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# FINANCE OF FOREIGN TRADE

*with particular reference to Exchange Control*

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## LECTURE I

I SHOULD like first to acknowledge the help I have received in the preparation of these lectures from my colleagues and friends in the Overseas Branch of the Midland Bank. Several of them have read through my notes and have made extremely useful suggestions and corrections. They are in no way responsible, however, for anything I say, and any shortcomings particularly can be laid at the door of nobody but myself.

The title of this series of three lectures is the *Finance of Foreign Trade*. It is an ambiguous title. To us as bankers the word 'financing' immediately suggests some kind of bank accommodation or banking facilities, and the *Finance of Foreign Trade* might be interpreted as the ways in which foreign trade is 'financed' by the banks. For these lectures, however, I have adopted a wider interpretation, and my subject I have taken to be rather the general financial aspect of foreign trade, particularly from the banker's point of view. This, however, raises many issues and I could not hope to deal with all of them adequately in the time at my disposal. In these days practically all banking business in connection with foreign trade is affected by exchange control and I decided, therefore, that rather than try to cover the whole financial side of foreign trade in what would have to be a hurried and certainly an inadequate way, it would be better if I paid particular attention to Exchange Control and treated the whole subject more especially from that point of view.

This, the first lecture, will be entirely on Exchange Control—its objects, its principles, and particularly how it affects the banks; the second will be on banking practice in connection with exports, imports and multilateral trade, again more particularly from the Exchange Control point of view; and the final lecture will be on the various methods of payment in foreign trade—documentary credits, bills for collection, etc.—and their relative advantages and disadvantages. In the last lecture I shall also deal with the services which the banks make available to their customers in connection

with foreign trade and also with the services of official and semi-official organisations, such as the Export Credits Guarantee Department.

I make no apology for devoting the whole of the first lecture to Exchange Control as that system of control largely sets the pattern for the practice of banks in this country in relation to foreign trade. Some of the points I shall bring out in this first lecture may, at first sight, seem to be only remotely connected with foreign trade, but I would assure you that if their importance is not evident here it will be brought out subsequently when we come to consider in more detail banking practice in connection with overseas trade.

### *Exchange Control*

Operating the exchange control system is a development of commercial banking in this country which can no longer be looked upon either as new—it has now been with us for over ten years—or temporary. It shows every sign of having come to stay. Though it has brought to the banks added responsibilities and duties they recognise that they have a duty to the country to perform in looking after exchange control, and they co-operate with the authorities fully and willingly in administering the system. In so far as their relationship with their customers is concerned, they have as it were a dual function to perform. On the one hand they are technicians for operating the greater part of the control and on the other they are advisers to their customers on all problems relating to it. Some knowledge of the technique and of the mechanism of the control is therefore a prerequisite of a well-equipped banker.

This duty to know—or at least to have some knowledge—applies to all banks and bankers. It is not solely the concern of the specialised Overseas or Foreign Branches of the banks; it is important also to the domestic branches, for the control is now so wide that few branches or departments are unaffected by it and all of them are liable to be approached on matters of exchange control, if only for advice and guidance. This is a comparatively easy task for those engaged directly on the foreign side in the banks, for the whole of their work is coloured by this comparative newcomer to the business of banking in this country. Others, with the detailed picture of exchange control constantly changing, may be inclined to look on the whole subject as something quite outside their particular province and one for the so-called 'experts' only. May I hearten the less courageous, however, by saying that exchange control is something far less difficult to understand than some may think. The system is reasonable, it is logical, and once one has grasped the reasons for it and the principles on which it works, it is only a question of

assimilating as much, or as little, of the details as one needs. To most of us a wide knowledge only is necessary, and in these talks I shall try simply to paint the backcloth, in broad outlines. The details and technicalities are available in the seemingly endless stream of regulations and instructions, and he who runs may read. In any event, for the purposes of my present subject I shall deal with only that part of exchange control which directly affects foreign trade, and shall not touch at all on the regulations governing 'financial' remittances, travel, emigration, legacies, etc., of which the details are readily available in the various regulations.

### *Origin and Purpose*

Exchange control came into being with the issue of the first Defence (Finance) Regulations in August, 1939, and actually came into force on the outbreak of war on 3rd September, 1939. The outlines of the system had been worked out in the preceding months and one must acknowledge the perspicacity of those authorities responsible in that the first regulations and the many packages of forms necessary for implementing them were already in the hands of the banks when the first siren sounded. It was the Defence (Finance) Regulations with their constant flow of addenda and amendments which set the pattern of exchange control until permanent legislation in the form of the Exchange Control Act was passed in 1947. That Act put the major exchange control regulations into permanent statutory form, and since then additions and amendments have been made by the issue of new instructions by the Bank of England.

Some understanding of the basic principles of exchange control can best be obtained by considering the objects of the Defence (Finance) Regulations. They were essential to the successful prosecution of the war. The system of exchange control which they brought into being was designed to mobilise a large part of the financial resources of residents of the United Kingdom. Those resources were mainly their holdings of gold and foreign currencies, and the new regulations introduced called for those holdings to be placed at the disposal of His Majesty's Government. Not only was a hold placed over those financial resources of residents as they existed then, but a system was brought into being by which a control was established over all future incomings and outgoings of foreign currencies. Thus it was ensured that the resources then held and also those currently accruing came into a central pool to be used for the benefit of the country rather than of individuals.

It was fondly thought, or rather hoped, by many people that when the war was over we should be able to dispense with this

system, a system which to some extent interfered with individual freedom and liberty in financial affairs. Since the end of the war, however, the scope and ramifications of exchange control have tended to increase rather than diminish. Some people may perhaps quarrel with individual regulations, some may quarrel with the administration of the system, but no knowledgeable person would dispute the necessity of exchange control itself whilst the financial and general economic position of the country is such as it is.

Exchange control is no longer necessary to assist in the war effort, but certainly it is still essential to the country's peace-time efforts to establish equilibrium in its external balance of payments. As a country our finances *vis-à-vis* the rest of the world are unbalanced. We are unbalanced on both capital and income account. In respect of capital account we spent a large part of our holdings of gold and foreign currencies to pay for food, raw materials and other supplies to help us prosecute the war. In addition more than one-half of our foreign investments were sold. These investments were compulsorily taken over by the Treasury, who sold them, or pledged them in cover for loans from the U.S.A., and thereby obtained badly needed foreign currencies. The actual sale of British-held foreign securities during the war realised well over £1,000 millions, the compulsory sale of American and Canadian investments alone fetching the equivalent of over £400 millions. Some indication of the constant drain which the war caused to our holdings of foreign exchange may be seen from the fact that in April, 1941, just before Lease-Lend came into effect, the total holdings of gold and dollars in the Sterling Area's pool had fallen to the equivalent of no more than £3 millions. (By comparison our present holdings of around £600 millions at the new rates of exchange do not look nearly so discouraging.)

In addition to the loss of a large part of our capital assets a vast new volume of short-term indebtedness was created in London. Before the war London's position as the chief financial centre of the world resulted in the main trading nations holding very substantial short-term sterling funds in London. Just before the war we could reckon that there was a 'float' of around £500 millions of foreign-held sterling in London. During the war this figure grew considerably, chiefly as a result of the payments we made to other countries for the cost of maintaining our armies abroad and on account also of the troops' own spending. Many countries, mainly those in which our armies were stationed, accordingly became creditor nations *vis-à-vis* the United Kingdom. At the end of the war the total of those credits, the so-called 'sterling balances,' reached the phenomenal figure of around £3,700 millions, and even now they amount to over £3,000 millions.

From these two causes—spending of gold, foreign exchange and

foreign investments on the one hand and the creation of new debts on the other our total capital position in relation to the rest of the world weakened to the extent that instead of being a creditor nation as we had been for some generations we became actually a debtor nation.

On income account also we are unbalanced. Our balance of payments with the rest of the world on current income and expenditure account has been adversely affected not only by the loss of some of our former earnings from overseas investments, but also by the 'terms of trade' having moved against us. As compared with before the war, on broad lines the prices we have had to pay for our imports have risen very much more than the prices which we have been able to obtain for our own goods sold abroad, and this, of course, has had a serious effect on our balance of payments. Recently great progress has been made towards reaching equilibrium in our total balance of payments, but the position has not yet been permanently righted.

In addition there is the problem of the dollar deficit. This is a problem too familiar to you for it to be explored here. It is not a new phenomenon. The normal course of the United Kingdom's foreign trade for many years has shown an appreciable deficit with the dollar areas. In the past this deficit was covered to some extent by the income from our dollar investments, but mainly by surpluses in our trade with the rest of the world, for currencies were convertible one into the other. It is not now possible, however, to set off currencies one against the other, and we are forced into the position of having to try to cover our dollar expenditure directly by our dollar earnings. In this, in common with practically all other countries of the world, we are far from reaching a balance. We are selling to the dollar areas far less than we are buying and in spite of devaluation and in spite of great and sustained efforts towards selling more of our products to dollar countries, the Sterling Area as a whole is still running a deficit with that area as a whole at the rate of perhaps \$1,000 millions a year. The deficit is at present being covered by Marshall Aid, but that Aid is due to finish in 1952. The dollar gap is indeed one of our greatest problems, probably the most difficult to solve of them all.

These factors, the unbalanced position in which we find ourselves on both capital and income account and our constant shortage of dollars, make a system of exchange control necessary to the economy of the country and one seemingly likely to stay with us for many years.

#### *Present Objects of Exchange Control*

In the light of what we have already said we may now define in broad outline the aims and objects of exchange control as they are at present.

Exchange control aims firstly at bringing, and maintaining, equilibrium in our balance of payments with the rest of the world. This it does, in conjunction with the licensing authorities of the Board of Trade, by establishing a system of control over both imports and exports.

Secondly, the Control aims to conserve particularly our reserves of gold and hard currencies. It tries to ensure that our limited supplies of dollars and other hard currencies are used to the best advantage and, so far as possible, that they are used only to pay for imports from hard currency areas. In addition, any proposition which is of a 'dollar earning' or 'dollar saving' nature would be expected *ipso facto* to have the blessing of the authorities.

The third effort of the Control is aimed at capital movements. Restrictions are placed on the sending of capital out of the Sterling Area or its transfer to non-residents. These restrictions apply not only to residents of this country but also to non-residents who have capital assets here. As regards residents, they are also required to repatriate certain capital assets which they own abroad or which come into their possession.

A fourth object of the Control is to bring under regulation and supervision transfers in the ownership of sterling as between one foreign country and another. The reason for this is not only to 'spread the load' of our indebtedness so that it can be supported with the minimum of burden to the country, but also that our net financial position with each individual country, or group of countries, may be regulated and controlled. The United Kingdom's financial position *vis-à-vis* other individual countries, or group of countries, may well vary even from day to day, and this to some extent may explain why the attitude of the Control towards exactly similar transactions may seem sometimes — without bearing in mind this principle on which the Control works — apparently inconsistent.

The final object of the Control arises from the desirability of maintaining, so far as possible, both the use of sterling as a means of settlement in international trade and the position of London as the chief financial centre of the world. The Control accordingly aims at giving as much freedom to sterling as can be granted having regard to the operation of the other main purposes of the Control.

### *Mechanics of the Control*

The ultimate controlling authority is His Majesty's Treasury. The Treasury is entirely responsible for policy, but the day-to-day working of the Control is in the hands of the Bank of England. The Bank is the principal agent of the Treasury and also its adviser on matters of policy. The relationship between the

Treasury and the Bank of England, not specifically in connection with exchange control but on general lines, was recently put very simply by Sir Stafford Cripps. Answering a question on the Bank of England's advisory powers he said :

“The Bank is not my adviser, it is my creature . . . but like so many creatures it broadly goes its own way. But we do consult as to which way we should go from time to time.”

