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FOREIGN EXCHANGE EXPLAINED



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FOREIGN EXCHANGE EXPLAINED,

A PRACTICAL TREATMENT OF THE SUBJECT
FOR THE BANKER, THE BUSINESS
MAN, AND THE STUDENT

BY

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"PRACTICAL INVESTING," ETC.

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PREFACE

To a very large number of people who ten years ago had never even heard of a gear or a differential or a carburetor, these are to-day familiar terms. To an equally large number of persons, perhaps, such phrases as "demand sterling," "cables," "dollar drafts," etc. have, during the past few years, come to have a very definite and important meaning. Knowledge of foreign exchange used to be regarded as something of a luxury. It is, to-day, not far from being a necessity.

To supply the need for a book from which, without too great effort, the student, the business man, and the banker could get a working knowledge of the subject, the writing of "Foreign Exchange Explained" was undertaken. To set down, not a mass of figures and calculations, of interest only to the exchange expert and obsolete almost as soon as compiled, but rather a clean-cut, definite description of foreign exchange and of the underlying and unchanging principles on which it works — that has been the author's aim. So to state the theory of the thing as to make it applicable to everyday practical use — that has been his constant object.

If, in the attainment of this object, there has been any measure of success, it would seem perhaps as though that were due to the fact that the author's practical expe-

rience in foreign exchange has been supplemented by years of lecturing on the subject at New York University, during which time exceptional opportunities have been afforded to find out just what the man in the street wants to know about foreign exchange and what he needs to know.

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FOREIGN EXCHANGE EXPLAINED

CHAPTER I

INTRODUCTORY

FOREIGN exchange may perhaps best be defined as the business of buying and selling orders for the payment of foreign money at a foreign point. Between any two countries the rate of exchange is the price of the money of the one expressed in the money of the other.

To an American the term "money" means dollars and cents; to an Englishman pounds, shillings, and pence; to a Frenchman francs and centimes. Each thinks in the currency of his own country, and, naturally enough, demands that anything owing to him be paid for in that currency. The American who buys something in England knows he has got to pay for it in pounds sterling; but if, on the other hand, he sells something in England, he expects to get his pay for it in dollars. Different nations with different kinds of money all the while trading with one another and each demanding that payments to it be made in its own money — that, in a word, is responsible for what is known as "foreign exchange."

How International Payments Are Made. — There are two ways in which international payments can be made: (1) by having the creditor draw a draft on the debtor, (2) by having the debtor send to the creditor a bank draft drawn to the creditor's order. A merchant in New York, we will say, has sold to a merchant in London a bill of goods amounting to \$1000. The New York merchant can get his money: (1) by drawing a draft on the London merchant for enough pounds sterling so that when he (the New York merchant) sells the draft at the current rate of exchange, he will realize \$1000 from its sale, or (2) the London merchant may secure from his bank a draft on its New York correspondent for \$1000, and send that to the New York merchant in payment.

At any given centre having important financial relationships with the outside world, it will thus be seen, drafts drawn in foreign money on foreign points are all the time coming into existence. At any such centre, on the other hand, there is continually a demand for drafts drawn in foreign currency on foreign points.

Function of the Foreign Exchange Banker. — Now if it were possible, at a place like New York, for the people who have drafts to sell to get into direct touch with the people who want to buy drafts, there would be no need for the foreign exchange banker. A moment's thought will show why that is impossible. In the first place there is no way in which the man, for instance, who has bought silk in France and needs a draft in francs to pay for it can get into contact with the man who has sold cotton in France and in consequence has

a draft in francs on the buyer which he wants to dispose of. In the next place, even though they did get together, there is very little likelihood that the draft drawn against the cotton would be even of approximately the amount required by the man who has to pay for the silk. Further, the cotton draft would very likely be drawn at sixty days' sight, on a mercantile house and with bill of lading and other documents attached. For the purposes of the silk importer, requiring a banker's sight draft for a specified amount, such a draft would be quite valueless.

Just here is where the foreign exchange banker comes in. Smith, he knows, has a draft to sell. Jones has a draft to buy. Very well, says the banker, I will take off Smith's hands the draft he has to sell, and place it in my deposit account in Paris, thus putting myself in a position to sell Jones the draft he needs — *my own* draft on *my own* depository bank abroad. It doesn't make any difference to me whether the draft I buy from Smith is drawn at sixty days' sight, or is on a mercantile house, or has documents attached. All is grist that comes to my mill. All I have to do is to send Smith's draft to my correspondent in Paris, who, through the medium of the discount market there, will turn it into cash and credit my account with it within a few hours after its arrival. If to put the net proceeds in francs over there costs me less dollars and cents here than I can get from Jones for the draft for a like amount I am going to sell him, the difference will be clear profit.

So that is the function of the foreign exchange banker — to stand as an intermediary between the man who has

a draft to sell and the man who has a draft to buy; taking from the former (at an appropriate price) anything he may have to offer and selling to the latter the particular kind of draft for exactly the amount he may want.

Rate of Exchange. — The price in dollars and cents at which the foreign exchange banker will sell you drafts on the balance he is carrying somewhere abroad — *the rate of exchange* on that point, in other words — depends entirely upon the amount of dollars and cents it cost him to establish the balance. If a great number of drafts drawn in sterling against exports of wheat or cotton or securities are offered to the banker and he is able to buy them at constantly declining quotations, in like proportion will the price in dollars and cents (the rate of exchange) decline which he (the banker), will charge for his own drafts. All he is looking for and all the other foreign exchange bankers doing business at that point are looking for, is a chance to make a moderate profit. As the banker can buy cheaper he will sell his own drafts cheaper, and conversely, as he has to pay more, he will charge more.

The rate of exchange, it is thus evident, depends entirely upon the demand and supply of bills. If London owes New York heavily for purchases of commodities or securities or anything else, it is plain that merchants and bankers in New York are going to draw a large amount of drafts in pounds sterling and that when these drafts are offered for sale in the open foreign exchange market in New York, the natural tendency of the price for pounds sterling is going to be downward. Similarly,

if New York owes London largely, and every one in New York is trying to buy sterling drafts drawn on London with which to make payments, it is plain that the rate for pounds is going to rise.

Every Rate of Exchange Is a Two-ended Affair. — It must be remembered, however, that the rate of exchange between any two given points is a two-ended affair and determined by conditions at *both ends*. At New York, for instance, on some given day, the demand for and the supply of drafts on London might be so nearly equal as to hold the rate of exchange practically stationary; but in London on that particular day there might easily develop a demand for drafts drawn in dollars on New York which would cause the London rate on New York to go up. Such a movement would naturally have a quick reflection on the rate, in New York, for pounds sterling. If the rate in London goes up, the rate in New York must of course go down correspondingly, and vice versa.

If any explanation of the above is needed, it is to be found in the fact that it is obviously impossible that the pound sterling and the dollar should exchange at a material difference in price in New York and London at the same time. For purposes of illustration (with the cable working, such a thing would of course be impossible), suppose the price, in London, for drafts drawn in dollars on New York was \$4.86 to the pound while in New York the price for drafts drawn in pounds sterling on London was \$4.85. Is it not evident that in New York every one in the business would at once rush to avail himself of the chance to purchase for \$4.85 something which could

immediately be exchanged, by merely sending it to London, for \$4.86? And if that is the case, is it not evident that, as a result of this buying, the price of pounds in New York would tend to go up from \$4.85 toward the price of \$4.86 for which pounds were exchanging in London?

\$4.88 in New York — \$4.88 in London. — Between any two cities having important foreign exchange relations, the rate of exchange must invariably be the same or very nearly the same at both ends. If the rate in New York on London is \$4.88, the rate in London on New York will be \$4.88 or very close to it. If something happens in New York to drive the rate on London down to \$4.84, the rate in London on New York will rise to \$4.84.

Observe that the change in the quotation from \$4.88 to \$4.84, at New York, for drafts drawn on London, represents a *decline* in the rate — that is to say that pounds are cheaper. Observe that the same movement from \$4.88 to \$4.84 in the quotation, in London, for drafts on New York represents an *advance* in the rate — that is to say that less dollars can be bought for each pound sterling.

The rate of exchange between any two given points, it will thus be seen, works exactly on the principle of a see-saw. If you push one end of a see-saw down, by that very act you lift the other end correspondingly up. You can't move one end without affecting the other.

CHAPTER II

PARS OF EXCHANGE

BEFORE going on to discuss what makes rates of exchange go up and down from par, it is well to be sure that we have clearly in mind just exactly what "par" is.

All nations whose currency is on a gold basis — and with a few commercially unimportant exceptions the whole world's currency is to-day on a gold basis — decree by law just what weight of gold shall be contained in their standard gold coin and what the fineness of the gold shall be. Thus, in the United States the ten-dollar gold piece (eagle) is coined of 16.7182 grammes of gold .900 fine (90% pure); in Great Britain the gold pound sterling (sovereign) is coined of 7.98805 grammes of gold .916 $\frac{2}{3}$ fine (91.66% pure), etc., etc. Each coin on leaving the mint, whether it be the American eagle or the British sovereign or the French napoleon or whatever it is, weighs just so-and-so much and is of just such-and-such a fineness.

Now it is a simple arithmetical process, knowing the weight and fineness of a coin, to find the total amount of pure gold contained therein. Take the case of the American eagle, which weighs 16.7182 grammes and is .900 fine. Of absolutely pure gold in the eagle, obviously, there is 90% of 16.7182 grammes = 15.0464 grammes.

In the case of the sovereign, which weighs 7.98805 grammes and is $.916\frac{2}{3}$ fine, the calculation would be $91\frac{2}{3}\%$ of 7.98805 grammes, which is 7.32238 grammes.

Par and How It Is Found. — Having determined the exact weight of absolutely pure gold contained in any two coins as above, it is easy to find the relation — or “par” — between them by simply dividing the one by the other. Thus if we divide the amount of pure gold in the sovereign, 7.32238 grammes, by the amount of pure gold in the dollar (one-tenth as much as there is in the eagle), 1.50464 grammes, we find that the “par of exchange” between the sovereign and the dollar is 4.8665. To put it another way, there is 4.8665 times as much absolutely pure gold in the sovereign as there is in the dollar.

To find the par of exchange between any two gold standard countries is just as simple, provided you know the exact weight and fineness of their respective coins. Having that, it is an easy matter to find the weight of the pure gold contained in each; after which it is only necessary, in order to find the par, to divide the one by the other.

The par of exchange between two countries, then, may be defined as the price of the gold money of the one expressed in terms of the money of the other. Forget for the moment that the sovereign is a coined piece and think of it merely as a disk made of 7.3223 grammes of absolutely pure gold. If the price of 1.5046 grammes of pure gold in the United States is one dollar, what will be the price of 7.3223 grammes? \$4.8665 is the answer, which is what you would get at any United States Assay

Office for the amount of gold contained in a newly minted British sovereign.

“ Par ” and the Rate of Exchange. — Pars of exchange, from the standpoint of the exporter or the importer, whose foreign remittances are made exclusively by drafts, are of little interest; but to the banker who concerns himself with specie shipments pars are of very great importance indeed. The par of exchange between England and the United States, for example, being the amount in dollars which new sovereigns will fetch in this country, it stands to reason that no New York banker is going to sell drafts (orders for the payment of pounds in London) at a rate of exchange which will yield him less dollars and cents than he could realize by bringing the sovereigns themselves over here. Conversely, no American banker desiring to increase his deposit in pounds in London is going to pay more dollars and cents for those pounds than it would cost him physically to ship the amount of gold contained in those pounds.

Assuming, then, a free gold market on each end, the rate of exchange can rise only just so-and-so far above par and can fall only just so-and-so far below par, the extent of the possible rise being the amount it costs to ship gold to London and the extent of the possible fall being the amount it costs to bring gold in from London. A full discussion of these costs and of how they are figured is found in Chapter XII.

CHAPTER III

INTERNATIONAL BANKING

KNOWING now what constitutes the par of exchange between any two countries, it might seem as though the decks were cleared for discussion of what makes exchange rise above par and fall below it. Before going ahead, however, we want to be sure that the fundamental differences existing between some of the principal markets whose exchanges we shall be looking into are fully appreciated. On that rock many a serious effort to study the theory and practice of the foreign exchanges has gone to pieces.

In the first place it must be very clearly understood that among the financial markets of the world London occupies an entirely unique position. Recent years have seen New York come forward by leaps and bounds as a world market, but London's position, we must bear in mind, is a development of centuries — and financial confidence is a plant of slow growth.

Whatever strides forward have been made by other markets during recent years and however the balance of banking power may shift in the years to come, the fact remains that London is to-day as she has been for centuries, the world's banker. Nor is there any mystery about the fact that in parts of the world where the mark,

the franc, and even the justly esteemed American dollar have never been heard of, the pound sterling and the draft on London pass current. The fact of the matter is that where one bank in some outlying part of the world carries a balance in New York or Paris, ten carry a balance in London. Internationally speaking, every one carries a balance in London.

Breadth of the London Discount Market. — With the banks all over the world leaving large sums of money on deposit in London at all times, and with the use of all this money in British hands, is there any further explanation needed of the fact that the discount market in London completely overshadows in importance the discount market of every other point?

In its bearing on London's foreign exchange relationships with other financial centres, this fact that the banks all over the world keep balances in London is of the utmost importance. At all times these outside banks stand ready to sell drafts drawn in sterling on their London balances. At all times they stand ready to buy drafts drawn in sterling on London, for the purpose of replenishing these balances. Practically anywhere in the world and at any time, in other words, you can buy a draft on London if you need one, or, if you have a draft on London to sell, you can find a bank which will take it off your hands.

That being the case, it has come about that London conducts the vast bulk of its foreign business — *both* export and import — in its own currency, the pound sterling. Have you sold something to a merchant in England? — very well, says he, draw on me in pounds

for what I owe you. Has he sold something to you? — very well, says he, send me a banker's draft drawn to my order in sterling on London. In either case, observe, whether he owes you or whether you owe him, the obligation is settled *in sterling*. There is little or no question of his sending you a draft drawn on New York in dollars or, if you owe him, of his drawing on you in dollars.

To a certain extent the London banks do, of course, carry balances at New York and Paris and other primary points and so are in a position to buy and sell drafts in dollars or francs or other currencies when they so desire. By no means, however, can the market in London, for instance, for dollar drafts on New York, compare in breadth or scope with the market for sterling drafts here.

A market for exchange, to be worthy of the name, it must be borne in mind, must be a market on which not only bills payable at sight but bills payable at sixty and ninety days' sight can be freely bought and sold. And, of course, unless there exists a fair discount market at any given point, the drawing of sixty and ninety-day drafts to any extent on that point is out of the question. No one is ever willing to buy drafts of that character except with the assurance that they can be readily discounted and turned into cash.

The New Discount Market at New York. — So far as the United States is concerned, it is to be noted that it is only since 1913, when the Federal Reserve system was put into effect, that there has been even a semblance of a discount market in this country. Before the passage of the Federal Reserve Act, indeed, time drafts from abroad could not legally be drawn on the national banks.

Under special arrangements, the foreign correspondents of a few of the larger New York private banking houses drew drafts in dollars at sixty and even ninety days' sight ; but this was possible only where there existed no need that these drafts be turned into cash through the medium of an open discount market. Only very recently can there be said to have been any really considerable drawing of time dollar drafts on New York. Time drafts drawn in any volume require a market in which they can be readily discounted ; and a discount market, presupposing the carrying of large deposits at New York by banks all over the world, is something which it takes many, many years to build up.

So far as a discount market is concerned, Paris, Amsterdam, and several other European financial centres are far better off than New York, and the amount of " time " drafts drawn on these points probably far exceeds the amount of time drafts drawn on New York. In France, for instance, there is a large amount of accumulated capital, which gives to the Paris discount market a considerable degree of breadth and stability. Even so, however, the amount of drafts drawn on Paris is in no way comparable to the amount drawn on London.

To illustrate the above, suppose that on some given day a banking house, say in New York, found it necessary suddenly to dispose of a large amount of sterling drawn on London and equally large amounts of francs drawn on Paris and guilders drawn on Rotterdam. Under normal circumstances the chances are that whereas the sterling could probably all be sold without causing any recession of any account in the rate of exchange on London, the

rate of exchange on Paris would be appreciably lowered and the rate of exchange on Rotterdam be broken "wide open." It is going too far to say that, in foreign exchange, sterling is the "universal currency"; but it is undoubtedly true that in New York, at least, the amount of sterling dealt in largely exceeds the total of all the other currencies put together.

CHAPTER IV

SOURCES OF SUPPLY AND DEMAND

As stated in Chapter I, at any given city having important foreign financial relationships, drafts drawn in foreign currencies on foreign points are all the time coming into existence; while, on the other hand, there is always a demand for drafts drawn in foreign currencies on foreign points. Let us take the New York market and look at the various sources of supply and demand.

Supply, I. Exports of Merchandise. — Exports of merchandise from all over the United States originate a very large volume of bills of exchange drawn by the seller here upon the buyer abroad or upon some bank abroad designated by the buyer. In the vast majority of cases this is the method by which payment is effected. John Smith in Atlanta, Ga., has sold to John Jones in London so-and-so-many bales of cotton at so-and-so-many pence per pound of cotton and thus has a claim against Jones in London for, say, £1200. For this amount, therefore, Smith proceeds to draw a draft on Jones (or if it has been arranged that way, on Jones' bank in London), attaching thereto the bill of lading and the other papers.

Smith now finds himself in possession of a draft representing a valid claim on Jones or on Jones' bank for

£1200, payable in London. What Smith wants, however, is dollars in Atlanta not pounds in London. To some one who does want pounds in London, therefore, and who will pay him dollars for them, Smith must offer his draft. Practically, what Smith does is to get into touch with the foreign exchange market and sell his bill to the banker who will give him the most dollars and cents for it. (Observe that nobody *discounts* the drafts. Smith *sells* it outright at a price of so-and-so-many dollars and cents for each pound sterling contained therein.)

In Chapter VII there will be found a full description of drafts drawn against exports, the length of time they run (*usance*), the conditions governing the price at which they are bought and sold, etc. At this point in our study of exchange it is only necessary to point out how exports of merchandise create a constant supply of bills of exchange — bills drawn in all the various currencies of the various countries to which the merchandise is sent.

Supply, II. Security Exports. — Next in importance to merchandise exports as creators of exchange come security exports, that is to say sales by Americans of stocks and bonds in foreign countries. Just as a grain exporter in Chicago reimburses himself for grain shipped to Great Britain by drawing drafts in sterling on London, so the American banker or broker who has sold a hundred shares of United States Steel or ten bonds of the Pennsylvania Railroad in London draws his draft for the proceeds in sterling on the buyer. Possibly to the draft the seller will attach the stock certificates or the bonds

themselves, with instructions that they are to be delivered to the drawee only upon his paying the draft. That, however, is by no means an invariable rule. Very often, where the credit and standing of the buyer abroad warrant such a course, the securities are sent by themselves and a "clean" draft (a draft without any papers attached to it) is drawn later. Sometimes, indeed, weeks are allowed to elapse between the time the stocks or bonds are sent and the time the reimbursing draft is drawn.

But whether the drawing against securities sold abroad is immediate or whether it is delayed, sooner or later the draft will be brought into existence — unless, of course, the buyer abroad sells an equivalent amount of securities to the seller here, in which case neither party draws on the other except for a small balance. Let a buying movement in "Yankees" set in in London or on the Continent, and quickly enough it will find reflection in increased amounts of exchange drawn on London offered for sale in the New York foreign exchange market. Let a big bond issue by one of the American railroads in which Europe is heavily interested be brought out in New York, and almost immediately the exchange market will feel the effect of the offering of sterling and franc drafts drawn on the participants abroad.

Supply, III. Foreign Loans. — The third great originator of foreign exchange in New York is the money market. Let the rate for sixty and ninety-day money in New York rule above the corresponding rate in foreign financial centres (most of the time it does), and immediately large sums of English and French banking capital

will find employment in this market. (These foreign loans to us, it is to be noted, are not to be confused with government bonds sold abroad by us or vice versa, and represent merely the use of free banking capital, for short periods, in that market where the best return is offered for its use.)

The mechanism of foreign loans to this market is a subject rather technical and, perhaps, confusing to the beginner, and so description thereof has been put off to a later chapter (13). How loans of this sort create a supply of exchange will, however, be clearly understood from the statement that when London bankers make sixty and ninety-day loans to New York, transfer of the funds is effected by having a banking house in New York draw sixty and ninety-day drafts on the bank in London which is doing the lending. At a time when London is lending heavily in New York, the New York market is likely to be literally flooded with offerings of sixty and ninety-day bills drawn in sterling on London.

It may be objected that this is not what might be called a "legitimate" source of supply of bills — that sooner or later these loans have to be paid off and that when that happens there is originated a *demand* for bills drawn on London, with which to make the payments, fully as large or larger than the supply created when the loan was originally made. All of which is quite true but in no way subversive of the fact that at the time the loans are made a large amount of new exchange is brought into existence. Nothing, in fact, "makes" exchange as fast as a disposition on the part of London and Paris bankers to lend money in New York, accompanied by

instructions to their New York correspondents to draw upon them.

Supply, IV. International Services Rendered by Us. — From the three sources enumerated above there originates the great bulk of the foreign exchange offered for sale in the New York market. It should, however, be noted that there is a certain amount of exchange all the time being created in the discharge of miscellaneous debts owed to this market from abroad. If, for instance, M. Jacques Bonhomme of Bordeaux decides to visit the United States and spend some little time there, the chances are that the American correspondent of M. Bonhomme's bank will be asked to pay out a considerable number of dollars for M. Bonhomme's account. Sooner or later that American bank (or some other bank to which it has transferred its claim) will draw a draft in francs on Bordeaux or Paris and offer it for sale in the foreign exchange market.

Similarly, a lawyer in New York who has done work for a capitalist abroad, a publishing house which has sold the foreign rights to a book — any one, in fact, who has "exported" services, may draw drafts upon the debtor abroad. The amount of such services rendered *by* us, it is true, is in no way comparable to the amount of services rendered from abroad *to* us, but nevertheless is annually productive of a very considerable amount of bills of exchange.

Demand, I. Merchandise Imports. — Looking at the other side of the picture, it is plain that just as exports of merchandise produce the bulk of the supply of exchange, so imports of merchandise produce the bulk of

the demand for bills of exchange. When we buy goods in England or in France or in South America, as has been pointed out, the sellers abroad very seldom draw on us in dollars. Either the buyer here has got to go to his banker and get a banker's draft in sterling or francs, or whatever the currency is, and send that, or else he (the buyer here) has got to arrange to have the seller in South America or out in the East or wherever he may be, draw a draft on London for the value of the shipment. Which latter, of course, amounts to the same thing. If some London bank is directed by a Commercial Letter of Credit (fully described in Chapter XIV) to pay the draft of a coffee shipper in Rio de Janeiro for account of some firm in New York which is importing the coffee, it stands to reason that sooner or later the New York coffee importer will be in the market for a draft on London with which to reimburse the London bank.

Whatever merchandise we bring into the country we have got to pay for — either by being drawn on ourselves or by arranging to have some bank abroad drawn on, or by sending abroad a banker's draft in the seller's currency drawn to the seller's order. However true it may be from the economist's standpoint that "goods are paid for with goods," in actual practice we get paid in money for what we sell and *we have to pay in money for what we buy.*

Demand, II. Security Imports. — Exactly the same thing is true with regard to securities bought abroad by us. There have been cases, it is true, where foreign governments purchasing goods in the United States have made direct payment in their own bonds, but such

is not the usual procedure. As a rule when we buy stocks or bonds abroad, the money to pay for them has to be sent to the other side in the form of a banker's draft drawn in the seller's currency. It may be, of course, that the party abroad who has sold the securities prefers temporarily to employ the proceeds here and so directs that they be deposited to his credit in some American bank, but even so the recall of the funds is only *postponed*. Unless, of course, the seller abroad at some time in the meantime becomes a buyer, and, so having a payment to make in America, directs that it be made out of his previously established American dollar bank balance.

Demand, III. Repayment of Loans. — The third great source of demand for bills of exchange comes from the repayment of short loans to the American market, alluded to earlier in the chapter. A bank in Paris may lend to some one in New York *fc.* 250,000 through the instrumentality of "long" drafts drawn by the Paris bank's New York correspondent (Chapter 13) but sixty days or ninety days later when the loan comes due, exchange on Paris with which to pay it off has got to be provided by the borrower. Even if the loan is renewed and more "long" bills are drawn to carry the loan along for another period, the chances are that they will be actually sold in the New York market and the proceeds used to purchase a demand draft to be sent over to Paris in payment.

Short loans of foreign banking capital to the New York market, it will thus be seen, have an important influence on both the demand for and the supply of exchange.

When the loan is made, bills of exchange (usually at sixty or ninety days' sight) are brought into existence. When the loan is paid off, there is created a demand for an equal amount of exchange (usually at sight) with which to pay off the sixty and ninety-day bills originally drawn, and which, as they mature, are presented at the office of the drawee for payment.

Demand, IV. Interest and Dividend Remittances. —

The next great demand for exchange to be considered originates from the necessity on our part of remitting abroad interest and dividends on American bonds and stocks held in Europe. The present amount of such remittances, of course, is considerably less than it was prior to the great liquidation of foreign-held "Americans" caused by the War, but does, nevertheless, still call for very considerable amounts of exchange.

Nor does it make any difference whether the foreign-owned American securities are held on this side of the water or the other, or whether the instructions of the foreign owners are that the interest and dividends be immediately remitted abroad or be credited to the owner's American bank account. Sooner or later the money must be sent abroad — either by having the foreign owners draw in dollars on their accumulating American balances or by direct remittances of banker's sterling exchange from this side.

Under this head, too, must be included the profits on foreign-owned American enterprises not publicly represented by stocks and bonds. Of many a peach orchard in Oregon and many a gold mine in Colorado the profits must annually be sent over to the other side.

To a greater extent than is generally appreciated foreign capital is at work here and there in the United States earning substantial returns for its foreign owners.

Demand, V. International Services Rendered to Us.

— Again, there must be considered the foreign insurance companies doing business in the United States, the foreign steamship companies carrying American overseas traffic, and the various other important services rendered us from abroad — such for instance as the maintenance and entertainment of Americans travelling or resident in Europe. Of these the aggregate is, of course, very much larger than anything in the way of services rendered by us. No figures of any sort are available as to the amount of the earnings of the foreign fire and marine insurance companies doing business in the United States, or as to the annual bill for freights paid by us to foreign ship owners, or as to what Americans spend annually on the other side, but certain it is that these items alone run well up into the hundreds of millions.

There seems to be a disposition on the part of most commentators on the subject to include among the services mentioned above, and, indeed particularly to emphasize, the commissions charged American importers by the London banks for “accepting” drafts drawn on London against shipments of merchandise to the United States. The volume of such business, it is true, is large, but so small is the commission charged that the total of what we pay London each year on this account can hardly run into really large figures, as such figures go. And, of course, with the increase of American prestige in

world banking, it is becoming less and less necessary for us to call upon London for such service.

Demand, VI. Remittances by Foreigners Resident.
— Finally, there is to be considered the demand for exchange originated by the constant remittances of foreigners resident in the United States. Even in the case of an alien who settles in this country with the intention of remaining here there is generally some one in the old country to whom he will send money, while in the case of an alien merely temporarily resident, it is not infrequent that everything he earns over a mere pittance for living expenses is sent home.

The form of remittance, of course, and the fact that the individual amounts sent are generally small, makes no difference. A banker who has sold a hundred little drafts on Italy for a hundred lire each has to go out and find some one who will sell him a bill for 10,000 lire with which to replenish his account. With the post office it is the same thing. Postal orders are nothing else than orders to a foreign agent to pay out money. Their issue on any given point in any number, even if the amounts are small, must inevitably be followed by the sending over of a reimbursing draft in pounds or francs or lire as the case may be.

CHAPTER V

THE RISE AND FALL OF THE EXCHANGES

THE rate of exchange between two countries, being the *price* of the money of the one expressed in terms of the other, is influenced, like the price of anything else, by the ancient and honorable law of supply and demand. When there is more exchange offered at any given point than there is a demand for, the rate has a tendency to go down. When there is more buying than there is selling, the chances are that the rate will go up.

We have seen in the last chapter what brings exchange into existence and what causes a demand for exchange. Let us now look over these various factors and see how the rate of exchange is practically affected by them.

The Movement of Merchandise. — Taking first merchandise exports and imports, it is here that we have what is really the dominant influence on the broad movement of the exchange market. International security transactions, suddenly creating large amounts of bills or a demand for a large amount of bills, may have the effect of temporarily driving rates sharply down or up; but, over a considerable period of time, what generally controls the level of exchange is the merchandise movement. If, for example, for every pound sterling of exchange created by the import of merchandise there is

created a demand for two pounds sterling by reason of merchandise exports, it is very evident that the rate of exchange is likely to go up. Other factors, such as sales of securities abroad or loans made by the foreign markets to ours may tend temporarily to increase the supply of exchange to pretty nearly the level of requirements, but taking it by and large the effect of the constant disparity in the merchandise movement is sure, sooner or later, to force a generally higher level of exchange rates.

There are times, of course, when bills of exchange created by merchandise exports come flooding into the market and force a sudden sharp decline in rates, but as a general thing the supply of mercantile exchange feeds into the market slowly and is absorbed without exerting much of an immediate visible effect. Even in the Fall, when bills drawn against wheat, cotton, and other produce come into the market in particularly heavy volume, the effect is apt to be less than might be expected. As a matter of fact, the sale of a large part of the bills drawn against merchandise exports each Fall is made during the previous spring for "future delivery." Exporters who know that in the course of a few months they will be shipping large amounts of merchandise and offering bills drawn against them, are apt to take this method of protecting themselves against having to sell their bills on a low exchange market.

Of this process of selling produce bills for "future delivery," the effect is naturally to stabilize rates. The bills, it is true, come on the market all at one time, but the rate at which they are to be taken having been arranged many months previously, the current rate is

not affected to anything like the degree to which it otherwise would be affected.

Security Exports and Imports. — Security exports and imports, while less important in their influence on the level of exchange than merchandise exports and imports, bring about much more sudden and violent fluctuations in rates. International transactions in shares and bonds often run up into very big figures within the course of a few days, following which there is apt to be suddenly thrown on the market a large supply of bills or, on the other hand, to be created an insistent demand for bills which will drain the market dry. Something happens, for instance, to start London selling American stocks — something not of primary importance, but enough to cause uneasiness and a certain amount of liquidation of speculative holdings. In the course of three or four days, under such circumstances, it is nothing unusual to have Europe sell us five or ten million dollars of our own stocks and bonds. When it comes to making payment, the demand for such an amount of exchange will very probably be enough to drive the market up sharply, at least for the time being.

