEIPT FOR LETTER OF DELEGATION

THE FIRST NATIONAL BANK OF SAN FRANCISCO

No. 180 San Francisco, Cal.

For value received from

We agree to write today to our correspondent in

to credit pay to (less expenses)

the sum of

without responsibility on the part of this bank for loss or delay in transmission.

Amount

Commission

Exchange @ $

THE FIRST NATIONAL BANK OF SAN FRANCISCO

Assistant Cashier

SPECIMEN SPECIMEN SPECIMEN

FIGURE 58
Receipt for letter of delegation

issuing bank to the foreign bank upon which the draft has been drawn. In this case the issuing bank itself notifies the foreign bank. A slight modification of this form, as used by some jobbing banks, lies in the fact that the issuing bank is required to send both advices to the jobbing bank which in its turn then forwards the advice to the foreign correspondent.

Letter of Delegation. Under the disturbed conditions brought about by the World War, one could not be certain that a draft, postal or express order, or other form of exchange ordinarily exployed in remitting money abroad, would reach its destination,[1] so that resort was

[1] The real cause for the wide use of the letter of delegation was the announcement of the British Government in 1916 that it had placed all negotiable instruments destined to enemy countries on the absolute contraband list, and subject to seizure. A letter of delegation is not a negotiable instrument and therefore could be safely used.

had to the "mail transfer" or "letter of delegation," which became very popular as a means of sending funds to certain sections of Europe (Fig. 58). Instead of issuing a foreign draft, the American exchange dealer simply writes to its foreign correspondent requesting it to pay a designated sum of money to a specified person or firm and to inform the latter that the money is being paid at the request of the sender. The letter of delegation is sent in duplicate, so that there is reasonable certainty that at least one copy will reach the foreign correspondent. A copy of the letter or a receipt is given the purchaser, who may forward it to the payee to advise him of the method and the amount of payment. The letter of delegation had been used to some extent before the World War, but primarily in connection with the establishment of bank credits.[1] Not being a negotiable instrument, it is not subject to the stamp taxes usually imposed by foreign governments on negotiable instruments.

B. Cables

Cables. Cables or telegraphic transfers (commonly abbreviated in foreign countries to "T. T.") are, technically speaking, not bills of exchange because they are not negotiable instruments. Nevertheless, they are a form of exchange because they are a credit means of paying bills abroad. They have played an increasingly important part in our exchanges during and since the World War, following the depreciation in the exchange rates on foreign countries. A cable, as may be surmised, represents the "cabling of money" to a foreign payee when occasion renders it advisable or profitable to use that means of making payments. "Cabling money" is a misnomer, because no money is sent via the route of the cable. Money is paid to the exchange dealer in the United States, and he cables his foreign agent or correspondent to pay out a designated sum to a specified party.

The customer who wishes to purchase a cable fills out a short application blank, or the clerk does it for him, giving his name, the amount in American or foreign money that is to be cabled, and the name and address of the payee (Fig. 59). The application is frequently filled out in duplicate and a copy given to the remitter as a receipt. The clerk converts the American money into terms of the foreign money, or vice versa, depending upon whether the customer states the sum that he wishes to send in terms of foreign money or American money.

[1] Cf. pp. 298–299.

The conversion will be made at the cable rate for that day. The cable rate is always higher than the rate for demand or for time drafts. The reason, as will be explained more fully in Chapter X, is that in the case of a cable transfer the foreign account of the exchange dealer is debited within a few hours after he has sent the order, and he thus loses a number of days' interest that he would otherwise have gained had the customer purchased a draft and forwarded it by mail. The costs of the cablegram message are paid by the customer. The profit to the exchange dealer comes out of the cable rate that he charges. The dealer does not hold himself "responsible for any delays, mistakes or omissions which may happen in the transmission of the message or for its misinterpretation when received." In a large foreign exchange department, one clerk will take the order, make the conversion, fix the charges, and receive the money from the customer while another will prepare the message in code form. A code is always used so as to save cable charges and also to guard against possibility of loss through wire tapping, etc. Test words at the beginning or at the end or at both the beginning and the end of the message are commonly employed for additional safety. During the World War the exchange operations in New York were greatly upset because code messages were forbidden by the Allies who were fearful

The Anglo & London Paris National Bank
of San Francisco

CABLE TRANSFER

To be placed to the Credit of

Address .....

At the Office of MESSRS. LAZARD BROTHERS & CO., LONDON

For Acc't of .....

Amount - .....

@ ..... $ .....

Cablegram - $ .....

Total - $ .....

San Francisco, ..., 191.....

Signature .....

Purpose of Remittance .....

No. .....

FIGURE 59

Application for cable transfer

of German spies. Cables may be "unregistered" or "registered." If a firm frequently sends cable exchange, it may register the full name and address of the payee firm with the exchange dealer, who sets aside a code word covering these data and forwards it to the paying office or correspondent abroad. Then when the American firm wishes to send a cable to that firm, the one code word alone will suffice for the name and address of the payee. Such "registered" remittance usually costs about one-half the regular rate charged for the unregistered cables, which, as may be inferred, do not have the name and address of the payee or correspondent registered with the exchange dealer. Brooks [1] gives the following example as illustrative of a registered cable transaction:

"The firm of H. J. Meyerfield and Co. of Chicago wish to have two thousand five hundred pounds sterling paid to Johnson, Gladstone and Co., 153 Threadneedle St., (E. C.), London, England, for their account.

"The message given to the telegraph company for transmission would be as follows (cipher words are fictitious):

"NETIPROV LONDON MURTIER MYERSON MARDADIE.

"Translated, these cipher words would mean:

"(NATIPROV)—To the National Provincial Bank of England, Ltd.

"(LONDON)—London, England.

"(MURTIER)—Pay to the person(s) named in this cablegram.

"(MYERSON)—Johnson, Gladstone and Co., 153 Threadneedle St., (E. C.) London, for account of H. J. Meyerfield and Co., Chicago, Ill., U. S. A. (Registered).

"(MARDADIE)—(£2,500) Two thousand five hundred pounds sterling."

The American Express Company has a combination "Express Money Order and Cable Money Order" that is unique. An ordinary foreign money order is issued with the words "By cable" stamped across the face of the advice which is mailed to the head office of the company in New York. When the advice has been received in New York the company immediately executes the cable as requested.

When a cable is sent from an inland point in the United States to an inland point in a foreign country, the telegraph charges, both here and abroad, are added to the cable charges.

At various times during the World War the larger part of our foreign

[1] "Foreign Exchange Textbook," p. 157.

remittances were made by cable because the mails were so uncertain.[1] Since that time, the very low exchange rates which prevailed and the possibility of their falling even lower, caused many merchants to resort to cables in the hope of effecting a saving on their foreign payments. If the merchant in New York buys a draft with which to pay a bill in Paris, he must send it by mail about nine to twelve days before the time when payment is due. On the other hand, if he thinks that the firm can make better use of the money for that length of time by waiting and then buying a cable, or if he thinks that the rate on Paris is likely to drop so that he will be able to buy a cable nine or twelve days hence at about the same rate that he would have to pay immediately for a sight draft, he will consider it to his advantage to wait and purchase a cable. Even in normal times circumstances arise that make it profitable and advisable for a firm to buy cables rather than sight drafts.[2]

Exporters who desire to obtain immediate use of funds due them from foreign merchants will frequently advise the exchange dealer, to whom they have given their drafts and documents for collection, to have the funds remitted to them by cable. An exporter may also instruct the foreign purchaser to place the funds covering the transaction in a foreign bank to his (the exporter's) account. He may then go to his local bank and sell his foreign account to it, using the cable to instruct the foreign bank to place the money to the credit of the bank to which the account has been sold.

[1] "Because of the uncertainties of the European mails, bankers last week transacted more business with Amsterdam by cable than by check, customers being willing to meet the additional expense for the sake of more certain transfer of their funds. The seizure of mail for Holland in recent weeks by British authorities has been the chief factor in expanding cable business. . . . Bankers say that complaints of non-delivery of letters containing drafts caused so much embarrassment to clients that many of them have declined to send funds through checks to the Netherlands and Switzerland, even though the due date lies several weeks in the future. . . .

"So difficult have means of communication between this country and Amsterdam become, bankers say, that clients have found recently that it is safest to allow on cabled remittances nearly as much time for delivery as though a check had been sent through the mails in ordinary times. Frequently as much as five days elapse in transmission." *Annalist*, March 6, 1916.

[2] "The continued fluctuation in foreign exchanges during the past year is largely responsible for the increased use of cable transfers for the meeting of obligations maturing abroad—debtors apparently waiting until the last possible moment to make their remittances, in the hope of getting a better rate.

"Even in the days of more stable exchanges there were many possible situations in which American firms with obligations abroad would find it to advantage to remit by cable transfer, and such occasions will still arise when the recovery of the exchanges commences, unless it is far more rapid than is to be expected at present." Foreign Trade Bulletin of the American Express Company, September–October, 1919.

Not only do banks, express companies, and cable or telegraph companies sell cables to the public, but they also buy and sell cables among themselves. Banks buy a large amount of cables from each other for the purpose of meeting obligations abroad, such as drafts that are falling due [1] or to cover cables that they have sold to others even though with insufficient funds in their foreign accounts to meet the amount sold. At times they also sell heavily to each other in order to bring their funds back home when needed for more profitable investment or to meet some pressing financial need.

C. Banker's Long Bills

Banker's long bills are drafts that are issued by a banker upon a foreign banker, running usually for ninety days, although drafts of sixty days usance are not uncommon. They are issued for a number of purposes but primarily to enable foreign bankers to loan money or credit in the United States, either on their own initiative or on that of the American banker.

Long Bills in Ordinary Course of Business. In our discussion of banker's foreign drafts [2] we stated that it is not unusual for a bank to sell a sixty or a ninety day draft to a customer who may wish to pay for goods which have been purchased abroad. If he purchases a ninety day sight draft on some foreign bank, it will be necessary for the party receiving it to have it accepted at the foreign bank. The payee may then hold it until it matures or he may get his money immediately after its acceptance by discounting it in the open market. A date bill may also be used in the same manner and for the same purpose. The reason why the customer purchases a long bill instead of a demand bill is that he may be able thereby to save on the exchange rate, the rate for long bills always being lower than that for demand bills because the bank has the use of the money during the interim. Although the purchaser, on the other hand, loses interest on his investment in a long bill, nevertheless he gets back a portion of it through the lower rate which he pays for the bill. It may also happen that the customer has to remit to some market upon which there is a small amount of exchange available, and so, because he cannot always be sure of getting demand exchange when he needs it, he purchases a

[1] It is not unusual for dealers to sell demand drafts and then within a few days, just before the sight drafts reach their destination, to cover by going into the market and purchasing cables from other dealers.

[2] Cf. p. 182.

long bill instead. Such long bills may be sold by the bank against its account already on deposit with the foreign banker or against remittances of commercial "payment" bills which the banker has purchased but which as yet have not matured. As will be seen later,[1] the banker learns from experience just about how many of the "payment" bills which he has purchased will be taken up or paid under rebate at approximate future dates. On the basis of his calculations he thinks that he will have a certain amount on deposit in his foreign account sixty or ninety days hence, and therefore feels that he can with safety sell his own long bills against the same. If the "payment" bills are not taken up by the dates that he has figured on, he will of necessity have to resort to other means of providing funds out of which to meet his long bills when they fall due.

Long Bills in Loaning Operations. The sale or purchase of the type of banker's long bill just described has, as is evident, nothing whatever to do with the loaning of foreign funds in the United States. Yet it is in connection with this latter matter that the banker's long bill plays its most important part. Not only have foreigners, especially the English, been very heavy investors in American stocks and bonds,—which really amounts in the end to their loaning large sums of money to American industries—but foreign banks, principally the English, for years previous to 1914 loaned large sums of money for short periods of time to American banks and also, through them, to American firms with which many a financial deal of importance was consummated. These loans were customarily made by means of a banker's long bill of one kind or another, running usually for ninety days, and at times renewed for a like period. Since 1914, however, the foreign bankers have had such pressing needs for funds at home that they have been borrowing very heavily from us, and the long bill no longer functions as prominently as of old in our exchange markets.

The initiative in negotiating these foreign loans may be taken either by the foreign bank, by the American bank, or by both. The foreign bank may note that the rates of exchange and the money rate in the American market promise profit on such a venture, and it thereupon notifies the American bank to loan a certain amount of money for it in the American market. Or it may be that the American bank surmises that the favorable exchange rates on the foreign country offer an opportunity to borrow profitably from the foreign bank by

[1] Cf. pp. 495–496.

means of an exchange transaction, or it may need the money to bolster up its legal reserves, or to float some stock and bond deal. Still another possibility is open, i. e., both institutions may enter into the transaction on the basis of a "joint account" whereby each party is to share equally in the profits or losses. Each of these arrangements requires a separate explanation.

Suppose that Barclays of London takes the initiative and decides to loan £100,000 in the New York market through its correspondent, the Fifth National Bank. It notifies the latter by cable of its decision and makes arrangements as to the terms of the loan, i. e., whether the Fifth National is to put the money out at a definite rate of interest, in which case the risk of exchange falls upon the English bank: or whether it shall charge the firm to which the money is loaned a small commission, the borrowing firm, instead of the English bank, in this case assuming the risk of exchange. The amount of the commission or fee which the Fifth National is to receive is also agreed upon. The Fifth National Bank in either case finds a borrower in the market, possibly some investment house, or industrial or commercial firm, which deposits collateral security for the loan just as it would for any other kind of bank loan.

Currency or Dollar Loan. Let us say that the arrangements are that Barclays will charge a fixed rate of interest, say 4 per cent, and that it will assume the risk of exchange. This form of loan is commonly known as a "currency" or "dollar" loan. The Fifth National Bank, following instructions, draws a draft or drafts on Barclays, running for 90 days and totalling £100,000, and sells the same in the open market to an exchange dealer, say the United Trust Company, at the going or current rate of exchange on that day for 90 day bills. If the rate is 4.83, the Fifth National Bank receives $483,000 (4.83 × 100,000). Suppose that it loans this amount to Jones and Smith, who have the use of the funds for the next ninety days at 4 per cent interest. Note that dollars are turned over to the borrowing firm. The United Trust Company, to which the draft is sold, immediately sends it to its correspondent in London, say Lloyds Bank, which presents it to Barclays for acceptance. After acceptance, Lloyds either has the draft discounted in the open market or holds it until maturity, depending upon the instructions that it has received from the United Trust Company. At the end of 90 days, if the loan is not to be renewed, Jones and Smith, in accordance with their agreement, pay the Fifth National

Bank $483,000 plus interest at 4 per cent for 90 days, or a total $487,830. Note that a predetermined number of dollars (principal plus interest) is paid back by the borrowing firm. It is because of this fact that this type of transaction is called a "dollar" or "currency" loan. The Fifth National Bank thereupon takes immediate action to cover the £100,000 draft falling due in London either by forwarding a demand draft against its own account with Barclays, or by going into the market and buying a demand draft from some other exchange dealer. Suppose that it does the latter. The amount of the draft would be for £100,000 plus the profit that belongs to Barclays after the Fifth National Bank has deducted its charges for acting as an intermediary. When the draft reaches Barclays it is immediately cashed at the bank upon which it was drawn, in order that the money may be on hand to meet the 90 day draft when presented at maturity. The profit that Barclays makes on the deal depends entirely on the New York rate of exchange for demand drafts existing on the day that the Fifth National Bank goes into the market and buys cover for the maturing 90 day bill. The English lending bank will usually enter into a dollar loan when the lookout in the exchange field appears to be for a falling sterling rate, because it assumes the risk of exchange and is therefore hoping to have cover purchased at a lower figure than is prevailing at the time when the loan is made. When dollar loans appear in large amounts, comment on the street is that the market may expect to experience lower exchange rates in the near future. Suppose that the rate for demand bills does fall from 4.87, which prevailed at the time the loan was made, to 4.85 at the time when cover is purchased by the Fifth National Bank. The full face value of the sum returned by the borrowing firm, $487,830 (not deducting the commission charges of the New York bank), converted into sterling at the demand rate of 4.85, will purchase £100,583 16s 2d of sterling exchange (487,830 ÷ 4.85), a gain of £583 16s 2d on the transaction. Figured on a percentage basis this amounts to a return of over 2.3 per cent. If the demand rate drops lower, the return will be larger. If the demand rate remains high, say at 4.86, the Fifth National Bank will be able to purchase only £100,376 10s 10d, representing a total gain of £376 10s 10d, or a return of only about 1.7 per cent. The rate of return received by the lending bank seems to be very small and it would be small had Barclays actually put up any of its own funds, but, as has been seen, the bank advances only its credit, i. e.,

allows its name to be used. It has merely accepted the draft and agreed to pay it when it falls due. Who or what it is that actually furnishes the money with which the deal is financed will be discussed later.[1]

Loans of this kind, so far as the American borrowing firm is concerned, are no different from any other loan that it might procure from its New York bank. In fact, in practically all cases the borrowing concern has no idea that it is not actually borrowing the funds from the American bank; it has no knowledge whatsoever that a London bank is the party primarily interested in the transaction.

Sterling, Franc, Mark, etc., Loans. Taking up another angle of foreign loans negotiated by means of bankers' long bills, suppose that Barclays advises the Fifth National Bank that it will accept a commission on a loan and that the borrowing American firm is to assume the risk of exchange. This is known as a "sterling" loan. If marks were to be loaned by a German bank under the same conditions, it would be a "mark" loan, or if francs by a French bank, it would be a "franc" loan. In this case, the borrower knows that the loan is being engineered at the request of the foreign bank, because, when getting the loan, the borrower agrees to pay the principal plus the usual commission by furnishing the New York bank with demand exchange or with sufficient funds to purchase an amount of demand exchange equal to that which forms the basis of the loan.

The English bank usually charges the small commission of 3/8 of one per cent for its acceptance of a 90 day draft. This amounts to 1/8 of one per cent per month, or 1 1/2 per cent per year. The commission may seem to represent a small return to the lending or drawee bank, but again it must be remembered that the London bank does not advance its own funds; it simply loans its credit or its name by accepting the draft, and the American borrowing firm, through the New York bank, puts it in funds with which to meet the draft when it matures. The London bank is liable for the full face value of the loan if anything goes wrong, but such possibilities are so slight as to be practically negligible.[2]

In tracing the various details of a "sterling" loan, suppose the data to be the same as those given in the case of the dollar or currency loan

[1] Cf. p. 217.

[2] By many it is felt that the commission charged by the accepting bank is not commensurate "with the risk involved should a monetary crisis ensue between the date of drawing and maturity of the bills." Spalding, *op. cit.*, p. 74.

above described. Barclays advises the Fifth National Bank to find a borrower for a sterling loan of £100,000. The terms are arranged by cable. A party willing to take such a loan, Jones and Smith, is found in New York. The commission is to be 3/8 of one per cent and the borrower is to bear the risk of exchange. The Fifth National Bank draws a 90 day draft for £100,000 on Barclays and turns it over, against a deposit of collateral security, to Jones and Smith. Note that a *sterling* draft is handed to the borrower. It is not unusual, however, for the New York bank, at the request of the borrowing firm, to sell the draft in the open market, because the bank is a keener bargainer and can secure a higher rate than can Jones and Smith. Say that the sterling draft is sold at the prevailing rate for 90 day bills, which happens to be 4.83, and that the United Trust Company buys it for $483;000. That amount of money is then turned over to Jones and Smith to be used by them for the next 90 days. The United Trust Company forwards the draft immediately to its correspondent in London, i. e., Lloyds, which presents it to Barclays for acceptance. Again, Lloyds will discount the bill or hold it until maturity, following the instructions received from the United Trust Company. At the end of 90 days, Jones and Smith will furnish the Fifth National Bank with a sterling demand draft for £100,000 plus the 3/8 per cent commission, or will pay it a sum of American money that will purchase such a draft in the open market. It is because the borrowing firm has to purchase a sterling draft or has to pay the New York bank a sum of money, not determinable beforehand, with which to purchase such a draft, that this type of loan receives its name. Suppose that at the end of the 90 days the demand rate on London is 4.85. The principal of the loan is £100,000, the 3/8 per cent commission amounts to £375. How much money will Jones and Smith have to pay for a demand draft for £100,375 at the rate of 4.85? Multiplying the former by the latter, we get $486,818.75, an increase of $3,818.75 over the sum which Jones and Smith had received 90 days earlier from the sale of the sterling draft. This would be at the rate of approximately 3.1 per cent per year. If the demand rate for sterling were 4.86, the draft would cost $487,822.50, an increase of $4,822.50 over the sum which Jones and Smith had borrowed, or at a cost of 3.9 per cent per year. If the demand rate should fall low enough, the borrower might be able to get the loan for an extremely small interest rate or possibly for nothing at all. But no matter what the rate is, the London bank receives its

commission of 3/8 per cent and pays the New York bank its fee for acting as the intermediary.

When Jones and Smith repay the loan, either in cash or by means of a sterling draft, the Fifth National forwards the sum to Barclays (minus its commission of possibly one-half of the 3/8 per cent charged by Barclays for the loan), thereby putting the accepting bank in funds with which to meet the £100,000 draft when presented by the holder at maturity. The transaction has been purely one of credit, no funds having been advanced either by Barclays or by the Fifth National Bank.

"Because of the speculative element which attaches to loans of foreign money in this market, they are a favorite form of operation with many houses. Take for instance the case of a borrower of money who figures out that the exchange market is bound to decline within a few months. By getting some foreign banker to lend him money on the basis of his, the borrower, taking the risk of exchange, he can practically get himself short of the exchange market, and if he is right in his forecast he can get the use of the money for nothing, or even make a profit on the deal. Similarly with the banker. Frequently it happens that foreign money is pressed on the market here on the idea that exchange rates are about to go down and that the lender of the money, by assuming the risk of exchange himself, can make a big return on the money put out." [1]

Finance Bills. Another very important class of banker's long bills is the so-called "finance bills." Authorities differ as to what sort of bills this term actually applies. Escher alone holds that finance bills are those that arise through the initiative of a bank that desires to borrow from a foreign institution. In his "Foreign Exchange Explained" [2] he declares:

"Make inquiry, even among those actively engaged in the exchange business, as to what the finance bill is and what it is used for, and the chances are that you will be amazed by the divergence of the expression you call forth. Almost generally you will find a tendency to confuse the finance bill with the loan bill [3] which has just been described. Now the finance bill is essentially different from the loan bill in that the loan bill is issued by bankers who want to lend out the money to third parties, on collateral, whereas the finance bill represents nothing more than the drawing of long

[1] Escher, Franklin, "Foreign Exchange", (Part II of "Banking Practice and Foreign Exchange" with Jefferson, H. M.), Alexander Hamilton Institute, New York, 1913, pp. 321–322.

[2] Pp. 102–103.

[3] He is referring to dollar and sterling loans.

drafts by one banker on another for the purpose of raising money to be used by either banker or both. In the case of a loan bill John Smith borrows from the First National Bank and puts up good and sufficient collateral for its repayment. In the case of a finance bill, the First National Bank draws a time draft on the Second National Bank, turns it into ready money, and uses the money (sometimes alone and sometimes, in connection with the drawee) for any purpose it sees fit.

"There is, of course, no apparent difference in appearance between a loan bill and a finance bill. . . . The circumstances which bring them into existence vary greatly, but the bills themselves, after they have been uttered, are all exactly alike."

Patterson states,[1] and Whitaker agrees with him,[2] that

"Other authorities are inclined to include [as finance bills] all long bills originating between bankers, whether secured or not. The latter is perhaps the more general understanding of the term."

Although opposed by majority opinion, I cannot help but agree with Escher. In my opinion there are some very essential differences between loan bills and the type that we shall henceforth call "finance bills." In the case of the former, the initiative is taken by the foreign bank that wishes to place its funds or credit in the American market. In the case of finance bills, the initiative is taken by the American bank that is desirous of borrowing funds for its own personal use, or on joint account for the profit of itself and the foreign accepting bank. With loan bills, the American bank receives only its commission as an intermediary; with finance bills it gets all the gain minus the small acceptance commission charged by the foreign bank, unless the deal is carried through on joint account, in which case the two banks divide the profits between themselves. With finance bills the risk of exchange is borne by the New York borrowing bank, or, if the deal is on joint account, the risk is borne by both banks; but with sterling or dollar loan bills the New York bank assumes none of the risk of exchange. With loan bills, the borrower is a third party; with finance bills the New York bank is the borrower.

Suppose that the Fifth National Bank of New York sees an opportunity of swinging some big stock and bond deal,—possibly underwriting some large corporation,—which it feels it can handle satisfactorily in three or possibly in six months and "get out from under" within that time; or suppose that some large stockbroker in New York

[1] "Domestic and Foreign Exchange," p. 144. [2] "Foreign Exchange," p. 380.

desires to borrow so as to invest heavily in stock and bonds; or suppose any similar situation arises in which the New York bank needs money but does not care to invest its own deposits and capital in the transaction; or suppose that the bank itself is getting rather short of funds and needs to build up its cash temporarily but does not wish to go to some other New York bank for a loan: any of these or similar circumstances may cause the New York bank to take the initiative and cable its London correspondent, say Barclays, to the effect that it wishes to draw £100,000 worth of 90 day bills against the latter. Will Barclays accept? The reply comes back that the arrangement is satisfactory. The New York bank may or may not be requested to deposit collateral security with some local trust company. The Fifth National Bank naturally will not consider entering into such a transaction unless it feels that exchange rates at the time that the bills mature will be at lower levels.

If the situation looks promising, the Fifth National Bank draws £100,000 in 90 day bills on Barclays and sells them to some local exchange dealer, say the United Trust Company, at the going rate for long bills on that day. If the rate is 4.83, it receives $483,000, which it will use for the next 90 days. The United Trust Company forwards the bills to its correspondent in London, say Lloyds, which presents them to Barclays for acceptance. When accepted the bills are either discounted in the London market or held until maturity, as indicated by the instructions of the United Trust Company. Another method of handling the deal would be for the Fifth National Bank to send the 90 day bills to another of its correspondents in London, say the London Joint City and Midland Bank, which would present them for acceptance to Barclays, and when accepted have them discounted immediately in the open market, and the proceeds (£100,000 minus the discount) credited to the account of the Fifth National Bank with the London Joint City and Midland Bank. The Fifth National Bank, in the latter case, could then sell demand drafts against the account which it has thus built up, and receive cash in New York for such drafts. The reason for following this latter method is that the New York bank is thereby able to take advantage of the position of the discount rate in the London market and the rate for demand drafts in the New York market. Unless these two conditions are satisfactory, it will follow the procedure first mentioned, i. e., sell £100,000 of 90 day bills in the New York market.

For the purpose of making our problem as concrete as possible, suppose that the Fifth National Bank loans the $483,000 in the New York market at the short time loan rate of, say, 6 per cent. It receives a total return at the end of the 90 days of $490,245. When it goes to buy sight exchange with which to cover the 90 day draft maturing in London, the sight rate on London is 4.85. To meet the £100,000 draft plus Barclays' acceptance commission of 3/8 per cent, it must purchase £100,375 at 4.85, which costs it $486,818.75. The profit of the Fifth National Bank on the $483,000 would amount to $3,426.25 ($490,245.00—$486,818.75) or a gain at the rate of 2.8 per cent per year. This 2.8 per cent return seems small, but it is placed in a different light when we remember that in the whole transaction the Fifth National Bank has not advanced one cent on its own funds.

Let us take the case in which the Fifth National Bank sends its 90 day drafts to London to be discounted immediately and against which it simultaneously draws drafts in order to take advantage of the discount rate in the London market and the demand rate for sterling in New York. The Fifth National Bank draws a draft on Barclays for £100,000 and sends it to the London Joint City and Midland Bank with instructions to present it to Barclays for acceptance, after which to discount it in the open market and credit the proceeds to its (the Fifth National Bank's) account with the London Joint City and Midland Bank. Let us say that on the basis of the rate of discount in London, the stamp tax which long bills must pay in England, and the commission of the accepting bank (Barclays), the Fifth National Bank is able to get its funds in London at the cost of $.04875 per pound sterling.[1] If the market rate for demand sterling is $4.8825, it sells £100,000 worth of demand drafts on its account with the London Joint City and Midland Bank and receives in return $488,250. It is able to sell for the full face value of the £100,000 because it has extra funds on deposit with the latter correspondent. It may then loan the $488,250 in the New York market at the current rate, say 6 per cent, and receive therefor $7,323.75. Suppose that, three months later, the demand rate for sterling, at which the Fifth National Bank has to purchase cover to forward to Barclays, is at 4.85. It will have to expend $485,000 for demand drafts to mail to Barclays so that the latter may meet the 90 day finance bills at maturity. The profits of the Fifth National Bank are figured as follows:

[1] Cf. Margraff, *op. cit.* pp. 38–39.

Received for £100,000 demand drafts @ $4.8825	$488,250.00
Paid for £100,000 demand drafts as cover @ 4.85	485,000.00
Gain	3,250.00
Interest on $488,250 for 90 days at 6 per cent	7,323.75
Total Gain	10,753.75
Cost of discounting, commission, stamps, etc., on £100,000 90 day drafts @ $.04875 per £	4,875.00
Net Gain	$5,878.75

A profit of $5,878.75 on $488,250 for a period of 90 days amounts to a gain of approximately 4.8 per cent per year. Out of this gain has to come the cost to the Fifth National Bank of the extra funds which it had to draw on in its account with the London Joint City and Midland Bank, the possession of which enabled it to draw demand drafts for the entire amount of the £100,000.

Margraff [1] gives another example of the advantageous employment of finance bills by the American banker. The banker may have a large amount of money invested in certain securities which have temporarily depreciated in value just at the moment when there is a demand for money in the local market at very favorable rates. The banker may either sell the securities at the depreciated quotation and take his losses, or he may hold them and not make the requested loans to his customers, or he may resort to the issuance of finance bills. Let us say that he puts up the securities as collateral for an issue of finance bills, and loans the money thus secured in the open market. If the finance bills cost him about three and a half per cent per year, and if the securities are yielding him an interest of three per cent, he has a net cost on the finance bills of about one-half per cent per year, but at the same time he has the return on the money received from the sale of the finance bills, which money he is able to loan in the open market. By subsequent renewals of the finance bills, "the securities can be carried in this manner until the value of the same has recovered by appreciation in price, and such holding would be advisable, provided: the securities were 'gilt-edge,' and there is every reason to believe that the shrinkage in value is only temporary." [2]

Another method of using finance bills occurs in connection with the investment of the funds obtained therefrom in issues of corporation securities either by the American bank or by it on joint account

[1] *op. cit.* pp. 40–41. [2] *Ibid*, p. 41.

with the foreign accepting bank. If the American bank wishes to "go it alone," it gets the permission of the London bank to draw the required amount of 90 day finance bills, sells them in the market, and invests the returns in the selected securities. During the 90 days that the bills have to run, the bank will hope to unload the securities on the market at a price high enough to yield a profit over the cost of the demand bills which it must buy to meet the maturing finance bills, the commission of the accepting bank, and any other expense that it may have incurred. Very often such deals are arranged and carried through on joint account. The New York bank may be asked to join a syndicate of banking houses interested in floating some large investment proposition. It may not desire to invest its own funds, but invites the coöperation of its London correspondent, which, because of past profitable experiences, agrees to such an arrangement. The finance bills are drawn and sold, and the money is invested in the corporation issues. As the days pass the securities are unloaded onto the public, and at the end of the 90 days the New York bank goes into the market and purchases demand exchange to cover the maturing finance bills. The rate at which the finance bills are sold, the prices at which the stocks and bonds are disposed of, and the rate at which the New York bank has to purchase demand sterling, determine the profit on the transaction, which profit will be shared between the two banks as stipulated in the agreement. An instance of the issuance of finance bills to take care of the needs of the security market occurred in October, 1912, when, owing to the international uncertainties caused by the Balkan War, a mass of American securities were thrown onto Wall Street by Europeans. The New York banks immediately issued large amounts of finance bills in order to satisfy the demands of the brokers for funds with which to absorb those securities.

It is not unusual for an American bank, when it is buying cover for its own maturing finance bills, to purchase finance bills that have just been issued by another bank in the same city, provided the rate is satisfactory. They are then sent abroad, accepted, discounted immediately, and the sum realized added to the foreign account of the American bank. Its foreign correspondent then has the funds on hand out of which the maturing finance bills are paid.

In the case of loan bills and finance bills it is possible and frequently necessary for the issuing bank to ask for a renewal for another period of 90 days. The bond transactions described above may not have

been pushed to completion, the borrowing American firm may wish to have the money for a little longer time, the American bank may feel that the rate for demand drafts has not declined sufficiently to make the transaction a profitable one and that there is a possibility of the rate going lower, or there may be some other contingency that may have to be met. Finance bills may be renewed by issuing a new lot at the then prevailing rate for 90 day bills and selling them in the market, the proceeds being used to purchase demand or cable exchange to meet the earlier issues as they mature; or they may be exchanged directly, "that is to say, they are swapped for demand or cable exchange. The swapping operations are tantamount to the discount of the long bills in London and are arranged on the basis of the prevailing rates for long bills and demand or cable exchange. The amounts swapped are in each case equal, the holder of the long bill paying the holder of the demand or cable exchange the difference between the two prices, which represents the London interest and bill stamp converted into New York funds. If a £10,000 90 day sight bill is exchanged for the same amount of demand exchange on the basis of $4.8090 for the long bill and $4.87 for the demand draft, the owner of the long bill pays the owner of the demand draft the difference between the two rates for every £1 exchanged, or $610 on the entire swap." [1] If the American bank does not want to swap 90 day bills for demand or cable exchange, but prefers to issue a new lot of finance bills and sell them in the New York market, it may find that the exchange rates have fallen, precisely as it had surmised would be the case, and that, if it issues only the same amount as before, the sum received from the sale will not be sufficient to cover the face value of the maturing bills. Suppose that it had originally issued £100,000 worth of finance bills at 4.85, receiving therefor $485,000, but that when the second lot is to be put on the market the rate has fallen to 4.82. If the bank issues only £100,000 worth of finance bills, it will receive $482,000, or $3,000 less than for the first issue. Under such circumstances, it will probably get the permission of its London correspondent to issue an additional amount to make up the difference, or a total of approximately £100,622. The same procedure may also be followed in renewing either sterling or currency loans.

In floating either loan or finance bills the American bank or the American borrowing firm is really speculating on the probable course

[1] York, T., "Foreign Exchange," p. 152.

of the exchanges. As in the case of stock and bond deals, when a dealer sells short of the market, i. e., sells securities that he does not have on hand but hopes to obtain later at lower prices than those at which sold, so the American bank or borrowing firm that has to purchase demand exchange with which to cover the maturing long bills hopes that exchange rates will drop to lower levels. Thus it is that finance bills and currency loans usually come onto the market during the summer months when the prospects for large crops and consequently large exports, with accompanying lower exchange rates, appear to be inevitable.[1] Prophets are not infallible, however, and it is not unusual for the exchange dealers to be deceived in their forecasts. Escher in his "Elements of Foreign Exchange" [2] states that in 1909 "Impelled thereto by the brilliant crop prospects of early summer, foreign exchange houses in New York drew and sold finance bills in enormous volume. The corn crop was to run over three billion bushels, affording an unprecedented exportable surplus—wheat and cotton were both to show record-breaking yields. But instead of these promises being fulfilled, wheat and corn showed only average yields, while the cotton crop turned out decidedly short. The expected flood of exchange never materialized. On the contrary, rise in money rates abroad caused such a paying off of foreign bills that foreign exchange rates rose to the gold export point and 'covering' operations were conducted with extreme difficulty. In the foreign exchange market the autumn of 1909 will long be remembered as a time when the finance bill sellers had administered to them a lesson which they will be a good while in forgetting."

In order to guard against these unexpected developments in the foreign exchange field it is customary for the party that has to purchase cover to engage in "forward exchange operations," i. e., to "hedge" by buying what is known as a "future." This is done by going to an exchange dealer and obtaining a contract from him to the effect that he will deliver the required amount of demand exchange at the designated date and at the rate contracted for. The dealer looks over the field, sizes up the possibilities of future developments,

[1] "There is no doubt, of course, that many finance bills have been drawn in times past for less legitimate purposes [than those drawn in anticipation of produce shipments], to provide money that was going into factory building or other forms of fixed capital which ought to have been provided out of more permanent forms of security, such as bond issues or creations of shares or debenture stocks." Withers, H., "War and Lombard Street," p. 85.

[2] Pp. 97–98.

and estimates approximately what the demand rate will be 90 days hence. If the rate is satisfactory to the purchaser a contract for future delivery is signed. If when the 90 days have passed the rate in the market is higher than the rate contracted for, the purchaser gains and the dealer loses, but if the market rate happens to be lower than the rate contracted for, the purchaser loses and the dealer gains. In either case, however, the purchaser is able to minimize his probable losses by means of the "future" contract.[1]

With the establishment of branches of foreign banks (including American banks) in London, an interesting development has taken place through the growth of what is technically "one name" paper, but what is familiarly known among exchange dealers as "house paper" or "pig on pork." This practice involves the drawing of loan or finance bills by a banking institution on its branch or on a financial institution which it controls. "The drawer and acceptor being virtually identical concerns, such bills represent but a single financial responsibility. The two-name class includes bills the drawers and acceptors of which are strictly separate and mutually independent establishments; they represent a twofold security. On this account prime two-name bills always command a lower rate in the London market and a higher price in the New York market than the best one-name bills." The latter bills are issued, however, because the loss that is suffered by the banks by reason of the lower price " is more than compensated for by the saving in acceptance commission they would otherwise be obliged to pay.

"Issuers of one-name bills frequently put them out merely for the sake of the acceptance commission they thereby obtain. In lieu of selling the bills themselves, they turn them over to others who lack the requisite facilities for drawing on London, and receive the customary fee in return. Those accommodated in this way are generally large stock brokerage houses or money brokers. They dispose of the drafts in New York, and either relend or utilize the proceeds in their own business. They procure the bills only upon giving satisfactory guarantee of furnishing the issuing banks with the exchange the latter will be obliged to remit to London as cover for the bills. This guarantee consists: (1) of immediately placing in the hands of the banks contracts of other prime institutions promising delivery of demand or cable exchange when the long bills fall due; and (2) of engaging to supply the

[1] See pp. 497–502 for a more detailed discussion of "futures," "hedging," and "forward contracts."

banks with the funds they will be required to pay on the future contracts, and to that end pledging with them stocks and bonds as collateral security." [1]

Loan bills and finance bills have for many years past played an extremely important part in the foreign exchange market. Before the World War it was customary for from $300,000,000 to $500,000,000 to be outstanding in the spring and early summer months when exchange rates were usually high with the possibility of a decline in the fall as the crops began to move toward European countries. Bankers, brokers, and large industrial concerns have made wide use of them as a method of obtaining money at low rates, in many cases as low as 1 to 1¼ per cent per year. London bankers, likewise, have been willing to act as acceptors and to receive their commission or their profits on joint accounts. They have also looked upon them favorably as a means of making loans to parties in other countries without as a rule entailing the exportation of gold.[2] Whenever exchange rates show a tendency to rise to higher levels, the banker immediately appreciates the opportunity of speculating on a possible decline, or it may be that he wants to build up his accounts abroad so that he may sell demand exchange against them and profit through the prevailing high exchange rates, or it may be that he has certain foreign obligations to meet and objects to paying such high exchange rates. Under these circumstances he will issue finance bills or loan bills. As Clare says in speaking of the situation between England and France, ". . . the bidding need only be raised a centime or two to tap an almost inexhaustible source of supply,—that of bankers' drafts." [3] A rising exchange market will normally bring forth a large supply of bankers' bills, which, because they increase the supply of exchange available, normally reduce the rates of exchange. In this way the floating of finance and loan bills usually keeps exchange rates from going to a point where it is profitable to export gold, and therefore assists in protecting the gold supply of the drawing country.[4] But it sometimes happens that the issuance of these bills may be the indirect cause of gold being drained from the country that has been drawn upon. A

[1] York, *op. cit.*, pp. 151–152.

[2] Finance and loan bills "afford the most powerful and cheapest means of raising money without the actual employment of gold." Gonzales, V., *op. cit.* p. 42.

[3] "The A. B. C. of the Foreign Exchanges," p. 29.

[4] "Finance bills of this kind, drawn in anticipation of shipments of produce, thus perform a most useful office by checking fluctuations in exchange, and expensive and clumsy

situation of this kind occurred in 1906 and 1907 between England, Germany, and France on the one hand and the United States on the other. Large amounts of corporation securities had been floated in the New York market in 1906, and in order to obtain the needed funds and also in order to take advantage of the high money rates existing here (with low discount rates abroad), enormous amounts of finance and loan bills were drawn on English, French, and German banking houses. The issuance of such large sums lowered the exchange rates, especially those on England, and started the flow of gold to this country. The movement of gold was aided both in the spring and in the fall by the Secretary of the U. S. Treasury depositing government funds with the importing exchange dealers, thus making the funds immediately available and saving the importers the loss of interest on the gold while it was in transit.[1] The net imports amounted to $103,000,000, which with the exception of the year 1898 were the greatest in the history of our country up to that date. The rates on England were further weakened by the large number of drafts drawn on London by insurance companies for the purpose of obtaining funds with which to pay the losses of the San Francisco earthquake and fire. The situation became rather critical for the foreign banks, especially for the Bank of England, the Bank of France, and the Reichsbank of Germany. The London money market was badly strained, and it appeared necessary, as an English writer of the time stated, "to restrict the creation of American credits on this [English] side of the ocean. For there is no doubt that the stringency in the money market would never have been so acute if Europe had not given excessive credits to America, who not only placed large amounts of finance bills in London, Paris and Berlin, etc., but began already, in the second half of the year, to place its railway debentures and railway 'notes' on the principal European money markets. All of the operations had to be liquidated by London, which was made responsible for the stringency that took place." [2] Another writer of the time also declared that "The London banks, by their treatment of New York finance bills, will decide whether the wild inflation of credit in the United States is to go on for another year or to be checked. So long as they accept and

shipments of gold from one side of the ocean to another. If they were abolished, the exchanges would tend to swing violently from one gold point to another, according as the movement of produce or the payment of other seasonal debts shifted the balance of claims from one country to another." Withers, H., "War and Lombard Street," pp. 84–85.

[1] Governmental aid ceased on October 23, 1906.

[2] Rozenraad, C., *Journal of the Institute of Bankers*, vol. 28, p. 206, April, 1907.

discount such bills, so long will the New York banks be able to buy gold in London, and the moment it is bought four more dollars may be lent against every dollar of it." [1] The Bank of England and the Reichsbank of Germany were forced to raise their discount rates, which made money dearer in those countries and thus made it unprofitable for American bankers to issue new bills or to renew the old ones at maturity. Banks in England, France, and Germany discriminated against the American bills, so that by 1907 there were but $25,000,000 to $30,000,000 outstanding in England with much smaller amounts in Germany and France. Temporarily the flow of gold toward this country was checked, and matters became somewhat more normal. During 1907, however, our exports of crops to England were extremely heavy, and an oversupply of sterling exchange was again created. The usual amount of maturing finance bills was not present in the market. Normally the demand for exchange with which to retire finance and loan bills always stiffens exchange rates somewhat during the fall and winter months. But with only a small amount of such bills to retire, and with only a slight demand for exchange with which to cover, the exchange rates on England fell below our gold import point and gold flowed into the United States in huge sums.

In the discussion of finance bills and loan bills we have continually stated that neither the American drawing bank nor the foreign accepting bank invests one penny of funds in the transaction. Just where, then, does the money come from? The answer is simple: It is the party that holds the bill until maturity that supplies the funds. As a rule, it is some discount house or bank in London. If the New York bank that purchases the long bill from the American issuing bank, gives instructions to its correspondent that the bill is to be presented for acceptance and held until maturity, the New York purchasing bank will under those circumstances furnish the funds with which the transaction is financed. On the other hand, if the New York bank instructs its London correspondent to have the bill discounted in London immediately upon acceptance, the money is advanced by the London bank or discount house that buys the bill, or, as we say, "the London discount market" advances the money. It is willing to do this, as has been noted earlier, because of the discount that is earned during the time that the bill is held.

The discount market, especially that of London, is very sensitive

[1] Lawson, W. R., *Bankers Magazine* (England), vol. 82, p. 468, Oct., 1906.

and carefully watches the amount of finance and loan bills that are issued bearing the acceptance of any one bank. As an English writer puts it, "Merely as a means of raising the wind temporarily, it [the issuance of finance and loan bills] is an easy and pleasant device so long as it does not excite suspicion." [1] The market has an uncanny way of keeping in touch with the amount of such bills that are offered for discount and, when once its suspicion has been aroused, it has no hesitancy in refusing to discount those bills that have been accepted by a London firm which it feels has "accepted" to too great an extent. Hints may be dropped that "so and so's" bills are too numerous, or a more unfavorable rate of discount may be asked when they are offered for sale, or the market may refuse absolutely to discount them, or some other action may be taken to show that the market feels that the accepting firm has exceeded its limit. Very seldom has this practice of issuing loan or finance bills been abused. Bankers and acceptance houses appreciate the fact that they must not arouse the suspicion of the market if they desire to retain their credit standing with it.

D. Traveler's Funds

American travelers, even in Canada, which has a monetary system practically the same as our own, find, as a rule, that American money cannot be used in foreign countries in making their purchases or in supplying their other needs. If they should take American money with them,[2] it would be necessary to have it exchanged at some money

[1] Lawson, *op. cit.*, p. 460.

[2] It is surprising, however, to learn what large amounts of American money are actually in circulation in foreign countries under the disturbed conditions caused by the World War, due in part to the great depreciation in the purchasing power of foreign monies. The Federal Reserve Bank of New York circularized banks and private banking houses in New York as to their shipments of United States paper money to and from foreign countries. The following tabulation covers the period from January 1 to April 30, 1921:

Country	*Imports*	*Exports*
Europe	$35,121,251	$105,168
Mexico and South America	1,773,062	1,355,000
Cuba and West Indies	12,257,779	9,684,500
Canada	2,318,662	20,000
Asia	687,239	.....
Africa	86,766	.....
Australia	3,690	.....
Country not reported	3,405,192	12,000
Total	$55,653,641	$11,176,668

An additional $22,500,082 in United States paper money was forwarded by the Federal Reserve Bank of New York to Cuba for the account of New York City banks. The actual total amount of exports of paper money is greatly in excess of the sum stated because of remittances by individuals and because of the amounts taken out of the country by travelers.

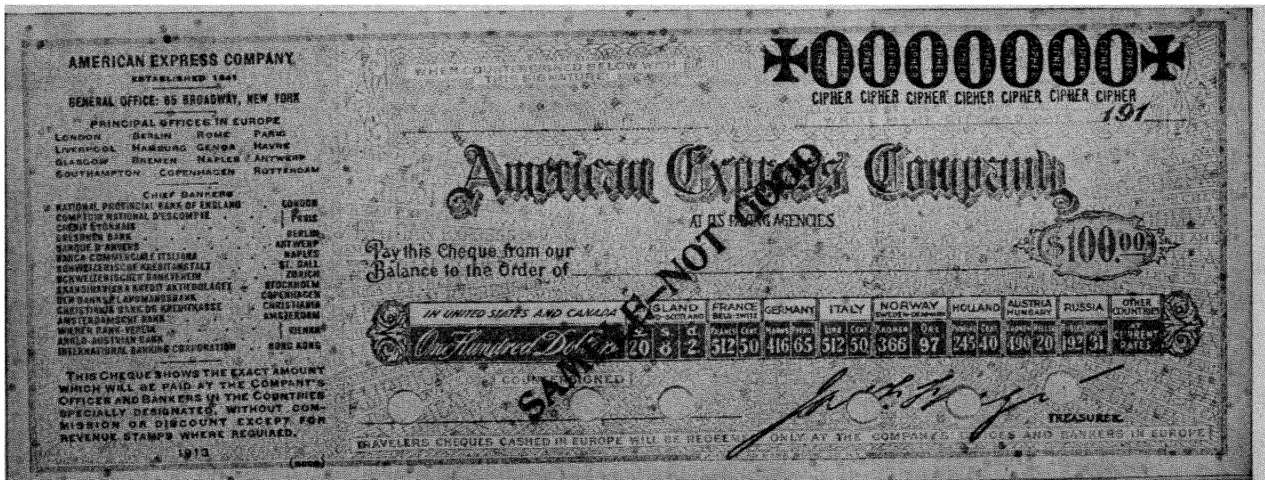


FIGURE 60

Old form of foreign traveler's check

changer's office or at some bank for the money of the country in which they were traveling. The rates of conversion in such cases in normal times are not usually satisfactory, so that the traveler takes the precaution of providing himself with the money of the country that he is to visit or with certain kinds of exchange documents that will furnish him with the needed funds when desired. He will usually resort either to traveler's checks or to a traveler's, or circular, letter of credit. We have already discussed the advantages and the methods of using traveler's checks and traveler's letters of credit in domestic travel. We may therefore confine our present discussion to their use in foreign travel.

Traveler's Checks. Before the great depreciation of the foreign exchanges occurred, the customary form of the traveler's check was as shown in Fig. 60. It was issued in denominations of $10, $20, $50,

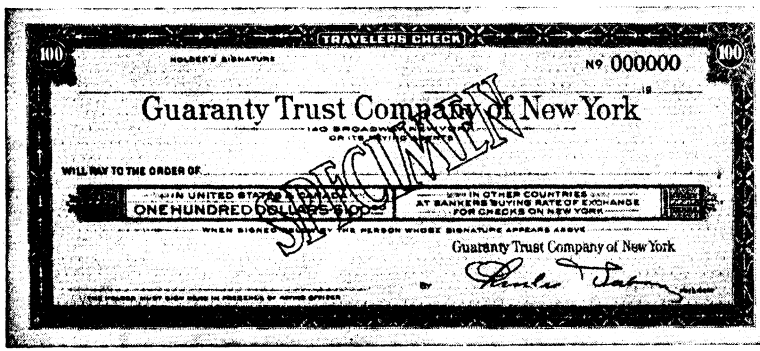


FIGURE 61

New form of foreign traveler's check

$100, and $200, and sold at the rate of face value plus one-half of one per cent commission, the selling bank or agent retaining the commission for its services as salesman. The express company or bank upon which the checks were issued received its return or profits through interest derived from the use of the funds until the checks were cashed. The old form of traveler's check was convertible into foreign monies at fixed rates. As shown on the accompanying check, for instance, a $100 check could be cashed abroad for £20 8s 2d in Great Britain, 512 francs and 50 centimes in France, Belgium, and Italy, 416 marks and 65 pfennigs in Germany, etc. If revenue stamps were required they had to be affixed by the holder when cashing the check, but other-

wise the rates of conversion remained as designated on its face. This arrangement was extremely handy for the traveler for he knew exactly how much his checks were worth in the country in which he was traveling, provided he cashed them at any of the branch offices or agents of the issuing express company or bank. If cashed elsewhere he might have to pay an additional, though slight, commission.

With the World War, the vagaries of exchange rates upset calculations and policies long followed, and it became necessary for banks and express companies to modify the form of their traveler's check, and also the method of conversion. Fixed rates of conversion were no longer possible, so the simplest thing to do was to issue a traveler's check payable at home in a fixed number of dollars, but payable abroad at the cashing banker's buying rate of exchange for sight drafts on New York (Fig. 61). This meant that the purchaser bought his traveler's check for $100 plus a one-half or three-fourths

FIGURE 62—American Express Company's franc traveler's check

per cent commission, and that when he cashed it in England he received in return $100 worth of English money calculated on the basis of the rate being paid that day for demand drafts on New York by the banker that cashed the check. If, for example, the English banker were buying demand drafts on New York at the rate of £1 for every $4.00 of American money, the traveler would receive £25 in return for his $100 traveler's check. As the exchange rates on the United States varied from day to day, he would receive varying amounts of foreign money for his traveler's checks. Another form that has been adopted has been a traveler's check payable in a fixed amount of money of one foreign country, but in all other countries made payable at the banker's rates for demand drafts on New York. Thus in the case of the above "French franc traveler's check" (Fig. 62), the American Express Company issues to the traveler a 200 franc check and charges him the franc rate for that day plus the usual commission. The traveler's check can be cashed in France for 200 francs, but if the traveler goes to London, his franc check will be converted by the London banker into English money at the rate that the banker is that day paying for demand franc drafts on Paris. In the case of a "sterling traveler's check," the check is drawn payable at a fixed amount of sterling, but if cashed in France or elsewhere it is converted at the banker's buying rate for demand drafts that day on London. If the traveler so desires, he may have a book of checks made up for him containing dollar, sterling, and franc traveler's checks, and thus save himself the trouble of having them converted into the money of some other country. A third variation has been introduced by the Bankers Trust Company of New York, which, as noted earlier, issues the A. B. A. Traveler's Checks. The form used by the latter bank and its agents provides that if a traveler is going to England he can buy a dollar traveler's check, such as we have described in Chapter III. When he reaches England he can go to the London office of the Bankers Trust Company and exchange his dollar checks for sterling checks at the banker's buying rate for demand drafts on New York. If he takes a notion to go to France, he can visit the Paris office of the Bankers Trust Company and exchange his sterling traveler's checks for franc traveler's checks at the banker's buying rate for demand drafts on London, and so on in the various countries in which the Bankers Trust Company has made similar arrangements with bankers and correspondents. When any of the above described forms of checks are cashed in any

country in which conversion is necessary, the rate at which it is converted includes a slight commission for the bank that makes the conversion.

If the traveler should lose his checks or they should be destroyed, he wires the nearest agent or the agent from whom they were purchased, and after he has put up an indemnity bond, the bank or express company will refund the face value of the lost or destroyed checks, or issue a new supply to him.

Traveler's or Circular Letter of Credit. When travelers plan to take with them more than $1,000 or its equivalent in foreign money they universally resort to a traveler's, or circular, letter of credit. A traveler's letter of credit is the oldest form of instrument used for the purpose of advancing funds to travelers and is still the one most widely used. The general form and methods of using such a document have been fully discussed in Chapter III. Only a few additional details, referring to its use in foreign travel, need be mentioned.

The general form of a traveler's letter of credit as used in foreign travel is practically the same as that for domestic purposes. It is customarily a four-page document, the first page bearing a printed letter addressed "To our Correspondents and other Bankers," requesting them to honor the drafts drawn against the letter by the accredited party. If the traveler is to remain in one country, it may be addressed only to a particular bank. The foreign circular letter is almost always drawn in terms of a foreign money, although it is sometimes drawn in dollars. The drafts that are drawn under it are almost universally ordered to be drawn against a designated foreign bank mentioned in the body of the letter, although the letter may require that they be drawn on the issuing American bank. The second page, sometimes both inside pages of the letter, contains columns in which are to be entered the dates on which drafts against the letter are paid, by whom, where, the amount in figures, and the amount in words.

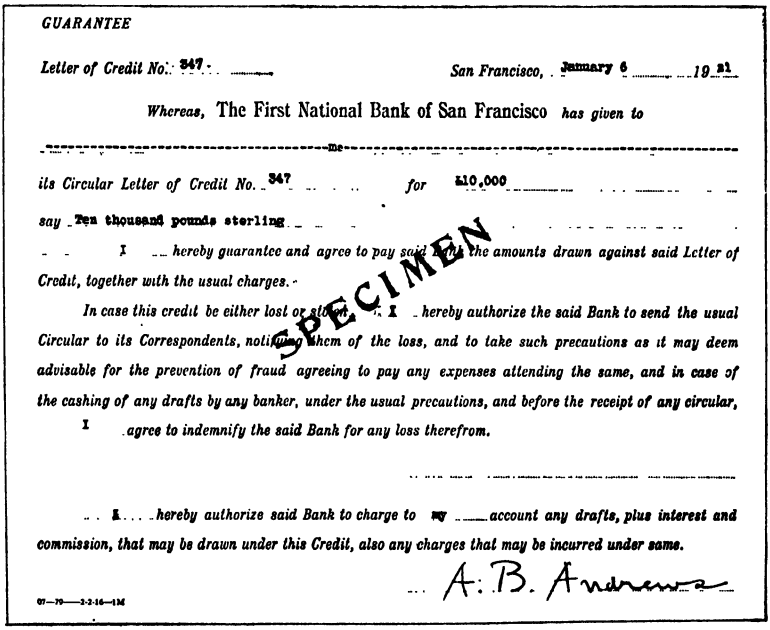
Let us say that Mr. Andrews goes to the First National Bank of San Francisco and applies for a £10,000 traveler's letter of credit. He may obtain it in return for a cash payment, that is, he may buy it outright by paying the value of £10,000 at the bank's selling rate for demand sterling exchange on that day. He may or may not have to pay a commission, but if it is exacted by the issuing bank, it is usually about 1/8 to 1/2 of one per cent of the face value of the letter. If the

banker's sight rate on England is 4.85 on that day, and if no commission is charged, Andrews gets his circular letter for $48,500. The bank gets the use of that sum of money while the letter is being drawn against, the amount available for the bank's use decreasing as drafts are cashed against the letter. If the traveler does not exhaust his letter, i. e., if he does not use all of the funds which it represents, the bank will buy the remainder from him upon his return, paying therefor the bank's buying rate for demand sterling drafts.

If the applicant is a depositor at the bank, enjoying a satisfactory credit standing, and also agreeing to keep on deposit an amount of money sufficient to protect the bank against loss, he may receive the letter of credit without making any payment at the time he gets it, or without depositing any security. He merely agrees to provide for the payment of the drafts together with the bank's charges. In this case, when the drafts drawn against the letter finally reach the First National Bank, it debits his account with the face value of the drafts plus its charges. The bank watches the account of the traveler so as to be sure that enough remains in it to meet all possible payments that may have to be made as the letter is drawn against. The bank may also issue the circular letter to the applicant upon a deposit of sufficient collateral to protect the bank against loss. Under these two methods the bank receives no money in advance, and therefore cannot count on gaining any interest on the use of the funds involved as was the case with the first method. Also, when the letter of credit has been drawn on the issuing bank's foreign account or deposit, say with Barclays of London, as the drafts drawn by the traveler are forwarded to Barclays and deducted by Barclays from the account of the issuing bank, the deposit of the latter with Barclays is to that extent reduced. It therefore loses interest on the amount involved from the time that its account is debited until it is reimbursed by debiting the account of the traveler or until it receives payment from him or from the guarantor of the letter of credit. As a consequence, if either of the last two methods is used, the bank will charge the traveler not only with the face value of the draft converted at the bank's selling rate on that day for demand sterling drafts together with its commission of one per cent, but also with an additional charge for the interest lost. Some banks charge interest only for the time that elapses from the debiting of their foreign accounts to the time that the draft reaches them, while others charge, in addition, interest

for the length of time that it takes for the "cover" to be sent to replenish their foreign accounts. It takes approximately seven days for mail to reach London from New York; some banks charge seven days' interest; others, however, make a charge for fifteen days. Banks located in the western part of the United States frequently charge fifteen or thirty days' interest.

The majority of traveler's letters are issued against a guarantee (Fig. 63) rather than against a deposit of collateral or for cash pay-



GUARANTEE

Letter of Credit No. 347 San Francisco, January 6 19 21

Whereas, The First National Bank of San Francisco has given to

me

its Circular Letter of Credit No. 347 for £10,000

say Ten thousand pounds sterling

I hereby guarantee and agree to pay said Bank the amounts drawn against said Letter of Credit, together with the usual charges.

In case this credit be either lost or stolen, I hereby authorize the said Bank to send the usual Circular to its Correspondents, notifying them of the loss, and to take such precautions as it may deem advisable for the prevention of fraud agreeing to pay any expenses attending the same, and in case of the cashing of any drafts by any banker, under the usual precautions, and before the receipt of any circular, I agree to indemnify the said Bank for any loss therefrom.

I hereby authorize said Bank to charge to my account any drafts, plus interest and commission, that may be drawn under this Credit, also any charges that may be incurred under same.

A. B. Andrews

07—70—2-2-16—1M

SPECIMEN

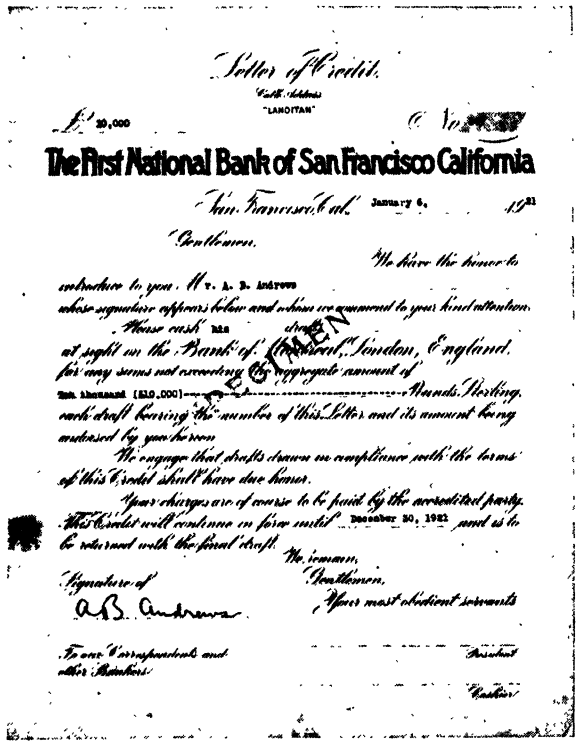
FIGURE 63

Foreign circular letter of credit agreement

ment. The letters of guarantee will vary as between banks, but usually follow a general type, guaranteeing that the issuing bank will be paid "the amounts drawn against said Letter of Credit, together with the usual charges," or that the traveler "hereby agrees and binds himself whenever notified of the payment of any or all drafts under said Credit, to provide for the payment of the same to you in Dollars, plus..... days' interest at..... per cent per annum, at the current rate of Exchange for your Sight Drafts on London, together with a commission

of..... per cent on the amount of the drafts made by virtue of this credit." When collateral is deposited the agreement provides that the bank is authorized to sell at any time, with or without notice, at public or private sale, any securities that may be held by it as collateral for the circular letter which it has issued.

When the clerk issues a circular letter he makes several copies. The



Letter of Credit.

"LANOITAN"

The First National Bank of San Francisco California

San Francisco, Cal. January 6, 1921

Gentlemen.

We have the honor to introduce to you Mr. A. B. Andrews whose signature appears below and whom we commend to your kind attention.

Please cash his drafts at sight on the Bank of England, London, England, for any sums not exceeding in aggregate amount of Ten thousand ($10,000)---------- Pounds Sterling, each draft bearing the number of this Letter and its amount being endorsed by you thereon.

We engage that drafts drawn in compliance with the terms of this Credit shall have due honor.

Your charges are of course to be paid by the accredited party.

This Credit will continue in force until December 30, 1921 and is to be returned with the final draft.

We remain,
Gentlemen,
Your most obedient servants

Signature of
A B Andrews

To our Correspondents and other Bankers

President

Cashier

FIGURE 64

First page foreign circular letter of credit

original goes to the traveler, one copy to the files of the issuing bank, and, in case the letter is addressed only to one foreign bank, on which the traveler will always draw his drafts, a copy is sent to it. When a business firm obtains a letter of credit for one of its traveling salesmen and guarantees the payment of drafts in the manner described above,

a copy may be given to it for its files. The copies are duplicates of only the first page of the letter.

One type of traveler's letters of credit bears the signature of the traveler on its face; the other type has the signature of the traveler appearing on the letter of indication which makes the first page of the small pamphlet containing a list of the bank's correspondents.[1] This

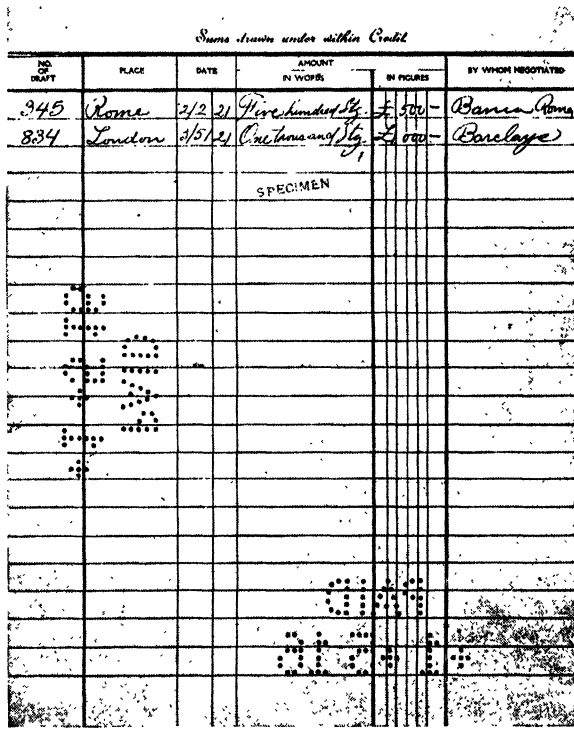


FIGURE 65

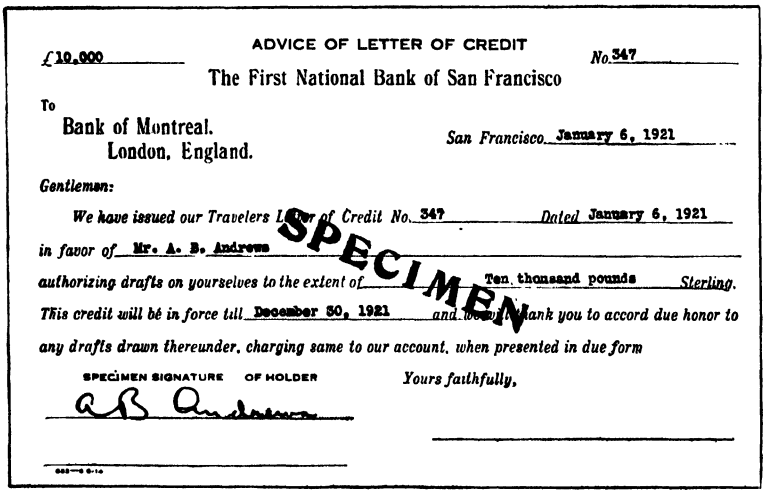
Second page foreign circular letter of credit

list of correspondents contains not only the names and addresses of the actual correspondents of the issuing bank with which it has an account abroad, but also, in case the letter is directed only to one foreign bank, the names of the correspondents of that foreign bank.

Let us say that Mr. Andrews gets his circular letter in sterling from

[1] Cf. pp. 54–55.

the First National Bank of San Francisco with the understanding that his account with that bank is to be debited with the face value of the drafts which he draws against his letter, converted at the bank's selling rate for sight sterling, plus commission and interest. The letter will be in the form on pp. 226–227 (Figs. 64–65). In this particular case the letter is issued in pounds sterling on the Bank of Montreal, London. The signature of the traveler appears on the face of the letter. The First National Bank clerk will also have Mr. Andrews sign a signature blank, which will be forwarded to the Bank of Montreal (Fig. 66).



£10,000 ADVICE OF LETTER OF CREDIT No. 347

The First National Bank of San Francisco

To

Bank of Montreal.
London, England.

San Francisco, January 6, 1921

Gentlemen:

We have issued our Travelers Letter of Credit No. 347 Dated January 6, 1921

in favor of Mr. A. B. Andrews

authorizing drafts on yourselves to the extent of Ten thousand pounds Sterling.

This credit will be in force till December 30, 1921 and we engage that drafts drawn hereunder will be duly honored by you.

We hereby engage with you to accord due honor to any drafts drawn thereunder, charging same to our account, when presented in due form

SPECIMEN

SPECIMEN SIGNATURE OF HOLDER

A B Andrews

Yours faithfully,

FIGURE 66

Advice of letter of credit

When Mr. Andrews arrives in Paris and finds that he is in need of funds, he leafs through the list of correspondents and notes that the Crédit Lyonnais is the Paris correspondent of the First National Bank. He thereupon presents himself at the exchange window of that institution and makes his wants known, handing the clerk the circular letter of credit. The clerk glances over it to see that the letter is still in force, i. e., that the expiry date has not passed, and also that the amount for which the letter was issued has not been exceeded. If in doubt concerning the form of the letter, he refers to his files and notes that the letter is on a form similar to the sample copies which have been received from the First National Bank when it established corre-

spondent relations. He may also wish to look up the signatures of the bank's officials attached to the letter, so he again resorts to his files and consults the signature sheet which the First National Bank has also sent to all of its correspondents, which sheet bears the printed signatures of the officers who are authorized to sign any of the documents issued by that bank (Figs. 16-17). Some banks will have but one sheet of signatures, while the larger banks with many branches will have a small sized book of fifty or more pages of signatures of the officials who sign documents for the various branches. If everything is in order, the clerk asks Mr. Andrews how much money he desires. The clerk then makes out a draft for, let us say, £50, drawn on the Bank of Montreal, writes thereon "Drawn under Letter of Credit No. 347 issued by the First National Bank of San Francisco," and passes the draft to Mr. Andrews to sign. The clerk then compares the signature on the draft with the one that appears on the circular letter of credit (or in the letter of indication if perchance it is that type of letter). If there appears to be no evidence of forgery, the clerk will pay Mr. Andrews as many francs as the £50 draft will buy at the prevailing rate for demand drafts on London, plus any commission that the correspondent may charge. Mr. Andrews will also have to pay any stamp duties or taxes that may be imposed. If the rate is 25.22 francs for £1, Andrews receives 1,261 francs. The clerk enters the data of the transaction on the second page of the letter and returns it to Andrews. The Crédit Lyonnais forwards the draft to its London correspondent which presents it to the Bank of Montreal for payment. Inasmuch as the Crédit Lyonnais makes its profit on the rate which it charges Andrews, the Bank of Montreal will have to meet no other obligation than the payment of the £50 draft. The clerk of the Bank of Montreal will look up the signature blank of Mr. Andrews, and compare his signature on the draft with the one that appears on the signature blank forwarded to it at the time the First National Bank of San Francisco issued the circular letter of credit. If everything is satisfactory the draft will be cashed and £50, plus any charges that may be made, will be deducted from the account of the First National Bank of San Francisco. The canceled draft or a statement to the same effect will be forwarded to the First National Bank, which in its turn will deduct a sum from Andrews' account equal to £50 in American money converted at the bank's selling rate for sterling sight drafts, plus commission and interest.

If the letter has been issued in *"dollars"* and the drafts are to be drawn *on the First National Bank* of San Francisco, the procedure is the same so far as the general features of the transaction are concerned. The draft will be drawn in dollars on the First National Bank, the Crédit Lyonnais will give Mr. Andrews as many francs as his dollars will buy at the rate charged by the bank, and the draft will be forwarded to an American correspondent of the French bank, either in New York or in San Francisco. The latter will present the draft to the First National for payment, and when paid, will credit the account of the French bank with the dollars collected. Otherwise the procedure is the same as in the case of the sterling letter. Some firms in the United States find it profitable to provide their salesmen with traveler's checks for small sums and with two letters of credit for large sums, one being drawn in sterling and the other in dollars, so that the salesman may take advantage of the more favorable rate of exchange.

"Fixed," "advised," or "restricted" letters of credit are frequently issued to clients who intend residing in a particular town or community. They are addressed to a specified bank, to which the issuing bank also sends a special "advice" containing the signature of the client, the amount for which the letter has been issued, the date of expiry, and other data. The beneficiary is expected to cash his drafts drawn against the issuing bank or its designated correspondent only at the bank to which the letter is addressed. The procedure followed in cashing drafts against the letter is the same as in the example first given.

Some American banks have lately inaugurated the practice of furnishing books of bank drafts to their clients who have obtained a circular letter of credit from them. These bank drafts bear the number and date of the circular letter of credit, thus avoiding one source of confusion, and enable the bank to segregate more easily from the day's mail those drafts that have been issued under its circular letters.

The smaller banks have no correspondents abroad against whom they may issue circular letters, so they arrange with exchange dealers in nearby financial centers either to have such letters issued on blanks bearing the local bank's name or else the name of the exchange dealer. For instance, the State Bank of Evanston, Illinois will arrange with the Continental and Commercial Bank of Chicago to issue such letters on the Bank of Scotland, London, England. The Evanston bank will fill out the letter form, bearing its own name and address. Signatures

will be taken from the applicant and forwarded with the letter to Chicago. The Chicago bank will make the necessary entries in its books, send the signatures and required advices to the Bank of Scotland, London, and after its own officials have signed the letter [1] will return it through the Evanston bank to the applicant. When the traveler goes abroad, draws and cashes his drafts, they are forwarded to the Bank of Scotland, which debits the account of the Continental and Commercial Bank. They are then sent to the Chicago bank which will figure out its charges and deduct the same from the account of the Evanston bank, forwarding a statement thereof for the latter's information. More often, however, exchange dealers do not allow a local correspondent to issue circular letters in this manner, but require that the applicant obtain the letter direct from them in the same way as would be done by one of their own customers, the local correspondent merely acting as the agent of the issuing bank, forwarding the necessary signatures, the funds for cash payment, etc.

Previous to the World War, all traveler's letters were issued only against foreign banks, usually in terms of pounds sterling. Now, however, an increasingly large number are being issued by American banks upon themselves, the drafts to be drawn in dollars as above described.[2] In 1915 a few of the larger New York banks originated a new form of traveler's letter which was a combination of the old-fashioned traveler's check with fixed rates of conversion and the ordinary traveler's letter of credit. The letter was issued in dollars, but when the traveler drew his drafts, he drew them in pounds, francs, marks, or in the money of any country in which he happened to be traveling. The drafts were then converted at the offices of the foreign correspondents designated by the issuing bank, at fixed rates (like those on the old-fashioned traveler's check [3]), which conversion rates were printed on the second page of the letter. Thus, if he drew a draft on the issuing

[1] This is necessary because the foreign correspondent does not have copies of the signatures of the officials of the Evanston bank.

[2] "Merchants are coming more and more to use American Express Traveler's Checks and Circular Letters of Credit drawn in dollars for trading in Central and Eastern Europe, our European offices report. Both these forms of financial paper are desirable for this purpose because they are so readily accepted and so widely available, at the same time combining the advantage of being issued in a stable currency.

"Traders who follow this practice are usually able to obtain considerable concessions over quoted prices by reason of being ab e to pay cash. Another advantage is that these forms of paper are so fami iar throughout Europe that it is possible by approaching several banks to get at all times the best rate of exchange." Foreign Trade Bulletin of the American Express Company, January–February, 1922.

[3] Cf. p. 219.

bank for $100 and presented it at the Paris correspondent's office, he would receive $100 worth of francs at the fixed rate of conversion thereby avoiding the uncertainties arising from the fluctuating rates of exchange and also the exorbitant rates frequently charged by certain classes of foreign exchange dealers. As a result of the extremely wide variations in the exchanges, which followed shortly after this new form was adopted, it had to be abandoned, but there is no good reason why it should not again be used when conditions return to normal, embodying as it does all the advantages of the traveler's check and the traveler's letter of credit.

E. Means by Which Creditors Secure Payments Due Them

The remaining group of exchange documents comprises those that enable creditors to obtain payments due them for things sold, services rendered, money loaned, etc.

Drafts Drawn without Commercial Letters of Credit, etc. An exporter will often use the trade acceptance as a means of obtaining payment for goods which have been sold to a foreign customer. This is the case, however, only where the two parties have had extensive dealings with each other and where the exporter has faith in the credit standing of the importer. When the goods are ready to be shipped and all the documents have been prepared, the exporter draws his draft directly on the importer, as per agreement, and sells the bill of exchange to his banker or hands it to him for collection. In either case, the importer accepts the draft when it is presented by the foreign correspondent of the American bank, and pays the draft at maturity or under rebate, depending upon whether the instructions are D/A or D/P respectively. As was noted in Chapter VII [1] it is not unusual for an exporter to sell goods to a foreign customer of excellent standing with the agreement that three months after the goods have been shipped, or possibly at the end of thirty days, a draft is to be drawn on the customer for the amount involved. The draft when drawn is sold to an exchange dealer or turned over to him for collection. Importers frequently run open accounts with exporting firms with the understanding that a draft for the amount due shall be drawn on them every month.[2] Such an arrangement is customary between American

[1] Cf. p. 139.
[2] Or the importer may remit monthly to the exporter.

firms and their foreign branches. Parties rendering professional services at the request of foreign firms or for individuals residing abroad usually draw drafts against their clients as per agreement and receive their fees or salaries in American money through the sale of their drafts to exchange dealers. American agents of foreign insurance companies, who desire to obtain funds from their home offices with which to make payments of losses, salaries, etc., do not wait for remittances to come from abroad, but draw drafts against their companies, sell them in the open market, and thus get the needed funds. In the late spring and early summer of 1906 foreign exchange rates were rather seriously weakened by the drawing of such drafts in large amounts in connection with payments made necessary because of the San Francisco earthquake and fire of that year.

Another very customary use of drafts in this connection is where they are drawn against securities which American stock and bond houses have sold to foreign clients. An order will come to a stock and bond house to buy 100 shares of Southern Pacific stock when the quotation in the market has reached a certain point. The stock is purchased by the bond house, a draft is drawn against the foreign customer for the amount of the sale plus the commission, and, with the bonds attached as collateral security, the draft is sold to an exchange dealer. Drafts of this sort find a ready market and always command high rates in the market for the reason that the credit of the drawer and of the drawee is further enhanced by the attached securities.

Commercial Letters of Credit. Commercial letters of credit, sometimes called "mercantile letters of credit," and how they function in domestic trade, have been rather fully discussed in Chapter III. Mention was made of the fact that business men were as yet but slightly acquainted with their use in that connection, but that they were commonly employed in foreign trade in the financing of exports and imports. There are so many types of import and export credits that it is advisable to devote a separate chapter to a discussion of their characteristics and varied uses.

CHAPTER IX

IMPORT AND EXPORT CREDITS

Exporters may agree to sell to foreigners, first, only for cash, i. e., cash to accompany the order, in which case the importer obtains the necessary amount of exchange on the exporter's country, usually a banker's sight draft, and sends it with his order. Or, second, the goods may be sent on open account, the agreement being that the foreigner is to remit for the goods when received, or that he is to pay for them at the end of a stated period, say within thirty or sixty days, or that the exporter is to draw a sight draft on him at the end of that time. In either of the last two cases, of course, the importer gets his documents and his goods without having to pay for them and without having to accept any draft before obtaining possession. Or, third, the exporter may draw a sight draft on the importer at the time the goods are shipped and thus compel him to pay for the goods before he gets them. Or, fourth, he may draw a long time D/P bill and send it along with the documents, which accomplishes the same result, because the importer cannot get the goods until he pays the draft. Or, fifth, he may draw a long time D/A bill on the importer, i. e., a trade acceptance, which is seldom done in foreign trade unless the exporter has implicit faith in the credit of the importer, or unless the latter has arranged for an "authority to purchase." Or, sixth, the goods may be sent to the importer under the terms of a commercial letter of credit, which of all the practices followed is the most important and the one most commonly employed.

Under a commercial letter of credit, the importer really substitutes the credit of a bank or accepting house for his own credit. We shall use the term "bank" in the subsequent discussion as including all classes of exchange dealers that are concerned with export or import credits. The exporter frequently does not know the standing of the importing firm, or if he does he may be unwilling to assume the risks involved in connection with shipping solely on that basis. American bankers and exporters have been extremely slow in accumulating credit information concerning foreign firms. An exporter is not

desirous of shipping goods to a foreign importing company unless he is assured of receiving payment. The foreign firm hesitates to send cash with its order because there have been many instances where exporters have failed in business before the goods have been shipped, thus causing a loss to the importers. Also, certain abuses of the trade which we do not need to consider have been fairly common among exporters when cash has been sent along with the order. Another reason why the importer does not wish to send cash with his order is that he does not care to stand the loss of interest on the money invested in the remittance. If, on the other hand, the goods are sent to him on any basis that approximates our domestic "C. O. D.," he does not particularly enjoy the prospect of having to pay cash for his goods before having a chance to inspect them. The importer much prefers to obtain possession of his goods, to have about three months or longer in which to dispose of part or all of them, and thus to put himself in funds so that he may meet the payment when due. But as we have seen, the exporter prefers not to enter into any such arrangement unless he is definitely assured as to the possibility of getting his money. The greatest advantage arising from the use of such import and export letters of credit and from the substitution of the bank's credit for that of the importer or the exporter is that the bank or the discount market carries the burden of financing the transaction. If the drafts covering an export of goods are drawn on the importer, the amount of such bills that a bank will negotiate for the exporter is limited by the financial standing and credit of the latter. But if the drafts are drawn under a commercial letter of credit against a foreign bank, the amount that the exporter's bank will then negotiate for him is practically unlimited. The exporter is able to get his money out of the transaction as soon as his shipment is ready and his documents have been sold to the bank. He can, therefore, finance many more export shipments than would be the case if he had to tie up his capital in them for an indefinite length of time. The importer also benefits from the use of a commercial letter of credit. He is not required to advance any of his own funds in order to import goods or to obtain possession thereof. He uses the credit of the accepting bank. He can therefore conduct a business of a much greater extent than if he had to depend solely upon his own resources. It is because of these reasons that the importing firm, having corresponded with the exporter as to the cost of the goods, the terms of sale, etc., and an agreement having been

reached between the two contracting parties regarding all details of the proposed transaction, goes to its bank and asks for what, under the circumstances, is known as an "import letter of credit." If a commercial letter of credit is requested by an exporter for the purpose of financing exports, it is known as an "export letter of credit." [1]

Commercial letters of credit are usually for large amounts. Banks ordinarily refuse to issue them for less than $500, sometimes for less than $1,000, because of the bother involved in handling small sums. It must be remembered that the commercial letter of credit itself is not a bill of exchange, but merely a means through which or by means of which a bill of exchange is brought into existence. Such bills may be either clean or documentary, demand or time, D/A or D/P. Commercial letters of credit have been used extensively by American merchants only since 1914.

Import Letters of Credit. In order to make our problems as simple as possible, let us first consider the intricacies of a "dollar" import letter of credit, issued to the American Importing Company of New York City by the Guaranty Trust Company of New York, covering the importation of a shipment of silk from the Asaki Silk Company of Yokahama, Japan. The silks are valued by the exporter at 40,000 yen. When asked by the American importer to quote prices, the Asaki Silk Company goes to its bank, the Sumitomo Bank Ltd., and obtains from it a contract in which the bank agrees to buy the exporter's draft on an American bank covering the shipment at the rate of 2 yen per dollar. The exporter is able to obtain this satisfactory rate because the draft will subsequently become a banker's acceptance, which involves little or no risk for the Japanese bank that has agreed to buy the draft. The exporter obtains this "forward" quotation in order to avoid the possibility of a loss through fluctuations in the exchange rate which may take place between the time that it advises the importer as to the cost of the goods and the time that the draft is sold to the Japanese bank. In quoting prices to the American Importing Company the exporter is thus able to advise that the silks will cost $20,000 (40,000 yen ÷ 2). It notifies the importer that shipment will be made only under a commercial letter of credit. All other matters concerning the shipment and the costs thereof having been definitely settled between the exporting and the importing firms, the American Importing Company goes to the Guaranty Trust Company of New York

[1] Cf. pp. 260–268.

Guaranty Trust Company of New York
APPLICATION FOR LETTER OF CREDIT

New York, *Jan. 2, 1921.*

TRANSFERRED FROM LETTER BY.....CABLE PREPARED BY.....CREDIT PREPARED BY.....DIV.....
APPLICATION CHECKED BY.....CABLE CHECKED BY.....CREDIT CHECKED BY.....HEAD.....

GUARANTY TRUST COMPANY OF NEW YORK
FOREIGN DEPARTMENT
Import Division
New York City

GENTLEMEN;

Please issue an Irrevocable Letter of Credit by ~~cable~~ ~~mail~~

For account of _____

In favor of *Asaki Silk Company*

Amount *$20.000.00* available by drafts at *Four(4)Months sight.*

against documents as follows:

Bills of Lading reading "Received for Shipment" or otherwise worded to same effect are acceptable against this credit. Bills of Lading / Invoice / Consular Invoice

other documents _____

covering Full 75%? invoice value of C. I. F., ~~C. & F., F. O. B., F. A. S.~~ (cross out all but one) Shipments

Raw Silk

to be shipped from *Yokohama.* to *New York City*

Drafts to be negotiated on or before *March 31, 1921.*

Insurance to be effected by *Shippers* (Shipper or Purchaser)

Partial shipments are to be permitted.

Special Instructions _____

The Letter of Credit is subject to your usual terms and conditions, and in consideration of the issuance thereof we agree to reimburse you on demand, and we hereby authorize you to charge our account with you with any and all amounts for which you are liable thereunder, plus your commission and charges.

Neither you nor your correspondents shall be responsible for the description, quantity, quality or value of the merchandise shipped under this credit, nor for the correctness, genuineness or validity of the documents, nor for delay or deviation from instructions in regard to shipment, nor for any other cause beyond your control.

Very truly yours,

American Importing Co.

New York City

The Guaranty Trust Company of New York does not assume responsibility for any inaccuracy, interruption, or delay in the transmission or delivery of messages by cable.

FIGURE 67—Application for commercial letter of credit

and asks for a commercial letter of credit, say for $20,000. It advises the bank as to the terms of the letter that is desired, the amount for which the drafts are to be drawn, by whom the insurance is to be effected, etc. If the bank is willing to issue the letter it may ask the importing firm to fill out an "Application for Commercial Credit" blank (Fig. 67) and a "Letter of Guarantee" (Fig. 68).

New York,——————*19*__

To the

GUARANTY TRUST COMPANY OF NEW YORK

Gentlemen:

Having received from you the Letter of Credit on——————*account of which a true copy is on the other side,* $\frac{I}{we}$ *hereby agree to its terms, and in consideration thereof* $\frac{I}{we}$ *agree with you to provide in New York, one day previous to the Maturity of the Bills drawn in virtue thereof, sufficient funds in cash, to meet the payment of the same with*——————*per cent commission, and* $\frac{I}{we}$ *undertake to insure at* $\frac{my}{our}$ *expense, for your benefit, against risk of Fire or Sea, all property purchased or shipped pursuant to said Letter of Credit, in Companies satisfactory to you.*

$\frac{I}{We}$ *agree that the title to all property which shall be purchased or shipped under the said credit, the bills of lading thereof, the policies of insurance thereon and the whole of the proceeds thereof, shall be and remain in you until the payment of the bills referred to and of all sums that may be due or that may become due on said bills or otherwise, and until the payment of any and all other indebtedness and liability now existing or now or hereafter created or incurred by* $\frac{me}{us}$ *to you on any and all other transactions now or hereafter had with you with authority to take possession of the same and to dispose thereof at your discretion for your reimbursement as aforesaid, at public or private sale, without demand or notice, and to charge all expenses including commission for sale and guarantee.*

Should the market value of said merchandise in New York, either before or after its arrival, fall so that the net proceeds thereof (all expenses, freight, duties, etc., being deducted) would be insufficient to cover your advances thereagainst with commission and interest, $\frac{I}{we}$ *further agree to give you on demand any further security you may require, and in default thereof you shall be entitled to sell said merchandise forthwith, or to sell "to arrive," irrespective of the maturity of the acceptances under this Credit,* $\frac{I}{we}$ *being held responsible to you for any deficit, which* $\frac{I}{we}$ *bind and oblige* $\frac{myself}{ourselves}$ *to pay you in cash on demand.*

In case $\frac{I}{we}$ *should hereafter desire to have this credit confirmed, altered or extended by cable (which will be at* $\frac{my}{our}$ *expense and risk),* $\frac{I}{we}$ *hereby agree to*

hold you harmless and free from responsibility from errors in cabling, whether on the part of yourselves or your Agents, here or elsewhere, or on the part of the cable companies.

This obligation is to continue in force, and to be applicable to all transactions, notwithstanding any change in the composition of the firm or firms, parties to this contract or in the user of this credit, whether such change shall arise from the accession of one or more new partners, or from the death or secession of any partner or partners.

It is understood and agreed that if the documents representing the property for which the said Credit has been issued are surrendered under a trust receipt, collateral security satisfactory to the Trust Company, such as stocks, bonds, warehouse receipts or other security, shall be given to the Trust Company, to be held until the terms of the credit have been fully satisfied and subject in every respect to the conditions of this agreement.

It is further understood and agreed in the event of any suspension, or failure, or assignment for the benefit of creditors on $\frac{my}{our}$ *part, or of the nonpayment at maturity of any acceptance made by* $\frac{me}{us}$ *of the nonfulfillment of any obligation under said credit or under any other credit issued by the Guaranty Trust Company of New York on* $\frac{my}{our}$ *account, or of any indebtedness or liability on* $\frac{my}{our}$ *part to you, all obligations, acceptances, indebtedness and liabilities whatsoever shall thereupon, at your option then or thereafter exercised, without notice, mature and become due and payable.*

It is understood and agreed that you shall not be held responsible for the correctness or validity of the documents representing shipment or shipments, nor for the description, quantities, quality or value of the merchandise declared therein.

(*Signature*) _____

FIGURE 68

Agreement signed by applicant for commercial letter of credit

Or the bank may ask the importing firm to fill out a blank which is both an application and a letter of guarantee. Most blanks are of the latter type. The application, usually printed, although sometimes typewritten, supplies data concerning the amount for which the letter is to be issued, the usance of the drafts, the party by whom they are to be drawn, the duration of the letter, the date before which the drafts must be drawn and negotiated, by whom the insurance is to be effected, the date before which shipments must be made, and various other details regarding the number and kind of documents that must be provided, to whom they are to be sent, how indorsed, etc. The "guarantee," as will be noted from the above form, advises the bank that the appli-

cant will provide it with funds with which to meet the drafts when they mature, that all expenses are to be paid by the applicant includ-

Import Letter of Credit (Dollars)

Credit No. 184567

Guaranty Trust Company of New York
Foreign Department

For $20,000—U.S.C.

New York, February 11, 1921

Messrs Asahi Silk Company,
Yokohama, Japan

Gentlemen;

At the request and for the account of The American Importing Company, New York we hereby authorize you to value on Guaranty Trust Company of New York, New York by your drafts at Four (4) Months eight for any sum or sums not exceeding a total of Twenty thousand dollars ($20,000) accompanied by commercial invoice, consular invoice, bills of lading Marine [redacted], insurance certificates representing cost, insurance and freight shipment of Raw Silk from Yokohama, Japan, to New York

Insurance Marine [redacted] insurance to be effected by the shippers

Bills of lading for such shipments must be drawn to the order of THE GUARANTY TRUST COMPANY OF NEW YORK, unless otherwise specified in this credit.

A COPY OF THE CONSULAR INVOICE AND ONE BILL OF LADING MUST BE SENT BY THE BANK OR BANKER NEGOTIATING DRAFTS, DIRECT TO THE GUARANTY TRUST COMPANY OF NEW YORK, NEW YORK.

THE AMOUNT OF EACH DRAFT NEGOTIATED TOGETHER WITH THE DATE OF NEGOTIATION MUST BE ENDORSED HEREON.

We hereby agree with bona fide holders that all drafts drawn by virtue of this Credit, and in accordance with the above stipulated terms, shall meet with due honor upon presentation at the Guaranty Trust Company of New York, New York, if drawn and negotiated on or before May 31, 1919

Guaranty Trust Company of New York

N. B.—All drafts drawn under this Credit must bear clause "drawn under G. T. Co. of N. Y. Letter of Credit No. 184567 dated New York, Feb. 11, 1921 to cover shipment of Raw Silk from Yokohama to New York

FIGURE 69
Dollar import letter of credit

ing the bank's commission, that title to the goods is to rest in the bank until the applicant has met his obligations, that the bank may take steps at any time to protect itself against loss, etc. An interesting clause that should not be overlooked declares that if the merchandise should decline in value either before or after its arrival, thereby possibly causing the bank to suffer a loss, the applicant will either provide additional security as required or allow the bank immediately to possess itself of the goods and sell the same and also that the applicant will reimburse the bank for any losses incurred by it. A copy of this document is given to the applicant for his files.

After the applicant has filled out the above form or forms, the bank clerk takes a commercial letter of credit blank (Fig. 69) and fills in the spaces in accordance with the data supplied on the application. The importing firm may or may not be required to put up collateral security.

The terms of the letter, the details of which vary from bank to bank, universally direct the exporter to draw a draft or drafts on the issuing bank covering the value of the goods which are to be forwarded.[1] The amount of the credit, the date of its expiry, how the documents are to be prepared, how many and what kinds, possibly upon what steamer or steamship line the goods are to be sent, these and all other necessary directions are contained in the body of the letter of credit. In brief, it is a statement by the issuing bank that it will accept drafts drawn on it by the exporter and that it will meet them at maturity provided goods are sent and documents are drawn in accordance with the directions contained in the letter of credit. The letter of credit seldom alludes to the sales contract between buyer and seller because the issuing bank has no direct concern in the terms of such contract or in any controversy that may arise over the merchandise to be imported. "Moreover, the banker negotiating the drafts under the letter would look with disfavor upon the inclusion of commercial details which he is unable to verify. In fact, a credit burdened with such stipulations, would prove of little value, as foreign banks generally would refuse to negotiate the drafts. On the other hand, some banks feel obliged to protect the interests of their clients, and this explains the considerable number of institutions reporting that

[1] Cf. *Federal Reserve Bulletin*, April, 1921, pp. 410–415, "Forms of Commercial Letters of Credit."

they do refer to the sales contract in their letters of credit. Such mention is made to a varying degree. In some cases the terms of the credit merely follow the stipulations of the contract in a general way. Other banks go to the extent of specifying the grade, quantity, and price of the merchandise." [1] Still others request "a declaration, furnished by the accredited party, that the goods were shipped in accordance with the terms of the contract between the buyer and seller." [2] Where the letter of credit incorporates some or all of the terms of the contract of sale, such terms become part of the letter of credit and both the issuing bank and the exporter (seller) are bound by them. The issuing bank has the right to refuse to accept the draft as drawn by the exporter unless he has completely followed the terms of the letter of credit. If the terms of the sales contract *are not* included, the letter of credit and the sales contract are two separate and distinct documents, and have been so declared by various courts. In case there is any breach, dispute, or default of the sales contract, where it is a separate document, the aggrieved party has a right of action at law to recover damages, but such breach or default cannot in any way affect the contract between the bank and the seller, or between the bank and the buyer as contained in the letter of credit.[3]

A commercial letter of credit is usually issued in duplicate, one copy for the files of the applicant, the other to be sent to the exporter. The issuing bank either keeps a carbon copy or makes a record of the transaction for its files. "The importer at whose instance the credit is opened may choose to have the exporter notified by cable or mail. If by mail, the bank hands the letter to the importer, who forwards it to the beneficiary. If by cable, the bank usually communicates with its correspondent nearest the point of shipment.[4] When it is definitely known through which bank the exporter will negotiate his drafts, the letter is then sent to this institution." [5] The exporter is ordinarily free to sell his drafts to any bank willing to negotiate them, although under certain conditions he may be limited by being required by the terms of the letter of credit to negotiate the drafts only

[1] *Federal Reserve Bulletin*, February, 1921, p. 166.

[2] *Ibid.* The *Federal Reserve Bulletin* of February, April, June and October, 1921, contains the results of a most excellent study of commercial letters of credit made by Mr. George W. Edwards of the Division of Analysis and Research of the Federal Reserve Board. A portion of the following discussion is based to some extent upon the data there presented.

[3] Cf. American Steel Company vs. Irving National Bank, 233 Fed. 41.

[4] Cable notifications are subsequently confirmed by mail.