The Exchange Control Department at the Bank of England, though representing one of the newest of the Bank's activities, bids fair, in both importance and size, to outstrip many of the others. The number of people at the Bank of England employed solely on exchange control matters is more than 1,500. The Bank of England delegates a large measure of authority to the commercial banks of this country, not only the British banks but also the offices in this country of overseas banks. The number of so-called ‘authorised banks’ is around 110. The extent of their powers is strictly defined and is always subject to the over-riding control of the central bank. For very many transactions, however, they have complete powers to authorise payments, etc., without reference to the Bank of England, and the great bulk of exchange control work in fact is done by the commercial banks themselves without the Bank of England or the Treasury directly being brought into the individual transactions except for notification afterwards.

In yet another sense the commercial banks have a dual function to perform in their relationship with their customers. Their prime function of bankers leads them to do all they can towards facilitating the carrying out of their customer's foreign business, but also they have what is sometimes quite a separate function to perform in their dealings with customers because of their position as authorised agents of the Control. Sometimes it may seem that these two functions may clash, and it is not unknown for customers to resent their bankers' imposing on them some of the restrictions necessary to the operation of the Control. As bankers we can only plead our higher duty : as authorised agents of the Control we have a specific duty to the public and to the country and that duty must be a first consideration.

### *Sterling Area and ‘Local’ Controls*

Before the war sterling was an international currency, a currency freely convertible into practically every other currency and almost every other currency was freely convertible into sterling. One of the first effects of exchange control is considerably to diminish this international quality of the pound. Sterling, in general, is not now freely convertible into other currencies, nor freely transferable from one country to another, except over a limited

area. That area, though limited, is still very large, covering as it does about one-fifth of the world's surface and over one-fifth of the world's population. It is the 'Sterling Area.' In the Exchange Control Act of 1947 the Area was given the new and unromantic title of 'Scheduled Territories.' The term Sterling Area, however, is something we have come to know and to understand over the years and when speaking of it most of us still refer to the Sterling Area rather than to the Scheduled Territories.

The Sterling Area came into official being as an area which, for exchange control purposes, could be considered as one unit. There have been many changes in its composition over the past ten years and at present it consists of the British Isles and British overseas territories except Canada, together with Burma, Eire, Iceland and Iraq. In general there is freedom of transfer of funds and of convertibility of currencies over the whole of this Area. The focal point of the Sterling Area is London. Each part of the Area, however, is autonomous. Each has its own exchange control authority, but those authorities work on similar lines. The separate exchange controls, or parts of the financial machinery in the member countries which act to the same end, are known as the 'local controls' and they have complete power in their own areas. All the local controls within the Sterling Area work in close association with the Bank of England. They are at liberty to impose their own regulations, but it is unlikely that any radical departures from the accepted general pattern would be made without prior consultation with the British Control. The individual measures taken by these local controls which depart from the generally accepted pattern are few. The most important are (a) the restrictions placed by South Africa at the beginning of 1948 on the movement of funds from the United Kingdom in order to check the large capital movements which were flowing to the Union at that time; (b) restrictions placed on certain remittances to India, Hongkong and Fiji from other Sterling Area countries; and (c) the powers taken by the Australian, New Zealand and Indian authorities to control, if and when they may think it necessary, the export of capital from their own countries.

Another important feature of the Sterling Area is that its members, with the exception of South Africa and to some extent of Ceylon, pool their resources of foreign exchange. The central holdings, particularly of hard currencies, are managed by the London Control. All dollars, for example, earned by any part of the Sterling Area (except South Africa and Ceylon) are brought into the 'central dollar pool' and it is from that central pool that the various component parts of the Sterling Area are allocated certain quantities of dollars for their needs. This is important. It means that the different parts of the Sterling Area have avail-

ments of dollars not according to their individual earnings of them but according to a scale agreed upon in accordance with their requirements. Most members of the Sterling Area in fact are net drawers on the pool. The only parts of the Area which in total contribute to the pool, i.e., they put in more than they take out, are Malaya, in respect of her exports to hard currency areas of rubber and tin, West Africa in respect of cocoa, and Tanganyika in respect of coffee. Ceylon also is a dollar earner, but for the time being at least she is retaining her net earnings.

The practical effects of the operations of the Sterling Area are that people in that Area can freely transfer funds to any other part of the Area whatever the purpose of the transfer, they may freely accept funds from another part of the Area, they may hold funds themselves in other parts of the Area without being required to surrender them to their own authorities and, subject to any necessary import and export licences required, they may freely trade with other parts of the Area. There are no statutes or other legislation governing the operating of the Sterling Area: it is bound together rather by ties of tradition and of understanding. Major decisions of policy, such as the agreement in the autumn of 1949 that each part of the Area should curtail its dollar purchases by 25 per cent., are brought into effect as the result of mutual agreement among all interested parties rather than by unilateral action enforced from London. The Sterling Area may then be looked on as a closely knit group of countries with common interests, countries which though separated from each other both geographically and in most cases politically also, are nevertheless individually surrounded by an exchange control fence of approximately equal height. Over the whole of that Area there is, with only the exceptions already mentioned, freedom as regards the transfer of funds, the convertibility of currencies and multilateral trade.

### *Designation of Accounts*

One of the main effects of exchange control on the work of the banks is that all bank accounts must be classified according to the country of residence of the account holder. All accounts held for residents of both the United Kingdom and any other part of the Sterling Area are designated 'Resident Accounts.' All others, that is the accounts of people resident outside the Sterling Area, are designated 'Non-Resident Accounts.' Sterling held for these non-residents is in fact 'canalised' into the different types of sterling according to the country of residence of the owner. Sterling held by a British bank on account of a resident of Sweden, for example, is called 'Swedish sterling,' whilst that held for a resident of Belgium is called 'Belgian sterling,' etc.

The qualification regarding the designation of these accounts is residence and not nationality. An Englishman permanently resident in Sweden, for example, who holds sterling with a British bank holds 'Swedish sterling' and his account is called a 'Swedish account.' On the other hand a Swede permanently resident in the United Kingdom would have his account designated as 'Resident' and the funds he holds here would be ordinary 'Resident' funds. For exchange control purposes he is virtually in no different position from an Englishman resident here. It must, of course, be understood that these remarks are a generalisation only and special considerations apply in certain circumstances, for example where an Englishman emigrates to a non-Sterling Area country. Under the special regulations covering emigration any funds he continues to hold in the United Kingdom would still be held on 'Resident' account, at least for a period of four years.

The authority of the Bank of England must be obtained for the opening of all non-resident accounts. There is no clear definition of what constitutes permanent residence and each case is considered on its merits. In practice doubts arise as to the proper designation of accounts only in very few instances, the test applied being the commonsense one of whether the holder is in fact permanently resident in that particular country or not. Where a person has changed his country of permanent residence, this can usually be evidenced by his producing a 'residential permit' issued by the authorities of the country where he is actually resident at the time in question.

### *Effect of Exchange Control on British residents*

Let us consider now some of the effects of exchange control on residents, particularly residents of the United Kingdom. Residents of other parts of the Sterling Area - Australia, South Africa, etc. - are bound by the regulations of their own local controls, but as already indicated these local controls work in close conjunction with the authorities of the United Kingdom and the broad details of the exchange control system are similar over the whole Area. One of the main effects of exchange control on residents is that they must offer for sale to the authorities - which in most cases means that they must sell to them - all gold and certain foreign currencies which come into their possession through trade or from any other source. The currencies which must be offered for sale are those listed as 'specified' by the Bank of England and they include the important foreign currencies of the world, except of course those of the Sterling Area. Currencies of the Sterling Area may be bought, sold and held by residents without let or hindrance.

Gold and foreign currencies must be surrendered to authorised dealers -- the banks and certain bullion brokers-- against payment in sterling at the Bank of England's official prices for gold or at its official rates of exchange for the purchase of foreign currencies. Under certain circumstances, permission might be given by the Bank of England for gold and foreign currencies to be retained if they are indispensable to the proper conduct of the business of the holders. Even in those cases, however, periodic returns must be submitted, usually every three months, to the Bank of England showing the holders' operations in gold or foreign currencies.

It is in this way, by requiring the surrender of all 'specified' foreign currencies and of gold, that the exchange control authorities bring into a central pool the means by which the country may make payments for its purchases of goods and services from abroad.

In addition to the obligation imposed on residents to surrender gold and foreign currencies they are also under obligation not to make payments, in either sterling or foreign currency, to non-residents of the Sterling Area without specific permission. Neither may they make payments to other residents on behalf of non-residents: if money is owed to somebody in this country by somebody abroad the debt may not be settled by the resident receiving money from somebody else in this country, as the United Kingdom would not then be receiving the appropriate foreign currency which is due to it from abroad. Also residents may not enter into transactions which are of a 'compensation' nature. Compensation transactions are those whereby residents of the United Kingdom might make payments to some other person in return for which somebody receives payment or acquires some kind of property outside the Sterling Area. The most obvious example was where some British tourists, whilst abroad, received payments in foreign currencies--Swiss francs, French francs, etc.-- and in return made payments in sterling to somebody in this country. The person in this country who received the funds was usually acting on behalf of the person abroad who provided the British traveller with more foreign exchange resources than he was really entitled to have.

Residents of the United Kingdom are also not allowed, without specific permission, either to take out or to bring in certain types of securities, currency notes and other valuables. British currency, for example, must not be taken out of the country or brought in by either residents or non-residents, except to a permitted maximum for each individual traveller of £5 in notes. Even this small amount is only a concession to enable travellers to meet incidental expenses incurred on British ships and British aircraft and to enable them to meet their initial expenses on arrival in the United Kingdom.

### *Non-Resident Accounts*

Let us consider now non-resident accounts and the regulations which govern their use. Sterling held on account of a non-resident, i.e., any person or firm permanently resident somewhere outside the Sterling Area, can as a right be used to make payments within the Sterling Area only, or it may be transferred to another non-resident account of the same country. For example, a person or a bank resident in Holland may use the sterling which he holds on an account with a British bank only to make payments to people within the United Kingdom or any other part of the Sterling Area, and to make payments to another Dutch account, and except with special permission that is all he is allowed to do with it. (There are in fact other uses permitted under the Transferable Account system but these we shall ignore for the time being.)

These restrictions limit the uses to which non-residents may put sterling funds they hold on banking accounts in this country, but there still remains a very wide range of purposes for which they may use their sterling. As a country we wish to give value for the funds which we hold on account of non-residents but our own financial position makes it necessary that we shall do it only in a way which, at the moment, we can support. Translated into practice, foreign-held funds may be used for the following purposes.

1. To make payments to any residents of the United Kingdom for any honest purpose whatsoever. In practice non-resident funds are used nearly always to pay for the purchase of goods from this country. In so far as it is 'old' sterling balances which are used for this purpose the exports are 'unrequited,' i.e., in effect we obtain in exchange for our own goods, not goods or services coming into this country from abroad but only a reduction in the total of our indebtedness to other countries. Whether the sterling arises from 'old' balances or newly acquired funds, however, the result is the same in that our indebtedness to that amount is eliminated.
2. To make payments to people resident in parts of the Sterling Area other than the United Kingdom, again chiefly to pay for goods bought from those countries wool from Australia, hides from South Africa, etc. The effect so far as this country is concerned is that our indebtedness is transferred from somebody outside to somebody within the family, the Sterling Area family.
3. To be transferred to another sterling account of the same country, from one Portuguese to another Portuguese

account, etc. The effect of this is that our indebtedness to that country as a whole is unchanged.

We have said that with special permission foreign-held sterling may be transferred from one country outside the Sterling Area to another outside that Area. There is no right about such transfers, however (except under the system of Transferable Accounts and other groups of countries, which we shall consider later) and each individual transaction must be submitted to the Bank of England. Sterling standing to the account of one country would be permitted to be transferred to the account of another country under two conditions : -

- (a) that it suited the United Kingdom to be more indebted to the receiving country than the giving, and
- (b) that the financial authorities of the receiving country were prepared to accept sterling in respect of the particular transaction.