Conversely, when, for instance, a syndicate bringing out a big bond issue in New York places a substantial proportion of it abroad, the drawing of exchange which results is likely to have the effect of driving the rate sharply down. Though here, too, as in the case of bills drawn against produce shipped in the Fall, it must be borne in mind that the drawers of the bills will do everything possible to avoid having to sell them on a falling exchange market. If they knew some time

previously that they would be drawing the bills, the chances are that they will have sold them "for future delivery." In any case the bills are not likely to be thrown out on the market all at once, but rather to be carefully fed out as the market will take them, even if this operation takes considerable time.

The Money Market Influence. — Next in importance to security purchases and sales as a cause of sharp fluctuations in the rate of exchange comes the making of short-term loans of foreign money to this market and the repayment of such loans. A condition, we will say, develops when the rate for ninety-day money in New York rises substantially above the ninety-day rate in London. Almost immediately the London bankers begin to put out money here — which, as is fully explained in Chapter 13, means that their New York banking agents begin drawing ninety-day drafts on the banks abroad who are doing the lending. These drafts, of course, to make the money available on this side of the water, have to be sold in the New York market. If it happens that there is a good demand for exchange at the moment, rates will possibly not be so very much affected. If, however, as is often the case, large amounts of these "loan bills" are projected on to a market in which the demand for exchange is not particularly strong, a very sharp recession in rates is likely to be brought about. So marked, indeed, does the recession often become that continuance of the loaning operations is rendered impossible. It is necessary, in order that foreign money be profitably loaned here, that a fairly high rate of exchange be realized from the sale of the

bills drawn on the lending banker abroad at the beginning of the operation.

But even more of an influence on the exchange market is the repayment of these short-term foreign loans when they come due. If it happens that not very much was borrowed at the time and that you and possibly one or two others are the only bidders for demand exchange with which to make repayments, the chances are that you will be able to secure your "cover" without running up the market too far. If, on the other hand, the loan you are trying to pay off comes due about the same time as a number of similar loans all of which have also to be "covered," the possibilities of your having to pay a very sharp advance in the rate are excellent. These foreign loan transactions run into large figures, a loan of £10,000 being about the minimum. If, then, buyers appear in the exchange market for considerable amounts of bills at a time when foreign loans previously made are known to be running off, the inference is immediately drawn that they are trying to buy "cover." And, with that rare charity which marks all dealings in foreign exchange, those who have bills to sell make it just as hard as they possibly can for those who have bills to buy. Securing "cover" for a loan that has matured or that is about to mature is an operation that allows of no delay. If sellers hold back and protest that they have no bills to sell except at an advance in price, there is usually nothing left to do but to pay the price.

Some of the sharpest movements that occur in the exchange market are brought about exactly in this way. For which reason, conservative borrowers, now-

adays, when they enter the market for foreign banking capital, frequently protect themselves at the time they make the loan by buying demand exchange to be delivered to them at a specified time in the future. Thus a stock brokerage house in New York which is borrowing £20,000 for ninety days from the New York agent of a London bank, and which knows that in ninety days it must secure a *sight draft* on London for £20,000 with which to pay off the loan, might contract for the delivery to it at the end of ninety days of the required sight draft. The "risk of exchange" would thus be eliminated, the borrower being able to tell in advance exactly what the loan was going to cost him.

If all our borrowing abroad were done on this basis, the effect on the exchange market would be much less than it is. Unfortunately, however, most borrowers, instead of protecting themselves by buying a "future," take a chance on the exchange market in the hope that during the life of the loan the rate may go down. Not infrequently they win out and are eventually able to "cover" at so low a rate as to make the loan cost them little or nothing. More often, however, it happens that when the loan comes due — and this is particularly true if there were a number of loans of similar character made at the same time — there ensues a scramble to secure the needed "cover," in the course of which the bidders run the market up on each other anywhere from a quarter to three quarters of a cent in the pound sterling. Then when the urgent bidding has all been satisfied, with corresponding pleasure and profit to the sellers, the market is allowed to slump back again.

Interest and Dividends. — Of the effect on the exchange market of the payment of interest and dividends on foreign-held American securities, and of the payments which we have to make for freights, insurance, and other services rendered us, it need only be said that these factors constitute a continuous sustaining influence on rates which only occasionally becomes so marked as to attract any attention. All the time there is going on the sending of money abroad to pay interest and dividends and to settle the claims of foreigners against us for various services rendered. Mostly, this takes the form of a quiet, steady buying of bills as they are offered, but every once in a while this buying assumes an urgency which cannot be concealed. That effect, for instance, is often produced by the maturing of a large issue of bonds which happen to be extensively held abroad. Again, around the first of the year and just before the first of July (the two great interest periods) there often develops a strong and urgent demand for exchange with which to make remittances for interest. The first of the year, too, is a great time for the foreigners who live in this country to send money home, the volume of these remittances often reaching a point where the resulting demand for bills of exchange sweeps the market bare and causes a sharp advance in the quotation.

The movement of the exchange market, it will be seen from the foregoing, is the resultant of a number of forces, some operating to drive it up and some operating to drive it down. To be able to distinguish these forces and, more particularly, to be able to judge their relative

market importance, is to be able to form an intelligent opinion as to the course exchange is likely to take. More than that can be expected of no man, the exchange market, like the wind, having the habit of blowing whither it listeth.

CHAPTER VI

PRINCIPAL RATES OF EXCHANGE

DISCUSSION, in a work of this kind, of all the various rates of exchange prevailing between all the countries that do business with one another would be out of place. Three rates, however — New York-London, New York-Paris and New York-Berlin — are of such particular importance that any work on the subject of foreign exchange from the American viewpoint would be incomplete without a description of them. For description how to figure in pounds, marks, and francs, see Appendix.

New York-London. — In New York, the rate of exchange on London is the price in American dollars and cents which must be paid for each pound sterling of a sizable draft, payable on presentation, drawn by a banker in New York on a banker in London. The “rate on London,” it is to be borne in mind (and this is equally true of the “rate on Paris” or the “rate on Berlin”), applies only to a draft of considerable size, drawn *by* a banker *on* a banker, and payable on presentation.

Between New York and London fluctuations in the rate of exchange were for years quoted in eighths of a cent per pound sterling, as for instance 4.86, 4.86 $\frac{1}{8}$, 4.86 $\frac{1}{4}$. Of recent years, however, there has been a

strong tendency to quote the rate "closer," as for instance 4.86, 4.8605, 4.8610, the progression in this case being by one-twentieth of a cent per pound sterling instead of by one-eighth of a cent, as above. On £10,000, which is a sort of unit of dealing among the banking houses, a difference of one-eighth of a cent in the rate makes a difference of \$12.50. One-twentieth of a cent in the rate, "five points," as they call it in the exchange market, means a difference of \$5 on £10,000.

During the course of a normal day's business in exchange when no particularly strong forces are operating one way or the other, a fluctuation of "fifteen points" (three-twentieths of a cent per pound sterling) is about what may reasonably be expected. Thus, in the morning, the market might open 4.86, run up to 4.8610, sell off at noon to 4.8605, and finally close at 4.8615. The difference between the day's highest and lowest price of a £10,000 draft, it will thus be seen, would, under the conditions noted, be exactly \$15 — a very much smaller amount than most people who have not given the matter much attention have it in their minds is involved in an average day's fluctuation.

New York-Berlin. — Reichsmarks, the currency of the German Empire, are quoted in the New York market at so-and-so-many American cents for each four reichsmarks — or "marks" as they are generally called. Why the quotation is for four marks instead of one, no one pretends to be able to explain.

In marks, the progression of rates is by sixteenths of an American cent to each four marks, as, for instance 95, $95\frac{1}{16}$, $95\frac{1}{8}$. These rates, however, not being suffi-

ciently "close" in the case of large amounts, are often modified by adding or subtracting small percentages of the amount of dollars involved. Thus, a banker not wanting to sell at $95\frac{1}{16}$ and yet not caring to charge as much as $95\frac{1}{8}$, might fix a price of $95\frac{1}{16}$ plus $\frac{1}{32}$. Or, in a case where a banker was willing to pay $95\frac{1}{16}$ for exchange offered him but not quite willing to pay $95\frac{1}{8}$, he might offer to pay $95\frac{1}{8}$ less $\frac{1}{32}$.

This modifying percentage, it is carefully to be noted, is a thing separate and apart from the rate proper, being figured on the amount of dollars *after* the conversion at the regular rate has been made. Thus if you have to find the amount of dollars required to buy M.100,000 at $95\frac{1}{8}$ less $\frac{1}{32}$ you go ahead first and find the amount of dollars at $95\frac{1}{8}$ (cents to each four marks). From the resulting amount of dollars you subtract $\frac{1}{32}$ of one per cent of itself, which is the result you want.

On small amounts, two rates such, for instance, as $95\frac{1}{16}$ less $\frac{1}{32}$ and 95 plus $\frac{1}{32}$ are practically the same, but where considerable sums are involved the difference is appreciable. By giving the arithmetic of the matter a little thought, it will plainly be seen that a fraction in the rate (which is less than 100) is a little more than the same fraction expressed as a percentage (reckoned on 100). For example, convert M.100,000 at $95\frac{1}{16}$ less $\frac{1}{32}$ and you get \$23,758.20. At 95 plus $\frac{1}{32}$ the result is \$23,757.43. The first rate is higher than the second by $\frac{1}{16}$ *in the rate*, which is more than the $\frac{1}{16}$ *per cent* which comes off.

New York-Paris. — In the case of pounds and marks,

the quotation of the rate at New York, as we have seen, is in terms of so-and-so-many dollars to the pound and of such-and-such a fraction of a dollar to the mark. In the case of francs, however, for some mysterious reason which no exchange man has ever attempted to explain, the quotation at New York is made in terms of so-and-so-many francs to each dollar. In the case of francs, in other words, we make the exception of quoting in the currency of the country on which the drafts are drawn. Thus, at New York, a quotation for francs of $5.18\frac{1}{8}$ means that 5 francs $18\frac{1}{8}$ centimes can be bought for one American dollar.

Now it is plain that if that is the case, the higher the rate for francs apparently rises, the lower it actually becomes. Take a concrete case: You want to invest \$1000 in a draft on Paris. The rate is $5.18\frac{1}{8}$. That means that your \$1000 will buy 5181.25 francs. Suppose now the rate *falls* to $5.18\frac{3}{4}$. Your \$1000 will now buy 5187.50 francs, 6.25 francs more than it would before. The change in the rate from $5.18\frac{1}{8}$ to $5.18\frac{3}{4}$, in other words, represents a *decline* — you can buy more francs for the same amount of dollars.

In the quotation for francs, under normal exchange market conditions, the progression is by $\frac{5}{8}$ of one centime (a centime is a hundredth of a franc) to each dollar, as for instance, $5.18\frac{1}{8}$, $5.18\frac{3}{4}$, $5.19\frac{1}{4}$. As in the case of marks, however, when large amounts are involved these rates are modified by adding and subtracting small percentages on the dollar amounts. Thus a banker, not being willing to buy at $5.18\frac{1}{8}$ and yet being willing to pay a little better than $5.18\frac{3}{4}$, might offer to pay $5.18\frac{1}{8}$ less $\frac{1}{16}$.

On the other hand, a banker having francs to sell and not being willing to sell at $5.18\frac{3}{4}$ but hardly wanting to charge $5.18\frac{1}{8}$, might offer to sell at $5.18\frac{3}{4}$ plus $\frac{1}{16}$.

These modifying percentages, it is to be noted, are separate from the rate proper, being figured on the amount of dollars *after* the conversion at the regular rate has been made. Thus, if you have to find the amount of dollars required to buy $\text{fc.}100,000$ at $5.18\frac{1}{8}$ less $\frac{1}{16}$, you go ahead first and find the amount of dollars at $5.18\frac{1}{8}$ (francs to one dollar). From the resulting amount of dollars, you then subtract $\frac{1}{16}$ of one per cent of itself, which is the result you want.

By a little figuring, it will be seen that a difference of $\frac{5}{8}$ of one centime in the rate is just a trifle less than $\frac{1}{8}$ of one per cent figured on the amount of dollars involved. The two rates $5.18\frac{1}{8}$ less $\frac{1}{16}$ and $5.18\frac{3}{4}$ plus $\frac{1}{16}$ are thus practically identical, so far as small amounts are concerned. In transactions involving say $\text{fc.}100,000$ or more, however, the difference is appreciable. At $5.18\frac{1}{8}$ less $\frac{1}{16}$, a hundred thousand francs would cost \$19,288.30; at $5.18\frac{3}{4}$ plus $\frac{1}{16}$ the cost would be \$19,289.15. The second rate is higher than the first by $\frac{1}{8}$ of one per cent (figured on the amount of dollars) which more than counterbalances the difference *in the rate* of $\frac{5}{8}$ of one centime in favor of rate number one.

In francs, then, a fraction in the rate is less than the same fraction expressed as a percentage. In marks it is the other way around. In sterling (in which the bulk of exchange figuring is done) there are, may Allah be praised, none of these qualifying fractions to be reckoned with.

CHAPTER VII

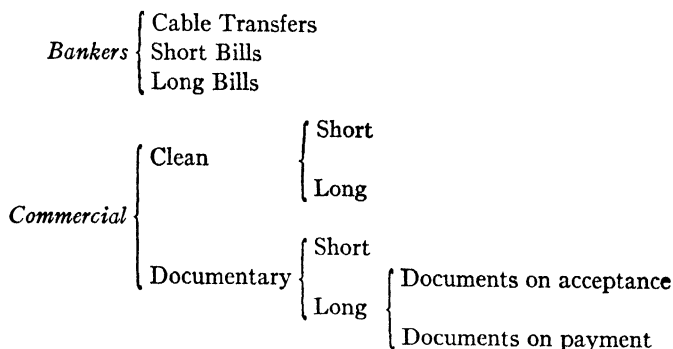
THE DIFFERENT KINDS OF EXCHANGE — BANKERS' AND COMMERCIAL

CONCERNING the different kinds of bills of exchange daily traded in at a market like New York there exists so much misunderstanding and misapprehension, that it seems well worth while to devote a chapter to the subject. The bills themselves, however, it is to be noted, rather than the conditions which bring them into existence and under which they are bought and sold (dealt with elsewhere) are the subject of the discussion.

In the first place, it is to be noted that in the parlance of the exchange market the term "bill" applies to any kind of an order to pay out foreign money, whether such order is made by a banker or a merchant, whether the order is to pay out the money immediately or at the end of a specified time, whatever, in fact, may be the various conditions that attach.

In the next place it is to be noted that in the exchange market the terms "Checks," "Demand Drafts," and "Sight Drafts" are used interchangeably as signifying an order to pay out money upon presentation of such order. "Short Bills" are bills having not over 30 days to run. The term "Long" is applied to all bills running over thirty days.

For the purposes of the subject under discussion, bills of exchange may be classified as follows :



Bankers' Cable Transfers and Short Bills. — Cable transfers, strictly speaking, should hardly be classified as bills of exchange and yet are essentially the same, the only difference being that in the case of a "cable" the instructions to pay out the money on the other end are telegraphed instead of being written on a piece of paper called a draft. When you buy a draft, say on London, you pay a banker here so-and-so-many dollars and in return he gives you a piece of paper addressed to some correspondent bank in London where he carries a balance, which paper instructs that correspondent bank to pay out so-and-so-many pounds sterling to you or to your order. When you buy a cable exactly the same thing happens except that the banker here, instead of giving you a *written order* on his correspondent abroad in return for your money, agrees to *wire* his correspondent to pay out the equivalent number of pounds sterling to whomsoever in London you may designate. In the case of a

sight draft the actual payment of the money abroad is not made until the draft arrives and is presented, which is not until a week or ten days after the draft is bought and paid for in New York. In the case of a cable the payment abroad is made immediately — unless it is too late in the day, in which case it goes over until the next morning.

Bankers' Long Bills. — Bankers' Long Bills are drafts drawn by bankers here on bankers abroad, usually payable sixty or ninety days "after sight" — that is to say, sixty or ninety days (plus the usual three days of grace) after the draft has been presented to the party on whom it is drawn and "accepted" by him. Until it *has* thus been "accepted" by the drawee, a "long" bill has no maturity date. The maturity date being determined by the date the bill is accepted (the sooner the bill is accepted, naturally, the sooner it will come due), the holder of such a bill will always take good care that it is presented to the party on whom it is drawn at the earliest possible moment. Besides which there is to be considered the fact that *until* a long bill is accepted, only the maker is liable for payment while, *after* it has been accepted, the party accepting the bill is liable as well. (For a drawee to accept a bill means for him to write across its face, over his legal signature, "Accepted, payable on such-and-such a date.")

Bankers' Long Bills are also sometimes issued payable so-and-so-many days after *date* instead of after *sight*. In such case acceptance is of course not necessary to fix the due date. Practically, however, on account of the additional protection afforded, acceptance is almost

invariably obtained from the drawee at the earliest possible moment.

Commercial Clean Bills. — Commercial bills are bills drawn by mercantile houses here either on mercantile houses abroad or on banks abroad. They are divided into two classes, “clean” and “documentary,” the latter class being infinitely the more important. A clean bill is a draft that has no bills of lading or other documents attached to it. A documentary bill is one that has.

So far as maturity is concerned, commercial clean bills that are drawn payable sixty or ninety days “after sight” are in exactly the same position as bankers’ bills — that is to say, they get a maturity date only after they have been accepted. Also, until a commercial clean bill has been accepted it is “one-name paper.” After acceptance it becomes “two-name paper.”

As previously stated, this chapter is not a discussion of the circumstances surrounding the issue of the various kinds of bills of exchange. With regard to these clean commercial bills, however, it is to be noted in passing that the only security that the banker buying them gets is the name of the drawer and, after acceptance, the name of the drawee. They are not in any way secured by the merchandise against which they are supposedly drawn.

Commercial Documentary. — Documentary commercial bills, on the other hand, are invariably secured by merchandise. As was pointed out in Chapter IV the shipper of cotton in Alabama or the shipper of grain in Illinois attaches to the draft he draws on the consignee or the consignee’s bank, the bill of lading, which, in

itself, carries possession of the goods. The bill of lading is the steamship or railroad company's receipt for the goods. Only the party which holds the bill of lading can get possession of the goods when they arrive. The banker who buys a documentary draft, it will thus be seen, is protected against loss not only by the name of the maker of the bill but by what virtually amounts to possession of the goods themselves.

To make clear his title to the goods, the banker often demands of the party from whom he buys the bill a certificate hypothecating the goods to him. This "hypothecation certificate" may either be attached to the draft itself, or, if originally issued in blanket form to cover all transactions between that particular exporter and that particular banker, is apt to be retained by the banker.

Certificates of insurance stating for how much and in what company insurance has been written are likely to be attached, with the other documents, to the draft. No banker will buy a documentary bill of exchange unless he knows that the insurance *has* been effected and made payable to him.

The more staple the merchandise, the more desirable, from the banker's viewpoint, the bill of exchange. The banker's security, after all, is the merchandise underlying the transaction. Naturally, if the merchandise is cotton or wheat or something which has a definite, realizable market value, the bill will appeal to the banker more than if the underlying security is some fancy article, the resale value of which is problematical.

Different kinds of merchandise are exported on dif-

ferent bases. In the case of one kind of goods the custom is to draw at sight, in the case of others at seven days' sight, in the case of still others at sixty or ninety days' sight. Commercial drafts with a longer "usance" than ninety days are rarely seen in the New York market.

"Acceptance" and "Payment" Bills. — Documentary long bills divide themselves into two classes, those which carry instructions that the bill of lading (which carries with it possession of the goods) is to be delivered to the drawee upon his accepting the draft, and those which carry instructions that the drawee is not to get the bill of lading until he has actually paid the draft. The former class are known as "acceptance bills"; the latter as "payments."

Who determines whether the draft shall be marked "documents for acceptance" or "documents for payment"? The shipper of the goods, naturally — it is *his* name which is on the draft and it is on *him* that the banker will come back if anything goes wrong with the payment of the draft on the other end. He, therefore, is the one to decide whether the drawee is good enough to receive the bill of lading on his mere acceptance of the draft or whether safety demands that the drawee should actually pay the draft before being allowed to come into possession of the goods.

It stands to reason, however, that the banker who buys the bill is going to have something to say about it, too. If the credit of the drawer is sufficiently good, the banker may be willing to take his word for it that the documents can safely be delivered on acceptance. Unless, however, the banker is willing to go on the standing

of the drawer exclusively, he (the banker) is apt to pass judgment himself on whether the documents are to be delivered on acceptance or payment. The shipper, of course, is under no obligation to mark the draft the way the banker wants him to, but, unless he does, the banker will simply refuse to buy the bill.

Most long commercial bills drawn on banks or on bankers or on mercantile firms of known standing and reputation are, in the very nature of things, marked "documents for acceptance." The fact that a bill is marked "documents for payment" is, however, no reflection upon the drawee. In some lines of business, indeed, the custom is to draw "payment" drafts even where the standing of the drawee would seem fully to warrant their being marked "for acceptance."

As the discount markets abroad take only bills *without* documents, it stands to reason that "acceptance" bills are discountable and that "payment" bills are not. Put yourself in the position of the London correspondent of an American bank presenting a bill marked "acceptance," to the drawee. The bill comes back to you, accepted, without any documents attached to it, the drawee having retained them. Provided that the names of the drawer and the drawee are good, you will have not the slightest trouble in discounting the bill at the current market rate.

But if it was a "payment" bill which you presented to the drawee and, when your messenger brings back the draft, accepted, it still has the documents attached to it, you are not in possession of something you can have discounted for your New York correspondent and for-

get. On the contrary, it is necessary that you have the goods represented by the bill of lading, "entered" and taken care of. The drawee, very possibly, isn't going to want the cotton or whatever it is for some little time — possibly not for the whole time the draft has to run. In the meantime it is in your custody that the goods must remain.

As a matter of actual fact, however, "payment" bills are seldom allowed to come to maturity by the drawee. Long before the bill comes due the drawee is apt to want to get possession of the goods. How can he do so? Only, of course, by paying the draft. But the draft, it is objected, isn't due. Well, that being the case, the holder says, you can pay the face amount of the draft, less a rebate for the unexpired time. The bill originally ran sixty-three days. Thirty-three days have now passed. Pay the face amount less a month's interest and we'll turn over to you possession of the goods.

The rate at which "payment" bills are *rebated* is fixed by custom at one-half of one per cent above the rate which bankers are publishing that they will pay for deposits. As the rate for deposits is usually two per cent under the Bank of England discount rate, another way of fixing the rebate rate on "payment" bills is to call it $1\frac{1}{2}\%$ under the discount rate.

So far as the relative value in pounds, shillings, and pence of an accepted "payment" bill and an accepted "acceptance" bill is concerned, everything depends upon when the "payment" bill is taken up under rebate by the drawee. Suppose the "payment" bill is taken up right at the beginning. In that case it would

yield its holder more cash than a prime "acceptance" bill for a similar amount running a similar time would yield. The payment bill, it must be borne in mind, is "rebated," whereas the acceptance bill is "discounted," and the rebate rate is always less than the discount rate. A smaller amount, to put it another way, is taken off the face of the "payment" bill than is taken off the face of the "acceptance" bill.

Where a banker in New York, for instance, knows positively that a certain "payment" bill will be taken up under rebate immediately upon arrival in London, he will pay a higher rate of exchange for it than he will for a prime acceptance bill of like amount and tenor. About most "payment" bills, however, the banker can have no such assurance, the chances, indeed, being that the bill will be allowed to run a considerable time before the drawee elects to take it up under rebate, during all of which time, of course, the owner of the bill is out of the use of the money he paid for it. "Payment" bills, for that reason, normally command considerably lower prices in the exchange market than do bills which are marked "doc's for acceptance."

CHAPTER VIII

PRICE RELATIONSHIP OF THE DIFFERENT KINDS OF BILLS OF EXCHANGE

FROM what was said in the last chapter, it must be evident that the element of credit enters largely into the price at which bills of exchange are bought and sold. A bill drawn against cotton, for instance, we have seen, is more desirable from the banker's standpoint than a bill drawn against some perishable article or some article which has an uncertain resale value. Similarly, the names on a bill of exchange — that is to say, the name of the party who draws it and the party on whom it is drawn — have an important effect on the price at which the bill can be marketed (turned into dollars and cents). Obviously, of two bills of exchange against the same kind of merchandise and of like tenor, one drawn by an A1 shipper with an international reputation, and the other drawn by some little firm which may be good but is relatively unknown, the former will sell at a higher price than the latter. If, for example, exchange market conditions were such that a banker were willing to pay 4.84 for the first kind of a bill, all he would be willing to pay for the second might be 4.83 or $4.83\frac{1}{2}$.

It is the prime bill of its class which is meant when

it is said that the rate of exchange for any of the types of bills mentioned in the last chapter is quoted at so-and-so-much. If, for example, you say that sixty days' sight documentary drafts on London are quoted at 4.84 you mean drafts against some staple commodity, drawn by a house of high standing on a house of high standing abroad or on a bank. Drafts of that character drawn by less well-known firms, or against less desirable forms of merchandise, might at the same moment be selling at considerably less than 4.84.

With bankers' bills, this element of credit does not exist — except to a slight extent in the case of bills drawn at sixty and ninety days' sight. All bankers' cables and short bills (assuming of course that they are bankers of standing) sell at about the same price. In the case of sixty and ninety days' sight bills, however, there is apt to be some slight difference in the price of bills drawn by various bankers, even when all parties concerned are in high standing. Where a banking house here has put out what the discount market in London considers too large an amount of "long" bills, it has often been the case that the paper has been discriminated against, at least to the extent of charging a slightly higher rate of discount. Where that happens there is, of course, quick reflection in the rate of exchange which will be paid for paper of that name as it is offered for sale in the New York market. Not infrequently, sixty and ninety-day paper of some banking house of unquestioned standing will be offered anywhere up to a quarter cent per pound below the prevailing market — not because there is any question about the

paper's being good but because there is too much of it around.

Generally speaking, however, all bankers' bills sell on about the same basis — so much so, indeed, that, when purchasing other bankers' bills through foreign exchange brokers, the purchaser often stipulates merely that the bills which are to be sent in to him are to be "prime paper," and does not even know who the maker of the paper is till it comes in.

Cables the Fundamental Rate. — So far as the relative prices of cables, sight drafts, and long bills are concerned, these are fundamentally based on the price of cables. The first thing in the morning the foreign exchange banker, say in New York, receives a cablegram from his correspondent in London (and any other important centres where he has close connections) telling him just what the rate on New York is over there, how discount rates are quoted, etc. With this information in hand (it is two o'clock in London when it is nine o'clock here), the New York banker is in a position to commence buying and selling. If dollar cables in London are, say, 4.87, it is from that figure that the market for sterling in New York will commence to move up and down.

The rate for cables having been established, it is easy enough to fix the price of demand drafts, the latter being cheaper by an amount corresponding to ten days' interest. When a banker sells you a cable he makes immediate payment out of his balance abroad. When, however, he sells you a sight draft, his balance abroad remains undisturbed for eight or nine or ten days,

which is the quickest time in which the draft he has sold can be presented for encashment. Naturally, under the latter circumstances, he will charge you less than where he sells you a cable and loses the use of his money at once.

Difference in Price between "Short" and "Long" Exchange. — Just the same principle holds true with regard to the difference between the price of a sight draft and the price of a "long" draft. You go to a banker here and buy from him a sight draft on London. Actual payment to you, out of the banker's balance abroad, will not be made for about ten days. You go to a banker here and buy from him a draft on London payable sixty days after sight. Actual payment in that case will not be made for about seventy days, during all of which time the banker's balance abroad remains undisturbed. Naturally the cost of such a draft in New York will be less than the cost of a sight draft, where payment abroad must be made at the end of ten days or less.

As to the difference, that is measured simply by the current rate of discount abroad, plus the slightly higher charges incurred in selling "long" drafts. If the discount rate abroad goes up, it tends to increase the difference in price between "sixties" and "demand." A decline in the discount rate, on the other hand, tends to bring the price of the two together.

All Classes Move Together in a Fixed Relationship. — All classes of prime bills, it will thus be seen, tend to move up and down together in a fixed relationship one to the other. Nor must the statement previously made

that the cable rate is the fundamental rate be taken to mean that the cable rate is the only one that counts in determining the price at which the various "usances" shall sell. Suppose, for example, that for any given reason the supply of sixty and ninety-day bills is suddenly increased and that the price of this class of exchange begins to fall. Instantly the price of "cables" and of "demand" will fall correspondingly, the relationship to the price of long bills (called for by the discount rate prevailing abroad) being constantly maintained. The rate for cables and demand may influence the rate for long bills, or the rate for long bills may influence the rate for cables and demand, but whatever happens, there will always be maintained an exact relationship as to price. Whatever readjustments there may be and whichever rate is influencing the other, the difference in price between the various usances will always continue to be measured by the rate of discount prevailing at the place on which the drafts are drawn.

Why this must be so will perhaps be most clearly seen from consideration of what would happen were the rates for "sixties" and "demand," for example, to get "out of line." At some given time, we will say, "demand" is selling at 4.87, "sixties" at 4.84. Suppose now, for purposes of illustration that, without any change in the discount rate abroad, "sixties" sell down to 4.83 without the price of "demand" being affected. Is it not plain that immediately every one in the business would rush in and buy "sixties" for the purpose of sending them abroad for discount and then selling demand drafts on the balance thus created?

And is it not plain that if that were to happen, the general buying of "sixties" would increase the price of "sixties" and the general selling of "demand" would decrease the price of "demand," until there was quickly reestablished a relationship between the two at which the chance to make a profit would have disappeared? The exchange market, it must be borne in mind, is simply full of operators keenly on the alert for just such opportunities to make a profit. The moment one rate "gets out of line" with the others, affording the opportunity to make even ten or twenty points (one-tenth or one-fifth of a cent per pound), there are plenty of people ready to take advantage of it, which, as has just been shown, tends quickly to restore the two rates to their correct relative positions.

Credit Element in Commercial Bills. — Too much emphasis cannot be laid upon the fact that the above applies only to bankers' bills. Commercial bills, particularly commercial long bills, are entirely different. There, as has been pointed out, the element of credit enters largely as a price-determining factor. Take the case of a bill drawn at sixty days' sight by an American exporter of moderate means on an importer abroad whose name is not particularly well known in this market. A New York banker buys the draft and sends it over to his correspondent, and it is duly accepted by the drawee. So far so good. But acceptance of a draft isn't payment, by a long shot. For sixty-three days the question as to whether the draft will be paid at maturity must necessarily remain an open one. And during a period of sixty-three days a great many things can happen.