[5] *Federal Reserve Bulletin*, February, 1921, p. 166.

at the bank so designated in that document. Exporters object to being restricted in this regard because it compels them to deal with a strange bank which as a rule will not give them so good a rate on their drafts as will the bank with which they have long been accustomed to carry on their financial relations. Sometimes copies of the letter of credit are sent to the exporter by separate steamers so as to lessen the possibility of delay in case one of the letters is lost in transit. "However, duplicate letters offer the opportunity of presenting drafts and letter to one bank and repeating the same operation with a second bank. To prevent a fraud of this nature, banks place negotiators on their guard by indicating clearly in the duplicate form that an original is in existence." [1]

The Asaki Silk Company, upon receiving the letter of credit, prepares the shipment, procures the various sets of documents as required by the terms of the letter of credit, draws a draft, one for each set of documents, a "first," "second," etc., and goes to the Sumitomo Bank Ltd. to sell its documentary bill of exchange. The draft will be drawn on the Guaranty Trust Company of New York, (not on the American Importing Company), for $20,000. Notation will be made on the draft that it is drawn under "Number 134567 letter of credit issued by the Guaranty Trust Company of New York." If the letter of credit were to cover two or more shipments, the Sumitomo Bank Ltd., when it bought the bills of exchange, would indorse the amounts and the dates on the back of the letter of credit, so as to avoid the possibility of any fraud arising.[2] The bank clerk looks over the documents to see that they are in order and in accordance with the terms of the letter of credit, and if everything is satisfactory the Asaki Silk Company will receive 40,000 yen for the documentary bill of exchange as per the "forward" contract mentioned above.

The Sumitomo Bank Ltd. then indorses the documents and forwards them to its correspondent in New York,[3] which in this case happens

[1] *Federal Reserve Bulletin*, February, 1921, p. 167.

[2] "American banks issuing import letters of credit uniformly require that foreign banks indorse on the reverse side particulars of all drafts negotiated. This precaution is taken to prevent an unscrupulous foreign exporter from presenting his letter and shipping documents simultaneously to several banks and thus overdrawing his credit." *Federal Reserve Bulletin*, February, 1921, p. 165.

[3] It is customary for the foreign purchasing bank to forward the documents to the accepting bank through a correspondent. But in case of banks located in China that are correspondents of the American accepting bank, it is customary to forward the documents direct to the accepting bank, which after accepting the draft will as a rule sell its own

to be its New York branch, with instructions to present the draft to the Guaranty Trust Company for acceptance and then to discount it in the open market.[1] Whether or not the letter of credit will accompany the draft that exhausts the credit will depend entirely upon the practice of the beneficiary, the Asaki Silk Company. The general rule is that the letter of credit is not attached to the final draft, although the tendency at present seems to be to return the original credit.[2]

When the documents have reached New York, the correspondent of the Sumitomo Bank, Ltd. presents the draft to the Guaranty Trust Company for acceptance. Under a commercial letter of credit the documents always go forward under "D/A" instructions, because of the unquestioned credit of the issuing bank upon which the draft is drawn. Therefore when the Guaranty Trust Company accepts the draft, it detaches the documents and returns the accepted draft to the presenting correspondent which, following instructions, has it discounted immediately in the open market at the prevailing rate for banker's acceptances, and credits the sum obtained to the account of the Sumitomo Bank, Ltd. In this manner, the Japanese bank builds up its account in the United States against which it may sell exchange in the future. If the draft has been drawn in duplicate, the New York correspondent does not wait for the second set to appear before presenting the draft for acceptance. The first set to arrive and to be accepted nullifies all other sets.[3] The documents are usually sent by fast steamers, one set to a boat to guard against possibilities of loss, while the goods are forwarded by ordinary freighters; but it sometimes happens that the goods arrive ahead of the documents.

The Guaranty Trust Company, having the shipping documents in hand, notifies the importing firm to make arrangements for their release. It may turn the documents over to the American Importing Company without taking any sort of security and without asking it to sign anything other than just a receipt. This is done only where the bank has implicit faith in the importer. It is more customary to

acceptance in the open market just as though it were the acceptance of some other bank, although at times, however, it will hold its accepted draft until maturity.

[1] The instructions from the Japanese bank may, however, be to the effect that the draft is to be presented for acceptance and then held until maturity.

[2] *Federal Reserve Bulletin*, February, 1921, p. 165.

[3] In Holland it is not legal for drafts to be presented for acceptance until the duplicate has arrived; the banker must have all sets of the documents in his possession before accepting.

ask the importer for a trust receipt,[1] the terms of which will vary somewhat depending upon just what the importer wishes to do. Many banks use the same printed form for all purposes, but usually different forms are used for different conditions. If the importer wishes to obtain the documents so that the goods may be warehoused upon

TRUST RECEIPT

(DOCUMENTS FOR WAREHOUSING)

Received from THE GUARANTY TRUST CO. OF NEW YORK Bill of Lading per_____ dated_____ for the following goods and merchandise, their property, marked and numbered as follows:

imported under the terms of Letter of Credit No._____, issued by them for {my / our} account the said Bill of Lading to be used by {me / us} for the sole purpose of entering the above described property at the United States Custom House at the Port of _____ and of storing the same in the name, and as the property, of the said THE GUARANTY TRUST CO. OF NEW YORK, and subject only to their order, {I / we} hereby agreeing to so store the said property and to hand the storage receipt for the same to the said THE GUARANTY TRUST CO. OF NEW YORK, when obtained.

{I / We} ALSO AGREE to fully insure said property against fire, the loss, if any, payable to said THE GUARANTY TRUST CO. OF NEW YORK, and to hand to them the policies of insurance thereon.

Dated_____ 192

(Signed)_____

£_____

FIGURE 70

Trust receipt (documents for warehousing)

arrival, the bank will take from him the above type of trust receipt (Fig. 70).

[1] The practice of using the trust receipt seems to have originated in the United States. It is not found in any other country. In the early days it was called "the red letter" because it was generally printed in red ink to emphasize its nature and intent. The *Federal Reserve Bulletin*, January, 1922, pp. 32–37, contains an excellent discussion of the trust receipt.

If he is to have access to the goods for the purpose of selling them to his customers, the following form of trust receipt will be used (Fig. 71):

TRUST RECEIPT

Received from THE GUARANTY TRUST CO. OF NEW YORK the following goods and merchandise, their property, specified in the Bill of Lading per S.S._____
Dated_____marked and numbered as follows:

(Space is left here for description of merchandise)

and, in consideration thereof, {I / we} HEREBY AGREE TO HOLD SAID GOODS IN TRUST for them, and as their property, with liberty to sell the same for their account, and further agree, in case of sale, to hand the proceeds to them to apply against the acceptances of THE GUARANTY TRUST CO. OF NEW YORK on {my / our} account, under the terms of the Letter of Credit No._____issued for {my / our} account and for the payment of any other indebtedness of {mine / ours} to THE GUARANTY TRUST CO. OF NEW YORK.

THE GUARANTY TRUST CO. OF NEW YORK may at any time cancel this trust and take possession of said goods, or of the proceeds of such of the same as may then have been sold, wherever the said goods or proceeds may then be found and in the event of any suspension, or failure, or assignment for the benefit of creditors, on {my / our} part, or of the non-fulfillment of any obligation, or of the non-payment at maturity of any acceptance made by {me / us} under said credit, or under any other credit issued by THE GUARANTY TRUST CO. OF NEW YORK on {my / our} account or of any indebtedness on {my / our} part to them, all obligations, acceptances, indebtedness and liabilities whatsoever shall thereupon (with or without notice) mature and become due and payable. The said goods while in {my / our} hands shall be fully insured against loss by fire.

Dated, New York City_____192____

(Signed)_____

£_____Stg.

FIGURE 71
Trust receipt (goods to be held or sold by importer)

If he has already sold the goods and wishes to deliver them upon arrival to the purchasers, the bank will require him to sign the form of trust receipt appearing on page 247 (Fig. 72).

If he is a customer of doubtful standing, the bank may request him to sign what is known as a "Bailee Receipt" (Fig. 73). This receipt is regarded as a little "more stringent than the trust receipt and is supposed to offer the bank more adequate protection. The opinion

TRUST RECEIPT

(FOR DELIVERY TO PURCHASER)

Received from THE GUARANTY TRUST CO. OF NEW YORK the following goods and merchandise, their property, specified in the Bill of Lading per _____, dated _____ marked and numbered as follows:

In trust to deliver the same to _____

who have purchased the same for _____

payable in _____

and to obtain from the purchaser the proceeds of the sale of the same.

In consideration of the delivery of said goods to {me / us} in trust as above, {I / we} agree to deliver them immediately to the said purchasers, and to collect the proceeds of sale, and immediately deliver such proceeds to THE GUARANTY TRUST CO. OF NEW YORK in whatever form collected, to be applied by them against the acceptances of THE GUARANTY TRUST CO. OF NEW YORK on {my / our} account, under the terms of Letter of Credit No. _____ issued for {my / our} account, and to the payment of any other indebtedness of {mine / ours} to THE GUARANTY TRUST CO. OF NEW YORK.

It is understood, however, that if such proceeds be in notes or bills receivable, they shall not be so applied until paid, but with liberty meanwhile to THE GUARANTY TRUST CO. OF NEW YORK to sell or discount, and so apply net proceeds.

THE GUARANTY TRUST CO. OF NEW YORK may at any time cancel this trust, and they may take possession of said goods until the same have been delivered to said purchasers and the proceeds of sale received from them, and thereafter of such proceeds, wherever the said goods and proceeds may then be found, and in the event of any suspension or failure or assignment for the benefit of creditors on {my / our} part or of the non-fulfillment of any obligation or of the non-payment at maturity of any acceptance made by {me / us} under said credit, or any other credit issued by THE GUARANTY TRUST CO. OF NEW YORK on {my / our} account, or of any indebtedness on {my / our} part to them, all obligations, acceptances, indebtedness, and liabilities whatsoever shall thereupon (with or without notice) mature and become due and payable.

Dated _____ 191

_____

£ _____

FIGURE 72

Trust receipt (for delivery to purchaser)

has been expressed that any trust receipt is *a priori* a bailee receipt, and so no legal distinction exists between these two documents." [1]

[1] *Federal Reserve Bulletin*, January, 1922, p. 36.

If the importer wishes to get the goods so that he may use them in manufacturing other products, the bank may, and often does, object to turning them over to him on a trust receipt because of the impossibility

BAILEE RECEIPT

Received *from the* Guaranty Trust Company of New York *solely for the purpose of selling same for account of said Company:*

_____

_____

marked and numbered _____

and _____ *hereby undertake to sell the property herein specified, for account of the said Company, and collect the proceeds of the sale or sales thereof, and deliver the same immediately on receipt thereof to the said Company, to be applied to the credit of* _____

_____

hereby acknowledging _____ *to be Bailee of the said property for the said Company, and* _____ *do hereby assign and transfer to the said Company the accounts of the purchaser or purchasers of said property to the extent of the purchase price thereof, of which fact notice shall be given at the time of delivery of the said property by* _____ *to such purchaser or purchasers and all invoices therefor shall have imprinted, written or stamped hereon by* _____ *the following:*

"Transferred and payable to GUARANTY TRUST COMPANY OF NEW YORK, 140 Broadway, New York."

If the said property is not sold and the proceeds so deposited within ten days from this date, _____ *undertake to return all documents at once on demand, or to pay the value of the goods, at the Company's option.*

The said goods while in { *my* / *our* } *hands shall be fully insured against loss by fire.*

The terms of this receipt and agreement shall continue and apply to the merchandise above referred to whether or not control of the same, or any part thereof, be at any time restored to the Guaranty Trust Company of New York, and subsequently delivered to us.

Dated at New York City, _____ *192*

_____

FIGURE 73
Bailee receipt

of identifying the goods once they have been transformed into other products.

The substance of these receipts is that the title to the goods rests in

the bank, that the importer is warehousing or selling them as the agent of the bank, and that all monies received from their sale are to be handed to the bank as soon as received, to pay off the importer's obligation to the bank. Whether or not the bank will *insist* "upon the application of the funds derived from the sale of the goods to the prepayment of the time drafts which the bank has accepted" will depend in each case upon the credit standing of the importer. As a rule such prepayment is not demanded, but where it is, a rebate is given, similar to the rebate on D/P bills above described.[1] The rebate is not fixed "but is graduated according to such factors as credit standing of customer, time of maturity, and prevailing value of money. Whether dollar, sterling, or foreign acceptances, the rebate is actually governed by the rate of the central bank. It may be determined directly by placing the rebate at 1 or 2 per cent below the discount rate of the Federal Reserve Bank in the case of dollar acceptances, or a little below the rate of the Bank of England for sterling bills. Another method is to allow a certain per cent below the market rate for prime bankers' bills. A third way is to grant the customer the same rate of interest allowed on deposit accounts." [2] The trust receipt also authorizes the bank to cancel the trust at any time and to take actual possession of the goods in order to protect itself against loss.

Sometimes the goods arrive before the documents, in which event the bank usually releases the goods to the importer so as to save warehousing charges, and also to save perishable goods from spoiling. The bank under such circumstances takes a trust receipt from the importer, also a statement that he accepts the goods even though the shipment prove to be somewhat irregular. The importer is also required to give the customs and steamship officials a bond of indemnity before being allowed to remove the goods without presenting the documents.[3]

There is considerable difference of opinion among bankers regarding the value of a trust receipt. By many it is considered a "necessary evil" that should be replaced by some more satisfactory method of protecting a bank's right to the property which it surrenders. As Escher so cogently remarks:

"A large volume could be written on the subject of trust receipts and the litigation which has grown out of the attempt to enforce them, but the

[1] Cf. p. 144.
[2] *Federal Reserve Bulletin*, February, 1921, p. 168.
[3] *Ibid*, p. 167.

whole sum and substance of it all would be that the trust receipt is just about as good as the party who signs it and no more. Bankers who hand over the documents on trust receipt (and an immense volume of business is so handled annually) do it almost entirely on the standing and credit of the party receiving the goods and hardly at all on the idea of being able to earmark and recover the merchandise or its proceeds in the event of failure.[1] Nor has the rating of the importer as much to do with the banker's being willing to let him have the documents against trust receipt as might be imagined. Many a firm of known large resources has trouble getting the banks to let it have the bills of lading against a straight trust receipt; whereas, many a firm whose resources are admittedly nowhere near as large have no trouble whatsoever. The importer's business and particularly the way he runs his business—that is what counts. What it comes down to is very much the same as though the importer were going to the bank and asking for a loan. Just about the same things are taken into consideration." [2]

To date the legal status of the trust receipt remains undecided. Federal courts have upheld the rights of the bank under the trust receipt on the basis of the trust receipt being a commercial necessity. Very little agreement can be found among the decisions of state courts, and as a result banks have been seriously limited in their efforts to maintain their rights over property released on such documents.[3]

To revert to our illustration: The American Importing Company gets the goods under a trust receipt and either prepays its indebtedness to the Guaranty Trust Company under the rebate system as already discussed, or waits until the maturity of the draft before putting the Guaranty Trust Company in funds with which to meet the obligation which it (the bank) has incurred on behalf of the importing company. The latter must also pay the commission of the accepting bank as well as any extra charges the accepting bank may have to meet. The commission of the American bank for accepting drafts drawn on it in terms of dollars will vary as between clients, and also

[1] "But whatever the form of the contract, it is to be borne in mind that when the banker issuing the credit hands over the bill of lading to the importer on trust receipt, he is allowing the only security he has to pass out of his hands, and is putting himself in the position of having made an unsecured loan to the importer." Escher, "Elements of Foreign Exchange," p. 152.

[2] Escher, "Foreign Exchange Explained," p. 126. The Federal Reserve Board, in its Regulations C Series of 1920, declares that "A trust receipt which permits the customer to have access to or control over goods will not be considered by Federal Reserve Banks to be 'actual security' within the meaning of Section 13" of the Federal Reserve Law.

[3] Cf. *Federal Reserve Bulletin*, January, 1922, p. 33.

as to the usance of the drafts. The customary commissions are sight, 1/8 per cent; 30 to 60 days, 1/4 per cent; 90 days, 3/8 per cent

When the draft matures, the holder, whoever that may happen to be, presents it to the Guaranty Trust Company and receives its face value. In the example which we have been following, it is readily seen, as has been true of the other examples of acceptances earlier discussed, that it is the discount market which advances the funds with which the transaction is financed. The accepting bank uses none of its funds, it simply advances its credit; the importing firm uses none of its funds, it employs the credit of the accepting bank. The exporter gets his money when he sells his documents to the Japanese bank. The Japanese bank in the above example, advances the funds only temporarily because it has the bill discounted as soon as it is accepted. When it buys the bill from the Asaki Silk Company it does so at a rate calculated to net it a profit. As soon as the draft has been accepted, the Japanese bank shifts the burden onto the discount market by selling the draft to some party willing to buy it as a short time investment. The latter carries the obligation until its maturity, but receives in return the current rate of discount for a banker's acceptance.

The fact must not be overlooked that the liability of the drawer and of the indorsers continues until the transaction has been concluded by the payment of the draft by the Guaranty Trust Company.

When *exports* from the United States are financed by means of a commercial letter of credit issued in terms of the money of the foreign country to which the goods are to be sent, the practices followed are along the same general lines as those outlined above.[1] To give a concrete example, let us have the Anglo Automobile Company of London arrange with the American Truck Company of New York for a shipment of automobiles. The Anglo Automobile Company goes to its bank, say Barclays, and secures a sterling letter of credit, and mails it to the American Truck Company. The latter prepares the shipment, gets all the documents required, draws its draft in pounds sterling on the English issuing bank, and sells the draft, i. e., discounts it for dollars at a New York bank. The latter sends the documentary bill to its correspondent in London, which presents it for acceptance

[1] "In these days of restricted exports an increasing number of cases are apparent where foreign buyers prefer to open credits through their own banks in terms of their own currency. Hesitancy on the part of American exporters in accepting such credits in foreign currency has, in many instances, resulted in loss of current business." Foreign Trade Bulletin of the American Express Company, June, 1921.

to Barclays. The latter accepts the draft, and retains the documents. The correspondent bank, acting upon instructions from the New York bank, either holds the draft until maturity or discounts it in the open market. Barclays hands the documents to the Anglo Automobile Company against a trust receipt or other form of security. The Anglo Automobile Company gets the goods, sells them, and puts the bank in funds with which to meet the payment of the draft when presented at maturity by the party holding it at that time. The importing firm also pays the accepting bank its commission for having advanced its credit during the period of the transaction. If the American Truck Company were located in Detroit instead of New York, an additional step in our story would have to be added provided the Detroit bank to which the documents had been sold had no direct London connections. The Detroit bank would have to indorse the documents and discount them with a New York bank, and the documents would then follow the course outlined above. Or the Detroit exporting company, having a number of similar shipments to make during the year, might arrange directly with a New York bank to take all its exchange at the prevailing market rates. Under such conditions, the exporting company draws a draft in sterling against a shipment, after wiring the New York bank for the rate which it is willing to pay. The exporting firm then converts the amount of its sterling draft into dollars at the quoted rate, and draws a draft for that sum in dollars on the New York bank. It then hands the sterling draft and documents and also its dollar draft to its local bank. The latter may credit the exporter immediately with the value of the dollar draft or may take it for collection. In either case, the local bank sends the shipping documents, the sterling draft and the dollar draft to the New York bank. The New York bank pays the dollar draft by crediting the account of the Detroit bank with that sum. The New York bank sends the sterling draft and documents to its correspondent in England, and from this point, the procedure is the same as outlined above. Or it may be that the Detroit exporter has made arrangements with a New York exchange dealer through whom it is able to market all of its documentary exchange at better rates than it could if it dealt only with one New York bank. The exchange dealer will secure the best market rate for the exporter, and wire a notice of the rate quoted and to what bank the exchange has been sold. The exporter then draws a dollar draft on that bank, as in the case just cited, hands the dollar draft

and the sterling bill with accompanying documents to the local bank which forwards them to the New York bank, giving the exporter immediate or deferred credit for its dollar draft. From this point, the New York bank handles the bill as above described. The New York exchange dealer receives a small commission for marketing the exporter's bill at the best obtainable sterling rate. The last two methods are customarily employed where the exporter has to dispose of a large amount of documentary exchange.

In the cotton trade it is a more or less common practice for the importer not to furnish the exporter with a letter of credit. Trading in cotton is for the most part in the hands of responsible firms and all that is necessary is for the importer to wire the exporter the name of the London bank upon which his drafts are to be drawn. American bankers, knowing these firms and their excellent reputation, buy the cotton bills of the exporters without question because they feel that "their implied word when offering the bills for sale is sufficient guarantee that the London banks will honor the bills with their acceptance." [1]

It is not unusual for an American importer to be required to obtain a commercial letter of credit drawn in terms of a foreign money because of the customs of trade in the exporting country, or because drafts drawn in terms of a foreign currency command a higher rate in the foreign market, or because of some other reason. Before 1916 American banks were not permitted to accept drafts drawn on them in connection with the financing of foreign trade. It therefore followed that they could not issue commercial letters of credit except as agents of foreign banks. Drafts in all cases had to be drawn against foreign banks. American banks acted only as the intermediary in supplying the American importer with his letter of credit. With England supreme in the trading and financial world and with the sterling draft more readily discountable than drafts drawn in other monies, the sterling letter of credit was the type most commonly used, not only by English importers, but by importers throughout the world. American firms importing goods from South America, the Orient, Europe, or Australia employed the sterling letter almost exclusively, although at times the mark or the franc letter was used. Estimates of the commissions which we paid annually to English bankers for their acceptance of our long sterling bills vary from a minimum of

[1] York, *op. cit.*, p. 136.

$10,000,000 [1] to a maximum of $150,000,000.[2] The practice of paying for imports by means of sterling drafts drawn on a London bank is still followed rather universally by all trading countries. Even, for example, where a Peruvian sells sugar to a Chilean firm, the goods are paid for by means of a 90 day draft on London. South American firms frequently remit sterling drafts to exporters in the United States or send sterling letters of credit to us; and when we export goods to them, we not uncommonly draw our drafts on London banks and in terms of sterling. Since 1916, however, we have made substantial progress toward popularizing the "dollar" letter of credit, especially among our exporters. The fluctuating exchanges were primarily responsible for the rather rapid development of this form of credit. American houses engaged in shipping goods abroad wanted to be assured of a definite return on their drafts. With the foreign exchanges fluctuating so adversely from day to day, our exporters stood to lose on their shipments. They then began to ask foreign importers either to establish dollar credits in the United States or to forward a dollar letter of credit issued by the importer's bank on an American correspondent. Under such letters of credit the draft is drawn in dollars on the American bank, accepted by it, and then discounted in the American market. At maturity the holder is paid by the American bank out of funds supplied by the foreign importer and forwarded to the American accepting bank by the foreign bank that had issued the dollar letter of credit. Such dollar letters of credit, however, have been used only to finance trade into or out of the United States and have never been employed, so far as I have been able to ascertain, to finance shipments between other countries, such as from Brazil to Portugal, or from China to France.

The progress that was made in developing the use of the dollar acceptance credits is nicely pictured by the following report of the Acceptance Committee of the American Bankers Association, published in May, 1921:

"Your committee is pleased to report that marked progress has been made with the development of certain phases of the American acceptance method of financing in the past half-year. Hundreds of banks, individuals, firms and corporations have been converted during that period to the idea

[1] Pamphlet on "Acceptances" issued by the American Exchange National Bank of New York, 1921, p. 11.

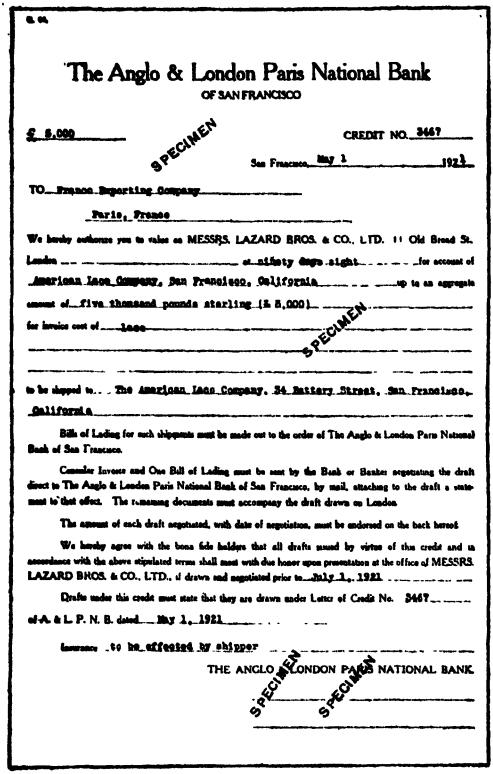
[2] Statement by Prof. E. E. Agger in the National City Bank of New York Correspondence Course in Foreign Exchange.

of investing temporarily available funds in bankers' acceptances. Prime bankers' acceptances are now regarded as a dependable reserve. The open discount market here has become a reality—every interest in America is benefitting from its operations. Dollar credits have gained preference everywhere. Many commercial banks have qualified for the utilization of their full acceptance powers. New and substantial acceptance houses have been organized and plans have been perfected under which funds are now being loaned on call or demand against acceptances as collateral in preference to stocks, bonds, and other long-term securities.

"Through the use of and investment in acceptances funds heretofore idle and practically useless are being mobilized and made to serve commerce and industry. Over-night money, spot and forward rates and other discount market terms so well known abroad are rapidly finding their way into our business and financial vocabulary . . . The bankers' acceptance method has been thoroughly tested here; its merits are established, and, if it is honestly applied, allowed to develop along natural lines and is not stifled by over-regulation, its further success is assured. According to figures compiled by the American Acceptance Council, the volume of bankers' acceptances outstanding April 1, 1921, was approximately $665,000,000, while the volume one year ago was $800,000,000. Considering the slump in our exports and the drop in prices, this showing is highly satisfactory. The drawings to create dollar exchange have shown a notable increase. The discount rates on prime bankers' acceptances for the six months' period ranged from 5 1/2 to 6 3/8%. Dealers buying rates from 5 5/8 to 6 3/8%. Dealers selling rates from 5 1/2 to 6 1/4%. Acceptances call or demand loan rates ranged from 4 1/2 to 6%. The commission charged by banks on acceptance credits ranged from 1 to 1 1/2% (¼ to 3/8% for ninety days), varying with the character of the transaction covered and risk involved."

Even as yet, in spite of the opportunities that arose during the World War, American bankers have not become experienced in the financing of foreign trade. Our interest and commission charges are usually higher than those of foreign bankers. Our exchange or discount market is not so thoroughly developed as that of London. America bankers are but slightly versed in the purchase and sale of acceptances. All of these matters, however, are of a comparatively recent growth, and as with the passage of years the rough places are ironed out, our dollar credits may be able to compete successfully with sterling credits. In spite of these shortcomings, a large proportion of our exports and imports is being financed at present by "dollars" as a result of the depreciation and uncertainties of the foreign

exchanges, but during the last two years sterling credits have been regaining their former place of supremacy. This is inevitable, of course, for the long standing tradition of sterling exchange and the familiarty of foreign exporters with London bankers and accepting houses cannot be easily overcome.



The Anglo & London Paris National Bank
OF SAN FRANCISCO

£ 5,000 SPECIMEN CREDIT NO. 3467

San Francisco, May 1 1921

TO Franco Exporting Company

Paris, France

We hereby authorize you to value on MESSRS. LAZARD BROS. & CO., LTD. 11 Old Broad St. London ... at ninety days sight ... for account of American Lace Company, San Francisco, California ... up to an aggregate amount of five thousand pounds sterling (£ 5,000) ... for invoice cost of laces SPECIMEN

to be shipped to... The American Lace Company, 34 Battery Street, San Francisco, California

Bills of Lading for such shipments must be made out to the order of The Anglo & London Paris National Bank of San Francisco.

Commercial Invoice and One Bill of Lading must be sent by the Bank or Banker negotiating the draft direct to The Anglo & London Paris National Bank of San Francisco, by mail, attaching to the draft a statement to that effect. The remaining documents must accompany the draft drawn on London.

The amount of each draft negotiated, with date of negotiation, must be endorsed on the back hereof.

We hereby agree with the bona fide holders that all drafts issued by virtue of this credit and in accordance with the above stipulated terms shall meet with due honor upon presentation at the office of MESSRS. LAZARD BROS. & CO., LTD., if drawn and negotiated prior to July 1, 1921.

Drafts under this credit must state that they are drawn under Letter of Credit No. 3467 of A. & L. P. N. B. dated May 1, 1921.

Insurance to be effected by shipper

THE ANGLO & LONDON PARIS NATIONAL BANK.

SPECIMEN SPECIMEN

FIGURE 74
Sterling import letter of credit

When an American bank issues a sterling letter of credit to an importer, it customarily issues the letter either against its own London branch or directly against a correspondent bank in London with which it has previously made arrangements regarding such matters.[1]

Suppose that the American Lace Company of San Francisco wishes to import a shipment of laces from the Franco Exporting Company of Paris, and that it has been notified by the exporter to send a £5,000 letter of credit to cover the costs. The American Lace Company obtains from the Anglo and London Paris National Bank a commercial letter of credit on Lazard Brothers of London (Fig. 74).

The letter may be made out in duplicate or in quadruplicate. If in duplicate, one copy goes to Lazard Brothers as an advice, notifying

[1] It is possible, though not customary, for an American bank to issue a sterling letter of credit upon itself. In that case the foreign exporter draws a sterling draft on the American bank, sells it to his local bank; it is then forwarded to the American bank for acceptance, which pays it at maturity by a dratt in pounds sterling drawn on its London account.

them of the contents of the letter that has been issued; the second copy is given to the purchaser, which forwards it to the Franco Exporting Company. The bank keeps its own record of the transaction and may also give a receipt to the purchaser for its files. When four copies of the letter are issued, one goes to Lazard Brothers, one is kept by the bank for its record, one is sent abroad to the exporter, and the remaining one is kept by the importer for its files. Or, of the four copies issued, two may be sent by separate steamers to Lazard Brothers and the other two copies in like manner to the Franco Exporting Company.

If the exporter demands that the letter of credit be actually confirmed by Lazard Brothers in order to make sure that the latter assumes the obligation placed upon it by the Anglo and London Paris National Bank, Lazard Brothers will give such a confirmation to the French exporter, charging therefor from 1/20 to 1/8 of one per cent of the face value of the letter, to be paid, of course, by the importer.

When the Franco Exporting Company has prepared the shipment as per agreement with the American Lace Company, and has obtained the various documents as per the requirements of the letter of credit, it draws a 90 day draft on Lazard Brothers for £5,000, the value of the shipment. It presents the draft and documents to its banker, say the Crédit Lyonnais, and receives £5,000 worth of francs at the rate of the day for that type of sterling bill. If the rate happens to be 25.51 francs per pound sterling, the Franco Exporting Company receives 127,550 francs (5000 × 25.51). The Crédit Lyonnais in accordance with the directions in the letter sends the consular invoice and one copy of the bill of lading direct to the Anglo and London Paris National Bank of San Francisco [1] and at the same time attaches a statement of that fact to the draft, which must be sent with the remaining documents to its correspondent in London to be presented to Lazard Brothers for acceptance. The documents which accompany the draft are sent merely to show that the shipment has been made in accordance with the terms of the letter. Lazard Brothers accept the draft, detach the documents, and return the accepted draft to the correspondent of the Crédit Lyonnais, which holds it until maturity or has it discounted immediately, depending upon instructions which

[1] The French bank is willing to do this because it has no reason to question the solvency and good faith of the San Francisco bank.

it has received from the Paris bank. Lazard Brothers may or may not send the documents to the San Francisco bank, depending again upon instructions. There is no need that they be forwarded, for the San Francisco bank has a copy of the bill of lading which has been sent to it direct by the exporter's bank, and which will enable the importer to get the goods off the wharf. When the draft has been accepted, Lazard Brothers notify the San Francisco bank so that the latter may know the maturity date of the draft.

When the documents and the goods reach San Francisco, the bank notifies the importer. The latter gives the bank a trust receipt or makes some other such arrangements whereby it is enabled to get possession of the goods. At the end of a certain time, usually about fifteen days before the accepted draft must be paid in London, the bank notifies the American Lace Company to deposit with it a sum in dollars which at the prevailing banker's sight rate for sterling exchange will be sufficient to purchase a £5,000 demand draft plus all commissions and charges. The commission of the English accepting firm will vary from nothing to ½ per cent or more, determined by the usance of the bill, the reputation of the parties concerned, the nature of the goods shipped, the competition of banks for the business, etc. American banks fix their commissions so as to include those charged by the English accepting bank. The total commission will range from ¼ per cent for the sight drafts to about 3/8 per cent for 90 day drafts, the arrangement between the English acceptor and the American bank usually being that the returns shall be divided evenly. If the face value of the draft plus the commissions and charges amounts to £5,040, and if the rate for demand drafts in the market is 4.86, the American Lace Company will have to pay the San Francisco bank the sum of $24,494.40 (5,040 × 4.86). The bank will then put Lazard Brothers in funds by sending a demand draft, or by waiting a few days and sending a cable, or by instructing Lazard Brothers to debit its account for the amount of the draft plus their commission. In any event, funds are on hand with which Lazard Brothers pay the draft when presented at maturity by the holder.

The greater portion of the world's trade is still financed by sterling bills of this character, and that condition will remain so long as England is dominant in foreign trade through her merchant marine and her far-flung system of foreign branch banking. A ready market for sterling drafts always prevails, no matter in what part of the world they

are drawn, because bankers and others with obligations to meet in London are continually in the market for sterling exchange. Letters of credit, handled in the above manner, are also issued in terms of francs, in which case the drafts would be drawn on a French bank and accepted by it, or in marks, with the drafts drawn on a German bank and accepted by it, or in lire, florins, etc.

Revolving Letters of Credit. Occasions sometimes arise which make it advisable for the importer to obtain a "revolving" letter of credit rather than the ordinary commercial letter of credit. He may be importing continually from some foreign house and does not want to be bothered with getting a letter for each lot of goods imported, or possibly the bank does not want to issue to him a letter of credit for an amount large enough, or for a period long enough, to cover his importations. To meet such contingencies, the banking world had developed a "revolving" letter of credit which meets such conditions admirably. Revolving credits are issued under the same terms and on the same type of form as the ordinary commercial letters of credit that we have discussed, the only difference being that a description of the conditions under which the credit is to revolve or be renewed is incorporated in the letter. Revolving letters of credit may be divided into four general groups. (a) The credit may be opened for, say, $50,000 with the agreement that the draft is to be for the total amount of the credit, and that the credit is to be automatically renewed as soon as the draft is paid. (b) The credit may be opened for, say $50,000, with the understanding that the total amount of drafts outstanding at any one time shall not exceed that sum. For example, the exporter may draw any number of drafts against the letter of credit up to the sum of $50,000, but no more may be drawn until some of those outstanding have been paid. As they are paid, the accepting bank advises the exporter of the payments and he may then draw additional drafts up to the amount of those that have been paid, but at no time may there be more than $50,000 worth of drafts outstanding and unpaid. (c) The credit may be opened on the condition that when the exporter draws a draft for any amount within the limit set by the letter, say $50,000, the credit becomes immediately available for the full sum. Thus if the exporter should draw a draft for $40,000 under the terms of this type of revolving letter, as soon as he had drawn such a draft, the letter would be automatically renewed for the entire amount. In types (a) and (b) the act of paying the draft or

drafts renews the letter, but in type (c) the act of drawing the draft renews the letter. (d) The letter may be drawn authorizing the exporter to draw for a certain amount weekly, monthly, or annually. This type of letter may be accumulative or non-accumulative, i. e., if the amount specified is not drawn each week, month, or year, the sum that is not drawn may be allowed to accumulate and become available for the next period (accumulative); or if not drawn, the beneficiary loses the right to draw for the lapsed amount (non-accumulative).

The convenience and usefulness of revolving letters of credit are clearly evident and do not need elaboration. The commission charged by the issuing bank is based, not on the amount for which the credit is issued, but on the amount that is availed of thereunder.

Export Letters of Credit. Situations arise at times in which the exporter is compelled to take the initiative in obtaining an export letter of credit or an export credit that may be known by some other name. It may be that a South American or Asiatic importer finds himself unable to obtain an import letter of credit because of the lack of banking facilities, or he may know that he will be unable to obtain dollar exchange when he wishes to remit payment with his order. The exporter always wants to get his money for the goods as soon as they are shipped. The practice of drawing directly upon the importer is seldom employed. Various forms of export credits have been devised for use in foreign trade. Previous to the establishment of the Federal Reserve System almost all export credits were in terms of sterling. Lately, however, as a result of the World War and also because American banks since 1916 have been authorized to finance trade by means of acceptances, an increasingly large amount has been drawn in dollars.

Suppose that Lima and Company of Rio de Janeiro desires to import $10,000 worth of goods from the New York Machinery Company. The latter is willing to ship the goods with the understanding that they are to be paid for thirty days after the acceptance of the draft. The exporter consults with the Chase National Bank of New York as to the best method of financing the shipment. An arrangement is entered into whereby the exporter is to hand all documents to the bank; the draft is to be drawn at thirty days sight; documents are to be turned over to the importer on acceptance or on payment, as the case may be, and the exporter is to receive in return a sterling export letter of credit. When the documents have been prepared, and the draft drawn in sterling on Lima and Company payable to the Chase

National Bank or order at thirty days sight, the exporter hands his documentary bill of exchange to the bank, and receives in return his export letter of credit. By its terms he is authorized to draw a ninety day draft on the London correspondent of the Chase National Bank, say Barclays, for ninety per cent of the invoice value of the goods. He may then sell this draft in the open market and receive dollars for it, or he may have the bank draw the draft and sell it in the market and turn the dollars over to him or to his account on deposit with the Chase National Bank. If the bank draws and sells the draft a larger return will be obtained because the bank's draft will command a higher price than will the draft of the exporter. The New York bank that purchases the draft, say, the United Trust Company, sends the draft to its London correspondent, say, Lloyds, which presents it to Barclays for acceptance. Barclays accepts the draft in accordance with the "advice" forwarded to it by the Chase National Bank. The draft then runs to maturity. In the meantime, the Chase National Bank forwards the documents covering the shipment to its correspondent at Rio de Janeiro, say the Banco do Brasil, with instructions to present the draft of the New York Machinery Company to Lima and Company for acceptance. Lima and Company accepts the draft, gets the goods, and disposes of all or part of them. Some time elapses before the goods and the documents reach Rio de Janeiro, perhaps twenty-five days; the draft runs for thirty days. At the end of that time [1] Lima and Company is required to pay the Banco do Brasil an amount of milreis sufficient to purchase a sterling demand draft on London, called the "return bill" or "return draft." The Banco do Brasil charges a commission for acting as the agent of the Chase National Bank, and includes that charge in the rate which Lima and Company pays for the demand draft on London. The stamp taxes also have to be paid by the importing firm.[2] The Banco do Brasil then forwards the draft to Barclays in London as per instructions from the Chase National Bank, thus putting the accepting bank (Barclays) in funds with which to meet the draft which it (Barclays) had earlier accepted. It will be noted that the draft drawn by the exporter on Barclays was a ninety day draft but for only ninety per cent of the

[1] If payments are made before maturity of drafts it is customary in South America to allow a rebate of 6 per cent on such pre-payments.

[2] Stamp taxes are imposed on commercial invoices, receipts, bills of lading, indorsements on the same, and upon practically all documents, legal or otherwise, in all South American countries.

value of the goods. The draft drawn by the exporter on Lima and Company was a thirty day draft for the full value of the shipment. The demand sterling draft sent from the Banco do Brasil to Barclays was for the full value of the shipment. It takes about twenty-five days for the mail to reach London from Rio de Janeiro, so that the demand sterling draft has sufficient time to arrive in London and thus put Barclays in funds before the exporter's draft on Barclays matures and has to be paid. Barclays cashes the demand draft sent it by the Banco do Brasil, pays its accepted draft at maturity and deducts from the remainder its usual acceptance commission. It then forwards the remainder to the Chase National Bank in the form of a dollar draft, or it may simply credit the Chase National Bank with the amount in question and send an advice to that effect. The Chase National Bank deducts its commission for having acted on behalf of the exporter and pays him whatever remains. Thus it happens that no bank advances any funds. The transaction throughout is purely of a credit character. The London discount market again carries the financial burden, and, as always, at its usual discount rate. The exporter has to pay two commissions, one to the London accepting bank (Barclays) [1] against which the export letter was issued, and one to the Chase National Bank,[2] but in return therefor he has the use of the money for at least ninety per cent of the value of the shipment during the period covered by the transaction. The exporter is willing to wait for the remaining ten per cent until the deal has been closed. The risk of exchange has been borne in this case entirely by the importer, for it is Lima and Company that has to buy sterling exchange at the market rate in Rio de Janeiro with which to put Barclays in funds wherewith to meet the exporter's draft.

With the changes wrought by the Federal Reserve Act, it is now possible for an exporter to draw the draft on an American bank instead of on an English bank. Taking the data of the above example, the exporter under this arrangement draws the draft in dollars on Lima and Company, payable in exchange on New York at the Brazilian bank's sight rate, and turns the draft and documents over to the Chase National Bank which forwards them to the Banco do Brazil in Rio de Janeiro. The draft will be accepted by Lima and Company and will run for the designated period. The exporter, at the same

[1] Possibly from 1/8 to 3/16 of one per cent.
[2] Usually 1/2 of one per cent for a ninety day acceptance.

time, also draws a draft in dollars against the Chase National Bank for 90 per cent of the invoice value of the shipment. The latter is accepted by the drawee (the Chase National Bank) and possibly discounted by it, although it is not advisable for a bank to discount its own acceptances. More often, after the Chase National Bank has accepted the draft, the exporter discounts it in the New York market, say with the National City Bank. Before the draft matures, Lima and Company puts the Banco do Brasil in funds by paying the draft drawn by the exporter. The Brazilian correspondent bank then puts the Chase National Bank in funds so that the exporter's second draft, i. e., the one which he drew on the Chase National Bank itself, may be paid when presented t maturity by the National City Bank.

There are other methods of financing exports from one country to another by means of drafts drawn on a third country, but without the use of a commercial letter of credit. For instance, say the New York Machinery Company as per instructions sent it, draws a 90 day sterling draft on Lima and Company for enough sterling at the prevailing market rate for 90 day bills to yield the dollar value of the goods plus certain charges for interest and commission that the negotiating bank imposes. The bank's commission will usually be ¼ per cent, and the interest charges [1] will be figured customarily at 6 per cent and for the length of time that it will take the draft to reach Rio de Janeiro, be accepted and run to maturity of 90 days, plus the time that it will take for the remittance to reach New York (calculated in all at 140 days). If the rate is 4.81 [2] for 90 day sterling drafts, and if the total

[1] Sometimes the face value of the draft will be discounted by the bank instead of interest being charged. The former, even though the same rate be employed, yields the exporter a slightly smaller sum.

American banks charge a "flat rate of from 1½ to 5 7/8 per cent for discounting drafts on South America, depending upon the tenor of the draft and the time and distance from New York to the country upon which the item is drawn. These rates are made up in this manner for general convenience in calculating and are arrived at by charging interest for the estimated time elapsing between payment of funds by the discounting bank and date of reimbursement in New York. To illustrate; if the draft be drawn at 90 days sight on Buenos Aires, an additional two months' interest is added to the 90 days to cover the estimated time in transit to and from that point. The bank reserves the right to adjust the interest charge with the drawer of draft should the elapsed time be longer than the time estimated.

"To some countries there is also added the foreign bank's collecting charge for drafts, plus foreign revenue stamp tax on bills of exchange. These charges range from 1/20 to 1/5 of one per cent. Malley, F. O., "Our South American Trade and Its Financing," New York, 1920, issued by the National City Bank, p. 29.

[2] Speaking of conditions before the Great War, the *Americas* (vol. 1, No. 3, p. 47) states that "For South American business, it is the custom, generally, to figure a rate of exchange of $4.80 for all transactions, owing to the fact that this is a well-ingrained usage with which

yield that the draft is to bring is $10,258 ($10,000 value of goods plus $233 interest at 6 per cent for 140 days plus $25 commission of the negotiating bank at ¼ per cent), the draft will have to be drawn for £2132 12s 8d (10,258 ÷ 4.81). The Chase National Bank gives the exporter $10,000, takes the draft and documents and forwards them to the Banco do Brazil. The draft is presented to Lima and Company for acceptance, and at the end of 90 days is paid by that firm in the exact amount of milreis required to buy a sight draft for £2132 12s 8d on London. If the rate is high, Lima and Company has to pay more milreis; if it is low, the firm has to pay less. The draft is then forwarded to the Chase National Bank, or, if the latter so desires, it may have the draft sent to its correspondent in London, there to be cashed and credited to its account. If the draft is forwarded to the Chase National Bank, instead of to London, the bank can either sell it to another exchange dealer in New York at the current rate for sight drafts on London, or it can forward it to London for collection, the proceeds to be credited to its account. It will follow the course that seems to promise the greater profit. In either case the Chase National Bank assumes the possibility of a decline in the rate for sterling exchange, and a corresponding decrease in its profit on the transaction. In the two instances, where the sterling draft is sent to London to build up the account of the New York bank so that exchange may be drawn against it, the rate for sterling may fall so low as to cause a loss to the Chase National Bank. Likewise, in the other instance where the draft is returned to New York and the bank sells the draft to another local dealer, sterling exchange may fall, and entail a loss to the bank. Of course, conversely, there are chances that the rate for sterling may rise and thus bring larger profits than anticipated.

It is possible for this latter method to be financed in terms of dollars. As an illustration, say the New York Machinery Company draws a dollar 90 day draft on Lima and Company, payable to the Chase Na-

South Americans are thoroughly familiar. Naturally, it suits very well in the case of a shipment of goods against sight drafts because, as a rule, they can always be sold to a better advantage than $4.80 in this market. However, if the draft were 90 days sight, it would not at all times bring $4.80 and it would be necessary, in making a price for goods, to bear that fact in mind. The rate is a matter of custom only. Rate making on the invoices can be adjusted satisfactorily to both the importer and the exporter. The rate of $4.80 on a sight draft in sterling on South America is favorable to the United States exporter, as it means about $4.85, if the voyage to and from is counted as 60 days at 6 per cent, making about five points difference or approximately 1 per cent. The banker purchasing it takes the risk in exchange."

tional Bank or order, and payable (in Brazilian currency) at the rate being charged on the maturity date by the Brazilian bank for dollar sight drafts on New York. The draft is drawn to include the bank's commission of ¼ per cent and interest at 6 per cent for the period of 140 days plus the invoice value of the goods, totalling, say, $10,258, and is sold to the Chase National Bank. The draft and the documents then take the same course as in the last example, i. e., they are sent to the Banco do Brasil, the draft is accepted by Lima and Company and runs for 90 days, at the end of which time the importing firm pays the Banco do Brasil a sum of milreis sufficient to purchase a $10,258 demand draft on New York. The commission of the Banco do Brasil is included in the rate that it charges the importer for the dollar sight draft on New York, or it is obtained in some manner from the Chase National Bank. The demand draft for $10,258 on a New York bank is then forwarded to the Chase National Bank and cashed by it at the bank upon which the draft has been drawn.

In the last two examples, the Chase National Bank of New York has advanced its own funds during the life of the transaction, and has therefore charged interest as well as its commission. In the earlier examples, the Chase National Bank loaned only its credit to the exporting firm, and it was the discount market of London or of New York that bore the burden of financing the transaction. Normally, banks much prefer to follow the latter practice, because to them the loaning of credit is always more acceptable than the loaning of actual funds.

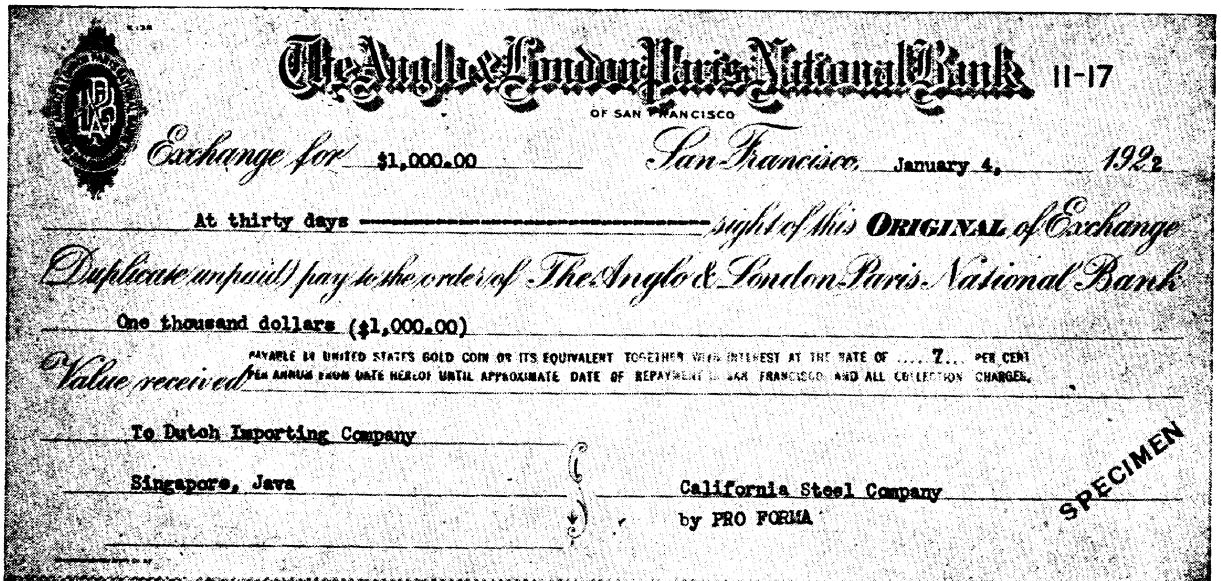
In all the examples given above, the importer, Lima and Company, has furnished funds with which to purchase a sterling or a dollar demand draft as cover for the draft drawn by the exporter. Lima and Company may, instead, resort to a purchase of cables, for by that means it is possible for the firm to save from twenty to twenty-five days in time. If Lima and Company wishes to get an extension of time, permission must be secured from the Rio correspondent of the Chase National Bank to buy a cable instead of a draft. The importer pays an extra commission for this privilege and also a higher rate for cable exchange, because cables are always more expensive than drafts. If there is a possibility of a decline in exchange rates, it may be that the importer may secure a cable twenty days hence at about the same rate that a demand draft would have cost originally.

As was noted above [1] it is rather customary for exporters in certain

[1] Cf. pp. 182–183.

of the South American and Central American countries to pay their obligations in 90 day sight bank drafts. Before the World War these drafts were drawn almost exclusively on London; since that time, however, an ever increasing number has been drawn in dollars. Such drafts mature 90 days from the time that they are accepted by the bank upon which they have been drawn by the selling bank, and if they are sterling bills, three days grace additional must be allowed. In such cases, the draft of the exporter on the importer is drawn payable at "the bank's drawing rate on the day of payment for 90 day sight drafts on London," or in the case of dollar drafts, "on New York." On the date that the draft of the exporter falls due, the importing firm has to hand the bank, that presented the original draft, sufficient funds with which to buy the "return draft" as specified. If the 90 day sight bank draft is drawn in sterling, it is forwarded to the New York bank that originally purchased the bill of exchange from the exporter. The New York bank either sells the draft in the New York market at the rate for 90 day sight bank drafts on London, and thus gets its money, or forwards it to London for acceptance and, very probably, for discount. The accepted draft will run for 93 days and will be paid at maturity. In the meantime the South American or Central American bank which sold the draft to the importer will put the accepting or paying bank in funds with which to meet the draft at maturity. It may do so by sending a sight draft or a cable, or by merely advising the London bank to deduct the amount of the draft from its (the selling bank's) account. When the 90 day sight bank draft is drawn in dollars and sent to the New York bank, the latter presents it to the American bank upon which it has been drawn, and upon acceptance the bill may be discounted in the New York market or held until maturity.

When such 90 day sight bank drafts are to be used as "return drafts" it is possible for the importer to ask for a postponement of payment in order to obtain the temporary use of the funds; later he will purchase a sterling or dollar cable in order to reimburse the New York bank. It must be remembered that 90 day drafts are always worth less to the receiving bank than sight drafts, because of the delayed payment. Both yield the same number of dollars when paid at maturity, but with 90 day drafts the bank has to wait longer for its money and thus loses interest on the funds represented. If it wishes to get the immediate use of the money tied up in the transaction and there-


The Anglo & London Paris National Bank 11-17
OF SAN FRANCISCO

Exchange for $1,000.00 San Francisco, January 4, 1922

At thirty days ——— sight of this ORIGINAL of Exchange

(Duplicate unpaid) pay to the order of The Anglo & London Paris National Bank

One thousand dollars ($1,000.00)

PAYABLE IN UNITED STATES GOLD COIN OR ITS EQUIVALENT TOGETHER WITH INTEREST AT THE RATE OF .... 7... PER CENT PER ANNUM FROM DATE HEREOF UNTIL APPROXIMATE DATE OF REPAYMENT IN SAN FRANCISCO AND ALL COLLECTION CHARGES.

Value received

To Dutch Importing Company

Singapore, Java

California Steel Company

by PRO FORMA

SPECIMEN

FIGURE 75

Draft with interest clause

fore discounts the draft immediately upon acceptance, a sum smaller than the face value of the draft is realized. The bank appreciates these facts and takes them into consideration in fixing the amount for which it advises the exporter to draw his draft. A delayed payment necessitates that the exporter draw the draft for a larger amount than would be required were payment to be made by means of a sight draft. Thus the importer really pays for the privilege of enjoying the delayed payment, but, of course, he has a longer period in which to speculate on a fall in exchange rates on London or on New York.

In all of the above instances of export credit transactions it is possible for the New York bank to instruct the foreign bank to accept funds from the importer and to credit them to the account of the New York bank, instead of bothering about remitting the exchange as called for in the wording of the exporter's draft. It will ask that this procedure be followed if it is desirous of building up its foreign account for exchange purposes or if it feels that more profit can be made by such an arrangement.

Interest Clause. In the examples given above the interest charged by the bank has been figured in the amount for which the draft has been drawn. The practice in the trade with the Far East and also with the British West Indies is slightly different and requires that when the American bank purchases the draft and documents from the exporter it stamp on the face of the draft the so-called "interest clause" (Fig. 75), which varies in its wording as between banks. Some banks print the interest clause on the draft. The following are typical examples:

"Payable at Bank's selling rate for sight exchange on New York with interest at 8% per annum from date hereof until estimated date of arrival of return remittance in New York."

or

"Payable with exchange, commission, stamps and interest at 6% per annum from date hereof until estimated date of arrival of return remittance in New York."

or

"Draft to be paid at current rate for Bank demand draft at date of payment with interest added at 9% per annum from date to approximate date of returns reaching London."

or

"Payable in United States gold coin or its equivalent together with interest at the rate of 9 per cent per annum from date hereof until approximate date of repayment in San Francisco and all collection charges."

The foreign correspondent that presents the bill for acceptance and which later collects its value from the importing firm also computes the interest and commissions that must be paid. It knows the approximate or customarily accepted number of days required for the original draft to arrive from the purchasing bank and for the remittance to be returned to that bank. It also knows the usance of the bill, and is therefore able to calculate at the designated rate the amount of interest that will have to be paid by the importer. This sum will be added to the face value of the original draft, and will determine the amount of exchange that the importer must purchase for remittance. If the clause states that the draft is payable at "*the bank's selling rate*" for the kind of exchange designated in the interest clause, then the importer is compelled to purchase such exchange from *the bank holding the accepted draft.* If that phrase is absent, the importer is free to go to any bank, procure the required exchange at the best obtainable rate, and turn it over to the correspondent bank to be remitted to the payee bank.

The commission of the foreign bank depends upon "local custom and the degree of accessibility or inaccessibility of the point where the collection is made." [1] It will be noted that several of the interest clauses mentioned above do not contain any reference to commissions or who shall pay them. The reason is that the rate of interest, which is generally high, is intended to cover the usual commissions. Stamp taxes are also passed on to the importer.

The rate of interest varies from time to time, but is customarily fixed for the United States by the rate quoted in the New York exchange market, which in its turn follows closely the rate charged by the London market. Exchange dealers state that a small group of the large banks in New York fix the interest rate used in such transactions.

Hough in his excellent volume "Practical Exporting," in discussing the insertion of the interest clause, concludes that "There is an element of great uncertainty about it, and a great many foreign houses object to this practice, in fact object to paying more than the charges specifi-

[1] Irving National Bank, "Trading with the Far East," p. 91.

cally named by invoices. The clause in question, therefore, should not be included except by previous agreement with the customers." [1] Exporters are urged by bankers to draw their drafts for an amount that will include interest charges, commission, stamps, etc., because importers, especially those in South America, refuse at times to pay more than the face value of the draft. In Argentina a banker cannot legally collect more than the face value of the draft. In the Scandinavian countries, notations relating to the payment of interest and other charges may be placed on the bill of exchange, but they are without legal effect, the drawer being under no legal obligation to pay them. It should also be noted that in the Scandinavian countries if drafts are to be paid at the "bank's selling rate," banks are not permitted to apply their own rates, but are legally compelled to use the official rates published by the Stock Exchange Committee of their respective countries.

Colonial Clause. Another clause requently met with is the "colonial clause" [2] appearing only on drafts drawn against South African and Australasian merchants and issued against exports to them. It is never used on drafts drawn on other countries and seldom on drafts drawn on banks in the two countries mentioned. This clause may read, "Payable with exchange and Eng sh Colonial stamps at the current rate for negotiating this in London on the colonies," or "Payable with exchange (English and Colonial stamps added) at the current rate in London for negotiating bills on the Colonies" [3] (Fig. 76). The importer, i. e., the drawee, is by this clause compelled to pay all charges for English and Colonial stamps, collection fees, interest from the time the draft is drawn until the date of arrival of the proceeds in London, the difference in exchange rates, etc., so "that the bank that finally presents the draft for payment, collects from the drawee not only the face value, but also all these accrued charges." [4] South Africa and the Australasian colonies have the same sovereign for their unit of value as has England. The rate of exchange in London on

[1] P. 493.

[2] Cf. Whitaker, *op. cit.*, pp. 310–318 for the best available discussion of this clause.

[3] "Bills upon South Africa or Australasia originating in England do not customarily bear the colonial clause. But a substitution for the clause is in constant use by English drawers. Instead of enfacing the latter on their bills they simply add the 'exchange' to their *invoices*, and reach the same result. Thus if £100 is due the English exporter, he adds the £2 for exchange to the invoice and (disregarding stamps) draws an ordinary bill for £102." Whitaker, *op. cit.*, p. 317.

[4] "Selling in Foreign Markets," compiled by G. E. Snider, U. S. Bureau of Foreign and Domestic Commerce, Miscellaneous, Series No. 81, p. 548.

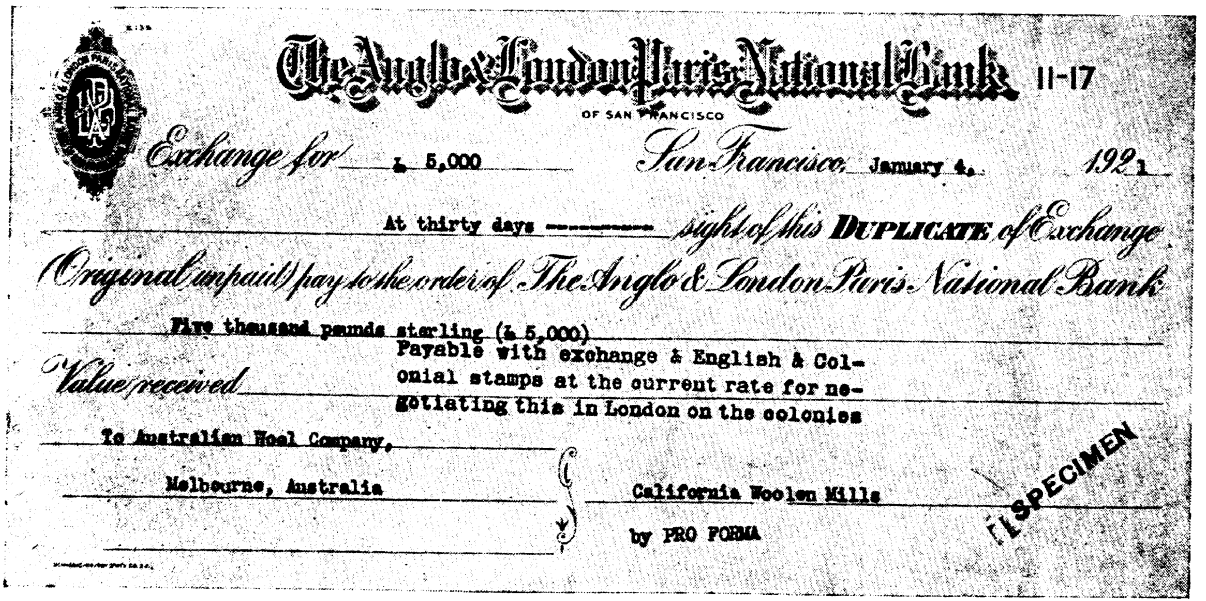


FIGURE 76
Draft with colonial clause

these countries, however, varies just as does the rate of exchange between the United States and Canada which have the same "dollar" for their standard of value, or as the rates of domestic exchange between New York and San Francisco formerly fluctuated before the introduction of the Federal Reserve System. A draft bearing the Colonial clause is payable by the drawee in the pound sterling of his own country, not in the pound sterling of London. It is not the rate of exchange *on* London in the drawee's country that determines what the drawee shall pay: it is the rate of exchange *in* London on the drawee's country on the date of maturity of the draft that fixes the cost of the draft to him. Furthermore, it is the rate *in* London on that date *for bills of the same usance*, not for sight bills or for telegraphic transfers. It will be noted by reference to the wording of the Colonial clause that it requires that the bill be payable "at the *current* rate" (meaning the rate existing on the date that the drawee pays the draft), "for negotiating this *in London*" (meaning the rate at which a bill of the same type, same usance, etc., would be negotiated in London on the same day that the draft becomes payable by the drawee).

To illustrate a case where the colonial clause is used, say that the San Francisco Exporting Company sells goods valued at $48,600 to the Australian Importing Company of Melbourne. If the sight rate on London on the day the draft is drawn stands at 4.86, the exporter will draw against the Australian firm for £10,000, regardless of whether the usance of the draft be sight, 30, 60 or 90 days. The exporter draws always at the prevailing sight rate on London. The Colonial clause is stamped on the face of the draft, which is thereupon sold, along with the documents, usually to a branch of an English or Colonial bank. The draft is sold at par, sometimes at a premium, because when the draft is finally paid by the importer it will yield a sum that is above par for reasons that will be later explained. "It is not necessary for the shipper to concern himself with a calculation of the approximate time that will elapse before his draft is presented, the time it has to run, and the time required for the return of funds, and to add interest for all this time to his invoice or provide for it in his price, nor need he be concerned regarding fluctuations of exchange. He has only to convert his invoice from dollars into pounds sterling at the sight rate on London and draw his draft for the resultant amount. This draft can be sold to any bank having the proper London and Aus-

tralian connections for full face value. The transaction is to all intents and purposes a cash one for the manufacturer or shipper, although, of course, he still runs the credit risk, as such drafts are not bought 'without recourse' unless a confirmed banker's credit has been opened. In the case of sight drafts this risk is reduced to a minimum, since the drawee cannot obtain possession of the corresponding goods until the draft is paid. In other or doubtful cases it is not difficult for the manufacturer to satisfy himself of the standing or reputation of the client through the reliable commercial agencies that have branches in Australia or through the correspondents of the Australian banks." [1]

The draft and documents are forwarded to the importer through a Melbourne bank, the draft is accepted by him, and runs, say, for 90 days. At maturity, the importer comes in and pays the bank the face value of the draft and the accrued charges, plus the premium that is being charged *in* London on that date *for 90 day bills on Melbourne.* Exchange rates in London on Australia (and also on South Africa) normally stand at a premium,[2] the amount of the premium varying from day to day, so that the bank that has purchased a draft bearing the Colonial clause is always certain of receiving more than the amount for which the draft has been drawn. American banks always ask Australian banks to remit directly to London because sterling exchange is cheaper than dollar exchange. Australian banks have accounts in London and are able to draw drafts on their accounts when remitting to the London accounts of the American banks.[3] The practice is for the Australian banks to forward the original draft to the designated London bank and the duplicate draft to the American bank.

Writing on "Exporting to Australia," [4] Mr. Philip B. Kennedy in 1916 stated that:

"Since the war a fair number of drafts have been drawn in dollars and sent to the Australian banks for collection. If the drawer wishes to realize the face amount of the draft, this should be provided for by a clause stamped

[1] Commercial Attaché W. C. Downs of Melbourne in "Export Trade Suggestions," Miscellaneous Series No. 35, U. S. Bureau of Foreign and Domestic Commerce, p. 53.

[2] It was not at a premium in 1921.

[3] American banks do not have branches or accounts in Australia. The Australian banker has maintained a closed monopoly of banking in his country.

[4] Miscellaneous Series No. 45, U. S. Bureau of Foreign and Domestic Commerce, pp. 15–16.

on the draft. The Bank of New South Wales, which does more of this collection than any other Australian bank, advises that the following clause should be added to enable them to remit the face amount in dollars:

> 'To be converted into sterling at the Bank of New South Wales rate on due date, and payable at the current rate of exchange for purchasing demand drafts on London with all charges.'

"At this date (June 28, 1916) the Bank of New South Wales will convert at the rate of $4.75. This rate is on collections forwarded by an American bank. Exchange at 1 1/4 per cent is added, together with 3/8 per cent commission. If a draft of a face value of $475 had been sent forward for collection with this clause added, the importer would be called upon to pay the following amount:

$475 at 4.75	£100	os.	od.
Exchange	1	5	0
Commission		7	6
Duty stamp		0	1
Total	£101	12s.	7d.

"If the terms of the sale were on the basis of draft against date drawn in New York, the Australian bank may also be asked to add interest for the time taken for the round-trip mail, which is usually reckoned at 72 days. The rate of interest is 6 per cent, and in this case the importer would also be asked to pay 72 days' interest at 6 per cent.

"The Bank of New South Wales, the largest bank in Australia, will now forward a draft upon the National City Bank of New York, where an account is kept, for the full amount in dollars up to £1,000. For larger amounts the sum will be forwarded to be converted at the New York sight rate on London. This limit on dollar exchange is due to the difficulty that the Australian bank may have in replenishing its funds in New York. It is not policy to carry large accounts in New York, because New York banks pay only 2 per cent interest on bank accounts, whereas at present 4½ per cent is being paid in London for similar accounts.

"The advantage of adding the colonial clause to the draft is that the full amount may be obtained at once. The London banks that accept and carry these bills finance the time consumed.

"It is probably fully as cheap for the importer at present to have drafts drawn upon him directly in dollars, because the Australian exchange on London is now much higher than normal, 2½ per cent. Drafts drawn in dollars with the above mentioned clause attached and forwarded direct are entirely feasible at the present time."

Exchange as per Indorsement. Another practice, again peculiar to the English exporter, is the drawing of drafts bearing the clause "Exchange as per indorsement" or "At the rate of exchange as per first London indorsement." This makes the bill drawn by the English exporter in sterling eventually payable in a foreign currency at a predetermined rate for each pound sterling. Thus if an English merchant draws a 90 day draft for £1,000, on a New York firm, and includes the clause "Exchange as per indorsement," the London banker who negotiates the bill will pay the exporter the face value of the draft less the usual commission and charges, will then convert the sterling into dollars at the 90 day rate on New York and will indorse on the bill either the total amount of dollars to be paid by the importer or the rate of sterling exchange at which payment is to be made. The object of the drawer is to avoid the risk of loss in exchange and at the same time to satisfy the drawee that the rate of conversion has been fixed by an impartial referee, viz., the bank. Previously it was customary for the banker to indorse the rate of conversion on the draft (note that the clause says "rate as per indorsement") but "owing to the increased number of cases in which the persons on whom bills of exchange are drawn refuse to pay the equivalent at the rate of exchange indorsed on the bills, the custom among some of the bankers is to quote the seller the rate and insist on his indorsing it on the bill himself. Under this arrangement any dispute which may subsequently arise when the bill is presented can be referred back to the drawer for settlement between the drawee and himself." [1]

Domiciled Bills. A variation of the documentary bill drawn under a commercial letter of credit and drawn in one country on a second but payable in a third country, either in the money of the second or in the money of the third, is found in the "domiciled bills," known for short as "domiciles." Suppose that an American exporter draws a bill on a French bank covering shipments of cotton to a French firm. The French bank accepts the draft, and by the wording of its acceptance makes it payable at a certain bank in London. The bank that presented it for acceptance then forwards it to London to its correspondent either for discount or to be held until maturity. The draft therefore becomes "domiciled" in London. A short time before it falls due, the French accepting bank forwards funds to the London

[1] Spalding, Foreign Exchange and Foreign Bills," (1st ed.) p. 141. Cf. *Bankers' Magazine*, (England), January, 1921, pp. 65–66.

bank that is to pay the draft, and with these funds payment is made at maturity. All charges, of course, are met by the French importing firm. The London discount market harbors a very great prejudice against domiciled bills and charges a higher rate of discount, usually a quarter to one half per cent per annum higher than for bills bearing the acceptance of a British bank. The bill must bear two stamps, one for the accepting country and one for England. These facts are taken into consideration in the New York market when the bill is offered for sale, and as a consequence a bill that is to become a domicile commands the lowest price for documentary bills of the same usance. Another matter that similarly affects the price of the bill is that it is sent by an indirect route to London, taking much longer than if it were forwarded directly to London from New York. The New York bank is out of funds for the additional time, not being able to have the draft discounted until it reaches London, and therefore has to charge for the loss of time. "Partly because of these disadvantages attaching to the domiciled bill, some foreign banks in their eagerness to retain the financing of native imports by means of sterling bills, have established branches in London for the purpose of giving their bills the status of London acceptances. But London bill buyers show some discrimination even against the sterling bills of these foreign agencies. As a rule they reserve the lowest discount rate for bills of purely British acceptors, the great joint-stock banks, and the world-renowned private banking firms, whose business is primarily that of accepting bills." [1]

The attitude of the discount market in the United States toward domicile bills closely follows that of London. During the spring of 1920 a plan was submitted to the Federal Reserve Board in connection with a proposed method of financing cotton shipments whereby the American exporters would draw six months drafts on foreign spinners, not on banks; the spinners after accepting the drafts were to present them to their local banks for indorsement, giving a chattel mortgage on the cotton as security. These drafts were to be made payable in the United States. The question arose as to whether or not such bills could be discounted at the Federal Reserve banks. The General Counsel of the Federal Reserve Board ruled that "Although a draft drawn by an American exporter upon a foreign buyer and accepted by that buyer payable in the United States in dollars may be technically eligible for discount under the terms of section 13 of the Federal Re-

[1] York, *op. cit.* p. 142.

serve Act, nevertheless, a Federal Reserve bank may, in its discretion, decline to discount such an acceptance on the ground that, inasmuch as it is a domicile bill, it is not a desirable investment." The *Federal Reserve Bulletin* of April, 1920, in commenting upon this ruling added that "The Federal Reserve Banks have evidenced their unwillingness to discount acceptances made by foreign banks payable in this country in dollars unless the accepting bank has an office and assets in this country. It is also understood that most of the central banks of Europe have generally declined to afford a market for bills of this character. With the foreign exchange market in its present unsettled condition the principles which make domicile bills undesirable even in normal times are now all the more pertinent." [1]

As it is possible for local banks which do not have an international reputation to arrange through other bankers for the sale of certain kinds of exchange, as has been described, so it is also possible for them to arrange for the issuance of letters of credit through their correspondents located in either domestic or foreign commercial centers. In this connection as in all others, state laws govern state banks and national laws govern national banks. So far as I know there has been no question raised regarding the powers of state banks to make such arrangements, but lately (May, 1921) the Federal Reserve Board has handed down a significant ruling affecting the manner in which national banks have been accustomed to issue letters of credit to their clients. It has been rather customary for an interior bank to have its large city correspondent issue the letter for the customer's account which letter the interior bank would guarantee, i. e., if the client should fail to put the issuing bank in funds with which to meet the drafts at maturity, the interior bank guaranteed that it would do so. The Federal Reserve Board has ruled that a national bank does not have the right to act as surety on a letter of credit issued by another bank; that, while it itself has the right to issue a commercial letter of credit and to accept drafts drawn under such letters of credit, nevertheless "such powers do not carry with them the power to guarantee, or act as surety upon, acceptances or letters of credit issued by other banks." The Board, however, has outlined a plan whereby an interior bank may still have its large city correspondent issue letters of credit for local customers without running contrary to the Board's ruling.

[1] P. 386.

It is proposed that the interior bank merely designate the city correspondent as the agent which is authorized to issue letters of credit to customers of the former. The interior bank's name will not appear on the letter of credit, but the city correspondent is to look directly and unconditionally to it for reimbursement, and not conditionally upon the failure of the client to put the issuing bank in funds. Under this arrangement the client will pay the sum involved to the interior bank, and the latter will reimburse the city correspondent. To the layman this new arrangement seems to be merely a case of "beating the devil around the bush," but, in so far as banking law is concerned, it really represents an entirely new and also a legal practice. And, while, at first sight, the decision appeared to many to mean the curtailment of the activities of national banks in the financing of foreign trade through letters of credit, the new plan as suggested by the Board points to a thoroughly satisfactory and legal way out of the difficulty.

Collecting Drafts Abroad. It is not an uncommon practice for exporters to hand their drafts and documents to their local banks for collection rather than to offer them for discount. It may be that discount rates are unsatisfactory and that the exporter has sufficient funds to carry him until the collections are made; or possibly the consignee is unknown and the shipper is not quite certain as to whether or not the draft will be accepted, thus possibly involving extra expense in the shape of protest fees, etc.; or the shipper may have agreed that the consignee is to take the merchandise in part lots, making pro-rata payments therefor, thus having returns forwarded to him by the collecting bank as each separate lot is delivered.

If the collection method is adopted, the shipper should be careful to draw his draft in such a way that he will be sure to receive its full face value. The directions given by the American Express Company in this connection, which may advisedly be followed in all cases, are as follows:

"Drafts to be collected by the American Express Company should be drawn to shippers' own order, and indorsed to the American Express Co.

"If full face value of dollar drafts is desired, each draft should carry the following: 'Payable with exchange, all bill stamps and all collection charges at holding bank's selling rate of exchange for sight drafts on New York.'

"If full face value of drafts, plus interest is desired, each draft should carry the following:

"'Payable with exchange, all bill stamps and all collection charges plus interest at the rate of 6 per cent per annum from date of issue to approximate due date of arrival of cover in New York.'

"If collection charges are for account of drawer, the dollar draft should bear the following phrase: 'Payable at the collection bank's selling rate on day of payment for sight drafts on New York.'

"In drawing upon Spain and France, the check form instead of the draft form should be used (on account of resulting economy of bill stamps), in other words the phrases referring to the words 'exchange' and 'value received' should be omitted on the face of the draft. Dates and amounts must be written in words instead of figures."[1]

Detailed instructions relating to every possible contingency should accompany the bill of exchange. Are the documents to go D/A or D/P; what is to be done in case or non-acceptance or non-payment; shall the draft be protested; these and similar questions should be completely covered by the instructions. If the bank is advised beforehand concerning these matters it is then in a satisfactory position to care for the interests of the shipper. Furthermore, the bank is "on the ground," so to speak, and can care for emergencies as they arise. At times the importer for sundry reasons may be unable to accept the draft. The shipper, being informed by the collecting bank of that fact, may order the latter, if possible, to clear the goods pending their resale to another party. This type of service rendered by the collecting bank "is of great importance in many South American countries, where clearance must be effected within a limited time after the arrival of the shipment, or else heavy penalties are incurred. Or, if non-payment is due to temporary financial difficulties of the purchaser, the collecting bank, upon receipt of new authority, is in position to obtain full satisfaction by using the installment plan. Allowing payment of one-third of the draft in 30, 60 or 90 days has been successfully applied in cases which have appeared to be hopeless at first. Or again, if the shipment is valuable, instructions may be given to reforward it to another nearby market or even to return it to the United States." [2]

There is always the question as to who is to pay the collection charges. These are nominal sums and are levied at a graduated scale upon the face value of the draft. European banks charge from 1/16

[1] Foreign Trade Bulletin of the American Express Company, July–August, 1919.
[2] *Ibid*, October–November, 1917.

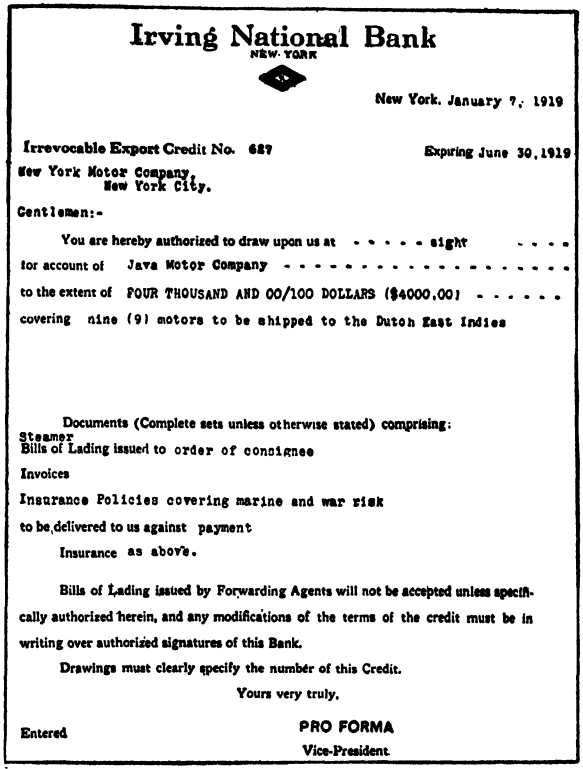
to 1/8 of one per cent. The fees of the American banks are slightly higher. The seller and buyer usually agree beforehand as to which party is to pay the collection charges. "In the absence of any previous agreement as to the payment of such charges, exporters should remember that the laws of many foreign countries, particularly in South America, make it impossible for the banker to collect more than the amount for which the bill is drawn. Quite frequently the above clause [relating to collection charges] is used without the consent of the purchaser, and the collecting bank has the alternative of declining to receive payment altogether or of waiving all claim to the charges. If they are waived, the banker does so because he believes it to be against the exporter's interest to refuse the face amount of the draft and naturally will look to the exporter to refund him for his services to the extent that he was entitled to collect from the drawee." [1]

Export Credits. There are still other ways by means of which international trade may be financed. For example, the importer may go to his local bank and arrange to open an account with a bank in the exporter's country. He can deposit funds with his local bank, which will then forward exchange or by other means open an account for him with the designated foreign bank. Instructions will also be forwarded at the same time asking the foreign bank to receive the documents and to pay the sight draft of the exporter when presented by the latter. The exporter is notified by the bank with which the account has been opened. The exporter prepares his documents and draws his draft on the local bank. The bank cashes the draft and forwards the documents to the correspondent bank in the importer's country. The latter bank then turns the documents over to the importer and he gets the goods. Both the bank in the exporter's country and the one in the importer's country will charge a small commission to the importer for acting in the above capacity. One advantage of this method is that the importer is saved the risk of forwarding cash with his order.[2] No money is paid out by the foreign bank until the shipment has actually taken place. The importer, however, loses interest on the funds involved.

Another practice followed at times is to have the importer arrange to have his bank instruct its foreign correspondent to pay out a specified sum of money to the exporter under certain designated conditions

[1] Foreign Trade Bulletin of the American Express Company, October–November, 1917.
[2] Cf. p. 235.

and to charge the same to its (the importer's bank's) account. The importer then has to pay the commission of the foreign bank and also of his own bank plus interest on the use of the money, but these charges generally compare favorably with what he would have to



Irving National Bank
NEW YORK

New York, January 7, 1919

Irrevocable Export Credit No. 687 Expiring June 30, 1919

New York Motor Company,
New York City.

Gentlemen:-

You are hereby authorized to draw upon us at - - - - - sight - - - -
for account of Java Motor Company - - - - - - - - - - - - - - - - - -
to the extent of FOUR THOUSAND AND 00/100 DOLLARS ($4000.00) - - - - - -
covering nine (9) motors to be shipped to the Dutch East Indies

Documents (Complete sets unless otherwise stated) comprising:
Steamer
Bills of Lading issued to order of consignee
Invoices
Insurance Policies covering marine and war risk
to be delivered to us against payment
Insurance as above.

Bills of Lading issued by Forwarding Agents will not be accepted unless specifically authorized herein, and any modifications of the terms of the credit must be in writing over authorized signatures of this Bank.

Drawings must clearly specify the number of this Credit.

Yours very truly,

Entered PRO FORMA
Vice-President

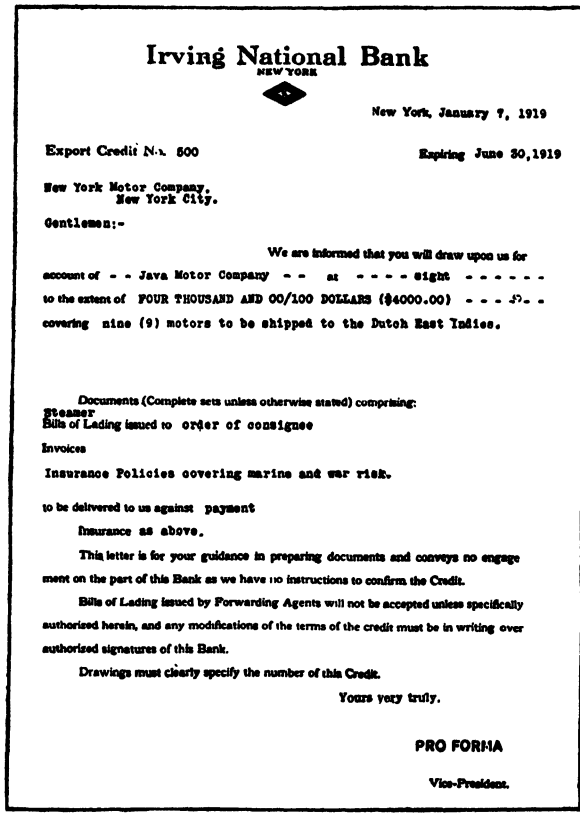
FIGURE 77
Confirmed export credit

pay for sight drafts should he choose that method of paying the exporter.

Somewhat similar is the method whereby the importer arranges with his bank for the establishment of a credit [1] in the exporter's country. A great deal of Asiatic trade with the United States is

[1] The term "letter" is seldom employed in connection with export credits such as are described in the following pages. The terms "export credit," "credits" or "advice of

financed in this manner. Such credits may be established in one of several ways. The importer, say the Java Motor Company of Batavia, may ask the Netherlands State Bank to issue an "export



Irving National Bank
NEW YORK

New York, January 7, 1919

Export Credit No. 500 — Expiring June 30,1919

New York Motor Company,
New York City.

Gentlemen:-

We are informed that you will draw upon us for account of - - Java Motor Company - - at - - - - sight - - - - - - to the extent of FOUR THOUSAND AND 00/100 DOLLARS ($4000.00) - - - - - covering nine (9) motors to be shipped to the Dutch East Indies.

Documents (Complete sets unless otherwise stated) comprising:
Steamer
Bills of Lading issued to order of consignee
Invoices
Insurance Policies covering marine and war risk.

to be delivered to us against payment
Insurance as above.

This letter is for your guidance in preparing documents and conveys no engagement on the part of this Bank as we have no instructions to confirm the Credit.

Bills of Lading issued by Forwarding Agents will not be accepted unless specifically authorized herein, and any modifications of the terms of the credit must be in writing over authorized signatures of this Bank.

Drawings must clearly specify the number of this Credit.

Yours very truly,

PRO FORMA

Vice-President.

FIGURE 78
An unconfirmed export credit

credit" [1] on its New York correspondent in favor of the New York Motor Company, covering the shipment of nine motor cars. The Java Motor Company then fills out and signs a letter of guarantee,

credit" are, however, generally used. The reason probably is because the banks in the exporters' country that advise the exporters of the existence of such credits do not assume any primary obligations, but rather secondary obligations contingent only upon the default of their correspondents abroad. Cf. Federal Reserve Bulletin, April, 1921, p. 413.

[1] When an English bank establishes for its client a credit in a foreign country and in the money of that country, it is called a "currency credit."

similar to the one discussed above in connection with commercial letters of credit.[1] The Java bank then notifies the Irving National Bank, its New York correspondent, and asks it to act in the desired capacity. The Irving National Bank sends to the New York Motor Company either a confirmed (Fig. 77) or an unconfirmed export letter of credit (Fig. 78). This form notifies the exporter that he is to draw upon the Irving National Bank at sight or at so many days sight for goods to be sent to the Java Motor Company. If the draft is drawn at sight the Irving National Bank will pay when it is presented with documents attached, provided the terms of the credit have been complied with. It may pay directly out of its own funds, or it may instead be advised to debit the account of the Netherlands State Bank which it holds. The Irving National Bank forwards the documents to the Netherlands State Bank, accompanied by a statement of its charges. If it pays the draft from its own funds the charges will include the face value of the draft, the bank's commission, and also interest on the funds invested from the time the draft has been paid until a remittance can reach it from the Netherlands State Bank. On the other hand, if it simply debits the account of the Java bank for the transaction, the charges cover only its commission for acting as the representative of the Java bank. All charges are finally passed on to the importer in accordance with the terms of the letter of guarantee which he signed at the time he asked that the export credit be opened for him.

If the draft is for 90 days sight the Irving National Bank accepts the draft and returns it to the exporter, takes the documents and forwards them to the Netherlands State Bank, notifying it at the same time of the due date of the draft. The Java bank collects the funds from the Java Motor Company in time to forward them to the Irving National Bank so that the latter bank may be put in funds wherewith to meet the payment of the draft at maturity. The exporter may either hold the accepted draft until maturity or he may have it discounted immediately in the New York open market. The accepting bank may discount its own acceptance, thus making it unnecessary for the exporter to discount it elsewhere, but this is not generally done. When it is, however, the draft may be canceled as paid, or it may even be sold to some other bank and later paid at maturity.

[1] Pp. 238–239.

It should be evident, from our discussion in this chapter, that bank credits of all kinds used to finance foreign trade may be grouped into irrevocable, revocable, confirmed, and unconfirmed. When a bank issues a letter of credit on itself the letter may be revocable or irrevocable, depending upon whether or not it reserves the right to rescind its engagement to honor drafts drawn on it by the beneficiary.[1] When it issues a letter of credit on a foreign bank and asks it to notify the beneficiary that it (the foreign bank) agrees to honor the drafts drawn on it, or where the beneficiary asks the foreign drawee bank to give such a guarantee and the foreign bank does so, the letter of credit then becomes a "confirmed" credit. If such a guarantee is not asked for, or if it is asked for and not given, it is known as an "unconfirmed" credit. There has been much confusion in the use of these terms both by bankers and by traders. The statements of Mr. George W. Edwards in the *Federal Reserve Bulletin* of February and June, 1921, are so excellent and so authoritative that I take the liberty of quoting them verbatim.

"If the credit-issuing bank reserves the right to withdraw from the undertaking, the document is styled a 'revocable' letter of credit. The 'irrevocable' letter of credit contains a definite engagement on the part of the issuing bank to honor drafts drawn by the beneficiary in accordance with the terms and conditions specified in the letter. This engagement may not be canceled by the issuing bank prior to the expiration date without the consent of the beneficiary. The 'irrevocable' letter of credit may be strengthened further by having the notifying bank in the same country as the exporter add its unqualified assurance that it will pay or accept the bills drawn by him even if the foreign bank should refuse to honor them. It is then called a 'confirmed export letter of credit. Expressing, therefore, both the definite undertaking of the issuer and also of the notifier, it is actually an 'irrevocable-confirmed' letter of credit. Where the notifying bank does not add its guaranty, the credit is described as 'unconfirmed,' since the advising bank maintains that it is merely transmitting the information of the credit to the beneficiary without incurring liability for its continuance. Thus three classes of letters of credit may exist: (1) Irrevocable by the issuer and confirmed by the adviser; (2) irrevocable by the issuer but unconfirmed by the adviser; (3) revocable by the issuer and also unconfirmed by the adviser." [2]

[1] The beneficiary is always the party who is authorized to draw drafts under the terms of a letter of credit.

[2] *Federal Reserve Bulletin*, February, 1921, p. 158.

"It is . . . clear that a distinction must be drawn between an irrevocable and a confirmed letter of credit. The irrevocable letter of credit is a document in which a foreign bank promises to honor the drafts of the beneficiary, provided he complies with certain conditions stated in the letter, and it is an obligation absolutely binding upon the issuing institution. This credit may be sent directly by mail to the exporter, or it may be transmitted by cable to a correspondent bank, which in turn informs the favored party of the credit. This report is conveyed without the assumption of any liability by the informing bank. However, if the notifier, at the request of the issuer, adds its guarantee or confirmation to the advice addressed to the beneficiary, it then becomes an engagement binding upon both banks. In other words, one credit is irrevocable by the issuer but unconfirmed by the notifier, and the other is both irrevocable by the issuer and further confirmed by the notifier." [1]

Most bank credits are irrevocable and not confirmed. Some are irrevocable and also confirmed. A very small number are revocable because an exporter does not care to ship goods under the terms of a revocable letter of credit.

Regarding the type that is revocable by the issuer and unconfirmed by the notifier, Mr. Edwards states that this form "does not constitute a true letter of credit, for the document is the obligation neither of the issuing nor of the notifying bank, and hence cannot be described as a 'credit.' This document should be termed rather a 'letter of advice.' It serves a definite trade purpose especially in financing shipments from agents, affiliated concerns or firms which, of course, would not cancel their obligations. Most banks do not issue these revocable letters of advice." [2]

The above classification "is a departure from the usual precept that the terms 'confirmed' and 'irrevocable' are synonymous as applied to commercial credits. However, while writings on this subject accept the two-fold grouping of confirmed or irrevocable as against unconfirmed or revocable credits, actual banking practice operates on the classification given above." [3]

While it may be said that the exporter is normally protected against loss by an irrevocable letter of credit, nevertheless it is always advisable for him to examine most carefully the phrases and clauses, terms and conditions which the letter contains. A letter of credit will lapse

[1] *Federal Reserve Bulletin*, June, 1921, p. 683.
[2] *Ibid*, p. 683.
[3] *Ibid*, February, 1921, p. 158.

if not availed of within the designated time; or it may contain a "joker" of some sort, hidden away in a mass of verbiage, that may make it impossible for the exporter to realize on it regardless of how closely he lives up to its terms; or it may be so worded that errors, and subsequently disputes and legal proceedings, may easily arise if the exporter does not study and understand its various parts. The beneficiary must ever be on his guard, and should remember, as someone has well said, that "A letter of credit is just as safe as its wording." A situation similar to those that exporters have to meet from time to time is illustrated by the following: An American exporter received a letter of credit from an Oriental importing firm, the letter containing a clause to the effect that "Shipments are to be made as per buyer's shipping instructions." No additional instructions were given as to shipping dates. The goods were awaiting shipment in August, the letter was to expire in October, but prices fell greatly in the meantime and the importer took advantage of the loophole, refused to give shipping instructions and thus canceled his engagement. Such clauses enable an unscrupulous importer to assure himself of a supply of goods, and if prices fall or if he can obtain better terms from some other exporter, he can simply allow the credit to expire by refusing to forward the necessary shipping instructions.

Statements similar to the following appear in irrevocable letters of credit:

"We hereby agree with the drawers, indorsers and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same shall be duly honored upon presentation to us."

or

"We hereby engage that drafts in compliance with the terms of this credit will be duly honored."

or

"We engage that the bills so drawn shall be accepted on presentation and paid at maturity."

Banks may confirm credits by stating that:

"We herewith open a confirmed credit in your favor."

or

"We are informed by ———————— (the issuing bank) that they

have established a credit with us in your favor, which we herewith confirm."

or

"We hereby confirm the following credit opened at the request of———————(the issuing bank)."

Bank credits that are revocable contain statements similar to the following:

"This credit is revocable and subject to cancellation."

or

"Please note that this credit may be modified or canceled with or without notice to you."

Banks may refuse to confirm credits by using such statements as the following:

"Please note that this is an unconfirmed credit."

or

"We have no authority from our clients to confirm this credit."

Legal Aspects of Commercial Letters of Credit. During the last half-century the commercial letter of credit in one form or another has been the financial basis for the development of the greater part of the foreign trade of England. Questions have arisen from time to time as to the rights of exporters, importers, issuers, and negotiators, and a line of decisions has been handed down by the British courts. With the United States, however, it has been only since 1916 that the commercial letter of credit issued by American banks in terms of dollars has played even a small part in our foreign trade. When prices were rising and while trade was booming, almost no questions arose among American bankers and traders as to the rights of the parties under letters of credit. But when in 1920 prices began to tumble in an incredible manner, and importers found themselves held to pay for goods contracted for at higher prices, and facing losses of considerable magnitude, they hastened by every conceivable device to attempt the cancellation of their contracts and to avoid fulfilling the terms of confirmed letters of credit which banks had issued at their request. Not only did cancellation of contracts become a common practice among our own merchants and importers, but American exporters

also found that foreign merchants likewise availed themselves of every excuse and form of trickery for the purpose of avoiding their legal obligations as purchasers of American goods. Injunctions and court proceedings became matters of common occurrence, but fortunately, courts both here and abroad maintained their earlier attitude and held that a bank which has issued a "confirmed credit has no option but to pay drafts presented against the credit, provided the conditions specified in the credit are complied with." When a bank issues a letter of credit it promises to make certain payments to designated beneficiaries provided the conditions of the credit are fulfilled. Court decisions have uniformly held that if the shipper has complied with those conditions the bank has no option but to pay the draft or drafts that are drawn under the credit. "It has neither the right nor the power to go behind the transaction in the interest of its client and endeavor to assist the client in avoiding payment" even though such payment may "result in a loss to the client. If the routine specifications called for by the letter of credit as to quality of goods, time of shipment or other details appear to have been complied with, any breach of contract between the buyer and the seller is a matter for litigation between them, and concerns the bank in no way. The bank is bound to pay, and an attempt to abet the efforts of clients who are seeking by questionable means to avoid losses will inevitably react against the bank which tries such a thing and the purchaser who instigates the action, and it will inevitably ruin the reputation of the American business community in foreign countries . . ." Foreign "sellers of goods to this country ship the goods with the understanding that the credits against which their drafts are drawn are irrevocable, provided shipping documents are in order. They feel an absolute assurance of acceptance upon presentation. Of course, after a draft has been accepted by the bank, it is then the obligation of the bank itself which the bank is bound to pay at maturity. No legal action can possibly be maintained that would serve to prevent the bank paying at maturity its acceptance when presented by a holder in due course. All these attempts to evade the carrying out of contracts have been made with the idea of preventing a bank from accepting under the terms of its irrevocable letter of credit and have not had to do with drafts previously accepted. It is well to bear in mind that nothing can transpire which can effect the integrity of the banker's acceptance after it has in fact become an acceptance. To allow any

movement to get started having for its purpose the slightest deviation from this would be disastrous and would result in the complete disappearance of the dollar acceptance outside of the United States. If the integrity of the dollar acceptance becomes impaired, American importers will be forced to resort to the humiliation of financing their purchases by means of sterling or other foreign credits." [1]

After giving a most comprehensive and excellent review of British decisions concerning commercial letters of credit, Mr. George W. Edwards of the Division of Analysis and Research of the Federal Reserve Board [2] concludes that the following principles may be deduced: "(a) A letter of credit is not a negotiable instrument. (b) It does not create a trust fund in favor of the beneficiary. (c) An issuer of a letter of credit may not dishonor drafts presented by a negotiating bank under a clean irrevocable letter of credit if all the terms of the credit are fulfilled. (d) An issuer may dishonor bills drawn in violation of the conditions specified in a documentary letter of credit. The negotiator is not liable for the genuineness either of goods or documents. (e) The issuer is responsible to the party requesting the credit for the observance of the conditions by the beneficiary. (f) The contract between the issuer and the beneficiary is entirely independent of the contract of sale between the buyer and seller, and the issuer cannot, because of the seller's breach of contract of sale, refuse to honor drafts which comply with the terms of the letter of credit." [3]

Recent American cases have closely followed the principles laid down by the British courts in such matters. Mr. Edwards, in the

[1] *The Americas*, December, 1920, p. 2.