As regards the first condition, sterling in the ownership of different countries is of varying degrees of hardness. American sterling, for example, is one of the hardest for we have arrangements with the United States under which sterling held on account of a resident of any of the American Account group of countries can, at the option of the holder, be converted into dollars. Every credit to an American account represents therefore a potential loss of dollars to the United Kingdom. At the other end of the scale would be countries like Denmark which have few sterling resources. To the extent of her shortness of sterling Denmark may be less of a buyer of British goods than she might otherwise be, and our authorities would be inclined to look with favour on any proposal by which she would earn sterling from other countries as that might raise the volume of British exports. Between these two ranges of, say, America and Denmark there are very many other countries whose sterling holdings are of varying degrees of hardness or softness. The hard currency countries at present are Switzerland, the United States of America and other American Account countries, Canada, Belgium, Argentina, Portugal, Germany and Persia. They are hard chiefly on account of obligations which we have entered into to convert their sterling into dollars or gold or on account of other obligations of an 'exchange guarantee' nature.

In considering applications involving the transfer of sterling from the ownership of one foreign country to that of another it is reasonable to suppose that the Bank of England works on the principle of being prepared to allow transfers from hard to soft but not from soft to hard. It may well be that at the Bank of England there exists something in the nature of a 'League Table', countries moving up or down the Table according to the relative

degree of hardness of their sterling balances. Transfers would be permitted in a downward direction in the 'League Table', but not in an upward.

This transfer of sterling, with the special permission of the Bank of England, between different non-resident countries, is sometimes referred to as 'controlled transferability' or 'administrative transferability'. In order to extend the use of sterling in international trade, in conformity with the final object of the control which we stated, it is likely that the Bank of England would approve as many transfers under this 'controlled transferability' system as would fit into the general picture. During 1948 over £150 millions was transferred between non-resident accounts in this way.

The second condition under which transfers of sterling from one country to another would be allowed, that is in addition to the advantages to this country, is that the authorities of the receiving country are prepared to take it. Some countries, owing presumably to the restrictions placed on the uses to which they may put their sterling resources, are not prepared to add unduly to their holdings. Whilst in nearly all cases they would accept sterling in respect of the sale of their goods to Sterling Area countries they might insist on dollars or some other acceptable currency in respect of their sale of goods to third-party countries. This willingness to accept sterling varies with different countries according to their total holdings of sterling and any special financial arrangements they might have with the United Kingdom. Belgium, for example, at present would probably be very pleased to accept sterling in payment for her goods sold to other countries, for under the special arrangements she has with the United Kingdom she can convert her sterling into gold once her total sterling resources reach a specified figure, and that figure has been reached. No such agreement exists for example with Italy, and Italy having seen her holdings of sterling grow appreciably over the past few years is not keen to increase the level of her sterling balances except as a result of normal trade between herself and the Sterling Area. Italy therefore would probably not be so keen to accept sterling in payment of her goods sold to third-party countries.

This unwillingness on the part of some few countries to accept sterling in respect of their trade with countries other than the Sterling Area is given recognition by the Bank of England in that certain transactions she approves 'subject to the approval of the . . . authorities', i.e., the authorities of the receiving country. If Italy were selling goods to Portugal, for example, and the contract between buyer and seller stipulated for payment in sterling, that transaction would probably require the authorisation of both the

British and Italian authorities. The Bank of England might approve the sterling transfer in the form 'Subject to the approval of the Italian authorities', meaning that, so far as the United Kingdom is concerned, she is agreeable to sterling being transferred from Portuguese to Italian account for this particular transaction. Subsequently, however, the Italian exchange authorities would also have to give their permission.

### *Transferable Accounts*

In addition to the system of 'controlled transferability' transfers of sterling between certain non-resident countries are allowed without the express permission of the Bank of England. This is the Transferable Account system and it is linked with the efforts made by the British authorities in the post-war years to make sterling convertible. One of the terms of the Anglo-American Loan Agreement of December, 1945, under which the United States made a loan of \$3,750 millions to the United Kingdom, was that not later than one year from the coming into force of the agreement the United Kingdom would remove all 'restrictions on payments and transfers for current transactions.' This meant in effect that all sterling earned by other countries from current transactions—as distinct from 'old' sterling balances and sterling acquired from capital operations—would be convertible into other currencies, including dollars. The effective date by which this convertibility was to be established was July 15, 1947.

Steps were taken during the course of 1947 towards building up some system which would implement this obligation of convertibility. Already in September, 1946, an agreement had been made with Argentina which provided that all sterling received by Argentina after that date would be freely available for current transactions anywhere by means of transfers to American Account or even by payments in gold. The main step towards convertibility, however, was taken in February, 1947, when a new type of sterling account, a 'Transferable Account,' came into being and the 'Transferable Account' system was instituted. At first the system applied to only five countries: Argentina, Canada, Belgium, Holland and Portugal. Certain sterling accounts of those countries—not all but only those of the central banks or exchange authorities and certain specified commercial banks were called 'Transferable.' Transfers were freely permitted from one 'Transferable Account' to another—from a Dutch Transferable Account, for example, to a Belgian Transferable Account. In addition—and this was very important—transfers were permitted from Transferable Accounts to American Accounts. This gave a far greater degree of freedom to the sterling held by these countries on Transferable Accounts.

and also by allowing transfers to American Accounts the new system made their sterling balances on 'Transferable Accounts' in effect convertible into dollars. The British commercial banks holding these Transferable Accounts were allowed to make the transfers without previously asking the permission of the British authorities : the only stipulation was that such transfers had to be reported afterwards to the Bank of England.

It was agreed with the monetary authorities of those countries which were allowed to operate Transferable Accounts that the sterling they would pass over the Transferable Accounts should be only that resulting from current transactions. 'Old' balances and sterling resulting from capital transactions were not to be given these additional facilities. The onus of ensuring that only current sterling was used for passing over the Transferable Accounts was left with the monetary authorities of the foreign countries.

During the next few months, as agreements were reached with other countries, the list of countries within this new Transferable Account group was extended so that by the time the vital date, July 15, 1947, arrived the number of countries enjoying the privileges of this system was seventeen. By adopting the Transferable Account system the United Kingdom had fulfilled to a very large extent its obligations to the United States in respect of convertibility. The period of convertibility lasted, however, only a short time. In the ensuing few weeks after July 15, so much sterling was transferred from the Transferable Accounts to American Accounts that the working of the system resulted in very serious losses of dollars from the limited dollar resources of the Sterling Area. It became quite obvious that the Sterling Area as a whole could not indefinitely support this draining away of its dollars, that it could not in effect continue to cover the dollar deficits not only of itself but also of many other countries of the world. In the five weeks after July 15, the rate at which dollars were being lost to the Sterling Area, chiefly as a result of the operation of the Transferable Account system, became so great that the United Kingdom had no option but to suspend convertibility. This was done on August 20, 1947.

The method by which convertibility was suspended was simple. An edict was published by the Bank of England stating that as from that date transfers from Transferable Accounts to American Accounts were no longer permitted. The Transferable Account system, however, was kept in being. Transfers between the Transferable Accounts of the different countries were still permitted, the only difference being that no longer could they transfer their sterling balances to American Account and so, effectively, into dollars.

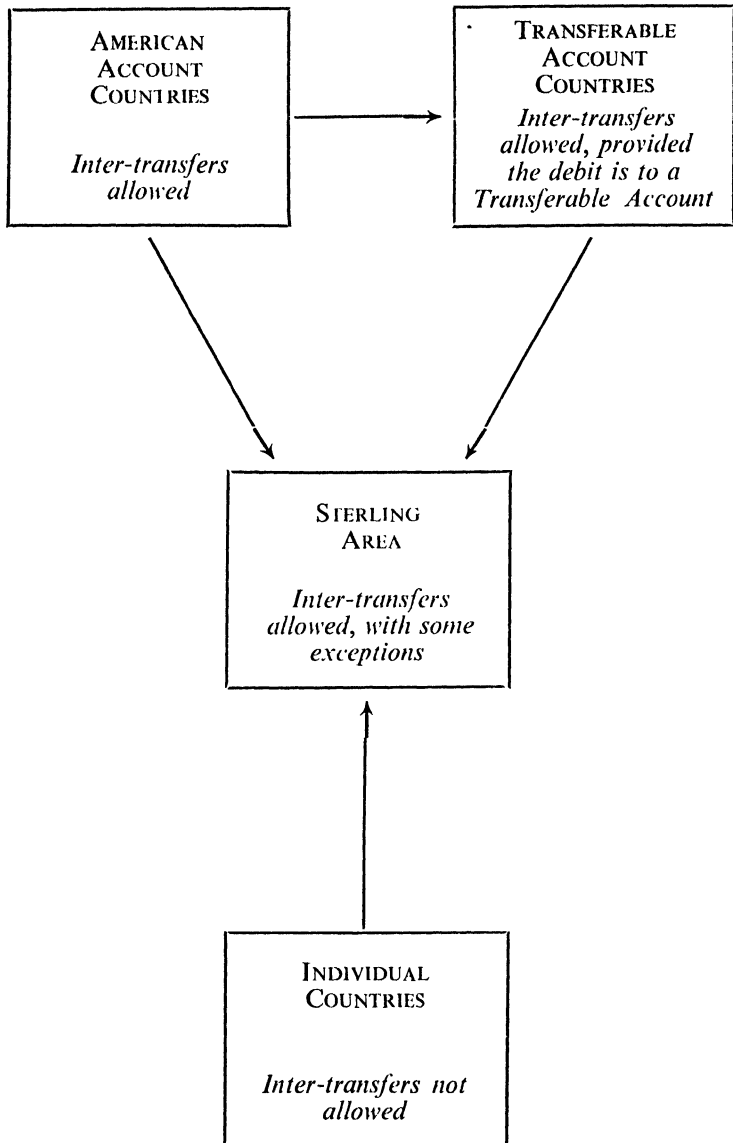
It would be easy to be dogmatic in assessing the reasons for convertibility being so short-lived. Let us say only that though some blame might be attached to the United Kingdom for having attempted to introduce convertibility too precipitately, it must be remembered that we had undertaken to introduce it by a certain date and accordingly we had to give convertibility a trial. In the event it turned out that the general pressure for dollars fell heavily and suddenly on sterling. A dollar-hungry world rushed in to convert and the pressure became so great that the Sterling Area's limited resources could not stand the strain.

The system of Transferable Accounts is still in being and individual countries are from time to time brought into the group or taken out. At the moment the number of countries in the group is fifteen, the most important being Holland, Egypt, Sweden, Norway, Persia, Italy, Spain and Russia.

All the above applies to the uses to which sterling accounts held by non-residents may be put, i.e., the permitted withdrawals, the permitted debits to the accounts. What of the permitted credits? Firstly, transfers are freely allowed from the same type of accounts, e.g., from one Spanish Account to another Spanish Account, from one Belgian Account to another Belgian Account. Secondly, there are the transfers permitted within the Transferable Account group of countries. Thirdly—and this constitutes the most important source of credits to non-resident accounts—credits to non-resident accounts may be made as the result of the United Kingdom, or another part of the Sterling Area, buying goods from that particular country. The Sterling Area buyer must have a valid import licence or the goods may come in under Open General Licence, but provided the physical importation of the goods is allowed there are no restrictions on sterling accounts of the selling country being credited. (This matter will be explored more fully in the next lecture.) Finally, non-resident accounts may be credited in respect of duly authorised payments abroad by residents of this country—for travel, emigration, legacy payments and the many other payments of a 'financial' rather than of a 'trade' nature.

### *Summary of Permitted Transactions*

The following diagram gives in a simplified form a summary of the transfers between different sterling accounts which are freely permitted. Any proposed transfers which do not fall within the pattern of this diagram are not automatically permissible. On the other hand they are not categorically forbidden, but to be allowed they must be approved specifically by the Bank of England or, within its powers, by one of the authorised banks.



It will be seen that there are four main groups of countries. In fact there is another group, known as 'Other Countries', but this is relatively unimportant and has been omitted in the interests of simplicity.

Within the American Account group, which comprises the sterling accounts of residents of the United States of America and its dependencies and certain Central and South American countries, inter-transfers within the group are freely allowed; for example, a bank holding two American Accounts can freely make transfers between them. Within the Transferable Account group again inter-transfers are permitted, but provided the debit is to a Transferable Account. In the third group, the Sterling Area, inter-transfers again are permitted, with the exceptions only of those we have already stated, relating to South Africa, Australia, etc. In the last group, which really comprises nearly all those which cannot be fitted into the other three, inter-transfers are not automatically allowed. France and Denmark, for example, are members of this group, and no transfers between French and Danish Accounts are permitted without specific permission from the Bank of England.