If the drawee fails to pay the draft at maturity, the holder can, of course, come back on the drawer. Drawee and drawer, however, it must be remembered, are presumably in the same line of business, and the development of the conditions which caused inability on the part of the drawee to make good his obligations have not improbably hit the maker of the draft as well. Then, if it is a "documents for payment" bill which is in question, the holder must fall back on the security of the merchandise itself and realize on that. If it is a "documents for acceptance" draft, there is nothing for him to fall back upon.

Naturally, under the above circumstances, a banker will pay considerably more for one bill than he will for another. And, by the same token, a not particularly well-known drawer has to do considerable shopping around before he can be sure that he is getting the best possible price for the bills he has to offer.

CHAPTER IX

THE FOREIGN EXCHANGE MARKET

THE closing sentence of the last chapter must suggest to the thoughtful reader that there is a good deal more to the buying and selling of exchange than simple bidding and offering in an established market. Right here, indeed, it is time that we looked a little into how the "market" for bills of exchange is actually constituted.

Years ago bills of exchange were traded in on the New York Stock Exchange. To-day the market is directly between the banks and bankers. There is no market place where the man having a bill of exchange to sell can go and sell it at a quoted rate. The "market" for his bill is what the various banks and banking houses happen at the moment to be paying for that particular class of paper. The only way in which he can find out what they are paying, is for him to approach some of them and make his offering.

To the seller of exchange the protection afforded by this system lies in the fact that there are a great many foreign exchange bankers all in active competition. Before that was the case, the bid which the man with exchange to sell used to get was generally well below what the banker could well afford to pay him and still make money. Nowadays the banker is far less apt to

do business that way. He knows very well that the substantial seller of exchange is not going to jump at the first quotation he hears and that if his offering draws a bid of 4.81 from one banker and a bid of 4.83 from another banker, banker number one is never going to receive another offering from that particular seller. It is, in other words, a plain example of competition for the business establishing a fair market.

The Foreign Exchange Banker. — The New York exchange market, then, consists of a large number of banks and bankers, all in close touch with one another. All day long over the network of telephones by which they are connected, and through the foreign exchange brokers who circulate ceaselessly throughout the "Street," bankers interested in the exchange market keep themselves apprised of exactly what is going on. And remarkable indeed is the closeness of the contact between the houses — it is practically unheard of, except during periods of great excitement, for exchange to be selling at one price in one part of the "Street" and at another price in another part. Let some important bank start bidding for bills at a certain price and almost immediately all the others of any account will know about it. Though a good half mile separates some of the most important foreign exchange banks in New York, it is almost as though their representatives met face to face and did their bidding and offering openly in a common market. When conditions are anything like normal, the rate of exchange rises and falls just as "evenly" as though the trading were all carried on under one roof.

The "Broker." — Mention has been made of the "brokers" who execute orders for a commission as distinguished from the "bankers" who buy exchange for their own account, send it abroad, and draw their own bills against it. Of these "brokers" the lot is becoming increasingly hard. There was a time not so many years ago when the competition for business among the bankers was less keen, quotations were wider, and the broker was able to render his client a real service and incidentally earn a substantial commission for himself. Nowadays, however, with the increasingly close contact between the bankers, it is becoming more and more difficult for the broker to make anything. The human element in working through a broker rather than over a telephone wire makes his services still valuable to the banker in connection with certain classes of operations, but the big profits in foreign exchange brokerage are a thing of the past. It is just a case of another middleman being crowded out.

The "Dealer." — The above refers particularly to the foreign exchange brokers whose dealings are principally among the banks. There is, it is true, another class of brokers — *dealers* in exchange, they are generally called — who handle the business of commercial firms to better advantage than these firms could handle it themselves, and so occupy a position which will never be taken away from them. A big cotton shipper who year after year draws thousands and thousands of pounds sterling on big firms and banks abroad, and whose bills are as well known in the market as are the bills of the bankers who buy them, hardly needs a broker

to secure him the best possible rate. With a less well-known shipper, however, or with a firm which is only an occasional drawer of exchange, the case is different. Here a broker may be of very great service indeed.

In connection with this matter of the market for exchange, it is to be noted that in New York there is practically no "dealing" in bills, at least in the strict sense of the word. Just as soon as a bill is drawn it is sent abroad either for payment or acceptance. It is seldom, indeed, that it passes through more than one or two hands before it goes. Every moment's delay in sending over the bill for presentation to the party on whom it is drawn means a loss of interest.

In the United States, New York is, of course, the great market for foreign exchange. In the district around Chicago there is originated a substantial part of all the bills drawn against produce and these find their way largely into the western banks, but when it comes to the disposing of their own bills drawn against these commercial bills, it is to New York that the western banks must largely turn. The same thing is true of the very large volume of commercial exchange originated by exports of manufactured goods from the Pennsylvania district. Pittsburgh and Philadelphia banks absorb the greater part of these bills, but find it necessary, to a great extent, to go into the New York market to sell the bills which they draw against them. And, so far as rates are concerned, it is in New York that rates for the entire country are practically made. Southern and western banks keep in constant touch with New York, and, in the quotations they make, closely follow the lead of New York.

CHAPTER X

RELATIONSHIP OF OUR OWN TO THE FOREIGN MONEY MARKETS

BEFORE passing on to the vitally important question of the influence of the money markets on exchange rates, we want to be sure that we have clearly in mind the position of the foreign money markets relative to our own.

Great as is the wealth of the United States, it is a fact that there is far more accumulated banking capital abroad than there is here. London's capacity for discounting accepted bills of exchange, for example, or for making short loans, is greater than our own. Relatively speaking, this is a new country, with far greater demands made by its undeveloped resources upon its capital supply than is the case with the nations abroad. The level of money rates, therefore, logically rules lower in Europe than it does here.

That being the case, it is entirely reasonable that in normal times Europe should continuously be a lender of money in the American market. For a substantial part of the banking capital which the great foreign lending institutions have at all times at their disposal and for which employment must be found, the American money market offers greater opportunities than can be

found at home. By "opportunities" is meant the chance to lend the money out for short periods (sixty days to six months) to responsible parties and on the very best of collateral.

The American Market a Chronic Borrower. — The relationship of the money market here to the great money markets abroad, then, is that of a chronic borrower. Relative money rates, of course, strongly influence the *amount* of our borrowings, but year in and year out they run into very large figures — often into what is the equivalent of many hundreds of millions of dollars. Even when money rates here fall to the level of rates abroad these loans to a great extent, as they come due, are not paid off but are allowed to continue. The idea, from the lender's viewpoint, is that this is a satisfactory market to lend money in, a market in which a continuing loan will show an entirely satisfactory rate of return. The borrower (ourselves), on the other hand, figures that it is good business to pay the foreign lender as high a rate of interest as would have to be paid here, or even a little more, in order to keep this source of supply constantly open.

There are times, of course, when short money becomes so plentiful in the New York market that we actually assume the rôle of lenders and put out money abroad, but it is very much of a question whether operations of this sort ever run into very big figures. In the first place the American banker as a rule is not sufficiently familiar with foreign exchange conditions to make him feel justified in attempting to take advantage of the better rate offered by some foreign market. In the second

place we have not yet developed in this country the machinery necessary for the profitable lending of money abroad.

A full description of the mechanism of international loaning operations would be out of place here. (See Chapter 13.) It may, however, be pointed out that such operations are carried on by having the borrower (or the bank which is acting for the borrower) draw sixty or ninety days' drafts on the bank in the foreign country which is doing the lending. A bank in New York, for example, which was borrowing £10,000 from a bank in London would draw "long" drafts on the London bank for £10,000. These drafts it would then sell in the exchange market in New York, realizing dollars on them.

Borrowing and Lending Facilities. — Now it stands to reason that such operations are possible only where the borrower can be sure of being able easily to convert into his own currency (and at a fair rate of exchange) the long drafts he has drawn on the party abroad who is lending him the money. Unless he can be sure of that, there is no use in his drawing at all. To a New York stock brokerage house, for instance, the right to draw a ninety days' sight draft in sterling on some London bank is of use only if the draft can readily be converted into dollars and at a close market.

Such a draft drawn from the New York end can, of course, always be easily disposed of. But how is it when it is London and not we which is doing the borrowing and which must draw the drafts? Just there is where the necessary machinery is lacking. London,

for instance, can't draw on us in dollars at long sight, at least to any great extent. Why? In the first place because under the Federal Reserve Act the banks here wouldn't be allowed to accept such drafts, and in the second place because even if they were, there is no discount market here which would absorb any very considerable quantity of such bills. A discount market, as has been pointed out, must be existent at any point on which long bills to any considerable amount are to be drawn. Otherwise there is no guarantee that the bills, after acceptance, can be turned into cash—which means, of course, that nobody would be willing to take them off the drawers' hands.

Only those markets, in other words, can be a factor in international loaning operation which have the capacity of absorbing a large amount of time drafts drawn on themselves.

International Loans and "Free" Gold Markets.—Still another point which ought to be emphasized in connection with this matter of the lending of banking capital among nations, is that it is only to countries having free gold markets that such loans can safely be made. (Gold, Chapter XII.) It is not that payment of the loan may be demanded in gold, but that, unless gold *can* be freely exported from a country, there is no height to which the rate of exchange in that country cannot go—which, of course, is likely to make repayment of the loan a ruinously expensive operation.

Take, for instance, the case of the United States, which has by far the freest gold market of any country in the world. Neither the outside bank which lends

pounds or francs or whatever the currency may be, in New York, nor the borrower in New York, runs any very great risk so far as the rate of exchange at the time of repayment is concerned. The rate may rise to a point which means that the borrower will have paid a stiff rate for the money, but beyond a certain point (as long as gold is available for export) the rate cannot go. When the loan comes due the borrower will be under the necessity of making a payment of so-and-so many pounds or francs in London or in Paris, as the case may be. This debt can be discharged either by sending over a banker's draft or by sending over as much gold as is the equivalent of the pounds or francs to be paid, at mint par. It is thus a matter of cold figuring as between sending drafts or sending gold — in which of the two ways the obligation can be discharged at the expenditure of the least number of dollars. In no case can it cost more dollars than is represented by the mint par of the pounds or other foreign currency to be paid, plus the expenses of physically shipping the gold. Should the rate of exchange buyers are willing to pay exceed that point, bankers will be quick enough to ship gold, creating fresh balances abroad on which they can draw, and thus furnishing the bills of exchange for which there is such a demand.

The above, of course, presupposes (as is the case in the United States) that gold for export can be had at a fixed price. Where that is not so, the case is entirely different, there being hardly any height to which the rate of exchange on countries where substantial debts are owed, cannot go. For which reason lenders are ex-

tremely chary about putting out their money in places where such conditions are likely to develop, and borrowers themselves think twice about putting themselves in a position where the noose may so tightly be drawn about their necks.

Six per cent bid for money in one market while in another market near by unlimited supplies are offered at 4 per cent — that is a phenomenon which possibly the above may help to explain.

CHAPTER XI

THE INFLUENCE OF MONEY RATES ON THE EXCHANGE MARKET

To the fluctuations of the money market both here and abroad the exchange market is extremely sensitive. In determining the general level of exchange rates the merchandise movement is perhaps more important, but as an influence producing sudden sharp movements in exchange, the factor of money rates stands quite by itself.

How the money market affects the exchange market will perhaps be most clearly seen if we consider certain definitely outlined conditions. Let us, for example, take the four separate cases of a rise in money rates and of a fall in money rates at New York, and of a rise in money rates and a fall in money rates at London, and see what the logical effect on the exchange market will be.

A Rise in Money Rates at New York has a twofold effect on the exchange market. In the first place it brings foreign banking capital into this market. In the second place it causes New York bankers to draw down the balances they are carrying abroad, for the purpose of employing the money here.

Foreign banking capital, as explained in the last

chapter, is constantly on the alert for profitable loaning opportunities. The rate for sixty-day money here and in London, we will say, is 3 %. All of a sudden the rate in New York begins to strengthen, without the rate in London being similarly affected. Immediately, bankers abroad begin to take advantage of the opportunity to get a better rate here than at home, and instruct their New York banking correspondents to draw on them at sixty days' sight and put out the proceeds.

The effect of such operations is, naturally, to depress the exchange market. Every £10,000 that London lends here means four £2500 60 days' sight bills brought into existence and offered for sale in the exchange market. Let the volume of bills so offered become considerable, and quickly enough reflection will be found in a decline in the rate of exchange at which they can be turned into dollars. Which, of course, as explained in Chapter VIII, will have the effect of putting down the rate for cables, demand, and all other classes of bankers' bills.

The second way in which a rise in money rates here tends to drive down the exchange market by causing a recall of balances carried abroad, is almost too obvious to require explanation. A better return being offered in New York, it is plain enough that New York bankers carrying excessive balances in London will bring them back for use here.

Whether that is effected by drawing sterling drafts on the banks abroad where the balances are kept, or whether the transfer is made by having the holders of the money in London send it over here in the form of dollar drafts, makes no difference so far as the resulting

depression of the rate of exchange is concerned. In the one case sterling drafts will be drawn and offered for sale in the New York market, tending to put the rate on London down. In the other case, drafts drawn in dollars will have to be bought in London by the London bankers having the remittances to make to this side, tending to put the rate on New York up — which, of course, looking at it from this end, is the same thing as a decline in the rate on London.

A Decline in Money Rates at New York affects the exchange market by reason of the fact (1) that under such circumstances American bankers are likely to increase their balances abroad, (2) that repayment on a considerable scale is likely to be made of the foreign money loaned out in this market.

When money rates begin to fall in New York, the natural tendency on the part of bankers is to increase their balances at foreign points, with the result that exchange with which to make the remittances comes very much into demand and rates rise. It must be remembered, however, that in the transferring of balances from point to point there are other things which must be considered — for instance the rate of exchange which must be paid for the bills with which the remittances are to be made. It would be wrong, therefore, to assume that just as soon as the money market begins to show a weakening tendency large amounts of money are sent out of the country. In the long run that is what inevitably does happen, but very often not until after rates here have ruled above rates prevailing abroad for some considerable time.

A decline in money rates here, in the second place, has the effect of causing a good many of the foreign short loans running in this market to be paid off as they mature instead of being renewed. There are, as has been pointed out, reasons why borrowers on this side sometimes keep their foreign loans running even when the money rate here is as low as it is abroad or lower; but inevitably, when those conditions prevail, foreign loans running in this market do suffer substantial reduction. Whatever special reasons certain borrowers may have for paying a higher rate to foreign lenders than they would have to pay here, most borrowing is done on the basis of getting the money on the best possible terms.

As the repayment of a loan of foreign money means that the party who is doing the paying must go out and secure a demand draft for the necessary amount of pounds or francs or whatever the currency may be, it is apparent that when any considerable amount of such loans are being paid off at the same time, there is set up a demand for exchange likely to exert a strong uplifting influence on the rate. And such, indeed, is the case. As an influence tending to bring about the sharpest kind of advances in the rate of exchange, nothing can compare with a sudden fall in the rate for money and the spread of a feeling that this will be the cheapest market in which to borrow. Borrowers of foreign money, under such circumstances, seem to become suddenly possessed of the idea that they have been caught short of the exchange market and that they must "cover" at any price.

A rise in money rates in London, so far as the exchange market here is concerned, exerts very much the same effect as a decline in money rates in New York. A higher rate of interest being obtainable abroad, balances carried with the foreign banks are logically increased. The rate which they can get at home for their money being greater, in the second place, foreign bankers demand that their short loans to us be paid off as they come due instead of being renewed.

This question of the influence on the exchange market here of a rise in money rates abroad is particularly important when it is considered that not infrequently the money rate at some foreign financial centre is artificially raised because of the resulting effect upon the rate of exchange on that city at outside points. Take a time, for instance, when, at New York the rate of exchange on London is so low that New York is trenching heavily on London's gold supply. A point is finally reached where the Bank of England considers it necessary to take positive action. The bank rate is arbitrarily raised. That carries the whole London money market to a higher level. On the exchange market at New York the effect is instantaneous; rates, for the reasons given above, being driven sharply upward — away from the point at which gold can profitably be imported from London. If that isn't enough, the screw can be given another turn.

A decline in money rates in London has the same effect on the exchange market in New York as has a rise in money rates in New York. American balances in London, earning less for their owners, are drawn

down by heavy drafts against them from the New York end. The loaning rate for money in London being lowered, in the second place, the New York market becomes a more attractive place for the owners of foreign banking capital in which to lend. Large amounts are thus placed at the disposal of New York. The transfer of those funds being affected by having New York draw long bills in sterling on the lending banks, and it being necessary, in order to turn these sterling drafts into dollars to sell them in the New York exchange market, rates, under the weight of these offerings, are likely to be severely depressed.

CHAPTER XII

GOLD

ON the question as to whether international balances are settled in gold or not there exists a wide difference of opinion. By one school of economists it is held that actual balances are so settled; by another, that the creation of such balances one way or the other brings about conditions in the merchandise markets which result in the balances being settled by shipments of merchandise. The movement of gold, economists of the latter class are likely to claim, is nothing more than a manifestation of money market conditions and no proof of which market actually owes which.

As the reader will have noticed, it has been the author's aim to keep this book free of academic discussion; but so important in its practical application is this theory as to what makes gold move, that it would seem hardly right to pass it over with no attention whatsoever.

What Makes Gold Move. — The financial relations between two nations, it has always seemed to the writer, are no different than the financial relations between two individuals who do a good deal of business with each other. Mr. A, we will say, sells Mr. B a hundred dollars' worth of goods. Mr. B, however, has previously given Mr. A a mortgage on his house, the

interest on which, now due, amounts to \$100. So far as the necessity for any immediate payment is concerned, therefore, they are all square. But now it happens that Mr. B, who is a lawyer, does a hundred dollars' worth of work for Mr. A. Mr. A not wanting to pay in cash, asks Mr. B to add that amount to the mortgage — in other words to lend him the money. Again no need for any money to pass. After a while Mr. A renders Mr. B. a hundred dollars' worth of medical services, but instead of asking for it in cash arranges that the previously contracted hundred-dollar debt be cancelled. And so it goes. Mr. A sells goods and renders services to Mr. B and Mr. B renders services and charges interest to Mr. A. And as long as the balance one way or the other doesn't get too large, the one that has money owed to him just charges the account of the other and doesn't demand settlement of the balance in cash.

Now as long as the various transactions come somewhere near balancing, this can go on indefinitely. But let a time come when the balance runs too heavily in favor, we will say, of Mr. B, and Mr. A is likely to receive a request for some real money with which to even up things. After that, Mr. B assures him, things can go on the same as before.

Between two countries like Great Britain and the United States which do business with each other on an extensive scale, the financial relationship is not dissimilar to that prevailing between the Messrs. A and B above referred to. England buys goods and securities from us and is all the time making us short-term loans. We, on the other hand, buy goods and securities

from England, beside which England renders us services in the way of carrying freight for us, insuring us, etc. We owe England and England owes us, and at any given moment, could the figures be set down, there would be a definite balance one way or the other. The figures, of course, never have been set down and never possibly can be; but that in no way alters the fact that the balance, one way or the other, is an absolute reality.

Every once in a while it happens that the balance — not the trade balance, remember, but the balance of all these varied obligations — swings so far one way or the other that payments in actual money (gold) become necessary to even things up. It is not, of course, a case of England demanding that we send gold or of our demanding that they send gold. What happens is that, as a *result* of the various obligations incurred, the rate of exchange between the two countries goes to a point where gold becomes the cheaper medium through which to make remittances. On all our various money dealings with London, we will say, for example, the balance at some given time gets so very much against us that some sort of a cash settlement becomes necessary. Nobody will ask us to send any cash, but what will happen will be that the rate of exchange on London will go so high that any American having remittances to make will find that he can make them cheaper in the form of gold than in any other way. Then, after a lot of gold has been sent out, the balance is brought nearer to equalization and the rate of exchange readjusts itself to a point where remittances can again be made in the form of bills.

Another Theory. — The other theory — held far more strongly, by the way, among economists than among practical bankers — is that when the balance swings too far against one country, exports of commodities and securities from that country are automatically stimulated to a point where readjustment of the too adverse balance is begun. And, undoubtedly, if you look at the matter in its broadest economic sense and over a considerable period of time, there is a tendency in that direction. In the meantime, however, if gold to the extent of many millions of dollars has been shipped out of the country because drafts were not available, it is hard to get away from the conclusion that the reason the gold went out was because the adverse balance drove the rate of exchange to a point where the gold *had* to go out.

Eschewing the temptation further to continue the controversy and getting down to the practical side of the matter, it is to be noted that in the world there are just two gold markets which can in any sense be called “free.” Those two markets are in England and the United States. It is in London and New York only that you can be sure of buying gold at anything like a fixed price (even in London the price of bar gold fluctuates) and of being allowed to export it where you please.

The Market for Gold in the United States. — In the United States the price of gold is absolutely fixed and nonfluctuating. You can take as much gold to any United States Assay Office as you please and have it coined at the rate of \$1.00 for each 1.67182 grammes,

.900 fine (90 % pure gold). On the other hand you can at any time buy gold from the Government at the same price, plus only a nominal charge of 4 cents per \$100 to cover the cost of refining, etc. If, after others have purchased fifty or a hundred million dollars of bar gold at some sub-treasury, you come along to that particular sub-treasury and try to buy a large amount, you may be informed that the supply has temporarily been exhausted and that unless you want to wait until more bars have come in you will have to supply yourself in some other city. But as long as a sub-treasury has any bar gold on hand it is for sale — to the first comer, at \$1.00 for 1.50464 grammes, .1000 fine, and with no questions asked what you expect to do with it. It is not as it is all over Continental Europe, where the buyer of gold on a large scale is apt to be quietly advised that the Government is not at the moment looking on exports of gold with particular favor.

The Market for Gold in Great Britain. — In Great Britain the Government, too, coins all gold offered it, at a fixed rate — 3 pounds 17 shillings 10½ pence for each ounce of gold .916½ fine. The market for bar gold in England is not, however, as it is in the United States, with the Government. The Bank of England, it is true, must buy all gold of standard fineness (.916½) offered to it, at 77s. 9d. per ounce. But it is not to the Bank that the buyer of bar gold goes. The real market for that is at the “gold auction,” held once a week, when the new gold arriving from the mines is sold to the highest bidder.

The price at which the gold is sold ranges between

77s. 9d. and 78d. per ounce. Below 77s. 9d. it cannot go — at that rate the Bank of England *must* by law, take all the gold offered. Nor can the price rise above 78d. for the very simple reason that 78d., invested in sovereigns (even slightly worn sovereigns) will always produce at least an ounce of gold. To put it more concretely, you want to buy an ounce (or many ounces) of gold, with the expenditure of the least number of pounds, shillings, and pence and you find that in the open market you have to pay, 78s. Under those circumstances, the amount of gold you would get by exchanging your bank notes for sovereigns would be greater than if you used your bank notes to buy bars in the open market. (The above assumes, naturally, that you *can* exchange bank notes for gold. If you can't, there is no height to which the price of bar gold cannot rise.)

There are, of course, times when for patriotic or other reasons, bankers refrain from exporting or importing gold even when it could be done at a profit. But, under normal conditions, at all important centres, conditions are carefully watched with a view to taking advantage of such profit possibilities. At New York, for example, any one of half a dozen or more large banking institutions is constantly on the alert for a chance to make a profit either by shipping gold out of the country or by bringing it in. Between the whole lot of them it may very well be the case that these banks may not owe a franc or a pound on the other side, but if they see a profit in shipping gold and then selling their own drafts to some one who *has* debts to settle, they

will be quick enough to do so. Conversely, a bank may not have a sou on deposit in Paris above its normal needs, but if it finds that it can buy a draft on Paris at so low a price that when the draft has been turned into gold and the gold brought to New York the net proceeds in dollars will be more than the draft originally cost, the operation is likely to be made.

Gold Exports — Direct. — As the figures on gold export and import transactions vary with each transaction and are good for about twenty-four hours after they are made, no attempt will be made here to set down as a constant what is *per se* a variable. To put that into business English, it would be worse than useless to put into a book of this sort a lot of calculations which would immediately become out of date. What can be done, however, is to show what factors enter into the export and import of gold, so that the calculation can at any time be made according to the actual conditions then prevailing.

Take the concrete case of a shipment of gold bars from New York to London, where the idea is that the banker is going to buy gold here, ship it abroad, have it credited to his account, and then draw and sell sterling drafts on the balance thus created. Obviously, before he goes into such a transaction, there are certain things the banker must know. The price he is going to have to pay for his gold at the United States Sub-treasury is fixed and doesn't change, but the cost of sending the gold abroad (freight, insurance, etc.) constantly does change. That is the first thing that has to be considered. Next there is the question as to the price at which the

gold is to be sold upon its arrival in London — how many pounds sterling, in other words, are going to be credited to the account. Thirdly, there is the question of the loss of interest, if any. Finally, and most important of all, there is the rate at which the drafts, drawn on the balance created by the gold shipped, can be converted into dollars.

In figuring the possibilities of profit on a gold shipment, the banker goes about it in the very common-sense way first of setting down what it will cost him to create a balance of so-and-so-many pounds abroad, and then figuring how much he can realize by selling out that balance. The initial step is, naturally, to ascertain the cost of freight and insurance, and loss of interest, and the price at which the gold can be sold in London “to arrive.” Knowing that, the banker is in a position to tell at what price (rate of exchange) he must sell his drafts in order to make the desired profit.

All factors bearing on a gold export transaction can be accurately determined at any given time except loss of interest, which, however, can be closely approximated. The gold is shipped, and a draft, we will assume, is drawn against it the same day. That means that there is no loss of interest to be figured on this side, the proceeds of the sale of the draft being used to pay for the gold. But on the other side a loss of interest must be figured, it being a practical certainty that the draft sold will be presented and will have to be paid before the proceeds of the gold are credited to the account. Usually the overdraft thus created lasts anywhere from three to five days.

If, instead of a sight draft, a cable is sold against gold shipped, it is plain that the loss of interest must be reckoned for the full time the gold is in transit. Such additional loss of interest will, however, be compensated for by the higher rate of exchange which the cable will bring.

How to Figure a Gold Export Transaction. — The way, then, to figure the gold export point at any given time is (1) to find the cost of the gold (plus the Assay Office charge), (2) to add thereto the charges for packing, carting, freight and insurance, and loss of interest, (3) to figure how many pounds sterling in London that amount of bar gold will produce at the current rate, (4) to find the rate of exchange at which the new balance must be sold to produce as many dollars (plus the desired profit) as were originally expended in New York.

Where gold coin instead of gold bars is being exported, the procedure is the same except that the cost of the gold in New York will not be figured at so-and-so-much per ounce but at \$10 per eagle or \$20 per double eagle. Here is where the item of "abrasion" comes in. If new coin can be secured, it is very nearly as satisfactory to ship as bars. But in the case of gold which has been in circulation and is not full weight, a higher rate will have to be secured for the drafts drawn against the shipment than in the case of bars. Coin, it must be remembered, whether it is new or old, is bought on this side at *face value*, and credited on the other side *according to weight*. Consequently, if the coins have been in circulation for some time and have lost something of their weight, the shipper on this side is paying for some-

thing he doesn't get. The only way he can get it back is by obtaining a higher rate of exchange on the drafts he sells against the gold.

Gold Imports — Direct. — It might seem at first thought as though the figuring of gold imports were merely the reverse of figuring gold exports, but such is not the case. When we ship gold to London we draw drafts on the balances thus created. When London ships gold to us, London does not draw on us, but makes us send over sterling drafts in payment. The result is that the item of interest has to be figured differently.

The successive steps of a gold import transaction, for instance between New York and London, begin with the purchase of the metal abroad, at whatever the open market price may be. To this debit of the New York importing bank's London account, there must then be added the cost of freight, insurance, loss of interest (explained below), and sometimes a commission for buying the gold. In order to come out of the transaction even, the New York banker must be able, out of the proceeds of the gold when it arrives in New York, to purchase and send over sufficient exchange on London to cancel the debit to his account. Anything left over is his profit.

Where payment for the gold is made by the American banker with a cable on London, the loss of interest must be figured for the whole time the gold is in transit at the rate at which the money could have been used in New York. Immediate payment for the gold being made in London, there is no charge for interest there. But in New York there is a charge. The cable has to be paid

for at once, whereas the gold does not arrive for a week or ten days. In the meantime the New York banker is out of the use of his money. He must, therefore, charge up to the transaction a week or ten days' interest at the prevailing rate for money.

Where the New York importing bank pays for the gold in London by sending over a sight draft instead of a cable transfer, interest must be figured on *both* ends. Ship the gold, wires the New York bank, and we will send over a bankers' draft in payment. All very well, but the gold has got to be paid for *at once* — which means that the London bank is going to be out of the use of its money all the time that the reimbursing draft is on its way over. There is the first item for interest to be taken care of. Then, in addition, the New York banker is going to be out of the use of the money he paid for the sterling draft, for the whole time the gold is on its way. He has to pay for the draft the day the gold starts from London. He doesn't get his money back until the gold arrives on this side. About twenty days — that is what the interest amounts to on a gold import transaction where payment for the gold is made with a sight draft.

Where coin instead of bars is being imported, purchase of the gold abroad, it must be borne in mind, is made at face value; but the gold, when it arrives, is credited by weight. An American bank, for example, importing sovereigns from England or napoleons from France has to pay twenty shillings for each sovereign and twenty francs for each napoleon whether the coin is new and of full weight or whether it is old and "light."

Upon its arrival here, however, the coins are credited by weight — merely as so-and-so-much gold metal. If they are “light,” it means that the importer has paid for a certain amount of gold he didn’t get. The rate of exchange he can afford to pay for the pounds or francs, therefore, with which he is purchasing the worn foreign coin must be lower than if he were importing new coin or bars.

Indirect Gold Shipments. — Beside the “direct” gold exports and imports described above, there is still another kind of gold movement which, for lack of a better term, may be styled “indirect.” Reference is made to the kind of operation which takes place, for instance, when New York ships gold to Paris, has the resulting balance transferred from Paris to London, and then draws and sells drafts on London. Another kind of indirect operation is where some market like London, for example, owing large amounts in South America and happening to have large balances in New York, arranges to have payment made direct from New York in the form of gold.

The above must suggest that the form and variety of these “indirect” operations in gold are almost unlimited. New York may send gold to Japan at the solicitation of London, or London may send gold to South America at the solicitation of Paris — any market, in fact, may send gold anywhere because directed to do so by some other market. It is all a cold matter of rates of exchange and of the cheapest way of making the remittance. Some London bank, we will say, has to make a remittance to Buenos Aires. The rate in

London for drafts on Buenos Aires being high, the manager sits down with his pad and pencil and starts figuring whether he cannot discharge his obligation to South America more cheaply by directing his New York correspondent to ship the gold direct. If the London bank's balance with its New York correspondent is not sufficient, the New York bank can be advised to draw on London in order to raise the money with which to buy the gold.