[2] *Federal Reserve Bulletin*, February, 1921, pp. 159–162.

[3] *Ibid*, p. 162. These conclusions are based on the decisions of British courts in the following cases: Orr & Barber *v.* Union Bank of Scotland (1854), 24 Law Times, Old Series, 1; Waterson *v.* Edinburgh and Glasgow Bank (1858), 20 Dun. (Ct. of Sess., 642, Scot.); Sovereign Bank *v.* Bellhouse (1911), Quebec Reports, 23, King's Bench, 413; Morgan *v.* Lariviére (1875), Law Reports, vol. 7, House of Lords, 423; Bank of Toronto *v.* Ansell (1875), 7 R. L. Q. B., 262; Graham *v.* Mahony, Irish Law Reports [1st series], 385; Agra & Masterman's Bank, ex parte Asiatic Banking Corporation (1867), 36 Law Journal, Chancery, 222; Maitland *v.* Chartered Mercantile Bank of India, London, and China (1869), 38 Law Journal, 363; Oriental Banking Corporation *v.* Lippert & Co. (1875), Buchanan's Reports, South Africa, p. 152; Brazilian & Portuguese Bank (Ltd. *v.* British and American Exchange Banking Corporation, 18 Law Times, p. 823; Union Bank of Canada *v.* Cole, 47 Law Journal, Queen's Bench, p. 100; Chartered Bank of India, Australia & China *v.* Macfayden & Co., 64 Law Journal, Queen's Bench, p. 367; Woods *v.* Thiedemann I. Hurlstone & Coltman, 478; Ulster Bank *v.* Synnott, Irish Reports 5, Equity 595; Guaranty Trust Co. of New York *v.* Hannay, 87 Law Journal, King's Bench, 1223; Basse & Selve *v.* Bank of Australia (1904), 90 Law Times, 618; Borthwick *v.* Bank of New Zealand (1900), 17 Times Law Reports, 2; Prehn *v.* Royal Bank of Liverpool (1870) Law Reports, 5 Court of Exchequer, 92.

article cited, also presents a brief statement of the three outstanding decisions handed down by American courts from which statement the following quotations have been taken:

"The case of American Steel Co. *v.* Irving National Bank, 266 Fed. 41 (C. C. A., 2d Circuit, Apr., 1920), holds that the beneficiary of an irrevocable letter of credit has an absolute right to have the drafts honored by the issuing bank when drawn in accordance with the terms of the letter, and that the issuing bank cannot decline to honor drafts so drawn, even though requested to do so by its customer, because the contract of sale between that customer and the beneficiary has become impossible of performance. In that case the defendant national bank had issued an irrevocable letter of credit to the plaintiff steel company authorizing the plaintiff to draw at sight upon the national bank for account of the defendant MacDonnell Chow Corporation for $43,000 covering the shipment of tin plate. The plaintiff steel company had contracted to sell the tin plate to the defendant MacDonnell Chow Corporation f. o. b. Pittsburgh for export. The plaintiff shipped the tin plate and presented a sight draft to the defendant national bank with certain documents and the defendant national bank declined to honor the draft. The second defense alleged that by reason of the Federal prohibition against the export from the United States of tin plate the performance of the contract between the plaintiff and the defendant MacDonnell Chow Corporation became impossible of execution. The third defense alleged a resale by the plaintiff of the tin plate and claimed an offset of the amount realized on the resale. As to the second defense, Circuit Judge Rogers said:

> 'The second defense, that the contract became impossible of execution, inasmuch as the MacDonnell Corporation was unable to obtain a license from the United States Government permitting the export of the tin plate, is wholly inconsequential. The liability of the bank on the letter of credit as agreed upon between plaintiff and defendant was absolute from the time it was issued, and it was quite immaterial whether the defendant could export the tin or not. The law is that a bank issuing a letter of credit like the one here involved cannot justify its refusal to honor its obligations by reason of the contract relations existing between the bank and its depositor.'

"The opinion then cites with approval the case of Sovereign Bank of Canada *v.* Bellhouse, Dillon & Co. (Ltd.) (*supra*) upon the point that the customer at whose instance a bank has issued an irrevocable letter of credit cannot compel the bank to cancel that letter, since the letter constitutes a contract between the issuing bank and the beneficiary. The opinion concludes:

'The defendant in effect seeks to read into the contract a provision that the plaintiff's rights under the letter of credit should be subject to the superior right of the MacDonnell Chow Corporation to modify the contract which the bank had made with the plaintiff. We do not so understand the law.'

"The case of Frey & Son (Inc.) *v.* Sherburne Co. and the National City Bank, 184 New York, Supp. 661 (Appellate Division, N. Y. Supreme Court), expressly holds that the contract between the issuing bank and the beneficiary, as evidenced by the letter of credit, is entirely independent of the contract of sale between the buyer at whose instance the letter of credit was issued and the seller who is the beneficiary under the letter of credit, and that the issuing bank cannot repudiate its contract with the beneficiary merely because of a breach of the contract of sale. The facts in that case were that the plaintiff had agreed to buy from the defendant Sherburne Co. 350 tons of sugar to be shipped from Java; payment for the sugar to be made in New York on presentation of warehouse receipt or delivery order and the plaintiff to furnish an irrevocable letter of credit for the full amount of the invoice. The contract also provided that the plaintiff, the buyer, should have the right to cancel the contract in the event that the shipment was delayed. At the instance of the plaintiff the defendant national bank issued a letter of credit to the Sherburne Co. authorizing that company to draw sight drafts upon the bank accompanied by specified documents covering the shipments of sugar. The letter of credit also contained a provision whereby the bank agreed with bona fide holders that all drafts issued in accordance with the letter would be honored upon presentation. The letter did not, however, refer to the plaintiff's right to cancel the contract of sale if shipment was delayed. The plaintiff alleged that the shipment of 45 tons of the sugar had been delayed and that he had elected to cancel his contract for the purchase of so much of the sugar and that notwithstanding this the defendant Sherburne Co. threatens to negotiate or present for payment drafts drawn under the letter of credit and that the defendant national bank threatens to pay such drafts if so presented or negotiated. The relief sought by the plaintiff was an injunction restraining Sherburne Co. from drawing or negotiating drafts under the letter of credit and enjoining defendant national bank from honoring or paying drafts which have been or may be so drawn. In the opinion, Mr. Justice Greenbaum says:

'From our view of the case it is not important to discuss the rights of the plaintiff under the contract with the defendant Sherburne Co. . . .

'It is equally clear that the bank issuing the letter of credit is in no

way concerned with any contract existing between the buyer and seller. The bank is only held liable in case of a violation of any of the terms of the letter of credit. It therefore would follow that, if the bank issued any drafts violative of the terms of the letter, the buyer would have recourse to the bank in an action for damages for the breach of its contract. Similarly, if the defendant Sherburne Company violated its contract with the plaintiff, the latter has a remedy in an action at law for damages against the defendant. It is not alleged in the complaint that the National City Bank is in financial difficulties. Nor is it alleged that the Sherburne Company is not financially able to respond to damages. Our attention has been called to Higgins *v.* Steinhardter (106 Misc. Rep. 168; 175 N. Y. Supp. 279). We are of the opinion that the facts appearing in the opinion of that case did not warrant the granting of an injunction. Interests of innocent parties who may hold drafts upon the letter of credit should not be made to suffer by reason of rights that may exist between the parties to the contract of sale in reference to which the letter of credit was issued. It would be a calamity to the business world engaged in transactions of the kind mentioned in this complaint, if for every breach of a contract between buyer and seller a party may come into a court of equity and enjoin payment on drafts drawn upon a letter of credit issued by a bank. The parties should be remitted to their claims for damages in an action at law.'

"To the same effect is the case of El Reno Grocery Co., etc. *v.* Lamborn, et al., reported in the New York Law Journal for December 15, 1920, in which Mr. Justice Cohalan of the Supreme Court of New York said:

'There are before the court 24 motions for injunctions pendente lite in equity cases brought for the cancellation of certain contracts for the sale of sugar which the plaintiffs have attempted to rescind. The decision on this application is decisive of the 23 other motions. To enjoin the defendants from collecting upon a letter of credit established in their favor, because the plaintiff alleges there is a dispute, default or breach by the defendants of the contract is for the court to make a new, different and distinct agreement between the parties herein. This the court is not prepared to do. In my opinion the plaintiffs have an adequate remedy at law and there are no substantial reasons shown for invoking the extraordinary remedy of an injunction order. The plaintiff's motion is denied and the injunction vacated.'"

A recent decision by Judge J. M. Mayer in the United States District Circuit Court in New York City is also of interest as further supporting the contention that banks deal in documents and not in

goods, and that even where the goods themselves conform to the sales contract the bank that has issued the letter of credit cannot be held to pay if the documents do not comply with the conditions called for in the letter of credit. The court held that:

"The mere statement of the arguments pro and con destroys the plaintiff's case. When the bank issued this Letter of Credit, it did not purchase goods. It agreed to purchase documents in the sense that it would pay on receipt of certain documents which should conform in every respect with the requirements of the Letter of Credit. It was, of course, not concerned with the goods, but with the documents. It would gravely impair the business of issuing Letters of Credit if banks were required to construe the documents involved and determine arguable questions. The only safe rule for a bank is to refuse to pay if, by omitting, as here, a distinct and clearly expressed provision, the documents do not conform with the Letter of Credit." [1]

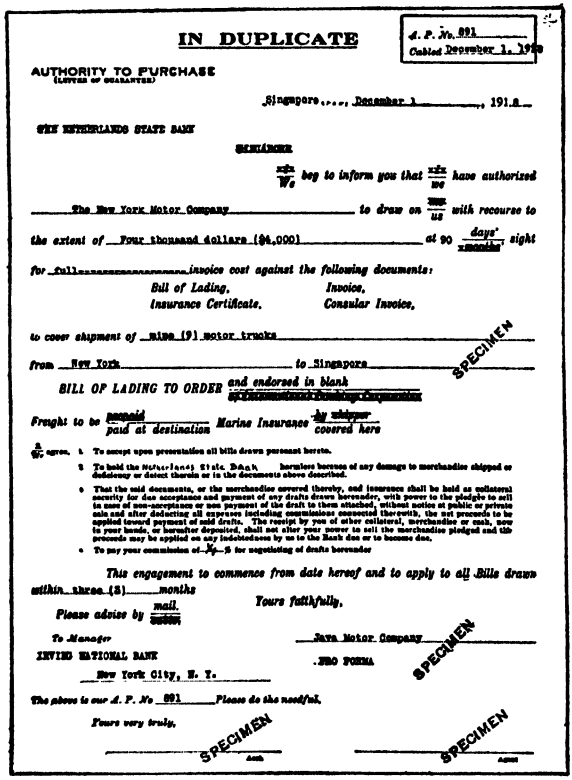
Authority to Purchase. Authority to Draw. Importers at times have recourse to what is known as an "Authority to Purchase," sometimes incorrectly called an "Authority to Draw," as a means of financing their transactions on a credit basis.[2] This document is seldom found outside of banking and trade circles of New York and the Pacific Coast. It is used primarily, if not solely, in the financing of Oriental trade, and almost always in facilitating exports from the United States. The authority to purchase is not a bank credit involving a banker's acceptance. It involves nothing more than a trade acceptance, the negotiation of which is facilitated by the services of a bank in the importer's country, which acts as the issuer of the authority, and a bank in the exporter's country, which acts as the purchaser of the exporter's draft.

To make matters somewhat clearer, let us take the transaction which we have discussed above, involving the shipment of goods to the Java Motor Company, and see how the shipment can be financed by means of an authority to purchase. The Java Motor Company, being desirous of importing a shipment of trucks from the New York Motor Car Company, goes to the Netherlands State Bank and asks it to issue an authority to purchase in favor of the latter. The Java concern being well known to the issuing bank may or may not have

[1] Quoted in Foreign Trade Bulletin of the American Express Company, September–October, 1921.

[2] Cf. an excellent article on "The Authority to Purchase" in the *Federal Reserve Bulletin*, August, 1921, pp. 926–931.

to deposit security before the bank will furnish the desired accommodations. If the bank consents, it asks the Java Motor Company to fill in and sign a "letter of guarantee." The Java bank then fills in another form, or merely types a letter to the same effect, asking



IN DUPLICATE

A. P. No. 891
Cabled December 1, 1918

AUTHORITY TO PURCHASE
(LETTER OF GUARANTEE)

Singapore, December 1, 1918

THE NETHERLANDS STATE BANK

CASHIER

We beg to inform you that we have authorized

The New York Motor Company to draw on us with recourse to

the extent of Four thousand dollars ($4,000) at 90 days' sight

for full invoice cost against the following documents:

Bill of Lading, Invoice,
Insurance Certificate, Consular Invoice,

to cover shipment of nine (9) motor trucks

from New York to Singapore

SPECIMEN

BILL OF LADING TO ORDER and endorsed in blank

Freight to be prepaid / paid at destination Marine Insurance by shipper / covered here

We agree, 1. To accept upon presentation all bills drawn pursuant hereto.

2. To hold the Netherlands State Bank harmless because of any damage to merchandise shipped or duplicates or dupes thereof or in the documents above described.

3. That the said documents, or the merchandise covered thereby, and insurance shall be held as collateral security for due acceptance and payment of any drafts drawn hereunder, with power to the pledgee to sell in case of non-acceptance or non payment of the draft to them attached, without notice at public or private sale and after deducting all expenses including commissions connected therewith, the net proceeds to be applied toward payment of said drafts. The receipt by you of other collateral, merchandise or cash, now in your hands, or hereafter deposited, shall not alter your power to sell the merchandise pledged and the proceeds may be applied on any indebtedness by us to the Bank due or to become due.

4. To pay your commission of ½ % for negotiating of drafts hereunder

This engagement to commence from date hereof and to apply to all Bills drawn within three (3) months

Please advise by mail / cable

Yours faithfully,

To Manager

Java Motor Company

IRVING NATIONAL BANK

PRO FORMA

SPECIMEN

New York City, N. Y.

The above is our A. P. No 891 Please do the needful.

Yours very truly,

SPECIMEN

SPECIMEN

FIGURE 79

Authority to purchase (letter of guarantee)

the Irving National Bank to purchase the draft drawn by the exporter and also giving other necessary instructions. This is the "authority to purchase." Some banks use separate forms for these two documents; others combine them into one form (Fig. 79). In short, all that the importing firm has done is to go to its local bank and ask it to arrange for, or to guarantee, a purchaser of the draft that is to be drawn on it (the Java Motor Company) by the New

York exporter. Trade acceptances are not easily marketable, and especially do those drawn on Oriental firms have to be provided with assured purchasers in the manner under discussion.

If the Irving National Bank is willing to carry out the transaction it writes the New York Motor Company, notifying it that it (the exporter) may draw on the Java Motor Company for a definite sum of money and that it (the bank) will negotiate the same for the Netherlands State Bank (Fig. 80). This letter constitutes what is known

IRVING NATIONAL BANK

NEW YORK
Organized 1851

Cable Address
"Irving Bank-New York"

Foreign Department
(In replying please quote Export Credit)
January 2nd, 1919

ADVICE # 600/100
New York Motor Co.
New York City, N. Y.

Gentlemen:

We are instructed by the Netherlands State Bank to negotiate as offered, without recourse, your documentary bills at ninety days sight on Java Motor Company, Singapore, to the extent of FOUR THOUSAND AND 00/100 DOLLARS ($4000.00) at one time outstanding, for invoice cost of goods shipped to that port.

The bills must be accompanied by a full set of Bills of Lading (Express Company's Bills of Lading not acceptable) and Insurance Certificates covering marine insurance and also war risk insurance, made out to order and endorsed in blank together with invoice covering merchandise shipped from America to Singapore, and shipping documents to be delivered against payment of the relative drafts.

The drafts must be drawn to order, endorsed in blank and be marked.

"Drawn under authorization of the Netherlands State Bank, # 100" and must bear the following clause:

"Payable with interest added at the rate of 6% per annum from date of draft until approximate arrival of cover in New York."

This authorization is subject to cancellation and/or modification by us at any time.

Kindly hand in this letter with your drafts in order that the amounts of the same may be endorsed on the back hereof.

Yours very truly,
PRO FORMA
Vice President.

FIGURE 80—Authority to draw or advice of authority to purchase

as the "authority to draw" or the "advice of authority to purchase." This advice also contains directions for the guidance of the exporter in preparing the shipment and in drawing the draft.

The exporter ships the goods, gets the documents, and draws the draft on the importer in dollars. Practically all drafts drawn under an authority to purchase are dollar drafts. They usually run for 60, 90, or 120 days. The exporter then takes the documentary bill of exchange (documents are almost always indorsed in blank under an A/P) to the Irving National Bank which pays the face value of the draft. The Irving National Bank immediately debits the account of the Netherlands State Bank with that sum plus charges. In order to reimburse the Java bank for interest lost as a consequence of such debiting, the customary interest clause is inserted in the draft.[1] The documentary bill is sent to the Netherlands State Bank, which presents it to the Java Motor Company for acceptance. The importer gets his goods and pays the draft at maturity plus interest and commissions.

Authorities to purchase may be revocable or irrevocable by the issuing bank, while authorities to draw (advices of authority to purchase) may be revocable, irrevocable, confirmed, or unconfirmed. When the Java bank sends an authority to purchase to the New York bank, it may agree to meet all obligations no matter what situations may arise. This is an irrevocable A/P. If it reserves the right to revoke the A/P at any time, it is a revocable credit. The New York bank may be asked by the Java bank to "confirm" the credit, and if it is willing to do so it includes in the authority to draw, which it sends the exporter, a statement worded somewhat as follows:

"We herewith open a confirmed credit in your favor"

or

"We hereby confirm the following credit opened at the request of ———."

If a bank confirms the credit, it charges an extra commission, usually one-eighth of one per cent, because such confirmation adds the credit of the notifying bank to the transaction and also causes it to assume the liability as a "confirmer" or "guarantor."

If the credit is "unconfirmed," the authority to draw will read somewhat as follows:

[1] Cf. pp. 267–270.

"Kindly note that this is not a confirmed credit, and is consequently revocable at any time, either by the parties granting the credit, or by ourselves under certain conditions."

or

"Please note that this is an unconfirmed credit and is consequently subject to modification or cancellation."

It is clear from these statements that an unconfirmed authority to draw is also revocable by the notifying bank, although not necessarily revocable by the issuing bank. When the credit is unconfirmed by the notifying bank, or revocable by the issuing bank, it is subject to cancellation at any time prior to the actual payment of the draft. If the credit is not confirmed by the notifying bank, it will receive its fee for acting as the representative of the foreign bank, for examining the shipping documents to see that everything is satisfactory and in accordance with the terms of the credit, etc.

It will be noted that in the authority to draw given above (Fig. 80), the credit is revocable and that the draft is to be drawn "without recourse" on the exporter. Exporters frequently refuse to ship goods under an authority to draw unless it is confirmed and unless the drafts are to be drawn "without recourse." "Several exporters of experience accept orders based on authorities to negotiate, without recourse, only for shipments of standard material and when billed to houses of undoubted responsibility and reputation for fair dealing. In all other cases they require either that an authority without recourse be given, or that some other arrangement be made whereby they may be assured of their money, in case the importer should refuse to pay." [1]

In all of the instances of *bank credits*, it will be remembered that the draft was drawn upon a bank, either domestic or foreign, which meant the almost absolute certainty that the draft would be paid at maturity regardless of what happened to the importer, unless, of course, the drawee (accepting) bank should fail.[2] In the case of an authority

[1] Irving National Bank, "Exporting to the Far East," p. 79.

[2] "Under the Law of Negotiable Instruments, any bona fide holder has full recourse upon the drawer of a draft under a letter of credit if the drawee bank dishonors the bill. Considering the question not from the strictly legal standpoint but from commercial usage, the drawer of drafts under a confirmed irrevocable letter of credit, issued by a reputable bank, may safely regard the transaction as closed upon acceptance by the drawee bank and he would be liable only in the extreme event of failure of the accepting bank." *Federal Reserve Bulletin*, June, 1921, p. 685.

to draw, which is not technically a bank credit, the draft is drawn against the importer who may become bankrupt before acceptance, or after acceptance and before payment. The banks act merely as agents in handling the transaction and if the exporter is not relieved from his liability by a "without recourse" clause he may be held liable by the negotiating banks for the face value of the draft plus protest charges, etc., just as in the case of an ordinary trade acceptance. It is because of this attendant risk that exporters do not favor the use of an authority to draw as a substitute for the more customary and reliable forms of bank credit. Most banks when they notify the exporter of the existence of an authority to draw make it clear to him that they are acting only as the representative of the foreign bank and that they are not opening a bank credit in his (the exporter's) favor. The following clause is frequently used in this connection: "Please note that this advice [the letter to the exporter] is NOT to be considered as being a 'BANK CREDIT' and does not relieve you from the ordinary liability attaching to the 'DRAWER' of a Bill of Exchange."

In handling export credits, the notifying bank does not insist that the exporter negotiate his drafts with it. In fact it is quite customary for the exporter to negotiate his drafts with his own local bank from which he can undoubtedly receive a much higher rate than from the notifying bank. His local bank then presents the drafts and documents to the notifying bank, so that the latter as a rule eventually gets possession of them. In the instance cited above, it would be possible for the New York Motor Car Company to sell its draft and documents to its local bank, say the National City Bank, which in its turn would dispose of them to the notifying bank, i. e., the Irving National Bank.

Letter of Delegation. There is still another method that may be resorted to by the exporter in obtaining payment for his shipments. In this case he draws no draft, either on the bank or on the importer, but takes the documents to his local bank and asks it to forward them to its correspondent in or near the importer's city. The correspondent is advised in a communication, called a "letter of delegation," [1] of

[1] Although the letter of delegation as previously described (pp. 195–196) was used in another connection, i. e., to pay funds to a designated party in a foreign country, in this case it is used by the exporter to get money for goods shipped. Nevertheless, in both cases it takes the form merely of a set of instructions or directions to a foreign banker or exchange dealer.

the terms under which the documents are to be turned over to the importer. This letter of delegation is not a bill of exchange; it is a set of instructions, and consequently is not negotiable. Neither does it have to carry any revenue stamps as negotiable instruments generally do.

CHAPTER X

RATES OF FOREIGN EXCHANGE

The rates of exchange are the prices charged for the different grades or kinds of bills of exchange. Bills of exchange are similar to any other commodity that has a number of different grades and is sold in a competitive market, such as shoes, for example. There are many grades and styles of shoes with a different price for each, although sometimes different styles or grades may sell for the same price; this is true of bills of exchange. The prices of shoes may vary from week to week or from day to day because of certain conditions or factors in the market; so may the rates of exchange. The price of a pair of shoes may be "shaved" a little for the old customer or for a buyer of large quantities; so it is with bills of exchange. Continuing our analogy, we find that the shoe retailer is both a buyer and a seller of shoes. He has the price at which he buys from the jobber, the wholesaler, or manufacturer, and the price at which he sells to the public. Likewise in the exchange market we have the price at which various kinds of exchange are purchased by the dealer and we also have those prices at which the dealer sells his exchange to the public, or in the language of the exchange market itself, respectively the rates "bid" and the rates "asked." Naturally it is the desire, and the practice wherever possible, of the exchange dealer to buy low and to sell high. In the exchange market, the public and the exchange dealers are simultaneously both buyers and sellers, the buying price of the exchange dealers being the selling price of the public, and vice versa. The public as a seller is made up of exporters desirous of receiving money for goods shipped abroad, individuals wishing to be paid for services performed for foreign clients, tourists with traveler's checks or foreign drafts to be cashed, etc., etc. Exchange dealers whose main stock in trade is a supply of foreign funds or credits are the most active sellers in the market. The public, as a buyer, is composed of importers who must pay for goods purchased in foreign countries, prospective travelers who wish funds for travel, customers desirous of paying foreign debts incurred for any of a number of reasons, etc.

Exchange dealers are continually in the market as purchasers of large amounts of exchange with which to replenish their stock of foreign funds or credits, of which they must always have an available supply in order to carry on their business. These two large groups, i. e., the buyers and the sellers, are the forces that influence the rates one way or the other. What their activities or desires may be, how much they can or are willing to pay or charge, depend upon certain other factors which will be considered in detail in this chapter. It must be recognized that in the foreign exchange field, as in the commodity markets, it is much easier for the smaller, better trained and organized group, viz., the dealers, to act effectively and to exert a predominating influence in the market than it is for the unorganized public. Whether we consider the latter as being made up of buyers or of sellers, it cannot be so closely in touch with all those matters that determine the rates of exchange as can the smaller group of exchange dealers. The public knows nothing of the supply of or the demand for exchange; it is unacquainted with the influence of the discount rates of the central banks of Europe; it is ignorant of fluctuations that may be caused by foreign political developments, war, abundance or failure of crops, and other matters of similar import. Exchange dealers in the important financial centers watch such matters most carefully and attempt to gauge their rates both as buyers and as sellers in accordance therewith. Selling rates are fixed by the dealers on the basis of the buying rates and at a point where a profit is expected on the business as a whole, and not on any particular bill that they buy or sell. In this respect the exchange dealers again are similar to the shoe dealers in that when, for example, the shoe dealer buys his spring stock of goods he attempts to fix his prices at a point that will net him a profit on his business as a whole. He may lose on one style of shoes or on a few sales, but he hopes to gain on his total business.

It is impossible in a discussion of retail prices to go into the details of why each and every retailer fixes his prices at this or at that point, and the same holds true in a discussion of exchange rates. It will be necessary, therefore, for us to confine our discussion to those more important factors that in general affect exchange rates in normal as well as in abnormal times.

It is advisable, first, to explain briefly the methods followed in quoting the exchanges on various countries so that the reader may be perfectly clear regarding all matters subsequently discussed.

In Chapter VI it was noted that as between countries actually on a gold standard basis, i. e., where all forms of money are readily redeemable either directly or indirectly in gold, where gold may be freely obtained for export and for domestic use, and where the mints are open to its free and unlimited coinage, the rates of exchange in normal times fluctuate around what is known as the "mint par of exchange" (more commonly known only as the "par of exchange"); that as between a silver standard country and a gold standard country the rates of exchange fluctuate on a basis of the purchasing power of the gold monetary unit of the latter country measured in terms of the silver monetary unit of the former country, or, in other words, on the basis of the gold price of silver; and that as between a gold standard or silver standard country on the one hand and a country having an irredeemable paper currency on the other, exchange rates vary in accordance with the purchasing power respectively of the gold or the silver monetary unit of the former countries as measured in terms of the paper monetary unit of the latter.[1] A discussion of the exchanges of silver standard, paper standard, and gold exchange standard countries will be taken up in Chapter XII.

The practice of quoting exchange rates is different in different countries regardless of whether or not they are on the same monetary standard. It is needless for us to take up all the different variations; therefore only a few of the more important types will be considered. All of the practices followed, however, may be grouped under the following three methods: (a) fixed exchange, or what Whitaker calls "direct" exchange;[2] (b) movable exchange, or what Whitaker calls "indirect" exchange,[3] and (c) premium and discount exchange.[4] Fixed or direct exchange is where we quote the value of the foreign unit of currency in terms of the money of the home country In quoting English exchange, for instance, we say that the pound sterling is worth 4.85, 4.86, etc. As the pound sterling falls in value we give less of our money, say 4.82, for it, and as it rises in value we give more,

[1] Cf. pp. 122–123.
[2] *Op. cit.*, p. 73.
[3] *Ibid.*
[4] Mr. C. S. Reuter of the Merchants National Bank of Los Angeles suggests that the terms "fixed" or "direct *quotations*" and "movable" or "indirect *quotations*" be used so as to avoid confusion inasmuch as banks sometimes use the term "direct exchange" as referring to the exchange which they sell on their own foreign accounts, and "indirect exchange" as referring to the exchange which they sell on the foreign accounts of their American correspondents.

say 4.90. In other words, we buy it as we would a lead pencil or any other commodity, i. e., on the basis of what it is worth in dollars and cents. Movable or indirect exchange is a little more difficult to comprehend because we then quote how many units of foreign money can be purchased with one unit of home money, i. e., London asks how many francs, marks, dollars, etc., can be purchased with a pound sterling. Instead of saying as we do in the case of fixed exchange that lead pencils are 5 cents each, we say, in quoting movable exchange, that we can get 20 lead pencils for one dollar. If lead pencils rise to 10 cents each, we say, quoting on the basis of movable exchange, that we can get only 10 lead pencils for one dollar. The higher the value of the pencils, the fewer we get; the lower the value, the more we get. When London quotes francs at 25.20 per pound sterling, and later quotes them at 26, it means that more francs are obtainable per pound sterling, or that francs have fallen in value, even though the quotation as a numerical quantity is greater. When the London quotation is 20.35 francs per pound sterling it means that we get fewer francs at that rate, that they are more valuable, even though the quotation as a numerical quantity is smaller. As is frequently said, "The higher the rate, the lower the price; the lower the rate, the higher the price." The rule to follow in dealing in fixed exchange is to buy at the low quotation and sell at the high, but in dealing in movable exchange the rule is to buy at the high quotation and sell at the low.

The discount and premium method of quoting exchange is used between countries that have the same monetary unit. Taking for example the United States and Canada, we note that New York on May 1, 1921, quoted the Canadian dollar at 10½ per cent discount, i. e., to obtain a Canadian dollar draft would have cost a New Yorker but 89½ cents of American money. If there had been a great demand for Canadian dollars, a demand much greater than the supply, the rate might have been quoted at a premium, possibly a 1 per cent premium, which would have meant that for a New Yorker to get a Canadian dollar's worth of exchange he would have had to pay $1.01 in American money. In some cases in using the premium and discount method only the rate of the premium or discount itself is given in the exchange tables, i. e., 1 per cent premium, 2 per cent discount, etc.; in others the cost of one unit or 100 units of the foreign money in terms of the home money is given, i. e., Canadian exchange may be quoted

at $.98, or $98.00; while in still other quotations, the cost of a unit of the foreign money is expressed in terms of a percentage of the home money, e. g., Canadian exchange in New York may be quoted as being at 98 per cent of par, 102 per cent of par, etc. London quotations of the pound sterling of South Africa and of Australia offer an interesting example of how in one country two separate types of the premium and discount method are employed in quoting the value of the same monetary unit current in two other countries. The following table is taken from the London *Economist* of May 21, 1921:

TABLE I

South African Exchange Rates

The South African Banks quote the following rates:

	Union of South Africa From May 13, 1921 London on South Africa		*Union of South Africa* From May 16, 1921 South Africa on London	
	Buying	*Selling*	*Buying*	*Selling*
T. T.....		1/2% prem.	1/2% dis.	1/2% prem.
Demand....1	% dis.	3/8% "	1 1/4% "	1/2 to 1/4% "
30.....1	3/4% "		2 1/8% "	1/8% dis.
60.....2	1/2% "		3 % "	1/2% "
90.....3	1/4% "		4 % "	7/8% "
120.....4	% "		5 % "	

Overseas Dominions Rates

Commonwealth of Australia and Dominion of New Zealand

	London on Aust. & N. Z.				Aust. & N. Z. on London			
	Buying		*Selling*		*Buying*		*Selling*	
	Aust.	*N. Z.*	*Aust.*	*N. Z.*	*Aust.*	*N. Z.*	*Aust.*	*N. Z.*
Cable.....			99	99 1/2	101		102 1/2	103
On demand..96	1/2	96 1/2	par	par	100 3/8	100	101 7/8	101 7/8
30 days....95	7/8	95 7/8			99 3/4	99 1/2	101 3/8	101 3/8
60.....95	1/4	95 1/4			99 1/8	99	100 7/8	101 7/8
90.....94	5/8	94 5/8			98 1/2	98	100 1/2	100 1/2
120.....					97 7/8	97 1/4		
5 months sight.....					97 1/4			
6 months sight.....					96 5/8			

The above tables show that on May 13, 1921, London banks were buying demand exchange on South Africa at one per cent discount and selling it at 3/8 per cent premium; in other words, they were buying £100 on South Africa for £99 and selling at £100 3/8 (£100 7s 6d) per £100. At the same time, they were buying demand exchange on Australia at 96½ and selling at par (100 per cent); in other words, they were paying £96½ (£96 10s) for £100 worth of demand exchange on Australia and selling it for £100. The use by London of both of these methods of quoting discount and premium rates (a person might think that only one method would be employed) has no rhyme or reason, and can only be explained on the basis of long standing custom and tradition. Somehow it got started and somehow it has continued to date without a demand arising for a change. In the financial world, as in all other fields, it is difficult to uproot custom no matter how foolish and useless the practice may become.

There has been a noticeable tendency among American exchange dealers to adopt a uniform system of quoting exchange by the fixed exchange method, as is evident from the following table taken from the New York *Journal of Commerce and Commercial Bulletin* of December 17, 1921: [1]

TABLE II

Open Market Quotations

Open market quotations for sterling and Continental exchange yesterday for large amounts were as follows:

	Range		*Close*	*Prev. Close*
LONDON—Par $4.8665 per pound				
‡Bankers' 90 days	4.13 5/8 *a*	4.11½	4.11¾	4.13
‡Bankers' 60 days	4.15 5/8 *a*	4.13½	4.13¾	4.15
Demand sterling	4.17 5/8 *a*	4.15½	4.15¾	4.17
Cable Transfers	4.18 1/8 *a*	4.16	4.16¼	4.17½
Bills—				
Grain, 7 days	4.16¼ *a*	4.14 1/8	4.14 3/8	4.15 5/8
Com'l, sight	4.16 7/8 *a*	4.14¾	4.15	4.16¼
Documents for payment—				
60 days, against grain	4.12 5/8 *a*	4.10½	4.10¾	4.12
Com'l, 90 days	4.11½ *a*	4.09 3/8	4.09 5/8	4.10 7/8
Com'l, 60 days	4.12½ a	4.10 3/8	4.10 5/8	4.11 7/8

[1] Tables of exchange rates similar to the one shown are to be found on the financial pages of the large metropolitan papers and in the financial and commercial weeklies, such as the New York *Journal of Commerce and Commercial Bulletin*, the *Commercial and Financial Chronicle*, the *Annalist*, etc. Monthly surveys of the range of exchange rates are also published in the Monthly Bank and Quotation Section of the *Commercial and Financial Chronicle*.

TABLE II—*Continued*

OPEN MARKET QUOTATIONS—*Continued*

	Range			*Close*	*Prev. Close*
CANADIAN EXCHANGE IN N. Y.—Par 100c per Canadian dollar					
Checks			7 3/8 per cent. discount		
PARIS—Par 19.3c per franc					
Bankers' checks	7.90	*a*	7.78	7.78	7.92
Bankers' cables	7.91	*a*	7.79	7.79	7.93
Com'l, checks	7.88	*a*	7.76	7.76	7.90
Com'l, 60 days	7.82	*a*	7.70	7.70	7.84
ANTWERP—Par 19.3c per franc					
Checks	7.60	*a*	7.49	7.49	7.62
Cables	7.61	*a*	7.50	7.50	7.63
BERLIN—Par 23.8c per mark					
Bankers' checks	$.0050¾	*a*	$.0048½	$.0049	$.0052
Cables	.0051¼	*a*	.0049	.0049½	.0052½
AUSTRIA—Par 20.3c per krone					
Checks	$.0003¼	*a*	$.0003¼	$.0003¼	$.0003½
Cables	.0003¾	*a*	.0003¾	.0003¾	.0004
HUNGARY—Par 20.3c per krone					
Checks	14½	*a*	14½	14½	15
ITALY—Par 19.3c per lira					
Bankers' sight	4.59	*a*	4.50	4.50	4.52
Bankers' cables	4.60	*a*	4.51	4.51	4.53
HOLLAND—Par 40.2c per florin					
Bankers' sight	36.41	*a*	36.25	36.33	36.30
Bankers' cables	36.46	*a*	36.30	36.38	36.35
Com'l, sight	36.36	*a*	36.20	36.28	36.25
Bankers' 60 days	36.00	*a*	35.84	35.92	35.89
SWITZERLAND—Par 19.3c per franc					
Bankers' checks	19.38	*a*	19.35	19.38	19.35
Bankers' cables	19.43	*a*	19.40	19.43	19.40
GREECE—Par 19.3c per drachma					
Bankers' checks	4.11	*a*	4.11	4.11	4.20
Bankers' cables	4.16	*a*	4.16	4.16	4.25
TURKEY—Par $4.40 per Turkish pound					
Checks	59	*a*	59	59	60
DENMARK—Par 26.8c per kronen					
Bankers' checks	19.28	*a*	19.20	19.20	19.30
Bankers' cables	19.33	*a*	19.25	19.25	19.35
SWEDEN—Par 26.8c per krona					
Bankers' checks	24.45	*a*	24.40	24.40	24.65
Bankers' cables	24.50	*a*	24.45	24.45	24.70
NORWAY—par 26.8c per krone					
Banker's checks	15.56	*a*	15.39	15.40	14.45
Banker's cables	15.61	*a*	15.44	15.45	15.50
SPAIN—Par 19.3c per peseta					
Checks	14.65	*a*	14.54	14.54	14.85
Cables	14.70	*a*	14.59	14.59	14.90
CZECHO-SLOVAKIA—Par 20.3c per crown					
Checks	1.22	*a*	1.22	1.22	1.22
ROUMANIA—Par 19.3c per leu					
Checks	.85	*a*	.85	.85	.87½
POLAND—Par 23.8c per mark					
Checks	$.0325	*a*	$.0325	.$0325	$.0312½

TABLE II—*Continued*

OPEN MARKET QUOTATIONS—*Continued*

	Range			*Close*	*Prev. Close*
SERBIA—Par 19.3c per dinar					
Checks	1.54	*a*	1.54	1.54	1.58
FINLAND—Par 23.8c per mark					
Checks	1.85	*a*	1.85	1.85	1.85
PORTUGAL—Par $1.08 per escuda					
Checks	7.81½	*a*	7.81½	7.81½	7.87½
JUGO-SLAVIA—Par 20.3c per crown					
Checks	38½	*a*	38½	38½	
BULGARIA—Par 19.3c per leu					
Checks	70	*a*	70	70	75
RUSSIA (exch.)—Par 51.46c per ruble					
Currency			9½c per 100 rubles		
SOUTH AMERICA—					
ARGENTINA—Par 42.45c per paper peso					
Checks	33 1/8	*a*	33 1/8	33 1/8	33¼
Cables	33¼	*a*	33¼	33¼	33 3/8
BRAZIL—Par 32.45c per paper milreis					
Checks	12¾	*a*	12¾	12¾	12 7/8
Cables	12 7/8	*a*	12 7/8	12 7/8	13
BOLIVIA—Par 40c per boliviano					
Checks	20¼	*a*	20¼	20¼	20¼
COLOMBIA—Par 97.33c per peso..					
Checks	89¾	*a*	89¾	89¾	89¼
ECUADOR—Par 48.7c per sucre					
(Official 3.60)	27.77	*a*	27.77	27.77	
Open market	24.10	*a*	24.10	24.10	
URUGUAY—Par 103.42 per peso					
Checks	69 7/8	*a*	69 7/8	69 7/8	70
VENEZUELA—Par 10.3c per bolivar					
Checks	17.50	*a*	17.50	17.50	16.25
PERU—Par $4.8665 per pound					
Checks	3.55	*a*	3.55	3.55	
CHILE—Par 36.50c per paper peso					
Checks			10 5/8c per U. S. money		
ASIA—					
SHANGHAI ON LONDON—					
Four months' bank credits			2s. 8 5/8d.		
HONGKONG ON LONDON—					
Four months' bank credits			3s. 9d.		
JAPAN ON LONDON—					
Four months' bank credits			2s. 4 5/16d.		
FAR EASTERN CHECK RATES—					
Hongkong	54¾	*a*	55		
Shanghai	78¼	*a*	78½		
Yokohama	48¼	*a*	48½		
Manila	48½	*a*	48¾		
Singapore	48¾	*a*	49		
Bombay	28¼	*a*	28½		
Calcutta	28½	*a*	28¾		
Java	35½	*a*	35¾		

In a general way sterling quotations involved transactions approximating £10,000 or more. In the case of Continental quotations rates cover amounts representing $100,000 or over. # Nominal.

Without dealing to too great an extent with the details of the table, it may be well to explain briefly some of its items so that the reader may be informed as to their meaning. The terms "Check," "Bankers' sight," and "Demand bills" all have reference to the same type of exchange, i. e., bankers' sight drafts on a foreign center. The high and the low quotations are given, together with the rate at the close of the day and the rate at the close of the previous day. "London—par $4.8665 per pound" of course refers to the mint par of sterling exchange measured in terms of the American dollar. Mint par is given in all cases except for those countries that are on a silver or paper standard basis. It will be noted that all quotations, except for Canada, are based on the value of the foreign unit in terms of American money, i. e., fixed exchange. Canada is quoted on the basis of premium and discount. Under the London quotations the terms "Bankers' 90 days," "Bankers' 60 days," and "Demand sterling," all refer to drafts of those usances sold by bankers on their London accounts. "Cable transfers" needs no explanation. "7 day grain bills" are bills that are drawn against grain shipments, payable 7 days from date, which amounts to practically the same thing as a sight draft on the drawee. "Commercial sight" has reference to sight drafts that are drawn against shipments other than grain. "Documents for payment, 60 days against grain" refers to 60 day drafts that are drawn against grain shipments where the documents go forward with instructions "D/P." "Commercial 60 days" and "Commercial 90 days" refer to drafts that are drawn against shipments of various sorts where the instructions are that the documents are to be released on acceptance. It will be noted that the table also includes three quotations of Oriental markets *on* London, namely, Shanghai, Hongkong, and Japan. The rates refer to the cost in English money of sterling letters of credit against which four months' drafts are to be drawn. The table concludes with eight quotations dealing with Far Eastern check rates, giving the cost in New York for sight exchange on those centers per unit of foreign currency, i. e., 54 3/4 cents bid and 55 cents asked per Hongkong dollar, or 78 1/4 cents bid and 78 ½ cents asked per Shanghai tael, etc. etc.

Under the requirements of the Emergency Tariff Act of May 27, 1921, the Federal Reserve Bank of New York certifies daily to the Secretary of the Treasury the buying rate for cable transfers on the different countries of the world. The following table which needs

no explanation is taken from the *Journal of Commerce and Commercial Bulletin* of December 17, 1921:

TABLE III

Country	*Rate*	*Country*	*Rate*
Austria	$ .000406	Serbia	$.01587
Belgium	.0780	Spain	.1504
Bulgaria	.007592	Sweden	.2465
Czecho-Slovakia	.012138	Switzerland	.1943
Denmark	.1935	Hongkong	.5413
England	4.1991	Shanghai, tael	.7483
Finland	.018921	Shanghai, Mex. dollar	.5432
France	.0811	India	.2767
Germany	.005463	Japan	.4788
Greece	.0420	Java	.3567
Holland	.3642	Singapore	.4742
Hungary	.001480	Canada	.924375
Italy	.0462	Cuba	.996255
Jugo-Slavia	.003941	Mexico	.4919
Norway	.1553	Newfoundland	.9225
Poland	.000303	Argentina	.7509
Portugal	.0798	Brazil	.1274
Rumania	.00871	Uruguay	.6911

In many of the exchange lists, quotations will be found joined with the sign "@", e. g., 3.73 3/4 @ 3.74¼. This does not mean, as one might surmise, that the selling rates for the particular kind of exchange in question ranged between the two quotations given. The rate that precedes the sign represents the rate *bid* by the buyers, while the rate that follows the sign is the rate *asked* by the sellers at the opening of the day's market.

The English follow a less uniform practice than the Americans in their published tables of exchange quotations. They quote about one-half of their rates as movable exchange; the remainder, with only a few instances of premium and discount exchange, are quoted as fixed exchange. The following table is a portion of the daily "Money Market" article appearing in the London *Times*, December 2, 1921:[1]

[1] The London *Economist* (weekly) also devotes considerable space to tables of exchange quotations.

TABLE IV

"The outstanding feature in the foreign exchange market was a further distinct improvement in the value of the mark. The Berlin rate at one time fell to 700m., closing at 737½m., against 957½m. on Wednesday. Vienna fell a further 1,250kr. to 12,250kr. (having been down to 11,500kr.). The franc and lira appreciated, Paris closing at 55f. 63½c., Brussels at 57f. 57½c., and Rome at 95 lr. 25. Rates on Switzerland (21f. 08c.), and Holland (11fl. 37c) moved further against those countries. After rising to 4.05, New York closed at 4.04¾—a rise of 4½c. The following rates were current yesterday:

Place	*Method of Quoting*	*Par of Exchange*	*December 1*	*November 30*
New York	$ to £	4.86 2/3	4.00 1/2–4.05	3.99 1/4–4.00 1/2
Montreal	$ to £	4.86 2/3	4.37–4.32	4.36–4.38
Paris	Fr. to £	25.22 1/2	55.50–56.85	56.30–57.25
Brussels	Fr. to £	25.22 1/2	57.55–59.30	58.90–60.10
Italy	Lire to £	25.22 1/2	94.00–96.25	95 1/2–97 3/4
Berne	Fr. to £	25.22 1/2	21.00–21.10	20.95–21.10
Athens	Dr. to £	25.22 1/2	99.50–100.50	99.50–100.50
Helsingfors	M. to £	25.22 1/2	225–235	230–240
Madrid	Pts. to £	25.22 1/2	28.80–28.97	82.75–28.88
Lisbon	Per escu.	53 1/4d	4 1/2–5	4 5/8–5 1/8
Amsterdam	Fl to £	12.107	11.30–11.40	11.20–11.30
Berlin	M. to £	20.43	700–825	930–1050
Vienna	Kr. to £	24.02	11,500–13,500	13,000–14,000
Budapest	Kr. to £	24.02	2,500–3,000	2,900–3,500
Prague	Kr. to £	24.02	360–370	370–380
Warsaw	M. to £	20.43	12,000–14,500	13,000–14,500
Bukarest	Lei to £	25.22 1/2	*	*
Constantinople	Pst. to £	110	730–780	735–775
Belgrade	Din. to £	25.22 1/2	275–325	280–320
Sofia	Lev. to £	25.22 1/2	620–700	650–700
Christiania	Kr. to £	18.159	28.20–28.45	28.00–28.20
Stockholm	Kr. to £	18.159	16.86–17.00	16.90–17.00
Copenhagen	Kr. to £	18.159	21.55–21.70	21.45–21.62
Alexandria	Pst. to £	97 1/2	97 7/16	97 7/16
Bombay	Per rup.	24d.	1/3 15/16–1/4 1/16	1/3 15/16–1/4 1/16
Calcutta	Per rup.	24d.	1/3 15/16–1/4 1/16	1/3 15/16–1/4 1/16
Madras	Per rup.	24d.	1/3 15/16–1/4 1/16	1/3 15/16–1/4 1/16
Hongkong	Per dol.		2/8–2/8 3/4	2/8–2/9
Yokohama	Per yen.	24.58d.	2/4 7/16–2/4 9/16	2/4 11/16–2/4 15/16
Shanghai	Per tael		3/10–3/11	3/10–3/11
Singapore	Per dol.		2/3 13/16–3 15/16	2/3 13/16–3 15/16
Manila	Per dol.	24.066d.	2/4 1/2	2/4 3/4
Rio de Janeiro	Per mil.	27d.	8	7 3/4
B. Aires, T. T.	Per dol.	47.58d.	431/2–43 7/8	43 3/4–43 7/8
Valparaiso, 90 days	$ to £	$13 1/3	38.90	39.10
Montevideo, T. T.	Per dol.	51d.	40–421/2	39 3/4–40 1/2
Lima	Eng. to Peru £	Par	121/2% Prem.	
Mexico	Per dol.	24.58d.	32 1/4–33 1/4	32¼–331/4

* Nominal. No quotation.

"The price of Gold fell a further 4d. to 102s. 7d. per ounce (fine). All available supplies were taken for New York.

"There was a recovery of 1/8d. to 37 5/8d. per ounce in the cash price of bar Silver, owing to some bear covering, but the forward price remained at 37½d. The market closed steady."

With but a few exceptions, the rates quoted are for telegraphic transfers on London at the foreign points mentioned. Inasmuch as the greater part of the world's exchange is drawn in foreign centers *on London*, and not *in London* on those centers, it is readily seen why it is that London customarily quotes the rates existing in other centers *on London* rather than the rates *in London* on those centers. Before the abandonment of the Royal Exchange, the rates at which its transactions were handled were published Wednesdays and Fridays of each week, which were the days following the meeting of the Exchange. Inasmuch as these rates were those prevailing *in London on other centers* they were not considered so important as were the published daily rates of foreign countries on London.

In the London *Times* table, reproduced above, it will be noted that the first twenty-three rates, excepting that on Lisbon, are indirect (movable exchange) quotations, i. e., how much foreign money can be purchased with one pound sterling. The Lisbon rate and the rest of the rates in the table excepting that on Lima and Valparaiso are direct (fixed exchange) quotations, i. e., how much does one unit of foreign money cost in terms of English money, either in pounds sterling or in pence. Lima alone is quoted on the premium and discount basis, while the Valparaiso rate is quoted on the indirect basis. The South African and Australian rates which usually appear in separate tables have already been discussed.[1]

There are one or two items in the above table that may justify further explanation. In the opening paragraph where the Berlin rate is dealt with, the letter "m" refers to marks. In the next sentence the abbreviation "kr" has reference to the Vienna kronen. In the statements concerning Paris, Brussels, and Switzerland the abbreviations "f" and "c," mean francs and centimes, while in those concerning Holland the abbreviations "fl" and "c" refer to florins and cents. The quotation on New York is given in terms of dollars and cents. The second column explains the method of quoting the exchange while the third column gives the par of exchange where a

[1] Cf. p. 304.

par exists. The last two columns contain the buying and selling rates of exchange on the two days preceding publication. It will be noted that with Hongkong, Shanghai, and Singapore, there is no par of exchange, while with Lima the Peruvian pound is the equivalent of the English pound. The money market article concludes with a statement concerning the price of gold and silver. It is stated that the price of silver rose slightly, "owing to some bear covering, but the forward price remained at 37½c." This refers in the first place to the purchases made by silver dealers who had previously sold silver for future delivery, hoping to obtain it when needed at a lower price than that at which they had sold it. On December 1, they undoubtedly felt that the price had reached its lowest point, or else they were forced into the market to buy in order to deliver silver to purchasers, and their demand, as a consequence, exerted a strengthening influence on the price of silver. The "forward" price of silver is the price for delivery two months hence.

Published tables of rates are known as the "posted" rates and are by no means the rates at which the greater part of the business is transacted. As was noted in the case of the table taken from the New York *Journal of Commerce and Commercial Bulletin* of December 17, 1921, the quotations of sterling given were applicable to transactions of £10,000 or more while the Continental quotations were effective for amounts of $100,000 or over. Every dealer has a list of rates (posted rates) at which exchange is sold to the general public when ordinary amounts are desired, but these rates are either raised or lowered respectively for small or large purchases, or for strangers or old customers. The rates at which sales are made are known as the "actual" rates. The difference between these two groups of rates is shown by a comparison of the following tables taken from the *Commercial and Financial Chronicle*, Bank and Quotation Section, of December, 1911:[1]

TABLE V

POSTED RATES—BANKERS' STERLING BILLS

Nov.	*60 days*	*Demand*	*Nov.*	*60 days*	*Demand*	*Nov.*	*60 days*	*Demand*
1	4 84	4 87½	4	4 84½	4 87½	7	Holiday	
2	4 84	4 87½	5	Sunday		8	4 84½	4 87½
3	4 84	4 87½	6	4 84½	4 87½	9	4 84½	4 87½

[1] Pp. 20–21.

TABLE V—*Continued*

POSTED RATES—BANKERS' STERLING BILLS—*Continued*

Nov.	*60 days*	*Demand*	*Nov.*	*60 days*	*Demand*	*Nov.*	*60 days*	*Demand*
10	4 84½	4 87½	20	4 84½	4 87½	30	Holiday	
11	4 84½	4 87½	21	4 84½	4 87½			
12	Sunday		22	4 84½	4 87½	Open	4 84	4 87½
13	4 84½	4 87½	23	4 84½	4 87½	High	4 84½	4 87½
14	4 84½	4 87½	24	4 84½	4 87½	Low	4 84	4 87½
15	4 84½	4 87½	25	4 84	4 87½	Last	4 84	4 87½
16	4 84½	4 87½	26	Sunday				
17	4 84½	4 87½	27	4 84	4 87½			
18	4 84½	4 87½	28	4 84	4 87½			
19	Sunday		29	4 84	4 87½			

TABLE VI

ACTUAL RATES—BANKERS' AND COMMERCIAL BILLS

	Bankers' Bills			*Commercial Bills*	
Nov.	*60 Day*	*Sight*	*Cable Transfers*	*On Banks*	*Documents for Payment*
1	4 8360–4 8370	4 8680–4 8695	4 8720–4 8725	4 82 –4 83	4 82 3/4–4 83 3/4
2	4 8360–4 8370	4 8675–4 8695	4 8720–4 8730	4 82 –4 83	4 82 7/8–4 83 7/8
3	4 8370–4 8380	4 8690–4 8705	4 8730–4 8745	4 82 1/4–4 83 1/4	4 82 3/4–4 84
4	4 8365–4 8375	4 8695–4 87	4 8735–4 8740	4 82 –4 83 1/2	4 83 –4 83 3/4
5					
6	4 8375–4 8380	4 8690–4 8705	4 8735–4 8740	4 82 –4 83 3/8	4 83 –4 83 7/8
8	4 8375–4 8380	4 8695–4 8705	4 8735–4 8740	4 82 1/8–4 83 1/4	4 83 1/8–4 84
9	4 8370–4 8380	4 8695–4 87	4 8735–4 8740	4 82 1/8–4 83 3/8	4 83 –4 84
10	4 8370–4 8280	4 8695–4 8705	4 8735–4 8745	4 82 1/2–4 83 1/2	4 83 –4 84
11	4 8370–4 8380	4 87 –4 8705	4 8740–4 8745	4 82 1/4–4 83 1/2	4 83 –4 84
12					
13	4 8370–4 8380	4 87 –4 8705	4 8740–4 8745	4 82 1/8–4 83 3/8	4 83 –4 84
14	4 8375–4 8385	4 8695–4 87	4 8735–4 8740	4 82 1/8–4 83 3/8	4 83 –4 84
15	4 8375–4 8385	4 87 –4 8705	4 8745–4 8750	4 82 1/8–4 83 1/2	4 83 –4 84
16	4 8370–4 8380	4 87 –4 8705	4 8740–4 8745	4 82 1/4–4 83 1/2	4 83 1/8–4 84 1/8
17	4 8370–4 8380	4 8690–4 87	4 8730–4 8740	4 82 1/2–4 83 1/2	4 83 –4 84
18	4 8375–4 8385	4 8690–4 8695	4 8725–4 8730	4 82 1/4–4 83 1/2	4 83 1/4–4 84
19					
20	4 8365–4 8380	4 8685–4 8690	4 8710–4 8715	4 82 1/8–4 83 1/2	4 83 –4 84
21	4 8370–4 8380	4 8670–4 8685	4 8695–4 87	4 82 1/8–4 83 1/2	4 83 –4 83 7/8
22	4 8350–4 8360	4 8665–4 8670	4 87 –4 8705	4 82 1/8–4 83 3/8	4 82 7/8–4 83 3/4
23	4 8340–4 8350	4 8660–4 8665	4 87 –4 8705	4 81 3/4–4 83 1/4	4 82 7/8–4 83 3/4
24	4 8345–4 8360	4 8660–4 8665	4 8695–4 8710	4 82 –4 83 1/2	4 83 –4 83 3/4
25	4 8340–4 8350	4 8670–4 8675	4 87 –4 8705	4 81 3/4–4 83	4 83 1/4–4 83 3/4
26					
27	4 8335–4 8345	4 8655–4 8660	4 8685–4 8690	4 81 3/4–4 83 1/4	4 83 –4 83 3/4
28	4 8320–4 8330	4 8635–4 8640	4 8665–4 8675	4 81 3/4–4 83 1/4	4 82 3/4–4 83 1/2
29	4 83 –4 8310	4 8615–4 8635	4 8655–4 8660	4 81 3/8–4 83	4 82 5/8–4 83 1/4

It will be noted that the actual rates are consistently lower than the posted rates.

In reading articles dealing with foreign exchange, one frequently comes across such terms as "the spot rate," "spot cables," "spot sight," "futures," "forward transactions," "forward discount rate," "firm rates," etc. The first three terms refer to the rates of exchange where immediate delivery is intended. "Future rates," "futures," "future delivery," "forward transactions," "forward discount rate," and "arrival discount rate," all refer to the practice of the buyer or seller of exchange guarding himself against a possible unfavorable trend in the exchange or discount rates. If an importer has engaged a shipment of goods from abroad and will have to pay by means of a remittance of exchange three months hence, he can protect himself against an unexpected rise in the exchange rate by going to his banker and buying exchange for future delivery, but at a "future rate," not at the rate then current in the market. The future rate quoted by the banker may be higher or lower than the current rate, depending upon which way the banker thinks the market will turn. An exporter who has goods to ship, say a month hence, is likewise interested in the exchange rates that will then prevail, because the returns which he gets from the sale of his drafts will depend on where the rates are at that time. In order to guard against unfavorable developments, and also to have a fixed or certain basis from which to calculate the value of his goods and thus more accurately to fix the prices to be charged the foreign customer, he may go to his banker and get him to quote a "future rate" at which he (the banker) will purchase the exporter's bills of exchange a month hence. The banker quotes the exporter a "forward rate" or a "future rate," and if satisfactory, a contract for a "future" or a "future delivery" is accordingly entered into. No matter where the market rate may be, the banker is bound by the rate quoted in the agreement. The "forward discount rate" is slightly different from the "futures" above referred to in that it concerns the rate of discount at which a bank agrees to discount drafts when presented by another bank at a future date. Say that a New York bank is approached by a large exporter and asked to buy a large amount of long bills on English banks or firms a month hence, i. e., the importer wants the New York bank to quote him a rate for future delivery. In order to be able to arrive at a satisfactory basis for the rate which it will pay, the New York bank must be assured of a definite rate of discount by its English correspondent or by an English discount house. English rates of discount vary from time

to time, although normally they remain fairly stationary during any particular week because they are based on the official rate of the Bank of England, which as a rule is announced every Thursday. The New York bank cables the London bank and asks it to quote a rate at which it will discount the bills in question a month hence. This "forward rate of discount," or the discount rate at which the bills will be discounted a month hence on "arrival," is cabled to the New York bank, and the latter is then able, definitely, to enter into a contract with the exporter as to the exchange rates at which it will purchase the bills for "future delivery." No matter where the London discount rate is at the time the bills arrive, provided, of course, they arrive at the time agreed upon, the London bank is bound by its contract to discount them at the "forward rate" previously stipulated.[1] The part that futures play in the exchange market will be more fully discussed in Chapter XIII.

"Firm rates" are the prices set by a bank which has actually agreed to buy or to sell exchange at a definite rate, and are supposed to hold for a definite period. For example, New York bankers quote "firm" rates to their domestic correspondents at which the latter are authorized to draw bank drafts on foreign correspondents in connection with their sales of exchange. These "firm" rates are usually for a day only, although in normal periods, when the exchanges are practically stationary, they may hold for a week or until changed by subsequent notice.

In quoting sterling exchange in our markets two methods of progression are used. One, the older, progressses by one-eighth of a cent and is expressed as a fraction, while the newer, which is the more widely used, and which makes possible a little closer shading, progresses by 5/100th of a cent and is expressed in the form of a decimal. Where the first method is employed the rate advances in the following manner: 4.86, 4.86 1/8, 4.86 1/4, 4.86 3/8, 4.86 1/2 etc., "one point" being one cent; but where the second method is followed the rate advances by half a mill, as 4.8600, 4.8605, 4.8610, 4.8615, 4.8620, etc., "one point" in this case being not 5/100th but 1/100th of a cent. At certain points the two scales coincide, as at 4.86 1/4 and 4.8625, or at 4.86 1/2 and 4.865, etc.

We formerly quoted German exchange on the basis of the value of four marks in American money. The reason for this was that as the

[1] Federal Reserve banks are permitted to quote forward discount rates.

mint par of the mark is approximately 25 cents ($.23831), four marks would equal about $1.00 (four marks at par being quoted as $.95284). Thus in exchange books and tables published up to within a few years ago, mark quotations appear as the following: "M...95.5," which means that four marks could be purchased for $.95 1/2. Progression under the old system was made by 1/16th of a cent. The rates would thus run 95 1/16, 95 1/8, 95 3/16, etc. In order to shade the quotations more closely the practice was followed of supplementing the main rate with the slight percentages of 1/16, 1/32, and sometimes 1/64, meaning 1/16 of one per cent, 1/32 of one per cent, etc. The quotations would sometimes appear, therefore, as 95 1/8–1/16, or 95 1/4 + 1/16, etc. Thus if we were desirous of knowing how much M.10,000 would cost at 95 1/4 + 1/32 per four marks, we would first find out how much they would cost at 95 1/4 cents per four marks. Then, after taking 1/32 of one per cent of the result, we would add the latter sum to the total number of dollars first obtained. Thus, 95 1/4 $.9525 for four marks. $.9525 divided by 4 equals $.238125 per mark. M10,000 × $.238125 per mark equals $2381.25. 1/32 of 1 per cent of $2381.25 equals $.74. $2381.25 plus $.74 equals $2381.99, which would be the cost of M10,000 at 95 1/4 + 1/32. If the supplemental fraction were *minus* 1/32, we would subtract the $.74 instead of adding it. On the other hand, when dollars were converted into marks at fractional rates, the sign that appeared before the supplemental quotation was reversed. For example to convert $10,000 into marks at 95 1/4 −1/32 we would find the cost of one mark by dividing 95 1/4 by 4, which would give us $.2381 (without carrying out the decimal). Dividing $10,000 by $.2381 would give 41999.16 marks. 1/32 of one per cent of $10,000 is $3.125, which converted into marks at $.2381 per mark, would give 13.12 marks. Adding 13.12 marks to 41999.16 marks would give the result of 42012.28 marks. If the supplemental fraction were a *plus* 1/32, we would subtract the 13.12 marks.[1] The supplemental percentage fraction was usually applied to the *dollars* in the computation, not to the marks, although, as will be shown in Appendix III, the same results were obtainable by applying the supplemental percentage fraction to the marks and not to the dollars.

By means of these confusing supplemental percentage fractions bankers were able to shave the quotations a little more closely than would otherwise have been possible. As Escher says:

[1] Other methods of conversion will be discussed in Appendix III.

"On small amounts, two rates such, for instance, as 95 1/16 less 1/32 and 95 plus 1/32 are practically the same, but where considerable sums are involved the difference is appreciable. By giving the arithmetic of the matter a little thought, it will plainly be seen that a fraction in the rate (which is less than 100) is a little more than the same fraction expressed as a percentage (reckoned on 100). For example, convert M100,000 at 95 1/16 less 1/32 and you get $23,758.20. At 95 plus 1/32 the result is $23,757.43. The first rate is higher than the second by 1/16 *in the rate*, which is more than the 1/16 *per cent* which comes off."[1]

All quotations of the mark ceased in the United States on or about March 28, 1917, and when resumed again in July, 1919, another practice, the quotation of what one mark is worth in our money, was adopted by American dealers.[2] Thus today rates on Germany are quoted either as 1.36½ cents (1.365 cents) per mark, or as $.01365, progression in the former case being made by one-eighth of a cent ($.001/8) and in the latter by no fixed amount.[3]

The story of the franc quotation is somewhat similar to that of the mark. Until December, 1920, we quoted francs on the basis of the movable exchange, i. e., how many francs the dollar would purchase, or in other words, what was the dollar worth in terms of francs. The franc at par is worth $.19294, which would enable us at par to purchase 5.182 francs for a dollar. The situation was even further confused, as in the case of marks, by the addition or subtraction of supplemental fractions representing percentages. Thus our quotations on Paris would run something like this: 5.18 1/2, 5.18 1/8–1/32, 5.16 1/4 + 1/16, etc. Progression was by 5/8 of a centime (a centime being 1/100th of a franc), because 5/8 of a centime equals 1/8 of 1 per cent of a pound sterling, which made it easier to convert francs into pounds sterling for arbitrage purposes [4] than if some other method had been employed. It is said that the reason for the latter practice arose from the fact that in early years practically all franc exchange was covered or paid for by means of sterling exchange. Brooks,[5] however, assigns a different reason for this strange method of progression by saying

[1] "Foreign Exchange Explained," p. 35.

[2] Cf. Appendix III for examples of conversion on new basis of quoting mark exchange.

[3] Sample quotations of mark exchange illustrating the latter method taken from the weekly tables of cable rates published by the Federal Reserve Board are as follows: .01605, .0158, .015825 for May 28, 31 and June 1, 1921, respectively. The reader can readily appreciate the fine shading made possible by quoting marks up to the thousandths of a cent.

[4] Cf. Ch. XIII for a discussion of Arbitrage.

[5] *Op. cit.*, p. 114.

that "as there are five francs to the United States dollar, 1/8 of 1 per cent on one franc would call for 5/8 of 1 per cent on five francs; besides, until recent years, 1/8 of 1 per cent difference in quotation was regarded sufficiently close for commercial purposes." In the case of franc exchange, as was also true of mark exchange, the supplemental fractions represented a small percentage figured usually, though not always, on the basis of *dollars* involved in the computation. As will be shown in Appendix III, the same results could be obtained if the supplemental fractions were applied to the major franc quotation and not to the dollars. If we were calculating how many dollars we would have to pay for 5,000 francs at 5.16 1/4 −1/16, we divided 5000 by 5.16 1/4 which would give us $968.52, the number of dollars required at the major rate. We would then take 1/16 of one per cent of $968.52, or $.61, and subtract it from $968.52, which would give us $967.91. If on the other hand we were figuring how many francs we could purchase with $1000 at the rate of 5.16 1/4 −1/16, we would multiply 1000 by 5.1625 which would give us 5162.50 francs. We would then take 1/16 of one per cent of $1000 (not of 5162.50 francs), which would give us $.625. This then would have to be converted into francs at the given major rate, i. e., 5.16 1/4, and would equal 3.226 francs. This sum (3.226) would then be *added* to 5162.50, giving us the result of 5165.726, or 5165 francs and 73 centimes. When converting francs into dollars we followed the sign by adding or subtracting the amount obtained in using the supplemental fraction, but when converting dollars into francs we reversed the sign and if the fraction were minus we added the amount obtained in using the supplemental fraction, but if the fraction were plus we subtracted the amount. This reversal of the sign was necessary because the plus sign made the franc cost more, while the minus sign made it cost less. Thus in changing francs into dollars with a plus fractional quotation (remembering that francs then cost more), we had to add the supplemental amount because it would cost more dollars; but in changing dollars into francs with a plus fractional quotation (still remembering as before, that the francs cost more under such circumstances), we had to subtract the supplemental amount because we would get fewer francs per dollar.[1] Whitaker comments as follows upon one of the phases of this curious practice of using supplemental quotations:

[1] See Appendix III for a further discussion of franc conversion methods.

"To look a little further into the curiosities of this notation, we may explain that to place 'minus 1/16' after a rate brings that rate a little more than halfway towards the next cheaper main rate. Thus *5.19 3/8 less 1/16* is a little closer to 5.20 than it is to 5.19 3/8. On the other hand *5.20 plus 1/16* is a little closer to 5.19 3/8 than to 5.20! But the two rates, *5.19 3/8 less 1/16* and *5.20 plus 1/16* are almost identical. The interval of 5/8 centime between the main rates is an interval of almost exactly 1/8 of 1%. Consequently an addition or subtraction of 1/16 of 1% to or from any main rate takes us almost exactly halfway to the next rate. In point of fact it takes us a shade beyond the halfway point." [1]

To avoid the complexities of the situation, H. K. Brooks unsuccessfully urged the adoption of a plan of quoting francs and similar exchanges with an interval of 1/8 of a centime.[2] Instead of progressing from 5.15 to 5.15 5/8, he suggested that progression be from 5.15 to 5.15 1/8, then to 5.15 1/4, etc. The adoption of such a plan would have given practically the same results as were secured by the use of the confusing plus and minus fractional quotations. A change was bound to occur sooner or later, however, and in July, 1920, a number of New York banking firms agreed to abandon the old system of quoting francs, lire, drachmas, etc., as described above, and to adopt in its place quotations based on what the franc, lira, drachma, etc., are worth in American money, thus putting those exchanges on the same fixed or direct exchange basis as other foreign exchanges, excepting only the Canadian, which still was to be quoted on a premium and discount basis. As the result of further publicity, an announcement was made in November, 1920 by practically all the prominent exchange dealers in the United States that henceforth they likewise would follow the practice of quoting on the basis of fixed exchange. Progression in quoting francs is now made by one-eighth of a hundredth of a cent where fractional quotations are used, but where the decimal method is followed the shadings may at times reach four decimal places beyond the cents column.[3]

Rates of exchange fluctuate slightly in normal times and within certain well defined limits, but violently in times of panic or under the stress of war conditions. The accompanying chart (Chart I) and

[1] *Op. cit.*, p. 95, footnote.

[2] *Op. cit.*, p. 115.

[3] Rates for cables on Paris for May 27, 28, 31 and for June 1 and 2, 1921, respectively, as published by the Federal Reserve Board, were .08245, .08345, .0829, .0847, .082725, the quotations signifying that franc cables were selling at slightly over eight cents per franc.

table (Table VII) show the highest and lowest monthly quotations for sterling sight exchange for the two normal years, 1910 and 1913,

TABLE VII

HIGHEST AND LOWEST QUOTATIONS FOR SIGHT STERLING PER MONTH, 1907, 1910, 1913

	1907		1910		1913	
Months	*Lowest*	*Highest*	*Lowest*	*Highest*	*Lowest*	*Highest*
January	4.8440	4.8610	4.8615	4.8700	4.8570	4.8780
February	4.8440	4.8480	4.8600	4.8715	4.8720	4.8780
March	4.8275	4.8470	4.8665	4.8780	4.8675	4.8800
April	4.8365	4.8675	4.8760	4.8800	4.8625	4.8725
May	4.8610	4.8700	4.8640	4.8780	4.8595	4.8680
June	4.8655	4.8740	4.8585	4.8710	4.8635	4.8700
July	4.8655	4.8725	4.8520	4.8585	4.8645	4.8710
August	4.8625	4.8800	4.8525	4.8685	4.8575	4.8675
September	4.8525	4.8625	4.8595	4.8675	4.8535	4.8585
October	4.8240	4.8650	4.8570	4.8680	4.8500	4.8615
November	4.8500	4.8875	4.8540	4.8620	4.8480	4.8565
December	4.8410	4.8670	4.8475	4.8615	4.8500	4.8565

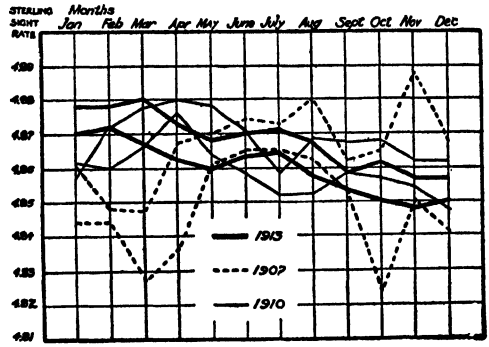


CHART I

Highest and lowest quotations for sight sterling monthly, 1907, 1910, 1913

and for the abnormal year, 1907. The fluctuations of sight rates during the period of the World War and later are shown on Charts XIII,[1] XIV,[2] and XV.[3] It will be noted that in normal years the sight rate fluctuates well within what are generally known as the "gold export

[1] P. 540. [2] P. 541. [3] P. 544.

point" and the "gold import point,"[1] although this does not of necessity signify that no gold was being exported from or imported into the United States during those years. During the panicky year of 1907 the fluctuations were very great. In any one month in the normal years of 1910 and 1913, it was unusual for the lowest and the highest quotation for sterling sight exchange to be more than one cent per pound sterling apart, although under conditions of stress and strain as in 1907 the lowest and the highest quotations of the month were from three to four cents per pound sterling apart.

It is not only the rates of exchange between countries with different monetary systems that fluctuate from day to day. If all countries of the world were on the same monetary basis, rates of exchange would still vary as greatly as they do today with our multiplicity of monetary systems. As noted above in the case of Canada and the United States, and in the case of England, Australia, and South Africa, the countries in each group have the same coin for their standard unit of value, yet the rates of exchange fluctuate just as greatly and for the same causes as do those between countries not on the same monetary basis.

The buying and selling rates of exchange depend primarily upon the relative bargaining power of the parties concerned although in the background a large number of factors are always at work influencing the rates in one way or another. The rates charged or paid by the small local dealers will usually depend in the first instance upon quotations which they receive by mail or by wire from the larger dealers. With these rates as a basis, the prices actually paid or charged will depend upon the amount demanded or offered for sale, the reputation of the customer, what the traffic will bear, etc. In the case of the larger dealers, their opening rates in the morning will be fixed upon the basis of the closing rates of the day before, the bids and offerings that come in by mail, wire, or phone before the office opens for business in the morning, cable advices received from abroad regarding the trend of rates in foreign centers, etc. The posted rates of the larger dealers will tend to be fairly uniform as is shown by the table of sterling rates on page 322 taken from the *Commercial and Financial Chronicle* of December 31, 1910.[2] Again, as is also true with the smaller dealers, the rates actually set for each transaction by the

[1] Cf. Ch. XI, Gold and Gold Movements.

[2] This is the last date on which such tables appear in the *Commercial and Financial Chronicle.*

TABLE VIII

BANKERS' POSTED RATES OF EXCHANGE

		Fri. *Dec. 23*	*Mon.* *Dec. 26*	*Tues.* *Dec. 27*	*Wed.* *Dec. 28*	*Thurs.* *Dec. 29*	*Fri.* *Dec. 30*
Brown Bros & Co.	60 days	4 83		83	83	83	83
	Sight	4 86½		86½	86½	86½	86½
Kidder, Peabody & Co.	60 days	4 83		83	83	83	83
	Sight	4 86		86	86	86	86
Bank of British No. A.	60 days	4 83½		83½	83	83	83
	Sight	4 86½		86½	86	86	86
Bank of Montreal	60 days	4 83½	HOLIDAY	83	83	83	83
	Sight	4 86½		86	86	86	86
Canadian Bank of Com.	60 days	4 83		83	83	83	83
	Sight	4 86½		86	86	86	86
Heidelback, Ickel-	60 days	4 83		83	83	83	83
heimer & Co.	Sight	4 86½		86½	86½	86½	86½
Lazard Freres.	60 days	4 83		83	82½	82½	82½
	Sight	4 86		86	85½	85½	85½
Merchants' Bank	60 days	4 83½		83½	83	83	83
of Canada	Sight	4 86½		86½	86	86	86

large New York houses will depend upon the amount involved, the reputation of the customer, what other firms are charging, etc.

Behind the actual rates of the day, however, are those forces that tend to raise or to lower the quotation, which forces may be briefly summarized as:

1. Supply of exchange.
2. Demand for exchange.
3. Length of time for which exchange is to run before payment, i. e., length of life of exchange.
4. The discount rate prevailing in foreign markets.
5. The standing or reputation of drawer and drawee.
6. The nature of the goods against which the drafts have been drawn.
7. The amount of drafts that drawer has outstanding.
8. War or rumors of war, political developments, and other miscellaneous influences.

It must always be remembered that "foreign exchange rates are results of forces playing not only in the market where exchange is being bought, but also in the foreign market upon which it is being bought." [1] No market stands alone, uninfluenced by what is going on in other markets. Developments of all sorts in London, Paris, Berlin, South America, or the Orient affect the rates in the United States; and likewise developments in the United States affect the rates in

[1] Agger, *op. cit.*

foreign centers. The corners of the foreign exchange market are knitted together into an unbelievably sensitive network, like the threads of a spider's web.

The two most important forces mentioned in the summary above are our old friends "Supply" and "Demand," each exerting a great influence upon exchange rates but in their turn being influenced by certain other factors.

I. *Supply of Exchange.* (a) Considering first the element of supply, it is easily seen that the greatest source of bills of exchange is foreign trade transactions. When goods are shipped abroad and the exporter draws his draft on the buyer or on the financial agent of the latter as authorized by a commercial letter of credit, his draft immediately adds to the supply of exchange in the open market, provided it is sold to some foreign exchange dealer. If, on the other hand, it is sent abroad for collection it has no influence upon the supply side of the market until it has been collected and added to the foreign account of the exporter or to the foreign account of the collecting bank. Then, to get the funds back home, drafts may be drawn and disposed of in the home market, or cables may be sold, both of which will increase the supply of exchange in the exporter's country.

According to the statistics of the United States government, there have been but three years since the Civil War when our exports have not exceeded our imports. The value of our merchandise imports and exports for 1909–1920 has been as shown on page 324.

The statistics compiled by the United States Department of Commerce do not include merchandise exported directly by our government, so that our excess exports have really been larger than as disclosed by the above table. This huge excess of merchandise exports does not of necessity mean that it was all covered, or that a majority of it was covered, by the issuance of bills of exchange. A very considerable amount of our exports during the war and since that time has been sold against dollar credits which foreign countries have established in the United States. Beginning with the Anglo-French loan of 1915, it became the customary practice of the European countries to which we advanced funds, either through governmental or private loans, to use the monies thus made available in establishing "dollar credits" in the United States. These funds were deposited principally in New York for the account of the foreign countries, and whenever exports were forwarded, drafts were drawn in terms of dol-

TABLE IX

MERCHANDISE EXPORTS AND IMPORTS, UNITED STATES, 1909–1920[1]

Year ended—	*Total Exports*	*Imports*	*Excess of Exports over Imports*
June 30:			
1909	1,663,011,104	1,311,920,224	351,090,880
1910	1,744,984,720	1,556,947,430	188,037,290
1911	2,049,320,199	1,527,226,105	522,094,094
1912	2,204,322,409	1,653,264,934	551,057,475
1913	2,465,884,149	1,813,008,234	652,875,915
1914	2,364,579,148	1,893,925,657	470,653,491
1915	2,768,589,340	1,674,169,740	1,094,419,600
1916	4,333,482,885	2,197,883,510	2,135,599,375
1917	6,290,048,394	2,659,355,185	3,630,693,209
1918	5,919,711,371	2,945,655,403	2,974,055,968
Dec. 31:			
1918 (6 mos.)	3,174,860,935	1,485,208,776	1,689,652,159
1919	7,920,425,990	3,904,364,932	4,016,061,058
1920	8,228,016,307	5,278,481,490	2,949,534,817

lars against those dollar credits. As a consequence, the foreign exchange market was not affected by the drawing of those drafts any more than it would have been affected by a Chicago merchant drawing a draft on a New York bank, although as a result of the drawing of those dollar drafts the exchanges of the Allies were relieved from the great weakening pressure of a mass of foreign bills that otherwise would have been drawn, thereby enabling those exchanges to be maintained during the war at a level that did not truly represent their real value. It must not be surmised, however, that this was the only means that was employed to stabilize the exchange rates of the Allies; others will be discussed in subsequent chapters.

During normal times exports from the United States to foreign countries predominate during the fall and winter months, for it is then that we ship large amounts of raw materials, such as grain, cotton, etc., chiefly to the European countries. During those months, therefore, a large number of drafts are drawn against exports, and exchange rates normally tend to weaken. Looking at the matter from the standpoint of an Englishman, Clare in his "A. B. C. of the Foreign Ex-

[1] Statistical Abstract of the United States, 1920, p. 397.

changes" [1] states that: "Owing to the magnitude of our imports from the States, the creation of bills in connection with the shipments of corn and cotton, &c., in the Autumn is so great as almost invariably to turn the exchange against us from about August until December, but during the rest of the year it is mostly in our favor, and as a rule attains its maximum about April, that is to say, after the whole of the old crops have been paid for and before drafts have been offered in anticipation of the new."

(b) A second source of the supply of exchange has to do with the sale of American securities to residents of other countries. When we sell stocks or bonds to foreigners, the ordinary practice is for a draft to be drawn against the buyer and sold in the New York market, usually with the securities attached as collateral. Such drafts necessarily add to the supply of exchange. Before the war enormous amounts of American securities were sold and held abroad. Sir George Paish in his report to the United States National Monetary Commission in 1908 estimated that the amount permanently invested by foreigners in United States securities was approximately $6,000,000,000, apportioned as follows: Great Britain, $4,500,000,000; France, $500,000,000; Germany, $1,000,000,000; Holland, $750,000,000.[2] Although the floating of new securities in the American market does not of necessity weaken the exchange rates on those countries whose citizens are heavy investors therein, nevertheless there is a very decided tendency in that direction, especially in times of active financing. For example, in May, 1895, exchange rates were demoralized during the first half of the month as a result of the offering of a large supply of drafts which had been drawn in connection with the foreign purchases of our securities. Inevitably exchange rates declined, although subsequently when foreign purchases eased off considerably the market became firmer. In October, 1913, the sale of $5,000,000 Interborough Rapid Transit bonds was one of the important causes that produced a decline in sterling rates. Hundreds of other instances might be cited. It sometimes happens that instead of the securities of a new concern or the new issues of an older firm being floated only in the United States, a large block of such stocks and bonds will be sent abroad by the trust company, syndicate, or invest-

[1] Pp. 135–136.

[2] "Trade Balance of the United States," 61st Congress, 2nd Session, Senate Document 579, pp. 174–175.

ment house that is underwriting the issue, and disposed of in European markets, the financial returns therefrom being added to the foreign bank account of this underwriting agency. These increased foreign accounts merely signify that an added amount of foreign exchange is thereby made available. It is not unusual for the foreign funds thus accumulated to be brought back to the United States through the drawing of drafts against such deposits, and at times their sale in the American market materially weakens the exchanges. In August, 1908, to cite one of the many instances, exchange became extremely heavy (the lowest rates existing on August 25th, when sight sterling sold at 4.8570 and cables at 4.8585), caused in part by the gradual recall from Europe, through sight sterling and cable transfers, of bankers' balances and credits representing the proceeds of securities negotiated abroad during the preceding months. It was estimated that about $30,000,000 was availed of in that manner at that time, the funds in question representing the proceeds from the sale abroad of securities of the National Railroads of Mexico, the Pennsylvania Railroad, and certain other corporations, the returns from which had been temporarily loaned in London, Paris, and other financial centers.

(c) A third factor affecting supply has to do with the money rates at home and abroad. If money rates are high in New York and low elsewhere, it necessarily implies that American bankers much prefer to have the use of their money at home rather than abroad.[1] In order to bring their funds home, they will draw drafts on their foreign accounts and sell such drafts in the open market, thus adding to the supply of exchange and tending to reduce the rates. Not only do high money rates at home and low money rates abroad influence the transactions of American bankers, but they also cause foreign bankers to place their money in the American market. This is done by their requesting American correspondents to draw drafts on them, to sell those drafts, and to loan in the American market the funds thus obtained, so as to receive the prevailing higher money rate.[2] At times the money rate may be higher in one foreign center than in another, whereupon the American banker withdraws his account from the

[1] In August and September, 1906, low discount rates abroad and the demand for funds in the United States at high rates caused a mass of finance bills to be drawn by American bankers.

[2] For example, in November, 1913, when the money market abroad stiffened and ease developed at home, exchange rates advanced, but when firmness in money rates occurred here, exchange rates declined.

lower money market and forwards it to the higher money market. The American banker effects this by selling a draft on his own account in the lower money rate center and buying with the funds thus obtained, a draft or cable on the higher money rate center. The draft or cable is forwarded abroad and the proceeds credited to his account. The first draft, or cable, i. e., the one which he has sold, will add to the supply of exchange on the low money rate center and, as a result, other things being equal, will have the effect of tending to weaken exchange rates on that point. The purchase of the draft or cable by which he remits to the other country will have the effect of increasing the demand for exchange on the country to which his funds are being transferred, and consequently will tend to increase or strengthen the exchange rates thereon. If, on the other hand, he cables his correspondent in the low rate center to purchase exchange and forward it to the high rate center, his cable in itself has no effect upon the exchange rate on either center, although the shifting of his account to the high money center will affect the demand for exchange on that center in the country from which his account is being shifted. When his account is finally in the high money rate center, it will add to his supply of exchange in that center, and will tend to weaken the exchange rate thereon.

The existence of high money rates in the United States and low money rates abroad, when linked with high exchange rates in the United States on foreign centers, will induce American bankers to issue finance bills in order to take advantage of the high exchange rate and also the high money rate at home. The sale of their finance bills provides them with the funds which they loan out in the home market, thus increasing the available money supply and tending to reduce money rates. Also, strangely enough, the very issuance of their finance bills creates a supply of exchange which in itself tends to weaken the exchange rate on the foreign center against which the finance bills have been drawn, thus enabling cover to be purchased sooner or later at lower rates, provided no unexpected developments occur to affect the situation adversely. Thus high money rates and high exchange rates bring forth a flood of finance bills which exert a weakening influence upon the exchange market and also upon the money market, and so tend to reduce both the rate of exchange and the money rate, unless other counteracting influences appear in the market.[1]

[1] Cf. p. 347, for discussion of the effect of the foreign discount rate on rates of exchange.

(d) Fourthly, we have that group of miscellaneous activities that bring forth a supply of exchange. Americans render all sorts of services to foreigners and in order to be reimbursed draw drafts on them. There are also those who have payments due them from abroad in connection with dividends, interest, maturing loans, brokerage charges, insurance commissions, repair work on foreign vessels, consular expenses, etc., and who draw drafts on their foreign debtors.

Another matter that must not be overlooked in this connection is the interest payments on the loans which we have extended to foreign nations during and after the World War as well as the interest payments on our investments in foreign municipal and corporation bonds. The total amount of foreign government, state, city, and corporation loans floated in the United States and outstanding on July 1, 1920, aggregated more than $12,000,000,000.[1] As 1921 came to a close the accrued interest owing on that sum totaled over one billion dollars. When interest payments on such loans are made, it is necessary for the foreign borrower (private party or government) to build up dollar credits in the United States. A means to this end is the purchase of American exchange in the foreign market, which makes the dollar more valuable in that market, i. e., able to command more of the foreign money unit, which weakens the value of the foreign money unit in our market. Another means is the sale of foreign drafts in our markets, which adds to the supply of exchange available on those countries and which has the same weakening effect on the exchange rates. The volume of these forthcoming interest payments is so large as to be almost unbelievable. Great Britain's annual interest debt to our government for funds advanced to her during the World War amounts to $209,840,000. The aggregate annual interest debt of the Allied Governments to the United States totals $475,000,000. We have permitted Great Britain to suspend interest payments until 1922, and it is now proposed that the interest payments of all the Allies be deferred for a period of at least fifteen years. This proposal in actuality would result in the creation of a loan to them of approximately $7,000,000,000 in addition to the $9,000,000,000 which we have already advanced.

When these public and private loans mature, they may be paid off out of funds made available (a) by means of drafts drawn on the Allies by their American agents, or (b) by the Allies forwarding us

[1] Cf. p. 333.

dollar exchange, or (c) by gold shipments. Any of these methods will necessarily result in a weakening of the exchange rates on the countries concerned and in the strengthening of the position of the dollar, provided, of course, no other outstanding developments occur to offset the influence of the great demand for dollar exchange and the creation of such a large supply of foreign exchange. The most important of the foreign loans paid off thus far has been the outstanding balance of the Anglo-French loan of $500,000,000, floated in 1915 and maturing October 15, 1920. About $200,000,000 was involved in the payment made on the latter date, being largely the share of the French government in the loan. The *Commercial and Financial Chronicle* of October 16, 1920, stated that the remaining amount of the bonds had been retired somewhat earlier through their purchase in the open market or in other ways, a considerable number being accepted in payment of subscriptions to the $100,000,000 French loan which had just previously been floated by an American syndicate. The *Chronicle* declared that the funds to meet the maturity had been raised by Great Britain and France by various methods, including operations in the exchange market, sale of American securities, gold shipments, and the placement of the above mentioned French loan. The transaction was handled most cautiously so as not to disturb the money market, most of the required funds as they were accumulated being loaned on call in the New York market and then very gradually called in before the day of payment. In July, 1921, however, as the result of a similar situation, not so carefully handled, sterling exchange displayed sensational weakness, falling from 3.735 on July 1 to 3.55 3/8 on July 29. While the chief weakening influence was the continued offering of commercial bills drawn largely against future shipments of grain and cotton, yet a powerful element in the situation was the sale of sterling bills by prominent British interests for the purpose of accumulating dollar credits in anticipation of the payment in the United States of the maturing British notes.[1]

Considering our foreign loans, the interest payments thereon, our huge excess exports, etc., it is difficult to see how in the future any very great strength can be evidenced by the foreign exchanges in our market, even after the leading nations of the world return to a gold standard basis. This statement does not mean to imply that the foreign exchanges will remain for any length of time as greatly de-

[1] *Commercial and Financial Chronicle*, Bank and Quotation Section, August, 1921, p 16.

preciated as they are at present, but that when conditions do return to normal the exchanges will be very apt to fluctuate between the gold import point and the par of exchange rather than between the gold import point and the gold export point.[1]

Ordinarily, American offices of foreign insurance companies keep sufficient funds on hand to meet losses as they occur, but in times of widespread disaster, such as the Baltimore and San Francisco fires, they are compelled to get funds from their foreign home offices, which they do by drawing drafts against the latter and selling them in the American market, an operation that tends to weaken exchange rates by greatly increasing the available supply.

Exchange offered for sale in connection with arbitrage operations and speculative transactions [2] must also be included as "Supply." Both arbitrage and speculation are common activities in normal times, but during the World War arbitrage practically ceased, while speculation became rampant, even among those who were ignorant of the simplest features of foreign exchange. Again and again speculative interests have been in control of the market. During 1921 when the mark registered such startling declines, millions of marks were dumped onto the market by speculators who hoped to avoid greater losses as a result of a further decline in the mark quotation. This dumping process helped to force the rate even lower than it would otherwise have gone.

An increasingly large number of travelers, both for pleasure and for business, have come to the United States in these later years, bringing with them travelers' checks or travelers' letters of credit. Travelers' checks or drafts against travelers' letters of credit, being payable by the foreign issuing bank or dealer, add to the claims of American banks on foreign institutions and result in an increase in the amount of exchange available on foreign countries.

(e) Finally, at times when it pays American bankers to export gold, it is the custom, as will be seen in Chapter XI, for drafts to be drawn or cables to be sold against the gold as soon as shipped. Gold is usually exported in fairly large sums, and the resulting drafts or cables necessarily tend to weaken the exchange rate. It is this same weakening influence of gold exports, as will be seen in Chapter XI, that in normal times tends to bring the exchange rate again below the gold export point.

[1] Cf. Chapter XI.

[2] Cf. Chapter XIII.

II. *Demand for Exchange.* (a) The demand for exchange is influenced by an equally large number of independent factors, the most important undoubtedly being the need for exchange instruments of various sorts with which to pay for imports of merchandise. Although, as we have seen in earlier pages, our exports have greatly exceeded our imports for many decades past, it is necessary for us to pay for imports just as we expect to receive payment for our exports. American firms who import from all parts of the world are continually in the market for exchange with which to pay their foreign creditors. A matter frequently overlooked in this connection is that a considerable amount of our imports coming from all parts of the world has been and will probably continue to be financed under sterling letters of credit.[1] When the foreign exporter draws his drafts on a London bank under a sterling letter of credit sent to him by an American importer, his drafts create a supply of exchange on London in his country. These drafts have to be met in London when they mature, and consequently add to our indebtedness to England. We then pay by remitting sterling drafts to London as "cover," thereby creating a demand for sterling exchange in the United States.

(b) In earlier pages we have seen that the sale of securities to foreigners creates a supply of exchange; conversely, when we purchase securities from them, our payments, being made by means of bills of exchange, increase the demand for exchange. A serious decline in the prices of securities often induces foreign holders to unload on the American market, although it is not unusual for high prices of securities to induce them to sell to us so as to reap the gains. We remit exchange to pay for the securities that we purchase. During times of stress and strain in the financial world we have always bought back large amounts of foreign-held securities. During the panic of 1893, partly as a consequence of the fear aroused at that time by the growing demand for a bimetallic standard in the United States, foreign holdings of stocks and bonds were dumped onto the American markets. Rates of exchange ruled high during the first six months of 1893 partly because of that fact and partly because our imports of merchandise were unusually heavy with an accompanying light export of domestic merchandise. Again, during the early weeks of the panic of 1907, millions of dollars worth of foreign-held securities were unloaded on the American stock exchanges, and as a result of the great

[1] In England, frequently called "reimbursement credits."

demand for exchange with which to remit, rates rose to what were their record levels, cables selling at one time for 4.91. During the week ending February 27, 1909, a demoralizing decline in United States Steel, Reading Railroad, and other stocks occurred, and a continued selling by foreigners ensued with a resulting demand for exchange which exerted a stiffening influence on the exchange market. Again, at the beginning of the World War we had the same sort of situation arising, but from other causes. On July 24, 1914, Austria forwarded her ultimatum to Serbia. The stock exchanges of the world closed between July 27 and July 31. The New York exchanges remained open until the 31st, while liquidation went on at an amazing rate from all parts of the world, necessarily producing startling declines in the prices of securities. New York investment houses had such a heavy list of orders to sell that had they been able to negotiate all of them the results would generally have been disastrous. The unprecedented demand for foreign exchange with which to make remittances caused sterling demand drafts to rise to 5.50 on July 31, while cables went to 6.35. Sterling demand drafts and cables rose to still higher levels within a few weeks, but for additional causes.

As the war progressed, and partly as a consequence of the methods pursued by England in stabilizing sterling exchange in the United States,[1] it became possible for us to buy back large blocks of American stocks and bonds. In the latter part of March, 1917, Mr. L. F. Loree, President of the Delaware and Hudson Railway Company in announcing the results of an exhaustive study which he had made concerning the return of European-held securities stated that we had, up to that time, purchased over 56.15 per cent ($1,518,000,000) of the total amount of American railroad securities which had been held abroad. It is impossible to estimate accurately the total sum which has been purchased since 1914, but it is claimed by many authorities that it is approximately $4,000,000,000 and that a relatively small amount still remains in foreign hands.

Concomitantly we have been investing heavily in the stocks and bonds of foreign corporations as well as in the bonds of foreign cities and foreign countries. These investments have taken the shape of

[1] As will be described more in detail in Chapter XIV, England bought or borrowed American securities held in England and sold them through Morgan & Co. in New York at those times when sterling rates fell below the pegged position of 4.76. The money realized from such sales was used to purchase cables on England, thus artificially strengthening sterling in our market and causing it to rise again to 4.76.