As for transfers from one group to another, the Sterling Area may receive payments from the other three. The only other permitted transfers between the groups themselves are from American Account countries to Transferable Account countries.

The above gives a general picture of those transfers which are quite freely allowed. Beyond that are the wide powers the authorised banks themselves have to approve credits to the sterling accounts of other countries to pay for goods we buy from them, the large volume of authorised payments for travel, etc., and beyond even that the system of 'administrative transferability' under which the Bank of England approves large volumes of payments between foreign countries themselves.

Though the restrictions placed on residents by the exchange control system are severe, it is revealing, when one examines the position as we have done, to see what a wide range of uses is permitted to non-residents in the use of their sterling. Short of converting it into dollars and allowing unrestricted dealings in securities, they may use it quite freely within the whole of the Sterling Area and to a very large extent, between themselves. Moreover, the tendency is for restrictions on the use of sterling to be eased wherever possible, as is evidenced by the relaxations recently introduced in respect of the three Scandinavian countries. As some indication of the extent to which sterling is still used as an international currency, the amount which during 1948 was transferred by countries outside the Sterling Area between themselves was £240 millions, a very considerable sum, and even this takes no account of transfers to and from American Account countries. Not all these transfers of sterling were directly in respect of trade, but the size of the figure suggests, as in fact we know from experience, that sterling is still very largely used as the means of settlement in international trade, not only within the Sterling Area itself but also throughout the world at large.

## FINANCE OF FOREIGN TRADE

*with particular reference to Exchange Control*

### LECTURE II

IN the first lecture we considered the general pattern of Exchange Control: in this, the second, we shall see how the Control affects, and in some ways determines, banking practice in connection with foreign trade.

#### *Exports*

Exports of goods from the United Kingdom are governed by two sets of controls. First, through an export licensing system there is a control over the outward movement of the goods themselves, and secondly there are regulations governing methods by which the goods may properly be paid for. Therefore before making final arrangements for exporting, British merchants and traders must make quite sure, first that they are allowed to export the goods, and secondly that they are allowed to receive payment in the manner contemplated by the respective sellers and buyers. In addition they should, for the sake of prudence, ensure that their buyers abroad have obtained import licences for the particular goods being bought or assurances that such licences are not necessary. Where allocations of exchange are necessary in addition to import licences these also should be obtained.

The movement of goods from this country is controlled by the Export Licensing Department of the Board of Trade. In conformity with the country's general economic policy, most goods can be sent abroad for sale without any licensing formalities, but in respect of some a licence must be obtained before they leave the country.

The goods for which an export licence is necessary fall into several broad categories, and it is fairly obvious from the very nature of the goods why such licences are necessary. The various types of goods which require export licences are as follows: -

1. Arms and ammunition,
2. Dangerous drugs,
3. Antiques, works of art and valuable books,
4. Jewellery,

5. Some goods on which foreign exchange must already have been expended, such as tobacco, tea and coffee,
6. Some goods which are vital to our own production, such as iron, steel and other metals,
7. Other goods which are controlled by official bodies, for example, coal and coke which are controlled by the Ministry of Fuel and Power.

The list of specific goods for which export licences are necessary is subject to frequent amendment. If a British exporter is in any doubt whatsoever as to whether a licence is necessary in respect of his particular goods he should consult the Export Licensing Department of the Board of Trade.

The more important control from the banker's point of view is that which governs payments. As funds may, with certain exceptions, be freely transferred from one part of the Sterling Area to another, trade within the Sterling Area is quite free from any purely exchange control regulations. Subject to licensing formalities, residents of the United Kingdom, for example, may freely buy wool from Australia and likewise Australians may freely buy machinery and other goods from the United Kingdom without having to comply with any purely exchange control formalities.

Exchange control applies therefore only to exports from this country to any country outside the Sterling Area. Goods sold by a resident of the United Kingdom to countries outside the Sterling Area may be paid for in sterling and sometimes in another currency. If they are to be paid for in sterling that sterling must, as a general rule, come from an account maintained in the United Kingdom by somebody, usually a bank, resident in the country buying the goods. If the destination of the goods is Belgium, for example, payment in sterling may be received only from a Belgian sterling account and not from a French or Italian account. That is the general rule sterling from the account of a resident in the country of destination of the goods is an approved method of payment. For certain countries— not all— payment may be received from an American sterling account as in effect this country would then be selling its goods for dollars.

Another departure from the general rule that the sterling must come from a sterling account of the country buying the goods is that goods sold by the United Kingdom in sterling to any Transferable Account country may be paid for in sterling from *any* Transferable Account. Goods sold to Spain, for example, may be paid for in sterling from a Swedish Transferable Account. The sterling must come from a Transferable Account and not from an ordinary Swedish account. This is logical as the Swedish

Transferable funds, so far as the United Kingdom is concerned, could freely be used for transfer to Spain, and the Spanish sterling, as it would then become, could quite freely be used to pay for goods bought by Spain from the United Kingdom.

This principle regarding the use of *any* Transferable Account funds has been modified to some extent by agreements recently made with the authorities of some of the Transferable Account countries. In order to curtail certain practices which had arisen in relation to Transferable Accounts, it has been arranged that the Transferable Account funds of one country—Holland for example—shall be used to pay for goods destined only for that country. The onus of ensuring that Transferable funds shall be used only for these purposes is left with the monetary authorities of the countries concerned.

If payment in sterling is proposed in any other way than is laid down within the permitted pattern, then the Bank of England's permission must be obtained before any other kind of sterling is received. Outside the Transferable Account arrangements the Bank of England does not ordinarily encourage goods being sold to one country and payment being received in sterling belonging to another. Logically, however, it would probably be prepared for payment to be received in a 'harder' type of sterling than that of the buying country. Normally the Bank of England insists that goods are paid for in sterling originating from a sterling account of the buying country, and of no other. Presumably payment in another type of sterling would cut across the various bilateral trade and financial agreements the United Kingdom has with many other individual countries.

As already indicated, payment for British exports may also be received in foreign currencies, but again only within a laid-down pattern. The only foreign currencies which may be received are those 'specified' currencies for which a rate of exchange is quoted by the Bank of England. If the currency of the buying country is one of these then British exporters may receive payment in that currency and in no other, except of course sterling. For certain countries, however, American dollars are specifically permitted, and even where not specifically permitted it is unlikely, were a special application to be made to the Bank of England, that the dollars would be refused.

A list is published showing, by countries, the ways in which British exporters may receive payment for goods sold to them—if sterling, from what types of account, and if currency, what particular currencies. If an exporter is offered payment in any other way he may not accept it unless the Bank of England gives specific permission. The last complete list was given in September, 1947, in a White Paper entitled 'Exchange Control—Payments' and needs even now only minor amendments arising mainly from

changes in the composition of the Transferable Account group of countries.

The machinery of Exchange Control as affecting exports is implemented by a system of control known as the C.D.3 procedure. Before shipping his goods to any country outside the Sterling Area a United Kingdom trader must complete a C.D.3 form in respect of each consignment of goods. The form consists of two parts, each part being similarly numbered with a distinctive serial letter and number. The same particulars are required to be given on each part. They are details of the seller and of the buyer, a description of the goods, the approximate date on which payment is to be made, the amount to be received (whether in sterling or in foreign currency) and how payment is to be made, e.g., sterling originating from a sterling French account.

This form is then handed to the Customs authorities at the port when the goods leave the country. The Customs stamp the form, in effect certifying that the goods actually shipped correspond with the particulars given on the C.D.3 form. One part of the form is retained by the Customs and the other is returned to the shipper.

The next step is taken when the exporter receives payment. Payment must, in general, be for the full invoice value of the goods, the only permissible deductions being reasonable agent's commissions on the actual shipment, trade discounts and bank charges.

Having received payment the exporter takes his own half of the C.D.3 form to his bank, usually at the same time as he pays in to his account the relative proceeds. With the form he supplies invoices covering the consignment for which he is being paid. The bank then completes the certificate on the C.D.3. The bank in effect certifies as to when payment was received, how much was received, and how it was received - in sterling from, say, a Norwegian account or in, say, Norwegian kroner. The bank then sends the form, with invoices attached, to its Overseas or Foreign Branch, which after recording the transaction passes it to the Bank of England. From there it is sent to the Customs where, from somewhere in the great mass of C.D.3's, this half is eventually 'married' to its other half. From the first half the Customs can see that goods of a certain value left the country on a certain date for a certain destination, and from the second half they can see that in respect of that consignment of goods payment of a certain amount, in a certain manner, was received on a certain date.

The two halves are examined by the Customs authorities in order to check up the following facts: first, that the amount of payment received corresponds with the value of the goods, secondly that payment has been received in an approved manner - for goods shipped to Portugal, for example, that payment has

been received in sterling from a Portuguese Account or in Portuguese escudos—and finally that payment has been received within six months.

If all these conditions are satisfied then the matter is finished. Any discrepancies are taken up by the Customs direct with the Overseas or Foreign Branch of the bank. The Overseas Branch passes on the inquiry to the domestic branch of its bank concerned, and it is the responsibility of the domestic branch to obtain from its customer the further particulars or explanations required. Sometimes the Customs take up the matter direct with the shipper.

There are several other points which should be made regarding this C.D.3 procedure.

1. The only exception to a C.D.3 being completed in respect of consignments of goods outside the Sterling Area is in respect of goods sent by post up to a value of £5, but even then the exporter is under obligation to obtain payment in the prescribed manner unless he has obtained permission to do otherwise.
2. Where a shipper wishes to send goods abroad and not to receive payment for them he must, before he ships the goods, first complete a C.D.3 and submit it to the Bank of England, through his own bank, for it to be franked 'Export without payment.' Such permission would normally be given in respect of the personal baggage of travellers where it does not accompany them, goods for display at fairs and exhibitions abroad, replacements for damaged or faulty goods, the return of empty containers, etc. Forms C.D.3 covering normal trade samples and printed advertising matter need not be submitted to the Bank of England but they must state that the goods covered are *bona fide* trade samples or advertising matter supplied without charge.
3. Six months is the period within which the authorities insist that payment shall be received for British exports. If the two halves of the C.D.3 are not 'married' within six months—usually because payment has not been received—the Customs begin to make inquiries. If the shipper knows beforehand that he is not likely to receive payment within six months he should ask the Bank of England before making the shipment for permission to grant credit terms longer than six months. That permission would usually be given in respect of long-term contracts for schemes of capital development, but not in respect of normal sales of goods.

To sum up, the whole purpose of the procedure relating to C.D.3's is to ensure that :

1. full payment is received for goods exported from the United Kingdom,
2. payment is received in an approved manner,
3. payment is received within six months.

The achievement of those objects employs the time and efforts of very many people—in exporters' offices, in shippers' offices, in banks and at the Customs. The Overseas Branch of one bank alone in the City deals with something over 300,000 of these forms a year. And yet the C.D.3 procedure is a vital part of the Exchange Control system and it is difficult to see how, under present circumstances, we could do without it.

### *Imports*

Let us turn now to the system of control over imports. This follows similar lines to that governing exports. Again there are two sets of controls, one governing the physical entry of the goods into the United Kingdom and another governing the method and means by which payment for them may be made.

Control over the movement of goods is exercised by the Import Licensing Department of the Board of Trade. As might be expected, imports are subject to rather wider supervision than are exports.

It is an axiom that once a British importer has obtained permission to import certain goods then automatically he will be allowed to pay for them, i.e., he will be allocated the means with which to make payment. This seems only logical but it is not so in all countries : in some parts of the world the importer has to fight two separate and often quite independent battles, one to obtain an import licence and another to obtain an allocation of foreign exchange with which to pay for the goods. When shipping goods to those countries British exporters must accordingly, as we have already indicated, make sure, before shipping the goods, that the buyer abroad has obtained both an import licence from his authorities and also an allocation of exchange with which to pay for them.