If it appears, in the case above, that the London bank's South American obligation can be discharged at an expenditure of less pounds sterling by having the gold sent from New York, the chances are that it will be done that way. And so it is with all these indirect gold transactions. Each time it is simply a case of taking all the appertaining conditions and exchange rates into account, and then figuring out in which way it can best be done.

Obstructing Gold Movements. — With regard to the above, however, it must always be borne in mind that no market likes to lose gold, and that when an outflow reaches substantial proportions, steps are likely to be taken to exert a check upon it. Such measures may take the form of arbitrary restrictions on withdrawing gold for export or, on the other hand, may take the much subtler form of money market manipulation. When, for example, the rate of exchange on London gets down to a point where more gold is being taken from London than bankers there want to see go, the chances are that the Bank of England's minimum discount rate will be advanced. The effect of that is to

raise the whole level of money rates in London, which, as is explained in Chapter XI, will immediately begin to exert an important uplifting influence, at outside points, on the rate of exchange on London. And, of course, as the rate of exchange on London begins to go up, it becomes increasingly difficult for the outside markets to take London's gold. *Quod erat faciendum.*

CHAPTER XIII

BANKERS' LONG BILLS

To a far greater extent than is generally appreciated, long bills of exchange (bills payable in from 60 to 90 days) enter into foreign exchange transactions. We saw in Chapter VII how exporters of merchandise draw long bills, with documents attached, on the parties to whom the goods are shipped or on banks designated by them. We have now to consider the long bill drawn by the banker in one country on the banker in another country, and the extremely important part it plays.

At the very outset it must be clearly understood that the only thing that makes the long bill possible is the credit of the drawer, the credit of the drawee, and the general belief (founded, of course, on experience) that the bill will be paid at maturity. Never mind how good a long bill may actually be, unless, on the part of those institutions which make a practice of discounting bills and which constitute the "discount market," there exists a belief that the bill is *good*, such a bill cannot possibly be issued and sold. A long bill is what it is and is used as it is only because it *can* at any moment be turned into money by discounting it.

It stands to reason, therefore, that for a bankers' long bill to be worthy of the name, it must be drawn by

Guaranty Trust Company of New York

L 8000/-

NEW YORK

March 30 1916

Sixty DAYS AFTER *Sight* OF THIS FIRST OF EXCHANGE (SECOND UNPAID)

PAY TO THE ORDER OF *Beacon Manufacturing Co.*

Eight thousand pounds

STERLING

VALUE RECEIVED WHICH CHARGE TO THE ACCOUNT OF

to Guaranty Trust Company of New York

Guaranty Trust Company of New York

33 LOMBARD STREET

NEW YORK

No A12183

LONDON

NEW YORK

Specimen

Guaranty Trust Company of New York

L 8000/-

NEW YORK

March 30 1916

Sixty DAYS AFTER *Sight* OF THIS SECOND OF EXCHANGE (FIRST UNPAID)

PAY TO THE ORDER OF *Beacon Manufacturing Co.*

Eight thousand pounds

STERLING

VALUE RECEIVED WHICH CHARGE TO THE ACCOUNT OF

to Guaranty Trust Company of New York

Guaranty Trust Company of New York

33 LOMBARD STREET

NEW YORK

No A12183

LONDON

NEW YORK

Specimen

BANKERS' LONG BILL - ORIGINAL AND DUPLICATE

a banker of unquestioned standing on a banker of unquestioned standing resident at some point where a broad discount market exists. That is the kind of bill that is meant when we read that "bankers' long bills" are quoted at such and such a price — the only kind of bankers' long bill, in fact, that is traded in in the exchange markets.

Pledging Credit. — When a banker in one country draws a long bill on a banker in another country, it is to be observed, the banker who is drawn on does not put up any money. What he does is to "accept" the bill and give it a due date. "Accepting" the bill, of course, binds him legally to pay it at maturity; but, as we shall see, pretty nearly all the operations in which banker's long bills are involved are worked with the idea that the banker who was drawn on shall be put in funds with which to meet the drafts he has accepted, before those drafts come due and have actually to be paid by him. The banker who "accepts" a long bill drawn on him from another country does not, in other words, except in the rarest instances, expect himself to have to find the money with which to pay the draft. Before the draft comes due, funds, he knows, will have been sent him by the drawer. The accepting banker does not put up any cash. What is being pledged — put in such a form, if you will, that it can be turned into money — is his credit.

Now it stands to reason that no banker will thus pledge his credit unless he is entirely satisfied as to the standing of the party who is drawing on him and of the certainty that the drawer will send him the cash to meet

the bill with, before the bill comes due. The bill having been accepted has got to be paid on the dot, at maturity. If the money to pay it with has failed to reach the accepting banker, he has got to pay it himself. A moment's hesitation in taking care of the accepted draft when it comes due, he very well knows, would instantly end his career as a banker.

A Privilege Seldom Abused. — The drawing of long bills by a banker in one country on a banker in another country is thus, like the holy state of matrimony, something which is not lightly to be entered into. If the discount market in London, for example, annually absorbs untold millions of pounds sterling of such drafts as it does, it is only because experience has shown that bankers don't abuse the confidence reposed in them. Once in a while it happens that a couple of banking houses whose long paper has always been well thought of take advantage of the fact and utilize their credit for illegitimate purposes and with consequences disastrous, but such cases are few and far between. Not infrequently, perhaps, the funds raised by the sale of bankers' long bills are used for purposes of which those who have discounted the bills, did they but know of them, would not strictly approve. The being able to raise money merely by drawing long drafts on a foreign correspondent is, however, such a remarkable privilege, that it is jealously guarded and seldom abused.

Where Does the Money Come From? — Right at this point, and before we get into the discussion of the various purposes for which bankers' long bills are drawn, we want to be sure that we understand where the money

comes from when A in New York puts himself in possession of approximately \$100,000 for 60 days, by drawing a £20,000 sixty-days' sight draft on B in London. Where does the money come from? — from the party in New York to whom A sells the £20,000 draft he has drawn — that is the natural answer and true as far as it goes. The trouble is it doesn't go far enough. A, to be sure, gets his dollars from the party in New York to whom he sells the £20,000 draft; but the only reason that party is willing to pay A cash for the draft is because he (the party who buys the draft from A in New York) knows that he can have the draft discounted in London and thus get his money back any time he wants it. The money that A gets in New York thus *really comes from the discount market in London* and is transferred to him through the instrumentality of the party in New York to whom he sells the draft he has drawn on B in London.

The discount market in London, it will thus be seen, has a big effect on A's willingness to utilize his privilege of drawing on B. If the discount market is away up in the air, it means that off the face of any draft A draws, there will have to come a considerable amount of discount before the draft can be turned into cash. When, therefore, A comes to draw his draft and offer it for sale, he finds that only a very low rate of exchange is bid him for it, a rate so low, that, very probably, he decides to defer his drawing to a more favorable time.

CHAPTER XIII

(Continued)

BANKERS' LONG BILLS

BANKERS' long bills may be divided as follows :

		<i>Purpose for which drawn</i>
Bankers' Long Bills.	I. Bills drawn in the regular course of business.	{ 1. Against remittances of nondiscountable commercial bills. 2. Against "Futures."
	II. Loan Bills.	{ 1. Loaning foreign money here.
	III. Finance Bills.	{ 1. Financing the purchase of securities. 2. In anticipation of a decline in exchange rates. 3. Regular working Capital.

Bills Drawn Against Nondiscountable Commercial Bills. — In the regular course of his business, as we have seen, the exchange banker buys pretty much any kind of a bill offered him, provided he considers it safe, and provided that he can get it at a price which will allow him to draw his own bill against it at a profit. Some of the bills he buys are drawn at sight and will be

credited to his account as soon as they get over to the other side; against those he can, of course draw his own sight bills. Some of the bills he buys are long "discountables"; those, too, can be turned into money as soon as they get over, and be drawn against at once. But others of the bills he buys are "payments" (Chapter VII), long bills which may or may not be taken up under rebate before maturity and so turned into money. Against such a bill it is palpably impossible for the banker to draw his own bill payable on demand. There is no certainty that the drawee will take up the bill before he has to, at maturity. Very possibly the full sixty-three days will go by before the deposit account of the banker who sent the bill over will be credited with the proceeds.

Now the profit in the business does not, of course, warrant the banker's money being tied up for any such length of time — he *must* draw against the bills he is remitting. He cannot draw drafts payable on demand, but he can draw drafts (and sell them at once for cash) which will not have to be paid out of his account abroad until the commercial bills against which they are drawn come due. Against a batch of £10,000 of sixty-day "nondiscountables," for example, he can sell his own sixty days' sight bill for £10,000. His correspondent bank abroad, it is true, will have to "accept" the draft; but with the "accepted" commercial bills in its own hands, the correspondent will be quite willing to do that.

It may be, and indeed it is very often the case, that through previous experience the banker here knows that John Smith and Co.'s sixty-day commercial bills are never allowed to run to maturity, but are always

taken up at the end of thirty days. That being so, the banker is reasonably safe in drawing his own thirty-day bills against such a remittance. There is always the chance that John Smith and Co. may break away from their regular custom and not take up the bills under rebate ahead of time as expected, but even if that does happen, the banker can cover the "thirties" he has previously drawn, in some other way. The balance of a banker doing this sort of business, anyhow, is apt to run to proportions which would easily take care of the maturing "thirties" without any immediate remittance from this side being made.

Bills Drawn Against Futures. — That is one way in which bankers' long bills are brought into existence during the regular course of business. Another is through purchases of "futures." Some large exporter, we will say, knows that in two or three months he will be making heavy shipments and will have a large amount of demand exchange to sell. Not wanting to take a chance on what the exchange rate then may be, he goes to a banker and offers to sell him a "future" — £5000 of his sight bills, say, deliverable to the banker here in New York in three months. The banker knows what the immediate market is for his own bills, payable in three months, and bases the bid he makes for the "futures" accordingly. If the merchant accepts and signs the contract to deliver the bills at the specified time, the banker goes ahead and draws his own ninety-day bills, secure in the knowledge that cover for them (at a fixed and definite rate which shows him the profit he wants) has been provided.

CHAPTER XIII

(Continued)

BANKERS' LONG BILLS

Loan Bills. — Loan Bills come into existence as a result of the short-term loans of pounds and francs and other currencies continually being made in this market. When Europe lends here the method of transferring the funds to this side is not, as is generally supposed, to send over the actual gold or to remit dollar exchange to the borrower. What actually happens in the vast majority of cases is that the American correspondent of the foreign bank which is going to do the lending draws sixty or ninety-day sterling drafts on London and then turns over the drafts themselves (or the dollar proceeds of the draft) to the borrower. The borrower then has the use of the money for sixty or ninety days as the case may be, at the end of which time he must see to it that the lender (the bank abroad which was drawn on) is provided with funds with which to pay the long drafts it has previously accepted. (No actual money, it is to be noted, is put up by the lender. What happens is that, in the manner described earlier in this chapter, the lender pledges his credit and puts the borrower in America in touch with the great reservoir of loanable bank capital in London.)

To take an actual illustration, a bank in London decides to lend out £50,000 in the New York market for three months and asks its New York correspondent to make the necessary arrangements. The New York bank, probably through a money-broker, finds, say, a bond house, which is willing to borrow the £50,000, depositing as collateral good bonds having a market value of \$300,000. The terms of the loan are that the borrower is to pay a commission of $\frac{1}{2}$ of one per cent on the £50,000 of ninety-day sterling bills turned over to him, and that at the end of ninety days he is to provide the New York banking correspondent of the London bank with a bankers' *sight* draft on London for £50,000.

These arrangements having been made, and the \$300,000 of bonds having been deposited, the New York banker goes ahead and draws £50,000 of *ninety days' sight* sterling bills and turns them over to the bond house. The bond house takes the bills and sells them in the exchange market at New York at whatever is the rate prevailing for bankers' long paper. It thus finds itself possessed of, roughly, a quarter of a million dollars, the use of which it is to have for ninety days.

Observe carefully that the borrower receives, *not dollars*, but sterling drafts on London drawn at ninety day's sight which, to be turned into dollars, must be sold at the ninety-day rate. Now the ninety-day rate, as we have seen, is lower than the sight rate by the price of discount prevailing abroad. The borrower, in other words, borrows pounds which he must convert into dollars at the ninety-day rate, whereas, when he comes

Guaranty Trust Company of New York

~~London~~ *By* New York, *March 30 1916*

Pay John Johnson & Co

or order (Duplicate being unpaid) the sum of
~~*Twenty thousand pounds*~~

which charge to New York account

Guaranty Trust Company of New York,

PER PRO

No 66695

33 Lombard Street,

London.

PER PRO

Specimen

THIS CHECK IS NOT
VALID UNLESS SIGNED BY THE
ISSUING BANK

Guaranty Trust Company of New York

~~London~~ *By* New York, *March 30 1916*

Pay John Johnson & Co

or order (Original being unpaid) the sum of
~~*Twenty thousand pounds*~~

which charge to New York account

Guaranty Trust Company of New York,

PER PRO

No 66695

33 Lombard Street,

London.

PER PRO

Specimen

THIS CHECK IS NOT
VALID UNLESS SIGNED BY THE
ISSUING BANK

BANKERS' CHECK — ORIGINAL AND DUPLICATE

to pay those pounds back ninety days later, he must provide a sight draft for which he will have to pay the sight rate.

The difference in the rate, plus the commission, is what the borrower actually pays for his money. He sold the long drafts turned over to him at perhaps 4.83, the rate for sight drafts being then 4.87. Ninety days pass and it becomes necessary to pay off the loan. Exchange rates, he finds, are just where they were — 4.83 for ninety-day bills, 4.87 for demand. This time, however, it is only the rate for *demand* which interests him — it is a demand draft which he must return. So he buys the pounds he wants at 4.87. He has paid in addition to the commission, exactly 4 cents per pound sterling for the use of the money for the ninety days.

The "Risk of Exchange." — In the cost of such a loan to the borrower, therefore, there is a variable factor — the rate which he will have to pay for the demand draft with which to pay off the loan when it comes due. The commission, he knows, is so-and-so-much — that is fixed. The rate at which he can sell the ninety-day bills in the first place is fixed, too, — he can settle that before he actually makes the loan. But the rate he will have to pay for his demand — that is the uncertain question. During the three months the loan runs the rate for demand may rise, in which case the loan will prove expensive. On the other hand the rate for demand may fall, in which case the loan will have been cheap. What the money actually *will* cost him, in other words, depends upon the action of the exchange market.

Unless, of course, not wanting to take the chance of

having the loan cost him a lot of money through a rise in the exchange market, he secures himself by buying a "future." He can do that and in some cases he does do it; but in the great majority of cases he doesn't. If at the time the loan is made the exchange market happens to be away down, the borrower will probably secure himself by buying a future and thus settling the rate in advance even if the protection costs him a stiff price. But if, when the loan is made, he can get a good price for the "nineties," and the price of demand is already so high that it seems more likely to go down than to go up further, he will very probably take a chance. Many a sterling loan, he is apt to reflect, is paid off with demand exchange purchased actually at a lower price than the "nineties" were originally sold for.

So much for the borrower and what he has to pay. Now what does the lender get out of it? Only the commission, and that less what his New York banking correspondent charges him for handling the details of the transaction. (Many of these loans are made "joint-account" both as to risk and profits.) Not very much of a return, is the natural comment, where so large an amount of money is involved. A large amount of money? — Yes, a large amount; but not of the banker's money. *He* doesn't put up any money. All *he* does is to "accept" a draft drawn upon him. A large amount of money, it is true, is put up, but that, as we have seen, comes from the discount market. The lending bank, in the strict sense of the word, isn't a lender at all but rather a sort of broker who, through the machinery at his disposal, puts the borrower in New York into touch

with the discount market in London. For which service he receives the commission charged the borrower.

Continuing this rather analytical view of what has happened, let us see who gets the difference between the \$4.83 which the borrower received for his nineties when the loan was made, and the \$4.87 he had to pay for his demand when the loan was paid off. That difference, a little thought will show, goes to the party in London who discounts the bills. It is just that difference, in fact, which is the measure of the amount that the party in London who discounts the bills will take off their face. This actual discount, reckoned of course, in sterling, was the very thing that, with the price of demand at 4.87, fixed the price of the nineties at 4.83.

Renewals. — Loans of the character mentioned above are often made “with the privilege of one renewal.” The first ninety days pass, we will say, and the borrower decides to avail himself of his option and renew. At the beginning, however, a lot of ninety-day sight bills were drawn and sold in the open market and these have got to be taken care of by a remittance from this side. So what happens is that the New York bank draws a fresh lot of nineties, the proceeds of which are then used to take care of the first lot of nineties which were drawn when the loan was originally made.

The second lot of nineties must of course be larger in amount than the first lot. Originally, we will say £50,000 was drawn. That comes due and has to be paid off — with a *demand* draft for £50,000. Another lot of ninety-day bills won't do the trick — won't, after they have been discounted, produce enough pounds

sterling to pay off the first lot. So the second lot has to be drawn for enough more than the first lot, so that, when the second lot has been discounted, there will still be an even £50,000 left. Assuming that the discount rate was 3 %, the second lot would probably be drawn for £50,390, the £390 representing the discount which would have to be taken off the face of the bills.

What has been described above is the straight "sterling loan," with the borrower taking the risk of exchange. There is, however, another way of making these loans so that the borrower does not have to take that risk. In that case, the *dollar proceeds* of the ninety-day bills instead of the ninety-day bills themselves are handed over to the borrower. And, instead of paying a commission and agreeing to return a demand sterling draft at the end of ninety days, the borrower pays a flat rate of interest on so-and-so-many dollars and binds himself to return that many dollars. In a great many cases the borrower, indeed, doesn't know anything about its being money raised abroad that he is getting. All he knows is that the bank is lending him a certain amount of money for which he is going to pay a certain amount of interest in the regular way. Where the money comes from is of no more concern to him than if it represented a part of the lender's Philadelphia correspondent's balance.

Now as this kind of a loan is just the same as the other so far as drawing ninety-day bills and having to pay them off at maturity with demand bills is concerned, it is plain that *somebody* has got to take the risk of exchange. Nor does it require any particular acumen to

see that it is the lender himself who must take this risk. In order to secure the dollars to lend to the American bond house, the London bank had itself drawn on by its New York correspondent and those bills sold to third parties. At the end of ninety-three days the bills will be presented and have to be paid. Ten days before that time the borrower in New York, it is true, will turn over to the London bank's New York correspondent the money previously loaned him, plus interest. That amount, however, will be in *dollars*, whereas pounds are needed. It will thus be necessary for the New York bank to turn into pounds the dollars returned by the borrower, at whatever is the current rate of exchange for demand drafts — unless, of course, that has been previously taken care of through the purchase of a "future."

What the London bank makes out of such a transaction, therefore, is the interest collected from the borrower, *less* the difference between the amount of dollars realized from the sale of the nineties, and the amount of dollars paid for the demand drafts when the transaction is closed. The higher the rate at which the nineties are sold and the lower the rate at which the "cover" is secured, the better it is for the lending bank.

To take a concrete case, suppose the amount of the loan was an even \$50,000, and that the rate for ninety-day bills at the time the loan was made was 4.84 ($\text{£}10,330\ 11/7$ of ninety-day bills would have to be sold at that rate to produce \$50,000). The rate of interest having been fixed at 6%, at the end of the ninety days the borrower returns \$50,750. The rate for demand

bills being, we will say, 4.88, the £10,330 11/7 needed by the bank will cost \$50,413.24. The transaction is thus closed at a profit to the lending bank of \$336.76 less expenses. A small enough amount to be sure, but one, it must always be realized, which was earned without the banker in London putting up a dollar in real money. And, at that, \$336.76 earned on \$50,000 in ninety days represents an annual interest rate of nearly 3 %.

The amount of profit on foreign loans made on the above basis depending to such an extent on the rate at which the "cover" is secured, it stands to reason that foreign bankers putting out money in this market do it in that way whenever it looks to them as though the rate for demand were likely to go down during the life of the loan. If, at the time the loan is made, the rate for demand is low and there is reason to think it may work higher, the lending banker will insist on passing along to the borrower the "risk of exchange." If he doesn't want to take it, the chances are that he will have to go somewhere else for his money.

A time, then, when foreign loans to this market are being very generally made on the "currency" basis is apt to be followed by a period of falling exchange rates. Bankers are by no means infallible in their judgment as to the swing of rates, but they do, at least, know a great deal more about it than their customers.

Further Considerations. — Before leaving this question of foreign loans in the American market, there are one or two other things to be considered. Such loans, in the first place, are, very frequently, made for joint account, the profit and the risk being equally shared.

Foreign bankers, as a rule, like this joint account arrangement, the charge which the American correspondent makes when it isn't "joint" being pretty nearly half the profits, anyway. And, of course, where the transaction is for joint account and the American banker is taking half the risk, there is a natural feeling on the part of the banker abroad that his interests are being better taken care of. The American banker will, in the first place, be more careful as to the party to whom he lends the money, and, in the second place, he will not only more closely scrutinize the collateral but will see to it more carefully that the market value of the collateral is kept up to the agreed percentage of margin above the face of the loan. Theoretically, when the American banker is acting merely as agent, for a commission, these things should be taken just as good care of; but, practically, there is nothing like having an interest in a proposition to get it your best possible attention.

Another thing to be considered is the reason, alluded to in an earlier chapter, why foreign loans will often be made in the American market and on a very considerable scale even at times when the money rate here is little, if any, more attractive than it is abroad. Several things may bring that about. In the first place the money may be loaned here not so much because there is any great demand for it, as because exchange conditions — a high rate for ninety-day bills, for example, and an outlook for a lower price for demand — make it seem to the foreign banker as though the lending of money here, with him (the banker) taking the risk of exchange,

would work out exceptionally well. (Many a pound sterling has come into the American money market merely because ninety-day bills happened at the time to be selling so high that bankers couldn't resist the temptation to take the mild speculation involved.) Then in the second place, a good many American borrowers, the stock and investment houses principally, keep foreign loans running practically the year round, merely in order to be sure that the sources of supply are kept open. Thirdly, foreign money is often extensively borrowed here by stock market operators who do not want their own banks to know what they are doing.

Some interesting episodes could be here set down as to borrowing of the last-named sort, but space requires that we confine ourselves to the foreign exchange aspect of the question. And from that angle there will readily be seen the superior chances of concealment where a large amount of money is to be borrowed and the borrower does not want the banks here to know it. Making straight time loans in the domestic market would mean the giving out of orders to money brokers, after which the collateral would be deposited with institutional banks all over the city — just what the borrowers want to avoid. Negotiation *abroad* of the whole amount needed could, on the other hand, in all probability be made through one agency in New York, and that some firm of private bankers. Then when the loans were made, the collateral would all go to one place; and the only possible inkling any one could have that a large amount of money was being loaned from the other side

would come from increased offerings of long bills in the exchange market. And that, unless the market happened to be particularly weak and susceptible, could be easily enough arranged so that no one could possibly tell the purpose for which the bills were being offered.

CHAPTER XIII

(Continued)

BANKERS' LONG BILLS

Finance Bills. — We have now to consider what is perhaps the most misunderstood of all classes of exchange, and withal one of the most important — the “Finance Bill.” Make inquiry, even among those actively engaged in the exchange business, as to what the finance bill is and what it is used for, and the chances are that you will be amazed by the divergence of the expression you call forth. Almost generally you will find a tendency to confuse the finance bill with the loan bill which has just been described.

Now the finance bill is essentially different from the loan bill in that the loan bill is issued by bankers who want to lend out money to third parties, on collateral, whereas the finance bill represents nothing more than the drawing of long drafts by one banker on another for the purpose of raising money to be used by either banker or both. In the case of a loan bill John Smith borrows money from the First National Bank and puts up good and sufficient collateral for its repayment. In the case of a finance bill, the First National Bank draws a time draft on the Second National Bank, turns it into ready money, and uses the money (sometimes alone and some-

times, in connection with the drawee) for any purpose it sees fit.

There is, of course, no apparent difference in appearance between a loan bill and a finance bill, or, in fact, any other kind of a bankers' long bill. The circumstances which bring them into existence vary greatly, but the bills themselves, after they have been uttered, are all exactly alike. To the buyer they are all just bankers' long bills and all he has to buy them on is the name of the maker and the name of the drawee. When you buy a bankers' long bill you have no possible way of telling whether it is a loan bill or a finance bill or what it is. Neither has the discount market — except that it can have its suspicions.

Bills Issued to Pay for Securities. — The first purpose for which finance bills are issued, as set forth in the little table at the beginning of the chapter, is in order to raise money to finance the purchase of stocks and bonds. A pool is formed by half a dozen banking houses, we will say, in United States Steel; with Messrs. John Jones & Co. agreeing to furnish the money to buy so-and-so-many shares. Messrs. Jones & Co., not wanting to put up that much money themselves, cable their correspondents in London offering to divide their share in the pool with them, the money to be raised by having Jones & Co. draw ninety days' sight bills on London. Before the ninety days are up and the bills have to be covered, the cable suggests, the pool will have sold out and made its profit. If the stock market operation runs over the ninety days, a fresh lot of nineties can be drawn to take care of the first lot.

The experience of the London banking house in the past having been that when so invited they generally make money, the chances are that a cable will come back telling the New York house to count them in and go ahead and draw on them. And so the question as to where the money for Jones & Co.'s participation in the pool is to come from is solved.

The same thing is likely to happen any time that Jones & Co., Bankers, instead of joining a pool in United States Steel stock, are invited to assist in the flotation of a new bond issue and to "bring in some of their foreign friends." Very likely the foreign friends will be glad enough to accept the invitation, the understanding being that the money they are to put up is to be raised through the sale of long bills drawn upon them. Messrs. Jones & Co. go ahead and draw — very likely for enough to cover not only their foreign correspondent's participation but their own as well. The bills are then sold in the exchange market and Jones & Co. have the necessary funds in hand. Very probably before the bills come due and have to be paid, all the bonds will have been disposed of, the money with which to furnish the needed "cover" being thus provided. If the distribution of the bonds takes longer than expected, the finance bill arrangement can be kept going by drawing fresh lots of bills every ninety days. Each time, as previously explained, the amount drawn must be increased, but that increase is nothing but interest, and probably no more than would have to be paid on a time loan made in the home market in the regular way.

Bills Issued to Take Advantage of Exchange Rates. —

The second reason why finance bills are drawn is in order to profit by a possible decline in the exchange rate. While we were discussing loan bills we saw how loans of foreign capital are at times fairly forced on the borrower here, simply because the banker abroad figures that a break in the rate of exchange on London is coming and wants to use this means of taking advantage of it. The same thing happens to an even more marked extent in the case of finance bills, where no regular borrower has to be found. Take a time, for instance in the spring when agricultural exports are not heavy, when the rate of exchange on London is away up — 4.85, perhaps, for ninety-day bills and 4.88 for demand. Now, while there is no certainty about it, there is every possible prospect that a lot of finance bills sold at 4.85 under such circumstances can later be covered at a considerably lower rate than 4.88. Not inconceivably, when the crops begin to move abroad and a large amount of bills drawn against them are pressed for sale on the market, the rate for demand bills will fall as low as the point at which the nineties were previously sold. And, of course, if that happens and the needed "cover" is secured, say at 4.85, the banker who drew the finance bills and the banker on whom they were drawn will have had the use of the money for three months for absolutely nothing.

Just prior to a jump in the money market, finance bills, drawn by bankers who are in a position to see it coming, are apt to make their appearance in large amount. There is, in the first place, the fact that the rise in money rates is more than likely to react on the

rate of exchange and drive it down (Chapter XI). Secondly, a time when money rates are getting up is a good time to have money around the use of which isn't costing you anything.

Bills Issued for Capital Purposes. — The third purpose for which finance bills are drawn is, strange as it may seem, for the purpose of providing working capital. Needless to say, the large institutions which deal in exchange hardly find it necessary to add to their resources in that way, but among those whose long paper is readily enough salable in the exchange market there are a good many banking houses that do. Particularly is this the case where a banking house has its own branch abroad or where the connection is extremely close between some house on this side and some house on the other. In such cases it is not unusual for an indefinite credit to be extended. The New York house, in other words, might draw a certain amount of long bills at the start, replace them with another lot at the end of ninety days, do it again at the end of six months, and so on for as long as it had use for the money in its business.

In the case of a banking house in New York which failed some years ago and which, up to within a short time of the failure, enjoyed a credit sufficiently good to allow the sale at current prices of large amounts of its long paper, it is said that it was found that the proceeds of such sales constituted about all the working capital the house had. That, of course, is an isolated instance, and in no way indicative of the way in which finance bills are generally used. It does, however, serve as a

striking illustration of how, where the connection abroad is sufficiently close and the credit of the two houses is sufficiently good, the use of the finance bill can be pushed to the limit.

Where, in the above case — in any case where money is raised by the sale of finance bills — does the money really come from? From the discount market at the place on which the bills are drawn. A firm issues finance bills and sells them. The only reason it *can* sell them is because the buyer knows he is getting something that the discount market wants and is willing to pay money for. It is this money from the discount market, coming to him directly or indirectly as you care to look at it, which the drawer of finance bills uses.

CHAPTER XIV

IMPORT AND EXPORT CREDITS

EVER since there have been bankers, bankers have assisted in the financing of merchandise exports and imports. It has been only during recent years, however, that that great phase of the exchange business expressed by the term "bankers' credits" has been brought to any degree of standardization. Even to-day, while the expression "bankers' credit" has come to mean about the same thing to a good many people, there is a wide variance in the credits themselves and in the conditions under which they are issued.

With the passing of a large part of the business of issuing commercial credits from the private bankers (who, up to the beginning of this century, had an absolute monopoly of it) to the large institutional banks, the business has, however, assumed a form sufficiently definite to allow an intelligent study to be made of it. It would be a mistake, though, for the reader to imagine that there can be set down in black and white a description of all the different kinds of commercial credits that bankers issue. Their name is legion, and almost infinite are the variations made to meet special circumstances and special requirements.

The Bankers' Credit an Authorization. — One great principle, however, underlies the whole business. All bankers' credits — and this is true whether the credit is issued to facilitate the import of matting from Japan or the export of machinery to South America — all bankers' credits are an *authorization*, for somebody, who has money coming to him, to draw drafts on a banker, somewhere. According to the particular transaction involved, the authorization may be for an American exporter to draw dollar drafts on a bank in New York or sterling drafts on a bank in London, or, on the other hand, for a shipper of goods in the Far East to draw franc drafts on Paris. The combinations, as stated previously, are almost without number. But, what is true in the case of practically every bankers' credit ever issued, is that some merchant has gone to some banker and secured from that banker an authorization for himself or some other merchant to draw drafts on that banker or on his correspondent.