TABLE X. SUMMARY, BY COUNTRIES, OF FOREIGN GOVERNMENT, STATE, AND MUNICIPAL AND CORPORATION LOANS FLOATED IN UNITED STATES AND OUTSTANDING AS OF JULY 1, 1920

Country	Government	State and Municipal	Corporation			Total	Cash Advances and other charges against credits established by United States (up to May 11, 1920)	Grand Total
			Railroad	Public Utility	Industrial			
Canada & Newfoundland	$152,500,000	$130,425,313	$121,328,500	$80,095,000	$39,899,500	$524,248,313	.....	$524,248,313
Mexico	500,000	.....	128,087,765	.....	.....	128,587,765	.....	128,587,765
Cuba	10,000,000	.....	.....	.....	.....	10,000,000	$10,000,000	20,000,000
Panama	2,705,000	.....	.....	.....	.....	2,705,000	.....	2,705,000
Santo Domingo	10,806,000	.....	.....	.....	.....	10,806,000	.....	10,806,000
Argentina	.....	.....	15,000,000	.....	.....	15,000,000	.....	15,000,000
Bolivia	4,048,000	.....	.....	.....	.....	4,048,000	.....	4,048,000
Brazil	.....	18,500,000	.....	.....	.....	18,500,000	.....	18,500,000
Chile	.....	431,000	.....	.....	.....	431,000	.....	431,000
Great Britain	772,633,000	.....	.....	.....	15,000,000	787,633,000	4,277,000,000	5,064,633,000
France	250,000,000	95,000,000	.....	.....	.....	345,000,000	2,997,477,000	3,342,477,000
Germany	2,000,000	.....	.....	.....	.....	2,000,000	.....	2,000,000
Russia	75,000,000	.....	.....	.....	.....	75,000,000	187,729,000	262,729,000
Belgium	75,000,000	.....	.....	.....	1,000,000	76,000,000	338,745,000	414,745,000
Italy	25,000,000	.....	.....	.....	.....	25,000,000	1,631,338,000	1,656,338,000
Greece	.....	.....	.....	.....	.....	.....	48,236,000	48,236,000
Roumania	.....	.....	.....	.....	.....	.....	25,000,000	25,000,000
Serbia	.....	.....	.....	.....	.....	.....	26,780,000	26,780,000
Norway	5,000,000	.....	.....	.....	.....	5,000,000	.....	5,000,000
Switzerland	30,000,000	.....	.....	.....	.....	30,000,000	.....	30,000,000
Sweden	25,000,000	.....	.....	.....	.....	25,000,000	.....	25,000,000
Denmark	.....	15,000,000	.....	.....	.....	15,000,000	.....	15,000,000
China	13,000,000	.....	.....	.....	.....	13,000,000	.....	13,000,000
Japan	102,552,000	5,250,000	.....	.....	.....	107,802,000	.....	107,802,000
Australia	.....	.....	.....	1,250,000	.....	1,250,000	.....	1,250,000
Czecho-Slovakia	.....	.....	.....	.....	.....	.....	56,524,000	56,524,000
Liberia	.....	.....	.....	.....	.....	.....	26,000	26,000
Total	$1,555,744,000	$264,606,313	$264,416,265	$81,345,000	$55,899,500	$2,222,011,078	$9,598,855,000	$11,820,866,078

loans of huge proportions to the Allied Governments made by the United States government for the purpose of prosecuting the war against Germany, and investments by individuals and financial houses in the bonds of foreign cities and nations [1] and in the stocks and bonds of corporations of various kinds in all parts of the world, totaling far in excess of $12,000,000,000. The data regarding our loans outstanding July 1, 1920 are shown in Table X (page 333), compiled by the Guaranty Trust Company of New York.

The above tabulation does not include subscriptions in the United States to foreign internal loans, as the amounts of such subscriptions are not available, nor does it include the following issues: "(1) Mexican loan of $25,000,000 (U. S.) 4 per cent bonds (of a total issue of $40,000,000), due in 1954; (2) two Cuban government loans, one of $35,000,000 gold 5 per cent bonds, dated March, 1904, and due March 1, 1944, and one of $16,500,000 external 4½ per cent bonds dated August 2, 1909, and due August 1, 1949. These issues were placed partly in the United States and partly abroad, but the amounts placed in this country are not available." [2] From July 1, 1920, to December 31, 1921, we floated an additional amount of foreign government, state, and municipal loans totaling $610,579,300.[3] No data are available as to the amount of our investments in foreign corporations since July 1, 1920.[4]

The larger part of our loans to foreign cities and nations has been in the form of cash advances and dollar credits established in the United States, which could have no immediate effect upon the rate of exchange except through reducing the supply of exchange on those countries. Later, however, when the loans are paid off or when interest payments are made, it is evident that foreign exchange rates will inevitably be weakened.[5] Some of the loans, however, and the greater part of our investments in corporation and foreign municipal securities made during and after the World War, have necessitated the remitting of the funds so invested and have therefore aided in sustaining the demand for exchange on those countries. The heavy investment

[1] T. W. Lamont of J. P. Morgan and Company stated in March, 1922, that out of a total of $2,587,399,000 European government obligations floated in this country from August 1st, 1914 to January 1, 1922, only $818,000,000 remained at that time in private hands. The amount held by bankers was declared to be negligible. *Commercial and Financial Chronicle*, March 4, 1922.

[2] *Federal Reserve Bulletin*, July, 1920, p. 687.

[3] New York *Journal of Commerce and Commercial Bulletin*, January 3, 1922.

[4] The *Federal Reserve Bulletin* of April, 1922, states that during 1921 and down to March, 1922, we had floated foreign loans aggregating $913,303,000.

[5] Cf. p. 329.

(speculative in character) of Americans in German municipal bonds immediately following the war undoubtedly held the mark at a higher level than would otherwise have been the case. In September, 1921, the floating in the United States of a $25,000,000 loan to Brazil and one of $50,000,000 to Argentina had the effect of strengthening the exchanges not only of those two countries, but of practically all of the South American countries as well.[1]

Excluding the large war advances which our government made to the three important Allies, Great Britain, France, and Italy, our heaviest investment thus far has been in Canadian loans of various kinds. Commenting on this matter, the Bankers' Trust Company of New York, in a statement issued December 6, 1920, declared:

"Prior to 1914, Canada secured in Great Britain the greater part of the capital required to develop her natural resources. The war immediately dried up the wells from which flowed this vivifying supply. In fact the current was reversed and Canada gave back to the mother country many millions of capital.

"Then it was that Canada turned to the United States for the capital no longer to be obtained overseas. The result is that in the past six years we have loaned Canada nearly a round billion of dollars. This money has gone to help Canada meet her military expenses, to help her finance her exports of wheat and other foodstuffs and of munitions of war.

"A large amount has been invested in American owned factories because on account of Canadian tariff regulations it is more profitable to manufacture certain classes of goods to be sold within her borders rather than to export them to her. Again we need paper pulp and paper and Canada has in abundance the raw materials to produce them if we will turn them into the manufactured product on her side of the boundary line.

"But this is not done at a loss. On the contrary, our interest and profits received from our Canadian investments are estimated to have been, during the past six years, around $330 million while Canadians have probably paid us over $90 million in freight money, insurance and the like. Therefore, of the approximately one billion dollars which we have invested in Canada in recent years, nearly half represents merely a reinvestment of payments made to us by our Canadian friends." [2]

Demand for exchange also arises in connection with the payment of maturing American corporation and municipal loans held abroad.

[1] *Commercial and Financial Chronicle*, Bank and Quotation Section, October 8, 1921, p. 17.

[2] *Commercial and Financial Chronical*, December 11, 1920.

Before the World War a large share of the securities of American corporations was floated abroad.[1] It was not unusual for corporations to issue bonds, the principal and interest of which were made payable to foreign holders, either in gold or at a fixed rate of exchange. When payments are made the corporation goes into the market and purchases exchange with which to make remittance, thus helping to strengthen the rate. The same holds true in the case of maturing city loans. To cite a concrete instance:—it had for some years been the practice of New York city to sell its tax warrants [1] in foreign countries, principally in France and England, because it could get a larger return therefor than when sold in the United States. At the outbreak of the World War, New York City owed about $82,000,000 on foreign-held tax warrants, payable in gold. A syndicate of bankers was organized to finance the city's demands, and subsequently remitted $80,243,941 in exchange, not to mention certain gold shipments. The demand for such a large amount of exchange increased the pressure upon the market and aided in raising the rates on England and France.[3]

The part played by the international dealings in stocks and bonds (both civil and corporation) can hardly be overestimated so far as their effect on the exchange and financial markets is concerned. The ramifications of such transactions and their importance in the financial affairs of a country are seldom appreciated by the layman or by the ordinary exchange dealer.

(c) In the past it has been necessary for us to remit, usually semi-annually, large payments of interest and dividends upon stocks and bonds held abroad. Those payments have been variously estimated as totaling from $200,000,000 to $300,000,000 per year. Every half-year the mail sacks coming from foreign countries would be bulging with clipped coupons being forwarded to us for payment. Since we had to remit payments to our foreign creditors by means of bills of exchange, the rates on foreign countries always showed a tendency at those times to increase. Inasmuch as since the war we have bought back the greater part of these European-held securities, it may be years before our payments of interest and dividends will again play

[1] It has been estimated that the aggregate amount of British capital invested in the United States in August, 1914, was about $3,888,000,000.

[2] Short time obligations secured by the forthcoming tax income of the city, and used by many cities as a means of anticipating future revenue from taxes.

[3] Cf. p. 530.

such an important part in our foreign exchange market. In fact our country has within the last few years become a creditor nation and has invested heavily in loans to European governments, cities, and corporations, not to mention the investment of much American capital in South America and in the Orient. The Europeans, however, especially in neutral countries, are still active in the market as purchasers of American securities, as is evidenced by a late report from The Hague, appearing in the New York *Times* of November 3, 1920, to the following effect: ". . . big capitalists are sending enormous sums to America and steadily buying scores of millions of dollars of American securities. . . . The Dutch feel that America is the one place safe from Bolshevism and other social disturbances and are investing largely in American securities. Even the small farmers who grew wealthy during the war favor those securities. Bankers in small provincial towns say that they invest millions of dollars monthly." The to-be-expected result of such heavy purchases by the Dutch was a sudden fall in the rate for guilders which had for so long been steadily maintained in our market. Later, however, as we remit interest and dividend payments to the Dutch, the increased demand will tend to raise the rate of exchange on Holland.

(d) Each year large amounts of money are sent abroad by immigrants to relatives and families, remittance almost always being made by means of some kind of exchange. The extent of such remittances is not definitely known but it has been variously estimated at from $100,000,000 to $150,000,000 a year. As showing the extent to which immigrants are an influence on the demand side of the foreign exchange market, it is interesting to note that during 1919 the Italians in the United States sent to their home country 432,692,497 lire [1] in addition to the savings which some 75,553 returning immigrants carried back with them.[2] The American Consul General at Athens estimated that during the same year the Greeks in the United States remitted approximately 350,000,000 drachmas.[3] It has been stated that English and Irish immigrants remit about $25,000,000 a year to friends and relatives in Great Britain.

[1] Approximately $83,509,651 when computed at 19.3 cents per lira. The lira at par is 19.294 cents.

[2] Statement issued by the U. S. Department of Commerce, *Commercial and Financial Chronicle*, October 9, 1920.

[3] This amounts to $67,550,000 when figured at 19.3 cents per drachma. The drachma at par is 19.294 cents.

(e) Another element that looms large as a factor in the demand for exchange concerns itself with the annual remittances which we have for many years been compelled to make to England and a few of the Continental countries for insurance premiums and ocean freight charges. From 1791 to 1820 our imports exceeded our exports by more than $500,000,000. We paid for that relatively vast importation by rendering a shipping service to foreign nations. For many years past, however, our exports have greatly exceeded our imports and in part payment of the difference foreign countries have rendered us a shipping service, carrying our ocean freights and exacting a charge therefor variously estimated at from $20,000,000 to $40,000,000 per year.[1] During the World War, however, the unusual conditions that existed made possible the sudden expansion of the American merchant marine; European-owned ships were being kept busy carrying supplies and troops for the warring nations. But since the signing of the Armistice it has been increasingly difficult for American ships to compete successfully with European and Oriental vessels. It is impossible at this writing to say what the outcome of the present struggle on the high seas will be. If American capital can make more money on the water than it can by investing in enterprises on the land, either with or without a subsidy, our merchant marine will remain an active and powerful factor in the world's carrying trade; otherwise not. Foreign competition is bound to be severe, especially between the United States, England, and Japan.

Before the war practically all of our marine risks were insured in foreign companies, mostly British. A great deal of life, fire, accident, and liability insurance was and still is carried in English and Continental companies. Dr. S. S. Heubner, Professor of Insurance at the University of Pennsylvania, estimated that in 1918 the insurance premiums which Americans paid on policies with foreign companies amounted to approximately $250,000,000. Although the American offices of these companies usually keep a large amount of reserve funds on hand or invested in American securities, nevertheless the greater share of the premiums is sent abroad by means of exchange purchased in the open market, which of course increases the demand for exchange and tends to strengthen the rate. During the war a large amount of insurance of all kinds, including quite a bit of marine

[1] Escher, "Elements of Foreign Exchange," p. 21, approves an estimate of $150,000,000 per year.

insurance, was written by American companies, and since the Armistice a serious effort has been made to retain the business so lately won. This state of affairs has naturally resulted in a lighter demand for exchange with which to pay premiums abroad.

(f) Europe has always been a favored land of travel for American tourists, and many a city on the Continent survives solely or mainly on the funds which our citizens take into those communities. Before the World War it was estimated that our tourists were in the American markets each year for from $200,000,000 to $500,000,000 in exchange to carry abroad with them. The effect of this recurring and fairly steady demand was always evident in the market. During the war, however, our tourists remained at home, and the lack of demand for such a large amount of exchange aided in weakening the rates on European countries.

(g) There are also a number of American families living temporarily or permanently in foreign countries to whom funds must be sent occasionally or at regular intervals. Nor must we overlook those instances in which American heiresses have wedded English and European husbands, making it incumbent on us to remit millions of dollars as dowries or as income from American-owned properties. As Withers facetiously remarks, "We (England) draw on the United States for the 'dowry drain' and repay it with affection and social distinction conferred on American heiresses by their English husbands." [1]

(*h*) Before the World War there was also a great demand for exchange with which to meet our maturing currency and sterling loans and finance bills. These long bills were customarily drawn so as to fall due in the autumn, at which time exchange rates on foreign countries were usually at their lowest levels.[2] Had it not been for the autumnal demand for exchange with which to pay off the millions of dollars of such long bills issued during the spring and early summer months, the rates of exchange every fall would have reached considerably lower levels. To cite an instance of the effect of finance bills on the rates of exchange: In October, 1912, a mass of American securities was thrown onto our markets following the declaration of the Balkan War. To obtain the funds with which to supply the stock and bond dealers with the money needed to absorb those securi-

[1] "Money Changing," p. 89.
[2] Cf. 324–325.

ties, finance bills were issued maturing in January, 1913. The demand for cover at that time caused exchange rates to rise to such levels that large exports of gold became advisable and profitable. During and since the World War, loan and finance bills have not exerted the influence on either the supply or the demand side of the exchange market that they did before that time. With the United States at present a creditor nation (and it is difficult to prophesy just how long we will be able to retain that position), it is not expected that loan or finance bills will in the near future function as actively in the exchange markets as they have in the past.

(i) The money rates at home and abroad also have their effect on the demand for exchange. If low money rates rule in the United States with high money rates in some foreign center, banks with funds to invest for a short period will enter the market as demanders of exchange with which to transfer their accounts abroad so as to take advantage of the high foreign money rate. Fluid capital, using those words rather loosely as signifying funds in the hands of bankers available for investment, is extremely mobile and shifts or is shifted from one center to another by cable or otherwise at a moment's notice for the purpose of taking advantage of a slightly higher rate of return. Our international bankers are quick to seize an opportunity of getting an increase in the yield of their funds.[1] High money rates abroad also make it unprofitable for us to renew maturing finance and loan bills, and hence tend to stimulate the demand for exchange with which to pay such bills when due. Thus it is that we can always expect to see low money rates at home and high money rates abroad increasing the demand for exchange and tending to raise the exchange rates, and vice versa. Low money rates abroad are at times, however, linked with low money rates at home. This brings about a slackening in the demand for foreign bills, with a resulting tendency to weaken the exchange rates on the foreign country. In the first week of June, 1898, a decline in the discount rate of the Bank of England caused bankers to stop purchasing long sterling bills for investment purposes,

[1] The *Annalist* of New York under date of January 15, 1917, stated that: "The marked ease of money rates last week stimulated the investment of banking funds in cotton bills and other paper drawn against exports. The process enabled the purchaser to draw interest at higher rates on an amount of funds in London equivalent to his investment on such bills. Before money advanced to the high levels current late in November, it was estimated that fully $400,000,000 American funds were being loaned in London in this manner, of which more than $100,000,000 was thought to have been drawn back here when the money market stiffened."

while easy money rates at home tended to prevent the purchase of sterling for future delivery. The result was a heavy market for sterling exchange with lower rates prevailing. The student should not overlook the fact that the money rates of a country are inseparably connected with the discount rate of the rediscounting institution or central bank. The discount rate, however, is so important a factor in affecting the rates of long bills that we shall devote a separate section of this chapter to it.[1]

(j) There are also those foreign payments which we must make to those who have rendered services for us, such as lawyers' fees, agents' commissions, payments to sales agencies, salaries to foreign employees and consular representatives, bankers' commissions, etc., etc., all of which create a demand for exchange. Before the World War we paid English discount and acceptance houses large sums of money as commissions on various financial transactions. These commissions, variously estimated at from $10,000,000 to $150,000,000 have largely disappeared as a result of developments during and since the war and therefore do not figure as prominently on the demand side as formerly. If the present tendency to return to the use of sterling letters of credit should continue, it seems safe to predict that in the future we shall again be in the market for large sums of exchange with which to pay acceptance commissions to English banking houses.

(k) Exchange is also demanded in connection with arbitrage and speculative transactions.[2] Especially during and since the war has speculation been an extremely important factor in the exchange market. First it was the demand for Russian rubles; then for francs and lire; later for marks. This speculative demand has been of great influence in strengthening the market, and at times has raised the speculative exchanges to higher levels than would otherwise have prevailed. On January 2, 1921, sterling exchange opened at 3.53 @ 3.54¼ and in a month's time (January 31) it had risen to 3.83¼ @ 3.85 3/4. One of the strengthening influences was the large outstanding "short" interest made up of those dealers who had sold futures, counting on covering later through an expected fall in the rate but who were compelled to purchase at the higher rates for fear of having to cover later at even higher prices.

(l) We have seen that gold exports tend to create a supply of ex-

[1] Cf. p. 347.
[2] Cf. Chapter XIII.

change and thereby weaken the rates. On the other hand, gold imports do not of necessity create a demand for exchange, although such is usually the case. An importation of gold must be paid for in one of two ways: first, by the dealer cabling his correspondent to take a certain portion of his (the importer's) deposit account and to use the same in purchasing gold. This cable request, in itself, does not create a demand for exchange in the American market, nor does it, as a cable, affect the supply; but the procedure does reduce the foreign account of the dealer and thereby decreases the supply of exchange. Also, when the importing banker later takes steps to build up his depleted foreign account, he will have to go into the open market and buy exchange, thereby increasing the demand for foreign bills. Second, if when the dealer makes his plans to import gold, he finds that his foreign account is relatively low, he may be forced to go into the market and buy a sufficiently large amount of either cables or sight exchange to send abroad to build up his account in order to be able to pay for the gold that he wishes to import. This procedure would create a demand for exchange and so tend to raise the rates.

(m) At times, although rather infrequently, the exchange market will be disarranged by the payment of an indemnity between nations. For example, in 1900 the United States government paid Spain a claim for $20,000,000, arising out of the Spanish-American War, and for several months our government remained in the market as an active demander of exchange, thereby materially increasing exchange rates. On May 17, 1921, Germany paid the Reparations Commission 150,000,000 gold marks, the payment consisting of foreign currencies. Germany secured these funds by drawing drafts on credit balances which she had accumulated in those countries with which she was trading. The Reparations Commission found itself possessed of a miscellaneous volume of drachmas, lei, francs, dollars, guilders, and every conceivable unit of currency in commercial use in the world, and requested Germany to convert these foreign funds into dollars. Germany did so by May 31, with the result that her demand for dollars strengthened the dollar quotation and weakened practically every European rate, sterling, for example, falling from 4.00 on May 19 to 3.86 on May 31. The Reparations Commission finally authorized Germany to pay in any foreign credits which she might possess in order to prevent the disturbing effects of similar demands for dollar credits in the future.

Before bringing to a close the discussion of the supply of and the demand for exchange, several other matters should be briefly referred to. For example, the reader must always keep in mind that when we state that increasing the supply of exchange tends to weaken the rate, or that decreasing the supply tends to stiffen it, we mean that such statements hold true provided the demand factor remains constant; and likewise, when we say that increasing the demand stiffens the rate or that decreasing the demand weakens it, we mean that the supply factor remains constant. It is not unusual, however, to find that an increased supply or a decreased demand does not weaken the rate, or that a decreased supply or an increased demand does not strengthen it, the reason being that the other factor has not remained constant and consequently has affected the condition of the market in a manner that was not anticipated. Also, one must not overlook the fact that there may be any number of bills drawn on creditors in a foreign country that are not sold to exchange dealers in the country of origin, but instead are sent abroad for collection. Such bills do not affect the supply side of the market until actually collected and the funds so obtained have been added to the foreign account of the exporter's collecting agency. The funds may then be returned to the country of origin in one of two ways: (*a*) the collecting agency may draw drafts on the foreign account, sell them in open market, and thus receive funds with which to pay the exporter; or (*b*) the collecting agency may advise its foreign correspondent to remit the account by means of sight drafts or cables. The first method creates a supply of exchange on the foreign country; the second method creates a demand in the foreign country for exchange on the exporter's country. Both affect the exchange rate in the exporter's country in the same manner, i. e., they tend to lower the rate. To illustrate: a demand in France for dollar exchange raises the rate for dollars, or what amounts to the same thing, it lowers the value of the franc, because it then takes more francs to buy a dollar. A supply of franc exchange in the United States lowers the value of the franc, or increases the value of the dollar because the latter then buys more francs. In this way, bills that are collected abroad may ultimately result in (a) a demand in the foreign country for exchange on the country of origin, or (b) in the creation of a supply of exchange in the country of origin on the foreign country, both of which in the end, as we have seen, have the same effect on the market.

A draft drawn on a party in a foreign country, say France, and disposed of in the country of origin, say the United States, may add to the supply of franc exchange in the United States, or it may create a demand for dollar exchange in France, but it cannot affect the supply side in the United States and the demand side in France *at the same time*. When it is offered for sale to an exchange dealer in the United States, it is clearly a part of our supply of franc exchange. But it cannot at the moment of sale affect the demand for dollar exchange in France. When the bill reaches France and is finally paid, say seven or ninety days later, the French correspondent may then possibly be requested to purchase dollar exchange and remit it to the American dealer. Such a proceeding is rather unlikely to occur,[1] but still it is practically possible. Thus the existence of a supply of franc exchange in the United States may ultimately lead to a demand for dollar exchange in France, but where only two countries are concerned it is not possible for the franc draft to figure *simultaneously* as a supply factor here and as a demand factor abroad.

The situation becomes slightly different, however, when we discuss relations that may arise between merchants and bankers in three countries. Say, for example, that a German bank issues a commercial letter of credit to a German importer, under the terms of which the drafts are to be drawn on an English bank, and that the letter of credit is forwarded to an American exporting firm. The draft that the American firm draws on the English bank may be considered as increasing the supply of sterling exchange in the United States and also at the same time as resulting in an increased demand for sterling exchange in Germany. In this case the draft drawn on England by the American firm will be sold in the New York market, thereby adding to the supply of sterling exchange in that market. The German bank that issued the letter of credit upon the London correspondent will have to reimburse the latter, i. e., cover the sterling draft drawn by the American exporter, thus increasing the demand in Germany for sterling exchange.

Trade relations between three countries may in various ways affect the demand for, or the supply of, exchange of those countries in a most interesting manner. Say that American importers owe English exporters; that German importers owe American exporters; and that

[1] To get the funds back to the United States, the customary practice is for the American banker to sell franc drafts against his account.

English importers owe German exporters. The usual method of handling such a situation would be for the United States firms to draw on the German firms so as to get the money which was due them; the German companies would likewise draw on the English importers; and the United States importers would remit to the English exporters. The American bankers who purchase the drafts drawn against the German firms may and frequently do send such drafts to their English correspondents for collection, the amounts collected to be credited to their English accounts. When these drafts reach England they are forwarded to German correspondents who in their turn collect the amounts due and then purchase sterling exchange with which to make remittance to the English bankers. Thus it is that the existence in the United States of mark drafts leads to the creation of a demand in Germany for sterling drafts. The German banks that sold the sterling exchange for remittance in the above connection undoubtedly had built up their accounts in England by purchasing the drafts that the German exporters had drawn on the English importers.

To cite another possible situation, say that England buys cotton from the United States, that Germany buys cloth from England, and that the United States purchases scientific instruments from Germany. We would draw drafts on England in order to receive money owing us by the English importers. These drafts would be purchased by the American bankers and might be sent to Germany for collection from England, the idea of the American bankers being to build up their accounts in Germany. The German bankers would send these drafts to England and ask that the funds be deposited to their accounts. They would thus have a supply of sterling exchange available with which to satisfy the needs of the German importers who require it for remittance to England to pay for the cloth. A supply of sterling exchange in the United States has thus led to the creation of a supply of sterling exchange in Germany. Or it might be that the American importers would send sterling commercial letters of credit to the German exporters, who would draw drafts on English banks for goods shipped to the United States. And in this way a demand for sterling exchange in the United States would lead to the creation of a supply of sterling exchange in Germany.

It is not unusual for a debtor in one country to pay a creditor in a second by means of exchange drawn on a third. An importer in New York may pay an exporter in Paris by sending him a draft on London.

The Parisian will be compelled to sell his sterling draft in Paris in order to obtain his money. This adds to the supply of sterling exchange in Paris. The Parisian banker who purchases the draft will forward it to London for collection, and have the proceeds credited to his London account. Thus the existence of a demand for sterling exchange in the New York market has created a supply of sterling exchange in the Paris market. Or if the Parisian banker asks that the funds, when collected in London, be remitted to him, franc exchange will be purchased in London in order that the funds may be returned to Paris. The existence of a demand for sterling exchange in New York has therefore led to the creation of a demand for franc exchange in London. While to the uninitiated this might seem to be a roundabout way of making payments in international transactions, it is not so uncommon as one might suppose. Sterling drafts have been universally used in such connections.

In 1912, Germany exported about £13,000,000 worth of goods to Argentina, but imported far less than that amount from her. The difference was undoubtedly paid for by means of sterling remittances sent to the German exporters by the Argentine debtors, drawn against credits which had been built up in England as the result of large English purchases of foodstuffs from the exporters of Argentina. Especially has it been customary among South American countries for payments to be made to each other or to foreign nations by means of 90 day drafts drawn on London.

Four-cornered transactions similar to the above triangular operation were frequently engaged in during the World War. The *Annalist* of May 7, 1917, in describing such a four-cornered operation, stated that:

"Russia owes Japan for war munitions, ships, steel, etc., but is forced by the exigencies of war to borrow in London to pay the bill. London in turn is a heavy borrower in New York, and so theoretically the burden is passed along to the New York market. Japan, then, in order to get her money, draws on New York, and it happens that at the same time she has a heavy trade balance here, resultant from extraordinary exports to this country. The addition of this debt to the debt of Russia, which has been shifted to the American market, acts to depress the value of the dollar in Tokio and makes more easy the outflow of gold. Last week shipments were made from San Francisco to a total in excess of $4,000,000, and the continuance of the flow is expected for some time."

III. *The Discount Rate.* The discount rate prevailing in foreign markets is an important matter that is kept in mind by every exchange dealer in purchasing acceptance bills. If a New York dealer purchases a long bill and sends it to London when the discount rate is high, he will receive less when it is discounted than if the discount rate had been lower. It is for this reason that the New York dealer pays less for long bills when the discount rate is high than when it is low. The discount rate applies only to long bills. Sight bills are never discounted because they are payable on demand. It is not unusual to have demand drafts on London sell for 4.86, and to find that the American exporter can obtain but 4.81 or 4.82 for his 90 day bills because of the high discount rate in London.[1] Conversely, if the discount rate abroad is low, the exchange dealer will be able to secure a greater return on bills discounted abroad and consequently will be willing to pay a higher exchange rate for them. Thus, in 1908, the discount rate of the Bank of England was lowered from 7 per cent on January 2, to 6 per cent on January 3; to 5 per cent on January 17; to 4 per cent on January 24; to 3½ per cent on March 6; to 3 per cent on March 20; and to 2¼ per cent on May 29. The rates for 60 day acceptance bills on those dates were respectively: 4.7950 @ 4.7975; 4.80 @ 4.8025; 4.8210 @ 4.8220; 4.8340 @ 4.8350; 4.830 @ 4.8325; 4.8315 @ 4.8325; 4.8520 @ 4.8530; a consistent though not a proportionate increase being shown as the discount rate was lowered.

The influence of the discount rate in narrowing the spread between the quotation for long bills and sight exchange will be discussed in the following section, while its connection with the flow of gold will be considered in the next chapter.

IV. *Usance of Bills.* The length of time for which the bill is to run before payment is made, i. e., its length of life, is a factor that also influences the rates charged or paid on any particular day for the different kinds of exchange. The sight or demand rate, as Whitaker so well says, "is forged out in the open market between the hammer and anvil of bid and offer," [2] (supply and demand), but the rates for cables and long bills are always calculated on the basis of the sight

[1] On January 3, 1908, the Bank of England discount rate stood at 6 per cent; the open market rate at 5 per cent. The rates of sterling exchange on that day were: 60 day bills, 4.795 @ 480; sight bills, 4.8470 @ 4.8475; cables, 4.8575 @ 4.86. On January 2, 1913, the Bank of England discount rate stood at 5 per cent, the open market rate between 4 per cent and 5 per cent. The rates of sterling exchange on that day were: 60 day bills, 4.8155 @ 4.8165; sight bills, 4.8570 @ 4.8580; cables, 4.8630 @ 4.8640.

[2] *Op. cit.*, p. 274.

rate and are not in themselves subject to any great extent to the influences that focus upon the sight rate. There has been some controversy among exchange dealers, as well as among those who have written on the subject, as to whether or not the sight rate or the cable rate should be taken as the basis for the calculation of the other exchange rates. The American Express Company in a late number of its *Foreign Trade Bulletin* calls attention to the fact that "It is interesting to note that the cable rate of exchange is the real rate indicating what the United States dollar is actually worth day by day, in terms of each foreign currency." Whitaker, on the other hand, maintains that:

". . . it must be confessed the thought that the cable rate is the 'real exchange rate,' unadulterated by discount or interest, so to speak, is an attractive idea to both the theorist and the banker. But be this as it may, the various long rates (and also the rates for merchants' sight bills, which are sometimes drawn) are tied to the rate for bankers' sight drafts in a way in which they cannot be connected with the cable rate. The spread between a long rate and the sight rate can be calculated at the time of the purchase of the long exchange, from factors which are then all foreknown. Neither speculation nor investment enters in. But the purchase of any kind of bill cannot be counterbalanced by a sale of cables without both a speculation and an investment of funds being involved. And so a banker cannot base his buying rate for long bills upon the cable rate without putting into the spread one speculative element, or one factor that is guesswork. The point remains even if under very quiet conditions the degree of speculation may be slight. . . .

"The rates for exchange which takes the form of written instruments that have to be transmitted by mail to the place where they are payable, happen then to be more intimately connected with each other than with the rate for telegraphic transfers. The sight rate is basic among this larger group. The sight rate and the cable rate are related, but the spread between them contains an ineradicable speculative element. Whether the cable rate is in some theore tical sense the basic one as between these two, is a question that it is practic ally idle to discuss. In point of fact the sight rate is not determ ined by a calculation from the cable rate. . . . Under ordinary condition s at least, the market would no more think of calculating sight rates from cable rates than the tail would think of wagging the dog." [1]

In actual practice the sight rate is always the starting point in all exchange calculations whether they concern the purchase of short or

[1] *Op. cit.* pp. 273–4.

long bills or the exchange rate at which gold may be profitably imported or exported.

A bank at any particular moment may be selling cables on London at 4.8715, sight drafts at 4.8675, 60 day drafts at 4.8305, and 90 day drafts at 4.815. In quoting the cable rate, the cost of the message itself is not included. Cables command a higher rate because they call for immediate payment. It takes but a few hours from the time a cable is sent until the sum it represents is deducted from the foreign account of the selling bank. From the standpoint of the dealer the sale of a cable allows no opportunity to earn interest on the transaction. If he sells a sight draft he has the use at home of the money which he receives for it and for the length of time that it takes the draft to reach London and be paid. In the meantime he also receives interest on an equal amount of money in his foreign account. Because he gains no interest on the sale of cables, he charges a higher rate therefor than for other kinds of exchange. From the standpoint of the purchaser it can be said that the cable enables him to wait until the last moment before making payment abroad, and so makes it possible for him to retain the use of his money for that length of time. The purchaser is willing therefore to pay more for a cable than for other kinds of exchange. If money rates are high, the purchaser in buying a sight draft will lose more interest than when money rates are low, and vice versa. If he buys a cable when local money rates are high, he gains more interest on his money at home and is therefore willing to pay a higher rate for a cable than when money rates are low. Money rates thus exert an influence upon the spread or difference between the rates paid or charged for demand bills on the one hand and those paid or charged for cables and long bills on the other. During 1908–09 a period of cheap money in the United States, the rates for sterling cables and demand drafts were often less than one-half cent apart.

The rates charged by a bank for 60 and 90 day bills, as well as the rates at which a bank will purchase such bills, are less than the rates charged or paid for sight drafts because the bank gains interest on the funds in the case of long bills sold, and loses it in the case of long bills purchased. If a bank sells a 60 day draft to a customer, the bank has the use of the money received therefor, as well as the interest on an equal sum of money in its foreign account, during the days that intervene before the draft is cashed and its face value deducted from the foreign account of the issuing bank. The purchaser of a long bill

invests his money a certain number of days ahead of time with the result that he loses interest on the amount involved. He will therefore not pay so much for a long bill as he will for a sight draft. Likewise when a bank buys a 60 day draft from an exporter, if it is a D/A bill, the bank will not be able to obtain the face value of the draft unless it holds the draft until maturity, in which event it will lose interest on the funds invested for the time involved. If the bank orders its foreign correspondent to discount the D/A bill immediately upon acceptance—and the greater part of such bills are immediately discounted—the bank receives the face value of the draft minus the discount. The bank will in the first case lose interest for the time involved, while in the second case it will lose the discount charged. A bank cannot afford, therefore, to pay as much for a long bill as it can for a sight draft. If the long bill that the bank purchases from the exporter is a D/P bill, it cannot be discounted in the London market, and the bank may have to wait until the maturity date before it gets its money out of the transaction. If the acceptor pays the bill before maturity the bank is compelled, according to the custom of the trade, to give him a rebate.[1] The rebate rate, as a rule about 1 per cent less than the discount rate, causes less pounds sterling to be taken off the face value of the bill than if the bill is discounted. Because of this fact, certain types of D/P bills that it is highly probable will be paid as soon as presented for acceptance command higher rates of exchange than do some kinds of D/A bills. As Escher says, ". . . bills for payment drawn against perishable goods which *must* be paid under rebate as soon as the goods arrive, command a better rate of exchange than even the best bills where documents are handed over to the consignee on acceptance." [2] Sixty day D/P bills against grain shipments are usually, though not always, purchased by exchange dealers at higher rates than even the very best D/A cotton bills drawn on English bankers.[3]

[1] Cf. p. 144.

[2] Jefferson and Escher, *op. cit.*, p. 315.

[3] On May 6, 1898, rates for grain payment bills on London were 4.80½ @ 4.80¾, while rates on sterling cotton acceptance bills were 4.80¼ @ 4.80½, and on cotton payment bills, 4.79½ @ 4.79¾. Again, to cite another instance, on September 5, 1913, the rates for commercial acceptance bills on London banks, including cotton acceptance bills, were 4.80¼ @ 4.82½, while grain payment bills were at 4.82 @ 4.82¼, and cotton payment bills at 4.81¾ @ 4.82. As stated above, grain payment bills do not *always* command higher rates than cotton acceptance bills. Thus, to cite only one instance out of many: on June 3, 1898, rates for sterling cotton acceptance bills stood at 4.83¼ @ 4.84, while rates for sterling grain payment bills stood at 4.83¼ @ 4.83 1/2.

When a bank purchases a trade acceptance, another element appears that is frequently overlooked by the student of the exchanges, and that is that the risk of non-payment increases with the usance of the draft. A firm may be of excellent standing at the time that it draws or accepts a draft, but before the bill matures the firm may have become bankrupt. Again, in two or three months' time the money rates in the market may fluctuate so adversely as to wipe out the holder's profit. The time element, therefore, must always be considered by the banker in buying acceptance paper.

Cables are always higher and long bills are always lower than sight bills. Their rates will ordinarily roughly parallel the sight rate, the long rates being at a greater distance below the sight rate than the cable rates are above it. This again is because the element of time is involved, the time in the case of long bills being greater than in the case of cables. Referring to Charts II [1] and III,[2] and to Tables XI [3] and XII [4] it will be noted that sterling cable rates are normally from 25 to 50 points higher than sight rates. Naturally, of course, there are exceptions to this general statement, as, for example, during the panic of 1907–08 when at one time cables were 375 points higher than sight bills [5] although a few months later they were only 10 points higher.[6] Again during the first days of August, 1914, a most surprising spread occurred when sterling cables were quoted at 7.00 with sterling sight at 6.00, a spread of 10,000 points.[7] Sterling bankers' 60 day bills will usually range from 350 to 425 points below sight bills, while 60 day D/A commercial bills on banks will range from 500 to 650 points below sight bills, a spread of about 150 to 225 points greater than in the case of bankers' bills. For example, during the period of 1907–08, the spread for sterling bankers' 60 day bills ranged

[1] P. 362.
[2] P. 363.
[3] P. 360.
[4] P. 361.
[5] On November 7, 1907, the highest sterling sight rate was 4.865 and the highest cable rate, 4.90, a spread of 3¾¢ or 375 points.
[6] On August 17, 1908, the highest sterling quotation was 4.865 and the highest cable quotation was 4.866, a spread of 1/10¢ or 10 points.
[7] The average spread between the lowest quoted cable rates for sterling and the lowest quoted sterling sight rates, taking only the closing weekly quotations for the period, October, 1907–September, 1908, was 23 points; and for 1913, 50 points. Cf. Tables XI and XII, pp. 360–361.

from 120 to 775 points, and for 60 day D/A commercial bills on banks from 140 to 1025 points.[1]

A question that inevitably arises in connection with any discussion as to the effect of the length of the life of the bill upon the rate is, what determines the spread, i. e., the variation between the demand rate on the one hand and the rates for cables, short bills and long bills on the other. In considering this question, the student must not overlook the fact that the exchange dealer acts in a dual capacity, i. e., he is both buyer and seller. As a buyer he has to consider the value of his money as it stands, part of it abroad in foreign accounts and part of it at home in his own vaults or loaned out in the home market. Are there plenty of satisfactory investment opportunities at home; are his funds that are invested locally earning as much as they would if invested in a bill of exchange to be discounted later at the rate existing in the foreign money market; can he secure a larger return on his money by investing it in such bills of exchange to be discounted abroad or paid under rebate or held until maturity, or, on the other hand, can he make a greater return by keeping his funds loaned out on call in the home market? As a seller of exchange, he has to keep in mind whether his money abroad is earning a higher return than it would if he should bring it home through the sale of exchange and loan it on call in New York City. If he sells cables he will lose part of his account in London immediately and at the same time add to his funds in New York. If he sells sight exchange or long bills he will have the use of his funds in London until the drafts are paid and at the same time the use at home of a sum of money equal in amount to the face value of those drafts. As a buyer of exchange he loses the use of money in New York and is out of the funds covering the transaction until he has realized on the exchange in the foreign center. Thus, no matter in what capacity he acts, and no matter what sort of exchange he buys or sells, he will be governed primarily, though not necessarily solely, by the money rates prevailing both at home and in foreign centers. May we not therefore lay down the *general* rule that money rates both at home and in foreign centers are the important, but not the sole,

[1] From October, 1907, to September, 1908, the average spread between the lowest quoted sight rates and the lowest quoted bankers' 60 day bills, using only the closing weekly quotations, was 310 points, and for the year 1913, 393 points. From October, 1907, to September, 1908, the average spread between the lowest sight rates and the lowest quoted 60 day D/A commercial bills, again using only the closing weekly quotations, was 356 points, and for the year 1913, 591 points.

factor that determines the spread? There are so many other influences at work affecting exchange rates—just as in the open market there are so many influences affecting the price of any commodity—that the most that can be said of any "law" or "principle" in this connection is that, "In general, it may be true," and that "Under all circumstances it must be interpreted and applied in a most general and liberal manner." In fact, no law or definite rule can be laid down. At best one can offer only an "explanation." In the field of commodity prices, we have no universally accepted *law* that explains where individual prices are fixed and why. All suggestions are mere theories or explanations. All that can be said is that out in the market the seller tries to fix his prices at those levels that will net him a profit, large or small as the circumstances permit. The same general statement applies to the question of the spread between exchange rates. A grocery storekeeper does not know whether he has made a profit until he strikes a balance at the end of his business year. He cannot know whether or not each article that he is selling is bound to yield a profit in the end. But he tries to watch his expenses and his prices in the hope that his business will be profitable. The same is true of the exchange dealer. He has funds to invest. He tries to keep them at work and to the best advantage. He hopes at the end of, say, every six months, to strike a balance sheet that will show a profit, and it is his funds, the money rates abroad, and the money rates at home that are the elements with which he works and from which he hopes to derive his profits.

In considering the spread between sight exchange and long bills many writers concern themselves solely with the influence of the foreign (domicile country) rate of discount. Others, quite properly, also include the discount rate of the home (drawing) country. Practically all writers declare or imply that the discount rates abroad and at home are the *only* factors that enter into the calculation of the spread in the market and that as discount rates rise one per cent the long bill rate should fall one per cent., and vice versa; in other words, that there is a rather direct or proportionate relation existing between the rise and fall in the discount rate, especially the foreign discount rate, and the rates ruling for long bills. Whitaker, more careful than the rest, remarks that, "In an ordinary case, perhaps 9/10 of the spread will be due to discount." [1] He then raises the question as to "which

[1] *Op. cit.*, p. 599.

discount rate is it that governs, that in the drawing city (e. g., New York) or that in the domicile city (e. g., London)." [1] Let us proceed to take up the various points involved, first theoretically and then practically to see whether or not we can discover a "theory" or "law" that is wholly or partially applicable to actual transactions.

Theoretically an exchange dealer having funds at home and abroad will always shift his funds back and forth in order to get the greatest possible returns. If money rates are higher at home than abroad he will bring his funds home and will refuse to invest money in foreign bills. Bringing his funds home involves the sale of exchange, primarily cables and sight, with a resultant increase in the supply of exchange on the market. His refusal to invest in foreign bills means a decrease in the demand therefor. An increased supply and a decreased demand normally cause a lowering of exchange rates. Sight rates cannot fall lower than the gold import point and remain below it for any length of time because of the corrective influence of the gold flow.[2] The rate for long bills is not directly affected by the gold flow except as it (the long rate) is tied to the sight rate. If bankers can purchase long bills at rates low enough so that they are able to obtain therefrom a return equal to the rate being paid on money in the home market, they will invest. In other words, they will then purchase the exporter's bills at the higher home discount rate, which will cause long bills to sell for a low rate and thus increase the spread between the long rate and the sight rate. The long bills will then be sent abroad and discounted at the lower discount rate in the domicile (foreign) country, thus netting the exchange dealer a nice profit. However, competition develops among the local exchange dealers who actively bid for the exporters' bills in order to make the larger than customary profit, and as a consequence the rate for long bills rises, and the spread between it and the sight rate decreases. If competition is strong enough, the long bill exchange rate may be raised so high that the home bankers will receive only their discount on the face of the bill calculated at the lower foreign discount rate. Thus in this case the maximum spread would be fixed by the lower discount rate abroad. The day to day spread would fluctuate between these two extremes. It must always be remembered that the exchange dealer uses the present or existing sight rate as the basis for his estimate of the value

[1] *Op. cit.*, p. 599.
[2] Cf. pp. 412–413.

of a long bill of exchange. The other two factors in his calculations are the discount rates at home and abroad existing, again, on the day of his purchase, although as has been noted earlier,[1] "forward discount" rates sometimes enter into exchange calculations.

To reverse the process, suppose the foreign discount rate is higher than the home discount rate. This signifies that bankers' funds will be more valuable abroad than at home. The banker will hesitate to sell sight or cable exchange because he wishes to keep his funds profitably employed abroad. He will likewise be in the market as a buyer of sight or cable exchange so as to send his funds abroad in order to obtain the larger return. The decreased supply and the increased demand will tend to raise the rates for sight bills and for cables. Sight rates will rise, but they cannot exceed the gold export point for any length of time because of the corrective influence of gold exportations.[2] But what of the rate for long bills? Long bills if purchased and sent abroad for discounting will have to be discounted at the higher discount rate, i. e., more will have to be taken off their face value,—they will not be so valuable as they would be with a lower foreign discount rate. Hence the bankers will pay proportionately less for them. This results in a low price for long bills and a greater spread between the long rate and the sight rate. Bankers, however, then see the advisability of investing their funds in the low priced long bills to be held until maturity, because by so doing they will receive the higher discount thereon (calculated on the basis of the higher foreign discount rate); and with the low money rates in the local market, such investments may prove to be more profitable than any other form of paper. Competition for such bills again develops, but this time for investment, not for discount as was the case in the former example. This causes the rate for long bills to rise and decreases the spread between the long and the sight rate. But the long rate cannot rise any higher than will be permitted by the existing lower discount rate in the home country. In other words, bankers will not pay a higher exchange rate for long bills that will yield them a smaller return (calculated on the low home discount rates) than they can get by investing their funds in other kinds of paper. Hence, again, the higher discount rate, this time the foreign discount rate, fixes the maximum spread; and the lower discount rate, this time the home discount rate, fixes the mini-

[1] Cf. pp. 314–315.

[2] Cf. pp. 412–413.

mum spread. The spread from day to day will vary between these two extremes. But in both this and in the former example, the tendency will be for the lower discount rate to govern, i. e., to exert a strong influence in decreasing the spread between the sight rate and the long rate through the competition of the exchange dealers for the more profitable form of investment. The lower discount rate will not completely govern because there is always a possibility of a fall in the sight rate which might wipe out profits if the long bills have been purchased on the basis of the lower discount rate. When sight rates are high, which is apt to be the case when foreign discount rates are high, there is always a possibility of their declining somewhat. High discount rates increase the demand for exchange, raise the sight rate, and attract funds. Ample funds being thus obtained, the discount rate falls and demand for exchange eases off, and the sight rate falls. The dealer always has to take the future trend of exchange rates into consideration in purchasing long bills, the returns from which are to be used as the basis for future sales of cables and sight drafts. So the dealer will not be willing to approach too close to the margin, and therefore will not calculate his purchase price for long bills on the basis of the lower discount rate, but always somewhat above it.[1]

[1] Whitaker, who presents an excellent discussion of this entire matter of the spread, takes a slightly different point of view. He states that, "*When the discount rate in the domicile city is the lower of the two, it alone governs that part of the spread due to discount. When the discount rate in the drawing city is the lower, it may affect, though it will not fully govern the spread.* Stating this in a slightly different form, the spread can never be greater than the figure proportionate to the discount rate in the domicile city, but it may be less than this when the discount rate in the drawing city is lower, though it will not become much less." The reason assigned for the last statement is that with a high money rate abroad and a low money rate here, the home bankers will bid actively for foreign long bills, which they will hold as an investment. This active bidding raises the exchange rate, which results in a decreased spread, but the spread will not be decreased sufficiently to correspond to the lower money rate existing in the home market. Whitaker, who follows the rule advanced by Prof. N. G. Pierson ("Principles of Economics," London, 1920, pp. 527–9), would undoubtedly accept Pierson's statement that when the rate is lower in the foreign country (e. g., London) it governs that part of the spread due to discount because, as Pierson says, "As the London rate of discount is known everywhere, holders of long-term bills on London will not accept a lower price for them than that for short-term bills, less interest, at the rate current in London." Theoretically this is correct, for in the field of theory we go on the basis of all buyers and sellers being supplied with all the available and necessary information regarding a situation, and being free to act according to their desires in the matter. Practically, this is not true, because exporters who have bills to sell do not know the market and are usually not in touch with its trend, possibilities, etc. They have no correspondents in London to whom they can send their bills if they are not satisfied with the exchange rate offered by the New York dealer. Of course, if over a long period of time they become thoroughly dissatisfied with the prices offered for their bills, they may possibly make connections with London correspondents, send their bills abroad, have them discounted, and the proceeds credited to their account in a foreign bank. But such a state

Looking at the matter from a slightly different angle, one might think that the difference or the margin between the discount rate at home and that existing abroad might give a clue to the variation in, or serve as a sort of gauge in estimating, the spread between sight and long bills. Clare [1] in following out this idea approaches the problem from a slightly different point of view, suggesting that the variation of the sight rate *from* the long rate is due to the influence of the discount margin. He claims that if, because of a better discount rate existing in the domicile (foreign) country, the dealer bids higher for long bills on that country so as to invest his funds therein, he will in turn be compelled to sell sight exchange on the domicile country at a higher rate. Consequently, there is a close but not an "arithmetical relationship between an increase in the discount margin and a rise in the sight-exchange." [2] Clare seemingly attempts to tie the sight rate to the long rate, rather than the long rate to the sight rate, through the variations in the discount margin. He presents some interesting charts with explanations that appear to justify his general conclusions for the years which he examines. We shall shortly [3] apply his theory to sterling rates in the United States during a normal and an abnormal year, and shall then see whether or not his explanation is of any service in helping us to solve the problem we are now discussing.

We have omitted thus far all mention of the varying rate of profits that a banker expects to get through the purchase of long bills. The profit usually runs from 1/8 cent to 2 cents. In our theoretical discussion we have been dealing with all bankers as a class, all of them calculating prospective profits on the same basis, and all being unmoved by any other circumstance than the cold single purpose of buying long bills for the largest possible profit. In actual practice, one banker might be content with a profit of 1/8 cent, another with nothing less than one cent, etc. The minimum and maximum spreads in each case would necessarily be different. Or if no profit were to be made by any banker, the minimum and maximum spreads would not be the same as though we had included a varying profit, although they would be proportionately just as far apart.

of affairs would not normally occur. It is because of this fact that the lower foreign discount rate does not govern so completely as Pierson and Whitaker seem to suggest is the case.

[1] "The A. B. C. of Exchanges," Chapters 14–16.

[2] *Op. cit.*, p. 92.

[3] Cf. pp. 359–364.

When we come to a consideration of the spread between cable and sight bills, we find that theoretically it is supposed to be gauged or determined, not by the open market discount rate prevailing in the foreign or home markets, but by the rate of interest allowed dealers on their foreign accounts, i. e., the deposit allowance rate. This is closely tied to the official bank discount rate, being usually one per cent lower. As we have seen, when an American banker sells a sterling cable he loses the amount of the cable, within a few hours, from his London account. Had he sold a sight draft he would have obtained the interest on the foreign account for at least six days longer (not to mention the use of an equal sum of money at home during the interim). Consequently, when he sells a cable he is supposed to charge not less than the rate for sight bills plus the interest lost on his foreign balance. If the sterling sight rate is 4.87, and the London deposit allowance rate is 3 per cent, he would presumably not be willing to sell a cable for less than 4.87 plus the loss of six days' interest at 3 per cent, or 4.8724 (4.87 + [6/360 × 3 per cent × 4.87]). The closest quotation to 4.8724 would be 4.8725. This rate would not include a profit, yet it involves a spread of 25 points. If a profit were to be obtained the rate would have to be made correspondingly higher and the spread therefore greater.

We saw that too great a spread between sight and long bills proved to be its own corrective through the heavy purchase of long bills by bankers, thus raising the rate for the latter and thereby decreasing the spread. Too small a spread would likewise prove to be its own corrective because if the spread should perchance become so slight that the bankers would not be able to make the lower discount rate on their investment of funds, they would refuse to purchase, thus reducing the demand for exchange and consequently increasing the spread. Customers who would purchase bankers' 60 day bills for remittance abroad would find it financially worth their while to purchase sight drafts rather than pay the high rate for 60 day bills. This would increase the demand for sight bills, would tend to raise the sight rate, and so increase the spread. Likewise in the case of cables and sight bills too small a spread is normally its own corrective. If the two rates get too close together, bankers are able to sell demand bills at high rates as compared to cable rates. This will cause them to go so far as to sell short, hoping to cover at about the same rate by means of cables. They will therefore receive the money from their

sale of demand bills and will have the use of it for at least six days before having to purchase cables to cover. Selling demand bills short increases the supply of sight exchange and lowers the rate. Covering with cables means an increased demand for cables and a higher rate therefor. The increased supply of sight bills and the greater demand for cables tend to push the rates farther apart and to bring the spread back more nearly to normal. If the spread between cables and sight bills becomes too great, bankers will appreciate the extra profits that can be made from the sale of cables and will take steps immediately to create or obtain a larger checking account abroad so as to use it for that purpose. A demand will therefore arise for any kind of exchange that can be sent abroad and realized on. The exchange rates for long bills and for sight bills will rise and the spread will decrease. On the other hand, too high a rate for cables as contrasted with sight bills, i. e., too great a spread, will lead to a decrease in the demand for cables. Customers will prefer to satisfy their needs where possible by means of sight bills. This decreased demand for cables will have a weakening effect on the cable rate and will tend to reduce the spread. For the time being the demand may be so unusually heavy that the rates may rise to unheard of levels, as was true during the strenuous days of August, 1914, but in the long run the supply is increased or the demand is decreased, and the spread again reverts to normal.

In order to test the theory of spreads outlined above, two typical years have been taken, 1913 for a normal period and the period, October, 1907–September, 1908, for an abnormal period characterized by panicky conditions and not by a world war. A study has been made of sterling rates during those two years. The accompanying charts (Charts II and III) and tables (Tables XI and XII) present the necessary data upon which to base our discussion. The tables show the closing weekly sterling rates for 60 day D/A commercial bills on banks, 60 day bankers' drafts, sight bills, and cables; the spread between the sight rate and the other three rates; the average call rate for money in the New York market for each week taken from the *Financial Review* (New York); the discount rate in the London money market for three months' bills, taken from the London *Economist;* the discount margin calculated weekly by the London *Economist*, showing how much higher or lower the London open market discount rate for three months' bills is than the New York call rate; and, finally, the deposit allowance rate in London.

TABLE XI—October, 1907, to September, 1908

Date		Sterling Rates				Spread			N. Y. Call Rate	London Open Market Discount Rate	Economist Difference	Deposit Allowance Rate
		1	2	3	4							
Mo.	Day	60 Day D/A Com'l	60 Day Bankers'	Sight	Cable	3-1	3-2	4-3				
Oct.	5	4.8190	4.8240	4.8580	4.8680	.0390	.0340	.0100	5	3 15/16	1/16 below	3 %
	12	4.8210	4.8235	4.8625	4.8685	.0415	.0390	.0060	5	4 1/8	1 5/8 above	3
	19	4.82	4.8210	4.86	4.8675	.0400	.0390	.0075	5	4 3/8	1 5/8 below	3
	26	4.7675	4.7775	4.8225	4.8650	.0550	.0450	.0425	40	4 5/8	15 3/8 "	3
Nov.	2	4.78	4.79	4.8675	4.885	.0875	.0775	.0210	50	5 11/16	11/16 above	4
	9	4.765	4.7875	4.8575	4.8825	.0925	.0700	.0250	22	6 3/4	3/4 "	4
	16	4.785	4.81	4.8775	4.9075	.0925	.0675	.0300	10	6 7/8	7/8 "	4
	23	4.78	4.795	4.8710	4.9025	.0910	.0760	.0315	10	6 7/8	1/8 below	4
	30	4.795	4.7975	4.8660	4.88	.0710	.0685	.0140	7	6 1/8	3 1/8 above	4
Dec.	7	4.80	4.8050	4.86	4.87	.0600	.0550	.0100	6	5 3/4	3/4 "	4
	14	4.795	4.7975	4.8560	4.87	.0610	.0585	.0140	18	6	2 "	4
	21	4.8025	4.810	4.86	4.8830	.0575	.0500	.0230	12	5 7/8	3 1/8 below	4
	28	4.785	4.795	4.845	4.8675	.0600	.0500	.0225	20	6	2 "	4
Jan.	4	4.80	4.8035	4.8530	4.8630	.0530	.0495	.0100	10	5	2 "	4
	11	4.81	4.8115	4.8550	4.8605	.0450	.0435	.0055	6	4 9/16	1/16 above	4
	18	4.8225	4.8275	4.8670	4.8725	.0445	.0395	.0055	4	4 1/4	1 1/4 "	3½
	25	4.8325	4.8365	4.87	4.8775	.0375	.0335	.0075	2	3 5/8	1 5/8 "	2½
Feb.	1	4.8325	4.8370	4.8685	4.8730	.0360	.0315	.0045	1 3/4	3 1/2	1 1/2 "	2½
	8	4.8250	4.83	4.8635	4.8665	.0385	.0335	.0030	1 7/8	3 3/16	1 13/ 16 "	2½
	15	4.8190	4.8230	4.8585	4.8615	.0395	.0355	.0030	1 7/8	3 3/4	1 3/4 "	2½
	22	4.8290	4.8340	4.8665	4.8705	.0375	.0325	.0040	1 3/4	3 1/3	1 3/4 "	2½
	29	4.8325	4.8350	4.8670	4.8720	.0345	.0320	.0050	1 3/4	3 5/16	1 9/1 6 "	2½
Mch.	7	4.8312	4.8345	4.8635	4.8660	.0323	.0290	.0025	1 7/8	3	1 "	2
	14	4.8275	4.8315	4.8590	4.8615	.0315	.0275	.0025	1 7/8	2 15/16	15/16 "	2
	21	4.8312	4.8340	4.86	4.8630	.0288	.0260	.0030	1 7/8	2 11/16	11/16 "	1½
	28	4.8365	4.8385	4.8630	4.8655	.0265	.0245	.0025	2	2 5/8	7/8 above	1½
Apr.	4	4.84	4.8425	4.8646	4.8675	.0246	.0221	.0029	1 5/8	2 1/2	3/4 "	1½
	11	4.84	4.8435	4.8680	4.87	.0280	.0245	.0020	1 3/4	2 7/16	15/16 "	1½
	18	4.8430	4.8475	4.8710	4.8750	.0280	.0235	.0040	1 1/2	2 5/8	1 1/8 "	1½
	25	4.8445	4.8480	4.8730	4.8760	.0285	.0250	.0030	1 3/4	2 11/16	15/16 "	1½
May	2	4.8420	4.8435	4.8690	4.8715	.0270	.0255	.0025	1 7/8	2 5/8	5/8 "	1½
	9	4.845	4.8490	4.8720	4.8770	.0270	.0230	.0050	1 3/4	2 3/8	3/8 "	1½
	16	4.8480	4.8510	4.8705	4.8730	.0225	.0195	.0025	1 3/4	2 1/16	5/16 "	1½
	23	4.8485	4.8525	4.8710	4.8735	.0225	.0185	.0025	1 1/2	1 15/16	3/16 "	1½
	30	4.8520	4.8555	4.8715	4.8740	.0195	.0160	.0025	1 5/8	1 9/16	3/16 below	1
June	6	4.8512	4.8545	4.8690	4.8720	.0178	.0145	.0030	1 1/2	1 5/16	3/16 "	1
	13	4.8485	4.8530	4.8680	4.8705	.0195	.0150	.0025	1 5/8	1 1/2	3/16 "	1
	20	4.8525	4.8540	4.8685	4.87	.0160	.0145	.0015	1 1/2	1 1/4	1/2 "	1
	27	4.8535	4.8560	4.8695	4.8720	.0160	.0135	.0025	1 1/2	1 5/16	3/16 "	1
July	4	4.8540	4.8575	4.8690	4.8710	.0150	.0115	.0020	1 1/2	1 1/8	1/8 above	1
	11	4.8540	4.8570	4.8695	4.8715	.0155	.0125	.0020	1 1/4	1 3/16	1/16 below	1
	18	4.855	4.8575	4.8695	4.8710	.0145	.0120	.0015	1 1/4	1 1/4	1/4 "	1
	25	4.85	4.8525	4.8675	4.8695	.0175	.0150	.0020	1 1/4	1 3/8	1/8 above	1
Aug.	1	4.85	4.8525	4.8685	4.8705	.0185	.0160	.0020	1 1/8	1 3/8	1/8 "	1
	8	4.8465	4.85	4.8645	4.8660	.0180	.0145	.0015	1	1 3/8	1/8 "	1
	15	4.8485	4.85	4.8640	4.8660	.0155	.0140	.0020	1 1/8	1 7/16	13/16 below	1
	22	4.8425	4.8465	4.86	4.8615	.0175	.0135	.0015	1	1 5/16	5/16 above	1
	29	4.8375	4.8425	4.8575	4.86	.0200	.0150	.0025	1 1/8	1 7/16	3/16 "	1
Sept.	5	4.8425	4.8450	4.86	4.8625	.0175	.0150	.0025	1	1 7/16	3/16 "	1
	12	4.8455	4.8490	4.8645	4.8670	.0190	.0155	.0025	1 1/4	1 9/16	7/16 below	1
	19	4.8475	4.8505	4.8625	4.8665	.0150	.0120	.0040	1 3/4	1 3/8	1/8 below	1
	26	4.8465	4.8490	4.8635	4.8655	.0170	.0145	.0020	1 1/4	1 3/8	3/8 above	1

TABLE XII—January to December, 1913

Date		Sterling Rates				Spread			N. Y. Call Rate	London Open Market Discount Rate	Economist Difference	Deposit Allowance Rate
Mo.	Day	1 60 Day D/A Com'l	2 60 Day Bankers'	3 Sight	4 Cables	3–1	3–2	4–3				
Jan.	4	4.7975	4.8205	4.8640	4.8685	.0665	.0435	.0045	5 1/8	4 9/16	1 3/16 below	3½%
	11	4.8087	4.8290	4.8675	4.8715	.0588	.0385	.0040	2 7/8	4 7/16	1 11/16 above	3½
	18	4.81	4.8310	4.8725	4.8770	.0625	.0415	.0045	2 3/4	4 9/16	1 13/16 "	3½
	25	4.8162	4.8350	4.8760	4.8825	.0598	.0410	.0065	2 5/8	4 5/8	1 7/8 "	3½
Feb.	1	4.81	4.8310	4.8730	4.8785	.0630	.0420	.0055	2 3/4	4 3/4	2 "	3½
	8	4.81137	4.8350	4.8775	4.8835	.0638	.0425	.0060	2 5/8	4 3/4	1 7/8 "	3½
	15	4.81	4.8290	4.8725	4.8798	.0625	.0435	.0065	3 7/8	4 13/16	13/16 "	3½
	21	4.81	4.8305	4.8745	4.8815	.0645	.0440	.0070	3 5/8	4 13/16	1 5/16 "	3½
Mar.	1	4.8112	4.8310	4.8750	4.8830	.0638	.0440	.0080	3 1/8	4 3/4	1 3/4 "	3½
	8	4.815	4.8350	4.8775	4.8850	.0625	.0425	.0080	3 3/8	4 3/4	1 3/4 "	3½
	15	4.8025	4.8255	4.8705	4.8785	.0680	.0450	.0080	4 1/2	4 3/4	1/8 below	3½
	22	4.8075	4.8270	4.8720	4.8810	.0645	.0450	.0090	4 1/2	4 7/8	1/8 above	3½
	29	4.81	4.8315	4.8715	4.8800	.0615	.0400	.0085	4 3/8	4 5/8	1/8 "	3½
Apr.	5	4.8125	4.8325	4.8705	4.8760	.580	.0380	.0055	4 7/8	4 5/16	5/16 "	3½
	12	4.8125	4.8275	4.8645	4.8700	.520	.0370	.0055	3 3/4	4 1/16	5/16 "	3½
	19	4.8112	4.8300	4.8640	4.8680	.0528	.0340	.0040	3	3 5/8	7/8 "	3
	26	4.8175	4.8330	4.8665	4.8695	.0490	.0335	.0030	2 3/4	3 9/16	13/16 "	3
May	3	4.8112	4.8300	4.8670	4.8705	.0558	.0370	.0035	2 3/4	3 15/16	1 3/16 "	3
	10	4.8112	4.8260	4.8600	4.8640	.0488	.0340	.0040	2 5/8	3 9/16	13/16 "	3
	17	4.8112	4.8270	4.8625	4.8665	.0513	.0355	.0040	2 7/8	3 3/4	7/8 "	3
	24	4.8125	4.8300	4.8640	4.8665	.0515	.0340	.0025	2 3/4	3 9/16	1 1/16 "	3
	31	4.8125	4.8300	4.8645	4.8680	.0520	.0345	.0035	2 3/4	3 11/16	15/16 "	3
June	7	4.8125	4.8285	4.8675	4.8705	.0550	.0390	.0030	2 3/4	4 3/16	1 7/16 "	3
	14	4.8075	4.8280	4.8670	4.8710	.0595	.0390	.0030	2 1/2	4 1/4	2 1/4 "	3
	21	4.8112	4.8300	4.8685	4.8730	.0573	.0385	.0045	2	4 1/4	2 1/4 "	3
	28	4.81	4.8300	4.8670	4.8750	.0570	.0370	.0080	2	4 1/4	2 1/4 above	3
July	5	4.8087	4.8315	4.8705	4.8750	.0618	.0390	.0045	2	4 1/4	2 1/4 "	3
	12	4.8087	4.8290	4.8675	4.8725	.0588	.0385	.0050	2	4 1/4	2 1/4 "	3
	19	4.81	4.8305	4.8655	4.8705	.0560	.0355	.0050	2 1/4	4	1 3/4 "	3
	26	4.8125	4.8320	4.8675	4.8725	.0550	.0355	.0050	2 1/2	4	1 1/2 "	3
Aug.	2	4.81	4.8315	4.8660	4.8700	.0560	.0345	.0040	2 1/4	4	1 3/4 "	3
	9	4.81	4.8325	4.8650	4.8695	.0550	.0325	.0040	2 1/4	3 7/8	1 1/2 "	3
	16	4.81	4.8300	4.8645	4.8680	.0545	.0345	.0035	2 1/4	3 13/16	1 9/16 "	3
	23	4.81	4.8285	4.8625	4.8660	.0525	.0340	.0035	2 1/4	3 13/16	1 9/16 "	3
	30	4.805	4.8255	4.8575	4.8610	.0525	.0320	.0035	2 1/4	3 5/8	1 1/4 "	3
Sept.	6	4.805	4.8230	4.8555	4.8590	.0505	.0325	.0035	2 3/4	3 5/8	7/8 "	3
	13	4.8037	4.8230	4.8565	4.8595	.0528	.0335	.0030	2 3/4	3 1/2	1 "	3
	20	4.80	4.8200	4.8575	4.8610	.0575	.0375	.0035	3	3 15/16	15/16 "	3
	27	4.7962	4.8190	4.8545	4.8585	.0583	.0355	.0040	3	4 1/8	1 3/8 "	3
Oct.	4	4.7962	4.8180	4.8585	4.8635	.0623	.0405	.0050	3	4 11/16	1 11/16 "	3½
	11	4.7912	4.8160	4.8555	4.8605	.0643	.0395	.0050	3 3/4	4 3/4	7/8 "	3½
	18	4.7875	4.8100	4.8520	4.8570	.0645	.0420	.0050	3 1/2	4 7/8	1 3/8 "	3½
	25	4.7875	4.8075	4.8510	4.8555	.0635	.0435	.0045	3 1/4	4 7/8	1 7/8 "	3½
Nov.	1	4.7825	4.8065	4.8510	4.8560	.0685	.0445	.0050	4 1/4	5	1 7/8 "	3½
	8	4.7825	4.8045	4.8405	4.8540	.0670	.0450	.0045	4 1/4	4 15/16	15/16 "	3½
	15	4.7875	4.8100	4.8545	4.8590	.0670	.0445	.0045	3 3/4	4 15/16	1 3/16 "	3½
	22	4.7937	4.8100	4.8545	4.8595	.0608	.0445	.0050	3	5	2 1/2 "	3½
	29	4.7875	4.8085	4.8525	4.8580	.0650	.0440	.0055	4	4 3/4	1/8 "	3½
Dec.	6	4.7875	4.8100	4.8535	4.8595	.0660	.0435	.0060	6	4 7/8	5/8 below	3½
	13	4.7887	4.8090	4.8540	4.8590	.0653	.0450	.0050	7	4 13/16	11/16 "	3½
	20	4.7912	4.8090	4.8535	4.8590	.0623	.0445	.0055	3 1/2	4 15/16	11/16 below	3½
	27	4.7912	4.8100	4.8520	4.8605	.0608	.0420	.0085	3 5/8	4 3/4	1 1/5 above	3½

These data are plotted on Charts II and III. A glance at either of the charts is sufficient to show that no close or proportionate correspondence exists between any of the spreads and the New York call rate, the London discount rate, the *Economist's* "difference" or discount-margin, if we may call it such, or the London deposit allowance rate. Any of the latter may rise or decline and the spread may remain the same or move in a direction opposite to that which the above theory holds should be the case. There are, of course, a number of instances in which the spread moves in harmony with the theory

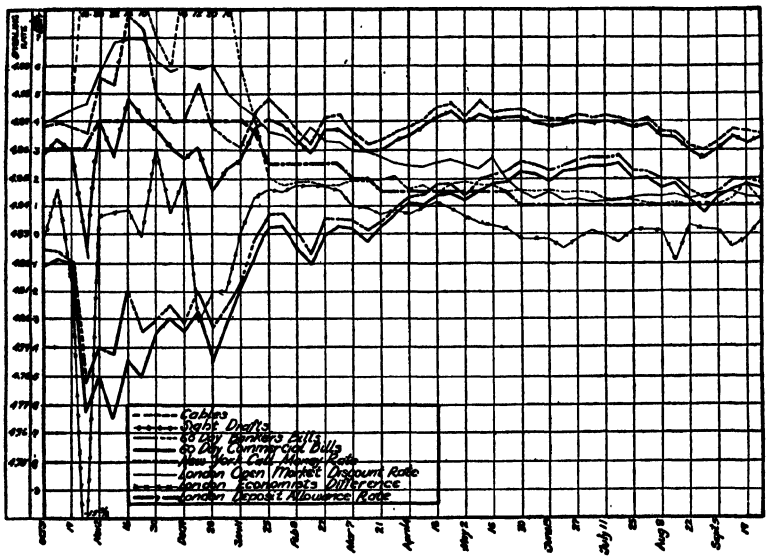


CHART II

Spread of sterling rates, 1907

above outlined; but is a theory to be justified by only occasional correlations?

Picking out a few instances for the purpose of illustrating how contrariwise the spread may move, and choosing the normal year 1913 in order to avoid the criticism that no rule holds good under abnormal conditions, let us take February 1, 1913. The London open market discount rate was 4 3/4 per cent; the New York call rate was 2 3/4 per cent; the *Economist's* difference was 2 per cent, and the London deposit allowance rate was 3 ½ per cent. The spread from the sight

rate for cables was 55 points; for 60 day bankers' bills, 420 points; and for 60 day D/A commercial bills, 630 points. A week later the London open market discount rate was still 4 3/4 per cent; the New York call rate had dropped to 2 5/8 per cent; the *Economist* "difference" was 1 7/8 per cent, and the London deposit allowance rate was still 3½ per cent. The cable spread had increased to 60 points; the 60 day bankers' bill spread had increased to 425, and the 60-day D/A commercial bill spread had increased to 638—all contrary to our theory. A week later, February 15, with a very slight increase

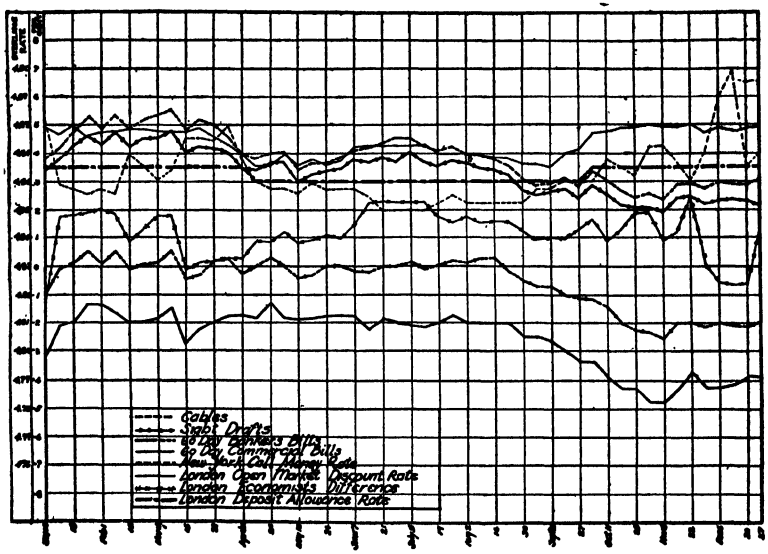


CHART III

Spread of sterling rates, 1913

(1/16 per cent) in the London discount rate, an increase of 1 2/8 per cent in the New York call rate, a decrease of 1 1/16 per cent in the *Economist's* "difference," and with no change in the London deposit allowance, there was a slight decrease in the spread of 60 day D/A commercial bills, an increase in the spread of 60-day bankers' bills, and an increase in the cable spread.

Considering for a moment only the cable spread and its relation to the London deposit allowance rate, we note that from April 19, 1913, to September 27, 1913, the deposit allowance rate remained at 3 per

cent yet the cable spread ranged from a maximum of 80 points to a minimum of 25 points, while from January 4, 1913, to April 12, 1913, and from October 4, 1913, to December 27, 1913, when the London deposit allowance rate was 3½ per cent, the cable spread ranged from a maximum of 90 points to a minimum of 40 points. With the deposit allowance rate at 3 per cent, the spread (25 to 80 points) was twelve out of a possible twenty-four times within the range of the spread when the rate was 3½ per cent (40 to 90 points), and with the rate at 3½ per cent, the spread (40 to 90 points) was 22 out of a possible 28 times within the range of the spread when the rate was 3 per cent (25 to 80 points). (Chart IV.) If the deposit allowance rate in London is such a determining factor in the spread between the sight rate and the cable rate, surely there should be a much closer correlation than the above data disclose.

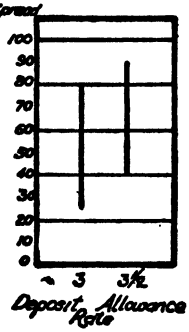


CHART IV

Relation between cable spread and deposit allowance rate in London

A similar conclusion may be arrived at if a comparison is made between the maximum and minimum spread from the sight rate in the case of the two types of long bills under discussion and the discount rate for three months' bills in the London open market. Chart V shows the greatest and the smallest spreads at varying rates of discount for the year 1913. The conclusion to be drawn is so evident that no discussion is needed. One point of importance is disclosed by this chart, however, and that is that as the rate of discount rises the spread tends to increase, but by no means proportionately.

A glance at Charts II and III is sufficient to show that there is no apparent correlation between either the New York call money rate or the *Economist's* "difference," on the one hand, and the spreads either of cables or of long bills on the other.

To conclude, and we must reach some conclusion in this attempt to apply theory to the practical world of the exchanges—all that can be said is that as the foreign open market discount rate rises there is a tendency for the spread between sight bills and long bills to become greater, but by no means proportionately greater. In fact, basing one's conclusions upon the above discussion, might not one be justified in disagreeing with Whitaker's statement in connection with long

bills that "In an ordinary case perhaps 9/10 of the spread will be due to discount"? Also we may conclude that as the foreign deposit allowance rate rises there is a very *slight* tendency for the spread between sight bills and cables to become greater. This is all that can be justly claimed in view of the data presented herewith.

In the transactions of the market dealers and the public are not on a basis of equality when it comes to bargaining. The public knows nothing of foreign discount rates or of the deposit allowance rate that is being paid on accounts abroad. When a business man wants a cable with which to make a payment, he usually wants it badly and does not stop to ask why it is that the banker charges a certain rate for it. Likewise when an exporter has exchange to sell, he does not stop to calculate why the banker gives him a certain rate. The banker will charge what the market will bear, unless he himself is in great need of funds at home and is selling exchange for the purpose of transferring his foreign account to his own vaults. When he buys exchange he buys it at what the market will stand, paying for it no more than necessary in order to get the exchange with which to build up his foreign accounts. As was stated above, the banker has three elements to consider in his money-making activities as an exchange dealer, viz., his funds, the money rates abroad, including the deposit allowance rate, and the money rates at home. He will lose on some deals; he will gain on others. To a great extent he works by rule of thumb and not with the exacting foresight and finesse that many exchange writers would have us believe to be the case.

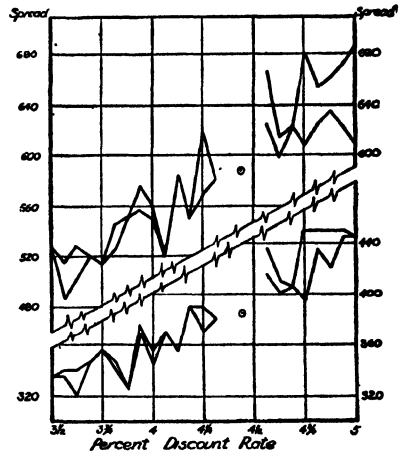


CHART V

Maximum and minimum spread of sixty day D/A commercial bills and bankers' bills at varying rates of discount in London, 1913. Upper portion of chart relates to spread of sixty day D/A commercial bills; lower portion of chart relates to spread of sixty day bankers' bills.

V. *Financial Standing of Parties.* The standing and reputation of the drawer and also that of the importer, and if the importer and the acceptor are two different parties then also that of the acceptor, greatly affect the rate of exchange that bankers will pay for bills of exchange. If the drawer has a very unsatisfactory commercial or financial standing the bank will pay a lower rate for his bills than for those of firms having an excellent reputation. Banks are usually very careful about ascertaining the financial rating of the drawer or exporter. Not only do they use their own credit files for this purpose, some of the larger banks having a very complete credit department, but they also consult the reports of rating bureaus such as Dun's, Bradstreet's, etc. The standing of the importer or acceptor is also of importance because it is the importer or acceptor who is obligated to pay the draft at maturity. Where the acceptor is a bank, no question regarding the bank's ability to pay will ordinarily arise. But where the acceptor is an importing foreign firm, as is the case in all trade acceptances, its financial standing is of course important. Trade acceptances drawn and accepted by firms of unquestioned standing are known in England as "fine trade bills" and are discounted at a lower rate than are other classes of trade acceptances—consequently they command a higher rate when being sold by the drawer to his bank. Bank acceptances will sell for higher rates than trade acceptances because of the unquestioned financial status of the acceptor and also because they are discounted abroad at a lower rate of discount.[1]

We have already dealt with the importance of the standing of the drawer in connection with our discussion of clean bills of exchange. Banks will ordinarily purchase clean bills only when drawn by first class reputable exporting firms. Some European banks make it a practice never to deal in clean bills. The rates paid by banks to exporters for such bills are always lower than the rates paid for documentary bills, the reason being that the risk is greater because clean bills have no security other than the reputation of the drawer. Clean bills issued by banks on their accounts abroad command, as one can well surmise, the highest rates that are paid for drafts of any sort and are discounted abroad at the prevailing market rate, while those drawn against firms of excellent reputation are discounted at a rate

[1] To cite an example: on June 3, 1898, sterling bank acceptance rates were 4.83¾ @ 4.84: sterling trade acceptance rates were 4.83¼ @ 4.83 ½.

about ¼ per cent higher. Demand drafts drawn by exporters and others who are not exchange dealers but who possess foreign bank accounts, are always quoted at lower rates than prime bankers' bills. It is also interesting to note that the bills of first-class small firms will sell for a little less than will those of first-class large firms, depending upon the market's estimate of the drawer's credit.

VI. *Character of Goods Drawn Against.* If the exporter's drafts have been drawn against a shipment of staple commodities, such as grain, cotton, raw materials, etc., other things being equal his drafts will sell for more than if drawn against specialties, such as clocks, phonographs, musical instruments, etc. The reason is that if any difficulty should arise in connection with the transaction and make it necessary for the holder of the bill of exchange to sell the goods at auction he would be able to realize on a shipment of staple commodities approximately the face value of the draft, while in the case of specialties nothing like their listed value could be obtained.

VII. *Amount of Drafts Outstanding.* Just as in the earlier part of our discussion we have seen that London discount houses watch very carefully the total amount of bills accepted by any London firm, and if the firm has assumed too heavy a liability in connection therewith the discount houses charge a higher discount rate than usual, so we find that in our own market if banks issue too many finance or loan bills they will be compelled to sell them for a little lower rate, probably ten to fifteen points less, than that which is being paid for the bills of other bankers who have issued a smaller amount. The same policy is followed in connection with the amount of bills drawn by an exporting firm. The purchasing bank is always desirous of ascertaining the extent of the liability that the exporting firm has assumed. If too heavy a burden has been incurred the bills command a lower rate. The rate paid for "pig on pork" bills is universally a little less than that paid for two-name paper, because the former are actually, as we have seen, only single-name paper.

VIII. *Miscellaneous Influences.* Finally, war and rumors of war, political developments of various kinds, the death of international financiers or rulers,[1] "sentiment" of one sort or another, and a host of miscellaneous causes affect exchange rates favorably or unfavorably as the case may be. For many years past, for example, the Balkan

[1] On January 5, 1916, the rumored death of the Kaiser of Germany caused a decline in the mark quotation in New York.

situation has been a disturbing factor in the field of the exchanges. Again, in September, 1908, a great deal of political uncertainty was caused in Europe by Germany's attitude on the Morocco question and brought about the extensive selling of securities in the United States by Europeans who were desirous of calling in their funds in order to have them handy if war were declared. An instance of another character is found in the case of the return of King Constantine to the Grecian throne in November, 1920. The Allies refused recognition and did not allow Greece to draw against the balance of unused credits which had been advanced in connection with her participation in the World War. They also levied a sort of financial boycott, with the result that drachmas, which had been well maintained up to 1919 fell rapidly, reaching 7.50 cents in February, 1921, 5.60 cents in May, and about 4 cents in December (par being 19.294 cents). Large military operations, the difficulty of absorbing the new territories added under the peace settlement, together with the issuance of millions of inconvertible paper drachmas, also played their part in weakening the rate. In the latter part of November, 1921, sterling and continental rates stiffened noticeably, due, so it was claimed, almost solely "to the sentimental influence of the proposal to grant Germany a two-year moratorium. Bankers generally expressed approval of the plan on the ground that Germany must soon default if regular payments are insisted upon." [1]

In brief, it may be said that almost any political or economic development or event that is likely to affect international relations is bound to exert some influence on the course of exchange rates. This is the main reason why every international banker is vitally interested in all such matters. He must ever be on his guard to take advantage of favorable situations and to avoid those that are likely to result in losses. He has to be possessed not only of excellent judgment but at the same time also of a sense of prophecy. The difficulties and uncertainties which he has to meet in gauging the direction in which rates may tend in turbulent times are uniquely evidenced by an instance that occurred during the early stages of the World War. Germany declared a war zone around Great Britain, and many dealers felt that exchange rates would inevitably decline. On the contrary, however, rates rose slightly on the theory that exports from the United States to England would be restricted and would result in a reduced

[1] *Commercial and Financial Chronicle*, December 3, 1921, p. 2350.

supply of bills of exchange. As a result of wrong guesses, it is said that many of our international bankers suffered losses amounting in some cases to millions of dollars when the exchange market went to pieces following the "unpegging" of sterling exchange in the spring of 1919.

The above discussion has had to do with the more important factors affecting exchange rates under average or normal conditions. In a period of world war, such as we experienced from 1914 to 1918, those factors that are normally of great influence recede into the background and become less important, only to be superseded by other factors which war conditions make possible and seemingly inevitable. The World War caused the abandonment of the gold standard by all of the European countries and resulted in the issuance of huge amounts of paper money. Gold commanded a premium, and the cost of living soared to unheard of levels. The exchanges necessarily depreciated to a startling degree. Artificial methods of stabilization have also interfered with the normal functioning of the market. These matters and their various ramifications, as well as the unusual fluctuations that have characterized the exchanges since 1914, will be more fully discussed in subsequent chapters.

CHAPTER XI

GOLD AND GOLD MOVEMENTS

Any contact with the field of the exchanges or with foreign trade reveals the fact that gold and silver are continually shipped back and forth between the nations of the world, regardless of whether or not those nations are on a gold, silver, paper, or gold exchange standard basis. At times these shipments are made even at a loss because of the requirements of the financial or trade situation, although they are usually made only because of the possibility of speculative profits. Gold is not always exported to pay off foreign indebtedness, as some might think. Bankers who owe nothing abroad may export gold to a correspondent in London because, the costs of shipment being low and the rates at which they can sell their exchange being high, they see a chance to profit by selling drafts against the gold exported. A banker may desire to build up his account in London and finds that he can do it much more cheaply by sending gold to Paris or to some other center where his correspondent, acting under instructions, will use the gold to buy exchange on London so that the New York banker will be able to sell drafts against the London account thus built up. Such a transaction, of course, will occur only when exchange in New York on London is fairly high and in Paris on London is fairly low, and also when at the same time the rate between New York and Paris is too high to make the purchase of French exchange advisable.

The financial and business worlds are more particularly concerned with shipments of gold, although as between some countries the silver market and shipments of silver bulk large in importance. Gold, however, is the metal in terms of which the value of practically all the wealth and trade of the world is measured. It forms the basis of our greatest banking and monetary systems. Trade balances, obligations of one government to another, private debts, all are paid by means of it or by credit instruments directly or indirectly based on it.

A nation's demand for gold varies from day to day and from week to week, just as a banker's need of gold for reserves or other purposes varies from time to time. The total stock of gold in the world, available for monetary purposes, is variously estimated at about $9,500,000,000. This amount is so extremely small compared to the tremendous demands made upon it, and the output each year, estimated before the World War at about $450,000,000 per year, is so limited, that in normal times the fluctuating demands of the various countries for the metal, provided no obstacles are placed in its way, cause it to flow freely from one part of the world to another, apparently seeking its level and satisfying, at least temporarily, the requirements of the country that needs it most. Being a non-perishable and constantly treasured commodity, the same gold may journey back and forth across the ocean several times a year, just as a National bank note may be sent back and forth between San Francisco and New York several times a year in payment of various obligations. As there are certain forces at work in the United States that cause the bank note to be sent to and from New York, so in international relations there are factors that cause gold to flow from one section of the world to another as occasion demands. If a country has an insufficient supply of gold, certain economic forces, if allowed to work freely, will bring it gold from other countries, while if it has too much gold, similar forces will cause it to be exported.[1] The forces concerned are primarily those that we have been discussing in connection with our examination of what it is that goes to make up the supply of and the demand for exchange.

Just as the rates of exchange in the market are "hinged" onto the sight rate, so we find that the sight rate is also the basis on which calculations are made as to the advisability of gold movements. To lay down then, at the beginning of the chapter, the general thesis or principle from which our discussion proceeds, we may say in brief that when the sight rate of exchange rises to too high a level gold will flow out of the country because it will pay to ship gold rather than to buy exchange at high rates. On the other hand, when the sight rate falls to too low a level gold will flow into the country because it will be profitable first, for foreigners to send gold rather than exchange; second, for domestic merchants to have gold sent them rather than

[1] Whether or not a country can ever have too much gold will be discussed in subsequent sections of this chapter.

to draw on the foreign importer and be compelled to sell their exchange at such a low figure; and, third, for domestic bankers to buy exchange at low rates, send it abroad for discount, get gold, and import it. While in general, we are correct in saying that in normal times the gold movement is dependent primarily upon the position of the sight rate, nevertheless we must also remember, as we have noted earlier, that the gold movement in its turn affects the sight rate.

There is as much necessity for providing means whereby gold may readily and easily flow from one part of the world to another as there is for the easy and ready flow of gold or funds in any form from one section of our country to another. Under our national banking system it was not possible for funds to be shipped with any degree of facility from East to West or vice versa, although gold and other forms of money were continually being sent back and forth. As a consequence of the difficulties, expense, and loss of time attending domestic transfers of gold, money rates in one section of the country were frequently widely divergent from those existing in another. With the introduction of the Federal Reserve System and the inauguration of the Gold Settlement Fund the situation was completely revolutionized. Federal Reserve banks now keep a large portion of their gold holdings with the Gold Settlement Fund in Washington and shift them, as the occasion demands, from one Federal Reserve bank to another merely by means of a book entry. Thus it is, that, figuratively speaking, gold is shipped instantly from one section of the country to another as the need arises. Since the inauguration of this practice a great saving in time and costs has been effected and sectional money rates have tended more and more to be on a par with one another. In the field of international dealings, however, transfers of gold and funds are not so easily and quickly effected. We have not as yet established an International Gold Settlement Fund, although one has been proposed by some of our prominent financiers. We are therefore compelled to ship gold and silver back and forth across the waters for the settlement of international obligations, although, as we shall see later, it sometimes happens that the gold is not shipped but is merely "earmarked," i. e., set aside to the credit of the foreign party and held in the debtor country until orders are received for its disposal. Normally, however, gold is actually shipped from one part of the world to another, entailing expenses of freight, insurance, interest, labor, etc.

For many years London has been considered the great international market for both gold and silver, but there is some question as to whether or not it has in times past been the only *free* gold market. In fact, some authors question whether or not it has ever been a *free* gold market. English writers before the World War [1] universally maintained that it was the only free gold market because the Bank of England stood ready at any time, as the storehouse of the world's gold, to part with gold sovereigns in return for Bank of England notes, thus making gold always available for export. They also cited the measures availed of at times by the Bank of France and the Reichsbank of Germany to prevent the outflow of gold when such was deemed to be detrimental to the financial interests of France or Germany respectively. It was claimed that New York was not a *free* gold market because gold could be obtained from the United States Treasury only by presenting gold certificates, and that even then the Treasury was not compelled to sell gold bars in return for gold certificates or anything else unless it wanted to do so. In England, before the war, gold coins and Bank of England notes were legal tender. Under the Act of August 6, 1914, however, the government was authorized to issue £1 and 10s. notes (called "Bradbury's") redeemable at the Bank of England in gold. English writers have urged that a person who desired to obtain gold for export could demand payment from his debtors in sovereigns, Bank of England notes, or government paper money. He could take the latter two kinds of money and demand gold from the Bank of England, and so get gold for export. Up to the time of the declaration of war in 1914, it was true that the exporter could get all the sovereigns, but sovereigns only, that he desired by following the procedure outlined. But after the outbreak of the war, although the Bank could not legally refuse to redeem its notes or the government notes in sovereigns, yet the same end was actually attained by appealing to the patriotism of the citizens, by placing gold exports under government control, by requiring licenses for gold shipments, and by various other devices. Down to the present time (April, 1922) London has not as yet resumed her former position as a gold market.

In the United States, four kinds of money, viz., gold coins, gold certificates, silver dollars, and Treasury (Sherman) notes of 1890, have full legal tender qualities under all conditions in the absence of

[1] Cf. especially Withers, "Money Changing," Chapter VIII.

contract, whether it be payments by an individual to the government or vice versa, or payments between individuals, banks, etc. Other kinds of paper and metallic money possess varying degrees of legal tender qualities. Legally, the Secretary of the Treasury is required to maintain all of our money at a par with gold, which in times of a crisis might mean redemption in gold; but in normal times the law specifically requires that only gold certificates, Treasury notes, United States notes, and Federal Reserve notes [1] be redeemed in gold, although in practice the Treasury will normally redeem any kind of United States money in gold. Thus, as the reader can easily appreciate, it is not possible in times of stress or strain for the merchant to demand that his debtor pay his obligations in money that may be redeemed in gold at the United States Treasury or at a Federal Reserve bank.[2] Technically, therefore, we do not now have, and never have had a *free gold market* in the sense that the English writers have used that term; but for all practical purposes, our market has been as free as, in fact in many regards freer than, that of London. Prior to the establishment of the Federal Reserve System we possessed no means of controlling the gold flow either into or out of our country. Gold went or came in response to the conditions prevailing in our own markets or in response to the policies followed by the central banks of foreign countries. If conditions were such that gold was expected to come to us, it might or might not come, depending upon what was happening abroad—primarily in England. If the financial situation were such that we would not ordinarily expect gold to flow out of our country, it still might go—again depending upon what action the foreign central banks might take to induce its exportation. A "*free gold market*," by the very connotation of the term, should imply a market where the forces of supply and demand work freely and without artificial restrictions. If the word had not been so greatly abused by our early *laissez-faire* economists, one might say that a free market is one in which gold is allowed "*naturally*" to flow into or out of a country. We shall see, as the discussion proceeds, that in normal times the "free" (?) gold market of London has always been under

[1] Federal Reserve notes are redeemable in gold at the United States Treasury in Washington, D. C., or in gold or lawful money (any kind of money issued by the United States government) at any Federal Reserve bank.

[2] The Federal Reserve banks now act as redemption agencies, the sub-treasuries by the law of May 29, 1920, having been discontinued and their powers and functions assigned to the Federal Reserve banks.

the complete control of the Bank of England when it desired to assume that control, and that again and again by artificial means it has prevented or encouraged the gold movement as required by the interests of the London money market. That statement applies likewise to the gold markets of other European countries. It goes without saying that during the topsy-turvy conditions following the declaration of war in 1914 down to this date of writing (April, 1922), London has ceased to be—or even to claim that she is—a *free* gold market or the *only free* gold market in the world. Needless to say, this statement is not made with any feeling of malice or exultation, for all American economists appreciate the wonderful service to the world which London has performed in her former position of dominance, the assistance which she has rendered in times of financial strain, and the relative generosity with which she has shared her gold holdings with other countries, at times even to the detriment of her own financial interests.

With the introduction of an open discount market in the United States following the inauguration of the Federal Reserve System and the adoption of a discount policy by the Federal Reserve banks as a possible means of controlling the gold flow, it is difficult to say to what extent our gold market will in the future be similar to that of London. As yet we have had no opportunity of seeing what possible effects our proposed methods may have on specie movements, because, with the exception of the short time during which our foreign exchanges were, as a war measure, completely under the control of the Federal Reserve Board, we have had no occasion to attempt a manipulation of the gold flow in either direction. The developments of the future alone will disclose to what extent our gold market is capable of remaining a really *free* gold market.

London has been the one important center to which the new gold of the world, especially that produced in South Africa and Australia, has been shipped for sale. More than one-half of the annual gold output is mined in countries that have little or no use of it for monetary purposes. In 1913, to take a presumably normal year, Africa produced over 40 per cent of the world's supply, the various provinces of Australasia more than 12 per cent, and the United States, Canada, and Mexico about 19 per cent, 4 per cent, and 4 per cent respectively. In 1913 the total output was $459,941,100; in 1920, because of conditions existing during and after the war, chiefly the increased cost of

mining, it fell to $337,951,000.[1] The greater part of this gold is shipped to London where it is auctioned off in the gold market held, in normal times every Monday morning. The buyers represent a small group of foreign and domestic banks and bankers. As the various lots of gold are put up at auction they are bid for in accordance with the needs of the buyers and the possibility of securing a profit on the transaction. If there are no bidders, the gold is usually disposed of by the producer's agent to the Bank of England, which by law is compelled to purchase it at a minimum price of £3 17s. 9d. (77s. 9d.) per ounce .916 2/3 (11/12ths) fine. It may pay more than this price if it desires to do so and, before the war, when sorely in need of the metal for reserve purposes, it was known to pay as high as 77s. 10½d. An ounce of gold 11/12ths fine can be coined into £3 17s. 10½d. (77s. 10½d.). The difference (1½d.) between that sum and the minimum price of the Bank of England represents a discount or demurrage charge which goes to the Bank to reimburse it for the loss of interest which it assumes by advancing cash to the seller and then having to wait fourteen to twenty days before receiving the minted gold from the Royal Mint. The Mint is compelled by law to receive gold at the fixed price of £3 17s. 10½d. per ounce 11/12ths fine, or £4 4s. 11 5/11d. per ounce for pure gold, but the seller must wait from two to three weeks while the metal is being coined into sovereigns. Almost all the gold that is not disposed of to foreign buyers is sold to the Bank of England rather than to the Royal Mint.