In the United Kingdom, however, an import licence will automatically be followed by an allocation of exchange and the more important part of import control is vested in the Import Licensing Authorities. Those authorities work under the general supervision of the Treasury and the Board of Trade, who between them presumably give guidance, or instructions, on how much may be spent on imports, both from different countries overseas and on different classes of goods.

A resident of the United Kingdom wishing to import goods

into the United Kingdom from anywhere outside, including other parts of the Sterling Area, must first obtain an import licence from the Import Licensing Department of the Board of Trade. These licences are numbered and dated, they are not transferable from one importer to another, and are valid only for definite periods, usually six months. If they have not been utilised within their validity period application must be made for them to be renewed or for a fresh licence to be issued. There is no certainty about their being extended and the application for renewal will be considered as if it were an entirely fresh application and in the light of circumstances ruling at that time and not at the time when the licence was first issued.

A *carte blanche*, in the form of an Open General Licence, is given for the importation of certain classes of goods. Goods covered by Open General Licence may be imported without separate licences for each consignment. The most usual goods covered by an Open General Licence are fruit, flowers and vegetables, the importation of which is usually freed during certain periods of the year. The Open General Licence system is being extended as part of the efforts of economic co-operation between European countries, and it is understood that as the result of positive steps taken by individual countries, including the United Kingdom, by the end of 1949 one-half of all private trade between O.E.E.C. countries had been freed from import licensing restrictions, except where balance of payments difficulties might have made this impossible.

No import licence is required in respect of a limited range of goods, for example trade samples and the return from abroad of goods in the same state as they were exported. The regulations governing the issue of import licences for specific goods and the range of goods covered by Open General Licence are subject to frequent change and in all cases where there is the slightest doubt as to whether import licences are required or not the latest information should be obtained from the Import Licensing Department.

The second set of controls over imports is that governing the financial aspect of the transactions, and that is the one which more directly affects the banks. Having obtained his import licence the importer goes to his bank in order to obtain authorisation to make the payment abroad. As has been already said, this should give no trouble, though payment must be made, as in the case of exports, within a definite pattern. If the contract or agreement made between buyer and seller stipulates that payment be made in sterling that sterling may be paid only to an account kept in this country for somebody, usually a bank, resident in the country selling the goods. If goods are being bought from Italy, for example, payment may be made in sterling to be credited

only to an Italian Account. The procedure in this case would usually be for the money to be paid in to an Italian bank's sterling account in London. The Italian bank would be notified that the payment was for account of the Italian seller, and ultimate settlement would be made by the Italian bank with the seller.

If the importer wishes to pay in foreign currency he may do so only if it is a 'specified' currency quoted by the Bank of England and also, as a general rule, only if it is the currency of the selling country. He may pay Czechoslovakia, for example, only in sterling as Czech crowns have ceased to be a 'specified' currency, and if he wishes to pay France in currency it may be only in French francs, not Belgian francs or Swiss francs.

The British importer may make payment abroad either before or after the goods have arrived. If payment is to be made in sterling he must obtain from his bank, and complete, a Sterling Transfer Form. There are two kinds of this form, one marked 'For imports only', the other marked 'Not for imports'. If he wishes to pay in currency the form used is 'Form E Application to purchase foreign currency'. Again there are two kinds, one for imports and the other for making payments in currency abroad for purposes other than for the import of goods. Sterling Transfer Forms, once approved by a bank, are valid for three months, whilst 'E' forms for the supplying of foreign currencies are valid only for 10 days. The reason for this marked difference in the period of validity of the different forms is presumably that the Bank of England does not like currency positions in 'specified' currencies to remain 'untidy' for more than quite short periods. Incidentally, British traders who are committed to pay foreign currencies in payment for goods bought from abroad should, as a matter of prudence, cover themselves against fluctuations in the rates of exchange by entering into forward contracts with their bankers for the supply of the relative currencies on the due dates.

Both the forms (for sterling and for currency) specifically for imports are in duplicate. Each part of the form is identically numbered to facilitate the two parts being 'married' at a later stage. On a Sterling Transfer Form the details required from the importer, on both halves of the form, include the amount in sterling and the type of account to be credited. This must, in general, be a non-resident account kept in London for somebody, usually a bank, resident in the country selling the goods. On the 'E' form particulars must be given of the amount of currency and the address of the beneficiary. On both forms other details required are a description of the goods, details of the import licence, the country from which the goods are consigned, the country of origin of the goods, etc. The country of origin is important and for the transaction to be approved automatically the country of origin must correspond with the country from which

the goods are consigned. If the United Kingdom is buying from Holland, for example, goods of French origin it is probably paying for not only the original cost of the goods but also the Dutch middleman's profit. This would not of itself rule out such a transaction, but in order to keep the cost of the country's imports as low as possible our Exchange Control authorities prefer that goods are bought direct from the country of origin of the goods.

Evidence of value and evidence of import are required to be given by the importer with his completed form. If application for permission to make the payment is made before the goods arrive the evidence usually required is *pro forma* invoices, the import licence and a copy of the contract or correspondence between buyer and seller which can be taken as proof that shipment will be made and will be accepted by the buyer. Where the goods have already arrived in this country the evidence required is the actual invoice and the Exchange Control copy of the Customs Entry, a document issued by the Customs as evidence that the goods have entered the United Kingdom.

The importer signs a certificate on the Sterling Transfer Form or the 'E' Form, declaring that :

1. the statements he has given are true,
2. the required supporting evidence is given or will be given as soon as possible, and
3. the sterling or currency for which he applies will be used solely for the purpose stated.

The bank which keeps the account of the importer is then required to stamp the form, so vouching for the accuracy of the statements given by the customer and certifying his signature.

The next step is the authorisation for either the sterling to be credited to non-resident account or for foreign currency to be provided. In this the authorised banks, the commercial banks, have very wide powers. Except for a limited range of goods they have complete powers to approve these applications themselves, up to any amount, provided that the supporting papers are submitted. Under this system almost all the payments made to people abroad by residents of this country to pay for the great volume of the country's imports are authorised by the commercial banks without reference to the Bank of England. It will be remembered that the main control has already been exercised through the issue of the relative import licence, but even so the banks' powers are far-reaching and as such they must be used both carefully and correctly.

The only applications in respect of imports which the banks are *not* allowed to approve themselves are those covering payments

for the importation into this country of tobacco, films, diamonds, furs and oil, and also payments in respect of oil freights and mining expenses. Applications to cover imports of timber and machine tools must also be submitted to the Bank of England unless prior approval to the importation itself has already been given by the Ministry of Supply.

Having approved the application the authorised bank retains the top half of the relative form and returns the other half to the customer. The top half becomes the authority for the foreign currency to be supplied or for a non-resident account to be credited in sterling. When the necessary entries have been made in the books of that or of another bank the form is sent to the Bank of England. The Bank of England checks it, particularly to see that the right type of foreign currency has been supplied or that the right type of non-resident account has been credited.

When the goods enter the country the importer obtains from the Customs a copy of the Customs Entry marked 'For Exchange Control purposes only.' He attaches this and a copy of the invoice received from his seller to the duplicate Sterling Transfer Form or 'E' Form and gives them to his bank. The bank forwards them, through its Overseas or Foreign Branch, to the Bank of England. At the Bank of England the two halves of the form are 'married' and examined. From the top half it is seen that a certain amount, in sterling or foreign currency, has been paid away into the ownership of somebody outside the Sterling Area, and from the other half they see that against this payment certain goods have entered the country. The forms are also examined by the Customs and particular attention is paid to the valuation of the goods, for invoices are not always a certain guide, and provided all is apparently in order the matter is closed. Any discrepancies or queries are taken up by the Bank of England or the Customs, again through the medium of the Overseas or Foreign Branch of the bank concerned. Inquiries are also instituted, usually direct with the importer, when the duplicate form is not submitted within a reasonable time after the funds have been paid away, i.e. after the top half of the form has been submitted. Inquiries are made usually after about six months.

To sum up again, the purposes of the system of control over imports are to ensure that :

1. our foreign resources are used in the best interests of the country as a whole,
2. for money we pay away we receive an equivalent value in goods into this country,
3. the goods are received within a reasonable time of payment being made, and
4. the money, sterling or foreign currency, is paid away in an

'approved' manner, i.e. the indebtedness thereby incurred with countries abroad is incurred in such a way as to impose as light a burden as possible, and/or in accordance with specific arrangements made with other individual countries.

### *Multilateral*

We have now dealt with the direct export trade and the direct import trade of this country. There remains to be considered the many kinds of trade known by the generic title of 'multilateral trade.' This is trade where either a British merchant is a party to the trade but only as an intermediary, or where there is not even a British intermediary but sterling is the currency used for the settlement of trade between two other countries both outside the United Kingdom.

One of the most usual types of this trade is where a merchant residing in the United Kingdom sells goods to a foreign country but the goods are shipped not from the United Kingdom but from a third country. A not uncommon example is the sale by British merchants to Italy of wool shipped from Australia direct to Italy, and of New Zealand cowhides sold by British merchants to Finland and Denmark. Where another part of the Sterling Area is concerned the British Control tries to ensure that the normal exchange control procedure relating to exports is followed. The shipper of the goods, be he in Australia, New Zealand, South Africa or in any other part of the Sterling Area, himself completes his own Control's equivalent of the C.D.3 form. After the goods have been shipped this form is forwarded to the seller in the United Kingdom. When he, i.e. the seller in the United Kingdom, receives payment for the shipment he himself lodges the form with his own British bank for certification in the same way as for our own C.D.3's. Eventually, usually through the London Offices of the Dominion and Colonial banks, the C.D.3's find their way to the local Controls who are thus in a position to have a full record of the completed transactions in the same way as our own authorities can do in London in respect of purely British exports.

Another, and a very important, category of this class of trade is that which arises from London's position as the chief financial and trading centre of the world. This is international trade conducted through the United Kingdom, that is trade between two countries both outside the Sterling Area but the trade itself is organised and/or financed by British undertakings. This in Exchange Control parlance is known as 'F.E.24 Trade.' Normally this trade requires to be financed in terms of 'specified' currencies or of sterling and the same currency must be used on both the bought and the sold sides. At one time this kind of trade was usually approved provided it was financed in terms of U.S.A.

dollars throughout, and only exceptionally was the Bank of England prepared for it to be financed in terms of any other foreign currency. Recently, however, there seems to have been some relaxation of our authorities' insistence on a financial basis of dollars. Presumably this relaxation is in conformity with official policy of encouraging the international use of sterling and of placing no undue impediments in the way of those British merchants who specialise in international trade in its widest aspects. As regards pure 'dollar for dollar' trade, the commercial banks themselves may approve such transactions under certain conditions. The most important of these conditions are that payment for the goods is both made and received in U.S.A. dollars, that the goods have been resold on the basis of a firm contract, that the full sale proceeds of the goods are to be received from the non-resident purchaser through orthodox channels (e.g. by means of an irrevocable confirmed credit in U.S.A. dollars, etc.) and finally that there is an assurance that the dollars to be received from the sale of the goods are received or will in fact be received.

Transactions which do not conform with these conditions must be referred to the Bank of England. The transactions must be referred to the Bank not on any set forms but by way of a letter setting out the proposals. As a broad generalisation, it may be said that such proposals would receive favourable consideration if :

1. the transaction was to be financed in the same currency throughout,
2. that currency is sterling or any 'specified' currency,
3. a profit accrues to this country,
4. that profit is remittable to this country, and
5. the currency used is a 'specified' currency other than U.S.A. dollars and the monetary authorities of the currency concerned give their consent to the transaction.

It must be emphasised, however, that there is no recognition of precedent regarding the approval or otherwise of multilateral transactions. The Bank of England's reaction to such proposals is on a day-to-day basis, and its attitude to specific proposals is decided by its policy ruling at the particular time the application is submitted, and no other.

Recent examples of multilateral trade which have come to our notice are the sales by British merchants to the Western Zone of Germany of sausage skins shipped from Argentina. In this case the trade had to be financed throughout in terms of U.S.A. dollars. This is a pure example of 'F.E.24 Trade'. The insistence on U.S.A. dollars may have been because of the special financial and banking arrangements at present governing the Western Zone of Germany, but it may be that the Argentine insisted on payment in U.S.A. dollars rather than sterling.