The reason why the credit is in the form of an authorization is, of course, because the merchant almost invariably wants to turn his claim over to some one else, *i.e.* sell the drafts he has drawn. Naturally, if he can show to the prospective buyer of the drafts his authorization by some responsible banking institution to draw, he is going to be able to dispose of those drafts more easily and at a higher rate of exchange than if he can show no such authorization.

The *raison d'être* for the system of bank credits ("commercial credits" they are usually called), is that from the standpoint of the merchant in one country who

has a claim against a merchant in another country, the right to draw on some bank and in a currency readily

Credit No. 10000

£ 50,000.-

Guaranty Trust Company of New York

Foreign Department

New York, March 30, 1917

Sumatra Trading Society,

Padang.

Gentlemen:

We hereby authorize you to value on the Guaranty Trust Company of New York, 33 Lombard St., London, for account of American Tobacco Corporation,

up to an aggregate amount of Fifty thousand Pounds Sterling -----

available by your drafts at Ninety (90) days sight -----

against shipment of Tobacco to New York

Insurance & War risk certificates to accompany drafts.

Bills of Lading for such shipments must be made out to the order of the Guaranty Trust Company of New York, unless otherwise specified in this credit.

CONSULAR INVOICE AND ONE BILL OF LADING MUST BE SENT BY THE BANK OR BANKER NEGOTIATING DRAFTS, DIRECT TO THE GUARANTY TRUST COMPANY OF NEW YORK, NEW YORK, UNDER ADVICE TO GUARANTY TRUST COMPANY OF NEW YORK, LONDON.

The remaining documents must accompany the drafts drawn on Guaranty Trust Company of New York, London.

The amount of each draft negotiated, together with date of negotiation, must be endorsed on back hereof.

We hereby agree with bona fide holders that all drafts drawn by virtue of this Credit, and in accordance with the above stipulated terms, shall meet with due honor upon presentation at the Office of the Guaranty Trust Company of New York, London, if drawn and negotiated prior to Nov. 5 1917.

Guaranty Trust Company of New York,

N. B. Drafts drawn under this Credit must state that they are "drawn under Letter of Credit No. 10000
Dated March 30, 1917 "

COMMERCIAL LETTER OF CREDIT—STERLING

convertible into his own, is greatly preferable to the right to draw directly on the party who owes him the money. Where the debtor is a mercantile establishment

of large means and with an international reputation, it doesn't make so much difference, but in the ordinary run of business between houses of average standing it does make a very great difference. An exporting firm out in Rangoon or Calcutta, for example, might willingly ship goods to a moderately rated firm in America provided the American firm furnishes a bank credit under which the Far Eastern exporter can draw in sterling on London, whereas, if no such credit were provided and the shipper had to draw direct on the importer in dollars, the shipper would in all probability refuse to do the business.

Probably the clearest and cleanest way of getting at the theory and practice of bank credits is to take an actual transaction and follow it through its successive steps. No one transaction, of course, can absolutely epitomize all the rest, but it is a fact that if we take a case, for instance, where a modestly rated American firm is importing merchandise from the Far East under bank credits authorizing the shipper to draw in sterling on London, we are getting a case where pretty much all the salient features of a commercial credit transaction appear. Let us, then, take a definite instance where a shipment of shellac is made from some port in India to the United States, payment being arranged by bankers' credit, and follow it along not only as to its material details but also as to the whys and wherefores of the successive steps taken.

The Credit and the Price of the Goods. — The terms on which payment is to be made, in the first place, exert an important influence on the price which the Calcutta merchant will quote for his shellac. If, in his

cable, the New York importer offers to send out a bankers' credit under which the shipper can draw drafts on some London bank at *three* months' sight, it stands to reason that the Calcutta merchant will sell him the shellac cheaper than if the forthcoming bankers' credit requires that the drafts be drawn at *four* or *six* months' sight. The shorter the term of the drafts he is going to draw, the better it is for the shipper. As soon as he draws he is going to sell the drafts for rupees at the current rate of exchange, and the shorter the term of the drafts, of course, the higher will be the rate he will get.

The question of price and the terms of payment having been settled, the importer here applies to his bank for the kind of credit he has agreed to send out to the East. In this case, we will say, he has agreed to send out a credit under which the shellac exporter in Calcutta is to be authorized to draw on some bank in London, at four months' sight, for the invoice value of the goods shipped, all bills of lading and other documents to be attached to the draft. It is agreed, furthermore, that it is to be a confirmed credit—that is to say, that the bank in London whose New York correspondent is issuing the credit, is to confirm to the Calcutta shipper the fact of the credit's having been opened. That having been done, the London bank is bound to accept drafts drawn under the credit as long as they are in order, and cannot cancel the credit until the regular date of expiration noted thereon.

If the New York importer is in the habit of regularly using bankers' credits, the chances are that he will have a "line" established at his bank, and that if he is inside

of his "line," the credit will be issued to him within a couple of hours after he has made his application. All the details as to the commission he is to be charged, the terms on which the goods are to be turned over to him when they arrive, etc., will have been previously arranged. All that is exactly as though he were making a loan at his bank, though in this case, of course, the importer gets no money from his bank, but merely a

New York, _____ 19__

To the

Guaranty Trust Company of New York

Gentlemen

Having received from you the Letter of Credit of which a true copy is on the other side, *I* ^{we} hereby agree to its terms, and in consideration thereof *I* ^{we} agree with you to provide in New York, twelve days previous to the Maturity of the Bills drawn in virtue thereof, sufficient funds in cash, or in Bills on London, satisfactory to you, at not exceeding sixty days' sight, and endorsed by *me* ^{us}, to meet the payment of the same with _____ per cent. commission and interest as hereinafter provided, and *I* ^{we} undertake to insure at *my* ^{our} expense, for your benefit, against risk of Fire or Sea, all property purchased or shipped pursuant to said Letter of Credit, in Companies satisfactory to you

I ^{we} agree that the title to all property which shall be purchased or shipped under the said credit, the bills of lading thereof, the policies of insurance thereon and the whole of the proceeds thereof, shall be and remain in you until the payment of the bills referred to and of all sums that may be due or that may become due on said bills or otherwise, and until the payment of any and all other indebtedness and liability now existing or now or hereafter created or incurred by *me* ^{us} to you on any and all other transactions now or hereafter had with you, with authority to take possession of the same and to dispose thereof at your discretion for your reimbursement as aforesaid, at public or private sale, without demand or notice, and to charge all expenses, including commission for sale and guarantee

Should the market value of said merchandise in New York, either before or after its arrival, fall so that the net proceeds thereof (all expenses, freight, duties, etc., being deducted) would be insufficient to cover your advances thereagainst with commission and interest *I* ^{we} further agree to give you on demand any *other* security you may require, and in default thereof you shall be entitled to sell said merchandise *forthwith*, or to sell "to arrive," irrespective of the maturity of the acceptances under this Credit, *I* ^{we} being held responsible to you for any deficit, which *I* ^{we} bind and *oblige myself ourselves* to pay you in cash on demand.

It is understood that in all payments made by ^{you} to you in the United States, the Pound Sterling shall be calculated at the current rate of exchange for Bankers' Bills in New York on London existing at the time of settlement, and that interest shall be charged at the rate of five per cent per annum, or at the current Bank of England rate in London if above five per cent.

Should ^I anticipate the payment of any portion of the amount payable interest is to be allowed at a rate one per cent under the current Bank of England rate.

In case ^I should hereafter desire to have this credit confirmed, altered or extended by cable (which will be at ^{my} expense and risk), ^I hereby agree to hold you harmless and free from responsibility from errors in cabling, whether on the part of yourselves or your Agents, here or elsewhere, or on the part of the cable companies.

This obligation is to continue in force, and to be applicable to all transactions, notwithstanding any change in the composition of the firm or firms, parties to this contract or in the use of this credit, whether such change shall arise from the accession of one or more new partners, or from the death or secession of any partner or partners.

It is understood and agreed that if the documents representing the property for which the said Credit has been issued are surrendered under a trust receipt, collateral security satisfactory to the Company, such as stocks, bonds, warehouse receipts or other security, shall be given to the Company, to be held until the terms of the credit have been fully satisfied and subject in every respect to the conditions of this agreement.

It is further understood and agreed in the event of any suspension, or failure, or assignment for the benefit of creditors on ^{my} part, or of the nonpayment at maturity of any acceptances made by ^{me}, or of the nonfulfilment of any obligation under said credit or under any other credit issued by the Guaranty Trust Company of New York on ^{my} account, or of any indebtedness or liability on ^{my} part to you, all obligations, acceptances, indebtedness and liabilities whatsoever shall thereupon, at your option then or thereafter exercised, without notice, mature and become due and payable.

It is understood and agreed that you shall not be held responsible for the correctness or validity of the documents representing shipment or shipments, nor for the description, quantities or quality of the merchandise declared therein.

AGREEMENT SIGNED BY IMPORTER — STERLING CREDITS

formal letter authorizing the exporter out in Calcutta to draw on London.

The form in which such credits are issued varies considerably, according to the relationship of the bank in New York which is issuing the credit to the bank in London on whom the credit is issued (on whom the drafts under the credit are going to be drawn). In some cases credits are issued on the New York banker's London branch. In

others, the New York bank has power to sign for, and legally bind, the bank in London on whom it issues its credits. All that, however, is a mere matter of detail. What counts is that when the importer here has gotten his bank to issue the credit he comes into possession of a document which he can send to the shipper in the East and which authorizes that shipper to draw on London for the invoice value of the goods he is shipping — furthermore, which cannot be cancelled as long as the shipper lives up to the terms of his contract.

From the shipper's standpoint such an arrangement is ideal, and to those buyers of his merchandise in foreign countries who are able to furnish him with such facilities he will naturally quote his best possible prices. What it means is that he gets paid for his merchandise as soon as he puts it on board ship. All he has to do is to go ahead and draw his draft on the bank in London which confirmed the credit to him, attach the bills of lading and other papers, take it around to his bank together with his authorization to draw (the bankers' credit), and get rupees for it at the current rate. For such drafts there is always a ready and close market.

But, it may be objected, is not this buying of the shellac by cable and then holding up its shipment from the East all the while that the bankers' credit is on its way out to Calcutta a slow and cumbersome way of doing the business? Answer to that is found in the fact that when there is any hurry about the merchandise coming forward, the bankers' credit can be cabled. The shipper out in Calcutta, in that case, will not, of course, have a formal signed authorization to draw, but if

he is a merchant in good standing, that will not stand in the way of his negotiating his drafts. The cabled confirmation from the London bank will almost invariably be regarded as sufficient warrant for the drawing of the drafts, by the local bank whom he is asking to take them off his hands.

The Sterling vs. the Dollar Credit. — Just here enters the question as to why London is chosen as the point on which the shipper draws his draft. It is plain enough, of course, that where a not particularly well-known American importing house is concerned, it would be out of the question to have the shipper draw in dollars direct on the American consignee. But why can't the consignee arrange to have the exporter draw, if not on him, *on his bank in New York*? If the importer can arrange it to have the shipper out in the East draw on his (the importer's) bank's London correspondent, why can't he arrange it to have the drafts drawn direct on New York? Why, in other words, drag London into the transaction at all?

The answer is that if the importer here is to buy goods abroad at the best possible price, he must furnish the seller with the best and quickest means of getting his money. And beyond argument or question, in most parts of the inhabited earth the draft drawn in sterling on London is superior to the draft drawn in dollars on New York. Superior, not in that it is one whit safer or more likely to be paid at maturity, but simply in that it can be turned into more rupees or taels, or yen, or whatever the local currency may be. Which is, of course, what the shipper cares most about.

The above is written with full realization of the progress in popular favor made by the dollar draft during the past few years. Because the dollar draft to-day, however, is known and recognized in places where it wasn't known and recognized a decade ago, is no reason to claim that it has in any way taken the place of the sterling draft on London. Here and there, for the time being, it is possible to point to places where the dollar draft is in just as great or even greater favor than the sterling draft, but that is the exception and not the rule.

The truth of the matter, and we in America may just as well recognize it, is that as long as foreign exchange and the financing of our overseas commerce is something that the great majority of our bankers know little or nothing about, it is out of the question that we should assume London's position in the financing of international trade. As long as "acceptance" facilities are extended by only a relatively few banks (and by them in a very cautious and constrained manner), it is impossible for a discount market on any really broad scale to be developed. And, as explained in Chapter III, the necessity of a broad discount at any given point is absolute if long drafts in any quantity are to be drawn on that point. There is no sense in sending out an authorization to some merchant in the Far East to draw long drafts unless he can immediately and at a close rate of exchange sell those long drafts for local currency. And that, in the case of long drafts drawn in dollars, he cannot do, — except at certain points where American banks have recently established branches and are making heroic

efforts to establish close foreign exchange relationships with the United States.

How the Shipper Uses the Credit. — We will assume, then, that in this particular transaction we have chosen as most illustrative of the business, the exporter of the shellac out in Calcutta has received his authorization to draw on London — either the actual letter of credit itself or the cabled confirmation that it has been issued and is on the way — and is thus in a position to go ahead with the shipment of the goods. The shellac having been placed on shipboard, the steamship company issues the bills of lading. (Possession of the bills of lading, it is to be noted, virtually constitutes possession of the merchandise.) These, together with the consular invoice, the shipper attaches to his own draft drawn in sterling on the bank in London designated by the credit, for the invoice value of the shellac. In addition there may be attached a certificate showing where and how insurance has been effected, and any other appertaining documents (often in a sealed envelope) which the shipper wants to get into the American importer's hands.

With this draft and the documents attached to it, and with his authorization to draw the draft, the Calcutta merchant sallies forth to see some of the banks and turn the pounds he has drawn into rupees at the best possible rate. That, as a rule, is anything but difficult, particularly where he can show a first-class bankers' credit which states on the face of it that drafts drawn thereunder will be duly honored on presentation. Nine times out of ten it will be but a very short time before he is back in his office with

£1800 #

No. 197625

Certificate of Insurance

EFFECTED BY

WILCOX, PECK & HUGHES

Galveston Texas, May 29, 1916

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

The American Surety Co

for account of

The Cotton Export Corporation

on

One hundred (100) BALES COTTON, valued at sum insured, per
A. B. C. Ry Little Rock & 3/5 Liberty at and from,

Galveston Texas to Liverpool Regland

It is hereby understood and agreed that in case of loss, such loss is payable to the
order of *The Assured* on surrender of this Certificate, which repre-
sents and takes the place of the Policy, and conveys all the rights of the Original Policy-
holder, (for the purpose of collecting any claims for loss or damage), as fully as if the
property were covered by a special policy of insurance to the holder hereof, and is free from
any liability for unpaid premiums.

Not valid unless countersigned by
Countersigned

The Cotton Export Corp

By Authority of the Above Named Insurance Company

WILCOX, PECK & HUGHES

Charles H. Hughes, President

MARKS AND NUMBERS

A. C. Z

J. B. 1/100.

CLAUSES

"This certificate is subject to the full terms of the policy in respect of being warranted free of capture, seizure and detention, and the consequences thereof, or of any attempt thereof, and also from all consequences of riots, civil commotions, insurrections, hostilities or warlike operations, whether before or after Declaration of War."

"With the exception of risks in the United Kingdom, no risk is covered hereunder on shore in any European country which is at war at time of shipment."

ON COTTON—To pay particular average on each ten bales as if separately insured, if amounting to three per cent, unless otherwise agreed, and on shipments to Europe to pay sea damage pickings claims without reference to series or amount. General Average and Salvage Charges payable according to Foreign Statement or per York/Antwerp Rules, if in accordance with the contract of affreightment.

Also to cover the risk of country damage on shipments insured hereunder to Europe, Japan, China, India or Manila, subject to settlement at destination, in accordance with customs and usage of the port of destination, unless otherwise specified in certificate, but no claim for loss of or damage to cotton picked or reconditioned in the United States nor for any cost or expense in respect of such picked or reconditioning shall be recoverable hereunder. Country damage is not covered on coast and freight shipments and land calls, and on shipments to ports in the United States or Canada or Mexico.

LINKERS. Subject to 1% particular average on each bale, but free from claims for country damage. Cotton pickings or grabbings free of particular average unless the vessel be stranded, sunk, burned or in collision.

In the event of loss or damage to the cotton insured hereunder, immediate notice to be given to the company or its agent, naming the risk of craft, to, to and from the vessel, each craft or lighter being deemed a separate insurance. Held covered by each of drawings or change of voyage, or transfer to other machinery at a premium to be arranged, provided notice be given on receipt of advice.

This Certificate is issued subject to the terms and conditions of the policy, except so far as hereby otherwise provided. NOTICE—To claim with the European Law of Great Britain, in order to claim a claim under this Certificate, it must be stamped within Ten Days after its receipt in the United Kingdom.

INSURANCE CERTIFICATE

the proceeds of the transaction safely banked and ready for the next transaction.

At this point — assuming, of course, that the shipper has drawn his drafts in conformity with the terms of the credit so that the bank in London can have no legal excuse for refusing to accept them — the shipper drops out of the transaction. He has shipped his goods, drawn his drafts, and got his money. The rate of exchange at which the four months' sight sterling drafts were turned into rupees was, of course, lower than if the drafts had been drawn at shorter than four months' sight, but that was something that he had a chance to allow for when he quoted the price at which he was willing to sell the shellac. The American importer wanted the shipment financed by means of four months' drafts and, as was right and proper, the India merchant made him pay for it.

Nothing much need be said as to the willingness of the Calcutta banker to take off the shellac shipper's hands the sterling draft drawn on London. To do that very thing, to buy and remit such drafts for credit of his London account so as to be able at any time to draw and sell his own drafts in sterling, that is the banker's business. But note that it is only because he knows there *will* be a demand for his own drafts from parties who have payments to make in London, that he is willing to buy the shellac shipper's draft. If, instead of on London, the shellac draft had been drawn on some other place, the chances are that the Calcutta banker would have politely declined to buy it, remarking, perhaps, that while there could be no question as to its goodness, for him to establish a balance at a point on which he could

not profitably sell his own bills would hardly be good business.

The London Acceptance. — To get back to the transaction itself, the shellac, we will say, is now on a tramp steamer ploughing its way toward New York. The draft drawn against it, on a fast mail steamer bound for London, will, of course, reach its destination long before the shellac reaches its. Very likely, while the Southern Cross still beams down on the tramp steamer carrying the merchandise, the draft will have been received by the Calcutta banker's London correspondent, sent around to the bank on which it was drawn and accepted by them, they of course retaining the bills of lading and other documents. After that, in all probability, the accepted draft was discounted, and the proceeds placed to the credit of the Calcutta bank's account.

Here again it is worth while to digress for a moment to note the source from which the Calcutta merchant really received payment for his shellac. And again, as in the case of all these long bills we have been talking about, we find that the money comes from the discount market in London. The actual rupees received by the shellac shipper, it is true, come from the bank in Calcutta, but the only reason the bank in Calcutta is willing to give up those rupees is because it knows that it can at once get their equivalent in pounds sterling from the discount market in London. What really happens, then, is that the shellac shipper gets his money out of the London discount market, the Calcutta banker being actually nothing more than an intermediary who makes the money transaction possible. In the last analysis,

as the financial writers love to say, the discount market in London gives the Calcutta shellac shipper his money at once, being content to await reimbursement from New York four months further along.

The Documents to New York. — To return to our muttons, the London bank, having written its acceptance across the face of the draft and, in consideration of its having done so, having been allowed to detach and retain the bills of lading and other documents, sends these papers by the first possible mail to the bank in New York which originally issued the credit. Along with these documents there goes a notice that the pertaining draft for so-and-so-many pounds sterling has been presented and accepted, the exact due date being so-and-so. If the bank in London is doing an active business in credits with its correspondent in New York, the chances are that the notification above referred to will take the form of a schedule on which there will be listed a large number of drafts accepted under various credits issued. In the case of each draft there is specified the number of the credit under which it was drawn, the exact due date, the nature and quantity of the merchandise against which the draft was made, and any other relevant details.

A week or so later the bank in New York receives the documents with the accompanying schedule of due dates. Immediately the client for whose account the credit was issued is notified. Our correspondent in London, the advice in effect states, has accepted a draft for so-and-so-many pounds drawn by your friends out in Calcutta. The due date on the draft (four months and three days from the time it was presented in London for acceptance)

is such-and-such a date. Ten days before that date we (the bank in New York) look to you to furnish us with a banker's sterling sight draft on London for the amount of the acceptance, plus the commission agreed upon between us.

Ten days before that due date, and that due date *four months away* — there is the heart and soul of the whole transaction. No obligation on the part of the importer, in other words, to pay for the merchandise until four months after it comes into the country. Plain enough now why the importer wanted the exporter to draw at four months' sight. The longer the exporter's drafts on London, naturally, the longer the time in which the importer has to pay for the goods.

The Credit Element. — But at this point, of course, the *credit* part of the transaction begins to make itself felt. Up to now the banker in London who did the accepting and the banker in New York who has guaranteed his accepting friends abroad that he will see that "cover" is provided, have both been protected by the fact that through possession of the bills of lading the merchandise itself has been virtually in their possession. Now, the steamer carrying the shellac having arrived, the importer comes around to the bank and asks for the documents so that he can make entry and get the goods. The banker, in other words, is being asked to give up the only security he has. If he does, the acceptance in London (which must be met by the New York banker if the New York importer fails to meet it) will assume the nature of an unsecured loan to the importer.

What the banker does about giving up possession of the merchandise to the importer depends entirely on what the banker considers the importer's standing and credit to entitle him to. To one client he will turn over the documents (the merchandise itself) against a mere "trust receipt." Of another client he will demand the signing of a form of receipt which binds him more closely in the use he can make of the merchandise, and, possibly, will demand something in the way of tangible collateral as well. Again, where he wants to take very little chance at all, the banker may have entry of the goods made himself, put them in warehouse, and only parcel them out to the importer on warehouse delivery orders, as they are actually sold.

Trust Receipts. — Where the standing of the importer warrants it, as stated above, the banker will deliver him the documents upon his signing a "trust receipt." Of this celebrated, and more or less useful, kind of document, the form varies greatly but the purport is always the same. The importer acknowledges having received, say, a hundred boxes of shellac from the First National Bank and agrees to hold said goods in trust for them, and as their property, with liberty to sell the same for their account and in case of such sale to hand the proceeds over to them. There then follows, as a rule, a sort of a waiver of rights in which the importer states that the First National may at any time cancel the trust and take possession of the goods or of the proceeds of such of the same as may have been sold, wherever the said goods or proceeds may then be found. Furthermore, that in the event of any failure, suspension or assignment for the

TRUST RECEIPT.

Received from THE GUARANTY TRUST CO. OF NEW YORK the following goods and merchandise, their property, specified in the Bill of Lading per S.S.

Dated marked and numbered as follows:

and, in consideration thereof, $\left\{ \frac{I}{we} \right\}$ HEREBY AGREE TO HOLD SAID GOODS IN TRUST for them, and as their property, with liberty to sell the same for their account, and further agree, in case of sale to hand the proceeds to them to apply against the acceptances of THE GUARANTY TRUST CO. OF NEW YORK on $\left\{ \frac{my}{our} \right\}$ account, under the terms of the Letter of Credit No. issued for $\left\{ \frac{my}{our} \right\}$ account and for the payment of any other indebtedness of $\left\{ \frac{mine}{ours} \right\}$ to THE GUARANTY TRUST CO. OF NEW YORK.

THE GUARANTY TRUST CO. OF NEW YORK may at any time cancel this trust and take possession of said goods, or of the proceeds of such of the same as may then have been sold, wherever the said goods or proceeds may then be found and in the event of any suspension, or failure, or assignment for the benefit of creditors, on $\left\{ \frac{my}{our} \right\}$ part, or of the non-fulfillment of any obligation, or of the non-payment at maturity of any acceptance made by $\left\{ \frac{me}{us} \right\}$ under said credit, or under any other credit issued by THE GUARANTY TRUST CO. OF NEW YORK on $\left\{ \frac{my}{our} \right\}$ account or of any indebtedness on $\left\{ \frac{my}{our} \right\}$ part to them, all obligations, acceptances, indebtedness and liabilities whatsoever shall thereupon (with or without notice) mature and become due and payable. The said goods while in $\left\{ \frac{my}{our} \right\}$ hands shall be fully insured against loss by fire.

Dated, New York City 191

(Signed)

£ Stg.

TRUST RECEIPT — REGULAR

benefit of creditors all obligations whether due at the time or not shall at once mature and become payable.

A large volume could be written on the subject of trust receipts and the litigation which has grown out of the attempt to enforce them, but the whole sum and substance of it all would be that the trust receipt is just about as good as the party who signs it and no more. Bankers who hand over the documents on trust receipt (and an immense volume of business is annually so handled) do it almost entirely on the standing and credit of the party receiving the goods and hardly at all on the idea of being able to earmark and recover the merchandise or its proceeds in the event of failure. Nor has the rating of the importer as much to do with the banker's being willing to let him have the documents against trust receipt as might perhaps be imagined. Many a firm of known large resources have trouble getting the banks to let them have the bills of lading against a straight trust receipt; whereas, many a firm whose resources are admittedly nowhere near as large have no trouble whatsoever. The importer's business and particularly the way he runs his business and the way the banker knows he runs his business — that is what counts. What it comes down to is very much the same as though the importer were going to the bank and asking for a loan. Just about the same things are taken into consideration.

Special Arrangements. — Where the banker is not willing to let the importer have the documents on trust receipt the matter may be adjusted in any one of several ways. All of them, however, whatever their variations,

are based: (1) on the putting up of collateral, such as stocks and bonds, by the importer, (2) on the banker's

BAILEE RECEIPT.

Received from the Guaranty Trust Company of New York,
solely for the purpose of selling same for account of said Company:

marked and numbered _____
and _____ hereby undertake to sell the property, herein specified, for
account of the said Company, and collect the proceeds of the sale or sales thereof,
and deliver the same immediately on receipt thereof to the said Company, to be
applied to the credit of. _____
hereby acknowledging _____ to be Bailee of the said property for the said
Company, and _____ do hereby assign and transfer to the said Company
the accounts of the purchaser or purchasers of said property to the extent of the
purchase price thereof, of which fact notice shall be given at the time of delivery of
the said property by _____ to such purchaser or purchasers and all invoices therefor
shall have imprinted, written or stamped thereon by _____ the following:

"Transferred and payable to GUARANTY TRUST COMPANY OF NEW
YORK, 140 Broadway, New York."

If the said property is not sold and the proceeds so deposited within ten days
from this date, _____ undertake to return all documents at once on demand, or to
pay the value of the goods, at the Company's option.

The said goods while in $\left\{ \begin{smallmatrix} \text{my} \\ \text{our} \end{smallmatrix} \right\}$ hands shall be fully insured against loss by fire.

The terms of this receipt and agreement shall continue and apply to the mer-
chandise above referred to whether or not control of the same, or any part thereof,
be at any time restored to the Guaranty Trust Company of New York, and
subsequently delivered to us.

Dated at New York, _____ 191

4 pp

BAILEE RECEIPT—FORM OF TRUST RECEIPT USED WHERE ACCOUNTS
ARE ASSIGNED

retaining control of the merchandise while it is in process
of being sold.

The way in which the latter is accomplished is by having the banker (usually through his own custom house broker) import the goods so that they can be placed in warehouse in the banker's name. A couple of weeks go by, and some varnish factory, we will say, buys from the shellac importer fifty of the hundred boxes brought in. The importer, very probably, takes the invoice around to the bank, showing that the sale has actually been made and at what price, and asks the banker to give him a delivery order on the warehouse so that he can get the shellac and send it to the factory. The invoice, not improbably, will direct that payment be made not to the importer, but to the banker direct. Really what the importer is doing in such a case is to assign over to the banker an "open account," *with* notification to the buyer that the account has been thus assigned.

Under such circumstances, it is plain, the banker is taking mighty little risk when he hands over a delivery order for the merchandise. The shellac, it is true, passes out of the banker's possession. But it doesn't go into the possession of the party that owes the money for which it is the collateral — except, possibly, while it is being taken out of the warehouse and shipped to the buyer. If the collateral has passed out of the banker's hands, it has gone somewhere where it will turn into money. Moreover, the banker holds the open account, legally assigned, which means that the money will come to him direct when the account is paid.

The above is one way in which, when the banker who has issued a credit doesn't want to turn over the docu-

TRUST RECEIPT.

(DOCUMENTS FOR WAREHOUSING.)

Received from THE GUARANTY TRUST CO. OF NEW YORK Bill of Lading per _____
 dated _____ for the following goods and merchandise,
 their property, marked and numbered as follows:

Imported under the terms of Letter of Credit No. _____, issued by them for $\left\{ \begin{smallmatrix} \text{my} \\ \text{our} \end{smallmatrix} \right\}$ account,
 the said Bill of Lading to be used by $\left\{ \begin{smallmatrix} \text{me} \\ \text{us} \end{smallmatrix} \right\}$ for the sole purpose of entering the above de-
 scribed property at the United States Custom House at the Port of _____, and of
 storing the same in the name, and as the property, of the said THE GUARANTY TRUST CO. OF NEW
 YORK, and subject only to their order, $\left\{ \begin{smallmatrix} \text{I} \\ \text{we} \end{smallmatrix} \right\}$ hereby agreeing to so store the said property and to
 hand the storage receipt for the same to the said THE GUARANTY TRUST CO. OF NEW YORK,
 when obtained.

$\left\{ \begin{smallmatrix} \text{I} \\ \text{We} \end{smallmatrix} \right\}$ ALSO AGREE to fully insure said property against fire, the loss, if any, payable to said
 THE GUARANTY TRUST CO. OF NEW YORK, and to hand to them the policies of insurance thereon.

Dated _____ 19

(Signed) _____

£ _____

TRUST RECEIPT — GOODS TO BE STORED

TRUST RECEIPT.

(FOR DELIVERY TO PURCHASER.)

Received from THE GUARANTY TRUST CO. OF NEW YORK the following goods and merchandise, their property, specified in the Bill of Lading per....., dated marked and numbered as follows:

In trust to deliver the same to who have purchased the same for payable in and to obtain from the purchaser the proceeds of the sale of the same.