Inasmuch as an ounce of gold 11/12ths fine when minted yields 77s. 10½d., it is maintained by some that the market price cannot rise above that figure. This is not the case, however, for even before the World War there were times when, as during 1907, we were drawing so much gold from the English market that it reached the price of 78s. 2d. During the war, the English government completely con-

[1] GOLD PRODUCTION OF THE WORLD

	1913	*1919*	*1920**
United States	$ 88,884,000	$ 60,333,000	$ 51,098,000
Canada	16,599,000	15,859,000	16,011,000
Russia	26,508,000	12,000,000	4,867,000
South Africa	196,160,000	184,498,000	180,065,000
Australasia	53,113,000	26,112,000	24,401,000
British India	12,178,000	10,486,000	9,194,000
All Others	66,499,000	55,878,000	52,315,000
Total	$459,941,000	$365,166,000	$337,951,000

* Estimates of London *Economist*, February 19, 1921

trolled the London situation, and no data are available as to what prices were actually paid for gold; but it is known that South African producers were compelled by the government to sell their gold only in England and at the customarily fixed price of 77s. 10½d. for gold 11/12ths fine. During the war every effort was made by the government to conserve the gold holdings of the nation. Gold exports were under its complete control, being made only on its behalf. Strangely enough, gold imports (either manufactured or non-manufactured gold) were prohibited by Royal Proclamation on December 5, 1916, unless such gold were consigned for delivery and sale to the Bank of England.[1] Sales of gold in the open market were abandoned. Gold disappeared from circulation, and the Bank of England, though legally compelled to redeem its notes in gold, resisted most strenuously the demands of those who made such requests. Lately I have been informed by a prominent English banker that it has not been possible to get gold in any amount from the Bank. This party stated that a sovereign or two might be obtained on the claim that it was to be used as "a gift to the bride," or for similar purposes, but even then, the recipient might be followed by detectives to see that the gold was not used for some other purpose.

We suffered from about the same sort of restrictions in the United States during the greater part of the war, even before our government took over the regulation of the exchanges. The Federal Reserve banks early mobilized our gold holdings, and so effectually was it done that gold practically disappeared from circulation. Banks, not being required by law to pay out gold, acceded to the request of the Federal Reserve officials and did not do so. With us, however, the situation cleared up shortly after the Armistice and restrictions on gold export, import, or trading ceased with the abandonment of the control of the exchanges by the Federal Reserve Board on June 25, 1919.[2] In England, however, some war restrictions still (April, 1922) remain. While it is technically true that the government of England did not legally prohibit exports of gold during the war, nevertheless all gold that was

[1] It was stated that the reason for this proclamation was the desire of the government to secure control of all the gold flowing into England in order to be able to use it in financing its war needs rather than to have it used in the manufacture of jewelry, for which there was a great demand during the war.

[2] Gold, however, was not put back into circulation in the United States until in March, 1922, when the Secretary of the Treasury notified the Federal Reserve banks that the need for complete mobilization of our gold holdings had ceased and that the Federal Reserve banks were at liberty to put as much gold back into circulation as they desired.

shipped out went only as the result of government action. On March 28, 1919, however, an Order in Council was issued under the Exportation Prohibition Act of 1915, formally prohibiting the export of gold in any form and to any destination. In July, 1919, a slight modification of this order was made, permitting *new* gold which had been shipped to the London market to be exported provided a license therefor was obtained from the government. This was embodied into law on December 23, 1920, through the enactment of the Gold and Silver Export Control Act, which not only prohibited, under heavy penalty, the export of gold and silver coin or bullion from the United Kingdom except under a license granted by the Treasury, but also made it unlawful for any person to "melt down, break up, or use otherwise than as currency, any gold or silver which is for the time being current in the United Kingdom or in any British possession or foreign country." [1] On September 12, 1919, war time restrictions on gold sales were lifted and gold trading was again resumed in the open market, the metal being sold to the highest bidder and exported only under license from the Treasury. Owing to active bidding, the price advanced rapidly and went to about a 15 per cent premium. On September 18 it rose to 99s. (per fine ounce), in early November to 100s., on November 20 to 103s., on December 4 to 106s. 4d.; and the price at the close of the year stood at 109s. 8½d. Computing this closing rate at par ($4.8665), gold was actually selling in London for $26.67 per ounce 11/12ths fine as measured in terms of American money.[2] With *pure* gold procurable in the United States at a price of $20.6718 per ounce, one might expect that it would have paid an American banker to ship gold to England and procure in English money the equivalent of $27.094 per ounce (the price of $26.67 above was for an ounce of gold 11/12ths fine); but it must be remembered that with gold at a premium, England was not (and still is not) on a gold standard basis. Her government paper money and the notes of the Bank of England did not and no longer do bring their face value in gold. They are at a discount as measured in terms of gold. Hence the American exporter would have received paper money for his gold, an extra amount it is true, but it could not be redeemed in gold—and furthermore, owing to the depreciated value of the paper money it would not have purchased

[1] This Act was designed to remain in effect until December 31, 1925.

[2] In other words, if an American banker had sent an ounce of gold to England, he could have obtained 109s. 8½d. in paper money for it. Converted into American money at the par rate of 4.8665 = £, 109s. 8½d. equals $26.67.

in England as much as an equal amount of gold. The premium on gold continues down to date (April, 1922), the price remaining almost constantly above 100s. until the closing days of 1921, when it fell somewhat below that level.[1] The significance of the premium on gold as affecting sterling rates will be discussed in a later portion of this volume.[2]

The order permitting the re-export of new gold sold in London came about primarily as a step taken by London to retain its position as the principal gold market of the world. With New York placing no restrictions whatsoever upon the import or export of gold, London realized that something had to be done to prevent a flow of gold from the producers directly to New York, thence to be distributed over the world—a situation that would enable New York to displace London as the gold center. South African gold producers had complained that they were being compelled to sell in the London market at the pre-war price in spite of their greatly increased costs of production and threatened to close down their mines unless the government gave them either a bounty or a free market. The government therefore decided to establish, as far as possible, a free market. The results justified the decision, and gold has continued to flow to London, and from London to various parts of the world, but principally to New York and India. The foreign market in which the gold exporting country's exchange

[1] The price of gold per fine ounce at the opening of each month since the resumption of active trading in 1919 has been as follows:

	1919		
September 1	99s.	November 1	99s.
October 1	99s.	December 4	106s. 4d.
	1920		
January 1	109s. 8½d.	July 2	104s.
February 5	127s. 4d.	August 3	112s.
March 2	119s. 6d.	September 1	115s. 1d.
April 3	105s.	October 1	118s. 4d.
May 1	107s. 6d.	November 1	119s. 2d.
June 1	106s. 3d.	December 1	117s. 5d.
	1921		
January 3	115s. 11d.	July 1	110s. 1d.
February 1	107s. 2d.	August 1	115s. 2d.
March 1	105s. 10d.	September 1	110s. 4d.
April 1	106s. 1d.	October 1	111s. 0d.
May 2	103s. 8d.	November 1	104s. 4d.
June 1	105s. 9d.	December 1	102s. 3d.
	1922		
January 3	97s. 9d.	March 1	93s. 3d.
February 1	96s. 3d.	April 1	95s. 3d.

[2] Cf. pp. 478–486.

is at the greatest depreciation gets the gold because it can bid the highest price for it.[1]

Paraphrasing a statement appearing in the *Federal Reserve Bulletin* for June, 1921,[2] what actually took place under the new arrangement was that the South African producers sent their gold to London, where they refined it to a purity of 999/1000. The gold was then sold at auction and was bid in by the agents of the producers, the price being determined on the basis of the dollar exchange rate with allowance made for commissions and expense of shipment. The gold was forwarded to New York where local agents of the producers sold it to the Federal Reserve Bank of New York through a member bank. Through this procedure it was possible for the South African producers to receive in New York $20.6718 for every ounce of pure gold, from which they had to deduct the cost of shipment from South Africa to New York via London and the commissions of the London and New York agents. If the bankers or gold using industries of England or the Continent required gold, it was necessary for them to bid above the price offered by the producers' agents, which price, as noted, was fixed by the New York exchange rate on London. There have been almost no other bidders (excepting a few parties who from time to time have obtained small amounts for use in the arts), owing to the fact that no banker can afford to bid more for gold than its price at the dollar rate. In fact, the quotation on gold prevailing in the London market has been practically paralleled by our sterling exchange rate.[3] The *Federal Reserve Bulletin* stated that "A comparison of the two rates shows that frequently there is a slight margin of less than ½ per cent between the premium on the dollar and the premium on gold. This margin is sufficient to pay the costs of transportation, insurance and commissions from London to New York. These charges, not allowing for interest or commissions, are estimated at approximately two-tenths of one per cent." [4] The sale of their gold in New York enables the South African producers to obtain American bank accounts (dollar exchange in New York), which they can easily dispose of, either in London, South Africa, or in any other exchange market.

[1] It was for this reason that most of our gold exports during the Civil War went to England, while during the Napoleonic wars Hamburg secured the greater portion of England's gold exports.

[2] P. 681.

[3] Cf. p. 479.

[4] *Federal Reserve Bulletin*, June, 1921, p. 681.

During the war, few questions were more frequently asked than why, in the face of war, of suspended gold payments, and of the very large increase in paper currencies, was no premium quoted on gold in the London market? Its absence during the war was due to the fact that the government completely controlled the market. Gold exports were prohibited, so there was no object in offering a premium for gold bullion, because the buyer could do nothing with it but sell it to the Mint or to the Bank of England, and neither would pay a premium.[1]

It is not at all unusual for gold coins, instead of gold bars, to be shipped from one country to another. Gold coins are not accepted at their face value (by tale or by count) but at their actual weight. The Bank of England buys gold coins 9/10 fine in normal times at a rate of about 76s. 4½d.[2] per ounce provided they are full weight. Coins are seldom full weight, so the Bank of England usually pays about 76s. 3½d. per ounce for coins 9/10 fine.[3] The student of the exchanges should not conclude that when foreign gold coins flow into the Bank of England, the Bank immediately turns them into bullion or presents them at the Mint later to receive English coins in return. The Bank in normal times has acted (and in the future may possibly continue to act) as the world's greatest keeper of gold upon which demands are likely to be made at any time for large quantities of the yellow metal in coins or in bullion. Rather than ask for bar gold those having payments to make in France may demand French Napoleons, those having payments to make in the United States may demand eagles, etc., etc., so that the Bank usually stores away the bags or boxes of foreign coins which it receives and pays them out when they are demanded.[4]

The easiest method by which foreign bankers obtain gold in England for export is to purchase bills of exchange in their home countries, send them to England for discount or payment demanding in return therefor

[1] *Commercial and Financial Chronicle*, February 7, 1920, p. 510.

[2] Or at the rate of $4.8719 per £1, which represents a slight discount.

[3] For an excellent discussion of the regulations and practices of the central banks of England, France, and Germany and of the United States Mint in connection with specie shipments, see Whitaker, *op. cit.*, Chapters 19 and 20.

[4] It is interesting to note that during the war, bags of gold that came to the Bank of England from Sweden were found to be American eagles which had been sent by France to Germany at the end of the Franco-Prussian War, and sent by Germany to Sweden in return for supplies during the World War. Even the original bags were used in shipping the gold to England. On December 28, 1916, we received $33,000,000 in gold from the British Government's depository at Ottawa. Over three-fourths of the shipment was in the form of American eagles, sent to us in the same boxes in which we had forwarded them to Paris in 1904 to pay the $40,000,000 claim of the old French Panama Canal Company for its equities in the Canal Zone.

Bank of England notes, and then to present the notes to the Bank of England for sovereigns. The Bank of England is compelled by law to redeem its notes at par in sovereigns (but not in gold bars). The Bank had never interposed any objections or hindrances to doing so until the outbreak of the World War.[1] The sovereigns, while not required by law to be full weight, are within the limits placed by the tolerance of the Mint.[2] This results, however, in the exporter of gold receiving from 2/10 of 1 per cent to 25/100 of 1 per cent less gold than the par value of the bank notes, making the gold cost him approximately 78s., instead of 77s. 10½d. In the foreign market, however, the sovereigns are accepted only by weight and not by tale, so that the English exporter or the foreign importer takes these facts into consideration when figuring on the possibility of the profitableness of a gold shipment.

Foreign gold coins of bar gold, rather than sovereigns, may be desired for export. The Bank of England and the Royal Mint are not compelled to supply these forms of gold, nor are they by law required to charge a fixed price for either. The price in all cases varies with the market. In the fall of 1890, when gold was urgently needed in New York, the Bank refused to sell gold bars and, although willing to sell foreign coin, nevertheless charged what was considered the exorbitant price of 76s. 7d. to 76s. 8d. for it, which was at the rate of approximately 78s. for gold 11/12ths fine.

The gold that is produced in our own country, and not used in the arts, may be disposed of to the United States Mint. Our government stands ready at any time to take gold in unlimited amounts[3] from producers or others at the fixed price of $20.67183 per ounce pure, or at $18.60465 per ounce 9/10ths fine. The price which our Mint will pay for gold is fixed and does not vary from day to day as does the price of the Bank of England. The Mint pays 90 per cent of the estimated value of the metal upon deposit, and the remaining 10 per cent less a melting charge of 4¢ per $100 as soon as the exact value of the gold has been ascertained. In some cases this requires a wait of only a few hours. Until the spring of 1921, all of the gold imports crossing the

[1] The Bank of Netherlands is the only bank in Europe besides the Bank of England where it has been possible in normal times to obtain gold for export without any serious obstacles being interposed. Its supply of gold, however, has never been large, so that heavy exports have inevitably led to the Bank's raising its discount rate within a very short time after exports have begun.

[2] Sovereigns may be legal tender if not lighter than full weight by .77447 grains.

[3] Although the law does not compel the mints to take gold in smaller amounts than $100.

Atlantic were handled by the New York Assay Office of the United States Mint. Its capacity was about $15,000,000 in gold a day, but owing to the tremendous influx of the precious metal in 1920, a large portion of the importations had to be sent to the Philadelphia Mint. The delay occasioned by the inability of the New York office to handle the gold resulted in a loss of thousands of dollars a day in interest to the shippers who were forced to hold the metal idle until it could be assayed and accepted by the Federal authorities.

Shipments of gold and silver are made only by international bankers who have equipment and facilities for handling large transactions, although under unusual circumstances, gold may be shipped by large mercantile houses. It is said that ordinarily not more than nine or ten bankers in New York and a few on the Pacific Coast concern themselves with gold shipments.

From what has been said above and in previous chapters, it may be seen that there are two main movements in specie shipments, one from the mines or producers to the market, the other arising in connection with the apportionment of the world's gold supply among the various countries through the settlement of trade balances or in order to take advantage of prevailing exchange rates. It is with the latter movement, depending as it does primarily upon fluctuations in exchange rates, that we are chiefly concerned in this chapter.

As a rule the precious metals are shipped only when it is profitable to do so, although, as we shall see later, occasions arise which necessitate or induce such shipments even at a loss. Whether or not shipment will take place depends usually upon the position of the exchange rates. If the rate that is being charged for exchange on some foreign country is so high that it will be cheaper to send gold than to buy exchange, gold will be forwarded. If, on the other hand, the price that bankers are paying or charging for exchange makes it profitable to import gold, gold will be shipped. The same general statement applies likewise to silver shipments. In the case of gold standard countries, the rates of exchange at which gold will flow into or out of a country are known as the "gold points," or "specie points." These points are fairly definitely fixed, but we shall see later that they are slightly variable. The gold export point is the par of exchange plus the cost of exporting gold, while the gold import point is the par of exchange minus the cost of importing gold. Thus while the par of exchange does not change unless either or both of the countries con-

cerned change the gold content of their standard monetary unit, nevertheless the costs of actual shipment, or possibly the cost of the gold itself, may vary from time to time, with corresponding changes in the position of the gold points.

Let us consider first the details of gold exportation as they concern the American banker in his relations with London. It is impossible in any volume to deal with other than typical cases. A knowledge of the fundamentals is sufficient for our purpose.

As has been stated above, gold may be shipped as gold bars or as gold coins. We find both being resorted to at all times. When coins are shipped, no matter how securely they may be packed, there is bound to be a certain loss through abrasion. They are also much more difficult to handle. There is less wear and tear on gold bars, so that, if possible, bankers prefer to use them. The United States Treasury stands ready at any time to supply the exporter with gold bars as long as they last at a charge of 4¢ per $100, which covers the cost of assaying, melting, etc. It usually takes at least a day to obtain the gold, pack it, and place it on the outgoing steamer. If the sailing date is two or three days hence, the interest lost in that connection must be taken into consideration in calculating the costs. Also, if the bank accumulates the gold bars or the gold coins over a period of time so as to have them available for use when needed, and if such gold cannot be used by the bank in any other connection for the time being, the interest cost of this investment must likewise be counted as part of the total costs.

The gold must be securely packed, usually in kegs holding $50,000—no more and no less—and carted to the wharves under the protection of guards. Wages and cost of material must be paid.[1] The shipment has to be insured against loss. In normal times, the insurance rate is approximately 1/20 of one per cent of the value of the shipment. At the outbreak of the World War, it rose to one per cent because of the extra risks experienced by all shipping. In February, 1917, following the establishment of a barred zone by Germany, a flat rate of 10 per cent on all shipments to ports within that barred zone became effective, although in some instances an insurance rate of eight and nine per cent was asked on shipments to the ports of the United Kingdom. Mediterranean quotations ranged from ten to twelve per cent at that time, but in December, 1916, they had gone as high as fifteen per cent.

[1] Approximately $60 to $70 per $1,000,000 of shipment.

[Copyright, 1915, by Underwood & Underwood]

Shipment of $4,000,000 in gold bullion and coin from China, being received at San Francisco

As the danger passed, the rates gradually declined,[1] until in May, 1921, according to Mr. René Leon, Manager of the Bullion Department of the Guaranty Trust Company of New York, marine insurance was obtainable at 3/40 of one per cent. Ocean freight charges also have to be paid. In May, 1921, Mr. Leon estimated these charges at approximately 3/4 of one per cent of the value of the shipment. Freight charges vary considerably and since 1914 have been much higher than the figures given by writers before that date.

If the gold is forwarded to London and no draft covering the value of the shipment is drawn and sold in New York, the exporter loses interest on the gold while it is in transit. If, on the other hand, he wishes to protect himself as much as possible against the loss of interest, he draws a draft against his foreign account, which he is increasing by the gold shipment, the draft usually being for the full amount of the shipment, and sells the draft to some New York banker who desires to obtain exchange on London. If the draft is sold on the day that the gold is shipped, the draft, if it is a sight draft, will arrive in London and be payable three days before the gold is ready to be deposited to the London account of the exporter. If as a result the account of the exporting banker is overdrawn, he will be put to the expense of an overdraft. The interest charged by the London bank will be at the Bank of England's discount rate or at from ½ per cent to 1 per cent above it. Cables are seldom, if ever, sold against gold exports, because a cable would reach London and become payable from seven to ten days before the arrival of the gold. If the banker in New York, to whom the draft against the gold has been sold, pays the exporter in cash, the bank would still lose interest for the one day that was required to obtain the gold, pack it, and place it on the steamer. And if payment is made by draft or check, it will be collected through the clearing house and another day's interest will be lost; if a holiday or Sunday intervenes, a third day's loss would be borne by the exporter. If, when the gold reaches London, the correspondent is instructed by the exporter to sell it to another party,[2] the London purchaser will pay out

[1] Insurance rates per $100 on gold shipments in June, 1916, were as follows: From New York to Japan, across the continent, 17½¢; to Argentina, 20¢; to European ports, 15¢ and to Spain, 37½¢. New York *Journal of Commerce and Commercial Bulletin*, June 16, 1919.

[2] It matters not whether the gold after its arrival is sold to another party in London or deposited to the account of the exporter; in either case, the London account of the exporter will be ultimately increased by the amount of the gold shipment and thus be capable of meeting the draft when presented for payment.

but 90 per cent of the value of the gold while its weight and fineness are being determined, the remaining 10 per cent being paid at the end of three days. This loss of interest on 10 per cent of the value of the gold for the three intervening days must be counted in by the exporter. If the London correspondent is paid a commission for its part in the transaction (which is by no means the custom), it will normally amount to 1/40 of one per cent of the value of the shipment. Finally, the prevailing price for gold in the London market is a matter of importance. When the gold leaves New York, the price in London may be 77s. 10d. for bar gold and 76s. 4½d. for eagles. By the time the shipment reaches London, the price may have declined to the Bank of England's minimum rates of 77s. 9d. and 76s. 3½d. respectively. If the exporter's expected profit has been calculated on the basis of the rates prevailing at the time of shipment (which in their turn are based on the mint par of $4.8665), he may find that the transaction will yield him a much smaller profit, no profit at all, or even a slight loss. The price of gold in the London market may fall at any time to the Bank of England's minimum price, but it cannot go below it. The exporting banker, therefore, must always keep that fact in mind when figuring on the expected profits from a gold shipment. It is because of that fact that many banks construct what they call a "practical" par of exchange for use as the basis of their export calculations in preference to the mint par. In the case of sterling exchange, they figure that if an ounce (480 grains) of gold 11/12ths fine may possibly bring only 77s. 9d. of English money, it is necessary to send a little more than one ounce, i. e., 480.7717 grains, in order to be sure that 77s. 10½d. of English money may be received. If 480 grains of gold 11/12ths fine equal 77s. 10½d., the mint par of exchange between England and the United States is $4.8665—but on the basis of the so-called "practical par" of 480.7717 grains of gold to 77s. 10½d., the cost of £1 becomes $4.8744.[1]

The cost of exporting gold varies in accordance with the items that make up the total charge.[2] If freight, insurance or interest rates de-

[1] Samuel Montagu & Company, prominent English exchange and bullion dealers, construct their "practical" pars of exchange on all countries in this manner. Gold parity between the pound sterling and the franc is thus set at 25.207 francs instead of 25,2215 francs; between the pound sterling and the mark at 20.418 marks instead of 20.428 marks, etc. Cf. any number of the *Weekly Review of Foreign Exchanges* issued by Samuel Montagu & Company of London.

[2] As typical of the changed conditions wrought by the World War, the *Annalist* of Jan-

cline, or if the charges for packing, carting, etc., fall, the total costs will be smaller, and vice versa. One must also remember that the costs of the individual shipper will depend upon whether he is shipping a large or a small amount, his facilities for packing, whether he is sending bars or coins,[1] and whether or not the mint or banking authorities in the country to which he is shipping the gold accord him certain concessions, such as giving credit for interest on the gold before it arrives, etc., etc. The gold export point is therefore not only a variable over a period of time for all shippers, but it is also a variable as between different shippers.[2] During the last twenty years of the 19th century, text-books gave the gold export point as 4.89 or 4.90 because of the higher costs of shipment. In the years immediately preceding the World War it was commonly stated that the cost was about 1½¢ or 2¢ per pound sterling, so that the gold export point was quoted as being 4.8815 or 4.8865, respectively. In May, 1921, Mr. R. Leon, of the Guaranty Trust Company, estimated the costs as then being approximately 1.1 per cent of the value of the shipment, apportioned as follows:

Freight, ¾%.....	.75
Insurance, ¾%.....	.075
Interest, 15 days @ 6%.....	.25
Incidentals, ¼%.....	.025
	1.100

On this basis the cost of exporting a sovereign would be $.0535315, and the gold export point would be 4.92. Whether or not gold will be exported depends normally on the position of the sight rate of exchange. If the sight rate is higher than the gold export point, gold will, as a rule, flow out of the country; sometimes, indeed, it flows out before the exchange rate warrants its going. It will usually be exported because it is cheaper or more profitable to ship gold than to purchase exchange at a greater cost. The position of the cable

uary 24, 1916, gives the following table illustrative of the costs of shipping $10,000 in gold to Amsterdam in that year, and also before the war.

		Current Cost		*Ante-Bellum Cost*
Insurance	(7/8%).....	$87.50	(1/20 of 1%)	$5.00
Freight	(3/4%).....	75.00	(1/4 of 1%)	25.00
Miscellaneous	(1/8%).....	12.50	(1/8 of 1%)	12.50
		$175.00		$45.50

[1] Shipments of coin are the more costly.

[2] For additional details regarding specie shipments, see Whitaker, *op. cit.*, Chapter XX; Patterson, *op. cit.*, Chapter 13; Johnson, J. F., "Money and Currency," (1921 ed.), pp. 90-91; Margraff, *op. cit.*, Chapter 27.

rate of the long bill rate has nothing whatsoever to do with the gold export point. This statement, as will be noted later, cannot be said to be wholly true in the case of gold imports.

The following example of an instance of gold export is taken from data supplied by Escher: [1]

Suppose that an American banker desires to export 10,000 ounces of bar gold, 993/1000 fine. He purchases that amount from the United States Mint at its fixed price of $20.6718325 per ounce fine, or for $205,271.29. He must also pay the premium of 4/100 per cent charged by the United States Assay Office for bar gold, or $82.08 for the amount of bar gold purchased. Packing, cartage, etc., of five kegs at $2.25 per keg, costs him $11.25. Freight at 5/32 per cent costs him $320.75, and insurance at 1/20 per cent less 10 per cent, comes to $92.34. The total cost of buying and shipping the gold is $205,777.71. When the gold reaches London, say that it is purchased at the Bank's minimum rate of 77s. 9d. per ounce 11/12ths fine. The exporter receives the sum of £42,112 10s. In addition to the 1/40 per cent commission to his correspondent, or £10 10s., he has to pay certain petty charges amounting to £1 18s., both of which sums are deducted from the amount he receives for his gold in England. The net proceeds credited to his account are £42,100 2s. In order not to lose on the shipment, it will be necessary for him to sell sterling sight drafts at 4.8878. If he is able to sell sight drafts at a figure above that sum, he obtains a profit on the shipment.

Gold imports usually, though not always, occur when it is profitable to undertake them. If exchange rates in the United States fall so low that it is profitable for bankers to purchase exchange, send it abroad, cash it in, and bring the gold back to the United States, gold imports will normally take place. Or if a large importer has become very discouraged with the prevailing low rate of exchange and prefers to send his drafts to England to be paid and the returns forwarded to him in gold, gold will flow into our country. This latter situation will seldom occur, however, because it is only the big international bankers who engage in gold shipments.

To pay for the gold which is to be imported, the banker may purchase long bills, say, on England, send them over for acceptance and discount, and advise his correspondent to return the proceeds in gold. Or he can purchase sight exchange or cables and forward them to Eng-

[1] Escher and Jefferson, *op. cit.*, p. 377.

land with the order that the proceeds be returned to him in gold. Or by cable or sight draft he can cash in on the account which he already has in London, and ask that the gold be sent him. No matter which method is followed, he must consider the rate charged for cables or for sight drafts. The position of one or the other will necessarily affect the position of his gold import point. If he uses cables with which to purchase gold in England, his import point will be a little higher than if he uses sight exchange. Sometimes the spread between the two rates is so slight as to bring the import point of gold when based on the cable rate very close to the import point when based on the sight rate. The cable rate is therefore one of the essential elements that go to determine whether or not gold will be imported.

The costs of importing gold are greater than the costs of exporting gold, for the reason that the loss of interest on the inward shipment must be taken into consideration. If the New York importing banker purchases a demand draft, say on England, and forwards it to his English correspondent with directions that gold be returned to him, he will have to bear the loss of interest on the amount of his investment until the draft reaches London, is cashed, and the gold returned to him, approximately twenty days. On the other hand, if he purchases a cable (it takes but a few hours for the cable to reach London), he will have to bear the loss of interest on the money invested only for the length of time required to have the gold arrive from London, which would be approximately ten days, but he will have to pay a higher rate for the cable than for the sight draft. With gold exports it is possible for the banker to draw a draft against the gold as soon as shipped, thus enabling him to minimize or to obviate entirely the loss of interest. But drafts cannot be drawn against gold imports, and the only way by which loss of interest can be offset is by the central bank or the mint in the importer's country according credit or paying interest for gold imports while in transit. This will be more fully discussed in a latter part of this chapter.

As in the case of gold exports, so with gold imports there are a large number of variables that must be taken into account, so that it is not possible to say that the gold import point is exactly or permanently fixed, either for an individual shipper or for shippers as a whole. In the first place, there is the rate that the importer will have to pay for exchange on London, whether it be drafts or cables, with which he pays for his gold, and these rates are continually fluctuating. Next,

there is the varying cost of gold itself in the London market. As noted above, the price of gold is not fixed in London, and although it can never fall below the minimum price of the Bank of England for gold coins or gold bars, it may rise considerably above that figure even in normal times. In the third place, there is the question as to the possibility of obtaining gold bars or of being compelled to take gold coins. Interest charges, freight, insurance, and costs of packing and cartage, are all variable items of expense. When the gold reaches the United States it can be sold to the United States Mint at the fixed price of $20.67183 for pure gold, or $18.60465 for gold 9/10ths fine. If gold coins are imported, another variable, that of abrasion, must be taken into consideration. There is, moreover, a slight delay at the mint, because the gold has to be assayed and weighed. The result of all the varying costs is that authors and bankers give out differing statements as to the gold import point for the United States. Some claim that as a rule costs approximate 2 cents, while others claim that they run as high as 2½ cents per pound sterling. The gold import point would accordingly be respectively 4.8465 or 4.8415. It is again well to advise the student of the exchanges that the gold points are only approximations and vary with each separate transaction depending upon the conditions existing in the market, the way the deal is handled, the amount shipped, etc., etc.

The data for the following example of an importation of gold from London are based upon an instance cited by Patterson.[1] On September 1, 1915, 5,282.157 ounces of standard gold were purchased in London at the rate of 77s. 11d. per ounce, costing in all £20,578 8s. 1d. The gold was received in New York on September 10, 1915, and immediately turned over to the United States Assay Office, which paid 90 per cent of its value on delivery, or $89,000. Four days later it paid the remaining 10 per cent ($11,097.18), the importer receiving a total of $100,097.18 for the shipment. From this sum he had to deduct certain charges. Freight and insurance cost him $1,389.94; assay charges, $15.59; interest at 3½ per cent on 90 per cent of the shipment during the nine days that it was in transit, $77; interest at 3½ per cent on the remaining $11,097.18 for four additional days (13 days in all), $13.81; making a total cost of $1,496.34. The cable rate on London on September 1 was $4.56 per pound. In using cables to purchase £20,578 8s. 1d. in London, the importer had expended $93,837.62;

[1] *Op. cit.*, p. 183.

import costs had amounted to $1,496.34; leaving net profits of $4,763.22. The profits would have been greater or less depending upon the fluctuations in the costs of shipment, the rate paid for the cable or sight draft with which the gold was purchased, the cost of the gold in England, whether coins or bars were shipped, etc.

For a number of years before the World War, the London *Economist* quoted the gold points on the United States as follows:

Dollars 4.89 —5 per mille for us (meaning for England)
" 4.867—par.
" 4.827—8 per mille against us (meaning against England)

The 5 per mille (5/10 of one per cent or .005 per cent) covered freight, packing, etc., on gold sent to England from the United States, while the 8 per mille (8/10 of one per cent) represented the costs when gold was sent from England to the United States. The reason why it cost the London bank more to export than to import gold was because there was little or no demand for bills in London on New York, making it necessary for the bank to wait for a return remittance from New York, thereby sustaining a loss of interest. This lack of demand in London for drafts on New York was due to our long prevailing policy of remitting to London when we owed London, and of drawing on London when London owed us, the result being that all bills went to London and few, if any, bills came from London to the United States.

As between the United States, England, France, and Germany, the gold points are normally quoted as follows:

	Import	*Export*
New York on London	$ 4.825	$ 4.885
" " " Paris	.19120	.19379
" " " Berlin	.23625	.240625
London on Paris	25.325 francs	25.1225 francs
" " Berlin	20.52 marks	20.33 marks

It should be noted that gold points for London on Paris and for London on Berlin are quoted on the basis of movable or indirect exchange, and that the points for New York are quoted on the basis of direct exchange. Gonzales gives the following data relative to the highest export and the lowest import gold points for the United States on various foreign countries: [1]

[1] *Op. cit.*, p. 86.

Country	*Import*	*Export*
London	$4.82	$4.9065
Paris	.19	.1940
Switzerland	.19	.1940
Antwerp	.19	.1940
Rome	.19	.1940
Berlin	.2350	.2410
Athens	.1850	.1960
Spain	.1850	.1950
Canada	.9950	1.0050
Japan	.4850	.5025
Norway, Sweden and Denmark	.26	.2750
Argentina	.4150	.4350
Brazil	.3150	.3350
India	.3180	.3380
Philippine Islands	.49	.51

Gold shipments are at times sent from one country to another at the request of a banker in a third country. It is not at all unusual for American bankers to ship gold to South America or to the Orient at the order of and for the account of English banking firms because it may be more profitable or convenient to have the gold sent in that manner. During the fall of 1914, American bankers made payments in London by shipping gold to Ottawa, Canada, for the account of the Bank of England.[1]

Gold is sometimes shipped to a financial center for the purpose of using it there to purchase exchange on a third center. Suppose that the exchange rate between Paris and London is low, between New York and London high, and that a New York banker figures that a profit can be made by sending gold to Paris and ordering his correspondent to purchase exchange on London, thus building up his London account against which to sell sterling sight drafts. The details of such a transaction based upon data furnished by Escher [2] are as follows: The exporter secures 48,500 ounces of bar gold .995 fine in New York at $20.5684 per ounce, costing him $997,567. He is compelled to add the assay charge of 4 cents per $100, or $400; freight of 1/8 per cent of the value of the shipment, or $1,247; insurance at 4½ cents per $100, or $450; cartage and packing, $60; a commission to his correspondent in Paris of $250, and interest at the prevailing call rate in

[1] Cf. p. 531.

[2] Escher and Jefferson, *op. cit.*, p. 378.

New York of 2 per cent for six days while the gold is in transit, amounting to $333. The cost of the gold plus the charges would amount to a total of $1,000,307. When the gold reaches Paris the Bank of France purchases it from the correspondent, say at the rate of 106.3705 francs per ounce, netting 5,158,969 francs. If exchange on London is at 25.10 francs per pound sterling, 5,158,969 francs will buy £205,536. The correspondent will forward this exchange to the New York banker's designated London correspondent and the New York banker will then be able to sell sight or cable exchange against the account thus built up. It may be that he has drawn his draft against the shipment of gold some days before the exchange from Paris reaches London, in which event his draft would be presented for payment before he has been credited with the amount in question, and he will have to pay interest on the overdraft. But if he calculates his time correctly and sells sterling exchange so that it reaches London after the remittance from Paris has reached London, there will be no overdraft. If he sells sight sterling at 4.8670, his shipment and exchange transactions will yield £205,536 worth of drafts, for which he gets $1,000,342. The shipment cost him a total of $1,000,307; he receives from the transaction $1,000,342 or a profit of $35 on a shipment of 48,500 ounces of bar gold. If the costs of shipping were lower, if the rate of exchange in New York on London were higher, if the exchange rate in Paris on London were more satisfactory, or if the money rate in New York were lower than 2 per cent, the New York exporter would make a greater profit on the transaction; and of course the reverse would be true if the costs were higher or the exchange rates less satisfactory.

Bankers export or import gold when there appears to be a reasonable opportunity of making at least 1/32 of one per cent, but gold shipments are frequently made at a loss. The best that can be said is that the profits from gold shipments are usually small. If from $500 to $1,000 is cleared on an import or export of $1,000,000 the banker feels that he has been fairly successful in the venture.

The student of the exchanges, however, should not conclude that gold always flows into or out of a country when the exchange rates are above or below the customarily accepted gold points. England has frequently experienced the failure of the gold points to work as they should in accordance with the principles laid down by the theory of the exchanges. It is not at all unusual for her to lose gold long before the exchange rates are sufficiently against her to justify its outward

shipment; she may even lose gold when the exchange rates are in her favor. On the other hand, it has also been her experience that gold does not necessarily flow toward her when exchange rates should induce it.[1] Our own experience also justifies the statement that the customary gold points are not infallible indicators of a forthcoming export or import of gold. The many reasons why this is true will be pointed out in subsequent pages.

During a panic or financial stringency when New York bankers are greatly in need of funds, they get cash in hand by selling exchange on their foreign accounts. This tends to lower the rate on those centers and it may fall below the import point without the bankers engaging gold for import. Their need is for immediate cash, and if gold is imported it will be from seven to ten days before it can possibly reach New York and relieve the stringency. Banks that are unwilling to wait for that length of time sell exchange at a rate lower than the gold import point. Gold may also be imported at times at an apparent—and sometimes at a real—loss. Interests that desire to influence the stock market favorably may import gold. Its importation affords the bankers a larger amount of credit for loans in the stock market, and tends to cause a falling off in the money rate. With the announcement that gold has been engaged for import or that it is on its way, those who are manipulating the market buy large blocks of securities on a margin and hold them until the gold arrives and the money rates drop. This fall in the money rates induces freer buying, securities rise, and the speculating gold importers unload their holdings at a profit.

Banks may import gold when exchange rates are still too high to warrant its coming, and to the outsider it might appear that a loss must be inevitably sustained. Investigation, however, may disclose the fact that money rates at home are very high and appear likely to remain so. The bankers may have felt that they can afford to take an apparent loss for the purpose of being able to get the gold, build up their credit, and expand their loans at the high rates of interest, thus more than recouping their loss on the gold shipments. A dollar's worth of gold may serve as the basis for three and a half or four times that amount of loans. One must not overlook the fact, however, that the importation of gold and the extension of credit may in their turn bring

[1] "Not only do we [England] always lose gold when the exchanges go against us, and often get none when they go in our favor, but we often lose gold long before the exchanges are sufficiently against us to justify its going, and sometimes even when they are strongly in our favor." Withers, "Money Changing," p. 163.

about a lowering of the money rate in the market and turn the venture into a real loss.

Bankers and investment houses sometimes import gold at a slight loss for the advertising that it gives them. If the public learns that the banking firm of X. Y. Z. & Co. has received $1,000,000 in gold from abroad, it is apt to have a little more confidence in that house and possibly shift some accounts to it. Sometimes it is necessary for a bank to import gold even at a loss for the purpose of strengthening its position. German banks before the World War were accustomed, at certain periods of the year, to import gold even though exchange rates did not justify it, so as to meet the great demand for money. In October, 1916, a large amount of gold was taken from New York by the Canadian banks when exchange rates did not warrant it. The only explanation offered was that the latter were preparing to make a fine financial showing ("window-dressing") preparatory to the publication of their November statement of condition.

In times of financial stringency it is not unheard of for the central banks of European countries or for our Treasury Department to give credit to the importer for gold that is in transit. Before the World War the Reichsbank of Germany frequently gave the importer credit for the gold as soon as it had left London or when it had reached the border of the country. When such aid is given, the importer can engage gold for shipment long before the exchange rate falls to the gold import point, his apparent loss being offset by the assistance given by the central bank or the Treasury Department. At one time during the panic of 1907–08, the Reichsbank gave interest to the consignees of gold while the shipment was in progress and also for three weeks additional. Gold shipments to the United States have been assisted at various times by the Secretary of the Treasury for the purpose of relieving banks of serious financial strain. In April and June, 1906, the Secretary of the Treasury aided the importation of gold by depositing governmental funds with seven New York banks, thus giving them the use of government money while the gold was in transit. $50,870,000 worth of gold was imported at that time. Two of the banks made a slight profit of $1,000, three broke even, and two sustained a loss.[1] Again on September 5, 1906, the Secretary of the Treasury deposited government funds with banks that were importing gold. As a consequence of the aid given, the drain of gold from Europe

[1] *Commercial and Financial Chronicle*, July 14, 1906, p. 61.

to the United States reached large proportions and deranged the European money market. The Reichsbank of Germany was forced to raise its discount rate on October 10, from five to six per cent while on October 11, the Bank of England raised its discount rate from four to five per cent and on October 19 to six per cent. Finally, on October 23, the Secretary of the Treasury announced the termination of the assistance. Approximately $54,000,000 worth of gold had been imported in that very short time; during the year the gold import had amounted to $103,000,000.

In the early months of 1913, both Germany and France were in the American market for large amounts of gold. In January, 1913, $10,000,000 of gold was shipped to France, although the exchange rates did not warrant it. In February, another $10,000,000 was sent to Argentina on Paris account, while Paris itself took $1,000,000. At this latter date, exchange rates began more nearly to approximate the gold export point. In March, $17,000,000 went to Paris, Berlin, Brussels, Venezuela, and Argentina, but all of the shipments to Europe were considered to be transactions involving a loss to the importing country. Shipments to France continued in May even though exchange rates had declined—about $12,000,000 being exported at that time. Several reasons were advanced for these unexpected shipments. The Balkan War had caused a renewal of the fear of war with Germany. French peasants had begun hoarding gold in large quantities causing a drain on the gold reserve of the Bank of France, which resulted in a bad showing for several weeks in the latter's bank statement. Gold had to be imported, even though not warranted by the exchanges. Gold was also commanding a premium in France, and the Bank of France could well afford to aid the importation by paying interest while it was in transit. The May importations were made partly because the Bank desired to be prepared to take care of the expected demand for loans by the home government and the Balkan States.

The existence of a premium on money (for ready cash) may likewise cause gold to flow in spite of the position of the exchanges. An outstanding instance of this sort in our financial history occurred during the panic of 1907–08. Because of the monetary stringency in the fall of 1907, banks throughout the country were paying a premium of about 3 per cent for gold, silver, or paper money in order to get funds with which to meet their local needs. This premium (3 cents on the dollar)

was equivalent to about 14 cents on the pound sterling ($4.8665). On October 26, sight sterling stood at 4.824 @ 4.825. During that week $19,750,000 of gold was obtained in London for shipment to the United States. The Bank of England on November 1 raised its discount rate to 5½ per cent, on November 4 to 6 per cent, and on November 8 to 7 per cent, and raised its price on bar gold to 78s. 1/8d. The Reichsbank of Germany raised its rate from 5½ per cent to 6½ per cent on October 29, and to 7½ per cent on November 8. The obstructions placed in the way of gold shipments through higher discount rates and the premium on gold charged by the Bank of England did not prevent the shipment of the metal to the United States. In October, sight sterling ranged from 4.8240 @ 4.8250 for low, to 4.8635 @ 4.8650 for high; in November from 4.85 @ 4.8525 for low, to 4.8850 @ 4.8875 for high; and in December from 4.8410 @ 4.8415 for low, to 4.8660 @ 4.8670 for high. It is evident that exchange rates played a minor part in gold imports, since they were for the most part consistently above the customary gold import point and at times approximated the customary gold export point.[1] The controlling factor in the situation was the high premium on ready cash dominating the New York market. Gold importations were unusually profitable notwithstanding the loss of interest on imports resulting from the high rate on money with which cables were purchased (call money rates on the bulk of the business ranged from 20 to 50 per cent) and the premium on gold charged by the Bank of England. Inasmuch as cables were largely employed to pay for the gold, the banks followed the policy of counting the gold in transit as part of their reserves, thus making credit based on the gold available for loans in the New York market. During the first week of November, the gold engaged for import from the Bank of England reached approximately $44,000,000. The Bank of France, fearing that if it did not come to the assistance of the Bank of England the latter would be compelled to raise its discount rate to 7 per cent and thus seriously interfere with the Paris market, decided in October to buy 58,870,726.77 francs of English bills and to pay for them in gold. It subsequently purchased additional amounts and on November 5 forwarded to the Bank of England 80,000,000 francs in American gold eagles, thereby relieving the pressure on the English market. Our government had attempted to induce the Bank of France to ship the gold directly to us, but we could not or would

[1] On November 4, 1907, the sight sterling rate was 4.885 @ 4.8875.

not give the guarantees demanded, so the gold went to England and from there was forwarded to us. During October, November, and December, over $112,000,000 gold actually arrived in the United States, chiefly from London.

The price paid for gold by the Bank of England and the price charged for gold in the United States may at times work to prevent gold movements when exchange rates justify them. This is illustrated by an instance that occurred in the spring of 1896. During the week ending April 3, 1896, the sight rate on England stood at 4.89½ @ 4.90, yet no gold was engaged for export. The price at which gold was selling in England was 77s. 9d., which, as we have seen, is the minimum rate at which the Bank of England purchases the precious metal. On March 25, the United States Treasury, in order to protect its gold holdings, had advanced its premium on gold bars from 1/16 to 3/16 of one per cent, so that with the low price of gold in England and with the high premium being charged for gold bars in the United States the sight rate of 4.89½ @ 4.90 was not sufficient to induce us to send gold to England.[1]

Difficulties in negotiating exchange transactions on outlying countries may also make it possible for the rates to remain for some time either above or below the gold points without gold shipments taking place. A supply of exchange on some outlying point may be available for which there is no demand, or there may be a demand for exchange on that point with no supply in sight. It is often difficult to negotiate bills on certain South American countries. The bills may be taken by the bank only as an investment, or the risk may be greater than in the case of ordinary bills, with the result that the rate that the bank will pay for the bills will be below the gold import point. Or it may be that an unusual demand may arise for exchange on some out of the way place, so that the exchange rate may rise and remain for some time above the gold export point without any gold being shipped. We also find that the rates charged or paid by small banks in dealing with their local customers are frequently above or below the respective gold points. Small banks charge or give "what the traffic will bear" without regard to gold points. In fact, many bankers who retail exchange of various sorts would be nonplussed if asked to explain the meaning and importance of "gold points."

While one might expect that, with the exception of war periods,

[1] On May 29, 1896, the premium on gold bars was reduced to 1/8 of one per cent.

the exportation of gold could be no more interfered with than the exportation of any other commodity, nevertheless we do find obstacles of various kinds being put in the way of its movement. Gold is the one commodity of all commodities that a nation as a rule is hesitant about exporting to too great an extent. Gold imports are much preferred and are anticipated with a great deal of optimism, although it remained for the World War, that destroyer of many ideals, "laws," and theories, to give us the strange phenomenon of nations protesting against receiving too much gold from their debtors and even taking steps to prevent its importation.[1] In times of war, gold movements are usually under the complete regulation and control of the government, or are absolutely prohibited. But even in normal times it is considered advisable that some means be provided whereby the gold supply of a country, and incidentally the import and export of gold, can be rather closely controlled, regardless of the exact position of the exchange rates. The central banks of Europe and the Federal Reserve banks of the United States are the custodians of the gold reserves of their respective countries. Up to the time of the enactment of the Federal Reserve Law, there was no possibility of regulating our gold flow in any manner whatsoever except through the action of the Treasury in granting credit for gold in transit, or through the government's contracting with a syndicate to control gold exports, as was done during the panic of 1893. Gold flowed into or out of our country in untold millions, yet we had no more control over its coming or going than over the waves of the ocean, and only in the most extraordinary situations, when the interests of the government itself were at stake, did we move to erect a dam to obstruct, or to dig a channel to guide, its flow. During the panic of 1893, Europeans dumped securities on our markets in such quantities as to crush our stock exchanges and to cause a tremendous outflow of gold,[2] crippling our banks and bringing our government to the verge of bankruptcy. Linked with these developments were the workings of the so-called "endless chain"[3] and the drain upon our gold resources caused by our very heavy adverse balance of trade, both of which were active factors in depleting our gold holdings and in almost wrecking our financial system. In

[1] Cf. pp. 424–425.

[2] During the first six months of 1893 we exported approximately $62,000,000 in gold.

[3] Gold was drawn from the United States Treasury by the use of greenbacks and Treasury notes, which, when paid out again by the government according to legal requirements, were gathered up and presented to the Treasury to be redeemed in gold.

its necessity, the government finally made arrangements with the "Morgan-Belmont" syndicate to protect its interests. The syndicate, in order to bring exchange rates below the gold export point, pursued the same tactics in pegging the rate that were adopted by England during the war. It sold large amounts of securities to European investors and drew drafts against such sales, thus increasing the supply of exchange and reducing the sight rate below the export point. In the early part of May, 1895, the exchange market was flooded by large offerings of such drafts. Sterling sight rates fell from 4.90 @ 4.90½ to 4.87½ @ 4.88. The syndicate also sold large amounts of exchange on the bank accounts of its members in European countries, and as the rates eased off it was able to recoup itself and buy cover at rather favorable rates. During June, 1895, issues of Illinois Central bonds, Alleghany Valley Railway bonds, and City of Chicago loans were negotiated abroad, but they fell short of supplying the demand for exchange, rates again rose, and the syndicate was forced to enter the market and supply the necessary exchange to take care of the situation. A month later sight sterling rose to 4.90½ with cables at 4.90 3/4, and the syndicate once more found itself obliged to meet the heavy demand for drafts. About $2,000,000 of gold was exported at this time. In August, with cables at 4.91, about $15,000,000 gold was exported. Finally in September, a shipment of $14,150,000 gold succeeded in breaking the market with the result that the rates eased off very satisfactorily. Also, at this time cotton future bills came forward and helped to create an adequate supply of exchange. Developments during the panics of 1907–08 and 1914 again revealed our absolute lack of control over the movement of gold. It was partly to remedy this condition of affairs that the Federal Reserve Law was passed in 1913, creating an open discount market and permitting the manipulation of the discount rate by the Federal Reserve banks for the purpose of controlling gold movements. As yet (1922) however, we have had no occasion to try out the new machinery devised to meet such emergencies. It is confidently expected, however, that it will work successfully when called into play, for it is a replica of the method followed by most of the central banks of Europe.

Until conditions in the financial world were upset by the declaration of war in 1914, the Bank of England had stood for centuries as the world's greatest warehouse of gold,[1] receiving and giving out gold in

[1] The following table shows the gold holdings of the Bank of France, the Reichsbank,

a lavish manner according to the requirements of trade, finance, or the foreign governments. It has not held the largest amount of the yellow metal (the Bank of France and, before the Great War, the Reichsbank and the Bank of Russia usually holding much larger sums), but it has really been the world's greatest warehouse because of the enormous sums of gold that have continually flowed through its vaults. The "Old Lady of Threadneedle Street," however, is wise enough, and possesses adequate means, to safeguard her hoard if the occasion demands it. To do so she has recourse to any of a number of different expedients. Usually her reserves against deposit liabilities range from 30 per cent to 50 per cent, averaging about 43 per cent. If as a result of the gold drain the Bank's reserves get dangerously low, or if a heavy gold export movement occurs which the Bank feels ought to be prevented or hindered, or if for some reason gold imports should be encouraged, the Bank may become the dominating and guiding factor in the situation. It may go into the market and bid high in order to obtain the needed supply of new gold; or, to hinder gold being taken for export, it may charge a higher price than customary for foreign gold coins, or it may refuse absolutely to sell gold bars.[1]

The Bank may find, however, that the gold is being drawn away more rapidly than it can be accumulated, or that other parties in the market are willing to bid higher for the new gold. The Bank can then resort to a change in the minimum rate at which it will discount three months' bills. Through its discount rate it may manipulate the gold movement without entering the market as a higher bidder. Raising the discount rate acts in several ways to influence the market and to assist the Bank in controlling the flow of gold. In the first place, a rise in the Bank's discount rate is usually followed by an increase in the money rates of other banks and discount houses in London. If, in normal times, the market money rates do not rise, the Bank may refuse to loan money to bill brokers or to stock and bond dealers. This refusal

and the Bank of England at the time of their last weekly reports for December of 1913 and March, 1922. The data have been reduced to pounds sterling for comparison:

Last Weekly Report	*December, 1913*	*March, 1922*
France	£140,696,000	£221,033,997
Germany	77,793,000	49,819,250
England	34,983,149	128,779,763

On March 22, 1922, the Federal Reserve banks held $2,976,703,000 in gold and gold certificates. Converting the same at the rate of 4.86 per pound sterling for comparison with the holdings of the European banks, gives the figure of £612,490,333.

[1] As it did in 1890.

compels them to go to the joint stock banks for their loans, and normally results in raising the market rates. When the Bank of England decreases the amount of loanable funds in the market the joint stock banks may have to call in their loans from brokers and others, compelling the latter to go to the Bank of England for funds. The Bank may then charge what rates it deems necessary to force the money rate in the open market to the desired level. When money rates are high in England, owing to the increased discount rate of the Bank of England, foreign bankers hasten to transfer their funds to England so as to earn the higher interest rate. Prices of securities usually fluctuate inversely to money rates. As money rates rise, the London prices of securities fall, and it becomes more profitable for foreigners to buy securities in London than at home. A demand is thus created for sight and cable exchange on London, which in the end tends to raise the sight rate in foreign countries to the gold export point and soon gold begins to flow toward England. Proceeding from another angle, the same object is accomplished. High money rates prevailing in England induce the English and foreign bankers to keep their funds at home in preference to exporting them to other countries. London bankers and others, who have funds invested abroad, recall them to England. Raising the discount rate therefore not only induces gold to flow toward England, but at the same time hinders its flow out of England. It also makes it more difficult to finance home industry because of the higher money rates. It causes goods, held for speculative purposes (mostly on borrowed money), to be thrown onto the market. Industry slows up; prices fall; it becomes cheaper to buy in England. This creates a demand for exchange on England with which to pay for goods purchased, and sterling exchange tends to rise in foreign centers to the gold export point.

The higher discount rate in England enables American bankers to pay less for long time bills because more will be deducted from their face value when they are discounted in England. Where ordinarily the banker will purchase long bills with the idea of discounting them in London in order thus to build up his account and make it possible to sell sight exchange against that account, he will find it more profitable, when the discount rate is high, to purchase long bills for investment and to hold them until maturity. This does not increase his foreign account and consequently does not create a supply of exchange available for sight drafts. Thus, by raising the discount rate,

the Bank of England creates a demand for sight exchange on the part of those who wish to transfer funds to England wherewith to take advantage of the higher money rates, and at the same time it effectively limits, for the time being at least, the amount of sight exchange in the market. The result is an increase in the sterling sight rate in foreign centers until it approximates or exceeds the gold export point.

If affairs in the financial world are running along smoothly and the reserves of the Bank of England are at a satisfactory level, the Bank's discount rate is of practically no significance. In normal times, very little rediscounting is done at the Bank by the bill brokers or the joint stock banks, because the Bank's rate is above that prevailing in the open market. The Bank's rate never falls below 2 per cent while the market, when carrying a large amount of surplus funds, may be willing to discount for as low a rate as 3/4 per cent. Clare, as a result of his study of the years 1881–1890, states that during that period the market rate averaged 77½ per cent of the Bank rate.[1] The failure of the market rate to move up and down in conformity with the Bank rate is partly due to the fact that bankers do not pay interest on all of the funds which they use, interest being paid only on interest-bearing deposits; banks therefore can afford to raise their rate of discount a little less than the Bank does. If a financial stringency strikes the London market and money becomes tight, the bill brokers and the joint stock banks have recourse to the Bank of England for rediscounting purposes. The Bank of England, however, must rely upon its own resources to stand the strain; also, when, because of adverse exchange rates, gold flows out of the country, it is the Bank of England's gold reserves that are first affected. Under such circumstances, the Bank of England will raise its discount rate for the purpose of tightening the money market, conserving its own gold resources, or preventing the outflow and encouraging the inflow of gold. If, when the Bank raises its discount rate, the money rates in the open market do not rise as the Bank hopes they will, the Bank proceeds to "make its rate effective." It enters the market as a borrower of funds, thus curtailing the available supply. During the early months of the World War, the Bank could not make its rate effective owing to the lack of commercial bills in the market and the great surplus of available funds. The open market discount rate on three months bills was as low as 1 3/8 per cent in February, 1915, while the Bank's rate was 5 per cent. To

[1] "A Money Market Primer," p. 140.

remedy the situation, the Bank began borrowing from the joint stock banks in March. As a consequence of this action and also partly as a result of the issuance by the Treasury of a large amount of Treasury bills, which supplied a satisfactory form of investment for the surplus funds, it was able to control the rates in the money market most effectively. Another means sometimes used by the Bank to make its rate effective, is through the sale of governmental bonds "on account," that is, to sell such bonds with the understanding that it may buy them back at a later date. Such sales remove a portion of the free capital from the market and thus tend to raise the open market money rates.

If one were to plot two curves showing the fluctuations in the Bank rate and the flow of gold, the results would clearly show that, as a rule, when gold flows into England the Bank rate drops, and that when gold flows out of England the Bank rate rises. Normally, gold flows into England during the spring months because of payments made to English merchants by foreign buyers. As the summer months pass and autumn comes, England buys supplies of raw materials such as cotton, grain, etc., from foreign countries and as a result gold tends to flow out of the country. Thus in the spring of the year the Bank rate is low and gold imports are high; in midsummer the two factors more or less approach each other; and as the year closes the Bank rate rises and gold imports fall off. Clare, after making a careful study of the situation, concludes that "Taking one year with another, it may safely be said that a net gain to the Bank of a million from foreign imports corresponds to a 1 per cent drop in the rate, and a loss of that amount to a 1 per cent rise. . . . It may be taken for granted, then, that the statistics of the Bank's gain or loss of strength from the gold sent into or out of the country forms the best ground-work on which to base a forecast of the future course of the market; but at the same time it must not be assumed that the connection is always so close and clear as in the instance given. Due allowance must also be made for other influences, such as the general conditions of the market, the state of trade, the political outlook, etc., all of which are considerations that the Directors, doubtless, take into account before deciding on a change of rate." [1]

As may be inferred, the frequent changes in the Bank's rate exert a most disconcerting effect upon the money market. Stability in the

[1] "A Money Market Primer," pp. 70–71.

discount rate of a central bank is an ideal much desired by those engaged in financial circles. The Reichsbank and the Bank of France likewise resort to a manipulation of the discount rate as a means of controlling the gold flow, but not to the extent that the Bank of England does. Taking the ten-year period, 1898–1907, the Bank of France changed its discount rate eight times, the Reichsbank forty-two times, and the Bank of England forty-eight times. Both the Reichsbank and the Bank of France rely upon other methods than a change in the discount rate to control the gold flow. Under abnormal conditions the discount rate of the Bank of England may fluctuate widely. The following table shows its discount rate from 1914 to date:

1914	January	8	Thursday	4½%
		22	"	4
		29	"	3
	July	30	"	4
		31	Friday	8
	August	1	Saturday	10
		6	Thursday	6
		8	Saturday	5
1916	July	13	Thursday	6
1917	January	18	"	5½
	April	5	"	5
1919	November	6	"	6
1920	April	15	"	7
1921	April	28	"	6½
	June	23	"	6
	July	21	"	5½
	November	3	"	5
1922	February	16	"	4½
	April	14	"	4

In commenting on these war-time fluctuations, the English *Bankers Magazine* of February, 1921,[1] states that "Under the abnormal position created by the recent War, it has to be borne in mind that Bank Rate changes during and since the War were not accurate indications of current financial strain nor controllers of floating indebtedness between London and foreign centers as in pre-war times," and it wisely adds that "until the gold standard is restored, in the future the Bank Rate must necessarily be largely considered as nominal."

[1] P. 198.

As a means of protecting the gold holdings of the Bank of England, it has been suggested that instead of manipulating its discount rate the Bank should increase its price for gold. Gold responds very readily to a slight change in price. Although the Bank would cut into its profits if it paid a higher price for gold in times of need, nevertheless it is claimed that the adoption of the proposal would obviate frequent changes in the Bank rate, and thus remove a most disturbing influence in the business and financial circles of England. As noted above, the Bank of England pays about 76s. 4½d. per ounce for full weight gold coins when 9/10 fine. But coins are seldom full weight, so that the sum paid is generally ½d. less than that amount. At times the Bank has actually raised its buying price with most satisfactory results, while attempting to maintain its Bank rate unchanged. In May, 1891, for example, when, because of the then existing Russian situation, the Bank was compelled to prepare for the withdrawal of £3,000,000 or more in gold, it found that it could not procure the needed quantity of gold from Berlin or Paris and decided to attract gold from New York. On May 6, the directors of the Bank of England agreed to pay a premium of ½ cent over the customary price for American eagles. The premium was gradually increased until in the middle of the month the Bank's price stood at 76s. 6½d. In the market bar gold 11/12ths fine was commanding 77s. 9 3/4d. The premium on American coin had the desired effect and during the month of May approximately $30,000,000 in gold was drawn from the United States. During this efflux, an American banker shipped several bars of gold and was surprised to learn that they were less acceptable than coin, because, as it was stated, when the fall movement of gold would set in toward the United States, the Bank of England would prefer to return gold coin than gold bars.[1] During the first week of June, the price was reduced to 76s. 5d. and shortly thereafter the premium was abandoned. The plan had worked successfully.

The central banks of Europe encourage gold imports by giving credit or making advances on gold while in transit. This was a rather customary practice of the Reichsbank before the war in order to care for the financial strain accompanying monthly or quarterly payments in Germany. Both the Bank of England and the Bank of France, as well as the Treasury of the United States, have at times resorted to the same method. In times of urgent need the Bank of France has been

[1] *Commercial and Financial Chronicle*, May 30, 1891, p. 810.

known to pay a premium on any gold deposited with it, as in November, 1921, when a premium of 1 per cent was paid.

In addition to relying upon the discount rate as a means of checking gold exports, the Bank of France at times falls back upon its right to redeem its bank notes in silver five franc pieces instead of in gold coin, thus preventing exporters from reducing the gold holdings of the Bank. At the same time it may—and usually does—charge a premium for bar gold or for foreign gold coins.[1] In October and November, 1907, when England, France, and Germany were being called upon for large amounts of gold, which either directly or indirectly found their way to the United States to relieve our financial stringency, the Bank of France charged a premium of 6/10 per cent for gold. The premium charged by the Bank is often prohibitive [2] and compels the exporting firms to secure the necessary gold from the internal circulation of the country. Coins are collected by money changers from railway stations, hotels, etc., and disposed of to the exporting houses. This process entails time and expense, so that it is not unusual for the demand for exchange on London in the meantime to raise the rate considerably above the gold export point, although the rate always declines when gold begins to flow out of Paris. This, for example, was the case in December, 1899, when sight exchange on London rose to 25.40 francs per pound sterling because of the delay in securing gold for export.[3] When the Bank of France charges a premium for bar gold or for foreign coins, the gold export point is raised because the premium adds to the expense of exportation. The possible loss on coins due to abrasion must also be considered. At a premium of 4/10 of one per cent, exchange on London has to rise to 25.425 before it pays the exporter to get gold from the Bank of France for export. It is because of the methods followed by the Bank of France in preventing gold from being freely obtained for export purposes that Paris has never been considered a free gold market. Some claim that it is that fact alone which has prevented it from becoming an important international financial center similar to London.

The Reichsbank of Germany, as noted above, resorts at times to

[1] "The Bank of France always maintains a premium on gold for export purposes varying from 2½ to 6 per mille (¼% to 6/10%)." H. V. Burrell, English *Bankers' Magazine*, 1916, p. 210.

[2] In November, 1912, a premium of nearly ¾ per cent was charged on gold for export.

[3] Gold usually flows from Paris to London in normal times if the sight rate rises to 25.32 francs per pound sterling.

changing its discount rate so that it may control gold movements, but it may also use two other means not availed of by either the Bank of France or the Bank of England. If gold is demanded from the Reichsbank for export and the Bank feels that the yellow metal should be retained in the country, it interposes objections of one sort or another or delays payment or appeals to the patriotism of the exporter. The Reichsbank is required at all times to redeem its notes in gold and, except during and since the World War, it has always done so. But banks and bankers of Germany do not draw upon the gold holdings of the Reichsbank if it objects to such loss. Instead, gold will be taken from the circulation of the country, which entails time and expense, so that exchange rates may exceed the gold export point for some time before the gold outflow becomes sufficiently large to affect the situation. The Reichsbank, and the Bank of Belgium as well, also follow the policy of keeping on hand a large supply of foreign bills of exchange which may be used for protection when occasion demands. The Reichsbank usually holds a large amount of sterling drafts together with some French drafts; the Bank of Belgium invests more heavily in French bills. These holdings are accumulated or replenished when exchange rates are low. If the rates of exchange rise so high that gold exports are apt to occur, the bills are sold in the local market, thereby creating a supply of exchange and lowering the rate below the gold export point. Also, if it is advisable to encourage gold imports, the rate may be forced down until it is below the gold import point, thereby causing gold to flow into the country.

Another method sometimes followed for the purpose of preventing gold exports is to have the nation or the central bank obtain loans in a country to which the gold should normally flow, and then sell exchange against the bank accounts thus created in that country, thereby adding to the supply, weakening the rate, and thus preventing gold exports. Or, again, such loans may be used for the same purpose but as a means of decreasing the supply of exchange *on* the borrowing country and so removing a most important weakening influence. Thus during the World War the Allies obtained loans from the United States, and the proceeds were deposited in New York banks. American firms selling goods to the Allies drew dollar drafts against those accounts. The drafts, being on dollar accounts and paid in the United States, did not add to the supply of exchange in the United States on the allied countries, as would have been the case had the drafts been

drawn on foreign accounts in sterling, francs, lire, etc. The exchanges were thereby relieved from what would otherwise have been the crushing and overwhelming weight of an untold amount of drafts drawn in foreign monies with no possibility of the Allies offsetting our claims on them by their claims on us, as would normally have been the case. We were selling to them but they were not selling to us. Such loans, however, merely postpone the evil day, because they must be paid sometime, and at maturity become a powerful influence tending to reduce exchange rates in the lending country to the gold import point.

It is not unusual for arrangements to be made between bankers for the "earmarking" of gold, thus making its shipment temporarily or permanently unnecessary. During 1917 the American dollar was at a discount in Argentina because of our adverse balance of trade with that country. Gold was destined to leave the United States in large amounts, even to the extent of possibly handicapping our participation in the European War. Not long after the outbreak of the European War, Argentina passed a law enabling American importers to make payments to the Argentine Ambassador in the United States, who deposited the proceeds with the Federal Reserve Bank of New York. Payments by Argentine importers were deposited with the Banco de la Nacion in Buenos Aires. Claims of the merchants of one country against those of the other were cleared through the two banks, obviating, so far as possible, the shipment of gold. This law had lapsed, but as a result of the dollar being so greatly at a discount in Argentina, the Secretary of the Treasury of the United States asked that the law be revived, which was done, and on January 7, 1918, he announced that an agreement had been reached with Argentina whereby the dollar rate on that country was to be stabilized at a little higher than the gold export point. Payments were to be made to the account of the Argentine Ambassador with the Federal Reserve Bank of New York at the rate of three per cent above par to cover costs of transportation, insurance, etc., which would have had to be paid had gold been shipped. The American importers were thereby saved a premium of approximately seven per cent. We were also able to keep our gold in the United States. Following the Armistice the Argentine account was gradually withdrawn, the arrangement being terminated in 1920.

Another instance of the "earmarking" of gold occurred in 1919 when

the Federal Reserve Bank of New York, acting on behalf of all of the Federal Reserve banks, purchased from the United States Grain Corporation about $173,000,000 worth of gold. This gold had been sent to the Bank of England from Germany as gold marks and after being reduced to bars had been "earmarked" by the former for the account of the Federal Reserve Bank of New York. The latter, from time to time, sold varying amounts of the gold to banks and bankers in the United States who desired to export metal to various parts of the world, and who were willing to take it from London. During the summer of 1920, the remainder of the account (approximately $61,500,000) was brought back to the United States by the Federal Reserve Bank of New York. Gold deposited in other countries makes importation or exportation unnecessary because it can be used just as satisfactorily for reserve or for other purposes as though it were actually on hand.[1] In the next chapter we shall discuss the policy followed by India in stabilizing her monetary system and her exchanges by using gold reserves kept in England. During the war the gold held for Argentina by the Federal Reserve Bank of New York was employed by that country as security for the issuance of paper currency.

When one coldly considers the matter, one can see how very foolish we are in continually importing and exporting gold, the same gold frequently coming into the country and then, as the exchanges shift a few weeks later, being sent back again to the place whence it came. Japan and Russia have consistently kept a large gold deposit in other countries. In 1912 it is stated that Japan held at least $175,000,000 of gold in the United States and London. At one time in 1917 she had over $287,634,000 to her credit in New York banks. "The economic gain to Japan by this operation is measured by the saved cost of transporting the gold. This includes freight, insurance, loss of interest, brokerage, packing, and the petty incidental expenses which would amount to one-half of 1 per cent or more of the value involved, or approximately $1,438,170."[2] R. H. Tingley has estimated that from 1895 to April, 1917, it cost us $19,850,583 to ship $3,970,116,765 in gold back and forth across the water, or at the rate of approximately

[1] Realizing that fact, the Federal Reserve Board in September, 1917, issued a request that all banks notify it of any gold that was being held "earmarked" for foreign account. It was feared that banks might be holding large sums for enemy countries. The Board declared that such earmarking was considered as "tantamount to the exportation of gold, and that in public interest it requests that no more gold be earmarked for foreign account except upon the approval of the Board."

[2] The *Annalist*, July 2, 1917.

$890,000 a year.[1] The universal adoption of the policy of earmarking or depositing gold in important financial centers, or the establishment of an International Gold Settlement Fund, would save this unnecessary burden to the financial and commercial world.

To reduce the costs of shipping gold it is not unusual for it to be sent from one country to another for the credit of a third. For instance: In 1909 England owed Argentina for wheat; we owed England for securities which we had purchased from her. We shipped gold to Argentina (to the extent of about $61,000,000 during that year) but for English account. To be reimbursed we drew drafts against England, and sent them to England for collection. We then sold drafts on those accounts to those Americans who had purchased securities from England and who had to remit exchange for payment.

In normal times, the flow of gold acts as a corrective in keeping exchange rates fluctuating between the gold points. If the rates are so high as to make the exportation of gold profitable, gold will be exported, foreign credits will be built up, and drafts drawn against them. The supply of exchange in the market is increased, unless the demand grows as rapidly as the supply. If the demand for exchange does not increase at least proportionately the result of the increased supply of bills will be a weakening of the exchange rate, thus tending to pull it back below the gold export point. Gold exports reduce bank deposits, curtail credit, and tend to tighten the money market. This state of affairs raises or tends to raise money rates, "provided other things remain equal," i. e., provided there is not at the same time a marked decline in the demand for money. Higher money rates make it more worth while to keep funds at home and to bring funds back from foreign markets. The recall of funds is accomplished by the sale of exchange. If too large a supply of exchange is thrown onto the market, the exchange rate declines to a point where gold may be profitably imported. Bankers will then be in the market as demanders of exchange to be sent abroad and used for the purchase of gold for importation. This demand for exchange will, "if other things remain equal," tend to raise the rate above the gold import point and bring it back somewhere near the par of exchange. Gold imports increase bank deposits and increase credit facilities, and thus tend to reduce money rates, provided "other things remain equal." But if the money rates fall below those prevailing in other centers, exchange will be demanded with

[1] *American Industries*, November, 1917, p. 11.

which to shift accounts to those centers. The demand for exchange may cause the exchange rate to rise high enough to make gold shipments profitable. So runs the universally accepted theory as to the corrective influence of gold movements.

During periods of war when it is inadvisable to ship gold because of the danger of capture at sea by the enemy's navy, or when in times of either peace or war, the government refuses to allow gold to be shipped out of the country, or refuses to redeem its paper money in specie, or does anything else to interfere with the free movement of gold, the flow of gold cannot act as a corrective to adverse exchange rates. "Gold points," under such circumstances, have no significance. During and since the war, "*normal*" conditions have not prevailed.

For several months before August, 1914, Germany and France were especially active in building up their gold stores, realizing that a break in international relations was likely to occur. With the beginning of hostilities all countries mobilized their gold holding for most effective use because they all realized that gold was the very foundation upon which their financial structure rested. Gold imports and exports were immediately placed under governmental control, either legally or to all intents and purposes. Specie payments were suspended and large issues of paper money flooded the market places. The United States, being the last to enter the contest, was the last to interfere with the movement of gold. Not till September 7, 1917, did it do so by placing the control of the exchanges with the Federal Reserve Board. We were also the first nation to abandon restrictions on gold movements, which we did in June, 1919.[1] At this writing, European nations are still controlling gold movements through various regulations and governmental machinery,[2] so that the "gold points" no longer function as they normally would. Nor has the enormous amount of gold that has been sent us succeeded in bringing the exchanges of foreign countries back to their customary levels. There are probably two reasons for this: first, the amount sent us is but a small part of the sums owing

[1] Except on exchange transactions with Soviet Russia or in rubles or to countries to which money could be sent only through the American Relief Administration. All restrictions were finally removed on December 18, 1920.

[2] According to the weekly circulars of Samuel Montagu and Company of London, under date of February 9, 16, and 23, 1922, the export of gold is prohibited in the following countries: Argentina, Mexico (coins), Syria, Hungary, Jugo-Slavia, Poland, Rumania, Sweden, and Turkey, while in the following countries a government license is required, Australia, Canada (until July, 1922), Chile, Cuba, England, Japan, Mexico (gold bars), Austria, Belgium, Bulgaria, Czecho-Slovakia, Denmark, Finland, France, Greece, Italy Luxemburg, Netherlands, New Zealand, South Africa, and Switzerland.

us by foreign countries; and second, the depreciation of the exchanges is due primarily to the large issues of paper money by foreign countries, and such depreciation will continue until they get back again to a gold standard basis. The erection of tariff walls to prevent "dumping" by Germany and to protect "home" industries against foreign products has also interfered with the free working of economic forces that otherwise might have enabled foreign nations to pay in goods rather than in gold, and thus might have assisted in the conservation of their gold supplies and in a more rapid return to the gold standard and normal exchange levels. Since August, 1914, rates of exchange on many countries, though greatly below our gold import point, have been of no significance as affecting gold flow. Gold has come to us from the Allies only when they have wished to send it. Since the war they have not had enough gold available to send to bring their exchanges back to normal. They have forwarded the yellow metal only as it has pleased them to do so, never with any idea that such shipments would relieve the serious discount on their exchanges.

The following table tells the story of the gold movements since August, 1914, at least so far as the United States is concerned:

TABLE XIII

GOLD EXPORTS AND IMPORTS, UNITED STATES

August, 1914, to December, 1921

	Imports	*Exports*	*Excess of Imports*
Aug. 1, 1914 to Dec. 31, 1914....	23,253,000	104,972,000	81,719,000
Jan. 1, 1915 to Dec. 31, 1915.....451,955,000		31,426,000	420,529,000
Jan. 1, 1916 to Dec. 31, 1916.....685,745,000		155,793,000	529,952,000
Jan. 1, 1917 to Dec. 31, 1917.....553,713,000		372,171,000	181,542,000
Jan. 1, 1918 to Dec. 31, 1918.....	61,950,000	40,848,000	21,102,000
Jan. 1, 1919 to Dec. 31, 1919.....	76,534,000	368,185,000	291,651,000
Jan. 1, 1920 to Dec. 31, 1920.....417,068,000		322,091,000	94,977,000
Jan. 1, 1921 to Dec. 31, 1921.....691,267,000		23,891,000	667,376,000

[1] Excess of exports.

From August 1, 1914, to December 31, 1921, we imported $1,542,119,000 more gold than we exported. During that period only two years, viz., 1914 and 1919, showed an excess of exports. The excess exports of 1914 were due to the efforts which we made at the beginning

of the war to pay our obligations to our European creditors who gave us no opportunity of offsetting our indebtedness to them by our claims upon them because of the moratoria which were declared at the outbreak of hostilities. In 1919, the greater part of our gold exports went to the countries of the Far East to pay for products which we had purchased during the war, or was shipped out to those nations (Japan and Argentina) for which we had "earmarked" gold during the period of the embargo. In the export movement of 1919 Japan received 94.1 millions; China, Hongkong, British India, Straits Settlements, and Dutch East Indies, over 125 millions; Argentina 56.6 millions; other South American countries, 33 millions; Spain 29.8 millions; and Mexico 10.4 millions. An interesting phase of the 1919 situation was that in spite of our exports of gold, our excess exports of merchandise amounted to over $4,000,000,000, not to mention the huge excess exports of the preceding year. We shipped to other nations approximately $291,000,000 of gold and $150,000,000 of silver more than we imported. A cry went up from many sources to the effect that our banking and credit structure could not long withstand the effects of a steady drain of that character. The Guaranty Trust Company in a leaflet on "The Gold Situation," issued at that time, declared that:

"The domestic credit stringency has been reflected in declining reserve ratios at the Federal Reserve Banks and has been in part caused by absolute losses of gold in these reserves. The Reserve Banks have raised their discount rates to the highest figures since the inauguration of the Federal Reserve System. As a consequence, credit liquidation has occurred, at the expense of both foreign and domestic credits.

"There are those, who in the light of these conditions, view with certain alarm the continued export of gold. They feel that, while deflation is undoubtedly necessary, it should take place gradually and not be unduly forced and accelerated by large losses of gold, the foundation of our monetary and credit structure."

In spite of the widely expressed fears and warnings, we kept our gold market *free* and allowed gold to flow in unlimited amounts and without restriction to any country that could take it. The stream, however, soon turned and in 1920 we again had an excess of gold imports approximating $94,977,000, and in 1921, a still larger excess of $667,376,000. At this writing (April, 1922) gold is still flowing into the United States, about two-thirds of the supply coming from England, France, and Sweden. That coming to us from England is and

for some time has been largely the new gold produced in the English colonies, which has been shipped to London and forwarded to us in the manner described above.[1] That which France and Sweden have sent has come for the most part originally from the gold stock of Soviet Russia. Authorities maintain that at least $100,000,000 of Russian gold has been sent to us via England, France, Switzerland, and other European countries.[2] How long this stream of gold will continue to pour into the United States cannot be surmised, but, as the *Federal Reserve Bulletin* of June, 1921,[3] remarks, ". . . so long as present exchange conditions prevail, and that means so long as the balances of international payments continue to be favorable to America, there is every reason to believe that most of the new gold produced in the world will find its way to the United States." These gold imports have materially strengthened the European exchanges and have aided in easing up our domestic money market. No one can estimate how much gold will still have to be sent to us in order to bring the depreciated exchanges back to their normal positions, but, needless to say, imports of gold alone will not suffice. Other measures, relating primarily to internal monetary, industrial, and financial conditions, must also be adopted by the European countries before matters can be brought back to normal.

A large portion of the gold that came to us during 1915–1918 served two distinct purposes; first, it paid for commodities which the Allies were purchasing from us, and second, it afforded the basis for credit expansion, and thus eased up our money market, thereby facilitating the flotation of loans to the Allies. These shipments of gold were usually so timed as to have the desired effect upon our money rates. The Allies had to borrow from us and it was necessary for them to keep the money market in an "easy" condition. They knew that money rates had to be kept low in the United States in order that we might more readily invest in their offerings. So whenever our money market gave evidence of stiffening,[4] or when our stock market became slug-

[1] Cf. pp. 379–380.

[2] *Federal Reserve Bulletin*, June, 1921, p. 681.

[3] P. 681.

[4] Typical of the statements appearing in the American press in reference to this matter is the following from the New York *Journal of Commerce and Commercial Bulletin* of December 5, 1916. "Gold is being rushed here from Canada to bring about a relaxation in the local currency market, which was featured yesterday by a sensational advance in call loans to 15 per cent, the highest rate in over three years." The same periodical under date of July 18, 1916, comments upon the reasons for such gold imports in the following manner: "The extent of the importations certainly suggests how fully alive the British

gish, gold was sent to the United States, to pave the way for additional sales of securities or flotation of loans. With the same objects in mind, England even went so far as to interfere with our gold exports to Spain, the Orient, and to South America. British steamship companies, evidently acting under orders from their government, refused to carry substantial amounts of gold from the United States to ports of the Far East. English underwriters raised their insurance rates to levels so high that gold exports were unprofitable. The Chancellor of the Exchequer forbade British banks or their branches in South America to receive any gold that we might forward, so that we were compelled to ship solely to neutral correspondents. The *Annalist* of January 1, 1917, quoted a prominent foreign exchange dealer as saying that

"The British authorities, of course, cannot stop the movement to Argentina, but they can retard transfers. American banks and trust companies will continue to send gold to neutral correspondents, but they cannot ship as much as would be possible if gold could be sent in British bottoms. Also the manner of insurance enters into the situation. Local underwriters put a limit upon the risks they will take, and if a banker desires to send more gold than American underwriters are willing to insure, an effort to take out the additional insurance in London finds rates so high that they are prohibitive. With South American exchange at a premium here, bankers would like to get the profit they see in gold shipments, but these profits quickly melt away if insurance costs rise to a stiff figure.

"The British Treasury is anxious to keep all the gold here which is here because of the effect its presence has on money rates. The allied Governments need to keep money as cheap as possible because of the vast accommodations in credits and loans they need month after month."

American ship brokers were also warned by England that they should not ship gold to Spain. "Investigation showed that several heavy shipments of American gold were held up as the result of the British

Treasury officials are to the necessity of keeping down money rates at the American centers. In no other way can they maintain sterling exchange rates on its present parity. More remunerative figures would necessarily cause the withdrawal of American funds from London. At the same time they would give a black eye to the investment situation, a development particularly unfortunate to British financial plans. It would prove an adverse feature in three distinct aspects. In the first place it would mean much lower prices for those American securities which the British Treasury still is prepared to sell outright. Secondly, it would interfere with the large loans based on American securities as collateral already placed on behalf of the British Treasury with American banks, trust companies and other lenders. Thirdly, it would especially be inopportune since it would prove a severe handicap to the new British loan arrangement so soon to be announced."

order. The shipowners fear blacklist or even confiscation of the shipment." [1] A large shipment of gold which American bankers forwarded to Holland in 1915 was confiscated by England, but later returned to its rightful owners.[2]

As a consequence of developments during and after the Great War, a decided change occurred in the distribution of the world's stock of gold among the central banks and the various governmental agencies of the principal countries. The proportions held by the more important nations at the close of 1913 and 1918, and in April, 1921, are shown in the following table: [3]

	Percentages of Distribution		
	1913	*1918*	*1921*
United States	21.74	37.74	37.00
United Kingdom	5.35	8.80	11.16
France	21.34	11.16	10.07
Italy	9.06	4.09	3.46
Germany	8.76	9.06	3.80
Spain	2.91	7.24	7.01
Canada	3.63	2.04	1.22
Argentina	7.07	4.53	6.59
Japan	2.04	3.79	8.17

It will be noted that the gold reserves of the United States increased from 22 per cent of the total in 1913 to 37.74 per cent in 1918, and then decreased slightly in 1920. For January, 1922, it was estimated that the total stock of monetary gold in our country amounted to $3,657,000,000 as against $2,245,720,000 in 1918, or about 40 per cent of the world's stock.[4]

In face of the huge excess of gold imports, shall we say "enjoyed" by the United States since August 1, 1914, one may be justified in raising the question whether or not a country can ever possess too much of the yellow metal. In the days of the dominancy of the mercantilist philosophy (approximately 1500 to 1750), it was maintained

[1] *San Francisco Examiner*, January 29, 1917.

[2] In January, 1916, with the then high rates for guilders, American exchange dealers could have cleared a profit of more than 6 per cent on gold shipments to Holland, had England permitted such shipments to be made. The English government was "averse to permitting shipments from other nations, lest this gold should ultimately get across the border and help strengthen German bank reserves." The *Annalist* January 24, 1916.

[3] *Federal Reserve Bulletin*, June, 1921, p. 676.

[4] *Monthly Review of Credit and Business Conditions in the Second Federal Reserve District*, February 1, 1922, p. 5.

that a country should so shape its affairs as to acquire a "store of treasure," the treasure being composed of the precious metals. Just as a man is counted wealthy if he has a supply of money on hand, so a country was to be counted wealthy if it had a hoard or store of precious metals in its possession. That country was the wealthiest and in the best condition that had the largest store of treasure. To obtain the precious metals it was urged that a nation should adopt certain economic policies such as encouraging exports and discouraging imports of merchandise thus securing a favorable balance of trade with a resulting inflow of treasure; restricting exports of gold and silver; developing the merchant marine; protecting and regulating home industry, etc., etc.[1] Many of the ideas advanced by the mercantilist writers are dominant today. "Trade at home;" "Buy goods made in the United States"; the protective tariff; the joy of politicians and others over a favorable balance of trade; the stress laid upon the necessity and advisability of developing foreign trade and a merchant marine; the exultation disclosed in newspaper and magazine articles, speeches, etc., over the fact that the United States now holds more than one-third of the world's gold stock;—these and similar matters are indicative of the widespread acceptance of ideas abandoned centuries ago by European nations when they embarked upon the policy of *laissez-faire*. The mercantilists maintained that a nation could never have too large a supply of the precious metals. Later economic writers have held to the contrary point of view and have based their contention chiefly upon certain propositions advanced by Ricardo. Ricardo maintained that when the precious metals are allowed to flow freely between nations the result will be an apportionment of the world's supply of gold in accordance with the needs of each individual nation. Ricardo was concerned with the precious metals rather than with gold alone, because in his time the prominent nations of the world, almost without exception, were still on a bimetallic basis. Today, however, gold is the standard among most nations, so that we may omit all mention of silver in the present discussion.

The apportionment suggested by Ricardo is supposed to be worked out in somewhat the following manner: If, because of a continuing favorable balance of trade, gold flows into a country, say the United States, an oversupply of gold results and gold falls in value, i. e., its purchasing power decreases, the converse of which is a rise in prices.

[1] Cf. Schmoller, G., "The Mercantile System and Its Historical Significance."

Money rates also weaken. Foreign nations find it increasingly hard to purchase goods from us at our higher level of prices. Their exports of gold to us have in the meantime brought about a decrease in their own price levels. They start purchasing at home, and thereby reduce both the favorable balance of trade of the United States and our gold inflow. The merchants of the United States find that prices have become lower abroad than at home and begin purchasing from foreign nations. An unfavorable balance of trade results; gold flows from the United States; foreign countries now begin to have an excess of gold imports; money rates stiffen in the United States because of the gold outflow. Gold, because of its scarcity, becomes more valuable with us and commodity prices fall; while abroad, gold, because of its abundance, becomes cheaper and commodity prices rise. If the foreign nations in their turn receive more gold than they should "*naturally*" have, prices will rise to too high a level, merchants in the United States will stop buying abroad, foreign merchants will buy in the United States because of the lower price level existing here, gold will flow in to us, prices will rise, and so on *ad infinitum*. As a consequence of this freedom of gold movement, it is claimed that gold flows from one country to another, tending to give each its *needed quota*, and bringing about a fairly uniform level of prices among all nations. Necessarily the theory should be considered as applying only to those goods that play a part in foreign trade, because goods that are neither exported nor imported should not enter into any calculations concerning international trade relations.

The theory as outlined is correct as a theory, provided one approves of the more or less universally accepted quantity theory of money, which, stated in its more widely accepted form, holds that "increasing the media of exchange tends to increase prices provided other things remain equal." As gold flows into a country it increases the available media of exchange, first by being used as money, and second—and this is the more important of the two—by being used as a reserve behind deposits, against which checks and drafts may be drawn. *Contra*, as gold leaves the country, it reduces the available media of exchange by (a) curtailing the gold coin in circulation and (b) reducing reserves and therefore bank deposits. The quantity theory as more generally accepted concerns itself only with the media of exchange that are *in circulation*. One must not think, however, that the media of exchange in circulation cannot increase unless we have gold im-

ports, or that gold imports must always increase our media of exchange in circulation. Today about 90 per cent of our financial transactions are handled by means of credit instruments—not by hard cash, as was the case in Ricardo's day. It is therefore possible for our media of exchange to increase and decrease regardless of the gold movement, although, inasmuch as credit instruments are based ultimately upon a metallic reserve of some sort, usually gold, it can be seen that gold imports may facilitate the issuance of an additional amount of credit instruments. This, as stated above, does not necessarily occur. The imported gold may be "earmarked" for another country and therefore not become available for use by the importing nation, or it may merely be stored away in the vaults of banks and not used to increase the amount of checks, drafts, etc., in circulation. During 1920 and 1921, gold came to us from other nations in millions of dollars, money rates fell, but prices, instead of rising, tumbled downward following the spring of 1920. In fact, instead of bringing about high prices and thus making it harder for foreign nations to buy from us, our tremendous gold imports have strangely enough been accompanied by just the reverse effect. Prices have fallen in spite of gold imports—of course not because of them; just why they have fallen need not concern us here. At the same time gold imports strengthened foreign exchange rates, giving the foreign monies a greater purchasing power than they had had following the unpegging of the exchanges in March, 1919, which, of course, meant lower prices to foreign purchasers. On the other hand, one must not overlook the fact that if the foreign nations should at any one time send us all the gold that they can spare, and then could send no more, their exchanges would decline because gold could no longer be sent to maintain them; their money therefore would buy less in the United States because of the depreciated exchanges. Our prices to the foreign nations would rise, primarily because of this lack of gold imports, although prices would not necessarily, and might not at all, rise so far as citizens of the United States were concerned.

Another circumstance that is of interest in this connection is that during the year 1919 we exported $291,651,000 more gold than we imported. Prices should have fallen, or have shown a tendency to fall, yet they continued to rise to higher levels. This may possibly be accounted for by the fact that during the four preceding years we had had a large excess of gold imports, although during 1918 the ex-

cess had amounted to but $21,102,000. One naturally raises the question as to just how long it takes an excess of gold imports to affect prices.[1] Authorities disagree slightly but usually maintain that there is a lag of from one to three months between an increase in the per capita of circulation and an increase in prices.[2] The per capita in circulation should include all things that are employed as media of exchange. The accompanying chart (Chart VI) and table (Table XIV)

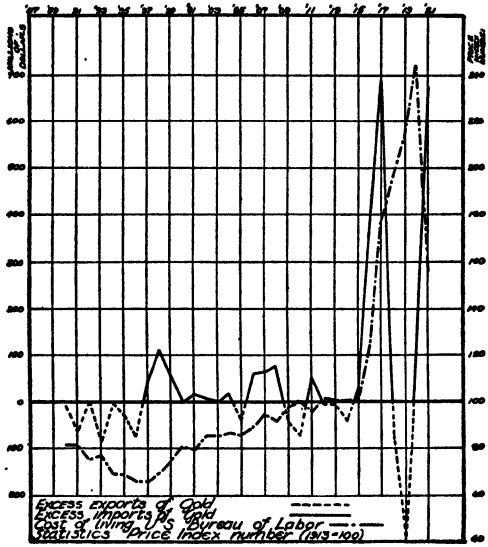


CHART VI
Gold movements and wholesale prices, United States, 1890–1921

disclose the fact that other instances than those cited above may show that gold movements and prices do not always move in the direction that would harmonize with the above theory. On Chart VI the data covering our gold imports and exports for the fiscal years 1890 to 1918, inclusive, and for the calendar years 1919 and 1920, have been plotted alongside of the wholesale price index number of the United States Bureau of Labor Statistics. During thirteen out of the thirty years

[1] Gold imports *may* almost immediately affect the per capita of media of circulation because gold is exchangeable for money at the mint after a lapse of a few days, which money may be put into circulation or used as reserves behind deposits.

[2] Fisher, I., "Stabilizing the Dollar," pp. 29–30.

TABLE XIV.—GOLD MOVEMENTS AND WHOLESALE PRICES
United States, 1890–1921

Year Ended June 30	*Excess Exports of Gold* [1]	*Excess Imports of Gold* [1]	*Wholesale Prices U. S. Bureau of Labor Statistics 1913 = 100*
1890	4,331,149		81
91	68,130,087		81
92	495,873		75
93	87,506,463		77
94	4,528,942		69
95	30,083,721		69
96	78,884,882		66
97		44,653,200	66
98		104,985,283	69
99		51,432,517	74
1900	3,693,575		80
01		12,866,010	79
02		3,452,304	85
03	2,108,568		85
04		17,595,382	86
05	38,945,063		85
06		57,648,139	88
07		63,111,073	94
08		75,904,397	91
09	47,527,829		97
1910	75,223,310		99
11		51,097,360	95
12	8,391,848		101
13	8,568,597		100
14	45,499,870		100
15		25,344,607	101
16		403,759,753	124
17		685,254,801	176
18	74,087,070 [2]		196
19	291,651,202 [3]		212
1920		94,977,065 [3]	243
21			

[1] Statistical Abstract of the United States, 1920, p. 530. *Federal Reserve Bulletin*, February, 1922, p. 000. Figures prior to 1895 relate to coin and bullion; subsequent to that date, they include ore also. [2] July 1, 1917, to Dec. 31, 1018. [3] Year ended Dec. 31.

in question, the two movements moved in opposition to the theory that we are discussing. Is not one justified, therefore, in questioning the general theory that excess gold imports raise prices and that excess gold exports lower them? The theory has to be discussed and accepted, if accepted at all, as one of those "provided-other-things-remain-equal" theories. "If other things remain equal" and excess gold imports result in increased bank deposits, loans, discounts and an increased per capita circulation, and if employment is general and demand for goods is great, and if industry is booming and markets are active, then excess gold imports may tend to raise prices. On the other hand, "if other things remain equal" and excess gold exports reduce bank deposits, loans, discounts and the per capita of circulation, and if unemployment becomes widespread, industry stagnant, demand for goods lacking, etc.,—then excess gold exports may tend to reduce prices. But even so, are we not stressing too much the influence of gold movements upon the price level and at the same time overlooking the influence of certain other very important factors?

But to revert to our earlier question as to whether or not any country at any time may be possessed of too much gold, either for its own good or for the good of those countries with which it trades, we are forced once more to deal with certain non-conformities between theory and fact. The early mercantilists naturally claimed that it was impossible for any country to have too large a supply of gold, the larger the supply the wealthier the country, the better was the lot of its people, etc. Our later economists, however, have tended to stress quantities of goods rather than gold, production rather than accumulation, health, happiness and the general welfare of citizens rather than a store of precious metals, and free trade rather than protective tariff or a continuing favorable balance of trade. But the theory or point of view that is commonly accepted by the people and acted upon by their governments is more nearly in accord with the doctrines of the mercantilist writers.

Never before the World War had a country ever been known to object to an excess of gold imports or to a continuing favorable balance of trade. Economic and political policies have almost always been shaped with the idea of attaining both of those objects. During the war, however, the public was amazed and dumfounded when Sweden, Norway, Denmark, Holland, and Spain, all neutrals, one after another announced that they had acquired too much gold and that steps

would be taken to prevent further importations. The influence of too much gold, it was said, had resulted in credit inflation, high prices, speculation, etc. On February 8, 1916, the Swedish Riksdag freed the Bank of Sweden from the legal obligation of purchasing bullion delivered by anyone to the Swedish mint.[1] The law had compelled the Bank to purchase a kilogram of gold from any person presenting it at the price of 2480 kronen less 1/4 per cent or 2473.80 kronen net. In 1916, as a result of the large supply of gold in the country, a kilogram could be purchased in the open market for 2200 kronen. The Bank was put in a serious situation because of the large amounts of gold which it was forced to buy at a price higher than that in the market. The law was therefore changed to give the needed relief. Shortly afterward, Denmark and Norway followed Sweden's example. These countries wanted goods or securities, not gold. In the case of Spain, the Bank of Spain was the only institution authorized during the war to import gold, and, as all shipments had to be made direct to it, the Bank had complete control of the market. When conditions within the country began to show the effect of too much gold, the Bank restricted imports by imposing an arbitrary purchase price on gold coin that really amounted to about a 6 per cent discount (American gold being accepted at the rate of 4.90 pesetas to the dollar instead of the mint par value of 5.18); and also by refusing to purchase gold bullion. In the case of none of the neutral countries mentioned was the importation of gold actually prohibited, although newspaper notices might lead one to believe the contrary.

As a result of our great excess of gold imports during 1915 and 1916, some of the more serious minded financiers began to question whether or not we were having too much gold thrust upon us,[2] but as the excess dwindled to $181,000,000 in 1917 and to $21,000,000 in 1918, and then finally turned into excess exports of $291,000,000 in 1919, the fear seemed to pass away. In 1920 and 1921, however, the inrushing flood of gold again became so great that financiers and economists once more raised the inquiry as to the seriousness of the situation. In 1921 the Mechanics and Merchants National Bank of New York

[1] This measure as first enacted was to remain effective only until February 4, 1917. It was later extended for a longer period.