However, the net result of this transaction was that a certain margin of profit, in terms of U.S.A. dollars, accrued to this country. Another recent example was the sale, through a British intermediary, of lemon juice from Italy to Holland. In this case our authorities allowed the transaction to be financed throughout in terms of sterling, provided that Holland paid in sterling from a Transferable Account. In this case the net result to the United Kingdom was a gain, by way of the intermediary's profit, in sterling and, to the extent of that profit, so was our indebtedness to the rest of the world in Transferable sterling correspondingly reduced.

A third example might be quoted bringing out another variation on the theme. There is yet another class of trade known as 'F.E.177 Trade'. This concerns the purchase by an English intermediary of goods outside the Sterling Area and sold to a country, other than the United Kingdom, within the Sterling Area. (An example of such a transaction would be a British merchant buying watches from Switzerland and selling them to India.) Before undertaking such a transaction the British merchant must be assured that his Indian buyer has obtained from his own authorities, i.e. the Indian authorities, a fitting import licence and also, if such is necessary, an allocation of exchange, in this case of Swiss francs or permission to credit Swiss sterling account, if in fact the import licence does not of itself carry such an allocation of exchange.

All the above relates only to that class of multilateral trade where there is a British intermediary. In addition there passes through the London banks the financial arrangements relating to another wide class of multilateral trade, i.e. that trade between two other countries, both outside the Sterling Area, which is financed in terms of sterling. In respect of this trade we, as a country, are concerned only to the extent that our indebtedness in sterling to other countries may or may not be improved by a shuffle of sterling from the ownership of one country to that of another. If Transferable sterling is provided by the buyer of the goods we would be no worse off if it were transferred to another Transferable Account — which it could well be — and, by the same token, if the Transferable sterling was transferred to *any* non-Transferable Account this country's position as regards the pattern of its general over-all indebtedness to the rest of the world would be improved. If ordinary non-resident account sterling was put up then the question of whether such transactions would be allowed by the Bank of England and/or be desirable to this country would be decided to some extent by the relative 'hardness' and 'softness' of the various types of sterling involved, but, more than that, by the current day-to-day policy ruling at the Bank of England at that particular time.

## FINANCE OF FOREIGN TRADE

*with particular reference to Exchange Control*

### LECTURE III

IN this third lecture I shall deal with the main methods of payment used in the export and import trade of this country and their relative advantages and disadvantages. I shall also, in the latter part of the lecture, discuss the facilities which the banks make available to their customers specifically to help them in their overseas trade.

There are various methods by which payment is made in respect of the sale of goods by one country to another and each of these methods has its own particular merits. Quite the best from the seller's, i.e. the exporter's, point of view is that he shall receive a clean payment in advance. Under this method the prospective buyer in the importing country remits the funds with which the goods shall be paid for before the shipper sends his goods. In British export trade this method of payment in advance was in fact adopted quite frequently in the early days after the war because of the very special conditions ruling in world markets at that time. In those days sellers' market conditions ruled almost universally. Goods were in short supply, there was a tremendous demand from a world starved particularly of consumer goods throughout the war years and means of payment were not lacking. Sterling was in the hands of many people throughout the world and they were only too anxious to use some part of it to make purchases in this country. Consequently in those early days after the war we saw frequently that sterling was paid by would-be buyers abroad long before the goods were, or could be, exported.

With the passing of seller's market conditions, however, methods of payment used in this country's foreign trade have reverted much more fully to the more usual and orthodox channels, i.e. documentary credits and documentary bills, the bills being either sent for collection or negotiated by a bank. These are the two main methods used in the finance of international trade and it is these two which we shall explore in some detail.

At the risk of being unnecessarily elementary let us follow through, very briefly, the procedure by which a documentary credit is established covering payment for an export of goods from this country to another country, say Sweden. The contract for the sale of the goods is arranged between the British seller and the Swedish buyer and it is agreed that payment shall be made by

means of a documentary credit in sterling established in favour of the British exporter. The Swedish buyer approaches his own bank in Sweden and asks it to arrange for such a credit to be established. The Swedish bank asks one of its correspondent banks in London to open, on its behalf, a documentary credit in favour of the British exporter. The British bank opens the credit against either sterling specially earmarked from those funds of the Swedish bank which it holds or against a documentary credit facility extended by it to the Swedish bank.

The British bank issues its own credit to the British exporter. This is a signed document which says in effect that the bank is prepared to pay the exporter a certain sum in sterling on his presenting to the bank documents showing that the specified goods have been despatched to Sweden. The credit would contain various conditions relating to the goods, the date by which shipment is to be effected, the various documents to be presented, etc. The British merchant then ships the goods strictly in accordance with the terms of the credit, and it must be remembered that these conditions are in effect laid down by the Swedish buyer in conformity with the conditions of the contract of sale between him and the British seller. The exporter then draws a draft on the London bank and presents it to the bank together with the documents called for. Provided the documents are completely in order and are in conformity exactly with the conditions laid down in the credit then the bank will pay the amount of the draft to the exporter. The British bank then forwards the documents by airmail to the Swedish bank. The Swedish bank, subject to satisfactory arrangements with its customer, gives the documents to the Swedish buyer, who is then in a position to take up the goods themselves when they arrive. The goods, having travelled by sea, would take longer to arrive than the documents sent by airmail, and provided the documents have been presented by the British exporter in good time they should be in the hands of the Swedish importer before, or at the same time, as the goods themselves arrive.

If the British bank has established the credit against specially earmarked funds then obviously it has those special funds available with which to pay the exporter. If the credit has been established against a facility the British bank on paying the exporter would debit the account of the Swedish bank and send it an advice to that effect. The Swedish bank would then put the British bank in funds on receipt of the advice that the payment had been made to the debit of its account. That is the theory but in practice there is no real 'tie-up' with particular transactions as the Swedish bank would in the ordinary course of its business keep funds with the British bank which would be more than sufficient to provide for its day-to-day business.

As between the Swedish bank and its own customer it is entirely a matter of arrangement between themselves whether the bank takes funds from its customer immediately on the opening of the credit or whether it requires funds to be put up by the Swedish importer only after payment under the credit has been made.

Let us consider now the procedure for the establishment by a British bank of a documentary credit covering the importation of goods into this country. The initiative would come from the British importer. If it is agreed between him and his buyer abroad that settlement shall be by means of a London banker's credit then the British importer would ask his own bank to establish such a credit in favour of the exporter abroad. As in the case of the customer of the Swedish bank it is entirely a domestic matter for the bank, in this case the British bank, whether it takes provision immediately it establishes the credit or allows the credit to run and recoups itself from its customer's account only after the bank itself has paid out under the credit.

The credit may call for payment in either sterling or foreign currency. If payment is to be in sterling and the greater proportion of these credits do in fact call for payment in sterling - the London bank opens its own credit in favour of the exporter abroad and sends the credit usually not direct to the exporter himself but to its own banking agent in the town of residence of the foreign seller. The British bank asks its correspondent to advise the terms of the credit to the exporter in its own country. These credits in sterling are usually available by drafts on London. If the credit is in sterling and it has a London expiry date then the British bank establishing the credit usually sends it direct to the beneficiary as this would probably save the opener of the credit from charges which the foreign bank might make purely in its capacity as an advising agent. When the credit calls for payment in foreign currency the British bank generally asks its foreign correspondent to establish its own credit in favour of the exporter.

The third type of credit is that established by the British banks to cover trade between two other countries both outside the United Kingdom. The procedure in principle is no different from that already described. The British bank establishes such credits on the instructions of its foreign correspondents and sends credit advices to the beneficiaries in the selling countries, either direct or through the intermediary of its own banking correspondents. It is gratifying to see that still a large part of international trade, i.e. trade between two other countries both outside the United Kingdom, is financed in terms of sterling, and of that trade a very large proportion is financed by means of documentary credits established through the British banks. Fairly regular lines of trade financed by London bankers documentary credits are the sales of wood pulp and paper by the

Scandinavian countries to South America, jute from India and Pakistan to European countries and the United States of America, and rubber from the Straits Settlements to the United States.

The proportion of the total credits opened by the London banks in respect of the three categories, i.e., exports, imports and multilateral, is of interest. It is of course impossible to give any precise figures, but based on the experience of one of the largest banks in this field the proportion of the credits they establish which cover exports of goods from this country is 50 to 60 per cent., that covering imports into the United Kingdom is around 20 per cent. and those covering multilateral transactions again about 20 per cent. These figures are not exact and it is not likely that they are the same with all banks but they do give some general indication. It is very noticeable that a far greater proportion of the total credits of the London banks cover exports from this country than imports. This arises mainly from the fact that in contrast to pre-war days a large part of the total import trade of this country is now carried out through various Government Departments and bulk purchasing bodies the Ministry of Food, Ministry of Supply, etc. and settlement for these large transactions is sometimes made by means other than normal commercial credits.

Credits issued by banks can be either 'confirmed' or 'unconfirmed'. If they are confirmed this means in effect that once they are established they cannot be revoked nor can their terms be altered except with the consent of the beneficiaries. If they are unconfirmed, however, their terms can be varied and even their very existence terminated at any time without the consent of the beneficiary. Some confusion on occasions arises between the terms 'confirmed' and 'irrevocable'. In this country the terms are, in general, interchangeable and a credit can be either confirmed or irrevocable and by the same token it can be either unconfirmed or revocable. In banking practice in the United States, however, the terms confirmed and irrevocable have separate meanings and this differentiation is gaining some ground in the United Kingdom. Under this interpretation the term irrevocable is applied to the undertaking given by the issuing bank that it will honour drafts drawn under the terms of its credit. Where the credit is valid in another country and requires to be advised by a bank in that country then the terms confirmed and unconfirmed are applied to the liability which the second bank undertakes. Thus where an American bank issues its irrevocable undertaking to honour drafts drawn under the terms of the credit and on the strength of the credit of the American bank another bank, in say France, confirms that it will negotiate drafts drawn under the credit, then the credit would

be irrevocable on the part of the American bank and confirmed on the part of the French bank.

It is an important matter to traders whether their credits are to bear the firm undertakings of one or possibly of two banks, for each bank would make a charge for adding its confirmation to the credit. British importers are almost without exception involved in the confirmation charges only of the British bank, for practically throughout the world the firm undertaking of a British bank is considered to be fully adequate security. The position of British exporters is rather different. Credits opened in their favour would originate from a bank abroad, but many British exporters insist, even though the bank abroad may have opened its irrevocable credit, that the credit shall bear also the confirmation of the British bank unless the original bank is one of very high standing. This attitude on the part of the British exporters is understandable as they are in no position to judge the financial strength of banks abroad and in the event of their failure they, as beneficiaries under their credits, would probably rank only as ordinary creditors. Moreover, with a credit which carries the irrevocable undertaking only of a bank abroad any legal action which might subsequently have to be taken would probably have to be pursued in courts abroad rather than in this country.

A few words might be said on other terms used in documentary credit practice. The term 'documentary' itself applies to credits which call for the presentation of specified documents. The contra to this term is 'clean' and is applied to a credit opened by a bank under which payment is to be made simply by the drawing of a draft on the bank by the beneficiary, no other documents being called for.

Another term used in connection with credits is 'revolving.' The expression 'revolving' is applied to credits which are in one way or another renewable. Such renewals can arise when limits are placed on the amounts which may be utilised under the credit within a stated period, for example so much during one week or one month. Another example of a revolving credit is one in which limits are placed on the amounts which may be drawn under the credit at any one time, but once an amount is drawn and paid then the original amount is automatically available again.

'Sight' and 'acceptance' are two other terms which have perhaps even greater importance. Sight credits are those under which the drafts to be drawn by the beneficiaries on the issuing banks are to be payable at sight. Under acceptance credits drafts are drawn on the issuing banks at a certain usance, usually at 30, 60, 90 or 120 days after sight or after date. The Bank of England will, in general, not allow the British commercial banks

to establish acceptance credits calling for drafts at a usance of more than 120 days and even then some of the banks prefer that the maximum tenor of drafts under their credits shall be 90 days.