In consideration of the delivery of said goods to { $\frac{me}{us}$ } in trust as above, { $\frac{I}{we}$ } agree to deliver them immediately to the said purchasers, and to collect the proceeds of sale, and immediately deliver such proceeds to THE GUARANTY TRUST CO. OF NEW YORK in whatever form collected, to be applied by them against the acceptances of THE GUARANTY TRUST CO. OF NEW YORK on { $\frac{my}{our}$ } account, under the terms of Letter of Credit No. issued for { $\frac{my}{our}$ } account, and to the payment of any other indebtedness of { $\frac{mine}{ours}$ } to THE GUARANTY TRUST CO. OF NEW YORK. It is understood, however, that if such proceeds be in notes or bills receivable, they shall not be so applied until paid, but with liberty meanwhile to THE GUARANTY TRUST CO. OF NEW YORK to sell or discount, and so apply net proceeds.

THE GUARANTY TRUST CO. OF NEW YORK may at any time cancel this trust, and they may take possession of said goods until the same have been delivered to said purchasers and the proceeds of sale received from them, and thereafter of such proceeds, wherever the said goods and proceeds may then be found, and in the event of any suspension or failure or assignment for the benefit of creditors on { $\frac{my}{our}$ } part or of the non-fulfillment of any obligation or of the non-payment at maturity of any acceptance made by { $\frac{me}{us}$ } under said credit, or any other credit issued by THE GUARANTY TRUST CO. OF NEW YORK on { $\frac{my}{our}$ } account, or of any indebtedness on { $\frac{my}{our}$ } part to them, all obligations, acceptances, indebtedness, and liabilities whatsoever shall thereupon (with or without notice) mature and become due and payable.

Dated 191

ments against a straight trust receipt, the actual sale and delivery of the goods can be accomplished. There are, of course, all sorts of other ways in which this can be done, but always it comes back to the question of the extent to which the banker feels his client is entitled to credit. If the banker knows that before the goods ever were imported they were sold or practically sold, he is apt to be much more lenient and liberal than if he has reason to believe that the goods are being imported merely to be carried in stock. In the first case speedy liquidation of the debt is a practical certainty, whereas, in the second case, if the importer has not judged his market right, it may be a long time before the goods can actually be disposed of and turned into money. No suggestion is intended to be made here that the importation, under bankers' credits, of goods, not already sold is not entirely legitimate. But that the banker is going to be much easier with the client whose goods *are* sold in advance than with the client for whose goods a market must be found, ought to be plain enough. Nobody likes to see his money "turn" as much as does a banker.

Prepayments. — Continuing in our efforts to hew to the line and follow the particular and typical transaction with which we started off, let us assume that the shellac importer got his documents on trust receipt and two months later had sold and received payment for fifty of the hundred cases. This money being actually in his hands he is, of course, bound to turn it over to the banker; to make a "prepayment," as it were, on the acceptance which must eventually be met. (As a matter of actual practice it is astonishing how many

importers will cheerfully sign a trust receipt which states that as soon as the goods are sold they will hand over the proceeds to the banker, and then will hand over nothing until ten days before the acceptance is due in London.)

Assuming that the parties of whom we are speaking are not of that kind and that, having received the money from the sale of the goods, they are going to live up to their agreement to turn it over to the banker, the question comes up as to the form in which it is to be turned over. The obligation, it must be remembered, is a pounds sterling one and not due for another couple of months. So, if the importer turns over to the New York banker the dollars he has received, the banker, before he sends the money abroad, will convert the dollars into sterling at a rate fixed by himself. That, of course, is all right for the banker, but not necessarily for the importer, who, after he has done it that way a few times, is apt to do the converting into sterling himself and send in, not dollars, but sight sterling. In either case, naturally, the importer, who is paying his obligation away ahead of time, gets a rebate of interest for the unexpired period. The rate, as a general thing, is fixed at one per cent less than the Bank of England's discount rate.

Very often, where the prepayment is being made as long a time as sixty days ahead of the due date of the acceptance, the importer, after careful figuring, will turn into the banker *neither* dollars nor sight sterling, but instead a sterling draft drawn say at sixty days' sight. The maturity of such a draft coinciding with the

maturity of the acceptance, the importer will, of course, receive no rebate of interest, but that will be made up in the lower rate of exchange at which he can buy the sixty days' sight draft as against what he would have had to pay for a draft at sight. That, as a matter of fact, is what it comes down to — a lower rate of exchange if the prepayment is made on one basis, as against a rebate of interest if it is made on another basis. Which way will be chosen — if the importer knows this part of his business (which he mighty seldom does) — is simply a matter of cold figuring. How can the remittance be made at the expenditure of the least dollars and cents? That is the whole question.

Several prepayments have been made, we will say, but a small proportion of the shellac still remains unsold when the date mentioned in the banker's original advice as to when the payment would have to be made on this side rolls around. The fact that the goods have been sold or have not been sold makes no difference; payment in full has got to be made. So, from the banker to the importer there comes, a day or two ahead of time, a statement showing the original amount of the acceptance (with the commission now added to it), the aggregate of the prepayments and the balance still due, in sterling. This the importer pays at once either in the form of a sterling sight draft which he goes out and buys, or in dollars at a rate of exchange fixed by the banker.

Immediately upon receiving this money, the banker here sends it over to his correspondent in London. And so, when a day or two after its arrival, the original acceptance comes due and is presented for payment, the London

bank has the funds on hand to pay it with. That closes the transaction. The party in the discount market in London who bought the Calcutta merchant's draft after it had been accepted has got back his money; the bank in London that accepted the draft has paid it; the New York importer has paid for his goods and owes his bank nothing. The goods have been bought and paid for. The circle is complete.

Cost of Bankers' Credits. — Now, of course, the question arises at once: What does the New York importer have to pay for all this service? Without putting up a dollar he not only had a valuable shipment of merchandise brought into the country from halfway across the earth, but he had four months in which to pay for it. Is not the providing of such facilities an expensive piece of business?

Strange as it may seem, the cost of this sort of financing, far from being high, is extremely moderate, even when the full rate of commission is charged. By the full rate is meant the traditional one-quarter of one per cent for each thirty days that the drafts run — that is to say, one-half per cent commission where drafts under the credit are drawn at sixty days' sight, three-quarters per cent commission where the drafts are at ninety days' sight, one per cent for four months', etc. And seldom, indeed, are these full rates charged. Almost invariably, where the business runs to any size at all, they are radically revised downward.

Do you mean to say, then, the importer unfamiliar with the business almost always asks, that I can import £1000 worth of merchandise under one of these credits

and have four months in which to pay for it, at a charge to me of only £10? No, that is hardly the case. £10, even assuming you are charged the full rate, measures the total *visible* charge. You are, however, paying an *invisible* charge, added by the seller to the cost of the goods because you arranged to have him draw *four months'* sight drafts on London, which he had to dispose of at a considerably lower rate of exchange than if he had been able to draw at sight. Added to the cost of the goods, in other words, was the difference between the four months' sight rate on London and the sight rate on London for the whole amount of sterling involved.

Even at that, the importer finds that he comes out of the transaction at wonderfully low cost, especially when he considers the facilities which have been extended to him. The commission on this side, we will say, was 1 % (less, if prepayments were made), which in a four months' transaction is at the rate of only 3 % a year. Added to the cost of the goods in the East there was the difference between the four months' exchange rate and the sight rate, 2 % at most, or at the rate of 6 % a year. A charge of 3 % flat (1 % commission plus 2 % in the exchange rate) for having a shipment of goods brought ten thousand miles, delivered at your door and you given four months to pay for them — surely that cannot be called other than extremely moderate. A great place is the London discount market to get money from when it can be arranged !

The Banker's Profit. — So far as the banker's profit is concerned, that consists merely of the commission charged, plus the little something he is generally able

to get by charging a full rate of exchange on the settlements. Unless, indeed, the amounts involved run into big figures, the banker's profits on this sort of business run surprisingly small. But then, it must be remembered, neither the banker here nor the banker abroad puts up any actual money. The banker here gets behind his client, of course, guaranteeing that the London acceptance will be taken care of, and the London banker does put his name on the drafts when he accepts them, but that is lending credit and not money. And surprising indeed is the small money consideration for which the foreign exchange banker will let the mercantile house make use of its credit, always providing, naturally, that the merchant's standing warrants the extension of such facilities.

That, of course, is the secret of the whole thing — the relationship between the banker and his client. If the banker doesn't like the way the merchant runs his business, the merchant, regardless of his net worth, will find the credit facilities described above closed to him. If, on the other hand, the banker's knowledge of the merchant's affairs leads him to believe that the business, however small, is being safely and conservatively conducted, there is almost no limit to the extent to which these credit facilities can be had. Many a small concern, starting out with small capital but running the business in the way the banker likes to see it run, has been built up to great strength during the course of a very few years through enjoyment of the facilities offered by bankers' credits.

CHAPTER XIV

(Continued)

IMPORT AND EXPORT CREDITS. — SPECIAL FORMS

BECAUSE the bankers' credits described in the preceding chapters are based on the importation of merchandise into the United States, the mistake must not be made of thinking that such credits are issued only for that purpose. When, indeed, the aforementioned transaction was chosen for description, it was chosen just because it did typify to so great an extent the whole business of issuing bankers' credits. In the case we took, an American importer went to his bank and had a credit opened for the importation of shellac from India. Just about the same procedure would have been gone through by a spinner in England desiring to import cotton from the United States or by a merchant in Russia desiring to import piece goods from the south of France. The English cotton spinner, for example, would have gone to his bank and asked them to issue a credit authorizing John Jones in Memphis, Tennessee, to draw sterling drafts on London, just as the shellac shipper in Calcutta was authorized to draw on London. The drafts drawn in Memphis would have found ready negotiation for the very self-same reason as the drafts drawn in Calcutta — because the shipper palpably had a

right to draw and because the purchasing bank knew it could readily discount the drafts after acceptance and get its money back. When the documents for the cotton reached the bank in London which issued the credit, exactly the same questions as to the basis on which the cotton importer was to be allowed to have the goods would have come up as came up in the case of the merchant importing shellac into New York. The two transactions, in short, run along side by side in all their essentials. Whether the goods are shellac or cotton and whether they are passing from Calcutta to New York or from Memphis to Liverpool, the principle holds good that the party who buys the goods goes to his bank and fixes up the means of the seller's getting paid.

Where Banking Facilities Are Lacking. — The above constitute the vast majority of the total of bankers' credits issued, but there is another form of bankers' credits which require consideration. Take, for instance, the case of a shipment of merchandise from New York to some place in South America or Oceania where there is no bank to which the importer can go and fix up a credit in favor of the American shipper. That means just one thing — that the *exporter*, if the business is to be done, must arrange the credit himself.

Why, it may be asked, is it necessary in such a case for a bankers' credit to be issued at all? Why doesn't the exporter just draw a draft on the party abroad to whom he has sold the goods and then sell the draft in the foreign exchange market?

A natural enough query, but evidently not propounded by any one who has ever tried it. A draft

drawn against a shipment of copper to England — yes, that can be sold, even without any banker's authorization to draw. But a draft drawn against a shipment of alarm clocks to Apia or a shipment of safety razors to Rangoon — try and sell such a draft sometime and see what you can get for it. Very glad, indeed, to take it "for collection," the bank says, proceeds to be credited to your account when received by us, but cash for the draft — hardly.

Seller Secures His Own Authorization. — So, in a case like that, the exporter is likely to go to his bank and ask that an export credit be issued him — that he be authorized, in other words, to draw some kind of a draft that he *can* turn into dollars and cents without waiting two or three months until it can be collected and the proceeds returned. But why, it may be asked, why should the exporter be authorized to draw on anybody? Why doesn't the bank just advance him the money and be done with it? Simply because of the ancient and honorable reason that where a bank can make money by lending its credit instead of its money, it will always do so. And here is an ideal case where that can be done. Instead of an actual cashier's check being handed over to the shipper he can be given a letter of credit authorizing him to draw drafts, say at ninety days' sight, either in dollars on the American bank itself or in pounds on the American bank's London correspondent. Having that authorization, the shipper can draw and get his money, without the bank's having to do anything more than accept a time draft in dollars or have its London correspondent accept a time draft in sterling.

Until up to within a few years ago, such credits almost invariably authorized the drawing of *sterling drafts on London*. With the increase in the "acceptance" powers of American banks, however, it has come about that such credits are now to a large extent issued in such a way as to allow the exporter to draw on New York in dollars. From the exporter's standpoint, the dollar credit is, of course, preferable. To the question as to why, then, these credits aren't *always* issued in dollars, the answer is that from the banker's standpoint the sterling credit possesses certain advantages. At a small additional cost — which anyway he can pass along to the exporter — the American banker can earn his commission without even accepting a draft, let alone putting up any actual money. Again, the shipment may very possibly be going to a place from which the remittance can be much more advantageously made to London than to New York. Fast as we have come along in recent years, there are still places all over the earth where the pound sterling is known and the dollar isn't and from which money can be sent to New York only by way of London.

The Banker's Protection. — The terms of the credit, of course, stipulate that the banker who issues it is to receive the bills of lading representing the shipment, together with the draft (if one has been made) on the buyer. These documents are the banker's protection. As long as he — or his banking correspondent out at the place where the merchandise was sold — keeps possession of the documents, this protection remains. And very careful indeed will be the correspondent bank about

letting the documents get out of his possession. If he lets the buyer have them, it is certain to be only on such terms as will keep his correspondent in New York fully protected.

The goods having arrived, and payment for them having been made, wholly or in part, the next step is the remittance of the proceeds, either to New York or London according as the time drafts drawn under the credit by the American exporter were drawn in dollars on the New York bank or in pounds sterling on its London correspondent. We will say for purpose of illustration, that in this particular case they were drawn in pounds, payable ninety days after sight. Thirty days after the credit is availed of and the drafts drawn, perhaps, the merchandise reaches its South American destination and a few days later the importer begins making payments on it. These payments the South American bank converts into pounds and sends along to the bank in London on which the credit was issued and which accepted the American exporter's ninety days' sight draft. Before that draft comes due and has to be paid, the presumption is, the London bank will have received remittances aggregating the whole amount of the draft or more, so that it will not have to put up any of its own money. The surplus above the amount of the sterling draft which must be met the London bank sends back to its New York correspondent which, in turn, hands it over, less commission, to the exporter. If, as is usual in the case of such credits, the importer originally drew for 90% of the value of the shipment, the money that comes back to him via London and his own

bank represents the other 10% plus his profit on the shipment.

In cases where the credit was issued in dollars instead of pounds sterling the remittances, instead of going to London, would come to New York and be held by the bank against its outstanding acceptance. From every standpoint that — *where it can be arranged* — is preferable, in that it does away with the conversions into a third currency (sterling) and saves for the exporter the commission which would otherwise have to be paid to the bank in London for accepting the drafts drawn under the credit and for handling the remittances from South America.

Usance of Drafts. — Now, to look a little into the why and wherefore of the above, it is to be noted that the credit stipulated the drawing of drafts thereunder having a long enough time to run so that the merchandise will have a chance to get to its destination and payment therefor to be remitted back to New York or London before the drafts drawn under the credit come due and have to be met. The bank issuing the credit, in other words, while perfectly willing to “accept” the exporter’s draft or have its London correspondent accept it, insists that it be drawn at long enough sight so that there will be no danger of the remittance not getting back before the draft comes due. The “usance” of the drafts to be drawn under one of these export credits, then, depends upon the remoteness of the point to which the shipment is being made and on the amount of time after arrival of the goods allowed the buyer in which to pay for them. If the shipment is made to some near-by point and the terms of the sale call for

payment upon arrival of the goods, the drafts drawn under the credit can be made relatively short. If, on the other hand, the shipment is made to some far distant point, say in Polynesia, and the terms of the sale allow the buyer considerable time in which to make payment for the goods, the usance of drafts drawn under the credit will be made as long as possible — ninety days' sight, perhaps, with the privilege of one renewal.

So far as the banker is concerned, it makes no difference to him at what usance the drafts under the credit are drawn, except that he wants to be reasonably sure that their maturity will not antedate the receipt of the remittances. To the exporter, however, the usance of the drafts does make a very great difference. The longer they run the lower will be the rate of exchange at which they can be converted into dollars, or, if the credit is a dollar one, the greater will be the amount of discount which will have to be taken off the face of the drafts. These charges, whatever they amount to, have to be added to the price at which the goods are sold — which doesn't help in the competition with the other markets for the business.

Credits Calling for Cash Payments. — From the fact that the various credits referred to above are all on the basis of the seller of the goods drawing a time draft on somebody, it must not be inferred that cash credits are never issued. Under certain conditions and in some kinds of business, in fact, the kind of credit where the buyer, through his own bank, arranges to have the seller paid in cash as soon as the goods are shipped, is the rule and not the exception. A retailing concern in Man-

chester, for example, sees the advertisement of a novelty manufacturing company in St. Louis. The English firm is interested, but after correspondence it develops that the factory in St. Louis has all the market it needs for its product right here in the United States and that the sales-manager doesn't know anything about foreign exchange and doesn't care anything about export business anyway. The English firm is informed, therefore, that, if they want the goods, it will be necessary for them to fix it so that the factory can get its money (dollars and cents, of course) as soon as the goods are shipped. Of drawing drafts in pounds or of drawing time drafts in dollars and then getting them discounted, the manufacturing concern's treasurer says he knows nothing. We'll sell you the goods at such and such a price, he very probably writes; arrange it so that some bank here will pay us cash for the bills of lading and we'll let the shipment go forward.

Such a method of doing business, as might be expected, often enough results in the transaction being called off right then and there, but in a good many cases the foreign buyer wants the goods badly enough to acquiesce. He goes to his bank in Manchester, therefore, and asks that the Manchester bank's St. Louis correspondent be instructed to pay out so-and-so-many dollars against presentation of the bills of lading showing that the shipment has been started for Manchester. In that way the American factory will get what it is demanding, immediate cash payment.

The Manchester bank, acting at the request of its client, instructs the bank in St. Louis to inform the

factory that the credit has been opened, and upon presentation of the bills of lading, to pay out the specified amount of dollars. Reimbursement of the St. Louis bank will then be effected by having that bank draw a draft on Manchester for enough pounds sterling so that that draft, when sold at the current rate for sterling, will produce the amount of dollars and cents paid out, plus a commission. The bills of lading will at once be forwarded to the bank in Manchester which opened the credit.

The sterling draft on the Manchester bank having been presented and paid and the American bills of lading having been received by the bank (sometimes they are attached to the draft, sometimes not), the bank advises its client to come around and take up the documents. This the client does by paying to the bank the amount of the draft just paid by the bank, plus the bank's commission. If the client acts promptly in taking up his documents, there is no interest to be paid. The interest, of course, is taken care of in the rate of exchange at which the St. Louis bank converted into pounds the dollars it paid out to the manufacturer.

Reimbursement of the St. Louis bank, in the above case, was by means of a sterling draft drawn on Manchester. That, while the customary, is by no means the invariable, practice. In many cases, instead of the American bank drawing in sterling, the Manchester bank would send over a dollar draft to its St. Louis correspondent. This draft would be for the invoice amount of the shipment, plus interest from the time the St. Louis bank paid out the money until its reimburse-

ment through receipt of the dollar draft, plus the St. Louis bank's commission. This amount converted into sterling at the current rate, plus the Manchester bank's commission, is what the Manchester importer would have to pay.

CHAPTER XV

DOLLAR CREDITS

BECAUSE in the typical transaction described in the previous chapter the bankers' credit was issued on London in sterling, it must not be thought that such credits are not issued on a large scale in other currencies, including dollars. As a matter of fact, while London's supremacy in the financing of international trade remains unshaken, the past few years have seen a tremendous increase in the financing of American overseas trade by means of dollar credits. And to whatever extent this may be due to the strain put upon the English money market from other directions, it is a practical certainty that a good proportion of the new-born dollar credit business is going to stick.

If, in the credit transaction we were talking about, we substitute New York for London, the dollar for the pound sterling, and some city say in South America for Calcutta, we will have before us a fairly typical dollar credit transaction. The underlying principles are exactly the same. Coffee, we will say, is being imported from Rio Janeiro, and just as in the other case, the problem is to provide the shipper with the best and most economical means of getting his money. The Calcutta shipper wanted to get the greatest possible number

of rupees for his shipment; the Brazilian shipper wants to get the greatest possible number of milreis. Neither

Credit No. 10001

\$10,000 U.S.C.

Guaranty Trust Company of New York

Foreign Department

New York, March 30, 1916,

Sino-Russian Export Corporation,

Shanghai.

Gentlemen:

We hereby authorize you to value on Guaranty Trust Company of New York, New York, for account of American Import Company, New York up to an aggregate amount of Ten thousand Dollars U. S. &. available by your drafts at Four (4) months sight against shipment of Raw Silk to New York insurance & War Risk effected in New York.

Bills of Lading for such shipments must be made out to the order of the Guaranty Trust Company of New York, unless otherwise specified in this credit.

CONSULAR INVOICE AND ONE BILL OF LADING MUST BE SENT BY THE BANK OR BANKER NEGOTIATING DRAFTS, DIRECT TO GUARANTY TRUST COMPANY OF NEW YORK, NEW YORK.

The remaining documents must accompany the drafts drawn on Guaranty Trust Company of New York, New York.

The amount of each draft negotiated together with date of negotiation, must be endorsed on back hereof.

We hereby agree with bona fide holders that all drafts drawn by virtue of this Credit, and in accordance with the above stipulated terms, shall meet with due honor upon presentation at the Office of Guaranty Trust Company of New York, New York, if drawn and negotiated prior to June 1, 1917

Guaranty Trust Company of New York,

Spencer

N. B. Drafts drawn under this Credit must state that they are "drawn under Letter of Credit No. 10001
Dated March 30, 1916 "

COMMERCIAL LETTER OF CREDIT — DOLLARS

cares in the slightest how he gets them — whether he is directed to draw on London in pounds or on New York in dollars or on Kamchatka in kopecks. All he wants

to be sure of it that the method provided for his getting paid insures his getting the greatest possible amount of his own local currency.

New York, _____ 19__

To THE

GUARANTY TRUST COMPANY OF NEW YORK

GENTLEMEN:

Having received from you the Letter of Credit on _____ account of which a true copy is on the other side, I, _____ hereby agree to its terms, and in consideration thereof I, _____ agree with you to provide in New York, one day previous to the Maturity of the Bills drawn in virtue thereof, sufficient funds in cash, to meet the payment of the same with _____ per cent. commission, and I, _____ undertake to insure at _____ expense, for your benefit, against risk of Fire or Sea, all property purchased or shipped pursuant to said Letter of Credit, in Companies satisfactory to you.

I, _____ agree that the title to all property which shall be purchased or shipped under the said credit, the bills of lading thereof, the policies of insurance thereon and the whole of the proceeds thereof, shall be and remain in your until the payment of the bills referred to and of all sums that may be due or that may become due on said bills or otherwise, and until the payment of any and all other indebtedness and liability now existing or now or hereafter created or incurred by _____ to you on any and all other transactions now or hereafter had with you, with authority to take possession of the same and to dispose thereof at your discretion for your reimbursement as aforesaid, at public or private sale, without demand or notice, and to charge all expenses, including commission for sale and guarantee.

Should the market value of said merchandise in New York, either before or after its arrival, fall so that the net proceeds thereof (all expenses, freight, duties, etc., being deducted) would be insufficient to cover your advances thereagainst with commission and interest, I, _____ further agree to give you on demand any further security you may require, and in default thereof you shall be entitled to sell said merchandise forthwith, or to sell "to arrive," irrespective of the maturity of the acceptances under this Credit, I, _____ being held responsible to you for any deficit, which I, _____ bind and obligate myself to pay you in cash on demand.

In case I, _____ should hereafter desire to have this credit confirmed, altered or extended by cable (which will be at _____ expense and risk), I, _____ hereby agree to hold you harmless and free from responsibility from errors in cabling, whether on the part of yourselves or your Agents, here or elsewhere, or on the part of the cable companies.

This obligation is to continue in force, and to be applicable to all transactions, notwithstanding any change in the composition of the firm or firms, parties to this contract or in the user of this credit, whether such change shall arise from the accession of one or more new partners, or from the death or accession of any partner or partners.

It is understood and agreed that if the documents representing the property for which the said Credit has been issued are surrendered under a trust receipt, collateral security satisfactory to the Trust Company, such as stocks, bonds, warehouse receipts or other security, shall be given to the Trust Company, to be held until the terms of the credit have been fully satisfied and subject in every respect to the conditions of this agreement.

It is further understood and agreed in the event of any suspension, or failure, or assignment for the benefit of creditors on _____ part, or of the nonpayment at maturity of any acceptance made by _____, or of the nonfulfillment of any obligation under said credit or under any other credit issued by The Guaranty Trust Company of New York on _____ account, or of any indebtedness or liability on _____ part to you, all obligations, acceptances, indebtedness and liabilities whatsoever shall thereupon, at your option then or thereafter exercised, without notice, mature and become due and payable.

It is understood and agreed that you shall not be held responsible for the correctness or validity of the documents representing shipment or shipments, nor for the description, quantities, quality or value of the merchandise declared therein.

AGREEMENT SIGNED BY IMPORTER — DOLLAR CREDIT

So that if at Rio Janeiro or Bahia or Santiago it happens that a time draft drawn in dollars on New York can be as advantageously disposed of as a time draft drawn in sterling on London, there is absolutely no reason why the bankers' credit should not be arranged that way. There are, as a matter of fact, important

advantages to be gained if it can be so arranged. By cutting London out of the transaction, in the first place, the conversions from one money to another (always relatively expensive to somebody) are reduced merely to the conversion of the draft drawn in dollars on New York into milreis or whatever the local currency may be. In the second place the New York bank is freer to go ahead and issue such credits as it sees fit without having to consider what its London correspondent will think, in addition to which the commission paid the London banker will be saved. Thirdly, by having the bills of lading come direct to New York instead of their having to go first to London, there is saved the delay and expense incident to the possible arrival in New York of the goods themselves ahead of the documents.

Eliminating Exchange Conversions. — Of these various considerations the one having to do with the rates of exchange is far and away the most important. One conversion of the draft drawn, into the local currency, must of course be made. But after that has been made, the foreign exchange element goes out of the transaction entirely and it becomes a matter of dollars pure and simple. The American merchant, as a matter of fact, has nothing to do with the foreign exchange end of it whatever. The drafts drawn by the shipper are in dollars and it is in dollars that the importer has to make his settlements. That, to the average American, whose knowledge of foreign exchange is, to put it mildly, limited, is a very great advantage indeed. However great the confidence he may have in his banker, he cannot get away from the feeling, when the settlements are made

in some mysterious currency like sterling or francs, that somebody is taking advantage of him. Dollars, on the other hands, are something he knows about and understands — naturally enough, considering that they are generally his life and soul.

Freer Issue and Saving of Commissions. — Secondly, it is a great thing to have London out of the transaction and the bank here free to grant credits “when as and if” it sees fit. Where the credits are issued on London, however close the relationship between the issuing bank here and the accepting bank abroad, the bank abroad is bound to exercise a certain amount of supervision over the business. The accepting bank is, of course, guaranteed by the American bank; but even so, where the business runs into big figures as it so often does, it is only natural that the bank abroad should want to know just what it is handling. Which, of course, acts as more or less of a restriction on the credits the American bank may want to grant.

Again, there is the matter of commissions. The London bank, as may be imagined, does not do the accepting of the drafts and the handling of the documents for nothing. The charge it makes it passes along to the bank in New York, which of course passes it along to its client, including it in the commission the client has to pay. When London is cut out of the transaction all that is saved, and the commission charged the importer can be made correspondingly lower. *Can* be; sometimes it is, and sometimes it isn't.

Operation of Credit Facilitated. — Then, in the third place, when London is left out of the transaction, the

handling of the bills of lading is made much cleaner and easier. Generally when a bank in London "accepts" under a bankers' credit, it demands that *all* the bills of lading shall accompany the draft, virtual possession of the merchandise being thus assured. All very well as long as the merchandise is on a slow steamer while the bills of lading are on a fast one and so pass through the bank in London and reach New York ahead of the goods. But how about it (as not infrequently happens) when the goods, coming direct, reach New York ahead



This acceptance is based upon
transaction involving the importation or
exportation of goods. COMPANY TRUST CO.
of N.Y.

First

Santos June 22, 1917.

Pay to the order of after sight of this First of Exchange
The Second being unpaid, pay to the order of
[Redacted]

Value received and charge the same to account of
To Guaranty Tru. & C. of New York
N.Y. 4000

APD [Redacted] *Santos Coffee Co.*
Signe Treasurer

DOLLAR DRAFT ON NEW YORK — DRAWN AGAINST MERCHANDISE
SHIPPED FROM SOUTH AMERICA TO THE UNITED STATES

of the papers, coming via London? That, for the importer, is an expensive piece of business and one which he wants to avoid if he possibly can. And, of course, where the papers come direct, it is avoided. Usually, as a matter of fact, the papers and drafts come on the same steamer as carries the goods.

The Future of the Dollar Credit. — With regard to the future of dollar credits and the substitution of New

York for London in the financing of international trade, the fact must not be lost sight of that much of the rapid progress made in the establishing of the dollar is directly attributable to the financial disturbance abroad. The whole thing, as we have seen, comes down to the question of a discount market, from which the shipper receives his payment at once, and which, in consideration of a certain rate of interest, agrees to wait two, three, four months for repayment. Now it is the merchant here who pays this interest and, naturally, he is interested in having it as low as possible. Other things being equal, it is purely a question of which market offers the lowest rate of interest which determines whether the merchant wants his credit issued on New York or on London. If the discount rate in New York is such that, by having the drafts drawn on New York, less need be added to the price of the goods by the shipper than if the drafts were drawn on London, the dollar credit will be the form used. If, on the other hand, the London discount market offers the greater facilities, the credit will be issued in sterling form. Our discount market as against somebody else's — that is the question in a nutshell.

The above refers, of course, to the general issuing of bankers' credits where it is a question of getting the business done cheapest. In numerous cases (as, for instance, that of the merchant who doesn't know anything about foreign exchange and doesn't want to bother with it) there may be considerations, other than cheapness, which will bring the business here even where it might more properly be done abroad. That, however,

is no very secure foundation on which to build a permanent position as the world's banker. Making water run uphill is an easy job compared to making a borrower choose the less favorable of two markets in which to get his money.

CHAPTER XVI

DOLLAR AND OTHER DRAFTS ON FOREIGN POINTS

WHERE no bankers' credit is provided by the purchaser and there is any question as to the negotiability of a draft drawn without such authorization, the seller of the goods, we have seen, is likely to get his own bank to give him an authorization to draw so that he can be sure of getting his money at once. There are, however, cases where no such authorization is wanted or needed for the simple reason that the drawer does not intend to sell his draft to anybody ("discount" it) but prefers to put it through his own bank *for collection*, the proceeds to be credited to his account only when the draft has actually been collected. As compared with the drafts on foreign countries sold outright to bankers as soon as they are drawn, the drafts thus put through for collection are greatly in the minority. They constitute, nevertheless, a class of foreign exchange business the importance of which must not be overlooked.