[2] The *Annalist* of November 13, 1916, editorially remarked that, "The threat of too much gold has come to be looked upon by bankers as one of the practical problems of the day." On November 2, 1916, the New York *Journal of Commerce and Commercial Bulletin* stated that, "Additional gold importations are neither needed nor desired by American bankers."

in one of its circulars excellently stated the problem in the following manner:

"Paradoxical as it may seem to those who see in the present inward flow of gold a powerful influence toward relieving them from the present level of money rates, it is not a good thing that so much gold should now be coming hither from abroad. It does not help matters. On the contrary, America having become the gold pivot of the world, it would be far better were gold going out to the countries where it is most needed, rather than coming from them. Gold accumulation abroad would strengthen currency systems and re-establish credit, and would thus contribute to restoring equilibrium and stability to the international exchanges. Gold accumulations here, on the other hand, in their present rapid pace, simply contribute new elements toward a renewal of inflation, and by just the degree in which they do that, stand in the way of restoring equilibrium and stability to the international exchanges.

"If, therefore, gold imports continue unchecked, the ultimate disturbing effect on our domestic banking position and on the international exchanges will have to be very seriously considered. It is one of the strange phenomena of a perplexing situation in world economics that gold should now be leaving those markets where it is most needed for the markets where it is not needed at all."

We have no need of this excess gold; we are unable to use it to advantage, and yet its coming has sadly crippled foreign nations that could much better employ it. Various plans and programs have been suggested (to be discussed in Chapter XIV) to alleviate the situation caused by our excess of gold and its scarcity abroad, but at present (April, 1922) the accepted policy seems to be to let matters take their course, naturally and without the application of artificial means of stabilizing exchange rates or of distributing the world's gold on a more satisfactory basis. The future alone will disclose whether or not present policies are to be justified. But, so far as our own country is concerned, we are still a *free* gold market, permitting the import and export of gold without any restrictions whatsoever.

CHAPTER XII

EXCHANGE RELATIONS WITH SILVER, GOLD EXCHANGE, AND PAPER STANDARD COUNTRIES

Thus far we have been dealing with exchange relations between gold standard countries. While some of the phases of the discussion may have seemed complicated, yet it will be found that the subject becomes increasingly intricate as we consider exchange relations with the silver standard, gold exchange standard and paper standard countries.

Before the opening of the 19th century, silver played an equally important part with gold in the trading activities of all nations, but as one by one the leading countries adopted the gold standard and closed their mints to the free coinage of silver, the white metal fell more and more into disuse as an international medium of exchange until today it serves as a legal standard only for China, Indo-China, Guatemala, and Honduras. It is hoped that the future may see it abandoned even by these four nations. Efforts have been made for decades past to accomplish this much needed reform for China, but as yet economic and political conditions have not progressed far enough to bring it about.

Before the war, the world's production of silver averaged between 220,000,000 and 226,000,000 ounces per year, but in 1914 it dropped to 211,000,000 ounces; in 1915 to 179,000,000; in 1916 to 157,000,000; rising to 174,000,000 in 1917, and to 197,000,000 in 1918; but again falling to 175,000,000 in 1919, and to an amount estimated at slightly less than that in 1920. The United States produces about one-third of the world's output, Mexico slightly more, with South America and Canada next in importance. About two-thirds of the silver output of our country, however, is incidental to the production of other metals.

London is the great international market for silver as well as for gold, and her price controls the price of silver throughout the world. Four large firms dominate the market. Their representatives meet daily to fix the price at which the metal shall be purchased from the smelting companies. The latter are the most important sellers and

act as agents for the producers. Two prices are quoted, "spot" or "ready," and "forward" or "future." The spot price is the price for silver which is to be delivered for cash within a week, while the forward price is the price for silver to be delivered within two months. No forward prices were quoted during the war. "Sometimes the Eastern exchange banks buy silver merely for covering operations against their exchange transactions and dispose of 'forward' silver before the date of delivery is due. There is also another operation carried on called a 'budlee.' To budlee silver is to buy 'ready' and to sell 'forward.'" [1] The buyers of silver are the governments that have need of the metal for monetary purposes, manufacturers engaged in the production of commodities in which silver plays a part, banks concerned with the financing of trade with silver standard countries, and speculators. The brokerage fee on sales, usually 1/8 per cent, is borne by the buyer.

In gold standard countries, the price of gold is fixed in normal times, either absolutely, as in the case of the United States, or within fairly well defined limits, as in the case of England. Rates of exchange between such countries normally fluctuate between the gold export and the gold import points, and the returns from exchange operations between parties in those countries are therefore capable of being calculated with a surprising degree of definiteness. The price of silver, however, is not fixed, but varies daily in terms of gold. Because of that fact, exchange transactions between a gold standard and a silver standard country are always highly speculative in character.

Until 1873, however, the price of silver fluctuated but slightly. Since that time, its vagaries of ups and downs, mostly downs, have greatly interfered with the trading and financial activities of silver standard countries. Taking the quotations of the London market (Table XV) as indicative of the trend throughout the world, the average yearly price in 1833–1873 fluctuated between the narrow limits of 59 3/16d. and 62 1/16d. per standard (0.925) ounce. The average yearly quotation then fell gradually with several slight recoveries, until it reached the extremely low point of 23 5/8d. in 1915. War conditions, however, brought about an amazing rebound until a new high average yearly quotation of 61 13/32d. was reached in 1920. In the New York market also silver reached its highest yearly average price ($1.34649 per fine ounce) that same year.

[1] Spalding, W. F., "Eastern Exchange, Currency and Finance," 1920 ed., p. 285.

TABLE XV

AVERAGE YEARLY QUOTATION OF SILVER PER STANDARD OUNCE IN THE LONDON MARKET, 1833–1921 [1]

	Pence		*Pence*		*Pence*		*Pence*
1833	59 3/16	1855	61 5/16	1877	54 13/16	1899	27 7/16
1834	59 15/16	1856	61 5/16	1878	52 9/16	1900	28 5/16
1835	59 11/16	1857	61 3/4	1879	51 1/4	1901	27 3/16
1836	60	1858	61 5/16	1880	52 1/4	1902	24 1/16
1837	59 9/16	1859	62 1/16	1881	51 11/16	1903	24 3/4
1838	59 1/2	1860	61 11/16	1882	51 5/8	1904	26 13/32
1839	60 3/8	1861	60 13/16	1883	50 9/16	1905	27 13/16
1840	60 3/8	1862	61 7/16	1884	50 11/16	1906	30 7/8
1841	60 1/16	1863	61 3/8	1885	48 9/16	1907	30 3/16
1842	59 7/16	1864	61 3/8	1886	45 3/8	1908	24 13/32
1843	59 3/16	1865	61 1/16	1887	44 11/16	1909	23 23/32
1844	59 1/2	1866	61 1/8	1888	42 7/8	1910	24 21/32
1845	59 1/4	1867	60 9/16	1889	42 11/16	1911	24 19/32
1846	59 5/16	1868	60 1/2	1890	47 3/4	1912	28 1/16
1847	59 11/16	1869	60 7/16	1891	45 1/16	1913	27 9/16
1848	59 1/2	1870	60 9/16	1892	39 3/4	1914	25 1/4
1849	59 3/4	1871	60 1/2	1893	35 9/16	1915	23 5/8
1850	60 1/16	1872	60 5/16	1894	28 15/16	1916	31 3/8
1851	61	1873	59 3/16	1895	29 13/16	1917	40 13/16
1852	60 1/2	1874	58 5/16	1896	30 13/16	1918	47 17/32
1853	61 1/2	1875	56 11/16	1897	27 9/16	1919	57 1/32
1854	61 1/2	1876	52 3/4	1898	26 15/16	1920	61 13/32

We cannot concern ourselves with the details of the causes of these wide fluctuations, such as the demonetization of silver by the United States in 1873, the closing of the Indian Mint to the free coinage of silver in 1893, the enactment by the United States of the Bland-Allison Law in 1878 and the Sherman Law in 1890 and their subsequent repeals in 1890 and 1893 respectively, the discovery of new sources of silver ore, reduced costs of production, silver as a by-product of the mining of other metals, etc., etc. One can find such data, if desired, in almost any volume dealing with the subject of Money. We are interested, however, first in the causes of the violent fluctuations during the World War, and second in the question as to how variations in the price of silver, either in normal or ab-

[1] Annual Report of the Director of the U. S. Mint, 1921, p. 137.

TABLE XVI

VALUE OF FINE OUNCE OF SILVER IN NEW YORK AT THE AVERAGE YEARLY QUOTATION, BASED ON THE LONDON PRICE CONVERTED AT PAR OF EXCHANGE, 1873–1920 [1]

1873....1.29769	1889.... .93511	1905.... .61027
1874....1.27883	1890....1.04634	1906.... .67689
1875....1.24233	1891.... .98800	1907.... .66152
1876....1.16414	1892.... .87145	1908.... .53490
1877....1.20189	1893.... .78030	1909.... .52016
1878....1.15358	1894.... .63479	1910.... .54077
1879....1.12392	1895.... .65406	1911.... .53928
1880....1.14507	1896.... .67565	1912.... .61470
1881....1.13229	1897.... .60438	1913.... .60458
1882....1.13562	1898.... .59010	1914.... .55312
1883....1.10874	1899.... .60154	1915.... .51892
1884....1.11068	1900.... .62007	1916.... .68647
1885....1.06510	1901.... .59595	1917.... .89525
1886.... .99467	1902.... .52795	1918....1.04171
1887.... .97946	1903.... .54257	1919....1.25047
1888.... .93974	1904.... .57876	1920....1.34649

normal times, affect exchange dealers, exporters, importers, and investors.

During 1914 the price of silver in the London market opened at 26 7/16d. per standard ounce and closed at 22 3/8d. With the new year (1915) the demands of the belligerents for silver began to be felt. Gold had disappeared from circulation, being hoarded either by the central banks or by the people. England, France, Russia, Italy, and other nations began to coin silver in large amounts so as to supply the needs of the people for "hard" money. Troops in strange lands had to have silver coins because of the objections of the natives to paper money. The decreased production of the Mexican mines, caused by the political conditions in that country, also had a strengthening effect. The European nations, together with India and China, remained in the market as active buyers with the result that the price of silver rose steadily during 1915, closing at about 26d. Shortly after the opening of 1916 the price began skyrocketing and reached 38 1/8d. in May, only to fall again to about 29d. in July. An astonishing recovery occurred and the year closed with the price at about 37d. At that time the

[1] Annual Report of the Director of the U. S. Mint, 1921, p. 137.

demand for silver was at a point unknown before in history. In the latter part of 1916, England, France, Russia, and Italy agreed to cease competitive buying and to pool their purchases. England also issued an order prohibiting all speculation in silver bullion, hoping thus to carry out more effectively the pooling arrangement. The price remained stationary for but a short time, and then began a steady advance. In April, 1917, we declared war against Germany and were immediately faced with the problem of supplying an increased circulation in order to care for the needs of our people for money with which to purchase Liberty Bonds, pay taxes, etc., for corporations to handle larger payrolls and buy increasingly greater amounts of supplies, and for the government itself to pay troops at home and abroad. In 1916 China had disposed of a large amount of her surplus silver to India and Russia at prices that, at the time, were considered most satisfactory. In 1917, however, she found herself forced into the market to replenish her stock, and purchased heavily from the United States. In June, 1917, silver was selling in London at 39d., and in July at 41d. England thereupon announced an embargo on imports of silver into India, her purpose being a more effective control of the market. But in the face of the prevailing economic conditions, England found herself powerless to regulate the price. In August it again advanced. By September 14, it had reached the high point for that year, 55d., the increase being due principally to the demands of China. At the price of 55d. the rupee of India was worth more as bullion than as a coin, and the natives began hoarding rupees or melting them down for export. England then raised the exchange value of the rupee from 1s. 4d. to 1s. 5d. and issued an order prohibiting the export of silver coin or bullion from India. England likewise prohibited the export of silver from England to neutral countries except under license. The New York *Journal of Commerce and Commercial Bulletin* of September 19, 1917, gave the following as the most outstanding causes for the then existing high price of silver:

"Extreme scarcity and worldwide demand.

"Withdrawal of gold from circulation in Europe and Oriental countries.

"United States, Great Britain, France, Russia and Italy have been obliged to make heavy purchases for subsidiary coinage to pay their troops. China, Japan and India have also been large buyers.

"Shortage of cyanide, which ordinarily sells at 14¢, now quoted at $3.25 per pound, with only limited amount available. If scarcity continues, some

authorities assert, the old fashioned method could be reverted to, such as mechanical concentration.

"Increased freight and insurance rates and higher mining costs. In time of peace the cost of shipping metal to London is ½¢ per ounce. Today it is 8½¢ per ounce.

"Hoarding of metal by plain people of various countries abroad.

"Curtailment of output of silver in Mexico.

"Silversmiths in market for bullion to prepare for the Christmas season."

The market eased off during the latter part of 1917 and closed at 43 ½d. In November, Great Britain entered into an agreement with the United States whereby both agreed to purchase a total of 100,000,000 ounces of silver in the American market during 1918. Both countries asked the silver merchants and purchasers to aid them in obtaining the metal as cheaply as possible. On December 5, our newspapers contained an announcement to the effect that "The Government will take over the country's silver output and will fix the price." Conferences were held with silver merchants and producers but with no results. Silver rose slightly in January, 1918, fell off in February, and in March commenced what appeared to be a consistently upward movement, reaching 45 5/8d. on March 29. On April 25 the President of the United States signed the Pittman Bill. We had been purchasing raw materials in large quantities from China and India. We disliked to pay in gold inasmuch as at that time we were doing all within our power to conserve our gold holdings. We finally arrived at the happy idea of paying India and China out of the large supply of silver dollars which our Treasury had stored away as security for the outstanding silver certificates. The natives of India at that time were in a state of unrest, which was further heightened by the efforts of the British government to force paper money into circulation in that country. To pay India in silver, therefore, would not only be conserving our own gold supply, but would also be assisting our ally to maintain peace within one of its most important possessions. The Pittman Act, in brief, authorized the Secretary of the Treasury to melt and sell as bullion not over 350,000,000 standard silver dollars, then being held as security behind the silver certificates, and to sell the bullion thus obtained at not less than $1.00 per ounce 1000 fine. In order to avoid the disadvantages of a possible contraction of our currency, the Federal Reserve banks were permitted to issue an amount of Federal Reserve bank notes not to exceed the amount of silver certificates retired,

these notes to be secured by United States certificates of indebtedness or United States one year gold notes. In allocating the silver thus obtained, the needs of our government and of our allies were given preference, although shipments were later permitted for commercial purposes. Up to May 6, 1919, the date of the final transaction, 260,121,554 silver dollars had been melted down under the provisions of the Act for use in foreign trade,[1] and up to December 31, 1919, $259,375,000 of Federal Reserve bank notes had been issued.

On August 9, 1918, the British Treasury fixed the maximum price of silver at 48 13/16d. per standard ounce. On August 20 it was compelled to raise this maximum price to 49½d., following the action of the United States government on August 16 in fixing the price of silver in New York at $1.01½. The export of the precious metals from the United States was absolutely controlled through the Federal Reserve Board and no licenses for export were given at that time. On November 13 the British Treasury fixed its maximum price at 48 3/4d., on December 6 at 47 7/16d., on February 11, 1919, at 47 7/8d., and on February 20, at 47 3/4d., the market price being the same as that fixed by the Treasury.[2] These changes were made because of the decrease in freight and insurance rates on shipments from the United States.

In March, 1919, England "un-pegged" her exchange, and sterling immediately fell away from 4.76, where it had been most skilfully held for several years. Thereupon it became necessary for the English government to readjust its maximum price of silver because thenceforth not only would the London price have to be calculated on the basis of the New York price plus shipping costs, but also on the additional factor of the cross-rate of exchange (the sterling rate in New York). The price fixed by England was 95¢ per ounce at the current rate of sterling exchange in New York. Thus if sterling exchange in New York fell, and if shipping costs remained the same, the price of

[1] 10,000,000 silver dollars were also melted down between December 5, 1919, and March 22, 1920, to provide our government with silver for subsidiary coinage purposes.

[2] "Owing to the restrictions imposed upon the transit of silver, quotations abroad have shown little relation to those ruling in this market, as will be seen below:

France	March 3, 1919	49 1/16d.
Italy	6	60 13/16d.
Spain	8	54 5/8
Sweden	24	60
India	23	51 9/16
London, on all above dates mentioned		47 3/4d."

London *Economist*, April 26, 1919.

silver in London would rise, and vice versa. Silver immediately rose to 50d. on March 28, but eased off during April, ranging between 48 9/10d. and 48 15/16d. during that month. On May 5 the United States announced that it had abandoned its control of the American silver market. On May 9, the British Treasury did likewise. Intimation was subsequently given by the British Treasury that "licenses would be granted freely for export. The immediate effect upon the market, which had been in a state of suspended animation for several months, was very great. No available stock of silver existed from which continental demands could be supplied. As a consequence the price moved at a speed absolutely without precedent. It leaped in one bound on the 9th from 48 5/8d. to 53½d. On the 10th, 58d. for cash delivery. . . ." [1] which was the record since January, 1877. In June and in early July, it dropped slightly but again advanced step by step until it reached the amazing figure of 79 1/8d. on December 16. On November 25 silver had sold in New York at the record price of $1.38¼ per fine ounce. It is said that some sales were consummated in San Francisco at $1.42. Our exchanges and our trade relations with silver standard countries were seribusly menaced, not to mention the possibility of subsidiary coinage being taken from circulation, melted, and exported as bullion in order to pay our existing adverse trade balance with Oriental countries. On December 6 an announcement was made that, under arrangements between the United States Treasury and the Federal Reserve Board, the "free" silver dollars in the Treasury [2] would be delivered against any other forms of money to the Division of Foreign Exchange of the Federal Reserve Board, which would, acting through the Federal Reserve Bank of New York in coöperation with the branches of American banks in the Orient, employ such dollars in regulating our exchanges with silver standard countries. About $13,000,000 of silver was shipped to Shanghai under this arrangement during the early months of 1920. The sudden decline in the price of silver which occurred within a few months made further shipments unnecessary.

During the opening weeks of 1920 silver continued to rise and in London reached the record price of 89½d. on February 11. India, China, and Japan had been starved for silver during the World War. When the market opened they rushed in and, bidding against each

[1] London *Economist*, May 17, 1919.
[2] Silver dollars not used as security for silver certificates.

other, forced the price upward to record levels. After the highest point had been reached in February, the market eased off rapidly and closed at 40 7/8d. on December 31. The startling rise in the London price of silver was due primarily to the collapse of sterling exchange in the American market. With every fall in the sterling rate the cost of procuring silver in the United States rose and the price of silver in London advanced accordingly. Thus silver at $1 per ounce 1000 fine in New York when converted at par ($4.8665 = £1) is worth 45½d. per standard (0.925) ounce in London. If sterling exchange falls to a discount of 28 per cent, silver at $1 per fine ounce in New York is then worth 63d. per standard ounce in London since it takes more sterling exchange to buy the same amount of silver. Thus the cross-rate (New York on London) was the dominating factor in the situation so far as the London price was concerned. In reality, during the war and down to the present time (April, 1922) New York has been the most important silver market in the world. When the United States government fixed the price of silver, England followed our lead and did likewise, fixing her price on our basis. When we abandoned official control over the silver market, so did England; and when we established a completely free market for silver, the English price fluctuated almost always in unison with the price of foreign silver in the New York market converted at the current rate of sterling exchange plus shipping costs. In face of these facts, it is not at all surprising that many Americans thought that there might be a possibility of New York displacing London as the world's silver market. But here again, as has been true in other connections, we had neither the foresight nor the leadership to capitalize our war-time advantages into permanent supremacy. Even today, in spite of the London silver quotation being based upon that of New York, London is considered as the world's silver center, and will undoubtedly remain so for many years to come.

But to resume the story of silver after the war: By May, 1920, silver in the United States had dropped below $1 per fine ounce, which was the minimum price provided by the Pittman Act for the re-purchase of government supplies to replace the silver dollars melted under the authority of that Act. The Treasury immediately entered the market as a purchaser at $1 per ounce 1000 fine. "The Act provided that the silver purchased should be of American origin and refined in the United States. The Treasury, however, placed a liberal

interpretation on this clause to the effect that individual silver need not be identified so long as each producer should sell as American silver that portion of his silver product which corresponded to the silver mined and refined in this country." [1] An agreement was entered into between the Treasury and the producers whereby the latter were to receive 99 5/8¢ per ounce 999 fine. The price since that time has fluctuated around 99 5/8¢, sometimes reaching 99 3/4¢, and at other times falling to 99 1/4¢. Up to July 25, 1921, about one-third of the total amount required to replace the melted silver dollars had been obtained, and it is now thought that the United States Treasury will be in the market as a purchaser of domestic silver at the fixed price until at least 1923. These purchases by the United States government and the absence of American silver from the world market tended almost immediately to have a slight temporary stabilizing effect upon the price of silver in London, but other factors soon appeared, chiefly the lack of demand by India and China and the increasing supplies from Mexican sources, with the result that the price of silver continued its downward course. On March 5, 1921, the low mark for the year was reached at 30 5/8d. There was a noticeable recovery during subsequent months, and on September 20, the high mark for the year was reached at 43 7/8d. the controlling influence being the appearance of China and India in the market as heavy buyers. The year closed with silver at 34 5/8d. Since that time (to April, 1922) the price in the London market has continued to fluctuate around 34d. per ounce.

In the New York market as well, the price of foreign silver has fallen to lower levels, reaching 53½¢ on March 5, 1921. This situation has inevitably produced a vigorous discussion in certain circles as to the wisdom of the requirement of the Pittman Law that the Treasury must purchase domestic silver at not less than $1 per fine ounce regardless of the market price of foreign silver. For example, when foreign silver was selling in New York at, say, 60¢ per ounce, as it did on February 17, 1921, the American government was paying 99½¢ for domestic silver, in other words, actually giving a bonus of 39½¢ to American producers. The total excess cost of silver to the United States government over what it would have had to pay if it had not been restricted by the Pittman Act to the minimum price of $1 per fine ounce, will approximate millions of dollars.

[1] *Federal Reserve Bulletin*, August, 1921, p. 935.

Tables XV [1] and XVI [2] and Charts VII and VIII [3] tell the story of the fluctuations in the price of silver. Chart VII is especially interesting as showing the striking similarity in the trend of the New York price of foreign silver and wholesale prices in the United States from November, 1918, to February, 1922. Such similarity does not appear in the early history of silver and may not appear again in future

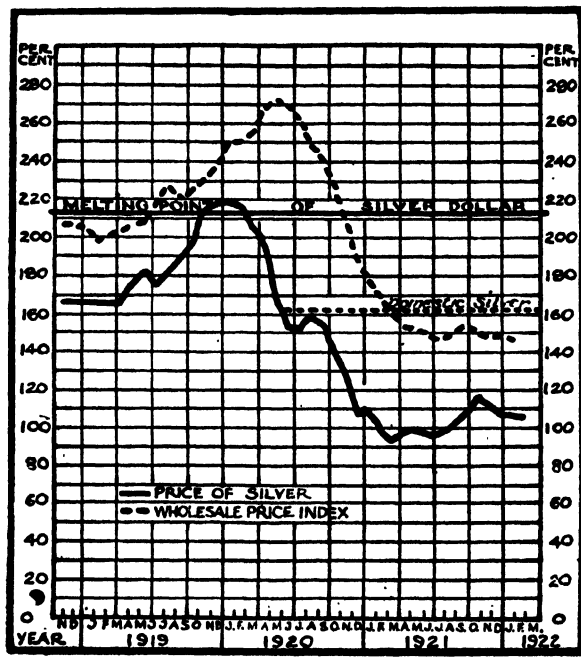


CHART VII

Prices of silver in the United States and wholesale price index, November, 1918–April, 1922 (per cent of 1913 averages). Adapted from *Federal Reserve Bulletin*, August, 1921, p. 937, and extended to date.

years. This strange coincidence is undoubtedly explained by the fact that for the time being, owing to the scarcity of the supply and the strength of the demand, the price of silver was subject to the same economic forces that were governing the prices of other commodities and responded accordingly.

The unparalleled advance in the price of silver during 1916–20 had

[1] P. 429. [2] P. 430. [3] P. 443.

some surprising effects upon the monetary systems of certain countries. As silver rose it became evident that silver coins would inevitably be worth more as bullion than as money, with the consequent danger of their being taken from circulation and hoarded or melted up and exported. The melting points of the silver coins of the more important countries are shown in the following table:

TABLE XVII

MELTING POINTS OF SILVER CURRENCIES [1]

Coin	*Fine Silver Content (Grains)*	*Melting Point (Price of Silver per Ounce)*		
		In Local Currency	*In U. S. Money*	
			At Par of Exchange	*At June, 1921, Rate of Exchange*
Dollar	371.25	1.2929 dollars	.....	.....
Subsidiary silver (dime)	34.722	1.3824 dollars	.....	.....
Shilling:				
Old	80.7263	5.946 shillings	$1.447	$1.124
New	43.6364	11 shillings	2.677	2.08
5-franc piece	374.22	7.234 francs	1.396	.584
1-franc piece	64.4286	7.45 francs	1.438	.602
Mark	11.16	6.221 marks	1.482	.09
Lira	64.4286	7.45 lire	1.438	.371

From November, 1919, to February, 1920, the price of silver was above the melting point for our silver dollar, although not for our subsidiary coins. It was for the purpose of trying to prevent a possible rise of silver to $1.3824 and thus to protect our subsidiary coinage from export, that the Federal Reserve Board and the Treasury cooperated with American banks having branches in the Orient in using the free silver dollars in our Treasury for the payment of our adverse Oriental trade balance, as has been noted above. In January, 1920, the old shilling of Great Britain became worth less as money than as bullion, and a new shilling of 500/1000 fineness (the former shilling

[1] *Federal Reserve Bulletin*, August, 1921, p. 936.

had been of 925/1000 fineness) was issued to forestall the danger that the shilling might be melted down. For the same reason Great Britain was compelled to change the value of the Indian rupee five different times between 1917 and 1919, advancing it from 1s. 4d. in 1917 to 2s. on September 10, 1919.[1] Norway, Sweden, Holland, and other countries took similar measures to protect their coinage. The silver 5-franc pieces of France, because of their greater bullion value, were smuggled in large quantities into Switzerland, where they had two or three times the purchasing power that they had at home. Switzerland, acting at the request of France, finally declared them no longer to be legal tender within Swiss territory, thus making their return to France more probable. Silver disappeared from circulation in Germany and Italy. Germany, with a supply of silver coins in her central bank, melted them and threw the bullion on the market at the prevailing high price for silver, as did several other continental nations. The unique factor that entered into the situation was the effect of the New York cross-rate upon the melting point of the silver coins of these countries. It will be noted from Table XVII above that, with exchange at par, the melting point was considerably higher than with exchange at the rates prevailing in June, 1921. Primarily because of the large amounts of depreciated paper money issued by foreign countries, exchange rates at that time were greatly below par, the extent of depreciation of their paper money being roughly measured by the discount at which their exchange stood in our country. Conversely, both gold and silver coins were at a premium as measured in terms of the paper money of those countries. The prices at which those coins could be profitably melted down on the basis of the value of their metallic content was therefore lower than if exchange had been at par, or if there had been no premium on the money metal. Thus, where nominally the silver in the mark is worth a mark when silver in the market sells at 6.2221 marks per ounce (or $1.482 when converted at the par of one mark = $.238), yet with the New York mark quotation at, say, .013, or approximately 1/18 of what it normally is, the melting point of the mark is reached when silver is worth as little as 8¢ an ounce. As exchange rates on continental countries rise to normal and the premium on gold and silver coins disappears, the

[1] A subsequent section of this chapter will be devoted to a discussion of the changes made necessary in the gold exchange standard of India by the unparalleled fluctuations in the price of silver.

melting point of foreign silver coins will likewise revert to normal.

With but a few exceptional years, the United States has always been a heavy exporter of silver, and the story of the period from August, 1914, to December 31, 1921, is no exception to the rule. The seemingly surprising thing is that the movement of silver should have been so strongly in contrast to that of gold in the face of our extremely large favorable balance of trade. The year 1921 alone shows an excess of

TABLE XVIII

SILVER IMPORTS INTO AND EXPORTS FROM THE UNITED STATES

	Imports	*Exports*	*Excess Exports*
August 1, 1914 to December 31, 1914	12,129,000	22,182,000	10,053,000
January 1, 1915 " " 31, 1915	34,484,000	53,599,000	19,115,000
" 1, 1916 " " 31, 1916	32,263,000	70,595,000	38,332,000
" 1, 1917 " " 31, 1917	53,340,000	84,131,000	30,791,000
" 1, 1918 " " 31, 1918	71,376,000	252,846,000	181,470,000
" 1, 1919 " " 31, 1919	89,410,000	239,021,000	149,611,000
" 1, 1920 " " 31, 1920	88,060,000	113,616,000	25,556,000
" 1, 1921 " " 31, 1921	63,242,000	51,575,000	11,667,000 [1]
Total	444,304,000	887,565,000	443,261,000

[1] Excess of imports.

imports over exports. In that year $41,250,000, or two-thirds of our total silver imports came from Mexico, while $7,088,000 came largely from Germany and Great Britain. Over 80 per cent of our silver exports during that year went to the Orient and to Great Britain,—those going to Great Britain being presumably for India.

During the War practically every nation either prohibited the export of silver or permitted it only under license from some governmental body. Even at this writing, many of those regulations still persist. Export of silver in any form is prohibited in Hungary, Jugo-Slavia, Poland, Roumania, Sweden, Turkey, and Syria, while the export of silver coin only is prohibited in Spain and Mexico. Export is permitted under license in Austria, Chile, Cuba, Japan, Belgium, Bulgaria, Czecho-Slovakia, Denmark, Finland, France, Great Britain, Greece, Italy, Luxemburg, New Zealand, Norway, South Africa and Switzerland.[1]

A. SILVER STANDARD

China is the only important silver standard country in the world. There is not need to discuss the efforts that have been made in the past

[1] Compiled from the *Weekly Review of Foreign Exchanges* issued by Samuel Montagu and Company of London.

to induce her to adopt either the gold standard or the gold exchange standard.[1] Those efforts have been of no avail, and as a result China stands alone as "the Paradise of the Money Changer."

"The currency situation of China has always been confused because of the non-existence of a uniform currency system. The present unit of currency is the tael or Liang. This is not a coin, but a measure of value. It is supposed to weigh an ounce of pure silver, but there is no fixity about this unit for it varies both in weight and value in the different cities and provinces of the empire. The only actual money coin is the so-called copper cash. It has been used in China for more than three thousand years. Its value as money is figured as the one thousandth part of a tael, but in reality it has deteriorated and its price varies according to the demand. Its copper contents have been greatly reduced by the provincial authorities who are responsible for its coinage, and the Chinese will accept it only as an approximate of its intrinsic value. Cash is a flat oval coin, with a square hole in the center for the purpose of stringing large quantities of them together, a knot being tied at each 100 coins in order to facilitate calculation. For commercial transactions on a large scale, a monetary unit so small as the cash would not be practicable. Therefore, all payments of consequence are made in silver bullion called sycee (silver ingots of different sizes, ordinarily worth about 50 tael), based on a money table of 10 cash equal one candareen, 10 candareen equal one mace, 10 mace equal one tael (both the mace and the candareen are also measures of value and not coins). From a fancied resemblance to the shape of a Chinese woman's foot, these ingots have come to be called shoes. Although they are the principal element in the monetary circulation of China, the Government has no hand in their creation, the issue of them being left to the bankers and money changers who cast them, according to their own standards of fineness. There are some ten varieties of Chinese dollars, in addition to the Hongkong or local currency dollar, the Straits dollar, the Mexican dollar (old die) and the old Spanish dollar." [2]

In 1914, the Chinese government issued the Yuan dollar and declared that henceforth it was to be the unit of Chinese currency. Since

[1] Cf. especially two reports by the Commission on International Exchange, dealing with "Introduction of the Gold Exchange Standard into China, the Philippine Islands, Panama, and Other Silver Using Countries," one of which was submitted to our Secretary of State on October 1, 1903, and the other to Congress on January 26, 1905.

[2] Curran, John S., *Bulletin of the American Institute of Banking*, July, 1921, p. 360.

then it has been gradually supplanting the Mexican dollar in the internal trade of China. The Chinese have a unique practice of preferring a "chopped" dollar to a "clean" dollar. The chopped dollar is one upon which a native exchange dealer has stamped his particular mark or "chop," guaranteeing that the coin is what it purports to be. Each time a dealer puts his chop on a dollar, a small portion of its silver content is removed. Clean dollars do not circulate. They are bought and sold for their commodity value as silver.

Nearly every important town in China has its own tael, differing from the others in weight and fineness, but usually approximating 1 1/3 oz. avoirdupois pure silver. More than 170 different taels are known to be in circulation. The four most important, however, are: first, the Haikwan tael of 583.3 grains of pure silver, used by the Chinese government as the basis for the collection of customs duties; second, the Kuping tael of about 573.865 grains of pure silver, formerly used exclusively, now only partly, by the government in its collection of internal revenues; third, the Shanghai or Tsao-ping tael, of about 545.25 grains of silver, 980 fine, used by banks in Shanghai in quoting exchange rates; and, fourth, the Canton tael of 579.85 grains pure silver, employed mostly in the Canton province. The Chinese Republic has attempted to bring uniformity out of chaos by adopting a dollar practically equivalent in weight and fineness to the Mexican dollar, and has used it in payment of salaries, budget matters, and for various official purposes. Confusion still reigns supreme, however, and will continue to do so until, with the passage of time and the introduction of monetary reforms, Chinese money becomes standardized throughout the republic.

The value of the dollar or the tael, no matter what particular kind it may happen to be, varies daily, although not exactly, with the price of silver in the market. It is not possible for us, therefore, to speak of "silver points" in dealing with the exchanges of silver standard countries as we have spoken of the "gold points" in connection with the exchanges of gold standard countries. The export and the import of silver depend upon its market price in terms of gold, plus its cost of shipment. Of course, between two silver standard countries, one may conceive of the theoretical existence of silver points (par of exchange plus or minus shipping costs) but the term is never employed in a discussion of the silver exchanges. Silver does, however, have a "shipping point" or a point at which it pays exchange dealers to ship

it into or out of a country. If, because of an increase in exchange rates, bankers find that their obligations can be more cheaply met by an export of silver, or if because of a decrease in the rates of exchange they find that it will profit them to import silver, then silver shipments

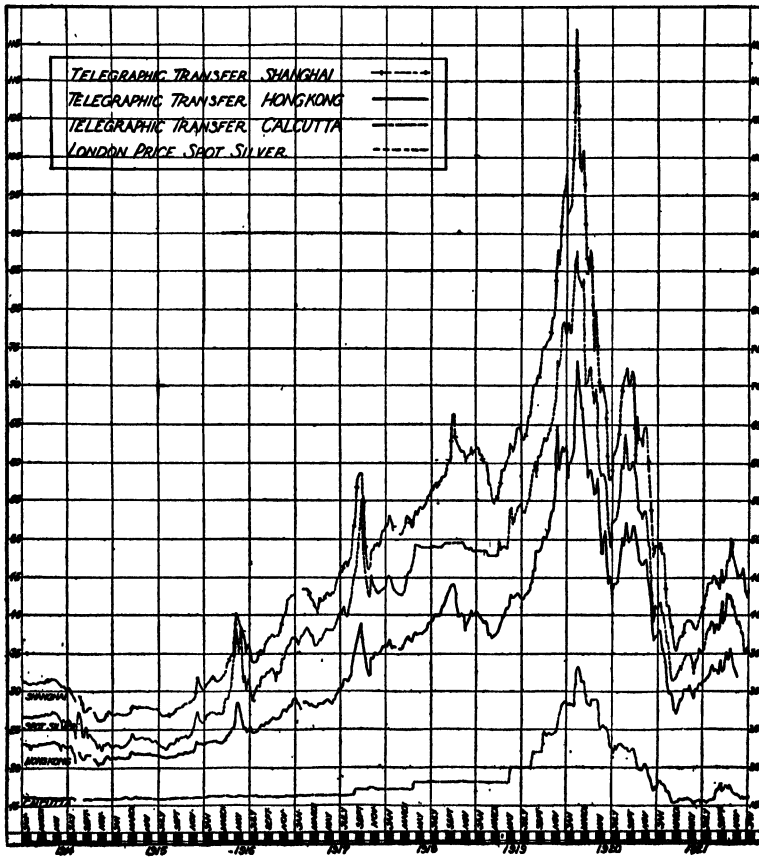


CHART VIII

London quotations of telegraphic transfers, Shanghai, Hongkong, and Calcutta, and of price for spot silver, 1914–1921

occur. The shipping points, i. e., the rate of exchange at which silver may be profitably imported or exported, are not approximately fixed because of the constant fluctuations in the price of silver.

The external trade of China and the investment of foreign funds in that country have been seriously handicapped because exchange on Chinese centers rises and falls, although not always proportionately, with the price of silver. This is graphically illustrated by Chart VIII.

During the last few years Chinese exchange has fluctuated much more widely than usual because of the extreme variations in the price of silver. A rise or fall of from six to ten points per day per tael or Chinese dollar has not been unknown. The following table, condensed from a statement appearing in the China Year Book for 1921–22 [1] gives an idea of the extent of the annual fluctuations in the Shanghai tael rate as based on the banks' selling rate for London telegraphic transfers during 1909–20, inclusive:

TABLE XIX

OFFICIAL QUOTATIONS SHANGHAI BANKS' SELLING RATE FOR LONDON T. T.

Year	*Range of Quotations (Highest—Lowest) During the Year*	*Average T. T. Rate on London*	*Percentage of Fluctuation to Average Yearly Quotation*
1909.....	1 3/4d.	2/3 7/8	6.2
1910.....	3 1/8	2/4 15/16	10.8
1911.....	1 9/16	2/4 15/16	5.4
1912.....	4 5/8	2/8 5/8	14.1
1913.....	3 15/16	2/8 1/12	12.3
1914.....	5 3/4	2/5 3/8	19.6
1915.....	5	2/3 7/8	17.3
1916.....	11 7/8	2/11 11/16	33.3
1917.....	1s. 7	2/10 3/8	55.3
1918.....	1s. 4 1/2	4/8 11/16	29.1
1919.....	3s. 4	5/7 7/8	58.9
1920.....	5s. 4	6/1 7/16	87.1

The phenomenal rise in the average yearly quotation of the Shanghai tael from 2s. 3 7/8d. in 1909 to 6s. 1 7/16d. in 1920, indicated that in 1920 the tael was worth almost three times what it was in 1909. Such an astounding increase in the value of the currency of any country as measured in terms of the moneys of other nations has seldom been known in the annals of exchange transactions.

[1] Pp. 322–3.

Inasmuch as there is no par of exchange which can be used as a basis of comparison, we have in the fourth column of the table given the percentage which the yearly range of the quotation bears to the average yearly rate. Inspection of this column shows that during the normal years of 1909–13, the percentage of fluctuation ranged from five to fourteen per cent while during the abnormal years of the war and down to 1920, it ranged from 17 to 87 per cent. Similar fluctuations were experienced by the other Chinese exchanges.

So long as silver rises in price and exchange rates follow its upward trend, just so long is the Chinese importer at an advantage. Rising exchange rates encourage imports and enable the Chinese to pay their foreign obligations more easily than they could under other conditions. During the last few years of high silver and resulting high exchange rates on China, the Chinese have been able to meet their foreign obligations, of both private and government character, to a decided advantage. Chinese exporters, however, have been greatly handicapped, because the high exchange rate (the decreased purchasing power of foreign money as measured in Chinese money) compelled the importers in foreign countries to pay high prices for Chinese products, a situation that resulted in curtailed exports. On the other hand, during the long period of falling silver prices and adverse exchange rates before the World War, Chinese exporters prospered, because the money of foreign countries, being worth more in terms of Chinese money, would buy more goods. The Chinese import trade, however, was hard hit, and so was the government, because the low rates of Chinese exchange i. e., lessened purchasing power, meant that the Chinese importers had to pay higher prices for their goods, and that the Chinese government had to expend larger sums to meet its foreign obligations.

The constant fluctuation in both the foreign and domestic exchange rates in China, even in normal times, has built up a group of exchange dealers whose like cannot be found in any other country. A commission of 1/8 per cent is charged the seller on ordinary transactions. Sometimes huge profits are made by the larger dealers as the result of their exchange operations. One of the more important Chinese banks is quoted as having cleared about $20,000,000 during 1918–19 on its exchange business.

Shipments of goods may be made into China either on the basis of the money of the exporter's country (foreign money) or on the basis of the money of the importer's country (Chinese taels or dollars). If

the foreign exporter selling his goods to a Chinese firm desires to protect himself against an adverse fluctuation in the exchange rate, he will quote his prices and draw his draft in terms of the money of his own country, say American dollars, thus guaranteeing the receipt of a definite sum of the money of his own country. Under such circumstances the Chinese importer has to assume the risks of exchange. If the rate of exchange in China on the United States should rise, that is, if the tael or the Chinese dollar should buy more American dollars, then the importer will have to pay less for his goods, i. e., he will have to give fewer taels or Chinese dollars to the bank in order to obtain a sufficient number of American dollars with which to pay his indebtedness. On the other hand, if the American exchange quotation should fall, that is, if the tael or Chinese dollar should purchase a smaller number of American dollars, the importer will have to give more taels or Chinese dollars in order to pay the American dollar draft which has been drawn on him. To guard against a possible decrease in the exchange rate, it is customary, although expensive, for the Chinese importer to arrange with a banker for "forward exchange" (a "future") so as to have a definite basis upon which to calculate his exchange payments, and also the cost of his goods. Under a future contract, the banker agrees to furnish the Chinese importer with a sufficient amount of the needed exchange at the time when the draft covering the importation falls due. From the above it is clear that if the American exporter draws a draft on the Chinese importer in terms of dollars and sells it to his American banker, he (the exporter) will receive dollars for it and will not need to bother further about fluctuations in the Chinese exchange rate. On the other hand, if he draws his draft in terms of dollars and sends it to China for collection, he will necessarily run the risk of adverse exchange fluctuations. The Chinese importer will pay taels or Chinese dollars to the Chinese banker and when the sum is remitted to the American exporter, he may find that the Chinese exchange rate has moved against him and that he will receive fewer dollars than he had calculated upon. Practically all goods are shipped from the United States to China under letters of credit or authorities to purchase, the drafts being drawn in dollars and bearing the "interest clause," thus removing, so far as the American exporters and bankers are concerned, all uncertainty as to the returns on the transaction.

If the American exporter quotes his prices to the Chinese importer

in terms of taels or Chinese dollars, and if when a few months later he draws his draft in Chinese money exchange rates have moved against him, he may lose on the transaction. Say that an American firm ships goods to China, billed at 10,000 taels for which a return of $7,000 is expected, the rate on Shanghai at that time being 70¢ per tael. The goods reach China, and are paid for by the importer, who deposits 10,000 taels with the exporter's bank as directed. If in the meantime, as a result of a decline in the price of silver, the tael falls to 66½¢, a decrease of 5 per cent, the American firm will actually receive 5 per cent less than expected, as it would soon discover should it ask to have the 10,000 taels remitted to the United States, for it would receive only $6,650 for the taels instead of the expected $7,000. The Chinese importing firm, would, under the circumstances, pay 10,000 taels for the goods, regardless of the position of the exchanges, and would therefore bear none of the risks of exchange. Had the transaction been financed in dollars instead of in taels, the decreased rate on taels would have compelled the Chinaman to pay more for his goods.

Investors have always been deterred from placing their funds at the disposal of Chinese enterprises because they can never be certain of the returns thereon nor can they know definitely how much their principal will be worth if at any time they see fit to withdraw it from investment in China. If the investment yields an interest payable in the money of the investor's country, then, of course, variations in the rate of exchange need not be feared; but if the return is payable in terms of Chinese money the foreign investor has to assume the risks of exchange. If, after a year or so, the investor wishes to withdraw his funds, he runs the chance of losing a portion thereof because of an adverse exchange rate. As between gold countries, there is, of course, a slight fluctuation in the exchange rates that every investor must take into consideration, but in normal times such fluctuations are very slight. As between a gold standard and a silver standard country, the price of silver in the London market is the basis for the position of the exchanges. Fluctuations in the price of silver are not possible of approximation, hence an element of uncertainty enters into and interferes with the investment of foreign funds in silver standard countries.

From the foregoing remarks it is evident that exchange dealings with silver standard countries necessitate far more care and attention than do transactions between gold standard countries. The price of

silver may change rapidly, as it did during and after the war, causing wide variations in the silver exchanges. China is far away; mails are slow and cables are expensive, thus making it difficult to transact business with the facility and cheapness that characterize our dealings with European nations.

The greater part of the drafts sold on China are for small amounts. Cables are seldom sold because the costs are so great. A banker in a day's time may sell ten or a dozen drafts ranging from $10 to $50, with only one or two for larger sums, so that it does not pay him to cable an advice to his Chinese correspondent concerning each of these sales. He usually does one of two things: He may sell a draft to the customer at a rate high enough to protect himself against any loss that may be occasioned by a rise in the rate caused by an increase in the price of silver during the next thirty days and before the draft is presented to his Chinese correspondent for payment. Or he may decide at the close of the day that he has sold enough of these small amounts of exchange to warrant the sending of a cable advice to the Chinese correspondent advising him if necessary to purchase enough cover (this is necessary when the draft has been drawn in Mexican currency) to meet the drafts when presented. "When the latter procedure is followed, the accounts at both ends practically balance within twelve hours. A cable sent from here in the late afternoon is delivered the next morning in China. The silver rate in China on a given morning is usually the same as the quotation in New York and London the day before. The agent and the seller have nothing to worry about for the ensuing month, as far as the particular day's dealings are concerned, because, however silver may move in the interim, both ends are protected." [1]

While it is not possible within the limits of this volume to deal with the intricacies of Chinese exchange, either foreign or domestic,[2] nevertheless it is well for the student of the exchanges to know the method followed in arriving at what is called the "parity of exchange," or in other words, the basis for telegraphic transfers between London and Shanghai and between New York and Shanghai.[3]

[1] *Annalist*, September 18, 1916.

[2] The student will find much of value in this connection in Spaulding, W. F., "Eastern Exchange, Currency and Finance," Chapters 20–24; Arnold, J., "Commercial Handbook of China," (U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Vol. 84), Vol. 2, pp. 175–194.

[3] The following discussion of New York and London silver parities is based on Arnold *op. cit.*, Vol. 2, pp. 185–188.

Bar silver is quoted in London at 980.5 fine (that is, 19.5 parts of alloy to 980.5 parts of pure silver), while in Shanghai it is quoted at 998 fine. In normal times, the charges for the shipment of a Shanghai tael between London and Shanghai fluctuate between 8/10 per cent and one per cent. These charges are approximately as follows: freight, about one-half of one per cent; insurance, one-sixth of one per cent; brokerage, one-eighth of one per cent; landing, cartage, etc., one-fourth of one per cent. Let us take nine-tenths of one per cent as the basis for our calculations. In ascertaining the value of one Shanghai tael in terms of shillings and pence, the exchange dealers use what is called a "constant," which when multiplied by the price of silver in London, gives the value of a Shanghai tael in terms of English money. The constant is derived in the following manner: If it costs nine-tenths of one per cent to ship one Shanghai tael to London, the cost of procuring and shipping 100 Shanghai taels would be 100.90 Shanghai taels. We know that in weight 111.20 Shanghai taels equal 100 Canton taels. The weight of the Canton tael is 579.84 grains troy. Bar silver in London is quoted on the basis of 222/240 fineness; in Shanghai on the basis of $239\frac{1}{2}/240$ fineness.

In working out a problem of this sort, resort is almost always had to the "chain rule." This process resolves itself into an arrangement of equations, the first of which states the problem. In the instance under discussion we want to know the figure which, when multiplied by the London price of silver, will give us the value of the Shanghai tael. The left side of the second equation must be in terms of the right side of the first equation: and so on until we have as the right side of the last equation an amount expressed in terms of the left side of the first equation. The product of the equations on the right side is then divided by the product of the equations on the left side, and the quotient is the desired result.

Working out our problem by means of the "chain rule" we have the following:

?	= 1 Shanghai tael
100 Shanghai taels plus charges	= 100.90 Shanghai taels
111.20 Shanghai taels	= 100 Canton taels weight
1 Canton tael weight	= 579.84 grains troy
222 grains standard silver	= $239\frac{1}{2}$ grains Chinese standard silver
480 grains silver	= London price for silver

$$\frac{100.90 \times 579.84 \times 239.5}{111.20 \times 222 \times 480} = 1.182, \text{ "constant"}$$

The above calculation gives us the constant that is used as the basis for computing the value of the Shanghai tael in terms of English money. With silver in London, say, at 49½d. per ounce, the "parity of silver" would be 58.50d. or 4s. 10½d (49.5 × 1.182). This "parity of silver" would be used by the Chinese bankers in figuring the rate to be charged for the Shanghai tael. The silver parity would, of course, fluctuate as the price of silver in London changed from day to day. The various factors affecting the rates of exchange, which we have already discussed, would raise or lower the actual market rate above or below this parity, depending upon the strength or weakness of the elements concerned.

During the period since the war, with the London quotation of silver based on the New York quotation, the formula has been modified somewhat by bringing in the cross-rate between London and New York and also the charges from New York to Shanghai, approximating about two per cent. If the price of silver in New York is $1.01½ per ounce, 100 ounces are worth $101.50. Taking the cross-rate between New York and London at 4.76½, the formula then appears as follows:

? d.	= one Shanghai tael
111.20 Shanghai taels	= 100 Canton taels weight
82.7815 Canton taels	= 100 troy ounces
100 troy ounces	= $103.50 (New York silver price plus 2% charges)
$4.76½ gold	= 240d.

$$\frac{103.50 \times 240 \times 100}{111.20 \times 82.7815 \times 4.765} = 56.63\text{d. or 4s. 8 5/8d.}$$

It will be noted that the New York parity is 1 7/8d. lower than the London parity obtained in our computation above, but the London computation included charges, interest, etc., from New York to London, which are heavier than those from New York to Shanghai.

If one desires to use the above New York computation for the purpose of arriving at the parity of Shanghai taels in terms of American gold dollars (with the price of silver in New York at $1.01½ per ounce), the following formula can be used:

? gold dollars	= 1 Shanghai tael
1 Shanghai tael	= 4s. 8 5/8d. or 56.63d.
240 d.	= $4.76½

$$\frac{56.63 \times 4.765}{240} = \$1.1243 \text{ gold}$$

Therefore with silver in New York at $1.01½ per ounce, the New York parity of the Shanghai tael would be $1.1243 gold.

If one wishes to obtain the value of the Shanghai tael in terms of the American dollar, without using the London parity, it can be obtained by means of the following formula:

? gold dollars = 1 Shanghai tael
111.20 Shanghai taels = 100 Canton taels weight
82.7815 Canton taels = 100 ounces troy
1 ounce troy = $1.03½ (New York price of silver plus 2% charges)

$$\frac{100 \times 100 \times 1.035}{111.20 \times 82.7815} = \$1.1243 \text{ gold}$$

These parities represent, as it were, the "par of exchange" for China in dealing with London and New York. There can be no real par of exchange between a gold standard and a silver standard country. For the purpose of buying and selling exchange on gold standard countries, the value of the silver exchange in terms of gold has to be ascertained from day to day or from hour to hour, and used as a basis for exchange calculations. As the price of silver changes the "silver parity" necessarily changes.

B. Gold Exchange Standard [1]

During the 19th century, the developing needs of commerce and industry required a more stable form of currency than was possible under either the bimetallic standard or the silver standard, and as the years passed the more progressive nations of the world one by one adopted the gold standard. In brief, this action meant providing for the free and unlimited coinage of gold, making a gold coin of some kind the standard or unit of value, giving to gold coins full legal tender qualities, and authorizing the redemption of other forms of money either directly or indirectly in gold. Several of the Oriental countries, however, were so accustomed to the use of silver and were so entirely without any internal need for gold coins, that it was neither advisable nor possible for them to abandon silver so completely as did the more advanced nations. For these Oriental countries a sort of halfway house was devised, i. e., the "gold exchange standard," and this

[1] For a more detailed discussion of the gold exchange standard and its application to various countries, cf. Kemmerer, E. W., "Modern Currency Reforms," Parts I, III, IV, V; Keynes, J. M., "Indian Currency and Finance"; Shirras, G. F., "Indian Finance and Banking"; Spalding, W. F., "Eastern Exchange, Currency and Finance," Chaps. 1–6, 11–12, 19.

standard is now in effect in India, the Philippine Islands, Siam, the Straits Settlements, and the Dutch East Indies.

Briefly, the gold exchange standard provides a gold standard in a silver using country, without the necessity of gold coins being actually in circulation. The monetary unit of a nation possessing a gold exchange standard is maintained at par by always being kept redeemable either in exchange on some gold standard country or in the more stable monetary unit of the latter. For instance, the silver rupee of India was until 1919 tied to the pound sterling of England through sales and purchases of exchange, but since that time it has been legally, though not in practice, tied to the gold sovereign. In the Philippines, the silver peso is tied to the American gold dollar by means of exchange transactions. Before the World War rupee exchange could be purchased in England and sterling exchange could be purchased in India at approximately fixed rates; Filipino pesos could be purchased in the United States and American dollars in the Philippine Islands at fixed rates. In this way in normal times the value of the monetary unit of the gold exchange standard country has been held closely to its legally fixed rate of convertibility. To assist in maintaining it at that point, reserve funds are kept both abroad and at home. As Keynes has well said, "The Gold Exchange Standard may be said to exist when gold does not circulate in a country to an appreciable extent, when the local currency is not necessarily redeemable in gold, but when the Government or Central Bank makes arrangements for the provision of foreign remittances in gold at a fixed maximum rate in terms of the local currency, the Reserve necessary to provide these remittances being kept to a considerable extent abroad." [1]

To illustrate more clearly how the exchanges may be used in the stabilization of a nation's monetary system, we may confine our discussion to India, with but a slight reference to the system adopted by the Philippine Islands. Up to 1893, India, because of her adherence to the silver standard, experienced the same disastrous effects as has China. The value of her rupee, containing 165 grains of pure silver, fluctuated with the price of silver. From 1873 to 1893, as a consequence of the fall in the price of silver, the value of the bullion content of the rupee decreased 40 per cent. The average London rate on India in 1873 was 1s. 10 3/4d. per rupee. By 1893 it had fallen below 1s. 3d. From our discussion of the Chinese situation, it can be seen that such

[1] *Op. cit.*, pp. 30–31

a serious decline in the value of the rupee would work to the disadvantage of India in her foreign relations. She annually owed the British government large sums of money for interest, pensions, taxes, etc., and she owed foreigners for goods purchased, all of which she had to pay in terms of her depreciated currency. Her foreign trade suffered because of the uncertainties of rupee exchange. Speculation in exchange was widespread. Finally in 1893, in an effort at relieving the situation somewhat, the Indian Mint was closed to the free coinage of silver, and the government agreed not to add new rupees to the country's circulation. The fundamental idea underlying the reform was to create a shortage of rupees, and thus bring about an increase in their value. The government also announced that it would exchange gold at the rate of 1s. 4d. per rupee, or 15 rupees to the pound sterling.[1] By this act, the value of the rupee was divorced from the value of its bullion content and connected semi-officially with the more stable pound sterling. In short, the rupee became a token coin, its face value or the value at which it was to be accepted in business being greater than the value of its silver content. It seemed at that time that there was no possibility of its metallic content ever being worth 1s. 4d. because the prospects were that silver would always remain at a level lower than that of 1873. Silver would have to sell for 43d. per ounce before the melting point of the rupee would be reached.

As the years passed, the rupee in the exchanges rose slowly until it reached 1s. 4d., whereupon the government in September, 1899, took steps to maintain it at that level. The government legally established the relation between the rupee and gold by decreeing that the sovereign and half-sovereign were to be legal tender in India; rupees also were to be legal tender, but not convertible into gold, although convertible into exchange on London at the rate of 1s. 4d. per rupee. A Gold Standard Reserve was provided for, to be gradually accumulated from the profits of rupee coinage. With standard silver at 24d. per ounce, the silver in the rupee would cost the government only 9.181d., and at 32d. per ounce it would cost but 12.241d. The difference between the value of the silver used by the government in coining rupees and the legal value of the rupee (in other words, seigniorage) was to be deposited in the Gold Standard Reserve Fund. The average profit which the government received from the coinage of rupees during

[1] Calculated on the basis of £1 sterling = $4.8665, this rate of conversion placed the value of the rupee at 34.44 cents.

1910–12, amounted to about 42 per cent of the face value of the coins minted. Rupees were to be coined and paid out by the government only in return for gold, or in exchange for Council Bills, i. e., exchange on Indian Treasuries, sold in London by the Secretary of State for India. As the Gold Standard Reserve has grown, a portion of the fund has been invested in securities, the interest therefrom also being added to the Reserve. On March 31, 1914, the Reserve totaled approximately £25,510,000 of which all but £4,000,000 was held in London at the Bank of England. Of the total, £17,165,000 was in the form of securities, £4,320,000 in gold, £4,000,000 in silver, and £25,000 in cash loaned out on call. In March, 1919, the Reserve had increased to about £36,000,000. The rupee *notes* issued by the government are sustained by a Paper Currency Reserve. We shall not concern ourselves with the details of Indian paper money in this brief résumé of India's monetary and exchange problems. Both of these Reserves are under the control of the Secretary of State for India, who has, since 1899 and until 1917, employed them most successfully (with few exceptions) for the purpose of maintaining the rupee at the designated par of 1s. 4d. The manner in which he has done this will be explained shortly.

Even though India suffered until 1899 from the effects of a fluctuating silver standard she did not have to undergo the disadvantages arising from the complexities of a confused and diverse currency made up of every conceivable form of money, as is the case even today with China. India's monetary system is fairly simple. The pice is a bronze coin and contains 75 grains troy. There is also a half-pice and a pie (one-third of a pice), both of which are bronze and of proportionate weight. A one anna piece of nickel (60 grains troy) is coined, as are also four and eight anna pieces of the same metal. A pice is the equivalent of ¼ anna. The silver rupee contains 160 grains of fine silver or 180 grains of silver 11/12 fine. An eighth, quarter, and half rupee are also coined. Under the gold exchange standard as it existed down to 1919, the rupee was *legally* the equivalent of 1s. 4d. (15 rupees = £1). In 1919 the legal rate of conversion was changed to 2s (10 rupees = £1). A gold mohur, of the same weight and fineness as the British pound sterling (123.27447 grains 11/12 fine), was issued in 1918 at the legal value of one mohur equals 15 rupees, but by a later edict of the government, this coin has been called in and demonetized to the newer ratio of 10 rupees, established in 1919. There is also a system

of governmental notes, supported by the Paper Currency Reserve, which need not concern us in this brief discussion of the Indian exchanges.

To stabilize Indian currency and exchange at the designated rate of 1s. 4d. per rupee, resort was had to two devices. First, it was necessary to have a gold fund somewhere, not necessarily in India itself, as a reserve or security behind the silver rupee, which might be used in case of need. It was to provide such a fund that the Gold Standard Reserve was established for the silver rupee and the Paper Currency Reserve for the Indian paper money, both of which funds were deposited for the most part with the Bank of England. Second, it was also necessary to provide some means whereby the government could dominate the sale of exchange, both in London on India and in India on London. Inasmuch as practically all Indian transactions pass through or are controlled directly or indirectly by London, it was only necessary to control the rupee on or from that point, because the rupee rate in other countries would, through the workings of the cross-sterling rate in those centers, tend very closely to approximate the rupee rate as fixed in the London market. The Indian government therefore established the practice of selling exchange in London on India ("Council Bills," payable by the Indian Treasuries at Calcutta, Madras, and Bombay) and in India (Calcutta) on London ("Reverse Council Bills") at fixed rates and in amounts sufficiently large to control the market. Thus does the system adopted by India fully satisfy the requirements laid down by Keynes for a gold exchange standard. Gold coins do not circulate to any extent in India. The local currency of the country was originally not redeemable in gold, although it was convertible into sterling exchange at the designated rate. The law was later amended and the rupee is now legally redeemable in gold, although in practice, owing to post-war conditions, convertibility is not maintained. The government provides for remittances, both in London on India and in India on London, at fixed maximum rates. Finally, the greater part of the reserve funds is kept abroad.

By making the rupee always convertible into sterling exchange at a fixed rate, the value of the rupee both at home and abroad was stabilized as thoroughly as though India herself were on the gold standard. The rupee could not rise above or fall below the fixed rate of 1s. 4d. to a greater extent than the cost of shipping gold to or from India so

long as the government was able to control the market by supplying all of the exchange demanded, either in London on India or in India on London. In both centers the government acted as a supplier but never as a buyer of exchange. There was never any need for it to become a buyer in either market because by supplying rupee exchange in London it could keep the rate in London on India from rising to too high a level (and conversely the rate in India on London from falling to too low a level) and by supplying sterling exchange in India it could keep the rate in India on London from rising to too high a level (and conversely the rate in London on India from falling to too low a level). One of the reasons why in the case of India, this system has almost without exception worked satisfactorily, is that India is a country which, as Spalding says, "would have brought joy to the hearts of the old Mercantilists—her international credits nearly always" exceeding her debits.[1] In normal years, her exports of commodities are about 50 per cent greater than her imports.[2] India, therefore, normally expects to receive payments from abroad aggregating from £40,000,000 to £50,000,000 a year. Over against this, however, are the extremely heavy payments that India has to make in England, consisting of shipping and insurance charges, interest payments on national and private debts, remittances to families residing in England, returns from Indian railways and other enterprises, pensions, allowances, etc. The Indian government always needs funds, actual money, in England. English banks, importers, and investors, on the other hand, always need funds in India. In order to transfer funds from the Treasury of India to England so as to pay the "home" charges, i. e., the debts of the government of India to the English government and to English creditors, amounting normally to about £20,000,000, the Secretary of State for India sells rupee exchange ("Council Bills"), which is to be paid in rupees from the funds of the Indian government on deposit with the Indian Treasuries at Calcutta, Madras, and Bombay. This exchange is redeemed or paid at the rate legally fixed by the Indian government. The rate of redemption as noted above, was formerly 1s. 4d. per rupee, but at present it is supposed to be 2s. per rupee. In normal times, the Secretary of State sells exchange only on India. If exports fall off and an

[1] Spalding, "Eastern Exchange, Currency and Finance," 1920 ed., p. 23.

[2] Average excess of exports for ten pre-war years, 51%; average for five war years, 52%.

adverse balance of trade develops, requiring India [1] to make greater expenditures in England, with less chance of offsetting them by English payments to parties in India or to the Indian government, it then becomes necessary for the Secretary of State for India to sell "Reverse Council Bills," i. e., exchange in India on London. These bills may be obtained by paying rupees to the exchange offices of the government of India and receiving therefor exchange on London at the fixed sterling rate, i. e., formerly 1s. 4d. per rupee; at present 2s. per rupee. This proceeding, as the reader can appreciate, is merely the reverse operation of that which occurs in the sale of Council Bills, and enables the government to transfer funds from London to India, whereas in the case of the issuance of Council Bills, the funds of the government of India are transferred to London. With Reverse Councils the government receives rupees in India for sterling exchange on London; with Council Bills, it receives sterling in London for rupee exchange on India.

A favorable balance of trade in the case of any country normally causes the value of its standard monetary unit to rise, because the surplus of drafts on other countries results in the weakening of the exchanges of those countries. An unfavorable balance creates a reverse condition.

Normally, the Secretary of State for India sells Council Bills on Bombay, Madras, or Calcutta, chiefly on the last center. When these drafts on India are presented to the government for payment, it pays out rupees. The rupees thus added to the supply already in circulation tend to keep the value of the rupee from rising. Selling Council Bills at the fixed rate, also prevents rupee exchange from rising above that figure and keeps rupee exchange in London at the designated level. On the other hand, if an unfavorable balance of trade arises, and India has to remit heavily to England, sterling exchange will normally rise as a consequence of the greater demand in India for sterling bills on London. The Indian government, however, stands ready to sell to Indian remitters all of the sterling exchange that they need and at the fixed price. It accepts rupees in payment therefor. The sale of these Reverse Councils therefore withdraws rupees from circulation and tends to raise the value of the rupee or to prevent it from falling. Because of the customary favorable balance of trade, the Secretary of State for India has seldom had to resort to the sale of Reverse Councils.

[1] Including payments by individuals, firms, and the government of India.

Selling exchange at a fixed rate makes it unnecessary for bankers and others in either country to pay more than that rate. The reserve funds may be called upon whenever necessary to enable the Secretary of State for India to support the rupee rate against an adverse condition of affairs, as was done in 1907–08 and also at times during and after the World War.

The Indian government, therefore, is the real source of the supply of exchange both in India on London and in London on India. It does not deal with the general public, however, but only with banks, bankers and exchange dealers. It is not compelled by law to sell Councils or Reverse Councils to supply the needs of trade. Its sales for governmental purposes, however, normally take care of the requirements of Indian foreign trade.

The plan followed by the Secretary of State for India in the sale of Councils or Reverse Councils may be summed up as follows: "Every Wednesday a notice is exhibited at the Bank of England, on the authority of the Secretary of State for India, inviting tenders, to be submitted on the following Wednesday, for India Council bills of exchange and telegraphic transfers drawn on the Government treasuries at Bombay, Calcutta and Madras. The notice states a limit which the aggregate amounts will not exceed, and tenders for either form of remittance must be for so many lacs of rupees—a lac being equal to 100,000 rupees.[1] Each applicant specifies the center at which he wishes the remittances to be payable. There is no obligation on the part of the Secretary of State to allot the whole amount mentioned in the notice, and, as a general rule, applications at rates lower than 1s. 3 29/32d. per rupee for the bills and 1s. 3 15/16d. for the telegraphic transfers are not accepted. The price charged for the latter form of remittance is ordinarily higher by 1/32d. per rupee than that charged for bills," [2] because approximately fourteen days' time is saved by means of such transfers. If the Bank rate in India is 9 per cent or above, telegraphic transfers are sold at 1/16d. higher than Council Bills. The allotment of the week's offering is made to the highest bidders. If the amount demanded by the purchasers exceeds the amount which the Secretary of State for India has offered for sale, the allotment is made on a pro rata basis. The Secretary also sells what are called "Intermediate Councils" or "Specials." These are

[1] 100 lacs = 1 crore.
[2] Spalding, "Eastern Exchange, Currency and Finance," p. 33.

bills or telegraphic transfers that are sold by the Secretary on days other than Wednesday, the rate never being less than 1/32d. above the price at which the Wednesday offerings have been sold. During the World War a new type of transaction, called a "Deferred Council" was introduced. The mails between London and India were so uncertain that the Secretary offered telegraphic transfers for sale that were deliverable and payable in India sixteen days after their purchase in London.

Although a gold exchange standard country does not enjoy the free and unlimited coinage of gold and is not ordinarily compelled to pay out gold in the redemption of its circulation, nevertheless its exchange does fluctuate around a par of exchange. Its exchange rates, therefore, are controlled, as is true also of a gold standard country, by the gold or specie points. Until the phenomenal rise in the price of silver broke down the gold exchange standard of India, her par of exchange was 1 rupee = 1s. 4d. To ship gold from London to India costs normally about 1/8d. per rupee. Under normal conditions the rate for Council Bills (sight drafts on India) therefore could rise no higher than 1s. 4 1/8d.; in fact, the Secretary of State for India for many years had maintained an offer of an unlimited supply of Council Bills at that rate, with telegraphic transfers at 1s. 4 5/32d.[1] If the rate on India should rise above the legally fixed par of exchange plus shipping costs, gold in normal times will leave England for India or the British bankers will procure gold from other sources (possibly gold in transit from Australia to London, or ready for shipment in Egypt) and send it to India where it will be presented to the Indian Treasuries and redeemed in rupees at the legally fixed rate. The possibility of diverting to India gold that is in transit from Australia to England involves an interesting transaction. If a banker is bringing gold to London from Australia and if the rupee rate in London rises so high as to make it worth his while to divert the gold to India, he will do so. Or he may sell the gold to another banker in London with the understanding that the gold is to be deposited in India. By this means gold is delivered in India at least fourteen days earlier than an English banker could forward it to India from London, and the importing London gold merchant gets his money in England fourteen days

[1] In January, 1900, however, the telegraphic transfer rate rose to 1s. 4 3/8d. and from December, 1906, to March, 1907, stood at 1s. 4 3/16d. because of the high bank discount rates prevailing in India.

earlier because he receives payment from the English purchaser as soon as the gold arrives in India. Before the World War, the importing merchant would probably accept 1s. 3 31/32d. in London for the gold diverted to India in this manner, which gold was formerly worth 1s. 4d. per rupee on its arrival in India. Telegraphic transfers on India, as we have seen, are usually 1/32d. higher than Council Bills. Thus before the system was changed, if the rate for Council Bills in London rose to a higher level than 1s. 3 15/16d., gold in transit from Australia could and did compete with Council Bills as a form of remittance to India. In the case of Egyptian gold ready for shipment to London, if Council Bills sold for more than 1s. 4d., there was a possibility that the gold might be more profitably forwarded to India from Egypt rather than to London. The gold exchange standard of India broke down so badly after 1917, and the control of the British government over gold shipments is still so complete, that it is impossible to state just what the gold points of the rupee are at the present time (April, 1922).

The reverse movement of gold, that is, from India to London, is not normally a possibility. India is our great "gold and silver sink." It is the greatest absorber of the precious metals that the world has ever had. Banking in India is backward and inadequate; money does not circulate rapidly; checks are almost unknown; the average family holds its own funds and acts as its own banker; social customs require much gold and silver. These matters explain India's ability to absorb gold and silver in untold amounts. Although Council Bills have been known to fall below the former gold import point of 1s. 3 29/32d. (as in 1895 when the rate of 1s. 1d. was reached), nevertheless, the Secretary of State has the means at hand for strengthening the rate if he so desires. If the rate weakens considerably, he may announce a smaller weekly offering of Council Bills. If that is not sufficient to strengthen the rate, he may withdraw entirely from the market. If neither action brings the expected result, he may, as a last resort, begin selling Reverse Councils in India on London. The government under the old scheme of things was pledged to keep the rupee at not less than 1s. 3 29/32d. and until the gold exchange standard broke down it did not hesitate to do everything within its power to keep the rate from falling below that point.

When gold is exported to India and exchanged at the Treasuries for rupees the Secretary of State's gold holdings increase in India. If

the demand for rupees becomes too great and more rupees have to be minted, the gold on deposit in India may have to be shipped to London and used to purchase silver with which to coin more rupees. This practice, however, involves a double loss: first, the cost of shipping gold from India to London, say 3/32d. per rupee; second, the loss incurred by the Secretary of State in letting gold go to India because of the higher rate, rather than to sell his bills for 1s. 4 1/8d. or 1/8d. more than par. It is not unusual, however, for the Secretary of State to allow gold to be sent to India so as to build up a larger gold reserve in that country to be used if necessary in time of need.

There were several instances before the World War when India was forced to protect the rupee rate from falling below 1s. 3 29/32d. During the panic of 1907–08, because of the lack of demand for Indian exchange, the rate showed signs of excessive weakening, falling to 1s. 3 11/16d. on November 25, 1907. The government thereupon stopped the sale of Council Bills and during the latter part of December began to sell Reserve Councils.[1] In August and September, 1909, Indian exchange again weakened and necessitated the sale of Reverse Councils. Upon the outbreak of the World War, the Indian government was again faced with the problem of maintaining its exchange rate. On August 3, 1914, it announced that it would sell Reverse Councils and telegraphic transfers on London to the extent of £1,000,000 a week. From that date until the following January, £6,807,000 were disposed of at the rate of 1s. 3 29/32d. per rupee and were very effective in steadying India's exchange.[2] Steps were also taken to prevent the depletion of the Indian government's gold holdings. Reverse Councils were again sold in 1915, 1916, 1918, 1919, and 1920, until finally on September 28, 1920, the status of the exchanges compelled the Indian government to cease all attempts to support the rate.[3]

The story of the gold exchange standard of India during and after the World War is a story of the close connection between the astounding rise and fall in the price of silver and the complete breakdown of the exchanges of a country whose standard of value for internal purposes is a silver coin. During the uncertain days of the fall of 1914,

[1] Approximately £8,058,000 of Reverse Councils were sold at that time at the rate of 1s. 3 29/32d.

[2] Telegraphic transfers were sold at first at 1s. 3 13/16d. but the rate was later raised to 1s. 3 27/32d. when the Bank of England reduced its discount rate to 5 per cent.

[3] During that period the rate had fallen from 2s. 4d. to about 1s. 4d.

the gold exchange standard of India surprised even its most ardent supporters by the manner in which it withstood the stress and strain of that period. Nothing further occurred until in the latter part of 1916, when the effects of an increased trade balance and the rise in the price of silver began to be felt through an increased demand for Council Bills. The prohibition of the export of gold by England removed one means of settling the Indian balances and intensified the seriousness of the situation. Toward the close of December, 1916, it became evident that conditions would force the rate for Council Bills to higher levels. To meet the situation, the Secretary of State raised the rate in January to 1s. 4 5/32d. for Council Bills, and to 1s. 4 1/4d. for telegraphic transfers. These rates were more or less satisfactorily maintained until August 27, 1917, when they were increased to 1s. 4 29/32d. for Council Bills and 1s. 5d. for telegraphic transfers. The continued rise in the price of silver, linked with the great balance of trade, again compelled the Indian government to revise its official rates, and on April 20, 1918, the price of Council Bills was fixed at 1s. 5 29/32d., with telegraphic transfers at 1s. 6d. At those levels the silver rupee in India was temporarily removed from the danger of the melting pot. When in May, 1919, the United States abandoned its control over the silver market, the Secretary of State for India raised the rate for Council Bills to 1s. 7 15/16d. and for telegraphic transfers to 1s. 8d. On August 12, the rates were again increased to 1s. 9 15/16d. and 1s. 10d. respectively; on September 15, to 1s. 11 15/16d. and 2s. respectively; on November 22, to 2s. 1 15/16d. and 2s. 2d. respectively; and on December 16, to 2s. 3 15/16d. and 2s. 4d. respectively. The necessity for so frequently modifying the official rates led the Secretary of State for India to appoint a commission to study the exchange and currency situation.[1] The report of the Commission rendered on February 2, 1920, made a number of recommendations, only a few of which are of interest to us in connection with the present discussion.[2] It was urged that the legal conversion rate of the rupee be changed from 1s. 4d. to 2s. and that instead of its being linked with the pound sterling (i. e., a bill of exchange) it be linked with the gold sovereign and be accepted as the equivalent of 11.3 grains of pure gold. It was felt that, inasmuch as the pound sterling was at that time

[1] Appointed May 30, 1919.

[2] The report of the Commission is excellently summarized in the *Federal Reserve Bulletin* of March, 1920, pp. 253–258.

depreciated in the world's exchanges, and would for some time remain a fluctuating quantity, it was better to link the rupee directly to a fixed weight of gold than to a variable amount of foreign exchange. It was also urged that India remove all restrictions on gold and silver shipments. The Indian government adopted practically all the recommendations of the Commission in the expectation that its difficulties would thus be satisfactorily solved. The results obtained to date have been far from encouraging. Almost immediately after the Commission had made its report, the price of silver began to decline in a most spectacular manner. The Commission had thought that silver would unquestionably remain at a fairly high level because of the Chinese demand and because of the withdrawal of the United States government from the international silver market.[1] As silver declined, the market rate for rupees eased off rapidly. The Indian government, however, continued to sell exchange on London at the rate of one rupee per 11.3 grains of pure gold or ten rupees per sovereign. On July 9, 1921, the pound sterling was worth 20 rupees in the market, a premium of 100 per cent. England was not a free gold market. A premium was being paid for gold, both in England and in India. The difference between the Indian rate of the government and the market rate finally became "so pronounced that the Government was obliged to change the rate from 10 rupees to a sovereign to 10 rupees to a pound sterling." Instead of the problem being how to keep down the price of the rupee, it now became one of how to keep it up.[2] The extensive sale of Reverse Councils had no effect. Importers who had bargained for goods on the basis of 10 rupees to the sovereign were faced with the necessity of giving 15 or 20 rupees instead.[3] A further complication arose from the fact that India's trade balance was strongly against her for some months. From February to September, 1920, the Indian government sold over £50,000,000 of Reverse Councils

[1] As a result of its purchasing only domestic silver under the terms of the Pittman Act.

[2] *Federal Reserve Bulletin*, January, 1921, p. 31.

[3] A report by the Senior Trade Commissioner in India during the latter part of 1921 contained the following significant statement:

"Enormous quantities of high-priced goods began to arrive at Indian ports and this flood of imports, coinciding with a slump in the export trade, led to a heavy adverse trade balance against India of 49 crores. Silver in London fell from 72d. to 30d. per ounce during the year and the exchange value of the rupee from 2s. 4d. on April 1st, 1920, to 1s. 2 7/8d. on March 7, 1921. Importers were faced with heavy losses on goods purchased at high prices, the shipments arriving when the markets were stagnant. In the meantime the exchange value of the rupee had fallen to a low mark. An additional menace was the lower prices ruling in the producing centres, importers having to consider the probability of being undersold by more recent purchases."

with no appreciable affect upon the exchange market. During that period the rupee rate fell from 2s. 4d. to 1s. 4d. All efforts of the government to maintain the rupee at its legal ratio of 2s. have failed thus far and it now seems as though matters were to be allowed to take their natural course, unhindered by governmental intervention.

"The rupee cannot, however, be expected to rise to and remain at its par value in exchange transactions until it becomes freely convertible into gold in India, and in turn convertibility can hardly be expected so long as gold commands a substantial premium in the market. It appears, therefore, that the new ratio of 10 rupees to 1 sovereign will remain purely theoretical so long as the market price of gold will exceed by a considerable margin the statutory ratio of 1 rupee for 11.3 grains of gold, or 10 rupees per sovereign, while the minimum below which the price of the rupee cannot fall is the value of its silver content. So that, in effect, the value of the rupee at the present time is more closely connected with the price of silver than with the rupee's statutory gold value." [1]

If, with the return of normal trade conditions, the rupee does not rise to its statutory rate, the Indian government will undoubtedly appoint another commission to investigate and recommend changes in the gold exchange standard and in the monetary system of the country.

The gold exchange standard also legally exists in the Straits Settlements, the Dutch East Indies, Siam, and the Philippine Islands. It is not necessary for us to present the details of each of the systems as applied in these countries; suffice it to say that the fundamental principles are the same as those that characterize the gold exchange standard of India. A few words about the scheme as applied to the Philippine Islands might not be amiss because of our relations with that dependency.

The reserve fund of the Philippine Islands is kept in New York and Manila. Drafts and telegraphic transfers are sold in Manila on New York and in New York on the Philippines, in sums of not less than 10,000 pesos or $5,000 (U. S. money). A premium of 3/4 of 1 per cent is normally charged for sight drafts and 1 1/8 per cent for telegraphic transfers. The peso is thus tied to the American dollar and its stability at the statutory level is maintained in the same general manner as has normally been true for the rupee. During and after the War, trade

[1] *Federal Reserve Bulletin*, January, 1921, p. 32.

conditions and the rise in the price of silver greatly upset the established order. The silver content of the peso rose in value to such an extent that pesos were being melted or exported from the country. The government vigorously enforced a law against exportation. In 1919 the premium on telegraphic transfers was raised to 3 per cent. Finally in March, 1921, the sale of exchange was temporarily abandoned because the reserve fund had fallen to such a low amount with no possibility of its being replenished.[1] For some time prior to that date, the government had been selling certificates of indebtedness to keep the fund intact, but, realizing that it could not carry the burden indefinitely, it temporarily abandoned the sale of exchange. On April 20, 1921, sales of dollar exchange were again resumed. During the first few days a premium of 10 per cent was charged, but as time passed it has been gradually reduced.

Other gold exchange standard countries suffered in the same manner and from the same causes as India and the Philippine Islands. The last eight years (1914–1922) have been a most trying period for all exchanges and exchange systems.

C. Paper Standard

The exchanges of gold standard, silver standard, and gold exchange standard countries are tied to some coin or fixed weight of precious metal, either gold or silver, in terms of which they are readily convertible. But an entirely different situation is presented in the case of those countries that are on an inconvertible [2] paper money basis. Their standard monetary unit is not linked to a gold or silver coin or to a weight of precious metal. Their inconvertible paper money is money solely because the people are willing to accept it as such either at par or at a variable discount, usually the latter. It is secured only by the good will of the government and occasionally by the government's promise to redeem it in specie at some indefinite future date. Its fluctuations have no fixed limits and know no specie points, nor do they follow the general rules that have been discussed in connection with the other exchanges. The causes of the variations in the value of irredeemable paper money or in the rates of exchange on a country having such a monetary standard are at times difficult to discover; in

[1] On March 12, 1921, only $1,500,000 in gold remained in the New York Reserve Fund.
[2] Paper money not redeemable in specie on demand.

fact, they present the most perplexing and confusing problem in the realm of exchanges.

The story of France and her *assignats* and *mandats*, and of our own bitter experience with inconvertible paper money during the Colonial and Revolutionary days and also during the Civil War period, is too well known to merit rehearsal here.[1] The events of the past, however, have amply demonstrated that a small amount of inconvertible paper money may be issued and continue to circulate at par, but that as soon as an over-issue takes place, and the people lose faith in the ability of their government to maintain the parity of such money, it falls to a discount, the extent of its depreciation being gauged by the premium demanded for gold. If it falls to a 25 per cent discount, gold commands a 25 per cent premium. For example, at one time during our Civil War, the inconvertible greenback currency dropped to a 10 per cent discount.[2] To obtain $100 in gold, therefore, one had to pay $110 in greenbacks.

The experience of every country on a depreciated paper money basis has demonstrated the truth of Gresham's law which holds that "cheap or overvalued money tends to drive out dear or undervalued money in case of an over-issue (redundancy) of the former." A depreciated paper money drives the more valuable gold and silver coins into hiding or out of the country. But if paper money becomes too greatly depreciated, the public may refuse to accept it and may demand gold or silver, or they may have recourse to the more stable and valuable money of another country. "There is an axiom among economists which has never been definitely explained, that once gold is free and allowed to seek its best market, the result will be that paper currency will gradually go into hiding." [3] In England, for example, in 1813, about 500 banks were given note issuing power and a flood of paper money resulted. When specie payments were again resumed, gold went to a premium (11os.) and gradually drove paper out of circulation. The premium on gold disappeared and monetary conditions returned to normal. Instances of the use of the money of another country in place of depreciated paper currency are numerous.

[1] Cf. White, A. D., "Fiat Money Inflation in France," New York, 1896; White, H., "Money and Banking," Part II, Book I, Chapters 1–6, New York, 1914; Mitchell, W. C., "A History of the Greenbacks," Chicago, 1903.

[2] The lowest level reached by greenbacks was on July 11, 1864, when they were worth $0.3509 on the dollar. Gold on that day commanded a premium of 285.

[3] *Commercial and Financial Chronicle*, December 13, 1919, pp. 2216–17.

Since the Armistice, many travelers and writers have called attention to the fact that the American dollar is in great demand as money in certain of the European countries which are at present suffering from a depreciated and worthless paper money. Typical of the statements found especially in the foreign press is the following notice appearing in the "*Weekly Review of Foreign Exchanges*" of January 5, 1922, issued by Samuel Montagu and Company of London: "The 'Isvestia' (Russia) announces that henceforth foreign advertisers must pay one dollar a line in American currency. This is not the first time that Bolshevik financiers have tried to introduce the dollar as the basis of foreign transactions. But they even go farther. The People's Commissars have had now for some time before them a scheme for permitting business deals inside Russia to be transacted in dollars. The argument in favor of this plan is that the paper rouble is hopelessly depreciated, and that one cannot foresee when the price relative to foreign valuations will become stabilized."

In a country suffering from a depreciated paper currency, prices follow in a general way the rise or fall in the discount on such currency. As the discount rises, i. e., as the degree of depreciation becomes greater, prices in terms of the depreciated paper money rise because the paper money has cheapened, but the increase in the price level is not in exact proportion to the extent of the discount on the paper money. On the other hand, if prices are measured in terms of gold instead of in terms of depreciated paper money, no increase or possibly only a slight increase in the price level may be noted.

Not only do domestic business and commerce suffer from the uncertainties of the situation, but foreign trade is also affected. Importers never know to what extent their home currency will have depreciated by the time they must pay for goods that have been purchased abroad. Every decrease in the value of the paper money is reflected in the exchanges, and calls for the expenditure of more home money in buying the needed exchange for remittance to the foreign exporter. Suppose that an Argentine importer has ordered some shoes from an exporting firm in the United States when the Argentine peso is at par, i. e., 100 per cent of its legally fixed value. The American firm draws a draft in dollars payable in Argentine pesos at the bank's selling rate on New York. When the draft falls due and has to be paid, say that the peso has depreciated 5 per cent. If the price for drafts on New York has at the same time increased 5 per cent,—which

in all probability would be the case,—the importer will have to give his banker 5 per cent more pesos than par to pay the draft. The importer, if possible, will pass the added cost on to the public in the form of higher prices for his goods. Argentine exporters will be similarly handicapped in their trading because they will be unable to calculate with any degree of certainty the amount that they will receive for their goods. If, for example, the peso falls in value, the exporter will receive more pesos for his draft drawn in foreign currency than if the peso rises. If the peso rises in value, it will be worth more in terms of the foreign money, and the exporter will get fewer pesos for his foreign draft. The greater the extent of the depreciation of the peso, the greater will be the peso returns of the exporter, and vice versa.

It has long been urged that over a short period of time the exporters of a paper standard country are benefited by a depreciated currency and the resulting high exchange rates, i. e., the rates at which *they can sell* their bills of exchange, while the importers are injured by such depreciation. If the exporter feels that the exchanges are likely to remain depreciated for some time, he may even reduce his prices to foreign customers for the purpose of meeting competition. He may calculate that he is able to do this because depreciated exchanges result in his getting more pesos for his goods than when the peso is at par. But his ability to compete in the market through the lowered prices made possible by the depreciated exchanges may be but temporary, because prices at home will rise soon after the paper money goes to a discount. Wages and other costs of production likewise increase, but not so rapidly as the paper money depreciates in value.

Within a short time, therefore, the exporter may find himself in approximately the same position as before the change occurred in the value of the currency and the exchanges. If perchance he is manufacturing his product out of materials imported from abroad, he will have to meet the increased costs of his materials brought about by his having to pay more for them owing to the depreciated exchange of his own country.

Under a régime of depreciated paper money, practically every international transaction becomes a matter of pure speculation. Daily fluctuations in the exchanges wipe out normal profits or compel the seller for safety's sake to charge such high prices for his goods as to handicap him greatly in building up his foreign trade.

Several of the South American countries have fully appreciated the defects of an inconvertible paper money standard, both in domestic

and foreign transactions, and have devised a method of stabilization that is unique in many respects. It embodies what might be called a double monetary standard. The basis of this peculiar monetary system is a gold coin, although gold coins are not in general circulation in those countries. The everyday medium of exchange is inconvertible paper currency, held more or less stable by being redeemable in gold through the instrumentality of a "Conversion Fund." Argentina has been most successful in putting this plan into effect, Brazil less so, and Chile least of all.

Argentina. Argentina [1] is legally on a gold basis, her monetary unit being the gold peso of 1.6129 grams of gold 9/10 fine. The gold peso is not in circulation. Her circulating medium is the paper peso which is of unlimited legal tender and which has a fixed ratio of 44 per cent to the gold peso, i. e., 2.27 paper pesos are the legal equivalent of 1 gold peso. [2] To maintain the convertibility of the paper peso, the government in 1899 established a Conversion Fund from certain sources and deposited it with the Banco de la Nacion, which acts as the conversion agency. The story of Argentina's experience with an inconvertible paper currency is interesting as indicative of how a country suffers through a fluctuating standard of value. In 1826 "a gold peso was worth 1.88 in paper; the next year the ratio was 3.53, and continued to increase uninterruptedly until 1840 when it was 23.33; a slight decline in the ratio was followed by a renewed rise and in 1864 the ratio was 28.84. For the period from 1868 to 1875 a fixed rate of 25 was maintained, but even at this high rate conversion could not be maintained and was suspended, with the result that the ratio still rose higher, reaching 32.2 in 1879. In 1881 a new monetary law was promulgated, establishing as a basis a peso containing 24.9 grains of gold or 383.8 grains of silver, both metals being 0.9 fine. Paper money was to be redeemed at par. The Government, however, was not able to maintain conversion and in 1885 paper money began to depreciate again, the ratio increasing to 3.87 by 1891. The year 1890 was one of economic disaster in Argentina, with an acute financial crisis and many failures." [3]

Argentina, however, presented a case different in many points from

[1] Cf. Williams, John H., "Argentine International Trade under Inconvertible Paper Money," 1880–1900, Cambridge, Mass., 1920; *Federal Reserve Bulletin*, June, 1920, pp. 592–7, March, 1922, pp. 314–316.

[2] A gold peso is divided into 100 centavos.

[3] *Federal Reserve Bulletin*, June, 1920, p. 593.

that of a country operating on a real paper basis. To the date of the establishment of her Conversion Fund in 1899, her exchanges were carried on upon a gold basis. There was no "paper exchange" as such. Paper money was paid for gold, and gold in turn for exchange on foreign centers. Gold moved freely into and out of the country as exchange rates fluctuated above or below the so-called "specie points." If exchange was too high, gold was exported; if too low, it was imported. Foreign business was conducted on a gold basis; domestic business on an inconvertible paper money basis. Gold was constantly at a premium in terms of paper money.

In 1899 the present system was introduced. It functioned most successfully until 1914, when the government suspended gold payments at the conversion office. This decree is still in effect, although there has been an insistent demand that they be resumed. The government maintains, however, that, inasmuch as practically all the European countries with which Argentina trades are on a depreciated paper basis, if she should begin paying out gold it would go to the United States to settle her unfavorable balance of trade, so that there would be no possibility of Argentina procuring gold in Europe to replenish her funds. This depletion of her supply might tend further to depress the exchange rate and seriously interfere with the stabilization of her currency. In December, 1921, Argentina held over 480,600,000 pesos of gold in her Conversion Fund, against which 1,362,564,000 paper pesos had been issued.[1]

From 1914 to December, 1917, dollar exchange in Buenos Aires was maintained practically at par only by reason of our heavy shipments of gold.[2] We were buying large quantities of goods from Argentina and not selling sufficient to offset her claims against us. When in the fall of 1917 we declared an embargo on gold shipments, the dollar went below par and remained at a discount of about 5 per cent until 1919 when we resumed gold exports. In 1920 the peso rate in New York declined and by December of that year it had fallen to about a 20 per cent discount. During 1921 it sank even lower, and closed at

[1] In December, 1914, Argentina had 224,000,000 pesos in gold in the Conversion Fund, supporting 823,000,000 paper pesos.

[2] In United States, exchange on Argentina is quoted in several ways, viz.: on the basis of the value of 100 pesos, or 1 gold peso, or 100 paper pesos, or 1 paper peso. The first and the last methods are more frequently followed. Thus, par is $96.48 per 100 gold pesos, or $0.4245 per paper peso. Dollar exchange in Argentina is quoted at how many gold pesos is one dollar or $100 worth. Thus par is $1.00 = 1.0365 gold pesos, or $100 = 103.65 gold pesos.

$74.8042 per 100 gold pesos (about $0.33 per paper peso). The reasons for this depreciation were her unfavorable balance of trade with us, her prohibition of gold exports, and her necessity of remitting large sums abroad for payment of interest on public debt and on private investments.

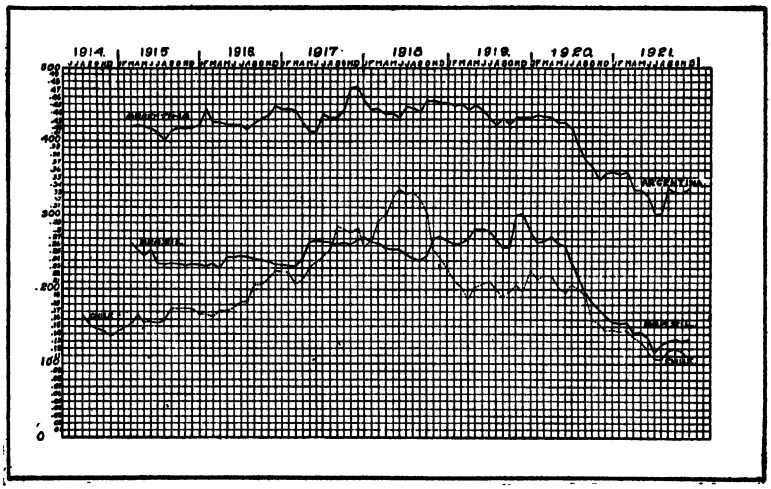


CHART IX

High monthly rate for sight drafts on Argentina, Brazil and Chile in New York, 1914–1921

Brazil. Brazil has also adopted the same plan for stabilizing her paper currency and her exchanges, but not quite so successfully as has Argentina.[1] Brazil's standard monetary unit is the gold milreis of 0.82207 grams of fine gold.[2] Gold coins of 5, 10, and 20 milreis are in circulation, but the gold milreis is not. The principal medium of exchange is the irredeemable paper milreis issued by the government.[3] In 1906 Brazil obtained a loan from the British government and established a Conversion Office, the plan being to use the funds of this office in gradually retiring the inconvertible notes and issuing convertible paper in their stead. The government also has a guar-

[1] Cf. *Federal Reserve Bulletin*, August, 1920, pp. 813–24.

[2] In the money of the United States its par value is $0.5462.

[3] A milreis is the equivalent of 1,000 reis. A thousand milreis is called a "conto." Brazil has a unique method of separating the reis from the milreis by what is called a "cifras," or, "$"; while thousands of milreis are separated from the hundreds by a colon (:). Thus, six thousand five hundred milreis and 450 reis would be written as: Rs. 6:500$450.

anty fund of gold used solely as security behind the outstanding convertible and inconvertible paper money.[1] The rate of conversion was first placed at 1 milreis to 15 pence in gold,[2] but in 1920 it was changed to 1 milreis to 16 pence in gold. Before the World War, whenever the exchange value of the paper milreis fell below 16 pence, "the holders of convertible notes would find it profitable to exchange them at the conversion office for the guaranteed amount of gold. The gold thus removed from the conversion office would be used for international payments, and this would tend to raise the exchange rate. On the other hand, when the value of the paper milreis rose above 16 pence, it would become more valuable than gold, and the public would take gold to the conversion office to exchange it for notes. This withdrawal of gold from circulation would in turn have a tendency to lower exchange rates. In this manner the conversion office exercised a steadying influence on the exchange value of Brazilian currency." [3] When the World War was declared, exchange fell steadily, and the run on the Conversion Fund became so serious that the government closed the office and suspended its operations. The office has remained closed to date (April, 1922). From 1914 to 1918 the Treasury paid out inconvertible notes for convertible paper and released a portion of the gold held in the Conversion Fund. This gold was used for export purposes and for stabilizing the exchanges; a portion being also transferred to the guaranty fund as security for the inconvertible notes. The failure of the government to replace its inconvertible paper money with convertible notes is clearly shown by the table [4] on page 473. In 1918 and 1919 there was only 1,600,000 milreis in gold behind 21,000,000 milreis of outstanding convertible paper money.