It is noticeable over the past year or so that acceptance credits are gaining something of the importance which they held before the war. In the early days after the war nearly all the documentary credits which the British banks were requested to open were sight credits. This was mainly because of the general conditions of sellers' markets. Owing to the shortage of goods sellers could more or less dictate to buyers the terms of payment, and, obviously, sellers stipulated for sight rather than acceptance credits as they were thus enabled to obtain their cash immediately without loss of interest. The emphasis on sight credits was due also to the fact that there was a relative abundance of liquid funds and buyers had no difficulty in putting up spot cash for their purchases. Under acceptance credits the relative funds are sometimes, i.e. when the British bank is prepared to give facilities, not required to be put up until maturity of the accepted drafts under the credits. This means in practice that buyers, subject of course to arrangements made with their own banks, may gain physical possession of the goods and are given, say, three months in which to sell them and so put themselves in funds with which to meet payments under the actual credits and so, in effect, pay for the goods. This in fact is a very cheap form of financing, the total cost of the beneficiary being appreciably less than the cost of a bank loan or overdraft. As a matter of principle some of the British banks will add their names as acceptors only to bills which have behind them a current movement of goods. If they accepted any other kind of drafts the acceptances might have some of the characteristics of 'finance paper'. Accordingly some of the big banks are prepared to open their acceptance credits only when the drafts cover a contemporaneous movement of goods and a request from a bank abroad to one of these British banks to open its acceptance credit against goods which have already arrived in the country of destination would often be refused. They would probably indicate their willingness to open such credits on a sight basis only.

Whenever a non-resident interest is involved in the opening of a documentary credit Exchange Control approval must be obtained. The special exchange control form used is 'E. 2'. The authorised banks have wide powers to open documentary credits themselves without having to obtain specific approval from the Bank of England. The more important of the credits which have to be referred specifically to the Bank of England are those which have an initial validity of more than nine months, credits under which it is proposed to draw drafts with a tenor of more than 120 days, those expressed in a currency other than that of either the importer

or the exporter, those covering movements of gold, diamonds, furs, films, tobacco and oil, and credits where both parties to the transaction are resident outside the Sterling Area.

When credits are expressed in terms of foreign currencies the exchange risk must be borne in mind. Where a British merchant is importing goods into the United Kingdom and paying for them in foreign currency by means of a bankers' credit, he should, as a matter of prudence, either buy the currency immediately or enter into a forward contract by which the foreign currency would be delivered at approximately the time he needs it. Unless special arrangements like this are made the British merchant would, of course, be debited at the rate ruling at the time documents are presented under the credit— which might be months after the credit is established— and the equivalent sum in sterling might be quite different from that envisaged at the time the credit was opened. In the same way if a British exporter is to be paid for his goods in foreign currency then he should sell the foreign currency forward so that again he may establish immediately the sterling equivalent of his contract.

A type of credit which is gaining some prevalence is the transferable credit. Under a credit which is specifically stated to be transferable the benefit in the credit can be transferred from the original beneficiary to another. Accordingly where the beneficiary is not the original supplier of the goods he may pass on the credit to a supplier, usually for a smaller amount, the difference representing his own profit. The incidence of exchange control results in even a transferable credit not being allowed to be automatically transferred to a resident in a monetary area different from that of the original beneficiary. Transferable credits are fairly common in the United States of America, and in Europe, and British banks are increasingly being called upon by their foreign correspondents, particularly on the Continent, to open such credits. It must be admitted that transferable credits do not find much favour with British banks, as they may ultimately become available to beneficiaries whose business standing may not be known or who in fact may be unsound financially. There is also the danger that through the system of transferable credits beneficiaries may be encouraged or, shall we say enabled, to trade beyond their own capital. Experience shows that when dubious cases occur the weaknesses are usually not in the ultimate buyers and sellers but in the middlemen who are acting only as agents to introduce buyers and sellers.

A further adaptation of the transferable credit is one which is both transferable and divisible. This means that the original beneficiary may transfer it to one or more beneficiaries. This adds considerably to the complications for the bank through which the credit is passing and I will say no more than that the

transferable and divisible credit is even more unpopular with British banks than the transferable credit.

Some reference should also be made to the documents called for under bankers' credits. The most important of these documents is the bill of lading. The bill of lading is not only a contract of affreightment between the shipping company and the shipper but it is also a receipt for the goods and the document of title to the goods themselves. Bills of lading presented under documentary credits must be those issued by steamship companies or their accredited agents. Forwarding Agents receipts are not acceptable in place of bills of lading unless they are specifically called for in the credit. Most credits call for a full set of 'shipped' or 'on board' bills of lading and banks to whom bills of lading are presented under credits must make quite sure that in fact they do give full evidence of shipment of the relative goods on the vessel named. Bills of lading which state that the goods have been 'received for shipment' are not in this country a valid presentation under a documentary credit calling for shipped bills of lading.

Bills of lading which, on the face of them, are 'stale' must not be taken up under credits. In British banking practice a bill of lading is considered to be 'stale' if it has, on the face of it, been held up so long after the shipment of the goods that it cannot be despatched, even by airmail, to reach the port of destination of the goods before the arrival of the goods themselves. It would be unreasonable to adopt too rigid an attitude in this respect and accordingly for short voyages most of the British banks are prepared to take up bills of lading covering journeys between the United Kingdom and the Continent, even though the goods might already have arrived, provided that the bills are dated not more than a week or perhaps ten days prior to the documents being presented.

Bills of lading presented under credits must be 'clean.' That is to say there must not be any clause or amendment in the bill of lading which is in any way detrimental to the condition of the goods or their packing, for example, bills of lading showing that the relative goods are in bad condition or that the cases in which they are contained are broken. Ordinarily, only 'clean' bills of lading are acceptable and therefore when issuing their credits British banks do not specifically call for 'clean' bills of lading, this condition being assumed. In the same way bills of lading which show that the goods or any part of them are 'shipped on deck' would not be accepted. Normally, 'on deck' shipments are inadmissible unless specifically allowed for in the credit. Where the goods are invoiced on a C. & F. or C.I.F. basis the relative bills of lading must show that freight has been prepaid or a receipted freight account must be tendered with the documents.

Frequently parcel post receipts are called for instead of bills of lading. They usually arise where consignments are small or very light in weight so that they can be sent by parcel post instead of by steamer. When parcel post receipts are presented under credits the receipts should show, according to the terms of the credit, that the goods have been addressed to either the buyers themselves or to the bank abroad which has given instructions for the opening of the credit.

The second most important document called for under credits is the insurance policy. The value covered by the insurance must be at least equal to the full invoice value of the goods and sometimes credits call for a percentage, say ten per cent., over the invoice value. Where an insurance policy is called for an insurance certificate is not acceptable. Insurance should be covered in the same currency as that in which the credit itself is expressed, or provision must be made for claims to be made payable at a fixed rate of exchange.

Other documents called for under credits are commercial invoices duly signed by the sellers, consular invoices, certificates of origin, weight notes, etc.

When documents are presented to a bank under a credit they must be scrutinised very carefully so as to make quite certain that all the conditions set out in the relative credit are observed and that the documents themselves do not show anything which indicates that the goods may suffer in transit.

It is sometimes contended that banks cause unnecessary inconvenience to traders by being too meticulous in examining documents and by refusing to accept documents which are irregular in only very minor respects. Such contentions do not show an appreciation of the banks' position. When the documents are submitted for payment to a bank under one of its credits the bank must either pay against the documents or return them because of irregularities. If it pays it cannot thereafter substantiate debits to its principal's account, i.e., the people for whom it has opened the credit, unless it can submit to them documents which comply in all respects with the conditions and terms of the relative credit. The principal would be fully entitled, legally if not morally, in refusing to accept documents which were in any degree not strictly in accordance with the terms of the credit, even though the irregularity might be quite irrelevant and completely non-prejudicial to the successful shipment of the goods. By the time a shipment of goods arrives in the importing country the market for the goods may have disappeared or prices might have fallen to such an extent that that particular shipment would involve the importer in a loss and not a profit. It would be possible—and in fact it has happened—that an unscrupulous buyer might, under such conditions, examine the relative documents most

meticulously, and if he found any irregularity whatsoever, no matter how irrelevant, he would legally be entitled to refuse to take up the documents and the shipment and the paying bank would then have the goods themselves on its hands. Obviously banks must be particularly observant in their examination of documents under general conditions of buyers' markets such as now rule fairly widely.

It would not be untrue to say that of the very many presentations of documents made to the banks—and one bank alone in the City deals with an average of several hundred presentations a day—about one-half are, on their first presentation, out of order. In respect of most irregularities in documents the banks are usually prepared to accept indemnities or guarantees holding them harmless and fully indemnified from any consequences which might arise from their paying against the documents which are irregular. The guaratee of another bank would usually be called for unless the presenters of the documents were themselves considered to be absolutely good for the amount involved. The validity of such guarantees should not be less than six months. It should be emphasised that there is no obligation on banks to accept these guarantees and they do so only to avoid the delays which would be incurred if fresh instructions or amendments were sought from their principals.

Banking and commercial practice in relation to documentary credits is not identical in all countries and consequently matters of contention sometimes arise when a credit concerns two countries whose practices are dissimilar. To overcome difficulties of this nature a code, called 'Uniform Customs and Practices for Commercial Documentary Credits' has been drawn up by the International Chamber of Commerce. Some countries have adopted this code and adhere to the practices and interpretations which it lays down. The British banks, however, have not adopted the standard rules; they prefer to be free to follow their own lines of policy and free to be able to judge each case on its own merits and to act accordingly.

An example of the differing customs which may arise between countries is the question of whether part shipments may be allowed under a credit. The code of 'Uniform Customs and Practices' does permit both part shipments and trans-shipments under credits, even in the absence of specific instructions to this effect in the credits themselves. Accordingly countries which adhere to the code allow partial shipments and trans-shipments. In this country there are no general rules of conduct between banks as to whether such shipments are allowed. The British banks prefer to judge each case on its own merits and in their judgment they are guided to a large extent by the countries and the commodities concerned. It would therefore seem that when the parties to a

documentary credit particularly wish for partial shipments and trans-shipments to be allowed they should arrange that a clause to that effect is specially included in the credit.

Next to documentary credits, documentary bills are the second most important method used for the financing of foreign trade. Under this procedure the exporter ships his goods and draws a bill on his foreign buyer. To this bill he attaches the relative documents of title and takes it to his own bank for them to collect. The bank would send it usually to its own agent in the country on which the bill is drawn, though sometimes a particular banking agent is decided upon by the drawer and drawee. It is preferable to let British banks choose their own agents abroad as they have a fairly intimate knowledge of them and of their charges. The banking agent presents the bill to the drawee and on his paying the bill the remitting bank is advised of the payment and it is credited in one way or another. The documents of title are usually surrenderable to the drawee only on his paying the bill or, of course, if the bill is drawn at usance, against the drawee's acceptance.

In respect of exports from the United Kingdom the British bank would not receive funds until the bill had actually been paid in the country abroad and advice of payment received in this country. This may take some time and in the meanwhile the exporter would be out of his money. By arrangement with his own bank, however, the British exporter may, nearly always, arrange to have funds immediately by negotiating the documentary bill with his own bank. The bank would in effect buy the bill and credit the customer immediately with the face value of the bill less the bank's discount charges. It must be understood, however, that the British bank would always have recourse against the drawer in the event of the bill not being paid. When the customer negotiates his foreign bills with a bank he will usually be required to sign a letter of hypothecation in favour of the bank. An omnibus letter of hypothecation is usually taken covering all bills a customer may negotiate with his bank. The bank, after it has bought the bills, would in any event have rights as a holder for value, but the letter of hypothecation makes the bank's position more certain as it gives the bank a valid title to the goods themselves.

The normal interest rate charged for negotiating bills is 4 per cent., i.e., the bank charges the customer interest at the rate of 4 per cent. from the time his account is credited until the bank itself is credited after the bill has been paid. Bills covered by the Export Credits Guarantee Department are negotiated by some banks at a more favourable rate—a recognition of the greater certainty of the bills being paid. In addition to the British bank's charges customers negotiating the bills must pay the

charges of the collecting banks abroad. These vary from country to country, but from very wide experience the British banks can give quotations for almost any town in the world where there is a bank.