The idea of a large firm, whose name alone would sell any drafts it had to offer, putting through its drafts "for collection" is, of course, to save the discounting charges. To a small concern, with limited capital, these costs are a secondary consideration, a charge which has simply got to be paid. The big firm, with

more capital than its business at the moment requires is, however, likely to figure that it might just as well use some of this capital collecting its own drafts and thus save the charges.

In the case of drafts drawn on Europe, where the drawee would never in the world allow interest while the draft is in transit to be added to its face, the putting of drafts through the bank "for collection" is all but unknown. In the case of drafts drawn on South America or Australia or the Orient, however, the case is different. So long is the time needed to send such a draft out



PAYABLE with exchange and all
collection charges plus interest
at the rate of .25% per annum
from date of issue to approxi-
mate date of arrival of
same in New York

First

Exchange for [redacted] New York April 3 1916

Thirty days after sight of this First of Exchange
(the Second being unpaid) pay to the order of
[redacted]

Value received and charge the same to account of
To Messrs John Smith & Co
No. 11169 Sydney (Australia) Mangrove & Co

STERLING COMMERCIAL DRAFT ON AUSTRALIA — DRAWEE PAYS EX-
CHANGE, COLLECTION CHARGES, AND INTEREST BOTH WAYS

and get a remittance back on it that it has become almost a universal practice to collect interest, from the drawee, from the date the draft is drawn until the proceeds are received in New York. And this interest, the large house which has plenty of capital feels, it might just as well earn itself as turn over to some bank which would be willing to take the draft off its hands for cash.

Interest and Charges Paid by the Drawee. — This whole question of what the drawee is to pay in addition to the face of the draft is a matter of individual arrangement between himself and the seller of the goods. If the seller is “easy,” or if he feels that he is getting a pretty good price for his merchandise, he may consent to bear the loss of interest himself, and perhaps the collecting bank’s charges as well. That, however, is the exception and not the rule. In the great majority of cases the seller figures that his money is tied up in the goods from the time they go out of his hands till the remittance comes back to him, and that interest on the money during this period is rightly due him. He is likely to insist, therefore, that there be stamped on the draft a statement to the effect that it is payable at face value *plus* interest for the time consumed in transit, both ways. (The time it will take the remittance to get back has to be approximated.)

The above refers only to the interest lost while the goods are going out and the remittance is coming back. If the draft is a time draft — 60 or 90 days — interest for that period will be collected from the drawee, as well. This is an important point to remember, that while the buyer of goods at some outlying place may demand and receive 60 or 90 days’ time in which to make payment, he can almost invariably be made to pay interest during that period. In the case, for example, of a shipment made to some point 30 days away, the buyer being given 90 days in which to make payment, there would be added to the face of the draft interest at six per cent for two periods of 30 days and one

period of 90 days — 150 days in all. This amount it would be understood that the collecting bank should collect from the drawee.

Payment of Dollar Drafts Made in Local Currency. — Drafts of the class referred to, it is to be noted, are drawn either in sterling or in dollars — generally dollars, nowadays — regardless of what currency is in use at the point drawn on. This, of course, necessitates the fixing of a rate of exchange at which the draft shall be paid by the party on whom it is drawn. The South American buyer, for example, has no means of paying in dollars. What he knows is *suces* or *bolivianos* or whatever the local currency may be, and in that he keeps his accounts and draws his checks. Theoretically, if some one draws a draft on him in American dollars he can go out and buy a draft on New York with which to make payment; but practically, what happens is that he asks the bank presenting the draft drawn on him in dollars how many *suces* or *bolivianos* or whatever it is they will accept in payment. Payment of the dollar draft, in other words, will not be made in dollars, but in local currency at a rate of exchange.

Now the South American bank, it must be borne in mind, must account for the draft, to its American correspondent, *in dollars* — it was just because the American shipper didn't want to have anything to do with the *suces* or *bolivianos* or *milreis* that he insisted on drawing in dollars in the first place. The South American bank, therefore, must collect in exchange for the draft enough local currency so that it (the bank) *can* account for the draft in dollars. It must, to put it another way,

collect an amount of local currency sufficient to purchase the needed remittance on New York.

Fixing the Rate of Exchange. — Here, it is plain, would be a source of endless controversy if the rate of exchange were not fixed in advance. The banker holding the draft would inform the drawee of his intention to collect from him at a given rate. The drawee would very probably come back at the banker with the statement that the rate quoted was altogether too high, and refuse to pay. It would then be a question as to who was right and who was wrong — a question mighty hard to settle at some little point where exchange is infrequently dealt in and demands for dollar remittances on New York are few and far between.

Gradually, therefore, it has come about that the rate of exchange at which the draft is to be paid is settled in advance by stamping on the draft itself a statement to the effect that it is payable at the collecting bank's selling rate for sight drafts on New York. The fact that it is the collecting bank's *selling* rate does, of course, give the bank considerable leeway in saying what the rate shall be; but the fact that the drawee can easily enough find out the rate at which the bank is accommodating its other customers keeps the bank from fixing its rate too high.

From the standpoint of the American maker and of the American collecting bank a draft bearing the above clause is a dollar draft, pure and simple, and will be accounted for in dollars. The foreign exchange part of the transaction is entirely between the foreign collecting bank and the party on whom the draft is drawn.

And as the foreign bank collects in local currency and remits back to the United States in dollars, the higher the rate of exchange it can fix, the greater will be its profit. In no case can the bank lose, as in no case will it accept an amount of local currency insufficient to purchase the needed dollar draft on New York.

Where the Rate Is Fixed in Advance. — The buyer of the goods, it might be thought, might object to such an arrangement. In some cases, as a matter of fact, he does. As a rule, however, he gets good treatment from his local bank and is required to pay only what is a fair rate of exchange. Sometimes, though, the buyer does refuse to do business under the usual clause and insists that a definite rate of exchange be marked on the draft when it is sent from the United States for collection. American shippers do not, however, take kindly to that proposition as it introduces an element of uncertainty into the returns they are going to receive. The South American collecting bank has got to buy a dollar remittance on the United States with the local currency it collects. That means that if the current rate happens to be above the rate marked on the draft, the remittance in dollars will be less than the face of the draft. On the other hand, there is, of course, the chance that the current rate will be lower than the rate marked on the draft, in which case the local currency will buy more dollars than the draft called for. What it comes down to is a speculation in exchange — unless the rate agreed upon in the first place is made so high as to preclude any reasonable chance of the current rate, at the time the draft is paid, being higher.

So far as collection charges, bill stamps, and other incidentals are concerned, these are generally borne by the party on whom the draft is drawn. Almost invariably there will be stamped on the face of the draft a clause to the effect that the draft is payable at the collecting bank's selling rate for sight drafts on New York, plus the commission for collecting, plus the bill stamps, and any incidental charges. Where the clause about the charges is not put on the draft, the probable amount of these charges is likely to be included in the amount for which the draft is drawn. The theory on which the American seller goes in a case, for instance, where he has sold a certain lot of merchandise, say for \$500, is that he wants to get \$500 net out of the transaction. If, in the process of collection, the draft is going to "lose weight," obviously the thing to do is to add to it at the start what it is likely to lose. That can easily enough be done either by putting on the draft the clause about payment of charges, etc., standard for the country to which the shipment is being made; or by adding these charges right into the amount for which the draft is made in the first place. Which method is adopted is simply a matter of arrangement between buyer and seller. To the banker who takes the draft "for collection" it makes, of course, no difference.

CHAPTER XVII

PROFIT POSSIBILITIES IN FOREIGN EXCHANGE

It was with a cynical smile that a certain well-known New York banker read the above caption. "Profit possibilities," he remarked to the author, "'Profit Possibilities' ? Why not call it 'Loss Possibilities' ? The establishment of a foreign exchange department was the most expensive thing in its line this bank ever did. We closed it out after we sold at somewhere around \$4.80 a big balance in London that it cost us \$4.86 to put over there."

That kind of possibility — of profit or of loss — it is not our purpose to discuss. Speculation in foreign exchange like speculation in stocks or commodities or anything else is very different from "dealing." Anything that fluctuates in value lends itself to speculation. A bank or an individual can speculate in government bonds or in foreign exchange but that does not prove that the business of dealing in government bonds or in foreign exchange is essentially a speculative proposition. Everything depends on the way the business is done.

It would be entirely outside the purview of a work of this kind to attempt to say what is legitimate and what is non-legitimate speculation in foreign exchange. Necessarily and of reason we must confine our discussion to

the business and profit possibilities of dealing in exchange, not of speculating in it.

The primary business of the foreign exchange banker, as was pointed out in Chapter I, is to purchase, at a price, all bills of exchange deemed safe by him that are offered to him, drawing and selling at a profit his own drafts on the balances abroad thus created. To get it into its most elementary form, if a banker can buy a sight draft in London, say for £1000, at a total outlay in dollars in New York of \$4860, can send it over there for credit of his account and then draw his own draft for £1000 and sell it for \$4870, it is plain that he has made \$10 gross on the transaction. Foreign exchange operations are not as a rule, it must be admitted, as simple as that, but the theory is always the same — that is to say, the putting of balances at foreign points at an expenditure of less dollars than those balances can be immediately sold out for. *Immediately*, because any delay whatsoever means the introduction of a speculative element. The banker who buys bills without being sure that he can simultaneously sell his own bills at a price to show him a profit, is taking a chance.

Selling Cables Against Cables, Demand Against Demand, etc. — Broadly speaking, the business of dealing in bills may be divided into two classes: (1) that of selling demand bills against demand bills, long bills against long bills, etc., and (2) that of selling one kind of exchange against another, as, for instance, demand bills against remittances of long bills.

To take the first class — cables are almost never sold against cables for the simple reason that it is but

rarely that any money can be made out of such an operation. A cable, as has been explained, is a standard form of remittance, issued almost invariably by bankers and, so, devoid of any element of credit. One bank's cable, in other words, is just as good as another's. The opportunity, therefore, of being able to buy a cable for any considerable amount less than you can sell your own for, is almost never presented. Once in a while in excited markets it happens that a cable can be picked up at a price which makes possible the sale against it of your own cable, but even then the profit is apt to run only five or ten points. Five or ten dollars on a £10,000 transaction is a small amount to go after even in these days of short profits.

Selling bankers' checks against bankers' checks is, like selling cables against cables, a nice safe form of business but one out of which it is next to impossible to make any money. As with cables, there come times when possibly as much as ten points can be made by selling your own check against some one else's, but such occasions are few and far between. In spite of the fact that foreign exchange quotations are established by direct dealings between a large number of banks and that there is no one central point at which they are registered, quotations rise and fall with quite remarkable evenness.

The Element of Credit. — Where it comes to selling bankers' demand bills against commercial demand bills, however, the case is different. The element of credit does not, it is true, enter into the market price of a commercial bill payable at sight to the same extent as it enters into the market price of a commercial bill payable

at the end of sixty or ninety days, but is a factor nevertheless. John Smith's bill drawn at sight against a shipment of meat may not, probably will not, sell at the same price as John Jones' bill drawn against a shipment of cotton. John Smith and John Jones may both be perfectly reliable parties but the exchange market will not hesitate to set its own valuation on each of the two bills. Smith's credit or Jones' credit, it must be remembered, is not the only thing that counts. There must be considered, as well, the respective standing of the parties on whom the bills are drawn and, after that, the relative marketability of the goods against which the drafts are drawn. Cotton, for instance, which won't spoil, is a whole lot better form of collateral than meat, which will.

So that, when we consider this question of making a profit out of selling bankers' sight bills against commercial sight bills, the amount of profit we are going to make depends upon the amount of risk we are going to take. Here is a bill drawn by J. Robinson, we will say, said Robinson being an exporter of the highest standing, and the goods he is sending out being of the most staple kind. Now that bill, very likely, will command a price only a little less than what you, a banker, can sell your own bill for. But wait; here is a bill drawn by J. Doe, who, as it happens, is one of your depositors. Doe hasn't the resources of Robinson and isn't nearly as well known, but his bill, you, as his banker, know, is as good as gold. *You* know it, perhaps, but the exchange market doesn't know it and so when Doe's bill is offered for sale it commands a price considerably — half a cent

in the pound, perhaps — less than Robinson's. You, knowing what you do, could buy that bill of Doe's and sell your own check against it and make money out of it and really be taking no greater risk than if you bought Robinson's bill.

How Bills Vary in Price. — Credit knowledge — knowledge that is more complete and accurate than the knowledge on which the general market bases its estimate as to the value of a bill — that is what is essential to the conduct of this business, if, indeed, it is to be conducted in such a way as to be really profitable as well as safe. Every day, among the great mass of commercial bills offered for sale, there are offerings that are real bargains, that present the opportunity to make a worthwhile profit without taking more than a legitimate degree of risk. To be able to recognize these opportunities for what they are is to be able to make, and with safety, anywhere up to a cent on the pound profit.

Selling bankers' long bills against bankers' long bills, like selling bankers' short against bankers' short, is all right where you can do it, but not usually a source of substantial profit. In the case of some bankers' long bills, though, as has been explained, the element of credit does enter, at least to a moderate degree, making it possible at times to buy bills that are perfectly good at somewhat below the market. The fifteen or twenty points (fifteen to twenty hundredths of a cent per pound sterling) that can be made out of this business is, however, hardly fair compensation for having to put your own long bills on the market and having to hold, undiscounted, the long bills purchased.

Where long bills are sold, not against other bankers' long bills but against long bills drawn by merchants, profit possibilities are much greater. In the commercial long bill the credit element finds reflection to the greatest possible extent and great is the variance in price at which such bills sell. Smith's bill and Jones' bill, each at sixty days' sight, may both be good, but if the market happens to like Smith better than Jones, Smith's bill is likely to sell anywhere up to a cent in the pound above Jones'. Probably if you asked some of the big buyers of exchange on what they based their estimates of relative value they wouldn't be able to tell you. The feeling about it would nevertheless remain and Jones' bills continue to fetch only, say, 481, at a time when Smith was getting 482 or even more for his.

Now, as the price of even the best — perhaps we should say best liked — commercial bills is invariably lower than the price of bankers' bills, it will be readily apparent that considerable profits can be made by the banker willing to buy long commercial bills which he knows to be good but which do not command the highest price in the open market. Here, in other words, there is considerable opportunity for the turning into dollars and cents of credit information.

Selling Cables Against Short, Short Against Long, etc. — Bankers do sell cables against cables and short against short as described above, but this is an elementary form of business and, in the long run, much less important than the selling of different kinds of exchange against each other — cables against demand, for instance, or short bills against remittances of long. Such opera-

tions, as a matter of fact, make up the bulk of dealings in exchange.

Take, for instance, a time when, as often happens, there is an urgent demand for cables, for some particular purpose. Sight drafts won't do — the money has to be gotten to the parties on the other side before the next steamer can possibly get over. So, for cables, the rate of exchange is bid up to a point considerably beyond what, based on interest rates, cables ought to sell for in relation to sight bills. Just here comes in the opportunity of the banker enjoying good facilities abroad. His balance over there may not be such as to warrant his selling the cables he wants to sell, but his correspondent, he knows, will stand for a substantial overdraft as long as he is sure that "cover," in the form of sight exchange, is coming along on the next steamer. So the banker here buys the necessary sight exchange and then goes ahead and sells the cable at the prevailing high price. Very often, on such an operation, it is possible to make anywhere up to a quarter of a cent a pound.

In the above case, where a cable is sold out of a non-existent balance abroad on the understanding that "cover" will be sent along on the next steamer, it is not, of course, necessary that this "cover" should consist of sight exchange. Anything that can be turned into money upon arrival is just as acceptable. As a matter of fact the "cover," in a case of this kind where a cable has been sold to take advantage of a particularly high bid, is likely to consist of a variety of exchange — short bills, discountable long bills, anything, indeed, that can be turned into money and "covered" into the balance.

Just here, perhaps, attention should again be directed to the fact that *any* kind of a good bill, *at a price*, is grist to the foreign exchange banker's mill. If he has a cash payment to make abroad, he can make it just as well by sending over a discountable ninety-day bill (which his correspondent can at once turn into money) as by sending over a sight bill. The whole thing is a question of the amount of dollars needed to put the necessary pounds into his foreign balance. Whether he puts a "sight" pound over there at a cost to himself here of \$4.87, or whether he pays out \$4.87 for an amount of ninety-day sterling which, *after discount*, will mean the crediting of his account by exactly one pound, makes not the slightest difference to him. He thinks, as a matter of fact, of all kinds of bills of exchange — cables, short, long, and all — in terms of cash proceeds on the receiving end. A sixty-day bill for £1000 isn't a bill for £1000 to the average foreign exchange banker at all. To him it is a sight bill for £995, or whatever its net proceeds will be after discount.

The Principal Source of Profit. — Keeping the above in mind will help us understand what is in reality the principal function and profit source of the foreign exchange banker; that is to say, the melting of merchants' long drafts against exports and the making available of the proceeds to those having obligations to discharge abroad. Putting it the way a banker rather than an academician would put it, the banker's main business is to sell demand against long.

The reason that this is the most profitable of all non-speculative foreign exchange dealings is because of

the extent to which the credit of the maker and the drawee influences the price at which a commercial long bill can be sold. The very best of such bills, as has been pointed out, sell slightly below the price for bankers' long bills; which latter price, in its relation to bankers' demand bills, is fixed by the discount rate. And, from the quotation for the primest and best-known commercial long bills, the quotation for less well known though perhaps equally good names runs off anywhere down to a cent in the pound lower. Here, then, is an opportunity for the banker to make a substantial profit by buying bills which he knows to be just as good as the best, but which, for one reason or another, the market rates below the top.

The Speculative Element in Exchange Dealings. — From this operation of selling "sight bills against long," the last vestige of a speculative element can be removed by the banker's arranging with his correspondent abroad, by cable, the rate at which the long bills will be discounted "to arrive." Knowing, thus, just exactly what the proceeds of a commercial long bill in pounds, shillings, and pence will amount to, and knowing just how many dollars and cents his own draft for that amount of sterling can be sold for, the banker is in a position to figure exactly what he can afford to pay for the commercial bill and break even. When he finds offered a bill, which he knows to be good, at, say, half a cent a pound lower than the rate he could afford to pay and still break even, it is plain enough that the half-cent per pound is a sure profit.

Now, if it seems to the reader as though even a half-

cent per pound profit (\$50 on £10,000) were a pretty small return to the banker, let him remember that, outside of the balance permanently carried abroad, no capital need be used in the business. Every day, the banker buys bills, paying out dollars. Every day he sells bills against what he has bought, taking in dollars. One hand washes the other and at the end of the day he is even — unless, of course, he has “ taken a position on the market ” and bought without selling or sold without buying. That, of course, is an entirely different kind of operation and fraught with far greater profit and loss possibilities than what we have been talking about.

Without attempting any discussion of the speculative possibilities in the exchange market, it may be pointed out that in the accumulation of balances at foreign points without selling against them, there exists great chances of both profit and loss. Looking at it the other way around, a banker who believes that the rate of exchange on some given point is headed down and not up, can, if he wants to take the chance, sell drafts on that point for future delivery. Then, if he is right about it and the rate does go down, he can go out into the open market when the time that he has agreed to make delivery comes around, and buy in at, say, 4.84, what he may have contracted to deliver at 4.85 or 4.86. Different so far as the details are concerned, such an operation in its essential features is exactly the same as taking the short side of the market in stocks, grain, or anything else.

Arbitrage — Three-Market Operations. — Besides the dealing operations mentioned above where short ster-

ling is sold against short sterling, sterling cables against sterling long bills, etc., there must still be considered that class of entirely legitimate and non-speculative operations where more than two markets are involved — where, for example, bills are sold on London against bills remitted not to London but to Paris. Infinite in variety and, by most foreign exchange men mentioned to the layman only with a pitying smile at his hopeless inability to comprehend, such operations rest on a principle which any one who gives it a little thought ought to be able to understand easily enough.

Take, for example, one of those “arbitrage” transactions along the lines mentioned above. At New York, we will say, there is at some given time a strong demand for sterling drafts on London while, at the same moment, franc drafts on Paris are being freely offered. In Paris, New York learns over the cable, sterling drafts on London are also obtainable at price concessions. What more natural, under such a combination of circumstances, than that New York bankers should buy franc drafts on Paris, send them to Paris with instructions to use them to buy sterling drafts on London, and then draw their own sterling drafts on the London balances thus created? The francs on Paris are obtained in a weak market, the pounds on London are obtained in a weak market, and the reimbursing drafts on London are sold in a strong market.

What Makes Arbitrage Possible. — The above is of course a very sketchy way of dealing with the super-sacrosanct subject of exchange arbitrage, but what it all comes down to is the making use of some third market

where exchange conditions happen for the moment to differ from those in your own. In the case noted above there was a strong demand, in New York, for sterling drafts on London. The problem was to get "cover" to London. As it happened, that could be done through Paris, where sterling drafts happened to be freely obtainable. So to Paris the remittance was sent, with instructions that the francs be turned into pounds and the pounds sent along to London. The remittance, to put it another way, was sent to London by the way of Paris. Had guilders been weak in Rotterdam or kroner been weak in Copenhagen, the remittance might just as well have been made through Holland or Denmark.

For such chances to make an "arbitrage" profit, the expert exchange man is constantly on the alert. With his extensive connections, he is constantly kept informed by cable as to how exchange rates are quoted at all the important foreign money centres. The moment he sees a chance profitably to draw, for instance on London, and remit by the way of Paris, or to draw on Paris and remit by way of London, he will grasp the opportunity. What he can make will rarely run over a quarter of a cent per pound sterling or its equivalent, but that, considering that no risk is taken and no money put up, is considered well worth while going after.

What is particularly to be noted about such operations is that they tend to keep all the important rates of exchange on a parity with each other. The moment one rate starts to get out of line — either up or down — the operations of the arbitrageurs tend to drive it back into its proper relationship with the other rates. If

for any reason, for instance, the sterling rate in Paris starts to fall considerably below what is its correct relationship to the sterling rate in New York, remittances to London via Paris will soon enough result in putting the Paris-London rate back where it belongs and where no profit can be made by the arbitrating operation.

Above, there have been outlined some of the principal ways in which the foreign exchange banker makes money dealing (non-speculatively) in bills. In addition to such operations, of course, he makes money out of issuing letters of credit, making sterling and other loans, exporting and importing gold, etc. To the question as to whether there is anything to be made out of foreign exchange, the answer is that in a good many banks the foreign department is the department which shows the biggest net return on the amount of capital used.

CHAPTER XVIII

THE SILVER EXCHANGES

INDIA, Japan, and most of the other great silver countries of former years have long since adopted either the gold standard or the gold exchange standard (under which the silver currency is maintained at a fixed gold value). There still remain, however, nine countries of more or less commercial importance where silver is used as legal tender and gold is not recognized. Most important of these is China where, in spite of continuous efforts during the past twenty years to get the currency on a better basis, a variety of silver coins continue to be recognized as legal tender.

Silver Coin Regarded as Bullion. — In considering the foreign exchange relationship of gold standard to silver standard countries, it is necessary to bear always in mind the fact that, in a gold standard country, the silver coins of a silver standard country are not recognized as money at all but simply as so-and-so-much silver bullion. The fact that a disc of silver is milled, and stamped "Hongkong Dollar" or "Mexican Dollar" affects its gold value in the United States not in the slightest. To the man who owns it, it is a piece of metal worth, in gold, just what that weight of that particular metal is selling for. If silver is selling at 84 cents

an ounce and the coin in question weighs three-quarters of an ounce, the value in American dollars and cents of that coin will be 63 cents. And 63 cents is all that it can be sold for even though there is stamped on the coin the statement that it is worth a million dollars.

Between a gold standard country, then, and a silver standard country, the rate of exchange is mainly a matter of the price at which silver is selling in the gold standard country. Take, for instance, London and Hongkong. What will determine the rate of exchange in Hongkong for pounds sterling — that is to say the price of the Hongkong dollar expressed in pounds, shillings, and pence? Simply the amount of sterling, of course, which, at that particular time, can be realized from the sale of the amount of silver that is contained in a Hongkong dollar. Some one in Hongkong wants to make a remittance to London. How many shillings and pence is he going to demand for each Hongkong dollar he gives up? Not less, certainly, than that Hongkong dollar, less the expenses of sending it there, could be sold for in London as silver bullion. It is the price of silver bullion, in other words, which fixes the rate of exchange.

Price of Silver and the Rate of Exchange. — As the price of silver bullion rises, the rate of exchange in the silver-using countries, on the gold-using countries, tends to go down. Why this is so will easily enough be seen from consideration of the fact that, as the price of silver goes up, the Hongkong dollar or the Salvador peso or whatever is the coin in question, will exchange for a greater number of shillings and pence or other gold standard currency. That is, of course, only another

way of saying that the rate of exchange has gone down. When, on one day, a hundred or a thousand pesos will buy a draft for so-and-so-many dollars on New York and the next day they will buy a draft for a *greater* number of dollars, it must be evident that the rate of exchange has gone *down*.

Conversely, when the price of silver falls, the rate of exchange in the silver-using countries, on the gold-using countries, tends to go up. The same amount of silver, in that case, buys a smaller amount of the gold currency.

Silver Exchanges Quoted in Gold Currency. — Much of the confusion of mind which prevails regarding the above, arises from non-appreciation of the fact that, in a silver-using country, the rate of exchange on a gold country is invariably quoted in the currency of the gold country. In Hongkong, for example, sterling drafts on London are never quoted at so-and-so-many Hongkong dollars for each pound, but always at so-and-so-many shillings for each Hongkong dollar. You are in Hongkong and you want to buy a sterling draft on London. Instead of the banker telling you what he is going to charge you in Hongkong dollars for each pound sterling of the draft you want, he tells you how many shillings and pence he will give you for each Hongkong dollar you put up.

The result is that an *apparent* rise in the exchange at a point like Hongkong is an actual decline. The rate on London, for example, changes from 2 shillings 5 pence for Hongkong dollars to 2 shillings 6 pence. At first thought it may seem as though a rise had taken place

but what has actually happened is that the rate on London has gone down.

Effect of Silver Prices on Foreign Trade. — Now, to glance for a moment at the economic effect of the rise and fall in the price of silver, it is plain that if a rise in silver puts down the rate of exchange on gold-using countries, it has the effect of increasing the silver countries' ability to import merchandise. The lower your rate of exchange on some outside point, of course, the easier it is for you to buy goods there. If, for example, a Hongkong dollar will buy 2 shillings and 5 pence worth of merchandise in London where formerly it would only buy 2 shillings' worth, Hongkong's ability to buy English merchandise is greatly increased. When, on the other hand, the price of silver goes down — driving, as it is bound to do, the rate of exchange *up* — the silver-using country's merchandise purchasing ability is correspondingly curtailed.

To the merchant or manufacturer dealing largely with the Orient, then, this question of the price of silver is of real and practical importance. The small fluctuations do not, of course, make any particular difference so far as he is concerned. The big swings in price, however, do make a very great deal of difference in that they mean that his customers in the East can or cannot buy the goods he wants to sell them. Take such a time as in the nineties, for instance, when the changing over from a silver to a gold basis on the part of a number of important countries coupled up with the development of important new silver mines resulted in the price of silver being cut in half. As the price of silver fell, the gold

exchanges out in the silver countries rose, until the purchasing power of those countries was seriously affected. Cotton manufacturers engaged in the Chinese trade will be a long time in forgetting how, as a result of decreased purchasing power on the part of their best customers, cotton mills all over the Lancashire district abroad, and right here in New England, had to shut down. Any number of commissions were appointed and committees sent out to the Far East to see what could be done about getting the exchanges on a more stable basis, but it was years before the effects of the great decline in silver (and the consequent rise in the gold exchanges) were overcome and normal trade relationships once more established.

Selling Goods in Silver-Using Countries. — The fluctuation in the silver exchanges, it must be borne in mind, is on an entirely different scale from the fluctuation in the exchange between two gold-using countries. Between London and New York, for instance, from the beginning of the century down to the opening of the War, the difference between the highest point touched by the exchange market and the lowest was a matter of only a trifle over one per cent. In such a rate as that between New York and Hongkong, on the other hand, a fluctuation of one per cent is a matter of almost daily occurrence. A change at Hongkong in the rate on New York, say from 50 cents to 55 cents, would mean a drop of no less than 10%. In these silver exchanges it is not a matter of fractions but of whole points at a time.

Fluctuations in the silver exchanges being thus violent, it has come about that prices of practically all merchan-

dise sold by gold countries to silver countries are fixed in the currency of the gold country. Where the movement of the exchange rate is apt to run up to several per cent between the time the sale is made and the time the goods are paid for, it is natural that the seller of the goods should insist that this risk be assumed by the buyer. On any other basis the sale would simply not be made.

APPENDIX

HOW TO CONVERT POUNDS, FRANCS, AND MARKS INTO U. S. CURRENCY AND *VICE VERSA* ¹

THE methods of figuring or converting the monies of the different foreign countries into the money of the United States and *vice versa* are not generally understood even by dealers in foreign exchange, for the reason that printed tables are provided and generally used for such purpose, which not only insure accurate computation but save much time and labor. Students, however, who desire to acquire a thorough knowledge of the science of foreign exchange should be able to figure all transactions without the use of tables. The operations in figures are shown in the following examples :

ENGLISH MONEY

TABLE

4 farthings (far.)	=	1 penny
12 pence (d.)	=	1 shilling
20 shillings (s.)	=	1 pound or sovereign
21 shillings	=	1 guinea

£	s.	d.	far.
1	= 20	= 240	= 960
	1	= 12	= 48
		1	= 4

¹ Used by permission of H. K. Brooks, New York, author of "Brooks' Foreign Exchange Textbook."

EXAMPLE 1

ADDITION, ENGLISH MONEY.

	£	s.	d.
	240	12	8
	15	10	5
	5	5	4
ANSWER	£261	8s.	5d.

EXPLANATION. — Since 12 pence equal 1 shilling and the total of pence is 17, carry 1 to shillings, leaving 5 pence. As the total of shillings is 28 (including 1 forward from pence) and there are 20 shillings to the pound, carry 1 to pounds, leaving 8 shillings.

EXAMPLE 2

MULTIPLICATION, ENGLISH MONEY.

	£	s.	d.
	215	12	8
			4
ANSWER	£862	10s.	8d.

EXPLANATION. — 4 times 8 pence = 32 pence or 2s. 8d., therefore carry 2 to shillings. 4 times 12s. = 48s. plus 2s. = 50s., or £2 10s., therefore carry 2 to pounds, leaving 10s. 4 times £215 = £860, plus £2 carried from shillings = £862.