Exchange between New York and Brazil is quoted on the basis of the value of the paper milreis in terms of the American dollar. Par is $0.5462 per gold milreis, but there is no par for the paper milreis, although it is customarily placed at about $0.3244. Brazil quotes milreis to the dollar. In the exchanges the paper milreis varies considerably. In 1918 its value was estimated by the Director of the

[1] In 1919 the gold holdings of the government in the guaranty fund amounted to about 48,000,000 milreis, or approximately 3 per cent of the paper money in circulation.

[2] Before the World War Brazil depended to a large degree upon English currency as a standard of exchange.

[3] *Federal Reserve Bulletin*, August, 1920, p. 814.

[4] *Ibid.* p. 815.

TABLE XX

NOTE CIRCULATION OF BRAZIL

(In 1,000 paper milreis)

December 31—	*Convertible*	*Inconvertible*	*Total*
1911	378,843	612,519	991,002
1912	406,036	607,025	1,013,061
1913	295,347	601,488	896,835
1914	157,787	822,496	980,283
1915	94,560	982,090	1,076,650
1916	94,560	1,122,560	1,217,120
1917	94,560	1,389,415	1,483,975
1918	20,912	1,679,176	1,700,088
1919	20,912	1,729,002	1,749,974

United States Mint at about $0.27; in October, 1920, at $0.1775. At the close of 1921, sight drafts on Brazil were selling at $0.12 3/4 per paper milreis. Brazilian exchange has been at a discount for many years past, owing to the country's system of inconvertible paper money. Even the favorable balance of trade which she had during the years of the World War was not sufficient to bring her exchange to par, and when her balance became unfavorable, the milreis sank to still lower levels. Exporters to Brazil usually draw in dollars or in sterling so as to avoid the uncertainties of exchange fluctuations.

Chile. Chile [1] presents the peculiar instance of a country which could retire all of its inconvertible paper money and place itself permanently on a gold basis if it so desired; but the agricultural and mining interests demand the retention of depreciated currency and depreciated exchanges, and so the date of final redemption has again and again been postponed. These interests are vitally concerned with the exportation of goods. Goods are sold abroad for gold, and the gold thus obtained is converted at a profit into the depreciated paper money with which to meet domestic expenses.

The standard monetary unit of Chile is the gold peso of 0.54918 grams of pure gold, with a par value of $0.365 in terms of our money. Practically all of Chile's circulation is composed of inconvertible paper pesos, which have no par in American dollars, but which are usually quoted as being worth from $0.18 to $0.22. Approximately 226,000,000 paper pesos were in circulation in March, 1920. A Conversion

[1] Cf. *Federal Reserve Bulletin*, October, 1920, 1052–1061, May 1921, pp. 572–8.

Fund of gold was established by the law of 1909 [1] and on October 31, 1919, it contained a sufficient amount of gold to retire all the paper money outstanding and to leave the government a surplus of about 19,000,000 pesos. As stated above, it is the opposition of the mining and agricultural interests that has thus far prevented redemption taking place.[2] Because of the irredeemable character of the paper money, it is subject to fluctuations of from two to three per cent a day or from five to fifteen per cent a month. "These fluctuations in value give rise to extensive speculation, which in turn tends to aggravate still further the exchange situation." [3] It is not uncommon for a business man to deposit money with his bank in terms of dollars or sterling, and to issue checks against his account in terms of dollars or sterling respectively, so that the Chileans have in circulation not only their own inconvertible paper money and checks drawn in its terms, but also checks drawn in terms of dollars and pounds sterling.

Similar extensive fluctuations characterize the exchanges. The highest quotation for the month of August, 1914, was $0.1667 per peso. It rose rapidly and reached $0.3351 in June, 1918, but gradually declined, closing in 1921 at $0.1063.

European Nations since 1914. With the outbreak of the World War in August, 1914, economists and financiers waited expectantly to see whether or not the battling nations would show that they had learned from past experiences as to the disastrous results following a resort to the printing press as a means of meeting unusual expenditures. Hardly had the call to arms been sounded when even England, which of all nations had stood for decades as the advocate of sound financial and monetary ideals, joined the rest of the belligerents in the mad rush to issue paper money. Some of the nations were frank enough to admit that their paper money was inconvertible; others declared it to be legally convertible into gold but refused to make it such in practice. In fact, regardless of what the letter of the law may or may not have required relative to the maintenance of the gold standard, not one of the European belligerents attempted to retain the convertibility of its paper money; in time the neutral nations were forced

[1] From 1901 to 1914 this fund was held mostly in England and Germany; in 1914, 74,000,000 pesos in England and 30,000 pesos in Germany; in 1919, 66,667,000 pesos in the Chilean Treasury, 45,788,000 pesos in England, and 10,000 pesos in the United States.

[2] The last date set for actual redemption was December 31, 1921, but so far as I have been able to ascertain it has not occurred.

[3] *Federal Reserve Bulletin*, May, 1921, p. 575.

TABLE XXI

CURRENCY NOTES AND GOLD RESERVE IN 36 PRINCIPAL COUNTRIES OF THE WORLD IN 1914, 1918, 1919, AND 1921

(In Millions of Dollars U. S. Currency)

	1914		1918		1919		1921	
	Gold	*Notes*	*Gold*	*Notes*	*Gold*	*Notes*	*Gold*	*Notes*
Argentina	$235	$428	$379	$494	$394	$513	$453	$578
Australia	29	48	85	255	86	260	*a* 112	*a* 277
Austria } Hungary } *b*	254	464	53	7,206	52	10,099	1 1	19,100 4,500
Belgium	53	180	....	.....	51	909	52	1,180
Brazil *c*	125	175	38	560	44	582	24	*a* 554
Bulgaria	27	32	12	342	9	476	7	615
Canada	155	210	201	468	203	534	190	447
Chile	*i*	*i*	18	42	37	75	42	60
Colombia	*i*	*i*	9	.....	5	10	25	16
Czecho-Slovakia	.....	.....	.....	.....	*i*	*a*2,090	280	2,260
Denmark	20	42	51	115	52	130	61	129
Ecuador	5	2	4	6	5	10	*e* 5	*e* 10
Egypt	8	13	16	198	17	301	16	150
Finland	7	24	8	213	8	205	8	272
France *f*	806	1,301	665	5,951	710	7,286	690	7,160
Germany *g*	298	692	621	4,127	266	7,561	260	24,300
Greece *c*	47	39	277	221	347	266	268	362
Italy *h*	167	521	156	2,721	157	3,628	161	4,110
Japan	106	159	330	401	389	532	540	511
Jugo-Slavia	.....	.....	.....	.....	.....	.....	15	880
Netherlands	66	126	282	439	256	420	241	408
Mexico	*i*	335	56	*i*	63	*i*	87	*i*
New Zealand	30	10	40	30	39	36	40	39
Norway	14	33	33	110	40	115	39	101
Peru	20	*i*	28	34	32	25	*a* 30	*a* 34
Poland	.....	.....	.....	.....	2	1,620	5	36,414
Portugal	6	83	9	265	10	400	9	667
Roumania	43	147	*d* 34	457	35	721	81	2,384
Russia *j*	777	795	628	8,936	*i*	8,936	*i*	8,936
Spain	106	378	434	627	471	749	487	837
Sweden	28	60	75	211	81	194	75	166
Switzerland	35	52	74	185	92	183	104	180
U. Kingdom	195	140	521	2,049	594	2,132	764	2,115
U. States	1,023	1,056	2,199	3,643	2,107	4,051	2,944	3,637
Uruguay	15	8	42	44	51	55	57	56
Total of 36 countries named	4,682	7,553	7,380	40,350	6,759	55,104	8,184	123,445
Ratio of gold to notes		63.3		18.4		14.7		6.7

a 1920; *b* Figures of Austro-Hungarian Bank prior to 1920; figures for 1921 represent the Austrian Bank and the Hungarian Bank respectively, organized in 1920; *c* Includes holdings abroad not separately stated; *d* Exclusive of gold holdings abroad; *e* 1919; *f* 1914 includes gold held abroad; in subsequent years exclusive of gold held abroad; *g* Includes Darlehnskassenschein notes; *h* Includes bank and state issues; *i* No data; *j* No official data on Russian currency subsequent to October 1917. Bolshevik currency is stated in Associated Press dispatches from Moscow on October 30, 1921, at 5,750,000,000,000 rubles.

into the same position. Gold disappeared from circulation. Paper in ever increasing amounts flooded the market places. The above table (Table XXI) prepared by Mr. O. P. Austin, Statistician of the National City Bank of New York, contains an excellent summary showing the extent of the expanding note issue of the principal countries of the world from 1914 to 1920.[1]

Mr. Austin has also compiled the following data (Table XXII) showing so far as ascertainable, the annual expansion of the total paper issues of the world, reduced to United States currency at the pre-war par of exchange.

TABLE XXII

WORLD PAPER CURRENCY, 1914–1920

Reduced to United States Currency at Pre-war Par

1914	$ 7,527,000,000
1915	8,562,000,000
1916	19,608,000,000
1917	32,747,000,000
1918	43,091,000,000
1919	54,782,000,000
1920	81,596,000,000

Gold reserves dwindled rapidly in proportion to the expanding note issues. To cite but a few examples: The gold reserves behind note issues of the following countries at the close of December, 1913, and at the close of June, 1921, were respectively: England, 118 per cent and 37 per cent; France, 73 per cent and 10 per cent; Italy, 58 per cent and 6 per cent; Germany, 56 per cent and 1.3 per cent.

During the past year (1921) practically no progress has been made toward retiring any of this enormous amount of inflated currency, and in the case of some countries, notably Russia, Germany, Poland, Hungary, Roumania, Jugo-Slavia, and Austria, the amounts have been greatly increased.[2]

[1] The *Americas*, November, 1920, p. 15.

[2] Decrease in Note Circulation of Various Countries between December, 1920, and September, 1921:

Denmark	13.6%	Bank Notes			
Norway	13.6%	"	"		
Sweden	11.6%	"	"		
Italy	8.1%	"	"		
Netherlands	6.6%	"	"	18.4%	State Notes
United Kingdom	6.2%	Bank of England Notes;		14.7%	State Notes

The immediate effects of such inflation were as anticipated. Domestic prices soared to record levels as a result of currency inflation (Chart X), and the exchanges quickly fell to a discount (Chart XI)[1] and would have gone lower in the case of the allied countries had not successful efforts been made at stabilization. England artificially

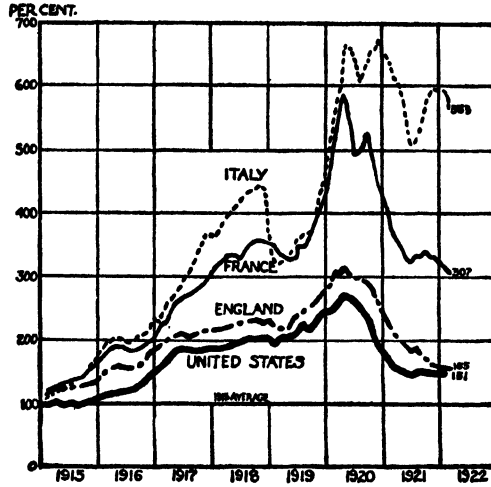


CHART X

Wholesale commodity prices in the United States, England, France, and Italy (average prices in 1913 = 100 per cent). From *Monthly Review of Credit and Business Conditions in the Second Federal Reserve District*, April 1, 1922, p. 6.

pegged her rate at about 4.76 until March, 1919. The franc and lira were more or less closely tied to it, although not closely enough as to avoid certain adverse fluctuations. A premium on gold, however, did not appear, for reasons stated above [2] until opportunities for

Bulgaria	*5.7%	Bank Notes	†9.0% State Notes
Switzerland	5.2%	"	"
France	2.0%	"	"
Spain	1.8%	"	"
Belgium	.8%	"	"

* Between Dec., 1920, and June, 1921.
† Between Dec., 1920, and March, 1921.
From the *Index* monthly circular issued by the New York Trust Company, January, 1922, p. 4.

[1] Cf. p. 483.
[2] Cf. p. 381.

public trading were afforded. Immediately following the date of the "unpegging" of sterling and the removal of artificial restraints, sterling tumbled headlong and went to its lowest record level on February 4, 1920, at 3.18 for bankers' sight drafts.[1] Francs followed, but did not reach their record low until November 11, 1920, at 0.05705.[2] Lire reached their lowest on December 28, 1920, at 0.0331.[3] The mark likewise declined, but far more rapidly, and reached the lowest quotation to date (April, 1922) on March 27, 1922, at 0.0028 5/8.[4]

With the unparalleled depreciation in exchange rates, a discussion was inevitable among economists as to the causes of such declines and also as to the advantages, if any, to be derived in foreign trade by a country whose exchange was at a pronounced discount in the world markets. The most widely accepted explanation of the unprecedented decline from the pre-war mint parities has been a revised or extended statement of the theory advanced in 1861 by Viscount Goschen. In his volume on "The Theory of the Foreign Exchanges," he states that "The bills on a given country fluctuate in value in proportion to the extent to which the prices of all purchasable articles—bullion included—are affected by the depreciation of the currency; in other words, in proportion to the discount of the paper money, or the premium on gold."[5] The extent of the depreciation of the money of a country, i. e., its purchasing power, is shown most clearly by the price index numbers of that country. If prices double, the purchasing power of money is halved. To state the problem concretely, suppose to begin with, that we have two countries, the United States and Germany, in which, in normal times, through the workings of the exchanges, the purchasing power of money is approximately the same. The exchange rates will remain practically at par, fluctuating normally between the gold points. But say that one of these countries, Germany, under the stress of war conditions, issues a large amount of inconvertible paper money and as a result thereof prices increase to twice their former level. Gold goes to a premium. What of the exchange rates? The value of the money of Germany has been halved. Will it command as much of the money of the United States as formerly? According to the theory of Goschen and others, the German

[1] Par $4.8665.
[2] Par $.19295.
[3] Par $.19295.
[4] Par $0.23821.
[5] Tenth ed., London, 1879, pp. 69–70.

exchanges will depreciate to an extent equal, or about equal, to the premium on gold or to what is the same thing, namely the discount on the paper money as shown by the higher price level. This theory merely restates what is known as "Lord King's Law of Currency," which is to the effect that "If a metallic and an inconvertible paper money are circulating together, and the market price of bullion exceeds the Mint price, while the foreign exchanges have fallen below the specie point (i. e., the point at which it becomes profitable to export specie), the paper currency is depreciated, and the difference between the market and the Mint price of bullion is the measure of that depreciation." Applying the above theory to the position of sterling exchange in the United States—which can be done more easily than in the case of other countries because we have the data as to the gold premium readily available—it may be said that as soon as England opened her market to gold trading and a premium on gold appeared, the extent of that premium roughly, but not exactly, measured the degree of depreciation of sterling in terms of dollars. Thus, for example, on December 30, 1920, the price of pure gold per ounce in the London market was £5 16s. 4d. The problem is to find the rate at which sterling exchange in New York should have stood on that day if the price for pure gold is normally £4 5s. and the par of exchange is $4.8665. The normal price of gold was 73 per cent of the price of gold on December 30, 1920. Seventy-three per cent of the par of exchange (4.8665) equals $3.5525, at which level sterling should have been on that day, considering the market price of gold in London. It stood, however, at $3.54, showing that the premium on gold roughly, but not exactly, determines the extent of the depreciation of a country's exchange in the world markets. The reason why it was not possible to gauge the discount of English exchange in this manner before 1919 is because trading in gold was prohibited and all exports of that metal were completely controlled by the English government.

Essentially, all transactions in foreign exchange involve a transfer of purchasing power. If we sell goods to England, we expect to receive in return certain funds which we can employ in purchasing goods, services, etc. If exchange on England declines 10 per cent, our drafts will sell for 10 per cent less than they would if sterling were at par. To offset the decline, we will have to charge 10 per cent more for our goods, which raises our prices for exports and makes our country a dear place

in which to buy. Even though the English exchange may be greatly depreciated, it may be necessary for England to continue buying from us at our high price level because war conditions interfere with her ability to purchase in other markets, or because she can get the desired goods only from us. But if she is free to buy elsewhere, or to manufacture at home, she will do so. During the World War she had to buy from us. As a consequence her imports from the United States were in record amounts. As soon as the war was over, however, she sought other markets, or developed her own manufactures. Her imports from us decreased at an astonishing rate, while her exports to all countries greatly increased. We were too dear a market in which to buy, because she had to pay in her depreciated exchange or in gold which commanded a premium and which could not be exported except under government license.

Gold exports from all of the European countries were (and in some instances still are) prohibited. Importers who had purchased goods from foreign countries could not export gold, and even if they had been permitted to do so, the extra premium demanded for the precious metal would have made it too costly. They did not want to pay in their own depreciated exchanges, so they began exporting goods in large quantities; thus building up their credits in foreign countries, against which they could draw exchange to pay their foreign obligations. From the standpoint of importers, foreign countries with a depreciated currency and exchange were good places in which to buy, because the internal price level of those countries had not risen so rapidly as their exchange rate had fallen. Soon, however, the importing countries began to fear the disastrous competition of the "cheap foreign-made goods," and erected tariff walls of sufficient height for the protection of their industries.[1] Also, strange to say, the governments of the exporting countries became alarmed at the

[1] The following note from the *Index* of January, 1922, aptly depicts the tariff situation: "That the United States is only one of many countries that have considered or are putting into effect increased tariffs is shown by an examination of the reports of tariff changes the world over, published regularly in the official Journal of the Board of Trade of Great Britain.

"In France last year there was a general revision of the tariff which advanced nearly all the coefficients by which the specific rates of 1913 are multiplied. This system of coefficients is common in France. Each city, for example, has its standard prices of building materials. As costs of production increase these standard prices are multiplied by coefficients. In the case of tariffs, the new coefficients by which the 1913 rates are multiplied vary from 3 to 10. Belgium, likewise, employs this system of increasing tariffs, and the government announces that it is about to make a thorough revision of rates of duty.

"Italy put into effect new and higher general customs tariffs last summer, the increases

stream of goods flowing aboard. A shortage of commodities for home consumption was threatened, which, linked with an inflated currency, was causing internal prices to rise to still higher levels. Hence, exportation was curtailed in various ways by licenses, by apportionment or rationing of the volume of exports, by embargoes on the exportation of certain goods, and by export taxes. Instead of improving the situation so far as the exchanges were concerned, the effect was just the reverse of what was desired. With restrictions of one sort or another placed on the exports of both goods and gold, there was no other means available for strengthening the exchanges, and the extent of the depreciation increased accordingly.

The effect of such a condition on the foreign trade of the United States was adequately stated in the *Federal Reserve Bulletin* of September, 1920: [1]

"Those countries whose currency is depreciated in terms of that of others presumably find it more costly to buy goods in countries where rates are high, while on the other hand the export trade with those countries whose exchange rates are low is subject to the difficulty of obtaining settlement from customers, while again competitive exporters in low-exchange countries are temporarily aided in selling their goods in neutral markets. This is a situation which the United States has been obliged continuously to meet for some time past. Inflation and uncertainty in the currency and banking systems of different countries and embargoes on the exportation of gold tend to aggravate such instability of exchange, while the recurring necessity of meeting maturities in international indebtedness likewise tends to make conditions more difficult."

Because of the advantages that were likely and expected to accrue

being intended to compensate for higher cost of production in Italy as compared with other industrial countries competing with her producers in the Italian market. In Italy, and also in Spain, there is a surtax which is intended to compensate for the varying exchange value of the currency. The value of the lira in New York is the basis for the application of this surtax in Italy, the tax being fixed every two weeks by the Ministry of Finance. Spain, where duties have been increased from 50 to 400 per cent in the past 14 months, determines the rate of surtax every month on the relation of her currency to the pound sterling.

"Switzerland, Esthonia, Latvia, Lithuania and Sweden have also increased their tariffs, while Denmark and Finland are in process of revising their tariffs upward.

"It is noteworthy that several divisions of the British Empire have surrendered to what appears to be a world-wide impulse toward the erection of tariff barriers. India largely increased her tariffs in 1921, and Australia, following new duties fixed in 1920, has made several increases in the past year. Canada is likewise planning higher tariffs. So is South Africa and New Zealand. In South America, Peru, Bolivia and Chile have increased their customs and other countries are, according to report, planning to do so. Japan increased her duties in 1920, and put into effect a further increase last year."

[1] P. 905.

to those exporting nations whose exchanges were at a discount in foreign markets, many countries began to express fears of being swamped with foreign-made goods, especially those from Germany because the mark was so greatly below par. Attention became focused on a study of the relation between the price level within countries whose exchanges were depreciated and the level of their exchanges in other countries; in other words, the comparative internal and external purchasing power of the currency of a country, or the "purchasing power parity" as distinguished from the "mint parity." Gustav Cassel, the eminent Swedish economist, has led in the discussion of this "purchasing power parity" theory,[1] although ably assisted by other European economists, notably Pigou of England,[2] Pantaleoni of Italy, and Bruins of Holland. The theory has been well and briefly stated by Reginald McKenna, Chairman of the London Joint City and Midland Bank, Ltd., in the following manner: "The ratio of exchange between any two countries is normally determined by the ratio of their general price levels." Or as Cassel puts it, "When two currencies have been inflated, the new normal rate of exchange will be equal to the old rate, multiplied by the quotient between the degrees of inflation of both countries," the degree of inflation being measured by the price levels of the respective countries. He wisely adds, "There will, of course, always be fluctuations from this new normal rate, and in a period of transition these fluctuations are apt to be rather wide. But the rate calculated in the way indicated must be regarded as the new parity between the currencies. This parity may be called the purchasing power parity, as it is determined by the quotient of the purchasing power of the different currencies."

As may be inferred from the last sentence of Cassel's statement, the method of computing the purchasing power parity, say, between Germany and the United States, is to find what percentage the price index number of the United States is of the price index number of Germany (1913 being taken as the base in all the late discussions), and then to multiply the resulting percentage by the par of exchange between the two countries. This gives the percentage depreciation of the purchasing power of the mark in terms of the dollar.

[1] Cf. *Annals of the American Academy of Political and Social Science*, May, 1920, p. 259 et seq.; Manchester *Guardian Commercial*, October 27, 1921; *Economic Journal* (England), December, 1918, pp. 413–415, December, 1919, pp. 492–496.

[2] Cf. *Economic Journal* (England), December, 1920, pp. 460–472.

The accompanying chart (Chart XI) prepared by the New York Trust Co.,[1] shows the increase in the commodity price indices and the decrease in the New York quotations of exchange on England, France, Italy, and Germany. More detailed comparison of the same data

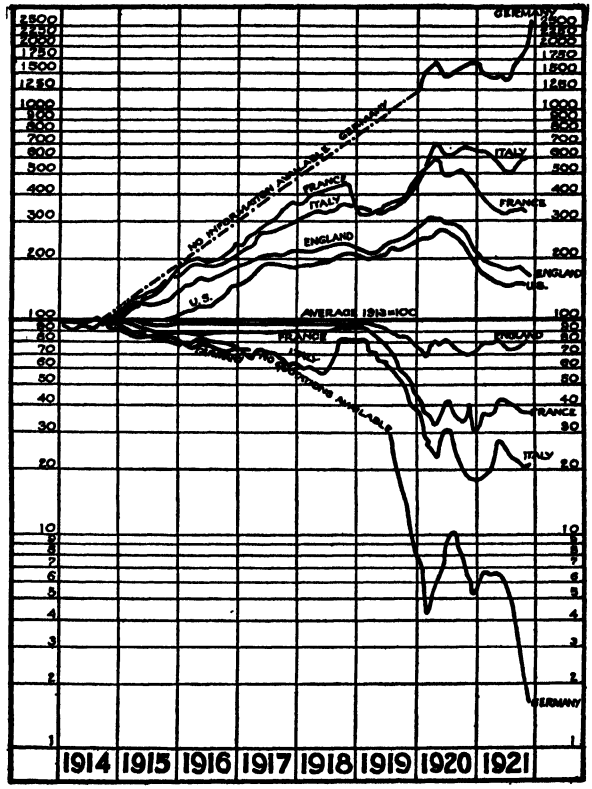


CHART XI

Commodity price indices and New York exchange rates on England, France, Italy, and Germany

for these countries has been made by the Federal Reserve Bank of New York, and the results are shown on Chart XII, in which the par line represents the value of the dollar, while the exchange rate and the purchasing power of foreign monies are plotted as percentage depreciation below the full value of the dollar.

[1] *Index*, December, 1921, p. 5.

The charts disclose the fact that before the free movement of the exchanges began, i. e., before the "unpegging" occurred, there was

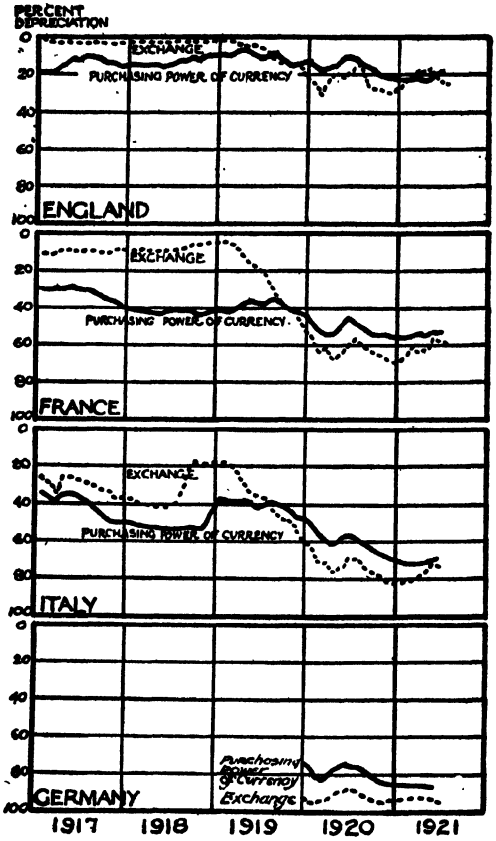


CHART XII

Purchasing power parity of sterling, francs, lire and marks, 1917–1921. Adapted from charts appearing in *Monthly Review of Credit and Business Conditions in the Second Federal Reserve District*, May 1, and August 1, 1921

but slight correlation between the rates of exchange and the purchasing power parities. Exchange rates did not decline so rapidly as price inflation developed. But after "the exchanges were 'unpegged,' depreciation in exchange and depreciation in purchasing power moved

in the same general direction. It is notable, however, that since the early part of 1919 exchanges have been constantly lower than relative purchasing power. The most important factor in this difference has undoubtedly been the constant balance of indebtedness against the European countries and in favor of the United States. A further factor has been the uncertainty of the political situation in Europe. In the last few months there has been a distinct tendency for exchanges to rise nearer to the purchasing power levels." [1]

In commenting upon the purchasing power parity of the mark, the *Index* [2] of the New York Trust Company states that a study of the situation during 1920 and 1921 "discloses a wide difference in external and internal values, with the internal value of the mark from 59 per cent to 288 per cent higher than the external value. Even here, however, it should be noted that given a period of stabilization the two values tend to become equal. From November, 1920, to May, 1921, the exchange value of the mark was comparatively stable, and the external and internal values were reduced from a difference of 135 per cent to one of only 59 per cent. Beginning at about the latter date, however, a violent decline in exchange value took place, and the difference increased to 236 per cent in November, 1921."

In presenting the theory of purchasing power parity, the fact must not be overlooked that the exchange market is the most sensitive market in the world, and is influenced by certain factors long before the prices of a country may be affected. To cite but one instance: Prices in Norway had closely paralleled those of Sweden during the early months of 1920 but rose sharply above them after April, 1920. A sharp decline in Norwegian exchange as measured in Swedish money began in March and except for a slight rally in April continued to decline for several months. The advance in commodity prices, however, occurred "two months later than the beginning of the decline in Norwegian exchange, attributable to the fact that the exchange market is the more sensitive one and reflects underlying changes sooner than commodity prices." [3] During periods of relative stabilization, however, the internal and external purchasing power of a currency tend to become equal. In applying this principle, one must be careful to

[1] *Monthly Review of Credit and Business Conditions in the Second Federal Reserve District*, issued by the Federal Reserve Bank of New York, May 1, 1921, p. 5.

[2] December, 1921, p. 7.

[3] *Federal Reserve Bulletin*, December, 1921, p. 1431.

do so in only the most general fashion, because, as has been said many times in this volume, theories in the field of the exchanges are capable only of general application and then only provided "other things remain equal." One may safely conclude, however, that "the exchange value of one currency in terms of the other may or may not vary in accordance with the changes in their relative purchasing power. Ordinarily at any given time, in actual experience, the adjustment of the one value to the other is imperfect. If commercial transactions between the two countries constitute the determining factor, the correspondence will be close. Usually, however, varying appraisals of the future value of an inconvertible currency give rise to an element of speculation which tends, according to circumstances, either to widen or contract the spread between the two sets of values." [1]

In normal times, any difference between the internal and external purchasing power of a currency is its own corrective, provided, of course, the various factors concerned are permitted to work fully and without restraint on the part of the government. When a difference does arise and cause exports to flow out of a country, the resulting drafts on the importing country force the exchange rate on the latter to fall, or, what amounts to the same thing, they increase the exchange rate in the importing country on the exporting country, thus bringing the exchange rate and the purchasing power parity into harmony with each other.

The numerous proposals that have been advanced looking toward the deflation of the currency, the resumption of the gold standard by the European nations, the lowering of prices, and the improvement or stabilization of the exchanges, will be discussed in Chapter XIV.

[1] *Guaranty Survey*, Sept. 26, 1921, published by the Guaranty Trust Company of New York.

CHAPTER XIII

INVESTMENT, SPECULATION, ARBITRAGE

In earlier chapters some reference has been made to the financial returns secured by exchange dealers from certain phases of their business activities. It is clear, no doubt, that the small local dealer who sells exchange only through the agency of the large city wholesaler runs no risk and can count definitely on making a profit on his sales. He is quoted a "firm" rate by the exchange wholesaler, which may hold for a day or for a week, and which represents the fixed cost of exchange to him (the small retailer) for the designated period. He adds his profit to this quotation, the amount of the profit being gauged by what he thinks the traffic will bear, and charges his customer the resulting, and correspondingly higher, rate. The wholesaler is the one who runs the risks of losing through an increase in the rates at which he has to cover the sales of the small dealer, and during 1921–22, when market quotations on European countries stiffened noticeably, the losses suffered by the wholesaler were very great. Thus in the latter part of 1921, when francs rose sharply, several New York wholesalers lost more than $4,000,000 because they had to cover at higher rates than they had quoted their out-of-town correspondents. Similarly, orders for marks which had been quoted at 0.0036½ had to be covered at over 0.0040. The practice of the New York wholesalers has been to issue a list of firm quotations based on the closing rates for the day, and to send this by mail to the country dealers, or by wire to the larger out-of-town dealers, where a similar process of distribution takes place. Competition is very strong among the New York houses so that the margin of safety allowed is unusually small. These rates are supposed to hold for the following day. If, in the meantime, the market stiffens to any extent the margin is wiped out and the New York dealers lose by having to cover at higher rates. The seriousness of the situation and the heavy losses sustained finally induced these dealers, in December, 1921, to form an association with the object of eliminating some of the more outstanding abuses in connection

with exchange wholesaling. At a meeting on January 25, 1922, the following recommendations were adopted:

"Exchange dealers should make a service charge of 25 cents for items amounting to less than $100 on which the profit at present is so small that such items are handled at an actual expense. It is also felt that the inland banks to whom the large New York dealers extend drawing facilities for foreign drafts and post remittances should bear part of the expense of the various supplies required, which in the past have been paid for entirely by the wholesale dealer. When rates are given out which are to be firm for an entire day it is felt that the unsettled market condition at present requires that adequate margin be maintained to provide against the sudden rises in exchange rates which are frequent, and that the limits up to which these drawings are to apply should be lowered. In quoting firm rates by telegraph it is suggested that as far as possible the offers be limited to a comparatively short space of time in order that the wholesale dealer may be partially protected. Speculative purchases should be discouraged. A charge of one-half of 1%, with a minimum of 50 cents, is suggested as fair and proper for drawings in small amounts on European points in United States dollars, which are to be paid at the rate of exchange prevailing on the day of payment. Uniform commissions to brokers should be arranged if possible through the Foreign Exchange Club by a joint agreement to be arrived at with the brokers themselves." [1]

Even though these recommendations become effective, the exchange business of the small local dealer will still be free from any attendant risks. And so far as the proposed additional charges are concerned, they will merely be passed on to the customer by means of higher exchange rates. The suggested reforms would, however, materially protect the New York dealers against loss, but only in so far as their relations with the small dealers are concerned.

Before taking up in detail a discussion of the innumerable risks that characterize the exchange business of a large dealer, and also the many methods to which he may resort in an endeavor to make his business profitable, it may not be amiss to mention the fact that at least in a few connections he is certain of his returns. When, for example, he charges a commission for the acceptance of drafts, or for the confirmation of a letter of credit, or for the collection of drafts, or for any other similar service, he is practically sure of receiving payment therefor. The risks attendant upon fluctuating exchange rates do not enter into such transactions. On the other hand, there is almost no other

[1] *Commercial and Financial Chronicle*, January 21, 1922.

phase of his business that is free from such uncertainties. His stock in trade is composed of funds kept abroad with various correspondents, against which he sells exchange at ever changing prices. Not only do his prices, i. e., the rates at which he sells exchange, vary from hour to hour and from day to day, but his costs are likewise a variable quantity. He has to create his foreign account by purchasing exchange which he sends abroad for collection and credit. The cost of such exchange fluctuates constantly. He may attempt to guard himself against losses through the purchase and sale of futures, but even so he still runs the chance of actually losing on such transactions. It is necessary, therefore, for the exchange dealer always to be on his guard, to watch the trend of the domestic and the foreign money markets most carefully, to shift his funds from center to center so as to take advantage of every opportunity of improving his position, to speculate on the course of the exchanges, to make investments in or by means of exchange when conditions appear to justify it, etc., etc. The three practices, however, to which he most frequently resorts are investment, arbitrage, and speculation. All three are to a certain extent speculative in character, so that it may be difficult at times for us to differentiate between them.

In discussing the problem of how money may be made by exchange operations, the reader must keep clearly in mind some of the fundamentals that have already been discussed, such, for example, as the fact that the exchange dealer is both a buyer and a seller, buying from and selling to both the public and other exchange dealers. He hopes to make a profit on his business, so he aims to buy low and to sell high. He hopes, not necessarily to make a profit on each transaction, but on his business over a stated length of time. Some large dealers figure profits every month; others only every half-year; while a few attempt to calculate profits daily, but merely for their own satisfaction, so as to see how matters are progressing. Also, the reader should not overlook the fact that the large exchange dealer buys and sells bills of exchange of all sorts and description, running for different lengths of time and drawn on parties in practically all countries of the world, and that he has funds or accounts in a number of financial centers which he may use in his money making activities. Fortified by this brief summary of certain necessary fundamentals, let us first take up the subjects of investment and speculation in and by means of exchange operations.

Investment and Speculation

Some writers have preferred to consider only investment and speculation *in* the exchanges and have objected to discussing investment and speculation in foreign stocks, bonds and other forms of property *by means of* the exchanges.[1] A certain amount of investment and speculation in the securities of foreign countries has always taken place, and future years will see American financiers even more active in this field than has been true in the past. It is well worth our while, therefore, to give some consideration to the possibilities of profit making in this connection as well as to the more customarily discussed methods of investing and speculating in the exchanges.

Investment is the act of laying out money productively. The very word itself connotes the expectancy of a return greater than the sum invested. An investment may be made for a day or for a year, in short for any length of time, although in ordinary conversation, when one speaks of having made an investment, the inference is, strangely enough, that the investor intends to retain title to the property for a considerable length of time so as to receive a number of periodical returns thereon. All investments in foreign exchange, no matter what their nature, are speculative in character because of the uncertainty of the investor receiving profits or interest at stated periods of expectancy or of being paid his principal at the maturity of the investment. One may be arbitrary, however, and say that when the risk is great the transaction is a speculation, and that when slight it is an investment, or that when one buys hoping to sell within a very short time it is a speculation, while if one buys with the idea of keeping the funds tied up in the property for at least several months it is an investment. Personally, however, I am inclined to class both groups of transactions as speculative because they contain an element of uncertainty, owing to the fluctuations of the exchange rate, that is greater than is the case when funds are invested in domestic channels. Nevertheless, I shall make no effort to differentiate between investment and speculation in the present discussion.[2]

[1] "Sometimes the remittance of funds to a foreign country to be put out there in the purchase of bonds or notes, or in the making of short-term loans or advances, is referred to as an investment in foreign exchange. It is true . . . there is here . . . a chance taken with respect to the rate of conversion of the recovered foreign funds back into home money; but there is not technically, and properly speaking, an investment in foreign exchange." Whitaker, *op. cit.*, p. 345.

[2] H. N. Laurie, Economist for the American Mining Congress, declared before the Committee on Banking and Currency of the House of Representatives (Hearings on Bill H. R.

Bankers buy at "buying" rates and sell at "selling" rates. The difference is supposed to net them a profit. By buying large amounts they are able to buy more cheaply, and by selling small amounts to their customers they are able to charge a little higher rate than for large sums.

The large dealers in exchange are continually buying sight drafts and long bills on foreign centers, and sending them abroad so as to build up their exchange accounts deposited with banks in other financial centers. A New York dealer may, for example, on May 1 buy £50,000 of sight drafts on London firms or banks, when the rate is 4.85, at a total cost of $242,500. The drafts reach London, are paid, and the account of the New York dealer is increased by £50,000. Seven days later, if the exchange rates have risen, he may be able to sell sight drafts against his London account at 4.86. If he sells £50,000 of sight drafts at that rate, he receives a return of $243,000, which is $500 in excess of the original outlay. If he can sell £50,000 of cables at 4.865, he will receive $243,250 or $750 more than he originally invested. Banks frequently sell cables to customers and are compelled to purchase cables from other banks in order to cover. Being keen buyers and also large purchasers, they may be able to cover at a profit. New York bankers usually expect a return of about 15/100 of a cent per £ 1 (15 points) in selling cables against remittances of sight drafts, or a profit of $15.00 on every £10,000 sold.[1] Of course the exchange dealer is not always able to buy and sell under such favorable conditions. He may have to sell at lower prices than the exchange cost him; or he may be able to sell only a small portion of his account at a favorable rate; or if the market is dull, he may have to let his account lie dormant for a short time, earning only the deposit allowance rate of the foreign correspondent.

If a bank has sold a large amount of sight drafts, and expects the rates to decline, it may wait until the last moment, just before the sight drafts reach their destination, and cover by the purchase of cables. If the sight drafts were sterling and had been sold at 4.86, and if seven days later cables had declined to 4.86, the bank would have had seven days' use of the money received from the sale of the sight drafts before being compelled to pay it out for cables as cover.

8404, p. 6) that "Exchange experts are of the opinion that from 50 to 75 per cent of the total value of all exchange transactions have no relation to the actual movement of commodities; or, in other words, are purely speculative."

[1] Escher, "Elements of Foreign Exchange," p. 73.

The bulk of exchange business is carried on by the purchase of sixty and ninety day documentary bills and the sale of cables or sight drafts against the accounts built up thereby. If, for instance, a merchant offers to sell to a banker a £10,000 ninety day draft when the sight rate in New York is 4.8655, and the London discount rate for three months bills is 4 per cent, the banker will calculate his price in the following manner:

Sight rate		4.8655
93 days discount at 4%	.04943	
Stamp tax, 1/20%	.0024	
Profit and commission	.01	
		.06183
		4.80367
Nearest market quotation		4.8035

In this calculation the discount is figured on the basis of 365 days to the year, which is the English basis of computation, and at 4.85 per pound, and is taken from the interest or discount tables used by the exchange dealers in such transactions. The expected profit of the buying bank and the commission of the London correspondent have been lumped together and placed at $0.01 per pound. Bankers usually calculate on a profit ranging from 1/8¢ to $0.02, depending upon circumstances. The correspondent's commission is normally about 1/40 per cent. At the rate of 4.8035, the New York banker would pay $48,035 for the £10,000 ninety day documentary draft. If the draft is sent abroad for acceptance and immediate discount, the following results would be obtained if the discount rate still remained at 4 per cent:

Discount on £10,000 at 4% for 93 days	£101	18s.	4d.
Stamp tax paid by correspondent and deducted from the proceeds	5	0s.	0d.
Commission of the correspondent (1/40%) likewise deducted	2	10s.	0d.
Total deductions	£109	8s.	4d.
Face value of the bill	£10,000		
Less deductions	109	8s.	4d.
Net proceeds	£9,890	11s.	8d.

Suppose that the banker sold sight drafts the same day or the next day after purchasing the ninety day bill, for the entire expected net proceeds and at the rate of 4.8655. He would receive $48,122.63 from the sale, or a gain of $87.63 on the transaction. If the sight rate had advanced and he was able to sell sight drafts at the rate of 4.87, he would receive $48,167.13 from the sale, or a gain of $130.13 on the transaction. The expected returns of a banker on exchange operations of this character normally range from 1/20 per cent to 1/10 per cent, and under very favorable conditions from 1/4 per cent to 1/2 per cent. While the returns appear to be very small, it must be remembered that the banker has his funds invested but a very short time and that he turns over his capital frequently, thus netting on the basis of a year's business a very fair return if all operations turn out as successfully as the one described above, which, of course, is not the case.

Instead of having the above bill discounted as soon as it has been accepted in London, the banker may decide to hold it until maturity. The facts of the operation would then appear as follows:

Investment in 90 day bill at 4.8035 per £.....$48,035.00

Face value of draft at maturity in London....	£10,000		
Deduct stamp tax.....	2	10s.	0d.
Deduct correspondent's commission.....	5	0s.	0d.
Net proceeds.....	£9,992	10s.	0d.

If, at the maturity of the bill, the sight rate on London is still at 4.8655 and the banker is able at that time to sell sight drafts to an amount equal to the above net proceeds (£9,992 10s.), he will receive therefrom the sum of $48,618.51, or a gain of $583.51 on $48,035 invested for 93 days. Had he been able to sell at 4.87, he would then have received $48,663.47, or a gain of $628.47. A high discount rate in foreign centers induces American bankers to buy and hold long bills until maturity in order to receive the high discount rate thereon; but a decrease in the discount rate causes them to discount the long bills held by their foreign correspondents and to discount immediately all bills purchased while the discount rate is low. It is a common saying that when high discount rates prevail in foreign centers American bankers buy exchange for investment and not for discount.

Should the London rate of discount or the New York money rates change during the usance of the bill, the banker instead of holding

the bill until maturity might possibly have it discounted so as to take advantage of the changed money rates. Taking the same data as above, let the London discount rate at the time of the purchase of the bill be 4 per cent, the usance of the bill 90 days, its amount £10,000, the sight rate on London 4.8655, and the New York money rate lower than the London rate. The purchase price of the bill would be, as above, $48,035. It is sent abroad and accepted, the correspondent being given orders to hold the bill until maturity or until notified to discount it. At the end of the first month, if the discount rate in London falls to 2 per cent, and the New York money market stiffens so that it becomes profitable to employ the funds at home, the London correspondent will be advised to sell (discount) the acceptance in the open market. The facts of the case will then appear as follows:

Face value of acceptance £10,000				£10,000		
Usance 90 days (plus three days grace)						
Draft has run for 30 days with 63 days remaining before maturity.						
Rate of discount, 2%.						
Discount on £10,000 at 2% for 63 days	£34	10s.	5d.			
Stamp tax (1/20%)	5	0s.	0d.			
Commission to correspondent (1/40%)	2	10s.	0d.			
Deductions	£42	0s.	5d.	42	0s.	5d.
Net proceeds				£9,957	19s.	7d.

If the sight rate on London has remained at 4.8655 and the banker is able to sell sight drafts for the entire amount of his net proceeds, he will receive $48,451.72 from his sales, or a gain of $416.72. If the sight rate has advanced to 4.87 he will receive $48,496.63, or a gain of $461.63.

In any of the examples given, instead of selling only sight drafts, the banker may sell all cables, or some cables and some sight drafts, thus netting a slightly larger return. In discussing the sale of sight drafts on any foreign center against remittances of time drafts, the reader must remember that the exchange dealer can sell sight drafts on European centers from 7 to 10 days before the maturity dates of the bills that have been remitted, because it takes from 7 to 10 days for the sight drafts to reach their destination and be presented for payment.

As we have seen in earlier pages, exchange dealers keep closely in touch with the financial standing of the firms whose bills of exchange are offered for sale. If a firm does not have an excellent financial standing, or has incurred what the exchange dealer thinks is too great a liability on bills of exchange outstanding, the exchange dealer will pay a little lower rate for the bills of that particular firm than for the bills of a firm in prime condition. The exchange dealer takes a little greater risk than usual and pays a little less than the market rate for such bills, but if the transaction turns out satisfactorily and the bills are met at maturity, he will make a profit greater than usual because of his lower purchase rate. Or again a firm may have acquired a bad reputation through one of many causes, but may have subsequently put itself in good condition. The old reputation may cause its bills to sell for less, but the exchange dealer, having access to the firm's financial statements, etc., may feel that it is a safe risk and be willing to purchase its bills at a rate about $0.02 less than that being paid for prime bills. When the bills in either of these last two cases have been realized on and their sums added to the foreign account of the dealer, he can sell exchange against them at the going rates, and thus make an extra profit thereon. The same conditions exist as regards clean trade bills (bills drawn by one merchant against another without documents attached). Some bankers refuse to purchase bills of that character; those that do, pay a lower rate for them than for prime (first-class) documentary bills. When they mature and have been paid, the dealer is able, as in previous examples, to sell exchange against the accounts thus built up, and at the going market rates, thus making an extra profit.

In handling documentary payment bills, which are not discountable in London (although discountable in Germany),[1] the dealer makes his gain on the lower rate that he pays for them. Moreover, while they are being held abroad, he may employ them as security for finance or loan bills, so that they are not "dead timber" on his hands in the meantime. Long experience with documentary payment bills enables the dealer to know approximately, because of the nature of the shipment, the practice of the drawees in taking up such bills, etc., about what proportion will be paid at sight, i. e., when presented for acceptance, what proportion at the end of five days, ten days, thirty days, etc. Having purchased £105,000 of such bills, he may ex-

[1] Cf. p. 145.

pect £10,000 to be paid at sight, £15,000 at the end of five days, £30,000 at the end of ten days, and £50,000 at the end of thirty days. Keeping these points in mind he may do one of two things. First: he may sell £10,000 sight drafts on his foreign account as soon as he has forwarded the documentary payment bills to his London correspondent. On the fifth day he may sell £15,000 of sight drafts, on the tenth day £30,000, etc., etc. If his surmise is correct, his account abroad will be credited with the above amounts before the sight drafts that he has sold are presented for payment. He buys at a low rate, because the bills are documentary payment bills, and sells at the higher sight rate. Second: on the other hand, he may, as before, sell the £10,000 sight drafts as soon as he has forwarded the payment bills. He may also sell £15,000 of drafts payable five days from sight, or twelve days from date. If the bills are five day sight bills they will have to be presented to the London correspondent for acceptance and will then run five days from that date. If they are twelve day date bills, they will not have to be accepted by the London correspondent, but will mature at the same time as the five day sight bills. He may also sell £30,000 of drafts payable ten days from sight or seventeen days from date, and £50,000 of drafts payable thirty days from sight or thirty-seven days from date. In all these instances, he is selling his own, a banker's draft, against an account built up by means of documentary payment bills (trade bills). His drafts always sell for a higher rate than the price that he has to pay for the payment bills, thus netting him a profit. The date bills which he sells against the expected returns from his documentary payment bills may be purchased by importers and others who have debts to pay in foreign countries on certain dates, and who prefer, because of the money rates in the United States or because of the lower exchange rate at which they can procure such bills from the dealers, to invest their funds therein. Or they may be purchased by bankers as a form of investment. They are sold at a lower rate than sight bills and, if the market appears likely to stiffen with a possibility of exchange rates rising, the bankers will purchase the date bills, hold them until within about five or seven days of maturity, and then sell them to other exchange dealers at the higher sight rate. By holding them until that time, the date bills have become practically the same as sight bills, because they will then be payable as soon as they can reach London.

Speculation on the trend of the rate of exchange is ever present and

plays a part in all transactions, no matter what may be their nature. But the greater portion of all speculative investments, if we may technically use such a term, occurs in other ways than those that have been mentioned. A banker may feel that the trend of the market is downward, and that, say in five days, the cable rates will be considerably lower. He may sell "short" on exchange and hope to cover by means of cables. Say that he sells sight drafts on his account in London when the sight rate is 4.8670, with cables at 4.8705. Five days later, owing to a weakening of the market, he covers by buying cables at 4.8640. He has not only had the use of the money involved for a period of five days, but he has been able to cover at $0.0030 less than he received for his sight drafts, which of course nets him an extra gain. If cables drop to 4.8670, he has the use of the money for the five days, although he is unable to make an extra profit through a lowered cable rate. If the cable rate remains at 4.8705, he will lose on the transaction unless the money rates in New York are high enough to enable him to receive a sufficiently large return on the funds received from his sale of sight drafts to offset the high cable rate that he has to pay for cover. Going "short" means selling and hoping to buy later (to cover) at lower rates. The above transaction is of ordinary occurrence in the exchange field.

A similar situation arises in connection with the sale of "futures." Suppose that an American importer is arranging for the purchase of goods from England. He will have to pay £10,000 three months hence to the foreign exporter. He fears that by that time the exchanges may have risen and thus be against him, so that he would actually have to pay more for his goods (i. e., for the drafts to pay for them) than he wishes to pay. He goes to his banker and arranges for the purchase of a future. The banker looks over the records for past years and sees that three months hence the rate for sight drafts is normally around 4.865. The banker feels that the market will behave as usual, and therefore enters into a contract with the American importer to sell him a £10,000 sight draft on London at 4.8655, adding a slight amount to the expected rate as a margin of safety. The bank may require security of some sort if it feels that the customer is not a safe risk. Forward sales to customers are not always made for a fixed date because the customer frequently does not know exactly at what time the goods will arrive or his obligation fall due. Under such circumstances it is the practice to sell a future for moderate amounts,

deliverable at the customer's option within a month or possibly within two months' time. A higher exchange rate will be charged for an indefinite contract of this character than for a definite contract, because of the necessity of the bank's always being prepared to deliver, thus compelling it to carry an adequate balance abroad, and also because of the impossibility of judging the range of exchange fluctuations over an indefinite period of a month or two.

To revert to our example: three months pass and the American importer goes to his bank and pays $48,655 for the £10,000 sight draft. He has safeguarded himself against a higher rate by having purchased the "future." But on the other hand, he will actually lose on the transaction if the market rate for sight bills has fallen, say, to 4.8580. In other words, had he, himself, taken the risk and waited until the day of payment, he could have obtained his £10,000 draft for $48,580, or $75 less than called for by his forward contract. The situation, however, is the same as that which exists in connection with any kind of property insurance. A business man may carry fire insurance on his property for many years, yet if he has no fires he receives nothing for his outlay except the satisfaction of being protected against loss from fire. So it is with the importer who buys a future. He may possibly be able to get his exchange at a lower price if he waits and takes chances on the market quotation, but he prefers to play safe and base his business deal on a certain rate of exchange. On the other hand, of course, he gains if the market rate at the time of payment is actually higher than the rate called for by his forward contract.

Now what about the banker? If at the time the delivery has to be made the market rate is 4.8755, the banker stands to lose (unless he had protected himself by a "hedge" of some sort) because the exchange that he has to deliver costs him, or is worth, $100 more than he receives for it. On the other hand, if the market rate drops to 4.85, he receives $150 more than it costs him to cover by purchasing sight exchange in the open market. Or if the market is evidencing a weakening tendency he may prefer to use the $48,655 (which he receives from the importer) for five or six days, and then cover by cable at a rate that may yield him an extra profit. Thus, for the banker the transaction is also speculative in character.

But it is possible in forward contract deals for even the banker to protect himself against possible losses from adverse exchange rates.

He, too, may purchase a future from another exchange dealer for delivery three months hence. Being a banker and knowing the inside of the market he will usually be able to purchase his future at a little lower price than that at which he sold his future to the importer. In fact, in quoting the future rate to the importer he may, before quoting a rate, obtain a forward quotation from another dealer, which he will use as a basis in quoting his forward rate of 4.8655. Or the banker may hedge by buying outright a £10,000 90 day bill from another dealer. Whether he hedges by means of a future or by means of a 90 day bill, he hopes that the rate which he pays for such a bill will be low enough to protect him against losses on his own future contract. The banker may also hedge by going into the market and buying £10,000 worth of 90 day payment or acceptance bills, which will mature and thus replenish his foreign account by £10,000 by the time that the forward contract draft is presented for payment in London. He will pay less for the 90 day acceptance and payment bills than for bankers' 90 day bills. In each of these situations he will have purchased £10,000 of exchange which will become available as part of his exchange account 90 days hence. If the market rate rises to 4.8755, he will be able to sell £10,000 worth of drafts on his foreign account for $48,755 and thus offset his loss suffered through his obligation to deliver a £10,000 draft to his customer at the rate of 4.8655. On the other hand, if the market rate falls to 4.85, he may have to sell £10,000 worth of drafts at $48,500, taking a loss thereon that offsets his gain on the sale of the £10,000 draft to the customer for $48,655. Hedging thus at times enables the banker to "play safe" on forward contracts.

Bankers may also speculate on fluctuations of the rate by going "long" on exchange, i. e., by buying or agreeing to buy in the present and hoping to sell in the future at a profit. We have already discussed certain phases of this method of procedure in connection with the purchase and sale of long bills, sight bills, and cables. But there remains one aspect of the matter that we have not as yet considered to any extent, and which again, as in our last example, arises in connection with forward contracts.

If an American exporter, for example, has been asked to quote prices to an English importing firm, he must be certain as to what his drafts will sell for so as to have a fixed basis upon which to calculate the prices of his goods. Therefore he gets his banker to quote him a for-

ward rate for drafts covering exports to be shipped, say two months hence. This guarantees him a fixed return for his drafts regardless of where the rate stands in the market at the time the goods are ready for shipment. Or it may be that an American exporter has received an order for goods to be shipped to an English importer, and that he expects to have the shipment ready within two months' time. To guard against a decline in the exchange rate he gets his banker to quote him a forward rate. Let us say that in both cases the draft is to be drawn for £10,000 and that the banker quotes a forward rate of 4.8655. In either case, when the exporter presents the draft to the banker, the latter pays $48,655 for it.

Again, as was the case with the importer in the previous example, the exporter is buying protection. If the buying rate of exchange should fall below 4.8655 by the time he sells his draft, he gains by being able to market his draft at the higher price of 4.8655. But if it rises above 4.8655 he is bound to sell at that rate and therefore loses the opportunity of gaining because of the higher market rate. However, when he refuses to take the risks of exchange, and enters into a forward contract, he cannot expect to obtain protection and also the chance to profit by the existence of a market rate that is higher than his forward contract rate.

Now as to the banker: He gains if the rate rises above 4.8655 and he loses if it falls below that figure. If it rises to 4.87 he is able to buy a £10,000 draft for $45 less than he would otherwise have to pay for it. If the buying rate falls to 4.85 he is paying $150 more than would have been the case had he not entered into the contract. Again must the reader be warned to remember that the banker's buying rate for exchange in the open market (in the absence of a forward contract) is lower than his selling rate. Consequently, even though the banker, with the open market buying rate at 4.85 pays $150 more for the draft than if he had not been bound by his forward contract, his actual selling rate for sight exchange may be sufficiently higher to offset this small loss on his forward purchase.

When a banker goes "long" on exchange, he may attempt to protect himself by hedging just as he does when he goes "short" on exchange. When, as in the example just given, he agrees to purchase the £10,000 draft from the exporter two months hence at 4.8655, he may have been able to sell a £10,000 draft to another customer deliverable two months hence. Or before quoting a forward rate to the

exporter he may have called up another dealer and arranged to sell him a future for £10,000 at 4.87 deliverable two months hence, and then have used his rate of 4.87 as the basis for his quotation of 4.8655 to the exporter. Or he may have gone into the market and sold 60 day bills on his London account at the prevailing market rate, because, if the rate should fall, he would be protected against loss, while if it should rise, he would only lose the chance of making greater profits by the sale of an equal sum of sight drafts two months hence at higher rates. His price for 60 day bills is supposed to yield him a profit at the market rate prevailing at the time of the sale.

The initiative in arranging a future contract may be taken by the banker himself as protection against losses arising out of purchases of long bills of any kind. He may, perhaps, have purchased a 60 day sterling bill which he sends abroad to be accepted and held until maturity. He can hedge or safeguard his interests by selling a future, payable 63 days hence, which will be the date on which the 60 day bill matures. He must make certain, however, that the rate that he gets for his 63 day future will be high enough to protect his investment in the 60 day bill that he has purchased.

The uncertainties of the exchange market during and since the World War have made the resort to forward contracts more frequent, although many banks have refused to enter into them because of the possibilities of attendant losses.

In normal times, forward contracts of any sort assist in stabilizing the rates of exchanges, just as grain or cotton futures or futures of any kind are of great service in stabilizing the prices of goods covered by such contracts.

Somewhat similar to the future transactions just described is the practice, but lately begun in the United States although a long standing custom in European centers, of quoting forward discount rates on bank acceptances. Foreign banks and exporters are able to protect themselves against an unexpected increase in the discount rate by arranging with American bankers for a fixed discount rate 30, 60, or 90 days hence. American exporters and importers, and merchants engaged in domestic trade may likewise be accommodated if the financing of their business requires the discounting of commercial paper. The difference between the spot rate and the forward rate is usually determined by the money market conditions, and normally

amounts to about 1/8 per cent per month of usance. Thus, if the spot discount rate (the rate for discounting bills immediately) is 6 per cent, the forward rate for 30 day contracts will be 6 1/8 per cent; for 60 days, 6 1/4 per cent, etc. If the tendency of the money market is downward, the forward rate may actually be quoted lower than the spot rate. The banker in quoting a forward discount rate is speculating on the trend of the money market. If it weakens and money rates fall, he gains; if it stiffens and money rates rise, he loses the opportunity of making a greater gain through the charging of a higher discount rate.

Forward contracts of any sort have but little to do with the greater part of the speculation that has been rampant during and since the World War. This speculation has been characterized by the rather general participation of the public in the purchase and sale of exchange and foreign securities to an extent never before known.[1] Indeed in many respects the exchange market has greatly resembled the stock market during its most active days. Purchases have been made almost solely for resale at a hoped-for higher rate. Few people have entered the market with the desire to keep their funds invested for any length of time. Many of the deals have been of small extent; practically all have represented what might be termed a "gambler's chance on a lucky turn of the market." A very small number of the speculators have known any more about the intricacies of the exchange market than does the average person who "plays" the stock market in boom times.

The majority of the deals have been and are represented by purchases of sight exchange on foreign countries. A person who desires to speculate in the exchanges goes to an exchange dealer and buys a

[1] In commenting upon this situation Mr. F. J. Wade, President of the Mercantile Trust Company of St. Louis, declared that:

"The trouble with European credit to-day is the gambling in foreign exchange, and there is not a man or woman or child in America, whether he be a street laborer or president of the biggest financial institution in America, with all the brains of all of the colleges in America, with all of the power of the United States, that can tell within $5,000,000,000 or $10,000,000,000 per annum of the gambling in foreign exchange. It is the only department of finance in this country that there is no check on. When I tell you that I know that there was more than $18,000,000,000 of foreign exchange sold in New York last year, when the necessity for that exchange was less than $6,000,000,000—then you will see to what extent gambling is going on. Does that affect us? Why, they are playing with international exchange in Europe and America just like two boys playing football. They kick it over one moment and kick it back again the next. I think if we would only take care of foreign exchange gambling to protect its use for normal business then one-half of our battle would be over." *Commercial and Financial Chronicle*, September 4, 1920.

sight draft on a foreign bank. He holds it hoping for a rise in the exchange rate. If a rise occurs, he sells the draft to his dealer or to another dealer and pockets the gains. Speculators have also purchased drafts on foreign banks, have sent those drafts abroad, and have opened up savings accounts upon which the foreign bank has paid its deposit allowance rate (interest on time deposits). Later, in case the exchange rate rises, the speculator has gained the interest on his foreign account as well as the profits arising from the sale of his account at the higher exchange rate.[1]

During the early years of the war speculation centered on the ruble. As it fell lower and lower, many persons purchased large sums of rubles hoping that they would soon return to par. On January, 22, 1916, rubles were at a discount of 42.7 per cent. Had the ruble returned to par shortly after the conclusion of the war, investors would have reaped a considerable profit in addition to the possibility of receiving interest on their ruble accounts deposited with the banks upon which they had purchased their exchange. On the same day marks, lire, and francs were at a discount of 21.4 per cent, 27.3 per cent, and 13.2 per cent respectively. Similar opportunities were afforded for speculation in these exchanges, but as the years passed the extent of the depreciation increased, except in the case of the franc. During week the ending March 17, 1917, the ruble, mark, lira, and

[1] Travelers have also had abundant opportunities to profit from exchange fluctuations. The following article appearing in many papers during March, 1920, explains an interesting method whereby an American traveler increased his funds while traveling in Europe.

"LONDON, March 6.—An enterprising traveler has demonstrated by actual experience how it is possible for an American to see Europe for nothing, or, disregarding his expenses, multiply any sum he may carry with him many times en route. Here is the formula:

"Leave America with say, about $350. Change it into 100 pounds, present exchange, in London. Cross to France and exchange into French silver coin (1 pound equals 42 francs), and you have 4,200 French francs. Smuggle these coins into Switzerland. Here they atta in twice the value they had in France, owing to the fact that the silver French franc is normal in Switzerland, but the paper French franc is worth but half its face value in exchange. Change the silver francs into Italian paper lire, then pass on into Italy and cash into Italian silver. You now have 21,690 Italian silver lire. Take these back into Switzerland you have 21,000 Swiss francs. Now purchase French paper money and you will receive for it 42,000 French francs. Return to France, there buy English notes and proceed to London with 1,000 pounds instead of the 100 pounds you set out with.

"Change these into American money at present exchange and you have about $3,500 instead of about $350 you possessed at the beginning of the journey.

"Of course, you have to do a bit of smuggling and you have to pay your expenses, but anyway you make money. That is one of the present features of the exchange situation and the premium on silver."

franc were respectively at 44.7 per cent, 27.5 per cent, 33.9 per cent and 11.3 per cent discount. A year later (March 11, 1918), the rate of depreciation was 74.4 per cent for rubles, 41.8 per cent for lire, and 10.4 per cent for francs; marks were no longer quoted.

Some of the weakening influence was caused by speculators dumping their holdings on the market as the rates declined, taking very heavy losses in doing so, but the more important factors in the situation were those that have already been discussed in earlier pages.

During the period of the war, and until March 19, 1919, sterling remained pegged at 2.2 per cent discount. After it was unpegged, however, it declined rapidly, reaching its lowest on February 4, 1920, at 3.18. Francs and lire likewise declined, francs reaching 0.05705 on November 11, 1920, and lire, 0.0331 on December 28, 1920. Many astute speculators bought in heavily at those astoundingly low rates, and their purchases had a pronounced stiffening effect upon the market, although being but one of the many factors present in the situation at that time. Say that a buyer purchased £10,000 of sight sterling on February 4, 1920, at 3.18, it would have cost him $31,800. Had he sent the exchange to England and opened an account he would have received an interest return thereon, say 3 per cent, for the length of time that it was left intact. On March 4, 1922, the rate for sterling sight drafts was 4.40. Had he closed out his English account on that day at that rate he could have sold £10,623 16s. 5d. of exchange (£10,000 + accrued interest at 3 per cent for 759 days = £10,623 16s. 5d.) and have received a total return of $46,744.82 on his original investment of $31,800, or a gain of $14,944.82. His investment had run for a period of 759 days and had brought a gain at the rate of 22.6 per cent per year. He could have made a slightly greater return had he sold cables, for the rate on that day stood at 4.41¼.

Had the speculator purchased francs at 0.05705 on November 11, 1920, and have held them until March 4, 1922, when they were selling at 0.0910, he would have made a profit of about 77 per cent on his investment during a period of 478 days, or at the rate of approximately 58.7 per cent per year. Had he used them to establish an interest bearing account in a French bank, his interest returns on the same during the 478 days would have added considerably to his gains. Lire had risen to only 0.05260 by March 4, 1922, and did not offer such large speculative profits as did francs.

Speculation in marks has been especially widespread and huge gains

as well as huge losses have been very common, even on short time investments. On January 9, 1922, the rate for sight marks fluctuated around 0.0058. Had they been purchased on that day and sold on March 23 of that year, when the rate was at 0.0029, the speculator would have taken a loss of 50 per cent. On the other hand, had marks been purchased at 0.0029 on March 23, 1922, and sold seven days later when the rate had risen to 0.003475, the speculator would have netted a gain of 13 per cent on a seven day investment, or at the rate of 677 per cent per year.

Nearly all such speculative transactions have been put through by the purchase of sight drafts. Some people, however, have preferred to buy the actual currency of foreign countries, such as the bank notes of England, France, Germany, or the paper money issued by the foreign governments. This practice is far less satisfactory than speculating by means of sight exchange or investment in foreign securities, because foreign currency usually commands a higher price than does foreign exchange or foreign bonds. It also has a much less active market. A bundle of 100,000 marks in bank notes would make a package about the size of a telephone directory of a large city like Chicago or New York. It costs more to transport foreign currency to the United States because of shipping and insurance charges. Foreign currency must therefore be sold for higher rates than foreign bonds or sight exchange. The risk entailed is also much greater, especially if the currency comes from a country where it is greatly depreciated, because one can never tell when a law may be passed changing its legal tender qualities, its redemption value, etc. Such laws would necessarily greatly decrease its value.

The following table presents the gains possible on foreign currency based on the rates charged therefor on May 3, 1922, and also on the assumption that the currency will return to par. Just how soon that happy condition of parity may come about, it is not possible even to prophesy, so that the probable yearly percentage returns on such investments cannot even be approximated.

That a large amount of foreign currency is held in the United States is evident from the advertisements appearing in newspapers and financial magazines and also from the great number of persons who visit the exchange dealers eager to buy or to sell. It has been estimated that about one-half of the total issue of German paper marks are in

TABLE XXIII

PRICES OF FOREIGN BANK AND CURRENCY NOTES AND PROFITS ON PURCHASES

Country	*Prices of Notes on May 3, 1922*	*Profits Obtainable Percentage on Cost, Provided Notes Return to Par*
France	.0918	110
Belgium	.0840	130
Italy	.0537	263
Greece	.0450	329
Great Britain	4.4350	9¾
Canada	.9850	1½
Norway	.1865	43
Sweden	.2590	3½
Denmark	.2128	26
Holland	.3840	4¾
Spain	.1555	24
Germany	.0035	6700
Austria	.00012	160740
Czecho-Slovakia	.0195	890

the hands of foreigners and that about one-third are held by Americans.[1]

Another phase of post-war speculation in the exchanges has taken the form of investment in foreign securities, both government and

[1] Samuel Montagu and Company of London in their *Weekly Review of Foreign Exchanges*, February 9, 1922, quote the following from an article by Prof. Gustav Cassel appearing in the *Norwegian Mercantile and Shipping Gazette*:

"Germany sells Marks by the milliard to foreign countries, but when the buyers of these Marks later on want to obtain German goods for them, Germany declares that she will not sell to purchasers at the prices ruling within the country itself, and this for the reason that the international value of the Mark has been reduced which has naturally been a consequence of their realizations of German Marks.

"As the value of the Mark is ultimately based on the fact that it represents purchasing power in the home German market, the behaviour of Germany indicates an extremely arbitrary plundering of those who previously supported Germany by purchasing its Marks.

"To this Germany may, of course, reply that it is in a position of need, and that it cannot possibly allow itself to be completely drained of goods, and that at all events, the pressure of the Entente forces it to sell continually new lots of Marks. By their efforts to secure protective customs against the undervalued Mark, foreign countries unite with Germany in this plundering of the unhappy holders of German Marks."

He concludes his article by characterizing Germany's manipulations of the Mark as "the greatest swindle the world has ever seen."

corporation. Foreign currency and sight drafts pay no interest, although some American banks have introduced the practice of selling sight drafts on foreign banks that bear 2 per cent interest, the holder of such exchange agreeing to give the exchange dealer at least thirty days' notice of desire to sell and convert his investment into dollars. Foreign bonds have been especially attractive to investors because their prices not only fluctuate with the rate of exchange, but they pay a good rate of interest while being held. One can thus invest in foreign bonds and expect to retain them for some years while they increase in value and at the same time have the opportunity of speculating on the exchange fluctuations by using the interest returns. Most of these bonds are coupon bonds, interest and principal being payable to bearer If interest coupons are held for an increase in the exchange rate, and if the rate rises, say 50 per cent,—the holder is able to sell his coupons to an American banker or exchange dealer at a 50 per cent advance. On a 4 per cent bond he would thus obtain a return of 6 per cent.

Those who invest in foreign bonds may do so either through American or foreign houses. Almost all the investments made by the general public in the United States have been handled through American stock and bond firms or through banks, all of which in their turn purchase from foreign firms. American dealers may require the entire purchase price with the order, or a deposit of 25 per cent, the remainder being payable on the delivery of the securities, or an initial payment of 40 per cent and the balance in ten monthly installments including interest. Others are willing to sell on a margin of 33 1/3 per cent, the customer putting up 33 1/3 per cent of the purchase price and the dealer advancing the remaining 66 2/3 per cent as a time loan at interest. The commission of the broker is included in the price which he charges the customer.

Investment in foreign bonds has afforded an excellent speculative opportunity for large profits, ranging from 50 per cent to 2,000 per cent, provided, of course, exchange rates on foreign countries again rise to normal levels and bonds are paid at maturity. Even though there be only a slight increase in exchange rates within the next few years, adequate profits may be obtained. Provided it takes five or ten years for the exchanges to reach par, there are still abundant opportunities for a gain of from 30 per cent to 40 per cent on certain of the bonds of our more dependable European countries and munic-

ipalities, to say nothing of the possibilities of even larger gains on the stocks and bonds of corporations within those countries. Many who have invested in sterling, franc, and lira bonds have been able thus far to realize satisfactory profits not only on their coupons but also on the sale of the bonds themselves, although many have also had to take losses. As exchange rates rise or fall the value of foreign bonds fluctuates accordingly.[1]

The foundations of many of the fortunes of England, France, Germany, and Holland were laid during and after our own Civil War when American exchange was at a considerable discount in Europe, the dollar at one time selling for $0.33 1/3 in England, and for $0.25 in France. Investments in first-class American bonds were made by many foreigners at that time, and large profits were obtained as the dollar slowly advanced to par.

To illustrate some of the more outstanding examples of how profits are possible,—always keeping in mind that the discussion is based upon the assumption that the foreign exchanges will ultimately recover—let us first take up some of the more evident cases.

If a speculator purchases, say, 100,000 kronen worth of Czecho-Slovakian bonds when kronen are worth 0.0190, the investment will cost $1,900, which could be carried on a margin of 33 1/3 per cent, or for about $635. If kronen advance 1/10 of a cent in a week or in a month, the profit would be approximately 15 per cent for that length of time. If the kronen return to par (0.2026) within a fairly reasonable time, say ten years, a good rate of return would still be obtained. Speculation in French bonds also offers an opportunity for large gains. If francs are quoted at 0.0810, and if the speculator purchases 100,000 francs worth of French bonds on a 33 1/3 per cent margin at that rate, the investment will cost approximately $2,885. If the franc rises ½ of a cent within a month's time, the profit on the increase in the value of the bonds will be $500, or at the rate of 17 per cent on a thirty day investment or at the rate of about 204 per cent per year. In March,

[1] Not only have individuals been able to profit by the low exchange rates on European countries but some of the South American nations have likewise been able to reap similar profits in connection with the payment of outstanding European loans. In August, 1920, Bolivia placed a loan in the United States, the proceeds of which were used to liquidate the French loans made to her in 1910 and 1913 amounting to 56,603,000 francs. At the normal rate of exchange that sum would have amounted to $10,924,079. Because of the low franc rate prevailing in New York in August, 1920, Bolivia was able to liquidate her 1910 and 1913 French loans with approximately $6,000,000, leaving a balance of $4,000,000 which she planned to use in the construction of certain railways.

1922, the French government 4's of 1917 were quoted at $56 per 1,000 francs; French Victory 5's at $67 per 1,000 francs; 50 per cent Premium Loan of 1920 at $82 per 1,000 francs, as was also the French government's 6 per cent Internal Loan of 1920.[1] At par these issues are worth $193, their value increasing as the franc exchange rate rises. If purchased at the above prices and held until par is attained, they would net the owner 264 per cent, 237 per cent, 224 per cent, and 224 per cent, respectively. Even though it takes fifteen years for the franc to reach par, the yearly return would amount to approximately 15 per cent.

English government bonds have not offered the opportunities for such large gains because the pound sterling has remained consistently higher than the other exchanges. In November, 1921, the English National War Loan of 1927, bearing 5 per cent interest, was quoted at $403 per £100; the National War Loan of 1922, also a 5 per cent bond, at $411; the Funding 4 per cent issue at $291, and the 4 per cent Victory Bonds at $315, par in all cases being $487. If these bonds had been purchased at the above prices and if held until they reach par, the profits on the face value of the bonds would amount to 20.8 per cent, 18.4 per cent, 67.3 per cent, and 54.6 per cent, respectively, in addition to the interest payments. If it should take five years from the date of purchase for the bonds to reach par, the percentage of profit per year would amount to 4.1, 3.6, 13.4, and 10.9, respectively on the face value of the bonds in addition to the yearly interest yield.

For many years before the World War it was the practice of American corporations to market some issues of bonds, or at least a part of their issues, in the shape of sterling, franc, or mark loans, the interest and principal being redeemable at par at the holder's option either in francs, pounds sterling, or marks, as the case might be, and at a fixed rate of conversion. Typical of such issues was that of the Chicago, Milwaukee and St. Paul's 4 per cent European Loan, issued June 1, 1910, and due June 1, 1925, redeemable at par at holder's option in francs or pounds sterling on the basis of £19 15s. 6d. for 500 francs. The semi-annual interest coupons called for 10 francs or 7s. 10 3/4d. In 1920 these bonds were offered in lots of 5000 francs at $580. The

[1] These bonds had been quoted on December 6, 1920, at $41, $51.25, $59.50, and $59.75 respectively. In the early days of November, 1921, they had been quoted at $47.25, $57.25, $65.25, and $68.25 respectively.

following data compiled by a New York investment firm show the percentage of profit on the investment (in addition to the interest) on the basis of sterling being at any one of four mentioned rates of exchange on the date of the maturity of the bonds:

Sterling Exchange	*Maturity Value of Bond*	*Profit on 5,000 francs invested at $580*
3.85	$751.34	Over 29%
4.00	791.00	" 36%
4.50	889.88	" 53%
4.8665	962.35	" 65%

An added feature in the case of these bonds is that both interest coupons and the bonds themselves remain valid for ten years after their due date, thus permitting the holders to retain them and take advantage of more favorable rates of exchange.

An actual transaction that took place during the week of December 13, 1919, in connection with an auction sale of £20,000 Pennsylvania Railroad Consolidated Sterling 3½ per cent bonds, illustrates the above principles. The low rate for sterling on the day of the sale was 3.88, yet the bidder bought in the bonds at the price of $663 per £200, or at the rate of 3.31½ per £. These bonds mature in 1945, and the purchaser evidently figured that sterling would be back to normal by that time. If it is, he will receive a profit of 46 per cent, or at the rate of about 2 per cent per year on the face value of the bonds in addition to the interest payments. The value of the interest coupons will also fluctuate with the exchange rate. At 3½ per cent the bonds bear £7 interest per year. With sterling at 3.50 per £, the interest would amount to $24.50 on an investment of $663, or at the rate of 3.7 per cent per year. With sterling respectively at 4.00, 4.50, and 4.8665, the percentage interest yield would be 4.22, 4.75, and 5.13.[1]

An example showing another method of profiting through exchange transactions and investment in bonds, but this time through falling exchange rates, occurred shortly after the Armistice. Japanese yen were being quoted above par, i. e., at 54½ (54½ cents per yen) or at the rate of 183.48 yen for $100. It was felt that Japanese exchange was bound to decline at least to par, possibly to the rate of 50 cents per yen (200 yen per $100). A certain United States government bond was being quoted at that time at $95. The exchange dealer

[1] *Commercial and Financial Chronicle*, December 13, 1919, pp. 2216–17.

advised his Japanese clients not to withdraw their dollar accounts from the United States but to invest them in this particular issue of bonds because it was thought that they would at least rise to $98 within twelve months' time. Expected profits were calculated in the following manner:

$100 at time of investment	183.48 yen	
$100 a year hence (expected)	200.00 "	
Gain	16.52 yen	or 9.00%
U. S. Government Bonds at time of investment	$95.00	
U. S. Government Bonds a year hence (expected)	98.00	
Gain	3.00	or 3.15%
Interest on the bonds at fixed rate		4.25%
Total expected yield on year's investment		16.4%

Yen did decline as expected, but the bonds at the end of twelve months were at about the same quotation, so that the investment netted approximately only 13 per cent instead of the anticipated 16.4 per cent.

During the past few years Americans have been especially urged to purchase German bonds, particularly the bonds of German municipalities, because of the possibilities of large future profits if the exchange rate for the mark should improve. The following list of quotations of German municipal securities and their prices per 1000 marks in January, 1922, needs no comment. The reader, in the light of the preceding discussion, will be able to calculate the percentage yield of profit should the mark return to normal.

GERMAN MUNICIPAL BONDS, JANUARY, 1922

Prices per 1000 Marks

Berlin	$4.75
Bremen	6.25
Cologne	6.00
Dresden	5.75
Düsseldorf	5.75
Frankfort	7.50
Hamburg	6.00
Münich	6.25
Bremen	6.00
Dresden	6.00

Similar prices prevailed for the bonds of German corporations. All securities quoted have a par value of $238 per 1000 marks.

From the above it can be seen that the exchange rate is the most important factor affecting the value of foreign bonds in the United States market. The value of bonds in the foreign markets may actually rise, and yet they may fall in the markets of the United States as a consequence of a decline in the exchange rate. During the week of July 24, 1920, for instance, the average London quotation for the British government's 4½ bonds rose from $377 to $379 as expressed in dollars at par of exchange, but the decline in the sterling rate in the United States from 3.91 to 3.80, caused this increase of $2 to become an actual decrease of $6 in the New York market where the price fell from $302 to $296. On the other hand, the prices of foreign bonds in the foreign market may remain stationary or may even decline, yet, through a rise in the exchange rates in the United States, the price of those bonds may increase in the United States. Thus from the first week in March, 1920, to the second week in April of the same year, the London prices of the British government's 4½ bonds fell from about $393 to $379 as measured in dollars at par of exchange, but because the sterling rate advanced in New York from 3.38 to 4.02, the value of those bonds in the New York market rose from about $274 to $313.

Aside from the speculative phases of investment by Americans in foreign securities, there are other considerations that must not be overlooked in the discussion of this matter. Citizens of European countries have for centuries past invested heavily in the stocks and bonds of other lands; Americans have not. That "trade follows investment" has been amply proven in the past, especially in the case of investments in countries that are primarily producers of raw materials. Also, as Paul M. Warburg has well said, "International security markets are healthy adjuncts of international discount markets; they are important equalizers of trade balances, and I trust we shall not neglect to provide this important part of Uncle Sam's equipment for his new career as a world banker." [1] Foreign countries still owe us large sums of money. Because of our protective tariff we are preventing them from paying us in goods. They have paid us in part in gold, but they cannot afford to send us much more without seriously crippling their internal credit structure. We already have on hand too

[1] *Journal of Commerce and Commercial Bulletin*, April 9, 1919.

large a supply of that precious metal. One of the most commonly suggested methods of aiding in the adjustment of this international indebtedness is through our investment in foreign securities. Without doubt, we should create in our country a broad open market for foreign securities payable not only in dollars, but also in the currency of the country issuing the security. As Mr. Warburg has well said,

"We should have international bonds rather than foreign bonds. While for many years to come the home market for such securities may be of very little importance to us, we cannot foretell what the future may bring. We know, however, that for England it proved of the greatest value in her hour of need that she owned billions of foreign securities enjoying markets outside the British Isles, while France suffered from the fact that her loans to foreign lands had been made in a special issue payable in francs, and having their exclusive market in Paris."

Arbitrage

We need not in this chapter discuss again the possibility of profits or losses for the exchange dealer through the issuance of finance bills, or through his acting as a correspondent on joint account or on commission in floating currency, sterling, franc, or mark loans; nor need we again consider the profits or losses arising out of gold and silver shipments. Those matters have been rather fully dealt with in earlier chapters. There still remains, however, one other group of activities, engaged in only by the largest exchange dealers, whereby gains may be made by taking advantage of existing exchange rates (a) to shift funds from one country to another, thereby increasing the amount of funds available, or (b) to transfer funds to a point through two or more other points or centers more cheaply than by sending the funds direct to their final destination. This practice is known as "arbitrage" or "arbitraging."

Arbitrage in foreign exchange may be defined as "a calculation to determine, or an operation to profit by, variations in cost of the same currency in different markets." [1] For its successful operation, arbitrage requires proper equipment and an expert knowledge of the exchange field. The equipment consists of free funds in various centers that can be readily moved from place to place, and cable information concerning the rates of exchange existing at any moment in the various markets. With funds and the needed information available, the ex-

[1] *Guaranty News*,, August, 1920, p. 184.

change dealer may take advantage of the best rates in a number of financial centers to transfer his funds in the cheapest manner, or to shift his funds from one place to another and make them grow as they go. To illustrate: The cable rates between New York and London may be high; between New York and Paris, normal; and between Paris and London, low. A New York banker who has funds to pay out in London can get them more cheaply in London by cabling his correspondent in Paris to purchase cables on London, than he could if he purchased sterling cables in New York at the prevailing high rate. This is one phase of what is known as "three point" arbitrage, because three points or centers are involved. "Four point" arbitrage is also possible and is sometimes resorted to by the more expert arbitragers. For example, cable rates between New York and London may be high, between New York and Paris, normal, between Paris and Berlin, low; between Berlin and London, low. The New York banker, instead of paying his bill in London by purchasing sterling cables, will cable his Paris correspondent to purchase a telegraphic transfer on Berlin, and will cable his Berlin correspondent to purchase a cable on London, thus getting his funds to London through Paris and Berlin (around three sides of a quadrilateral) more cheaply than by purchasing sterling cables in New York. At times "two point" arbitrage is possible, for instance, between New York and London. At a particular moment the rate in London on New York and the rate in New York on London may not be at exactly the same level. New York can then wire London to sell a cable on New York, and at the same time New York can sell a cable on London, and, because of the slight difference in the rates, a profit may be made.

The above description may be clarified by a consideration of some concrete examples. In the case of "two point" arbitrage, say that on a certain day, the officer of a New York bank who is in charge of arbitraging operations and who is known as the "trader," receives a wire from London that cables in London on New York are at 4.88. At that moment he finds that he can sell cables in New York on London at 4.885. He wires his London correspondent to sell $50,000 of cables, which, being done, adds £10,245 18s. od. to his London account. He then sells cables to the amount of £10,245 18s. od. at the rate of 4.885 and receives therefor the sum of $50,061.23. Out of this amount he will have to pay the $50,000 covering the amount of cables sold by his London correspondent. His gain on the transaction will therefore

be $61.23, minus, of course, the cable charges and the commission, if any, of the London correspondent.

Similar results could be obtained if purchases were made, instead of sales. With the rates reversed, i. e., cables in London at 4.885 and in New York at 4.88, say that the New York trader cables his London correspondent to purchase $48,850 of cables on New York, while at the same time the New York trader purchases £10,000 of cables on London. In New York $48,800 is paid out for £10,000 worth of sterling cables, and in London £10,000 is paid out for $48,850 worth of dollar cables. The London account of the New York trader is balanced, but he receives $50 (minus cable charges and commission of correspondent) more in New York than he paid out.

In two point arbitrage, New York buys on (remits to) London and London buys on (remits to) New York; or New York sells (draws) on London and London sells (draws) on New York. No other combination is possible in two point arbitrage.

Three point arbitrage is a little more difficult to understand because one more point or center is added. To illustrate such a transaction, say that the rate for sterling cables in New York is 4.89, that the rate for franc cables in New York is 19.25, and that the rate for sterling cables in Paris is 25.22. To transfer £10,000 directly to London by cable would cost the New York trader $48,900. If he transfers it through Paris, he will find it much cheaper because the rates between both New York and Paris, and Paris and London are, in our example, below normal. The New York trader could, if he desired, merely wire his Paris correspondent to purchase a £10,000 cable on London and deduct 252,200 francs from his (the New York trader's) account; but it is more probable that he would take advantage of the opportunity to make an extra gain by buying franc cables on Paris in New York and by having his Paris correspondent buy cables on London. The costs and gain to him from the latter method would be as follows:

£10,000 cables @ 4.89 ..... $48,900
$48,900 @ 19.25 cents per franc will purchase ..... 254,025.97 francs
254,025.97 francs @ 25.22 francs per £ will purchase £10,072 8s.

By thus working around two sides of a triangle, the returns are greater by £72 8s. than if cables had been bought directly; or, to put the matter another way, it has cost the New York trader less to get £10,-

000 to London via Paris than it would had it been sent direct to London. It is possible, however, for the rates in Paris on New York to be such that the New York trader might wire Paris to draw on him, i. e., to sell cables on him, and then for the New York trader to buy exchange on London with the proceeds. Or it is possible for the rate in London on Paris to be such that it might be advisable for London to sell exchange on Paris instead of having Paris remit the funds to London by cable. To transfer funds to London, therefore, we may have any one of the following combinations of operations:

New York remits to Paris; Paris remits to London
New York remits to Paris; London draws on Paris
Paris draws on New York; Paris remits to London
Paris draws on New York; London draws on Paris

To reverse the process and transfer funds to Paris instead of to London, we may have any one of four similar combinations of operations, as follows:

New York remits to London; London remits to Paris
New York remits to London; Paris draws on London
London draws on New York; Paris draws on London
London draws on New York; London remits to Paris

Three point arbitrage operations may also be engaged in at times because the rates of exchange may be such that it is profitable to transfer funds around three sides of a triangle, and finally bring them back home as a larger amount. Using the same data as in the above example, suppose that, when the funds have reached London, the rate in London on New York is at a level where the funds can be returned to New York at an additional profit. If they are so returned, it is possible to have at least sixteen different combinations of operations similar to those described above in our example where the funds were sent from New York to London through Paris, or from New York to Paris through London. There is no need of our listing them; the reader, if he desires to do so, may readily figure out the various combinations.

Four point arbitrage adds still another center to the transaction. Taking the data in the above examples of three point arbitrage and adding Berlin with mark cables in Paris at .81 (1 franc = .81 marks)

and sterling cables in Berlin at 20.5 (£ = 20.5 marks), we would have the following results:

£10,000 in New York @ 4.89 will cost.....$48,900
$48,900 with francs @ 19.25 will purchase.....254,025.97 francs
254,025.97 francs with marks at .81 will purchase...205,761.03 marks
205,761.03 marks with sterling at 20.5 will purchase.£10,037 2s. 5d.

Thus when the funds are sent to London via Paris and Berlin, they net £10,037 2s. 5d, but had they been sent from New York direct to London the $48,900 would have netted but £10,000.

To add another possible step to the above illustration: Even though the New York rate on London is very high, the rate on New York in London may be at such a position when the funds reach London, after passing through Paris and Berlin, that they may be sent back to New York at a further profit. In an instance like this, the funds will have gone entirely around four sides of the quadrilateral.

In the above examples the differences between the cable rates have been large, much larger than those that normally occur, but the fundamental thing for the reader to grasp is the method by which such operations are put through by the exchange traders.

While arbitraging by cable is the ideal practice, yet some arbitraging is done by means of other forms of exchange transactions. We have already mentioned the practice of sending gold to a foreign center and there using it to purchase exchange on a third country; also the remitting of exchange by cable to a second center and there using the funds to purchase gold to send to a third country. Arbitraging may also be carried on by means of sight bills and long bills, as is evident from our definition above, which was to the effect that arbitrage is a "calculation to determine, or an operation to profit by, variations in cost of the same currency in different markets." Say that a New York trader has to transfer $100,000 from New York to London. The exchange rates are as follows:

Sterling cables	4.88
Sterling sight	4.8750
Sterling 60 day	4.85
Discount rate in London	3%
Franc sight	.193
Mark sight	.238
Paris on London, sight	25.20
Paris on New York, sight	5.165

Berlin on New York, sight..... 4.21
Berlin on London, sight.....20.50
Shanghai on New York, sight..... .63
Shanghai on London, cable.....2s. 7d.

What will be the cheapest method for the trader to transfer the $100,000 to London? For the purpose of comparing the relative costs we have to reduce all calculations to the basis of the cost of sending a sight draft.

(1) Cable to London.....4.88
Loss of interest for seven days @ 3%..... .0028
4.8772

(2) Sight draft to London.....4.8750

(3) 60 day draft to London.....4.85
Plus 63 days interest @ 3%..... .0251
4.8751

(4) Franc sight draft to Paris and Paris to London

$X = £1
£ = 25.20 francs
1 franc = .193

$$\$X = \frac{25.20 \times .193}{1} = \$4.86360$$

4.8636

(5) Marks to Berlin, and Berlin to London

$X = £1
£1 = 20.50 marks
m = .238

$$\$X = \frac{20.50 \times .238}{1} = \$4.879$$

4.8790

(6) Order Paris to draw on New York and remit to London

$X = £1
£1 = 25.20 francs
5.165 francs = $1

$$\$X = \frac{25.20}{5.165} = 4.8789$$

4.8789

(7) Order Berlin to draw on New York and remit to London

$X = £1
£1 = 20.50 marks
4.21 marks = $1

$$\$X = \frac{20.50}{4.21} = 4.8693$$

4.8693

(8) Order Shanghai to draw on New York and cable to London

$X = £1
£1 = 240d.
31d. (2s. 7d.) = 1 Shanghai tael
100 Shanghai taels = $63

$$\$X = \frac{240 \times 63}{31 \times 100} = \$4.8774$$

4.8774

The cheapest method of making the transfer evidently will be to buy a sight draft on Paris and to have Paris purchase a sight draft on London. The above tabulation does not exhaust all the arbitrage operations that are possible between the above points, but it is sufficient to show the method and the principles involved.

Traders watch exchange fluctuations most carefully in order to take advantage of surprisingly slight variations in the rates. They are constantly in touch by cable with those markets in which their banks have funds. New York is several hours behind the opening of the financial day in foreign centers, so that when the traders reach their desks in the morning they find at hand cable information giving them a picture of the financial situation abroad. The morning cables also bring them offers of exchange and bids for varying amounts of exchange from foreign dealers. With these data as a basis the traders prepare their "parity sheet" for the day. The parity sheet contains a tabulation of the foreign discount rates, the exchange rates prevailing in foreign centers, and the trader's rates for buying and selling various kinds of exchange (cables, sight, 30 day, etc.), all expressed in American money. It is really a guide sheet, and is of constant service to the trader as he buys and sells exchange throughout the day.

The parity sheet has nothing to do with the mint par of exchange; it is concerned only with the commercial par, which is an entirely different matter. There can be a mint par only between those countries that have the same monetary standard; but there are commercial parities between all countries. "The commercial parities are the relative values of foreign exchange on a certain day in United States dollars." [1] If we have the New York rate on Paris and the Paris rate on London, what *should* be the correct New York rate on London? Or, to revert to our geometrical parlance, with two sides of the triangle given, how long *should* be the third side? If the rate that does exist is less than it should be, an opportunity is offered for an arbitrage operation. If the New York rate on Paris is 19.3, and the Paris rate on London is 25.22, the commercial parity between New York and London will be 4.86746. Working this out by chain rule the calculation would be:

$$\$X = £1$$
$$£1 = 25.22 \text{ francs}$$
$$1 \text{ franc} = \$.193$$
$$X = \frac{25.22 \times .193}{1} = \$4.86746$$

[1] Westerfield, R. B., *op. cit.*, p. 1176.

If the New York rate on London is 4.865 and the London rate on Berlin is 20.46, the commercial parity of New York on Berlin will be $0.23778 and would be calculated as follows:

$$\$X = \text{marks}$$
$$20.46 \text{ marks} = £1$$
$$£1 = \$4.865$$
$$X = \frac{4.865 \times 1}{20.46 \times 1} = .23778$$

Commercial parities are calculated for cables, sight bills, and long bills. In the case of long bills, stamp taxes and the discount are deducted.

As any of the rates change, a new commercial parity must be calculated. Usually the trader does this mentally by means of certain short methods of calculation and without changing his parity sheet for the day. At times, however, a trader may have recourse to parity tables, which he himself may have constructed or which he may have at hand in printed form. All parity and arbitration tables in print at present are out of date because of our decision in 1920 to quote all foreign exchanges in terms of dollars and cents. The table below is a small portion of a parity table formerly used, showing the commercial parity between sterling, francs, and dollars on the old basis of quoting francs to the dollar:

£1 =	25.18 $1	25.19 $1	25.20 $1	25.21 $1
4.85	5.1918	5.1938	5.1959	5.1979
4.8525	5.1891	5.1911	5.1932	5.1953
4.855	5.1864	5.1885	5.1905	5.1926
4.8575	5.1837	5.1858	5.1879	5.1900
4.86	5.1811	5.1831	5.1852	5.1873
4.8625	5.1784	5.1805	5.1825	5.1846
4.865	5.1758	5.1778	5.1799	5.1819
4.8675	5.1731	5.1752	5.1772	5.1793
4.87	5.1705	5.1725	5.1746	5.1766

When the New York rate on London was 4.85 and the Paris rate on London was 25.18, the commercial parity of New York on Paris was 5.1918. When the London rate on Paris was 25.19 and the Paris rate on New York was 5.1805, the New York parity on London was 4.8625. When the New York rate on London was 4.87 and the New

York rate on Paris was 5.1725, the London parity on Paris was 25.19.

The above table, with our present method of quoting franc exchange, would appear in part as follows:

£1 =	25.18	25.19	25.20	25.21
4.85	.192613	.192536	.192460	.1923839
4.8525	.192712	.1926359	.192559	.192483
4.855	.192811	.192735	.192658	.192582
4.8575	.192911	.192834	.192757	.192681
4.86	.193010	192933	.192857	.192780

In normal times, rates of exchange between countries cannot long remain out of line with one another. As soon as the market rates differ from the commercial parity, arbitraging begins. This creates a demand for or a supply of exchange on the center whose rates are out of line, and as a consequence of the resulting pressure they are forced back into place. Of course, arbitrage is only effective in readjusting the rates of exchange when the market is capable of being influenced by such operations. An extra issue of depreciated paper money, or some other similar matter, may completely wipe out or nullify any effect that an arbitrage operation might normally exert.