These—documentary credits and bills—are the two main methods by which foreign trade is financed. Let us consider some of the relative advantages and disadvantages of each method.

1. *Certainty of receiving payment.* Under a documentary credit the exporter is certain to obtain payment provided he ships goods and presents documents which are strictly in accordance with the terms of the credit. Thereafter no future liability attaches to him, unless of course he has transgressed any of the provisions of the contract between him and his buyer abroad. There is, however, no such certainty about receiving payment where the method of payment is by means of bills. Under this method the shipper relies solely on the integrity and financial standing of the buyer. There is no certainty at all of the buyer's broad taking up the bills and so of the exporter receiving his money. If the bill is not paid the drawer is in the invidious position of having to find a market for goods which are physically out of his possession in another country. In any event he would probably be involved in expenses of insurance and warehousing, and added complications would arise when the goods are of a perishable nature.

2. *Delay in receiving payment.* Under the documentary credit there is, or should be, no delay whatsoever in the exporter receiving payment. He ships his goods, presents the documents to the bank which has established the credit, and he should receive his funds at the most within a few days. Where payment is by means of bills, however, there will be a delay in the receipt of the funds until the bill has been paid abroad and advice of payment received in the United Kingdom. This delay, of course, would occur only where the bills were sent for collection. Where the shipper is prepared to pay the negotiation charges and the bank is prepared to give him the negotiation facility he may put himself in funds immediately, paying of course the negotiation charges.

3. *Certainty of receiving the right kind of goods.* Under a documentary credit there is certainty of the shipping documents being strictly in accordance with the terms of the credit, and as those terms have in effect been laid down by the traders themselves it may be presumed that the buyer can be certain of receiving the kind of goods for which he has asked. This, of course, is in the absence of any fraud in the transaction by way of fictitious invoices, etc. Where the method of payment is by bills there is no certainty whatsoever of the goods in the consignment being of the kind which has been agreed upon between the traders.

4. *Cost.* Documentary credits are the more costly method. The buyer, if it is he who initiates the procedure, has to pay the charges of both the British and the foreign banks. A uniform scale of charges for foreign business was agreed upon by the London Clearing banks and came into force on April 1, 1948. The new scale imposed rather higher charges than had formerly existed but even so they are still relatively low. In other countries the charges of the banks are usually two or three times as high as those of the British banks. The expenses incurred in connection with bills are the collection charges of the banks plus their negotiation charges if the bills are discounted. These charges are lower than for documentary credits, and in any event they are borne, ostensibly at least, by the seller rather than the buyer of the goods.

5. *Alterations in shipments.* Once a documentary credit has been established there can be no alteration in the terms of the credit unless the issuing bank establishes a proper amendment altering the terms of shipment. With bills the shipper can alter the shipment, he can add goods or take goods off the shipment right up to the last moment.

6. *Exchange Control and Trade Control requirements.* With documentary credits exchange control formalities and other controls relating to the physical movement of goods are nearly always surmounted before the credit is established. Where the business is financed by bills, however, these difficulties are often not begun to be tackled until after the goods have been shipped, and then there is no certainty that the obstacles will, or even can be, surmounted.

The balance of advantage between documentary credits and bills seems to lie with the documentary credit for exporters and with the bill for importers. At the end of the war it was natural that a larger proportion of foreign trade should be financed by means of documentary credits than in post-war days. Old-established relationships between buyers and sellers in different countries had been disrupted and, under prevailing conditions of sellers' markets, the sellers could insist on the method of payment in international trade which was the most advantageous to themselves, and this undoubtedly was the documentary credit. It was reasonable to think that, with the re-establishment of more normal relationships between buyers and sellers in different countries and with the declining strength of sellers' markets, foreign trade should show a swing away from such a marked emphasis on documentary credits and that a greater proportion of foreign trade would be financed by means of bills for collection or for negotiation. In practice, however, there has over the past two or three years been no general change from documentary

credits back to bills in the ordinary financing of foreign trade. This is probably due as much as anything to the new advantage which the documentary credit has established for itself since the war in that, as already indicated, exchange control and trade control formalities are completed before the credit is established, which is not so in the case of bills. It is probably for this reason as much as any that the documentary credit continues to maintain a more dominant position in the financing of foreign trade than ever it did before the war.

Let us consider now the facilities which the British banks make available to their customers specifically in connection with overseas trade. The first facility which comes to mind is, of course, ordinary advances which the banks make to their customers to enable them to manufacture the goods or to prepare them for sale abroad. This, however, is part of the banks' normal activities and we should consider here only those specifically related to foreign trade. These facilities might be listed as follows :—

1. *A world-wide service.* Most of the larger British banks have a network of agents all over the world and, almost entirely through their agents in other countries, they can undertake to do banking business for their customers practically anywhere in the world.
2. *The establishment of documentary credits.* British exporters would figure as beneficiaries under credits established by the British banks on the instructions of their banking agents abroad. To those exporters, not all of whom would be its own customers, the bank concerned would issue its credit and pay out funds to them on due presentation of documents. For those of its customers who are importers and wish to finance their shipments by documentary credits the bank would establish on their behalf documentary credits in favour of their suppliers in other countries. This, as we have already pointed out when dealing with documentary credits, the bank would do either against a specific deposit of cash when the credit is opened or, according to the financial standing of the customer, it would establish the documentary credit and debit its customer's account only after payments have been made under the credit.
3. *Discounting of bills drawn under documentary credits.* Where a customer is a beneficiary under an acceptance credit the customer would draw drafts on the bank which would be accepted by it at sixty days, ninety days or such other usance as is called for under the credit. The customer could then wait for his cash until the maturity of the

acceptances or he may discount these acceptances with his own bank. They would be first-class bank bills and accordingly would command the finest rate of discount. At the moment the rate for such bills is around  $\frac{3}{4}$  per cent. per annum and most customers avail themselves of the facilities for discounting at such fine rates.

4. *Negotiation facilities.* Where an exporter adopts the method of payment of drawing bills on his buyer abroad he may put himself in funds immediately by negotiating those bills with his bank. The usual rate applied to such negotiations is around 4 per cent. per annum for the period that the bank is out of its money. Some liability continues to be attached to the drawer of the bills and obviously the British bank would negotiate for customers only according to their financial standing.
5. *Foreign Trade Information services.* Since the end of the war there has, in nearly all the banks, been a considerable development of the special Foreign Trade Information Departments of their Overseas or Foreign Branches. Through these Departments the banks provide, for customers of all their branches, status reports on buyers and sellers abroad and information on overseas markets and on any special conditions which may rule in different countries and in the markets for different commodities. They also, by working in co-operation with their banking agents abroad, seek to put exporters and importers in different countries in touch with each other. A British exporter, for example, who is entering the foreign field perhaps for the first time (either of his own volition or because his allocation of raw materials is made dependent on a certain proportion of his production being sold abroad) may approach his bank and the bank will not only give him all the help possible regarding the technique of foreign trade, but they will also try to find for him actual buyers abroad.
6. *Liaison with official bodies.* Finally, the banks work in close co-operation with the various official and semi-official bodies concerned with foreign trade, and are only too pleased to explain the services of these bodies to their customers and to effect introductions to them, often on a personal basis. Such bodies are the Commercial Relations and Export Promotion Department of the Board of Trade, the Export Credits Guarantee Department, the Dollar Export Board, B.E.T.R.O. (the British Export Trade Research Organisation), Chambers of Commerce interested in trade with particular countries, and the various Trade Associations.

One of the most important of these bodies is the Export Credits Guarantee Department and we might well finish with a description of the activities of this Department.

The Department, which was established in 1926, was formerly a subsidiary Department of the Board of Trade but it now stands on its own feet and is a far more important factor in the foreign trade of this country than ever before. Its main object is to assist British exporters by covering them, on an insurance basis, against many of the risks they run in respect of their export trade. It provides them in fact with some measure of protection against the main causes of financial loss arising in the course of overseas trade. The chief risks covered by the Department are as follows :

1. Insolvency of the buyer abroad or his failure to pay for goods within twelve months of their being sold to him.
2. The introduction of new exchange regulations in the buyer's country which would prevent the transfer of sterling to the United Kingdom with which to pay for goods already ordered before the new regulations came into being.
3. The occurrence of war between the buyer's country and the United Kingdom, or of war, revolution, etc. in the buyer's country.
4. The cancellation or non-renewal of export licences granted—in respect, of course, of goods subject to export licences - or the imposition of restrictions on the export of goods from the United Kingdom not previously subject to such restrictions.

The main risks which British exporters cannot cover with the Department are the possibility of the buyer failing to take delivery of the goods, and the risks involved in any possible changes in rates of exchange.

The Department does not provide absolutely full cover against risks of financial loss : it is considered only equitable that the exporter shall bear at least some small part of the risk himself. The proportion of the full contract price which the Department is prepared to guarantee is 85 per cent. where insolvency or protracted default occurs on the part of the foreign buyer, and 90 per cent. in respect of all other risks covered. Any recoveries which might subsequently be obtained after the Department has paid out under a policy are shared between the exporter and the Department in proportion to their respective interests in the debt.

Exporters must, in general, cover the whole of their foreign business for a period of at least twelve months. They may not pick and choose which parts of their business they cover with the Exports Credits Guarantee Department : otherwise the Department would be carrying only, in banking parlance, the 'bad and

doubtful'. Sometimes, however, cover for particular markets may be arranged with the Department at special rates.

The Department makes available two main kinds of policy, (a) a 'contracts' policy which gives cover from the time the contract of sale is entered into, and (b) a 'shipments' policy, which operates only from the time that the goods are put on board ship at a United Kingdom port. The premium payable on a 'shipments' policy is obviously at a lower rate than that which would be payable on a 'contracts' policy as it provides cover for a shorter period.

The premium rates payable by exporters are moderate and are assessed by the Department for each country of destination separately. Even for consignments of goods to the same foreign country, however, the premiums for different transactions may vary: for example, premiums on shipments made under London bankers confirmed credits are likely to be lower than if the method of payment is one of cash against documents. The Department may also impose limits on the amounts which exporters may have outstanding against particular countries or particular importers abroad. It is not unknown for the Department temporarily to refuse further commitments at all in respect of particular countries, as the amount it already has outstanding against those countries has reached the limit it has set itself, and it would not enter into further commitments in respect of that particular country until some of its outstanding obligations had run off.

Claims are paid by the Department (a) immediately, where the buyer has become insolvent, or twelve months after the due date when the debt should have been paid, (b) in respect of other risks covered, six months after the due date of the debt or of the event which is the cause of the loss.

Most of the policies issued by the Department cover the simple export of goods to other countries but special policies also are issued in respect of the sale abroad by Britishers of capital goods, for example, plant, equipment, heavy machinery, contract work for the building of harbours, bridges, hospitals, etc. Under these special policies allowance is usually made for progressive payments to be made as the capital goods are shipped or as the capital development work proceeds.

Recently, in connection with the drive to increase British exports to the North American continent, the Department has offered special facilities covering exports to those dollar markets.

As some indication of the extent of the work of the Department, when the war broke out policies were being issued at the rate of £61 millions a year and, on the basis of figures of total exports, we might say that in 1939 around 10 per cent. of the export trade of this country was covered by this Department. In the financial

year 1948-9, however, the total of policies issued was £280 millions, and on a similar basis the proportion of British export trade covered by the Department had risen to around 20 per cent.

The Department has offices in London, Manchester, Bradford, Birmingham, Sheffield, Glasgow and Belfast and is very ready at all times to give advice and assistance to actual or potential exporters. The banks strongly recommend the Export Credits Guarantee Department to their customers and welcome the service given by them. When banks are asked to negotiate or to advance against bills drawn under cover of any of the Department's policies some at least of them are prepared to negotiate such drafts at specially low rates and the Department's policies are hypothecated to the bank on special forms provided by the Department. In general it may be said that the banks are more likely to extend financial facilities to exporters if their business is covered through the Export Credits Guarantee Department than if it is not.