Traders must know at any moment of the day just how their accounts stand with their foreign correspondents. For this purpose "position sheets," or "positions," are prepared by their clerks. These position sheets, one for cables and one for sight exchange, show the amount of exchange on deposit with each of the correspondents against which cables or sight drafts can be sold, and the dates on which additional exchange is to become available or is to be paid out. Traders must be in possession of these data, otherwise they might overdraw on one correspondent or carry too large an account with another. As deposits are shifted from one center to another, or as exchange is bought or sold, the position sheets are changed accordingly. Some traders also keep what is called a "Profit and loss position" which enables them to "determine daily the profit or loss on exchange transactions, and the conditions of the stock of exchange and the average cost. The demand or check rate is used as the basis of the calculations. The prices of all time bills purchased are brought up to the check rate by taking into consideration the discount, costs, and stamps. The prices of cables are brought down to the check rate by considering the

THE MERCHANTS NATIONAL BANK OF LOS ANGELES

WEEKLY STATEMENT
—OF—
FOREIGN ACCOUNTS

FOREIGN DEPARTMENT

No.———————

Week Ending———————

FOREIGN ACCOUNT	*Balance Foreign Ledger*		*Outstanding Entries—Futures*				*Actual Balance*			*Loss*	*Profit*	*Memorandum*
			SOLD		BOUGHT			*Dollars*		*Dollars*		
	Frgn. Cy.	*Dollars*	*Frgn. Cy.*	*Dollars*	*Frgn. Cy.*	*Dollars*	*Frgn. Cy.*	*Book Value*	*Market Value*			
Amsterdam												
Antwerp												
Athens												
Athens												
Barcelona												
Belgrade												
Berlin												
Bucarest												
Budapest												
Calcutta												
Christiania												
Copenhagen												
Helsingfors												
Hongkong												
London												
London												
London												
Mexico City												
Mexico City												
Montreal												
Paris												
Prague												
Rome												
Sofia												
Stockholm												
Vancouver												
Vienna												
Vienna												
Warsaw												
Yokohama												
Zagreb												
Zurich												

FIGURE 81. Weekly statement of foreign accounts

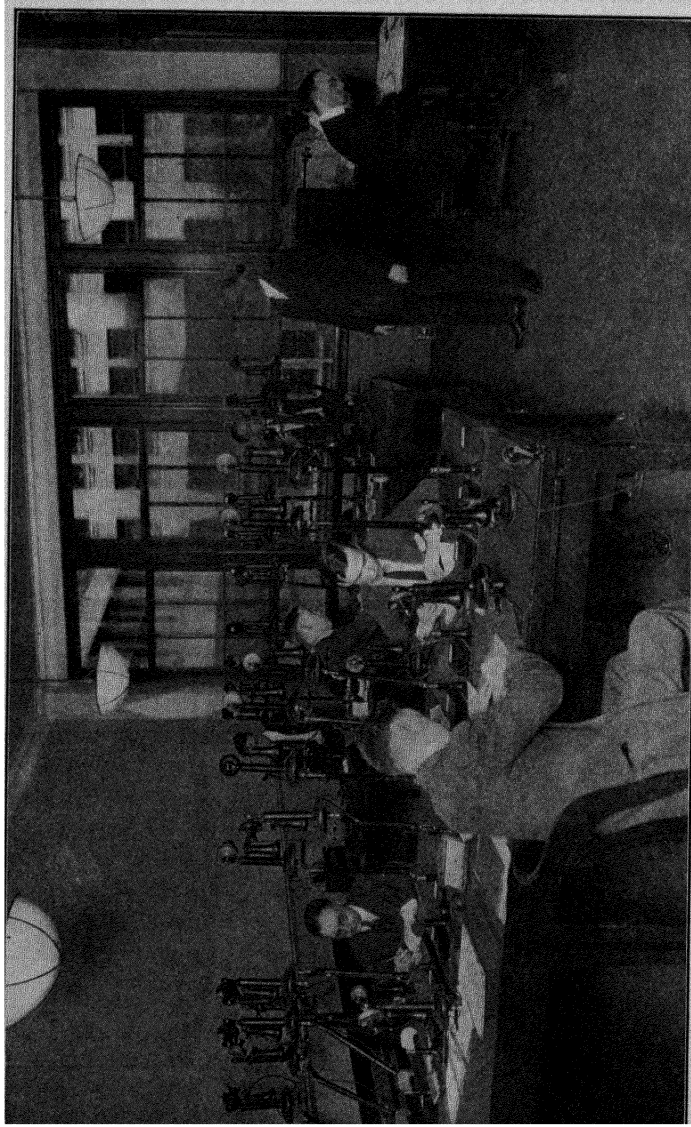
element of interest. After all purchases and sales for the day have been entered on the sheets and each price correctly determined, they are totaled and the average price for the whole is calculated. As the purchases and sales for the day are never exactly equal, it is necessary to make adjustments. If sales exceed purchases and there is sufficient exchange in stock to cover the excess sales, the excess is taken from stock at the stock price; if purchases exceed sales, the reverse process is performed." [1]

Traders not only buy and sell exchange, but at times find it to their advantage to "swap" exchange with one another. A trader with a large amount of sterling cables on hand may want to invest for a period of seven days the funds which they represent and may be willing to swap them for demand bills. The amounts exchanged are equal but the party that gets the cables pays the difference between the cable and the demand rates. Holding sight bills permits of speculation on the trend of the exchange rates during the succeeding seven days. During the World War British censorship made it difficult for American bankers with German names to carry on their foreign exchange business. The presence of a German name on a draft or in connection with a cable delayed the passage of the same until explanation was forthcoming. Bankers who were on the "black list" swapped their cables and bills for the exchange of other bankers whose business was not subject to such interference. Bankers who undertook to negotiate these war-time swaps did so at a commission of about $7 on every £10,000 transaction.

Traders also make up the lists of exchange rates which are used by their banks in dealing with their domestic correspondent banks, these lists as a rule being sent out daily by wire and by mail.

The traders are busy men, as may be appreciated from the above description of some of their activities. In addition to their dealing with foreign markets, they also keep closely in touch with their own local market and with other traders. They make constant use of the telephone, the telegraph, and the cable. The accompanying picture of the traders' room of the Guaranty Trust Company of New York shows thirty private line telephones, mounted on brackets. Some of these are connected directly with foreign exchange brokers, some with corporations that are large buyers or sellers of exchange, and some with other banks or with the branches of the Guaranty Trust Com-

[1] Westerfield, *op. cit.*, p. 1182.



An Exchange Trader's Room

pany. In addition there are switchboard connections through which the trader keeps in touch with the outside world and with the various departments of the bank. There are also four extra telephones for the personal use of the official in general charge of all trading operations.

From what has been said above in this and in other chapters, the reader must not conclude that exchange transactions by banks and by others net only profits and never losses. Under normal conditions the returns to large exchange dealers are extremely small even where millions of dollars of exchange are handled per year. Competition keeps down the rates and prevents excessive gains. The *Annalist* of February 14, 1916, in commenting upon this matter stated:

"It is reported that a trust company, whose turnover in the foreign exchange market last year rose into the billions, cleared so small a margin of profit that it was expressed as 'per mill' instead of 'per cent.' The direct purpose of a foreign exchange department in most banks is to facilitate business generally, in the way of increasing the number and size of deposits and in drawing to the institutions a greater clientele. It is natural for commercial houses with many remittances to make to other countries to do their banking with institutions which give them first-grade attention in exchange matters."

When exchange rates broke so unexpectedly in March, 1919, many of the large exchange dealers in the United States were caught unprepared and suffered losses aggregating millions of dollars. Again, when silver declined so rapidly in 1920, many dealers who had invested heavily in silver or in the silver exchanges suffered similarly. There are also the constant chances of loss through the non-payment of commercial bills at maturity. In 1920, American banks that had purchased large amounts of commercial bills on firms in Cuba, India, and South America lost excessive sums when, due to the rapid decline in prices, those firms refused to accept or to pay the drafts covering goods that they had contracted for at higher prices. American exporting firms, under the circumstances, found themselves in financial difficulties and many went into bankruptcy, so that the banks that had purchased the drafts were unable to collect the full amount owing them. Protest fees, cable charges, commissions to correspondents, and various other costs also eat into the expected profits. Unlooked for and adverse movements in the rates frequently turn anticipated profits into unexpected losses.

The individual who speculates or invests in the exchanges also runs great risks of taking losses rather than making profits. Exchange rates may move adversely at almost any moment. Many who purchased European exchange when it was starting on its downward path had to take heavy losses as it dropped lower and lower. Speculators in rubles and marks have been especially hard hit, while considerable losses have been incurred in francs, lire, and sterling. Investors in foreign bonds, especially national and municipal bonds, also run the additional risk of having such bonds repudiated or payments postponed indefinitely. Novices in exchange transactions must ever appreciate the fact that great risks always accompany opportunities to reap large profits.

CHAPTER XIV

THE WORLD WAR AND THE EXCHANGES

During the early months of 1914 the foreign exchange market followed its customary course with the exception that, owing to our unfavorable balance of trade, exchange rates on foreign countries were higher than usual. In May sterling touched the highest point reached since 1907 and a considerable sum of gold flowed to England. Gold shipments continued during June, approximately $47,000,000 being sent abroad, but principally to Paris. Added to our continuing unfavorable balance of trade were the heavy remittances of American corporations for July dividends and interest payments on foreign held American securities. Another element in the June movement was the fact that the Southern Pacific Railroad had $20,000,000 worth of notes maturing on June 15, and the Baltimore and Ohio Railroad had an equal amount maturing on July 1. These notes were payable in London at the holder's option in gold or in sterling exchange at 4.86½. As sterling exchange in June was approximately 2¢ higher than the designated rate of payment, many holders of the notes availed themselves of the option, preferring to take gold rather than the more expensive exchange. This action necessitated the transfer of a considerable sum of gold to London. As the gold was sent, exchange was drawn against it, and decreased the sterling rate slightly. The failure of the H. B. Claflin Co. stiffened the local money market and aided in weakening exchange rates. Although bankers' sterling sight bills had advanced from 4.8825 on June 1 to 4.8895 on June 12, they declined to 4.8755 on June 30. Early in July the pressure of finance bills and wheat bills weakened the market somewhat, but during the latter part of the month the crisis in Europe produced a state of affairs absolutely without parallel in the history of the world.

On July 24 Austria sent her ultimatum to Serbia; war followed. All stock exchanges on both sides of the Atlantic closed between July 27 and July 31. The New York Stock Exchange had remained open for a few days longer than some of the European exchanges

with the result that liquidation went on at an astounding rate from all parts of the world, causing startling declines in security values. This was the first time that the Stock Exchange of New York had closed since 1873. The London Exchange had never before been closed. European security holders objected strenuously to the closing of the American exchanges because they had hoped to be able to sell, at least, in our markets. It is said that a considerable amount of the unloading of securities in New York was caused by the attempt of speculators, who had been carrying marginal accounts, to "get out from under" and to seek safety at the first sign of war. Financial institutions and commercial firms in all countries hastened to place their houses in order for the oncoming storm. Many of the more far-sighted European financiers appreciated the fact that a credit balance in the United States would be of the utmost assistance in transacting their affairs, both during and after the war, and opened accounts in New York. With exchange rates mounting by leaps and bounds, gold exports increased accordingly. During the last ten days of July, gold to the extent of approximately $44,350,000 left New York. By July 31, demand sterling had risen to 5.50 with cables at 6.35, and in the early days of August some cable transactions were put through for as high as 7.00. For thirty years before the war the highest and lowest rates for sterling cables had been 4.91 and 4.82, respectively.

Throughout Europe panicky conditions of the worst sort prevailed. Financial and business relations were most hopelessly upset. The central banks immediately mobilized the gold holdings of their respective countries, refused to extend credit, and in every way made hurried preparations for the ensuing struggle, little appreciating how long it was to continue. Gold in France went to a premium before the end of July. On August 4, the Reichsbank was released from its obligation to pay its notes in gold. On November 23, the Bundesrat decreed that the buying or selling of German gold coin at a premium was a penal offense. The Bank of England, thinking that a European war was not possible, had been caught unprepared. Immediate recourse was had to the suspension of the Bank Act of 1844, under which it operates. This was accomplished by means of a note sent to the Bank by the Prime Minister and the Chancellor of the Exchequer on August 1, 1914, the formal suspension of the Act being decreed by Parliament five days later. England also followed the example of other European countries and declared a moratorium, thereby

postponing the payment of debts of certain kinds until a future date. The joint stock and private banks of England called in their loans and refused to renew American finance bills, which had been issued, as customary, in anticipation of fall shipments of cotton and grain, and which normally amounted to approximately $400,000,000. On July 30 the Bank of England raised its discount rate from 3 per cent to 4 per cent, a day later to 8 per cent, and on August 1 to 10 per cent, although reducing it to 6 per cent on August 6, and to 5 per cent on August 8, at which point it remained until July 13, 1916.[1] The Bank of France likewise raised its discount rate on July 30 from 3½ per cent to 4½ per cent and on August 1 to 6 per cent, although later reducing it to 5 per cent. The same policy was pursued by the other central banks of Europe. The excessive derangement of the exchanges was caused primarily by the moratoria, which had been made effective in all the leading European countries. American banks and firms had several hundred million dollars of credit abroad, which for the time being had to lie dormant and could not be used to offset American debts to European creditors. Our exports had been temporarily cut off, but even had they not, we would not have been able to compel the Europeans to pay us for them owing to the existing moratia. The discount houses of London were especially hard hit by the developments in the financial markets and finally weathered the storm only because of the relief extended by the government and the Bank of England.[2]

While the closing of the American stock exchanges made impossible the further dumping of foreign held stocks and bonds and thus prevented the piling up of a much greater indebtedness on our part to European creditors, at the same time, however, certain difficulties followed in its wake. There was no place where we ourselves could traffic in stocks and bonds, no price lists of securities were being published, with the result that banks and other financial institutions carrying investments in securities of various kinds were unable to dispose of them and thus obtain the funds so necessary for other purposes.

Gold continued to leave the United States in large quantities. During the first two weeks of August, $43,414,000 was sent to Great Britain and to France. The insurance rates on gold shipments became practically prohibitive, rising to as high as $5.00 per £100 sterling.

[1] Cf. p. 406.
[2] Cf. Withers, "War and Lombard Street," p. 59 *et seq.*

Shipments were risky and expensive, yet the Europeans, especially the English, insisted that we pay our debts, although at the same time they would not permit us, because of the existing moratoria, to make use of the credits which we had to our account in foreign countries. American bankers disliked to part with their gold holdings because they realized the difficulty of ever getting them back if in the future rates of exchange should fall below the gold import point. It was also felt that, as soon as the European moratoria expired, exchange rates would return to their normal levels. Europe, however, demanded gold, so gold had to be sent even though it meant seriously crippling our credit structure. We were owing England, France, and other European nations about $500,000,000, maturing between August 1, 1914, and January 1, 1915. Approximately $200,000,000 was due immediately. New York City alone owed $82,000,000 on tax warrants which had been sold in England and France, payment of which had been guaranteed in gold. Ordinarily we would have offset our foreign obligations by means of autumn exports of grain and cotton, but our exports were temporarily cut off. We could not part with all our gold, yet it was cheaper to send gold than to purchase exchange at the ruling exorbitant rates of exchange. But we also had to safeguard the future of our banking and commercial interests. The matter of first importance, therefore, was the conservation of our gold supply, for gold is the very basis of our credit structure. In doing so we had immediate recourse to the issuance of clearing house loan certificates and Aldrich-Vreeland emergency bank notes. These two forms of currency, it was thought, would at least partly relieve the pressure upon our domestic money supply. The Aldrich-Vreeland notes, which national banks, by the law of 1907, had been authorized to issue under emergency conditions, were difficult and expensive to put into circulation. The necessities of the situation being brought to the attention of Congress, it immediately (August 4) amended the law as requested by the bankers, and bank notes to the extent of $384,485,000 were subsequently issued under its provisions. Clearing house loan certificates to an aggregate amount of $211,778,000 were also issued by banks in twelve of our more important clearing houses, but were used solely in clearing house operations and did not get into circulation among the public.

To meet the extremely critical situation, various proposals were suggested. It was urged that we, too, declare a moratorium, which

would relieve us from paying our foreign obligations, but the suggestion luckily did not meet with approval. It was also proposed that England establish credits in the United States which could be offset by credits which were standing in our favor in England. But nothing came of that suggestion. Finally, on August 12, England agreed, for the convenience of American debtors, to accept deposits of gold with the Finance Department of Canada at Ottawa as the equivalent of gold deposited with the Bank of England, thus doing away with the risk and expense of shipping gold to England, as well as at the same time making us feel that in the future our exported gold might possibly be sent back to us if conditions justified its return. The proposal was accepted, and we began immediately to make gold shipments to Ottawa.

A syndicate of New York bankers was organized to take care of the outstanding tax warrants of New York City, the syndicate agreeing to purchase $100,000,000 of the short time bonds of New York City and to undertake the payment of its foreign indebtedness. In the course of the syndicate's operations, it sent $35,264,636 in gold to Ottawa and later forwarded $80,243,941 in exchange to foreign countries to cover the remainder of the payments that had to be made before January 1, 1915. It was also thought advisable to devise some sort of arrangement whereby the other outstanding obligations of American banks and firms could be taken care of. On September 4, 1914, the Federal Reserve Board and the Secretary of the Treasury called a conference of representatives of clearing houses in all reserve cities for the purpose of estimating our total indebtedness to Europe and of devising some means of handling the situation. It was calculated that we owed approximately $500,000,000 to European countries, maturing during the next few months. The conference recommended that a National Gold Fund of $100,000,000 be established for the purpose of meeting our obligations, and that the Federal Reserve Board circulate a request for subscriptions to this Gold Fund among the banks of all clearing houses in the United States. The response was prompt and $108,000,000 was immediately subscribed. The profit from the operation of the fund was to be derived from the sale of exchange against the sum provided, and was to be distributed on a pro rata basis among the contributing banks. This National Gold Fund operated secretly and cautiously and made but one call and that for only 25 per cent of the subscribed amount.

The above arrangements had the effect of causing a sharp break in exchange rates during September. On September 1, bankers' sight drafts sold at 5.0625, but they closed on the 30th at 4.98½. In October, we began retiring our clearing house loan certificates and emergency bank notes. The situation had seemed so critical that Sir George Paish and Basil B. Blackett had been sent from London for the purpose of arranging some sort of loan from England or the Bank of England to the United States or to American bankers, in order to make further shipments of gold unnecessary. But while our Treasury officials and leading bankers were in conference with these emissaries, the exchange market collapsed and rates fell below the gold export point, thus, temporarily at least, relieving us from the fear of a continuing gold drain. Our merchandise exports, which had been cut off, also began to increase rapidly, large amounts of breadstuffs and cotton being shipped, especially to England. The expiring moratoria on bills of exchange in European countries also assisted in bringing exchange rates back to normal. The moratorium on some bills of exchange in England terminated on October 19, and by December 3 all English moratoria were abandoned. During October exchange on Germany ruled at very low rates, because of the exports that we were sending indirectly to her and also because of the activities of German interests in transferring their accounts to New York, which appeared likely to remain a neutral market. Exchange in large amounts was being sold on Germany so as to secure funds in New York and thus build up German accounts in American banks. Under the system of quoting the mark that prevailed at that time, par was approximately 95.2 ($0.952 per four marks), with the import gold point at 94 7/8, yet cables on Germany dropped to as low as 89, while demand exchange closed in October at 88.75. During November the situation became even more favorable to the United States, all clearing house loan certificates having been redeemed, or a date set for their redemption, while the greater portion of the emergency bank notes had been withdrawn from circulation. Sterling exchange broke sharply. On November 9, bankers' sterling sight drafts stood at 4.90 7/8; on the 10th at 4.89 5/8; on the 11th at 4.89, and on the 12th at 4.86 3/4. The outstanding cause for the spectacular decline of November 12 was the announcement that the New York City loan syndicate had been able to purchase all the required exchange at a rate considerably below 4.90. Speculators who had been buying up exchange, hoping to sell

to the syndicate at higher rates, found that they had been outwitted, and threw their supply upon the market, causing the rate to decline unexpectedly. The rate, however, strengthened slightly during the latter part of the month, due to the announcement that the Stock Exchange of New York was to open on November 28, although only for bond trading. There was some fear that there might be considerable selling for foreign account, even though the latter was forbidden by the stock exchange authorities. Sterling closed on November 30 at 4.89. On December 12 the Stock Exchange was opened to limited trading in stocks, but issues of an international character were at first kept off the list. Three days later, however, came the announcement that the Stock Exchange was open to trading in all securities. On the 22nd, as indicative of the satisfactory condition that prevailed, the New York Clearing House notified its members that thereafter balances had to be paid in gold certificates or in other lawful money. The London Stock Exchange opened on January 4, 1915. As the year closed, new moratoria were declared by France, Italy, Sweden, Hungary, and other continental countries. Exchange in New York continued to seek lower levels, sight drafts on England closing on December 31 at 4.8525. The hindrances to our foreign trade had been gradually removed, and exports began to increase rapidly. Merchandise imports, however, were curtailed somewhat for the reason that trade with Germany was practically impossible. Our monthly favorable balance of trade during the winter and fall months of 1914 was as follows:

September	$16,341,000
October	56,630,000
November	79,411,000
December	131,863,000

This increasing balance of trade meant a large supply of exchange and therefore lower rates. Demand for exchange eased up considerably, partly because there were few American tourists abroad and because of the fact that a smaller amount of remittances was being made to relatives in foreign countries; also our obligations abroad had been fairly well taken care of by the means above described.

During the first week of January, 1915, the Treasury Department of the United States and the Treasury Department of Great Britain

reported that exchange conditions were back to normal and that there was no longer any necessity of carrying on the negotiations which had been begun during the fall of 1914 looking toward an adjustment of exchange relations between the United States and England. During January the exchanges continued to weaken without forcing the Bank of England to part with any of its gold, sight exchange selling as low as 4.8325. One special cause for this pronounced weakness was the fact that the Canadian Government had secured a loan in London for the purpose of purchasing war supplies in the United States. To make those funds available, Canada sold sterling bills in New York and oversupplied the market. In the latter part of January, a sharp rise in exchange rates occurred in spite of a rather liberal offering of grain and merchandise bills, occasioned by the demand on the part of American bankers for exchange with which to meet maturing finance bills as well as to make payments for foreign held American securities which had been sold in the United States. On the rise, sterling exchange reached 4.85 3/8, but closed at the end of the month at 4.84½. Gold now commenced to flow into the United States from various countries, and during the second week of January we received approximately $4,000,000 in gold. Our favorable balance of trade for the month totaled $145,536,000, the largest that we had had up to that time. The effect of this exceptional trade balance was a further drop in the exchanges, not alone on London, but also on all continental centers. By February 16, sterling sight drafts had fallen to 4.79, the lowest rate since the crisis of 1857. There was considerable selling of American securities for foreign account during that month, bond sales alone aggregating more than $2,000,000. The Bank of England still resisted the pressure to send us gold, although during February it did forward $8,250,000 from Ottawa to be deposited in a New York bank for the account of the French government and the Bank of France. France was purchasing war supplies from us and the gold was to be used to pay for them. Some gold also arrived from London, Japan, and certain of the South American countries. During March the National Gold Fund concluded its activities, announcing that since its organization it had sent only $10,000,000 in gold to Ottawa at an expense of $16,542, $11,000 of which had been expended for the transportation of gold. The Fund had operated without the payment of fees or salaries and had successfully served the purpose for which it had been created.

During the latter part of 1914 and the early part of 1915, merchants and bankers from practically all countries of the world established credits in the United States for trade purposes, which led to the question being raised as to whether or not England was paying dearly for her moratoria. For the time being it looked as though the financial center of the world was to be shifted from London to New York, for New York had remained the only free gold market in the world, placing no hindrances whatsoever on the flow of gold or on the use of credits deposited in that city. It seemed probable that New York would be called upon more and more, as time passed, to assist in financing the needs not only of the belligerents but also of the neutral countries. Early in 1915 the Canadian provinces had begun to borrow heavily from New York, their needs having previously been met by London, and this borrowing has continued to a great extent down to the present time. As months passed, other loans were floated on behalf of European and South American countries.

From January to April, 1915, we had imported approximately $43,000,000 in gold. These imports, together with the large amount of American securities which had been returned to us by foreign holders, and the interest and dividend payments and other incidental charges and remittances which we had made—all creating a demand for exchange—were not enough to maintain rates at their normal levels. Sterling dropped lower and lower, declining to 4.78 15/16 on April 22. Even at that low rate, the shipment of gold from England was hardly profitable because of the heavy costs of insurance and freight, coupled with the danger of loss by submarine attack. Sterling rates would undoubtedly have fallen to lower levels had not the New York dealers felt that an effort would soon be made to arrange credits in New York on behalf of the warring nations. Our favorable balance of trade continued to increase by leaps and bounds. Our huge excess of exports clearly indicated that exchange was destined to reach lower levels unless some effort was made to prevent a further decline. In June, 1915, sterling dropped to 4.7625, a new low record. Gold was flowing in to us at a rapid rate. Over $120,000,000 had arrived in the first six months of 1915, of which $90,000,000 had come from the Bank of England's holdings in Ottawa. On July 30, sterling reached 4.7575; on August 31, 4.555; and on September 1, 4.50.

At that rate it would have paid American bankers to buy gold in England for import. England now began to fear the loss of her gold

holdings and the crippling of her war finances. She was about to be forced to take steps to protect her exchange. The other European exchanges were also at a decided discount.

The declining rates of exchange created a most difficult situation for American exporters and for foreign importers. Exporters were unable to determine approximately what their drafts would be worth when goods were ready for shipment, and under the circumstances were forced to charge excessively high prices. With exchange on England, say, at 4.76, exporters who had been accustomed to receive at least 4.86 for a sterling draft were compelled to add 10¢ to their prices for every pound sterling's worth of goods sold in order to make up the loss which they would suffer because of the depreciated exchange. For the same reason the Allies, who were purchasing increasingly large quantities of war supplies, were forced to pay proportionately higher prices. England, who was in reality financing the war for the Allies, soon appreciated the necessity of obtaining a loan from the United States, and in September, 1915, sent a commission to us for that purpose. The commission asked for one billion dollars, but at that time, because we were new to the task of making international loans, we were willing to grant but $500,000,000. This loan was to bear interest at 5 per cent, and was to be a dollar loan, the proceeds to be deposited entirely in American banks and used only for the purpose of buying supplies in our country. When the commission left London for the United States, sterling was at 4.50. By the time its members reached New York, sterling had climbed to 4.725, but, after the terms of the loan had been arranged and the commission had departed for London, sterling fell to 4.605. During the remainder of the year, however, sterling gradually rose until in January, 1916, it reached 4.765, which, on the basis of the excessive insurance and shipping costs, represented in reality a new import point for gold. England thereupon decided to peg sterling at that level, and her efforts were so successful that, until she unpegged her exchange on March 18, 1919, she was able to keep sterling fluctuating around 4.75.

England's pegging arrangement consisted of four parts: first, the mobilization of English-held American securities and the use of the funds received from their sale in the United States in the purchase of sterling cables, thus artificially creating a demand for English exchange and stiffening the rate; second, the securing of loans and the establishing of credits in the United States, thus reducing the

supply of sterling exchange; third, gold shipments; and fourth, regulations looking toward the restriction of unnecessary imports.

In July, 1915, England had organized the Committee on American Dollar Securities, but nothing was done toward the mobilization of such securities until the close of that year. England then appealed to her citizens, and especially to the insurance and trust companies, either to sell or to loan their holdings of American securities to the government. In case of sale, payment was to be made in five-year 5 per cent Exchequer bonds, the price of the securities being fixed at the New York quotation converted at the prevailing exchange rate on the date of sale. This arrangement permitted the holders to profit by the depreciation in the sterling rate in the United States. If the securities were loaned to the government, the owner was to receive the regular interest and dividend payments thereon, plus an additional return of one-half of one per cent per year from the government. At first the loan was to be for only two years, but it was subsequently extended to an indefinite length of time. The owner was also given the privilege of requesting the Treasury at any time to dispose of the securities in New York and to pay him the proceeds converted into sterling at the prevailing rate. Canadian and South American issues were also mobilized, but were employed chiefly as collateral for loans which we later advanced to England.

England experienced great difficulty in securing a sufficiently large supply of securities for her purpose. Holders were reluctant to part with their high yield American stocks and bonds. The government was finally compelled to resort to force, and on May 29, 1916, passed a law imposing a special tax of 2s. per pound of income received from all issues asked for by the government. The Income Tax Act of 1916 also included a one per cent tax on United States securities held by non-resident aliens. After January 1, 1917, this was further increased to 2 per cent. But even so, a sufficient amount of the desired securities was not forthcoming, and under the provisions of the Defense of the Realm Regulations, the Treasury was given power to compel the holders of certain issues to turn them over to the government. This final regulation was most effective, and the government experienced no further difficulty in obtaining the needed securities.

The method of employing the mobilized stocks and bonds was very simple. As sterling weakened in New York, the American agent of the English government (J. P. Morgan & Company) went into the

market, sold a sufficiently large amount of the securities, and then with the proceeds purchased cables on London until the rate was forced back to its pegged position, which represented about a two per cent discount on the par of exchange. The rate determined upon was 4.76 7/16 for cables, which meant that sight sterling was expected to fluctuate between 4.75 and 4.76. This rate was a trifle lower than the point at which it would pay to import gold, but the risks of capture or loss by submarine were so great that England knew that American bankers would not be active as importers of the yellow metal.

The acquisition of securities was discontinued on April 29, 1919. During the existence of the Dollars Securities Committee, it acquired approximately $1,400,000,000 of American and Canadian securities, not to mention additional amounts of sterling, franc, krone, and other denominations. Of the securities loaned to the Committee, £307,605,065 were of sterling denomination, $648,314,720 were Canadian and American securities, and £21,096,800 were in other currencies. The cost to the government of the additional one-half per cent allowance on the loan of these securities was £1,800,000 in 1919–1920; and less than £1,500,000 in 1920–1921. All the transactions of the Committee were concluded by March 31, 1922.[1] The total cost per year to the English government of operating its security mobilization scheme was estimated at about $1,250,000,000. The arrangement was successful and in itself expensive, but had England not spent that sum of money annually in pegging its exchange rate, it would have had to pay an even greater sum because of the much higher prices that would have been charged for the war supplies of the Allies on account of their more greatly depreciated exchanges.

After our first loan to England and France in 1915, it was only a short time until the Allies were in the American market for additional advances. All the loans subsequently made were dollar loans, the proceeds being deposited in American banks and drawn on by American exporters. The extent of the loans privately floated, as well as the amount of credits advanced by the United States government after we entered the war, have been fully commented upon elsewhere.[2] Their effect was, in brief, the curtailment of exchange of all kinds on the Allied nations. Sterling, franc, and lire drafts were no longer

[1] Statement of the Chancellor of the Exchequer, *Commercial and Financial Chronicle*, April 9, 1921.

[2] Cf. pp. 332–336.

drawn as before; in their stead American exporters drew drafts in dollars on the accounts of the Allies which had been deposited in New York banks. This extensive reduction in the supply of exchange helped materially to stabilize the exchange rates.

Immediately upon the outbreak of the war, England, France, and Russia pooled their gold resources in order that their funds might be made more effective. The control of the gold was placed with England, who was to use it in such a way as to keep the exchange rate pegged and the American money market in an "easy" condition. Some of this gold came across the Atlantic convoyed by warships; some across the Pacific. The greater part was sent direct to Ottawa. From time to time, as the exchange market stiffened, or as money rates in New York gave evidences of rising, this gold was sent to the United States, its arrival being nicely timed to have the desired effect. By this means, the Allies were able to keep the exchange rate at the desired position and the money rates lower than they would otherwise have been.[1]

England and the other allied countries also succeeded in placing an effective embargo upon unnecessary imports and so reduced the amount of exchange that would otherwise have been drawn in connection therewith. Not only were luxuries placed under the ban, but an effort was also made to allow only the required amount of the necessities to be imported.

France and Italy also mobilized their American securities and cooperated with England in the stabilization of the exchanges. Germany was cut off from the American markets, but sold her American securities to Dutch and Scandinavian investors, who in their turn sold them in the United States until prevented from so doing by the confiscation policy adopted by the Allied countries. It was this sale of securities by the Dutch and the Scandinavians, either for themselves or for German account, that caused the New York exchange rates on Holland, Sweden, Denmark, and Norway to remain above par in spite of the adverse balance of trade of those countries with the United States.

After 1915 our favorable balance of trade continued to expand at

[1] A total of $1,200,000,000 gold was handled for England by the Department of Finance of Canada. Of that amount, $546,000,000 was for the account of the Bank of England and the remainder for the account of the British government. In 1914, $104,000,000 was received from the United States. This was subsequently returned to us when the rates of exchange shifted. Of the total amount passing through Ottawa, $491,000,000 came from Great Britain, $353,000,000 from South Africa, $253,000,000 from Russia, $692,000 from Borneo, and $172,000 from Brazil.

an astonishing rate, amounting to $3,091,005,766 in 1916, $3,281,044,642 in 1917 and $3,118,087,926 in 1918, while during the same years securities and gold flowed in to us in unsurpassed amounts.[1] Rates of exchange on England fluctuated but slightly during those three years, remaining constantly at a little less than a two per cent discount. Francs and lire, although tied to sterling, moved at lower levels. Francs during 1916 were down to about a 12 per cent discount, and in

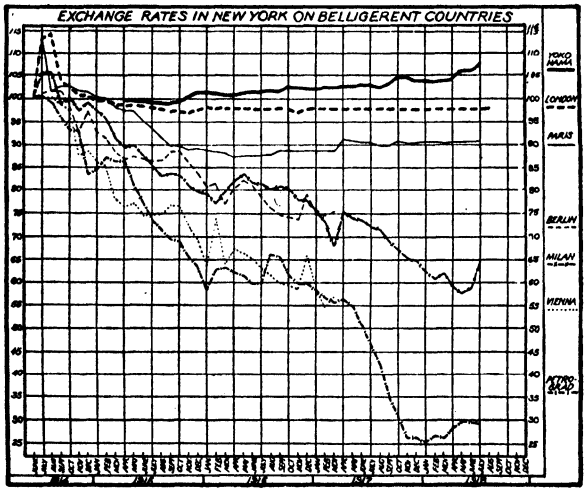


CHART XIII

Highest monthly sight rates in New York on belligeren. countries, June, 1914—July, 1918. Percentage fluctuations from par. Adapted from *Federal Reserve Bulletin*, September, 1918, p. 841.

1917 and 1918 they ranged at about a 10 per cent discount. Lire followed more closely Italy's fortune in war. During 1916 they were down to about a 20 per cent discount, while in 1917 and 1918 they dropped to a discount of about 30 to 35 per cent. Rather early in the conflict rubles began to depreciate, reaching a discount of 35 per cent in 1915, 41 per cent in 1916, 74 per cent in 1917, and finally disappearing altogether from the market in 1918. Although Germany made no effort to stabilize the mark, it held up much better than the ruble, falling to a discount of 17 per cent in 1915, 27 per cent in 1916,

[1] Our excess of gold imports for 1916, 1917, and 1918 was respectively $529,952,000 $181,542,000 and $21,102,000.

and 25 per cent at the time we entered the war in 1917. The rates on the European neutrals remained consistently above par until the close of the war, and as a consequence gave our importers consider-

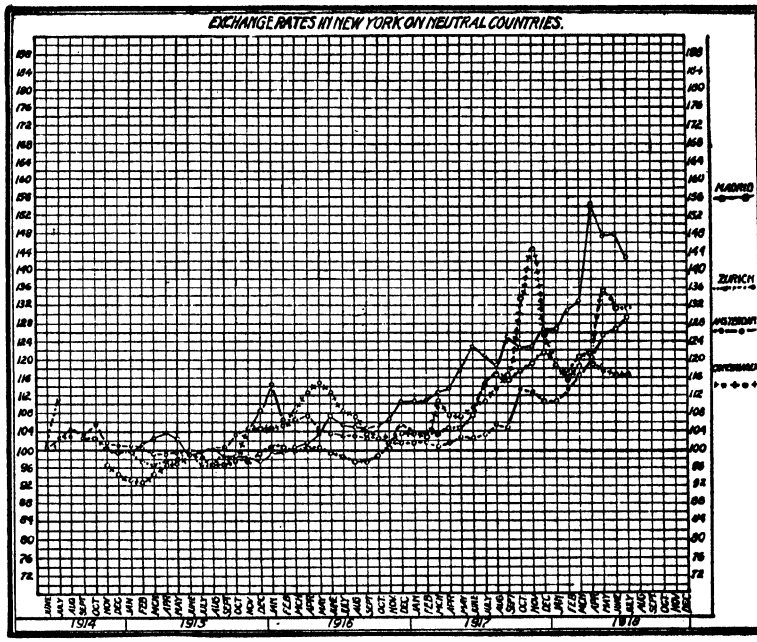


CHART XIV

Highest monthly sight rates in New York on neutral countries, June, 1914–July, 1918. Percentage fluctuations from par. Adapted from *Federal Reserve Bulletin*, September, 1918, p. 843.

able difficulty, especially those who were purchasing supplies in Spain. The peseta reached a 10 per cent premium in 1916, but in 1917 went to a 26 per cent premium, and in May and June, 1918, to a 42 per cent premium. The premium on the peseta and the necessity of shipping gold to Spain proved to be a problem difficult for the American importers to understand, especially in view of the fact that we were exporting a far larger amount of goods to Spain than we were importing from her. The reason for the premium on Spanish exchange was simply this: England was buying heavily from Spain. Spanish merchants had drafts on England which they wished to dispose of at the

highest possible rate. England had not stabilized sterling in any country except the United States, as a consequence of which sterling had fallen to a much greater discount in all other centers. Sterling drafts could be sold in New York for about 4.75, so the Spanish merchants disposed of their London exchange in the highest market, which was New York. These sales created Spanish credits in New York and caused such a heavy demand for Spanish exchange that it more than offset our favorable balance of trade with Spain and hence caused the rate for pesetas to rise greatly above the gold export point. American importers complained that England's pegging scheme caused us to bear an unjustified burden and also to lose a portion of our gold holdings.[1]

With the other European neutrals, however, the situation was not quite so serious. In the early part of 1917, after we had entered the war, the United States began to assist England in keeping supplies from Germany by placing an embargo on exports to the neutral countries. This action curtailed the supply of exchange on those countries and raised the rates above par. This state of affairs continued until the early months of 1919.

Exchange on Canada ruled at a discount during the period of the war, except for the months of August to November, 1914. Canada's purchases from us were so large, and the loans which we floated for her were so great, that no other result than a depreciated exchange (averaging about a 2 per cent discount) could be expected.

The United States did not interfere with exchange operations or with exchange rates until after we had been at war with Germany for several months. On September 7, 1917, the President issued a proclamation placing the export of coin, bullion, and currency under the authority of the Federal Reserve Board. Shipments to the neutral countries were absolutely prohibited by the rulings of the Board, because of the fear that they would undoubtedly reach Germany sooner or later. Some shipments were made to South America and Oriental countries, and later to other points.[2] By subsequent proclamations, complete control of the exchanges was placed in the hands of the Federal Reserve Board. This intensive (and really cumber-

[1] It was estimated that during 1917 and 1918, with the peseta considerably above par, the marketing of Spanish owned sterling drafts in New York cost the importers of the United States approximately $4,000,000 a year.

[2] The restriction on gold exports caused gold to rise temporarily to a premium of 35 per cent in China and 85 per cent in India.

some) regulation of the exchange market lasted until June 26, 1919. Restrictions on exchange transactions with Russia were retained, however, until December 20, 1920. During the period of control licenses were approved for the export of gold, silver, and currency aggregating $863,253,670.[1]

On November 11, 1918, the World War was brought to a close by the declaration of an Armistice. England, uncertain of the immediate future, continued to peg her exchange as before. By March 18, 1919, however, all danger seemingly being past, she withdrew her official support from the exchanges, and the market collapsed.[2] Her pegging arrangement was costing approximately $1,250,000,000 a year, and with the war over she could not afford to continue such a heavy expenditure. Rates of exchange were allowed to seek their "normal" or "natural" levels. In a day's time, sterling dropped to 4.70, francs to 5.75, and lire to 6.38 (the old method of quoting francs and lire was still in use at that time). The course of all exchange for some time thereafter was downward at an astonishing rate, the low quotations for the year being as follows: sterling on December 12, 3.6525; francs on December 10, 11.84; lire on December 11, 13.60. We had begun quoting marks during 1919, and they too declined to a low record of 0.0187 on December 9. Canadian exchange fell to a discount of 4 per cent in November. The neutral exchanges also weakened considerably.

During 1920, the exchanges in New York reached their lowest levels. On February 4, owing to the rumor that England was about to declare an embargo on cotton imports, sterling dropped to 3.18, but recovered rapidly, although easing off again as the year passed, and closing in December at 3.52. "The arbitrage of exchange through London was so free and constant throughout the year 1920 that, except for special conditions which applied to certain local currencies, sterling exchange was closely followed by all the other exchanges."[3] Francs reached their low record on November 11, at 0.05705 per franc (new method of quoting, or 17.528 by old method), closing at 0.05865 on December 31. Lire sank to 0.0331 (new method of quoting, or 30.211 by old method) on December 28. Canadian exchange declined to a 15 per cent dis-

[1] Cf. Annual Report of the Federal Reserve Board, 1918, pp. 39–46, for a statement of the regulations imposed on exchange transactions during the war.

[2] From February, 1916, to March 18, 1919, sight sterling had not fallen below 4.75 1/8, so successfully had it been pegged.

[3] Annual Report of the Federal Reserve Board, 1920, p. 29.

count in February, but recovered slightly as the months passed, and then closed at a discount of about 14 per cent.

During 1921 the exchange market stiffened slightly from January to May, then eased off somewhat until early fall and closed in December at a higher level than had prevailed at the opening of the year. Marks ruled at increasingly lower levels. The yen fell below par and

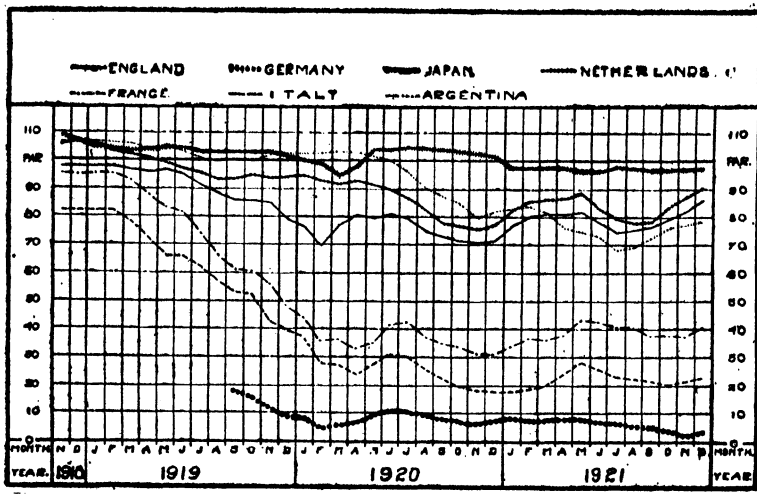


CHART XV

Exchange rates in New York on England, France, Germany, Italy, Netherlands, Argentina, and Japan, November, 1918–December, 1921. Percentage fluctuations from par. Adapted from *Federal Reserve Bulletin*, January, 1922, p. 115.

so remained during the entire twelve months. The Swiss franc advanced from a low of 15.22 in January to above par on December 14, and was the first of the European currencies to be quoted in New York at a premium after the general depreciation of the exchanges. The rates on other neutral countries likewise rose, but did not attain par during the year.

The spring of 1922 has seen a continued rise in the more important European rates, the closing quotations on March 31 being as follows: sterling 4.3725; francs 9.0025; lire 5.10; marks 0.0033; pesetas 15.45; and Swiss francs 19.40. On the same day the Canadian dollar stood at a discount of 2 13/16 per cent.

The rather phenomenal rise in certain of the European rates was due primarily to the success attendant upon efforts to put financial conditions on a better basis. England has been most active in that connection. The existence of a discount on sterling militated against its return as the international monetary unit in foreign trade connections. No country that has any regard for its financial standing among the nations of the world cares to see its currency at a discount. England furthermore has realized that with the possibility of having to pay off some of her foreign loans and also the interest on other loans in the near future (interest payments to the United States were to be postponed only until the spring of 1922), it would be rather expensive to have to make such payments in a depreciated currency. In fact, when she paid us her share of the Anglo-French Loan of 1915, it cost her £59,229,000 instead of £50,830,000 which were the proceeds of her share of that loan.[1] She has therefore been striving to bring sterling back nearer to par. Just how soon she will accomplish her object is, of course, uncertain. She hesitated to make any efforts in that direction immediately after the war because she felt, as Lloyd George so well put it in August, 1919, that "The adverse American exchange rate in itself is protection against the importation of manufactured goods, something which England is anxious to bring about in order to save herself from her present plight brought about by the war."[2] There has been a notable decrease in her imports from the United States and certain other countries which has given her a better opportunity to get her own industrial and commercial machinery on a more satisfactory basis in preparation for the extension of her activities in the world's markets. Other nations of Europe have likewise profited, at our expense, by permitting their exchanges to remain at a discount. We can buy—but we are hindered in selling because, with the dollar at a premium, our goods are too expensive for foreigners to buy.

Beginning with the debacle in the exchange market following March, 1919, there has been a constant agitation in all parts of the world, either for the stabilization of the exchanges or for their improvement. World trade has been seriously handicapped because of the many uncertainties of a financial character that have existed. In the discussion as to what ought to be done many have confused the meaning of the terms "stabilization" and "improvement." Stabilization

[1] *Commercial and Financial Chronicle*, November 13, 1920.
[2] *Journal of Commerce and Commercial Bulletin*, August 25, 1919.

refers to the act of fixing the exchange rate at some point, of course at a discount, and keeping it there, as England did with sterling during the war, or as Argentina has done with her paper peso. Improvement or appreciation means bringing the exchange rate of a country back to par or normal.[1]

It has been suggested that those countries whose currencies are at a discount of more than 20 per cent should make no attempt to restore their currencies to the 1914 level. To bring the exchanges of those countries back to normal within a short period of time would require extensive deflation, with serious results to all financial and business interests in the countries concerned. It took the United States about fourteen years to return its greenbacks to par, and there is no reason for presuming that countries like Germany, Austria, Poland, Russia, etc., can accomplish parity or should even attempt to accomplish it within the space of a few years. Stabilization of the currencies of these countries at a fixed discount is now being strongly recommended. Lloyd George is quoted as having declared before the Genoa Conference (April, 1922):

"Before trade can be fully restored you must have established everywhere convertibility of currency into gold or its equivalent—convertibility of liquid assets lodged in banks of a country maintaining a free gold market. This will involve the revaluation of currency. The world cannot afford to wait until currency is restored to par. What matters is stabilization at a figure that can be maintained and which will, therefore, contribute a reliable basis of international commerce."

At the close of the Revolutionary War, to cite again from our experience with depreciated paper money, we found ourselves swamped with a mass of inconvertible paper money with no possibility of ever being able to redeem it at par. We boldly—and from some angles probably unwisely—announced on August 4, 1790, that we would fund our paper issues in 6 per cent bonds "at the rate of one hundred dollars in the said bills for one dollar in specie." This was an outright repudiation of millions of dollars of our obligations, but it enabled our government to get on its feet financially much sooner than would otherwise have been possible. Some writers have urged that Germany,

[1] One of the most excellent discussions on this matter, entitled "The European Exchanges," by Professor J. M. Keynes, appeared in the *Manchester (England) Guardian*, April 7, 1922.

Austria, Russia, Poland, and other countries similarly affected by worthless currency should follow our earlier example in order to hasten, although by a bitter route, the progress of reconstruction. A still better plan might be the adoption at present of a rate of discount or redemption which would be decreased as the financial condition of the country improved in the future. Some writers have suggested that all of the old currency be abandoned and that a new unit be adopted as the standard of value, in terms of which the old currencies would be redeemed at a fixed rate of discount. This again would involve partial repudiation, which always seriously affects a country's credit standing among the nations of the world.

For nations like England, France, Italy, Belgium, Holland, Switzerland, Czecho-Slovakia, and the Scandinavian countries, convertibility into gold might be more easily established at the present moment on the basis of a sliding discount arrangement or by agreeing now upon a fixed future date when convertibility would be effective. The latter scheme was the plan adopted by the United States in connection with its greenbacks, and with satisfactory results.[1] Professor J. M. Keynes has proposed [2] that a sliding scale of appreciation be adopted by this group of countries, which should never advance by more than one-half of one per cent per month. Thus, if a nation's currency, as gauged by its exchange, were at a discount of 10 per cent, that country might, if financially able to do so, bring its currency back to par within the short period of 20 months. To aid in a more rapid recovery, he also suggests that gold be loaned to the central banks of Europe by the Federal Reserve banks of the United States at an interest rate of 10 per cent per year in order to enable the central banks to bring their gold reserves up to at least 15 per cent of the outstanding paper circulation. Not more than $150,000,000 should be loaned to any one institution and not more than $50,000,000 at any one time.

Various other proposals have been made looking more especially toward the rectification or appreciation of the exchanges rather than to their stabilization.

Senator Hitchcock of Nebraska has urged the United States to establish a "Bank of Nations" with a capital of $2,400,000,000, one-sixth of which would be contributed from the gold holdings of the

[1] In January, 1875, Congress passed a law authorizing the resumption of specie payments on January 1, 1879.

[2] *Manchester Guardian, op. cit.*

United States Treasury, the remainder to be subscribed by those nations which agreed to enter into the arrangement. The bank would be controlled solely by the United States, although it would be partly owned by foreign countries and could also act as their fiscal agent. It would issue what would be known as the "international dollar," which, presumably being freed from fluctuations, would, according to the proposed plan, become the international unit of value and thus stabilize exchange. Somewhat similar to this scheme is the suggestion that we should establish a Federal Reserve Foreign Exchange Bank, which would be owned by banks in the United States and which would be the central agency through which all foreign trade financing and all foreign exchange transactions should take place. Another proposal is that the central bank of a country should be given a complete monopoly of the exchange field. Centralization of control, it is thought, would bring much better results than are obtainable with the present condition of decentralization.

Some writers have proposed that all the nations of the world should adopt a universal or international standard of value, or coin, in terms of which all foreign business should be conducted. The advocates of this plan seemingly overlook the fact that in times of war, a standard of value which has been adopted by two or more countries may fluctuate just as widely as though the countries concerned were on different standards of value, viz., note the fluctuations of the Canadian dollar in terms of the American dollar; the fluctuations of the French franc in terms of the Belgian franc or the Swiss franc, etc., etc.

The adoption of "pegged" exchange might again prove effective, but it is far too expensive for any nation to countenance as a peace measure. It can be justified only as a war necessity. As the Brussels International Financial Conference declared:

> "Attempts to limit fluctuations in exchange by imposing artificial control on exchange operations are futile and mischievous. In so far as they are effective they falsify the market, tend to remove natural correctives to such fluctuations and interfere with free dealings in forward exchange which are so necessary to enable traders to eliminate from their calculations a margin to cover the risks of exchange, which would otherwise contribute to the rise in prices."

Czecho-Slovakia, however, is still attempting a modified form of "pegging" by acquiring a government reserve consisting of foreign

exchange bills, which it uses in purchasing Czecho-Slovak exchange whenever it declines to too great a discount. The object is not complete stabilization, but merely the reduction of fluctuations to a minimum.

Since the war we have made extensive loans to the European countries, their cities and corporations, which, as was to be expected, have had some beneficial effect on the exchanges. It has been urged that we continue such advances and thus further assist in returning conditions to normal. We have been happy to loan to those countries which are already in a fairly satisfactory financial condition, but we naturally hesitate to advance funds to those nations which are deepest in the mire of depreciated paper money, and yet which really need our assistance more than do those to which we have loaned so freely.

The cancellation of international debts has also been proposed. The United States has been urged to cancel the debts of England provided England in its turn cancels to an equal amount the debts owing her by the European countries. Cancellation would make interest payments and the payment of principal at maturity unnecessary, and would remove from the future markets what may prove to be a rather disturbing factor. It would also enable the countries which would thus be freed from their obligations to use the funds thereby made available to stabilize or improve their currencies. While cancellation of international indebtedness is not a probability, nevertheless steps are being taken at the present time to postpone payment until some far distant date. Congress has already authorized the funding of foreign loans in some form of long time bonds, so as to relieve foreign countries and our own markets from the disturbing effects of payment in accordance with the terms of the loans as originally made.

A resort to barter has not only been advocated but has actually and successfully been put into operation in Europe, especially between Germany, Holland, and Russia. But international trade cannot advance or function properly if confined to a barter basis. We are too accustomed to the practices of a credit society ever to be willing to revert to any extent to a system of barter which business and commerce abandoned many centuries ago.

Some of the European nations (Finland, Belgium, Germany, Poland, Italy, Greece) have enacted laws prohibiting speculation in the exchanges or limiting trading therein to bankers and to only those

transactions which are economically necessary. In Holland an Exchange Bank, Ltd., with a capital of 5,000,000 florins, has been established by a group of eleven banking concerns in collaboration with the Amsterdam Liquidation Bank, for the purpose of establishing an official terminal market in foreign exchanges, which will lend its services in the purchase and conversion of foreign currencies. In Belgium a "Caisse Internationale de Liquidation et de Garantie des Opérations en Marchandises" was organized in 1920 by a group of Belgium bankers to rectify the sudden and disturbing fluctuations in the various exchanges by means of extensive future transactions, and by facilitating "coverings by extending the market and centralizing the demand and supply of the whole world. Finally the promoters aim at assuring the contracting parties against risk of non-execution on the part of one or the other, by guaranteeing the settlement of all registered contracts." [1]

Some of the European countries have officially placed a ban upon imports of luxuries; others have raised tariff walls, or have adopted other policies for the purpose of decreasing foreign indebtedness, and thus relieving the pressure upon their exchanges. In Denmark in 1920, while no compulsory legislation had been passed, the bankers agreed to assist in restricting unnecessary imports by refusing to advance credit for their purchase.

Other schemes of reform have been advanced, having, as their primary object, the development or continuance of foreign trade activities through the medium of long time credits. European debtor nations require supplies; creditor nations, especially the United States, are eager to sell but cannot do so because the debtor countries are unable to pay. We might loan them the money to purchase our goods, but it would be similar to a customer receiving a loan from a merchant with which to purchase the merchant's goods, especially where the customer is acknowledged to be a poor financial risk. On the other hand, if the customer is able to put up satisfactory collateral, the chances of loss are by so much minimized. This last suggestion is the essence of the plan advanced by the Brussels International Financial Conference, which has come to be known as the "ter Meulen" plan. This scheme enables a country needing raw materials and primary necessities to pledge its assets as security for an issue of bonds with which foreign exporters may be paid. An international commis-

[1] Quoted from a circular issued by the Caisse Internationale.

sion of bankers and business men is to form the administrative commission. "The plan contemplates that parties desiring to import goods from another country, and particularly where a time credit is desired, shall lay before the International Commission whatever security they desire to offer and that this security shall be examined by the Commission and a value in gold fixed upon it. This having been done, the government of the importing country will issue its own bonds, in terms of the money of the exporting country, and loan them to the importer to be offered as collateral for the purchase money obligations. This proceeding produces a combination of private and government credit, with the entire transaction supervised by the International Commission. In case of default, the pledged security is to be in the custody of the Commission. The government bonds are differentiated from other government issues in that they are backed by specific security, supplied by private parties. The loan of government bonds is intended to secure the coöperation of the importer's government in the collection of the debt, and to supply an additional guaranty. It is true, of course, that the ter Meulen plan does not solve the very difficult exchange situation, which at this time is the chief obstacle to trade. It does not attempt to deal with this except as by making provision for the best obtainable class of time credits. It may make possible a considerable amount of trade without the necessity for immediate settlements," [1] payment for the goods by the country concerned being postponed until a future date, by which time, it is hoped, the country will be on its feet financially. The scheme has been widely approved by various financial and business organizations as well as by the League of Nations, but thus far only one country, Austria, has applied for assistance under its terms. From stray reports here and there, one is led to believe that it has not worked out successfully in that one instance because of the hesitancy of the investment market to absorb the ter Meulen bonds that have been issued in that connection.

Practically every nation has adopted some sort of scheme for the long time financing of foreign trade. England has been especially active in that regard, while we in the United States have our own Edge Law. This law authorizes the formation of Foreign Trade Banks, which may buy acceptances and issue bonds against them.

[1] *Monthly Letter on Economic Conditions, Government Finance, United States Securities*, issued by National City Bank of New York, December, 1921, pp. 10–11.

The above mentioned proposals are only a few of the more important suggestions that have been advanced as a means of stabilizing or rectifying the depreciated exchanges of the world. All undoubtedly have their good points; although for many of the schemes not much can be said in their favor. There may yet appear some plan that will prove to be adequate to meet the requirements of this extraordinary situation and which may be adopted by an international agreement among the more important nations, but it is doubtful, very doubtful, if that will occur. One nation alone can do little of a remedial nature except to put its own financial house in order, and the possibility of an international agreement on any sort of scheme is so improbable that one is almost forced to conclude that the exchanges in the future will be allowed to work out their own salvation, alone and unaided by any of the above or similar proposals. There are always present in the exchange field certain well-known correctives, discussed in earlier chapters, which, if allowed to function unhindered, will sooner or later bring conditions and relationships back to normal. It is time that war restrictions should be removed on exchange dealings of all sorts and that an absolutely free gold market be established by every nation. These two reforms would aid greatly in hastening the process of recovery. An adherence to contrary policies will merely retard the return of normal exchange relations. As an aid in bringing about the desired goal, to quote the official joint statement of the economists of the League of Nations,[1] "It is essential that the inflation of credit and currency should be stopped everywhere at the earliest possible moment. To this end, Government spending must be cut down, the conduct of Government enterprise at less than cost and the payment of subsidies on particular commodities and services must as far as possible be abolished, and military and naval expenditure stringently restricted. The equilibrium of State budgets must be restored, loans not being employed to meet ordinary current requirements. Artificially low bank rates out of conformity with the real scarcity of capital, and made possible only by the creation of new currency, must be avoided. Floating debts should, as soon as practical, be funded. . . . The serious depression of certain exchanges beneath their real parities would be ameliorated by (a) the funding of floating debts held abroad in the form of notes; and (b) the restoration as soon and as far as practicable of normal trade intercourse between the different countries."

[1] G. Bruins, G. Cassell, C. Gide, M. Pantaleoni, and A. C. Pigou.

APPENDICES

APPENDIX I

FORM OF AGREEMENT BETWEEN AN AMSTERDAM BANK AND ITS CORRESPONDENTS IN THE UNITED STATES

GENERAL CONDITIONS FOR "CHEQUE" ACCOUNT

	Value	*Charges*
WE CREDIT:		
Payments received	Date of payment if received before noon	Free of Commission
Remittances on ourselves or other Banks at Amsterdam and Rotterdam drawn in Dutch currency	Ditto	Free of Commission
Ditto with documents	Ditto	¼ o/oo; min. 50 cents
Collections on Amsterdam and Rotterdam	Next business-day after payment	Free of Commission
Collections on interior points	Ditto	Perte de Place, as per Collection Tariff
Remittances in foreign currency	Ditto	Extra comm. ½ o/oo; min. 10 cts., otherwise same terms as bills in Dutch currency
Transfers on our books	Day of transfer, as indicated by our committents	Free of Commission
Discounts as per special arrangement at our best rate of the day		
WE DEBIT:		
Drafts on ourselves	Date of receipt of advice	Free of Commission
Drafts on our Provincial Branches to the debit of your account with us	Ditto	Free of Commission
Drafts on our Provincial Correspondents to the debit of your account with us	Ditto	Uniform charge of 30 cents, as per our Tariff for Direct Drawings
Payments to Banks and to Commercial Firms at Amsterdam and Rotterdam	Date of actual payment	Free of Commission
Payments to Banks and Commercial Firms in the Provinces	Ditto	½ o/oo; min. 50 cents P. T. O.
Telegraphic transfers to Banks and Commercial Firms at Rotterdam	Date of actual payment	Free of Commission subject to telegram-charges
Telegraphic transfers to Banks and Commercial Firms in the Provinces	Ditto	½ o/oo; min. 50 cents plus telegram-charges

	Value	*Charges*
Payments to private persons	Ditto	½ o/oo; min. 50 cents
Telegraphic payments to private persons	Ditto	½ o/oo; min. 50 cents plus telegram-charges
Payments in virtue of clean Commercial Letters of Credit	Ditto	½ o/oo; min. 50 cents
Payments in Amsterdam and Rotterdam, against taking up of documents	Ditto	½ o/oo; min. 50 cents
Payments in the Provinces against taking up of documents	Ditto	1 o/oo; min. fl. 1
Confirmation of clean or documentary credits to the beneficiaries	Ditto	1/8% per 3 months or part, plus confirmation comm. of our correspondent, if any
Payments in virtue of Travelers' Letters of Credit	Ditto	1/8% deducted from payment to beneficiary with a min. of 50 cts. and 1/4% if paid in the provinces. This comm. is not deducted but charged to your account if so instructed
Acceptances in virtue of Commercial Letters of Credit	Day of maturity of the draft	30 d/s drafts 1/8% 60 " " 1/6% 90 " " 1/4% 120 " " 1/3% Confirmed Credits: 1/8% additional
Transfers on our books	Day of transfer, as indicated by our committents	Free of Commission

AMSTERDAM, September 8th, 1920.

APPENDIX II

VALUES OF FOREIGN COINS

Estimated by the Director of the United States Mint and used as the basis for estimating the value of foreign merchandise exported to the United States during the quarter beginning October 1, 1921.[1]

Country	*Legal Standard*	*Monetary Unit*	*Value in Terms of United States Money*	*Remarks*
Argentine Republic	Gold	Peso	$0.9648	Currency: Paper, normally convertible at 44 per cent of face value; now inconvertible.
Austria-Hungary	do	Krone	.2026	
Belgium	Gold and silver	Franc	.1930	Member Latin Union; gold is actual standard.
Bolivia	Gold	Boliviano	.3893	12½ bolivianos equal 1 pound sterling.
Brazil	do	Milreis	.5462	Currency: Government paper normally convertible at 16 pence (=$0.3244) per milreis.
British Colonies in Australasia and Africa.	do	Pound sterling	4.8665	
Canada	do	Dollar	1.0000	
Central American States:				
Costa Rica	do	Colon	.4653	
British Honduras	do	Dollar	1.0000	
Nicaragua	do	Cordoba	1.0000	
Guatemala	Silver	Peso	.4538	Guatemala: Currency, inconvertible paper.
Honduras	Silver	Peso	.4538	Honduras: Currency, bank notes.
Salvador	Gold	Colon	.5000	
Chile	do	Peso	.3650	Currency: Inconvertible paper.
China	Silver	Tael.. Amoy	.7439	The tael is a unit of weight; not a coin. The customs unit is the Haikwan tael. The values of other taels are based on their relation to the value of the Haikwan tael.
		Canton	.7417	
		Chefoo	.7116	
		Chin Kiang	.7268	
		Fuchau	.6882	
		Haikwan (customs)	.7570	
		Hankow	.6961	
		Kiaochow	.7209	
		Nankin	.7362	
		Niuchwang	.6977	
		Ningpo	.7153	
		Peking	.7253	
		Shanghai	.6708	
		Swatow	.6872	
		Takau	.7486	
		Tientsin	.7209	
		Dollar Yuan	.4875	The Yuan silver dollar of 100 cents is the monetary unit of the Chinese Republic; it is equivalent to 0.644 + of the Haikwan tael.
		Hongkong	.4893	
		British	.4893	
		Mexican	.4929	Mexican silver pesos issued under Mexican decree of Nov. 13, 1918, are of silver content approximately 41 per cent less than the dollar here quoted.

[1] 1921 Annual Report, Director of the United States Mint, pp. 139–140.

Country	*Legal Standard*	*Monetary Unit*	*Value in Terms of United States Money*	*Remarks*
Colombia	Gold	Peso	.9733	Currency: Government paper and gold.
Cuba	do	do	1.0000	
Denmark	do	Krone	.2680	
Ecuador	do	Sucre	.4867	
Egypt	do	Pound (100 piasters)	4.9431	The actual standard is the British pound sterling, which is legal tender for 97½ piasters.
Finland	do	Markka	.1930	
France	Gold and silver.	Franc	.1930	Member Latin Union; gold is actual standard.
Germany	Gold	Mark	.2382	
Great Britain	do	Pound sterling	4.8665	
Greece	Gold and silver.	Drachma	.1930	Do.
Haiti	Gold	Gourde	.2500	Currency: Inconvertible paper.
India (British)	do	Rupee	.4866	(10 rupees equal 1 pound sterling.)
Indo-China	Silver	Piaster	.4901	
Italy	Gold	Lira	0.1930	Member Latin Union; gold is actual standard.
Japan	do	Yen	.4985	
Liberia	do	Dollar	1.0000	Currency: Depreciated silver token coins. Customs duties are collected in gold.
Mexico	do	Peso	.4985	
Netherlands	do	Guilder (Florin)	.4020	
Newfoundland	do	Dollar	1.0000	
Norway	do	Krone	.2680	
Panama	do	Balboa	1.0000	
Paraguay	do	Peso (Argentine)	.9648	Currency: Depreciated Paraguayan paper currency.
Persia	Silver	Kran	.0836	Currency: Silver circulating above its metallic value. Gold coin is a commodity only, normally worth double the silver.
Peru	Gold	Libra	4.8665	
Philippine Islands	do	Peso	.5000	
Portugal	do	Escudo	1.0805	Currency: Inconvertible paper.
Roumania	do	Leu	.1930	
Russia	do	Ruble	.5146	
Santo Domingo	do	Dollar	1.0000	
Serbia	do	Dinar	.1930	
Siam	do	Tical	.3709	
Spain	Gold and silver.	Peseta	.1930	Valuation is for gold peseta; currency is notes of the bank of Spain.
Straits Settlements	Gold	Dollar	.5678	
Sweden	do	Krona	.2680	
Switzerland	do	Franc	.1930	Member Latin Union; gold is actual standard.
Turkey	do	Piaster	.0440	(100 piasters equal to the Turkish £.)
Uruguay	do	Peso	1.0342	
Venezuela	do	Bolivar	.1930	

APPENDIX III

METHODS OF CONVERSION

Although the average foreign exchange department is equipped with printed tables which facilitate the figuring of exchange rates, nevertheless it is well for the student to become acquainted with the more important phases of conversion practices. The following pages are concerned only with calculations in terms of English, French and German monies. Since we have lately begun the practice of quoting all exchanges by the direct method we no longer have recourse to the old methods of converting French and German money into that of our own country and vice versa, but it is well for the student to know how conversion of these two kinds of money was previously made so that he may understand earlier discussions of the subject.

ENGLISH MONEY

4 farthings = 1 penny
12 pence = 1 shilling
20 shillings = 1 pound or sovereign
21 shillings = 1 guinea

Therefore

1£ = 20s. = 240d. = 960 far.
1s. = 12d. = 48 far.
1d. = 4 far.

A. Addition

£	*s.*	*d.*	*far.*
15	8	3	0
38	6	2	3
20	3	9	6
£73	18s.	4d.	1 far.

9 far. = 2 pence and 1 far. Put 1 far. under the last column and carry the 2d. to the next column. The addition of the pence column, including the two that we have carried forward, gives 16d. which equals 1s. and 4d. Carry the 1s. to the next column and add, which gives 18s. With nothing to carry

to the £ column, we add and obtain £73. The correct answer is £73, 18s 3d. 1 far.

B. Subtraction

£	*s.*	*d.*	*far.*
14	3	6	2
9	8	6	3
£4	14s.	11d.	3 far.

Starting at the right hand column again, we note that 3 cannot be subtracted from 2, so we take 1d. from the 6d. in the next column, leaving 5d. One pence = 4 far. so we add 4 far. to the 2 far., which gives us 6 far. Taking 3 from 6 leaves 3 far. 6d. cannot be taken from 5d., so we take 1s. from the 3s., leaving 2s. 1s. = 12d., so we add 12d. to 5d. which gives 17d., and then take 6d. from it, leaving 11d. 8s. cannot be taken from 2s., so we take £1 from the £14, leaving £13. £1 = 20s. Adding 20s. to 2s. and subtracting 8s. leaves 14s. £9 from £13 leaves £4. The result is therefore £4 14s. 11d. 3 far.

C. Multiplication

£385	5s.	3d.	3 far.
			× 9
£3465	45s.	27d.	27 far.

Reducing the above product to its proper form, we note that 27 far. = 6d. 3 far. We add 6d. to the next column and obtain 33d. which equals 2s. 9d. Adding 2s. to the next column gives us 47s., or £2 7s. Adding the £2 to £3465 gives £3467. Our correct product would therefore be £3467 7s. 9d. 3 far.

D. Division

£436 8s. 7d. 3 far. divided by 7

7|436

£62 and £2 remaining

£2 = 40s. Add 40s. to 8s. and divide by 7

7|48

6s. and 6s. remaining

6s. = 72d. Add 72d. to 7d. and divide by 7

7|79

11d. and 2d. remaining

2d. = 8 far. Add 8 far. to 3 far. and divide by 7

7|11

1 4/7 far.

The correct quotient is therefore £62 6s 11d. 1 4/7 far.

E. Reducing English money to decimals of pounds sterling for ease in figuring

Reduce £3 9s. 5d. to decimals

A shilling is 1/20 of a £ or 5/100; therefore multiply shillings by 5/100 or .05. A pence is 1/240 of a £ or .004 1/6; therefore multiply pence by .004 1/6. To save trouble over the 1/6, multiply only by .004 and add 1 if the product is between 13 and 35, and add 2 if the product is over 35. Thus £3 9s. 5d. reduced to decimals would equal:

£3 = £3.
9s. = .45
5d. = .021
£3.471

F. Conversion of United States money into English money

Convert $10,000 @ 4.86 per £

Divide the American money by the rate per £, which gives the result in pounds and decimals of pounds. To reduce the decimals of pounds to shillings and decimals of shillings, multiply by 20 (the number of shillings per £). To reduce the decimals of shillings to pence, multiply by 12 (the number of pence per shilling).

10,000 /4.86
972 2057.613
2800 20
2430 12.260
3700
3402 .260
2980 12
2916 520
640 260
486 3.120
1540
1458
82

Answer = £2057 12s. 3d.

G. Conversion of English money into United States money.

Convert £2057 12s. 3d. at the rate of 4.86 per £.

Reduce to pounds and decimals of pounds for ease of figuring, which gives £2057.613 and multiply by 4.86.

$$
\begin{array}{r}
2057.613 \\
\underline{\quad 4.86} \\
12345678 \\
16460904 \\
\underline{8230452\quad} \\
\$9{,}999.99918 \text{ or } \$10{,}000
\end{array}
$$

FRENCH, BELGIAN, AND SWISS MONEY

The franc of these three nations is divided into 100 centimes. Until December, 1920, we quoted the franc by the indirect method, i.e., how many francs can be purchased for a dollar. We also used the supplemental percentage fraction, as described in Chapter X.

OLD METHOD

A. Conversion of French money into United States money

1. How many francs can be purchased with $1,000 at the rate of 5.16¼ Multiply the amount in dollars by the rate.

$$
\begin{array}{r}
\$1{,}000 \\
\underline{5.1625} \\
\text{Answer} = 5162.5000 \text{ francs}
\end{array}
$$

2. How many francs can be purchased with $1,000 at the rate of 5.16¼ — 1/16?

Multiply the amount in dollars by the major quotation (5.1625), which gives 5162.5 francs. Then take 1/16 of 1 per cent of $1,000, which gives $.625 and convert that sum into francs at the rate of 5.1625, which gives 3.226 francs. Add 5162.5 and 3.226, and the answer is 5165.726 francs. In converting dollars into francs, the minus sign before the percentage fraction makes the franc cost less, therefore we get more francs per dollar, and consequently reverse the sign and add 3.226 francs to 5162.5 francs to obtain the correct result. If the percentage fraction had been + 1/16, the francs would have cost more, i.e., we would have received fewer francs per dollar, and as a consequence we would have had to subtract 3.226 francs instead of adding them. Thus in converting dollars into francs where

the percentage fraction is applied to the dollars, we reverse the sign before the percentage fraction.

B. Conversion of French money into United States money

1. How much will 5,000 francs cost at the rate of 5.16¼?

$$5000 \div 5.1625 = \$968.52$$

Divide the amount of francs by the rate.

2. How much will 5,000 francs cost at the rate of 5.1625 — 1/16?

Divide 5,000 by 5.1625 which gives $968.52. Take 1/16 of 1 per cent of $968.52, or $.61 and subtract it from $968.52, which gives us the answer of $967.91. In converting francs into dollars, the minus sign before the percentage fraction makes the franc cost less, which means that we can get more francs per dollar, or in other words that we do not have to pay as much for them as we would at the major rate. If the fractional quotation had been + 1/16, francs would have cost more; we would have had to pay a larger number of dollars for 5,000 francs, and therefore would have added $.61 instead of subtracting it, making 5,000 francs at 5.1625 + 1/16 cost us $969.13. Thus in converting francs into dollars when the percentage fraction is applied to the amount of dollars obtained by using the major quotation we follow the sign that appears before the percentage fraction.

The above were the methods customarily used in such conversions, but the same results can be obtained if the percentage fraction is applied to the major franc quotation itself, provided the sign is reversed.

1. Convert $1,000 into francs at 5.1625—1/16.

1/16 of 1% of 5.1625 = .003266
5.1625 + .003226 = 5.165726
$1,000 × 5.165726 = 5165.726 francs

The reason why the sign is reversed and the sum of .003226 francs added to the major quotation is because a higher quotation for the franc means that francs cost less or that more of them can be obtained for a dollar. If the percentage fraction had been + 1/16, the sum of .003226 would have been subtracted from the major rate of 5.1625, giving 5.159274, which when multiplied by $1,000 would have given 5159.274 francs.

2. Convert 5,000 francs at 5.1625—1/16.

1/16 of 1% of 5.1625 = .003226. Again reverse the sign and add .003226 to 5.1625, giving us the rate of 5.165726. Divide 5,000 francs by 5.1657 and the result of $967.91 is obtained.

NEW METHOD OF QUOTING

The new method of quoting franc exchange presents no difficulties. The supplemental percentage fractions are no longer used and rates are quoted by the direct method. To convert 5,000 francs into American money at the rate of 20 cents per franc, we merely multiply 5,000 by 20 cents, which gives us the result of $1,000. If we want to know how many francs can be purchased for $1,000 when francs are quoted at 20 cents per franc, we divide $1,000 by $.20 and obtain the result of 5,000 francs.

GERMAN MONEY

The basic unit of the German monetary system is the mark. The mark is divided into 100 pfennigs. Before December, 1920, we followed the policy of quoting mark exchange on the basis of what four marks cost in our money. Supplemental percentage fractions were used as in the case of franc exchange to shade the rates a little more closely.

OLD METHOD OF QUOTING

A. Conversion of German money into United States money

1. How much will 10,000 marks cost at the rate of $.9525 per 4 marks?

First find the cost per mark by dividing .9525 by 4. Result = $.238125 per mark. Then multiply 10,000 marks by $.238125, which gives us the answer of $2381.25. The same result can be obtained by multiplying 10,000 marks by $.9525 and then dividing the product by 4.

2. How much will 10,000 marks cost at the rate of $.9525 + 1/32 per four marks?

First find the rate per mark on the basis of the major quotation. $.9525 + 4 = $.238125. 10,000 marks at .238125 = $2381.25. We then take 1/32 of 1 per cent of $2381.25, or $.74, and add it to $2381.25, which gives us our answer of $2381.99. If the supplemental fraction had been — 1/32 we would have subtracted the $.74 instead of adding it. In converting marks into dollars we follow the sign appearing before the supplemental fraction.

B. Conversion of United States money into German money

1. How many marks will $10,000 buy at the rate of $.9525 per 4 marks?

Divide $.9525 by 4 to get the rate per mark ($.238125). Divide $10,000 by $.238125 to secure the number of marks that can be purchased with $10,000. Answer, 41,994.75 marks.

2. How many marks will $10,000 buy at the rate of $.9525 + 1/32 per four marks?

Again find the rate per mark on the basis of the major quotation. $.9525 ÷ 4 = $.238125 per mark. Divide $10,000 by $.238125 and the quotient is 41,994.75 marks. 1/32 of 1 per cent of $10,000 is $3.125, which, when converted at $.238125 per mark gives 13.12 marks. Reversing the sign and adding 13.12 marks to 41,994.75 marks, we have as our answer 42,007.87 marks. Had the supplemental fraction been + 1/32 we would have subtracted 13.12 marks instead of adding it. The reason for reversing the sign when converting dollars into marks is because a minus sign appearing before the supplemental quotation makes the mark cheaper and therefore enables us to procure more of them for our dollars. If the sign is plus, the marks cost more, we get less of them, and we therefore have to subtract instead of add.

While the above method of always applying the supplemental fraction to the dollars in the problem was generally followed, the same results can be obtained by applying the supplemental fraction to the marks instead of to the dollars. For example, in converting 10,000 marks into dollars at the rate of $.9525 + 1/32, if 1/32 of 1 per cent of 10,000 marks is taken (3.12 marks) and converted at the ascertained rate per mark ($.238125), the result will be $.74295. 10,000 marks at .238125 would equal $2381.25. Adding $.74 to $2381.25, we obtain the same result as we did in the previous example. Again, converting $10,000 into marks at the rate of $.9525-1/32, we first convert $10,000 at $.9525 per four marks, which gives us 41,994.75 marks. If we take 1/32 of 1 per cent of 41,994.75, we obtain 13.1233 marks, which when added to 41,994.75 gives us the same result as in the paragraph above.

NEW METHOD OF QUOTING

As in the case of franc exchange, the new method of quoting mark exchange has greatly simplified matters. We now quote on the basis of how many cents the mark is worth. We are no longer bothered with supplemental fractions. To find out how much $1,000 will buy with marks at 25 cents per marks, we simply divide $1,000 by $.25 and get the answer of 4,000 marks. To ascertain how much 1,000 marks will cost us at 25 cents per mark, we multiply 1000 by $.25 and find that the cost is $250.

INDEX

Acceptance, defined, 60, 64, 84–85; kinds of, 85–87, 138–139, 143–146; presentment for, 89
Acceptance, banker's, defined, 70–71; advantages of, 73–74; in domestic trade, 72–78; in foreign trade, 236 ff; formerly forbidden in the United States, 77–78
Acceptance, trade, defined, 64; in domestic trade, 62–70; in foreign trade, 232, 234
Acceptance commissions, 16, 250–251
Acceptance houses, London, 111; New York, 100
Acceptor, liability of, 88
Actual rates, 312–313
Advances of interest or credit to facilitate gold imports, 396–397, 407
Advice, defined, 8
Aldrich-Vreeland bank notes, 530
Allonge, 81
Anglo-French Loan of 1915, 536, 545
Arbitrage, defined, 513; four point, 516–517; parity sheets, 519; tables, 520–521; three point, 515–516; two point, 514–515; stabilizing effect on rates, 521
Arbitration. *See* Arbitrage
Argentina, 469–471
Arrival or forward discount rate, 314–315
Assignor, defined, 83
Australian exchange, 270–275; London quotations, 304–305
Authority to draw, 295–298
Authority to purchase, 293–295

Bailee receipt, 247–248
Bank credit used by importer, 234–235
Bank of England, buying and selling price for gold, 376, 381, 382; control of gold movements, 402–407; discount rate defined, 115; making rate effective, 404; changes in rate during the war, 406; suspension of Bank Act in 1914, 528
Bank of Belgium and gold flow, 409
Bank of France and control of gold exports, 407–408; gold premium policy, 408
Bank of Nations proposed, 547–548
Bank post money order. *See* Post money order
Bank rate of discount, England, 402–407; Federal Reserve banks, 75; France, 406; Reichsbank, 406
Banker's acceptance. *See* Acceptance, banker's
Banker's demand draft, domestic, 44–49; foreign, 182–195
Banker's long bills, 200–218; ordinary, 200; currency or dollar, 202–204; finance, 206–212; sterling, etc., 204–206
Bearer bills of exchange, 79
Bibliography, 2–3 n
Bill brokers, London, 107–111; New York, 99–100
Bill of exchange, defined, 22–23; classified, 79, 137–140; clean, 14, 61, 139; documentary, 14, 61, 139–140, 143
Bill of lading, defined, 65, 140; clean, 161; order, 65; straight, 65; steamship, 159
Branch banks, foreign, 113
Brazil, 471–473

Cable exchange, 137, 196–200; spread, 351–352, 358–364
Canadian exchange, 132, 303–304; 542, 543, 544
Cancellation of international debts, 549
Cassell, G., and purchasing power parity theory, 482
Chain rule, 449
Checks, defined, 38; crossed, 87; in domestic trade, 38–44; in foreign trade, 171–172; par collection of, 38–44
Chile, 473–474
China, monetary system, 441–442; exchange, 443–451
Circular letter of credit. *See* Traveler's letter of credit
Clean bill of lading, defined, 161
Clean bills, defined, 14, 61
Clearing house loan certificates, 530, 532
Collection of domestic bills, 38–44; foreign bills, 278–280
Colonial clause, 270–273
Commercial bills, acceptance of, 143–144; documentary, 14, 61–62, 139; payment, 144–146; rebatable long bills, 144–146; with colonial clause, 270–273; with interest clause, 267–270. *See* Acceptances, trade and banker's
Commercial letter of credit, domestic, 71–72
Commercial letter of credit, foreign, advantages of, 234–235; contents of,

241–242; contract for, 238–241; dollar, 236–251; legal aspects of, 287–293; progress in use of dollar letters of credit, 254–255; confirmed, 281, 284–287; irrevocable, 284–287; revocable, 284–287; revolving, 259–260; sterling, 251–252, 256–259; unconfirmed, 282, 284–287; used in importing, 236–260; used in exporting, 260–268
Commercial par of exchange, defined, 135
Commercial parity, defined, 519
Confirmed credits, 284–287
Consular invoice, 167–169
Conversion methods, 559–565
Correspondent agreement, domestic, 17–18; foreign, 13–14, 555–556; instructions for drawing, 18–20
Council Bills, 454–455
Currency or dollar loans or long bills, 202–204, 339–340
Corrective influence, of arbitraging, 521; of gold movements, 412–413; of rates of exchange on spread, 355, 358–359

Date bills, 61, 138
Days of grace, 89, 137–138
Dealers in exchange, England, 105–115; United States, 94–105
Deferred Council Bills, 459
Delegation, letter of, for transmitting funds, 195–196; for handling exports, 298–299
Demand for exchange, sources of, 331–346
Deposit allowance rate and cable spread, 358, 363–364
Depreciated exchange as protection against imports, 545
Depreciated paper money exchanges, Argentina, 469–471; Brazil, 471–473; Chile, 473–474; Europe since 1914, 478–486
Direct exchange, 302
Discount, defined, 67; differentiated from interest, 67
Discount houses, London, 107–111
Discount rate, Bank of England, 115, 406; Federal Reserve banks, 75; Bank of France, 406; forward rate, 501–502; Reichsbank, 406; relation to exchange rates, 347; relation to investment in foreign bills, 493–494; relation to spread of long bills, 353–365; used to influence gold movements, 402–407
Dishonor, 89–93
Documentary bill of exchange, 14, 61–62, 139–140
Documentary payment bill, defined, 144; discountable in Germany, 145; not discountable in England, 145; rates, 350; speculation and investment in, 495–496
Dollar commercial letter of credit, 236–251
Dollar exchange, progress in use of, 254–255
Dollar or currency loans or long bills, 202–204, 339–340
Dollar traveler's letter of credit, domestic, 52–58; foreign, 230
Domestic exchange, defined, 4, 22; rates, 47–48
Domiciles or domiciled bills, 275–277
Draft, defined, 58–59; classified, 60–62; bank domestic, 44–48; bank foreign, 182–195; against stocks and bonds, 62, 233; individual, 58–62
Drawee, defined, 47, 80; liability of, 88
Drawer, defined, 47, 80; liability of, 88
Duplicate bills of exchange, reasons for, 157

Earmarking gold, 104 n, 410–412
Edge Law, 551
Eligibility of bills for rediscount, 75–77
Endorsement. *See* Indorsement
England, exchange dealers, 105–115; legal tender, 373; methods of quoting exchange rates, 309–311; mint and bank price of gold, 376, 381; monetary system, 559. *See* Bank of England
English exchange. *See* Sterling exchange
Exchange as per indorsement, 275
Exchange market most sensitive, 485
Exchange rates. *See* Rates of exchange
Exchange trader, 514; activities of, 519, 521, 523–525
Export credits, 280–283
Export letter of credit, 260–268. *See* Commercial letter of credit
Exports as affecting supply of exchange, 323–325
Express company limited check, 175–177
Express company money order, 26–27

Federal Reserve Banks, forward discount rate, 315 n; Gold Settlement Fund, 32–33; par collection system, 39–44; rediscouunt rates, 75; rediscount operations, 74–78; rediscount policy contrasted with that of European central banks, 68 n; telegraphic transfer system, 32–37
Finance bills, 206–218; contrasted with dollar and sterling long bills, 206–207; effect on rates of exchange, 215, 327, 339; relation to speculation, 212–213
Firm rate of exchange, 315, 487
Fixed exchange, 302
"Floaters," 110
Foreign coins, value of, 129, 557–558
Foreign exchange, defined, 4

Foreign loans, effect on rates of exchange, 332–336; extent of, 333
Forward discount rate, 314, 501–502
Forward exchange operations, 213–214, 314
Franc exchange, conversion into United States money, 562–564; basis of progression, 317–319; method of quoting, 317–319; mint par, 131–132
French exchange. *See* Franc exchange
Futures, 213–214, 314, 497–501

German exchange. *See* Mark exchange
Giro Conto system, 33
Going long on exchange, 499
Gold, distribution among nations, 418; theory of international distribution, 419–424; world's monetary supply, 371; world's production, 371, 375, 376
Gold exchange standard, defined, 452; India, 451–464; Philippine Islands, 464–564
Gold exports, costs, 384–388; interest loss, 386; obtaining gold for export, England, 381–382; obtaining gold for export, United States, 374, 389; relation to cable rate, 388–389; restrictions on, England, 377–379; restrictions on, United States, 377; relation to supply of exchange, 330; statistics of, United States, 414
Gold imports, 389–392; costs, 390–391; encouraged by interest and credit advances, 396–397; interest loss, 390; Morgan-Belmont syndicate, 401; relation to demand for exchange, 341–342; relation to cable rate, 389–390; relation to sight rate, 389–390; restrictions on during the war, 424–425; statistics of, United States, 414
Gold market, London, 373–376; New York, 373
Gold movements, absence of control over in the United States, 372, 400; classified, 383; corrective influence of, 412–413; domestic minimized by Federal Reserve banks, 372; effect on commodity prices, 419–424; encouraged by interest and credit advances, 396–397; minimized by international loans, 409; relation to discount rate, 402–406; relation to money rates, 416–417; relation to premium on gold, 378–381, 399; to premium on money, 397–399. *See* Gold exports, Gold imports, Gold shipments, Gold Settlement Fund, International Gold Settlement Fund, Gold points
Gold points, defined, 383; affected by premium on money, 397–399; failure of gold points to function, 394–395, 413–414; relation to mint par, 383–384; relation to sight rate, 371; variable, 387–388, 390–391; United States on England, 392; United States on foreign nations, 392–393
Gold, price of, England, 376, 381; United States, 380
Gold Settlement Fund, 32–33; domestic gold movements, 372; proposed International Gold Settlement Fund, 412
Gold shipments, costs, 384–388, 390–391; diverted to India, 459–460; foreign interference with during the war, 417–418; interest loss, 386, 390; made by bankers only, 383; made at a loss, 395–396; means of control by England, 402–407; by France, 407–408; by Germany, 408–409; by the United States, 401; relation to practical par of exchange, 387; triangular transactions, 393–394, 412; typical between United States and England, 384–392. *See* Gold exports, Gold imports, Gold movements, Gold points
Gold standard, defined, 451
Gresham's law, 466

Hedging, 213–214, 314, 497–501
Holder in due course, 80 n
House paper, 214
Hypothecation certificate, 152; general letter, 153–155

Import letter of credit, 236–260; dollar, 236–251; sterling, 253–259. *See* Commercial letter of credit
Imports and demand for exchange, 331
Improvement of exchanges, defined, 545–546; proposed methods, 546–552
In case of need, 86 n, 147–148
India, currency system, 454–455; gold exchange standard, 451–464
Indirect exchange, 303
Indorsee, defined, 80
Indorser, defined, 80
Indorsement, kinds of, 82–84
Inflation and the exchanges, 474–486, 552
Inland exchange, defined, 22
Insurance, effect on exchange rates, 330, 338–339; on marine shipments, 161–166; marine certificate, 140, 164–165; marine policy, 140, 163–165
Intermediate Council Bills, 458
Interest and discount differentiated, 67
Interest clause, 268–270
Interest free advances to induce gold imports, 396–397
International Gold Settlement Fund, proposed, 412

International standard of value, proposed, 548
Investment, defined, 490; contrasted with speculation, 490; in foreign bonds, 506–513; relation to foreign discount rate, 493; relation to demand for exchange, 331–336; relation to supply of exchange, 328–330
Invoice, defined, 65, 140, 166; consular, 167–169
Irrevocable credits, 284–287

Joint account transactions, 202
Joint stock banks, England, 113–114

League of Nations' proposal for improving the exchanges, 552
Legal aspects of a commercial letter of credit, 287–293
Legal tender, England, 373; United States, 373
Letter of credit. *See* Commercial letter of credit, Traveler's letter of credit
Letter of delegation, for transmitting funds, 195–196; for handling exports, 298–299
Letter of guarantee, authority to purchase, 294; commercial letter of credit, 238–239; traveler's letter of credit, 225
Letter of indication, 54
Liability of parties to bill of exchange, 88
Limited check, 175–177
London, gold market, 376; silver market, 427–428
Long bills, banker's, 200–218; dollar or currency, 202–204; finance, 206–212; sterling 204–206
Long on exchange, going, 499
Long rates of exchange, spread, 353–357, 359–365
Lord King's law of currency, 479

Mark exchange, basis of progression, 316; conversion methods, 564–565; method of quoting, 315–316; mint par, 132
Mercantilism, 418–419, 424
Methods of conversion, into United States money and vice versa, francs, 562–564; marks, 564–565; sterling, 561–562
Methods of quoting foreign exchange classified, 302–305
Mint par defined, 130–131; between important countries, 131–133
Mint price of gold, England, 376; United States, 382
Monetary standards, gold, 451; gold exchange, 452; silver, 440; paper, 465
Monetary systems, Belgium, 562, China, 441–442; England, 559; France, 562; Germany, 564; India, 454
Money orders, express, 26–27; postoffice domestic, 23–26; postoffice foreign, 172–175
Money rates and demand for exchange, 340–341; and supply of exchange, 326–327
Moratoria, 528–529, 532
Morgan-Belmont syndicate, 401
Movable exchange, 303

National Gold Fund, 531, 534
Negotiable Instruments Law, Uniform, 22 n
Negotiability, defined, 81
Negotiating a bill of exchange, 80; liability of parties, 88
Neutral exchange, defined, 136; during and since the war, 539, 541–542
New York exchange, defined, 44–45
New Zealand rates of exchange, 304

Open book account system of financing domestic trade, 62–63
Open discount market, England, 107–114; United States, 77–78
Order bill of lading, 65
Order bills of exchange, 79
Overdraft in financing domestic trade of England, 64 n; in gold shipments, 386

Paper standard, defined, 465; and depreciated exchanges, 465–486; effect on prices, 467, 476–477; effect on commerce, 467–468
Par check collection system, 39–44
Par, mint. *See* Mint par
Parities, commercial, 519–521
Parity sheet, 519
Parity tables, 520–521
Payee, defined, 47, 80
Payer, defined, 47, 80
Pegging the exchanges, England, 536–539, 548
Philippine Islands and gold exchange standard, 464–465
"Pig on pork" bills, 214
Pittman Act, 432–433, 435–436
Positions or position sheets, 521
Post money order, 177–182
Postal remittance. *See* Post money order
Posted rates, 312–313, 322
Postoffice money order, domestic, 23–26; foreign, 172–175
"Practical par of exchange," 387
Premium and discount method of quoting exchange, 303–305
Premium on gold, England, 378–381, 466, 479; France, 408; and rates of exchange, 478–479

Prepayment, of acceptance bills, 144; of documentary payment bills, 144
Presentment of negotiable instruments, 89
Price levels, effect on of gold flow, 419–424; of depreciated paper money, 467–486
Private banks, England, 113
Profit and loss position, 521–522
Profits of exchange dealers, 525
Proposed remedies for the disarranged exchanges, 546–552
Protest, 83, 90–93
Purchasing power parity, 478–486

Quantity theory of money, 420
Quotation of rates, methods classified, 302–305; in England, 304, 309–312; in the United States, 305–309, 315–319; franc, 317–319; mark, 315–317; sterling, 315

Rate of discount. *See* Discount rate.
Rate of exchange, defined, 129; methods of quoting, 302–305; range of, 319–321; spread of, 352–365; improvement of, 545-552; stabilization of, 545–552; tables, England, 304, 309–312; tables, United States, 305–309
Rate sheet, 176, 189
Rebatable commercial long bills, 144–145
Recourse, without, 83, 297
Rediscount, defined, 67; forward rate, 314, 501–502; policy of Bank of England, 115; policy of Federal Reserve banks, 75–76
Referee in case of need, 86 n, 147–148
Reform of exchange practices, 488
Reichsbank and control of gold exports, 408–409
Retirement rate of discount, 144
Return bill or draft, 261
Reverse Council Bills, 455
Restrictions during the war on gold exports, England, 377–381, United States, 377; on gold imports by neutral countries, 424–425
Revolving letters of credit, 259–260
Risks of exchange dealings, 487–488, 525–526
Royal Exchange of London, 105–107
Rupee exchange, 452–464

Sales contract as part of the commercial letter of credit, 241–242
Shanghai exchange, 442–451
Short selling, 497
Sight bills, defined, 60
Sight rate as basis of other rates, 348–349; of gold shipment calculations, 371
Silver exchanges, China, 440–451; effect on commerce, 445–447; effect on investment, 447
Silver imports and exports, United States, 440
Silver market, London, 427–428; New York, 435
Silver production, 427
Silver parity, Shanghai on London, 448–450; on New York, 450–451
Silver, price, 429–437; causes affecting, 429–432; future, 428; London, 429; New York, 430; relation to commodity prices, 437; relation to melting points of silver coins, 437–439; spot, 428
Silver standard countries, 427
South African rates of exchange, 304
South American exchange, 469–474
Special Bills, 458
Specie points. *See* Gold points.
Speculation, defined, 490; by use of sight drafts, 505; contrasted with investment, 490; during and since the war, 502–513; going long on exchange, 499; going short on exchange, 497; in finance bills, 213; in foreign bonds, 506–513; in foreign currency, 505–506; in futures, 499–501; prohibition of, 549–550
Spread of exchange rates, 351–365
Stabilization of disarranged exchanges, proposed methods, 545–552
Sterling exchange, basis of progression, 315; conversion methods, 559–562; methods of quoting, 315; mint par, 131; superiority of, 258; used as return drafts, 261, 264, 266
Sterling letters of credit. *See* Commercial letter of credit, Traveler's letter of credit
Sterling loan or long bills, 204–206
Stock exchanges, closed by war, 527–528; opened, 533
Straight bill of lading, 65
Supply of exchange, sources of, 323–330
Suspension of the Bank Act of England in 1914, 528
Swapping exchange, 212, 523

Tael, 441–442
Tariffs and the exchanges, 480
Telegraphic transfer, domestic, telegraph companies, 27–29; banks, 29–32; Federal Reserve banks, 32–37. *See* Cables
The Meulen plan, 550–551
Theory of the exchanges, 123–125
Time bills or drafts, 60
Trade acceptances. *See* Acceptances
Traders, exchange. *See* Exchange traders
Transferee, defined, 80
Transferrer, defined, 80

Traveler's check, domestic, 49–52; foreign, 220–223
Traveler's letter of credit, domestic, 52–58; foreign 223–232
Triangular exchange, 344–346, 393–394, 412
See Arbitrage
Trust receipt, 244–250

Uniform Negotiable Instruments Law, 22 n
Unpegging exchange, 543
Usance, defined, 140

Vendee, defined, 80
Vendor, defined, 80

Without recourse, 83, 297