EXAMPLE 3

SUBTRACTION, ENGLISH MONEY.

	£	s.	d.
	215	12	8
	212	15	10
ANSWER	£ 2	16s.	10d.

EXPLANATION. — Since 10d. cannot be subtracted from 8d., add 12d. to the minuend (upper figures), making 20d. 10d. from 20 = 10d. Since 16s. (includes 1s. brought forward) cannot be subtracted from 12s., add 20 to the

minuend, making 32s. 16s. from 32s. = 16s. Carry 1 to pounds. £213 from £215 = £2.

EXAMPLE 4

DIVISION, ENGLISH MONEY.

	£	s.	d.
	4)25	10	4
ANSWER	£ 6	7s.	7d.

EXPLANATION. — Since 4 into 25 goes 6 times, leaving remainder of £1 or 20s., carry 20 to shillings, making 30s. 4 into 30 goes 7 times, leaving remainder of 2s. or 24d., thus making 28d. into which 4 goes 7 times.

EXAMPLE 5

REDUCING POUNDS, SHILLINGS, AND PENCE TO DECIMAL OF POUND FOR CONVENIENCE IN FIGURING.

Reduce £525 10s. 6d. to pounds and decimal.

Operation: £525 = £525.

s. 10 = .50

d. 6 = .025

ANSWER (Decimal) £525.525

EXPLANATION. — Multiply shillings by .05 because 1s. is 1-20 or 5-100 of a pound. Multiply the pence by .004 1-6 because 1d. is 1-240 or $4\frac{1}{8}$ thousandths of a pound. To avoid the use of the fraction $\frac{1}{8}$, add 1 if amount is over 12 and 2 if over 35, and result will be the same.

NOTE. — The reducing of pounds, shillings, and pence to decimal, as above shown, simplifies the process of converting English money into United States money, as will be seen by examples following.

EXAMPLE 6

CONVERSION: ENGLISH MONEY INTO UNITED STATES MONEY.

To find the equivalent in United States money of £525 10s. 6d., at "rate of exchange," \$4.96 $\frac{1}{2}$ per pound.

Operation: £525 = £525.

$$\begin{array}{r}
 \text{s. } 10 = .50 \\
 \text{d. } 6 = .025 \\
 \hline
 \text{£}525.525 \\
 \text{4.9650 RATE} \\
 \hline
 26276250 \\
 3153150 \\
 4729725 \\
 \hline
 2102100
 \end{array}$$

ANSWER — 2609.2316250 (\$2609.23)

NOTE. — See Example 5 for explanation of reducing pounds, shillings, and pence to decimal.

EXPLANATION. — Reduce pounds, shillings, and pence to decimal as explained in Example 5. Multiply the decimal by rate of exchange (\$4.96 $\frac{1}{2}$), which gives amount in dollars and cents United States money.

NOTE. — See Example 7 showing conversion of same amount United States money (\$2,609.23), into English money, which verifies correctness of figures in Example 6.

EXAMPLE 7

CONVERSION: UNITED STATES MONEY INTO ENGLISH MONEY.

To find the equivalent in English money of \$2,609.23 (United States money) at rate of exchange, \$4.96 $\frac{1}{2}$ per £.

$$\begin{array}{r}
 \text{Operation: Rate 4.9650} 2609.2300 (525.524 \\
 \hline
 2482.50 \quad \quad 20 \\
 126.730 \quad \text{s. } 10.480 \\
 \hline
 99.300 \quad \quad 12 \\
 27.4300 \quad \text{d. } 5.760 \\
 \hline
 24.8250 \\
 2.60500 \text{ ANSWER — £}525 \text{ 10s. 6d.} \\
 \hline
 2.48250
 \end{array}$$

NOTE. — See Example 6 showing conversion of same amount English money (£525 10s. 6d.) into United States money, which verifies correctness of figures in Example 7.

$$\begin{array}{r}
 122500 \\
 \hline
 993000 \\
 232000 \\
 \hline
 198600 \\
 \hline
 33400
 \end{array}$$

EXPLANATION. — Divide amount in dollars and cents (United States money) by the rate of exchange per pound, and it gives the amounts in pounds and decimal of pound. Multiply the decimal (not the pounds) by 20 (20s. = £1) and it gives the shillings and decimal of shilling. Multiply the decimal (not the shillings) by 12 (12d. = 1s.) and you find the pence and decimal of penny. If decimal of penny is 50 or over add 1 to amount in pence, otherwise discard same.

EXAMPLE 8

CONVERSION: ENGLISH MONEY INTO UNITED STATES MONEY (another way).

To find the equivalent in United States money of £226 8s. 9d. at "rate of exchange," \$4.86 per £.

Operation: £226 8s. 9d.

$$\begin{array}{r}
 \begin{array}{r}
 20s. \\
 \hline
 4528 \\
 12d. \\
 \hline
 54345 \\
 4.86 \text{ RATE} \\
 \hline
 326070 \\
 434760 \\
 217380 \\
 \hline
 240 \overline{)264116.70(1100.486} \\
 \underline{240} \\
 241 \\
 \underline{240} \\
 1167 \\
 \underline{960} \\
 2070 \\
 \underline{1920} \\
 1500 \\
 \underline{1440}
 \end{array}
 \end{array}$$

ANSWER — \$1,100.49

NOTE. — The method shown in Example 6 for converting English money into United States money will be found more simple than that employed in this example.

EXPLANATION. — Multiply the pounds (226) by 20 (20s. = £1) and add thereto the amount in shillings (8), which gives amount in shillings. Multiply that product by 12 (12d. = 1s.) and add thereto the amount in pence (9), which gives total amount in pence. Multiply the pence (54345) by rate per pound (\$4.86) and we find the pence and decimal. Divide that product by 240, there being 240 pence to the pound, and you arrive at the equivalent in dollars and cents, United States money.

EXAMPLE 9

INTEREST OR PERCENTAGE, ENGLISH MONEY.

To find interest at rate of 4 per cent on £550 15s. 11d. for one year. Or what amount in English money 4 per cent of £550 15s. 11d. would be.

Operation: £550 = £550.

$$\begin{array}{r} \text{s. } 15 = .75 \\ \text{d. } 11 = .046 \end{array}$$

Decimal

$$\begin{array}{r} \text{£}550.796 \\ .04\% \end{array}$$

$$\hline 22.03184 \text{ (pounds and decimal)}$$

$$\hline \text{20s.}$$

$$\text{s. } 0.63680$$

$$\hline \text{12d.}$$

$$\text{d. } 7.64160 \quad \text{ANSWER — £22 os. 8d.}$$

EXPLANATION. — First, reduce pounds, shillings, and pence to decimal as explained in Example 5. Multiply the WHOLE decimal by rate per cent (4%), which gives pounds and decimal of pound. Multiply the decimal (not the pounds) by 20 (20s. = £1) and you get the shillings and decimal of a shilling. Multiply the decimal of shilling (not the shillings) by 12 (12d. = 1s.), and it gives the pence and decimal of penny. As the decimal of penny exceeds 5 ($\frac{1}{2}$ d.) add 1 to pence.

EXAMPLE 10

INTEREST, ENGLISH MONEY.

To find the interest in English money, on £50 12s. 6d., for 93 days at rate 6 per cent, allowing 365 days to the year.

Operation: £50 = £50.

s. 12 = .60

d. 6 = .025

Decimal £50.625

.06 %

(Days in year) 365) 3.03750(00832

2920

1175

1095

800

730

.00832

93 days

02496

.07488

£0.77376

20s.

s. 15.47520

12d.

d. 5.70240

ANSWER — £0 15s. 6d.

EXPLANATION. — Reduce pounds, shillings, and pence to decimal as explained in Example 5. Multiply the pounds and decimal by rate per cent (6%). Divide the product by the number of days in year (365) and multiply the quotient by the number of days for which interest is to apply (93). Multiply that product by 20 (20s. = £1) and it gives the shillings and decimal. Multiply the decimal of shillings (not the shillings) by 12 (12d. = 1s.) and you find the pence and decimal of penny.

EXAMPLE 11

INTEREST OR PER CENT, ENGLISH MONEY.

To find 4 per cent of £550 15s. 11d.

Operation: £5.50	15s.	11d.	
		.04 %	(Rate per cent)
<u>£22.03</u>	3s.	8d.	
20s.			
s. 0.63	(3s. added)		
12			
d. 7.64	(8d. added)		ANSWER — £22 os. 8d.

EXPLANATION. — Point off two figures from the right in pounds. Multiply by rate per cent (4 %). 4 times 11d. = 44d. or 3s. 8d. 4 times 15s. = 60s., plus 3s. (carried from pence) = £3 3s. 4 times £5.50 plus £3 = £22.03. Multiply DECIMAL of pounds .03 by 20s. = 60 plus 3s. = .63s. Multiply .63s. by 12d., adding 8d. = 7.64d. or 8d., thus giving answer, £22 os. 8d.

EXAMPLE 12

IMPORTATIONS, VALUED IN ENGLISH MONEY.

To find in United States money value of goods imported, invoiced at £550 15s. 11d., the ad valorem duty upon which is 30 per cent.

Operation: £550 = £550.		
s. 15 =	.75	
d. 11 =	.046	
Decimal	£550.796	
Rate of Exchange (par)	<u>4.8665</u>	As used by Custom House.
	2753980	
	3304776	
	3304776	2680.45
	4406368	.30 %
	<u>2203184</u>	\$804.135 duty
Cost in U. S. money without duty.	\$2680.4487340	
	<u>804.13</u>	
Cost including duty	\$3484.58	— ANSWER

EXPLANATION. — Reduce pounds, shillings, and pence to decimal as explained in Example 5. Multiply decimal by the par rate of exchange as fixed by Director of the United States mint. Multiply product by rate per cent duty (30 %) and add that product to cost, not including duty.

FRENCH, BELGIAN, AND SWISS MONEY

1 FRANC = 100 CENTIMES

The money of account of France, Belgium, and Switzerland is the franc of 100 centimes, the actual value of the gold unit in the money of the United States being 19.3 cents.

In exchange transactions between the United States and France, Belgium, and Switzerland, the rate of exchange as usually quoted in large cities is the variable number of francs and centimes allowed per \$1.00, which is expressed, for example, thus: Frs. 5.16 $\frac{1}{4}$, meaning that 5 francs and 16 $\frac{1}{4}$ centimes would be allowed for each \$1.00 United States money. At the smaller cities and towns it is customary for sellers of exchange to quote the rate for a single franc, as follows: 19.35 cents, meaning 19 and 35-100 cents (United States money) for each franc.

APPENDIX

EXAMPLE 13

CONVERSION: FRENCH, BELGIAN, AND SWISS MONEY INTO UNITED STATES MONEY.

Find cost of francs 5250.50 at rate of exchange francs 5.16 $\frac{1}{4}$.

Operation: (Rate) 5.1625)5250.5000(1017.046

$$\begin{array}{r}
 51625 \\
 \hline
 88000 \quad \text{ANSWER — \$1017.05} \\
 51625 \\
 \hline
 363750 \\
 361375 \\
 \hline
 237500 \\
 206500 \\
 \hline
 310000 \\
 309750 \\
 \hline
 \end{array}$$

EXPLANATION. — Divide the amount in francs by the rate of exchange.

EXAMPLE 14

CONVERSION: UNITED STATES MONEY INTO FRENCH, BELGIAN, AND SWISS MONEY.

To find the amount in francs and centimes that can be purchased for \$1017.05 at rate of exchange, francs 5.16 $\frac{1}{4}$ per \$1.00.

$$\begin{array}{r}
 \text{Operation:} \quad 1017.05 \\
 \hline
 5.1625 \\
 508525 \\
 203410 \\
 610230 \\
 101705 \\
 \hline
 508525 \\
 \hline
 \text{Francs} \quad 5250.520625 \quad \text{ANSWER — Francs 5250.52}
 \end{array}$$

EXPLANATION. — Multiply amount in United States money by the rate of exchange.

NOTE. — Example 14 is reverse of Example 13. The difference of 2 centimes ($\frac{1}{2}$ cent) is caused by not using exact fraction .046 centimes.

EXAMPLE 15

CONVERSION: FRENCH, BELGIAN, AND SWISS MONEY INTO UNITED STATES MONEY.

To find cost of francs 5250.50 in United States money at rate of exchange, francs $516\frac{1}{4}$ minus 1-16 of 1 per cent (expressed francs $516\frac{1}{4} - 1-16$).

Operation: $5.1625)5250.5000(1017.046$ (U. S. money)

	<u>51625</u>	
	88000	
	<u>51625</u>	
(1-16 of 1% of amount)	363750	
\$1017.05	<u>361375</u>	
	237500	
16) <u>10.1705</u>	<u>206500</u>	\$1017.05
.6356 or 64c.	310000	<u>.64</u>
	<u>309750</u>	\$1016.41 — ANSWER

EXPLANATION. — Divide amount in francs and centimes (5250.50) by rate of exchange without using fraction 1-16 of 1 per cent, as that applies only to amount in United States money. Find 1-16 of 1 per cent of amount in United States money (\$1017.05), which is 64 cents. Deduct 64 cents from amount in United States money and you have the answer.

EXAMPLE 16

CONVERSION: FRENCH, BELGIAN, AND SWISS MONEY INTO UNITED STATES MONEY.

To find cost of francs 5250.50 in United States money at rate of exchange, francs $5.16\frac{1}{4}$ plus 1-16 of 1% (expressed francs $5.16\frac{1}{4} + 1-16$).

Operation: $5.1625)5250.5000(\$1017.05$

(See operation Example 15)

1-16 of 1 per cent of \$1017.05 = 64 cents (See Example 15)

\$1017.05 plus 64 cents = \$1017.69 — ANSWER

EXPLANATION. — Divide amount in francs and centimes by rate of exchange, which gives amount in United

States money. Find 1-16 of 1 per cent of amount of United States money and add same thereto.

EXAMPLE 17

CONVERSION OF UNITED STATES MONEY INTO FRENCH, BELGIAN, AND SWISS MONEY.

To find amount of francs and centimes that can be purchased for \$1017.05 at rate of exchange, francs $5.16\frac{1}{4}$ minus 1-16 of 1 per cent (expressed francs $5.16\frac{1}{4} - 1-16$).

Operation: $5.1625 \times 1017.05 =$ francs 5250.52

(See Example 14)

1-16 of 1% of \$1017.05 = 64 cents

$$\begin{array}{r}
 5.1625 \\
 \underline{.64} \\
 206500 \\
 \underline{309750} \\
 3.304000 \text{ francs}
 \end{array}$$

Francs 5250.52 plus francs 3.30 = francs 5253.82, the ANSWER

EXPLANATION. — Multiply amount of United States money by rate of exchange, as in Example 14, which gives amount in francs and centimes. Find 1-16 of 1 per cent of amount of United States money, as in Example 15. Multiply that product (64 cents) by rate, which gives amount in francs and centimes (F. 3.30) to be added to amount of francs and centimes given at the regular rate (frs. $5.16\frac{1}{4}$).

EXAMPLE 18

CONVERSION: UNITED STATES MONEY INTO FRENCH, BELGIAN, AND SWISS MONEY.

To find amount in francs and centimes that can be purchased for \$1017.05 at rate of exchange francs $5.16\frac{1}{4}$ plus 1-16 (expressed francs $5.16\frac{1}{4} + 1-16$).

Operation: \$1017.05

$$\begin{array}{r}
 \underline{5.1625 \text{ (rate)}} \\
 5250.52 \text{ francs} \\
 \text{(See Example 14)} \\
 1-16 \text{ of } 1\% \text{ of } \$1017.05 = 64 \text{ cents} \\
 \text{(See Example 15)}
 \end{array}$$

Equals

64 cents at rate of exchange, francs $5.16\frac{1}{4}$ will be francs 3.30, which is arrived at by multiplying rate 5.1625 by 64 cents.

Deduct francs 3.30 from francs 5250.52 = francs 5247.22 — ANSWER

EXPLANATION. — Multiply amount in United States money by rate of exchange (not including fraction 1-16 of 1 per cent) to find amount in francs and centimes at regular rate which can be purchased for \$1017.05. As the fraction is plus, a less number of francs and centimes would be given, therefore francs 3.30, which are equivalent to 64 cents at rate $5.16\frac{1}{4}$, should be deducted.

NOTE. — Always bear in mind that where the fractional rates of plus or minus are used, it applies only to the amount in United States money; therefore, in determining the amount of francs and centimes that can be allowed for a certain sum in United States money, if the fraction is minus, more francs and centimes will be given; and if plus, a less number.

EXAMPLE 19

CONVERSION: TO FIND PRICE PER SINGLE FRANC WHEN RATE QUOTED IS PER \$1.00.

To find the price of a single franc when rate of exchange is quoted at francs $5.16\frac{1}{4}$.

Operation: $5.1625)1.000000(.1937$

$$\begin{array}{r}
 \underline{51625} \\
 483750 \\
 \underline{464625} \\
 191250 \\
 \underline{154875} \\
 363750 \\
 \underline{361375}
 \end{array}$$

ANSWER — .1937 cents or 19 37-100 cents per franc.

EXPLANATION. — Divide one dollar by the rate per \$1.00.

NOTE. — For figuring large sums the amount in cents should be carried out five or six figures, as for example: .1937046.

Always bear in mind that the higher the quoted rate per \$1.00 for French, Belgian, and Swiss exchange the lower the actual price. For example: \$5000 at rate francs 5.15 would give 25,750 francs, while 25,750 francs at rate francs 5.20 per 1.00 would cost only \$4951.92.

CONVERSION, FRENCH EXCHANGE: TO FIND THE PRICE OF A SINGLE FRANC WHEN RATE IS QUOTED PER \$1.00 AND IS SUPPLEMENTED BY A FRACTIONAL RATE OF PLUS OR MINUS, SUCH AS FRANCS 5.16 $\frac{1}{4}$ - 1-16.

EXPLANATION. — First find the price of a single franc at the straight rate of 5.16 $\frac{1}{4}$, as shown in Example 19, which, if carried out, would have been .1937046 +, then find 1-16 of 1 per cent of that rate, which in this case would be .000121. If fraction were minus, as quoted above, you would deduct .000121 from .1937046, which would leave net rate .1935836 +, THE ANSWER. If fraction were plus 1-16 of 1 per cent the product .000121 should be added to rate, thus making net rate per single franc .1938256 +. It is unnecessary to use all the figures of the decimal when figuring the smaller amounts in francs and dollars.

EXAMPLE 20

CONVERSION: FRENCH, BELGIAN, AND SWISS MONEY INTO UNITED STATES MONEY, WHEN RATE OF EXCHANGE IS QUOTED PER SINGLE FRANC.

To find cost of francs 5250.50 at rate 19.37 cents per single franc.

$$\begin{array}{r}
 \text{Operation:} \quad 5250.50 \\
 \quad \quad \quad .1937 \\
 \hline
 \quad \quad \quad 3675350 \\
 \quad \quad \quad 1575150 \\
 \quad \quad \quad 4725450 \\
 \hline
 \quad \quad \quad 525050
 \end{array}$$

1017.021850, or \$1017.02 — ANSWER

EXPLANATION. — Multiply the amount in francs and centimes by the rate per single franc.

NOTE. — See Example 13. You will note that the same amount in francs and centimes at rate francs $5.16\frac{1}{4}$ gives same result, or practically so, for the reason shown in Example 19. In other words, the rate francs $5.16\frac{1}{4}$ per \$1.00 is practically same as .1937 cents per single franc, the slight difference being due to not using the full decimal of cents.

EXAMPLE 21

CONVERSION: UNITED STATES MONEY INTO FRENCH, BELGIAN, AND SWISS MONEY WHEN RATE OF EXCHANGE IS QUOTED PER SINGLE FRANC.

To find the amount in francs and centimes that can be purchased for \$1017.02 at rate of exchange — .1937 cents per franc.

Operation: $1937)1017.0200(5250.49$

$$\begin{array}{r}
 9685 \\
 \underline{4852} \\
 3874 \\
 \underline{9780} \\
 9685 \\
 \underline{9500} \\
 7748 \\
 \underline{17520} \\
 17433 \\
 \underline{87}
 \end{array}$$

ANSWER — Francs 5250.49

EXPLANATION. — Divide the amount in dollars and cents by the rate of exchange per single franc.

NOTE. — You will observe that Example 21 is proof of the correctness of Example 20 of same amounts, the slight difference in amount of centimes being on account of not using the full fraction.

ADDITION, SUBTRACTION, DIVISION, AND MULTIPLICATION OF FRENCH, BELGIAN, AND SWISS MONEY ARE DETERMINED BY SAME PROCESS AS WITH UNITED STATES MONEY.

GERMAN MONEY

1 MARK = 100 PFENNIGS

The monetary unit of Germany is the reichsmark or mark, of 100 pfennigs, the value of the gold unit in the money of the United States, as fixed by the Director of the United States mint, being 23.8 cents.

In exchange transactions with Germany it is the custom in large cities to base the rate of exchange upon the equivalent of 4 marks, expressed in cents thus: "95 $\frac{1}{4}$ cents," meaning that for each 4 marks 95 $\frac{1}{4}$ cents would be charged.

In the smaller cities and towns, the rate of exchange is quoted for a single mark, thus: "23.85 cents," meaning that for each mark 23 and 85-100 cents would be charged.

EXAMPLE 22

CONVERSION: MARKS INTO DOLLARS AT RATE PER 4 MARKS.

To find the cost of marks 5240.20 at rate of exchange, 95 1-16 cents per 4 marks.

Operation: $4).950625$ (95 1-16) $.237656 = 1$ mark

Marks	5240.20
at	<u>.237656 per 1 mark</u>
	3144120
	2620100
	3144120
	3668140
	1572060
	<u>1048040</u>

\$1245.36497120, or \$1245.36 — ANSWER

EXPLANATION. — Divide the rate per 4 marks by 4 to determine the cost of a single mark. Multiply the

amount in marks and pfennigs by cost per single mark, and the result will be the cost in United States money.

EXAMPLE 23

To find the cost of 5000 marks at rate of exchange, 95 $\frac{1}{4}$ cents per 4 marks.

$$\begin{array}{r}
 \text{Operation:} \quad 5000 \text{ marks} \\
 \quad \quad \quad .9525 \text{ rate per 4 marks} \\
 \quad \quad \quad \hline
 \quad \quad \quad 25000 \\
 \quad \quad \quad 10000 \\
 \quad \quad \quad 25000 \\
 \quad \quad \quad \hline
 \quad \quad \quad 45000 \\
 4) \hline
 4) 47625000 \\
 \hline
 1190.625 \text{ — ANSWER — } \$1190.63
 \end{array}$$

EXPLANATION. — Multiply amount in marks by the rate of exchange per 4 marks and divide the product by 4 (marks).

EXAMPLE 24

CONVERSION: DOLLARS INTO MARKS AT RATE PER 4 MARKS.

To find the amount in marks and pfennigs that can be purchased for \$1245.37 at rate of exchange, 95 1-16 per 4 marks.

$$\begin{array}{r}
 \text{Operation: } 4) .950625 \text{ rate per 4 marks} \\
 \quad \quad \quad .237656 \text{ rate per 1 mark} \\
 .237656) 1245.370000 (5240.22 \\
 \quad \quad \quad \hline
 \quad \quad \quad 1188280 \\
 \quad \quad \quad \hline
 \quad \quad \quad 570900 \\
 \quad \quad \quad \hline
 \quad \quad \quad 475312 \\
 \quad \quad \quad \hline
 \quad \quad \quad 955880 \text{ ANSWER — Marks } 5240.22 \\
 \quad \quad \quad \hline
 \quad \quad \quad 950624 \\
 \quad \quad \quad \hline
 \quad \quad \quad 525600 \\
 \quad \quad \quad \hline
 \quad \quad \quad 475312 \\
 \quad \quad \quad \hline
 \quad \quad \quad 502880 \\
 \quad \quad \quad \hline
 \quad \quad \quad 475312 \\
 \quad \quad \quad \hline
 \quad \quad \quad 27568
 \end{array}$$

EXPLANATION. — Divide the rate by 4 to determine rate per single mark. Divide amount in dollars and cents

by rate per single mark and the result will be amount in marks and pfennigs.

EXAMPLE 25

CONVERSION: DOLLARS INTO MARKS AT RATE PER 4 MARKS. (Another way.)

To find the amount in marks and pfennigs that can be purchased for \$1190.62½ at rate of exchange, 95½ cents per 4 marks.

Operation: .9525)1190.6250(1250.00

$$\begin{array}{r}
 \underline{9525} \qquad \qquad \qquad 4 \text{ marks} \\
 23812 \qquad \qquad \qquad 5000.00 \text{ marks} - \text{ANSWER} \\
 \underline{19050} \\
 47625 \\
 \underline{47625}
 \end{array}$$

NOTE. — See Example 23 for proof of correctness of these figures.

EXPLANATION. — Divide amount in dollars and cents by the rate per 4 marks, and multiply the quotient by 4, and the result will be in marks and pfennigs.

EXAMPLE 26

CONVERSION: MARKS INTO DOLLARS AT RATE PER 4 MARKS, SUPPLEMENTED WITH FRACTIONAL QUOTATIONS.

To find the cost of marks 5240.50 at rate of exchange, 95½ cents per 4 marks, minus 1-32 of 1% (expressed 95½ — 1-32).

Operation: 4).9525 rate per 4 marks

.238125 rate per 1 mark

5240.50 marks

at .238125 cents per mark

2620250 1-32 of 1%

1048100 1247.89

524050 .01

4192400 32)12.4789(.389 or 39 cts.

1572150 96

1048100 287

\$1247.89406250 256

1-32 of 1% = 39 318

ANSWER — \$1247.50 288

EXPLANATION. — Divide rate per 4 marks (without fraction) by 4 to find rate per single mark. Multiply amount in marks and pfennigs by rate per single mark and the result will be amount in dollars and cents. Find $\frac{1}{32}$ of 1 per cent of amount in dollars and cents and deduct same from cost at regular rate.

NOTE. — If supplementary fractional rate were PLUS $\frac{1}{32}$ of 1% instead of MINUS, its equivalent of 39 cents would be added to cost at regular rate.

EXAMPLE 27

CONVERSION: DOLLARS INTO MARKS AT RATE PER 4 MARKS, SUPPLEMENTED WITH FRACTIONAL QUOTATIONS.

What amount in marks and pfennigs can be purchased for \$1247.89 at rate of exchange, $95\frac{1}{4}$ plus $\frac{1}{32}$ of 1% (expressed $95\frac{1}{4} + \frac{1}{32}$).

Operation: $4)9525$ rate per 4 marks

.2381 rate per 1 mark, or .238125, carried out

.238125)1247.890000(5240.48

1190625

572650

476250

964000 Marks 5240.48

$\frac{1}{32}$ of 1% of

952500

1.64

marks 5240.48 = marks 1.64

1150000

5238.84 marks — ANSWER

(See below)

952500

5240.48

1975000

.01

1905000

32)52.4048(1.637 or marks

70000

32

1.64

204

192

120

96

244

224

20

EXPLANATION. — Divide the rate per 4 marks (without fraction) by 4 to determine rate per single mark. Divide amount in dollars and cents by rate per single mark and the result will be amount in marks and pfennigs. Find $\frac{1}{32}$ of 1 per cent of amount in marks and pfennigs, deducting same from amount in marks and pfennigs at regular rate.

NOTE. — If supplementary fractional rate had been MINUS $\frac{1}{32}$ of 1% instead of PLUS, its equivalent of 1.64 marks would have been added instead of deducted.

EXAMPLE 28

CONVERSION: MARKS INTO DOLLARS AT RATE PER 4 MARKS, SUPPLEMENTED WITH FRACTIONAL RATE. (Another way.)

To find the cost of marks 5240.50 at rate of exchange, $95\frac{1}{4}$ cents per 4 marks minus $\frac{1}{32}$ of 1% (expressed $95\frac{1}{4} - \frac{1}{32}$).

Operation: 5240.50 marks

$$\begin{array}{r}
 \underline{.9525} \text{ rate per 4 marks} \\
 2620250 \\
 1048100 \\
 2620250 \\
 \underline{4716450} \\
 4)4901576250 \\
 \underline{1247.894} \\
 39 \\
 \hline
 \$1247.50 - \text{ANSWER}
 \end{array}$$

$\frac{1}{32}$ of 1% of \$1247.89 = 39 cents
(See Example 26)

NOTE. — For verification of the result see Example 26.

EXPLANATION. — Multiply amount in marks and pfennigs by the rate per 4 marks and divide the product by 4, which gives amount in dollars and cents at regular rate. Deduct therefrom $\frac{1}{32}$ of 1 per cent and the result will be the cost.

NOTE. — If the fraction had been PLUS instead of MINUS, the 39 cents would have been added instead of subtracted.

EXAMPLE 29

CONVERSION: DOLLARS INTO MARKS AT RATE PER 4 MARKS, SUPPLEMENTED BY FRACTIONAL RATE. (Another method.)

To find the amount in marks and pfennigs that can be purchased for \$1247.89 at rate of exchange, $95\frac{1}{4}$ cents per 4 marks plus $1-\frac{32}{100}$ of 1 % (expressed $95\frac{1}{4} + 1-\frac{32}{100}$).

Operation: $.9525)1247.89000(1310.12$

<u>9525</u>	<u>4</u>	
29539	5240.48	marks
<u>28575</u>	<u>1.64</u>	
9640	5238.84	marks — ANSWER
<u>9525</u>		
11500		
<u>9525</u>		
19750		
<u>19050</u>		
700		

$1-\frac{32}{100}$ of 1% of
marks 5240.48 = marks 1.64
(See Example 27)

NOTE. — See Example 27 for verification of these figures.

EXPLANATION. — Divide amount in dollars and cents by rate per 4 marks and multiply that result by 4 to find amount of marks and pfennigs at regular rate. Find $1-\frac{32}{100}$ of 1 per cent of amount in marks and pfennigs (5240.48) and deduct same from amount of marks and pfennigs at regular rate and the result will be the net amount of marks and pfennigs that can be purchased.

NOTE. — If the fraction had been MINUS $1-\frac{32}{100}$ of 1% instead of PLUS $1-\frac{32}{100}$ of 1%, the 1.64 marks would have been added instead of subtracted.

GERMAN EXCHANGE

Quotations, per 4 Marks

To determine the price of a single mark when rate is quoted per 4 marks, supplemented by fractional quotations, plus or minus, such as $95\frac{1}{4} - 1-\frac{16}{100}$: First find the

rate per single mark at the regular quotation ($95\frac{1}{4}$) by dividing same by 4, as in Examples 22, 24, 26, and 27. This would make .238125 cents per mark. 1-16 of 1 per cent of .238125 is .0001488, which if deducted from .238125 gives .237976 +, the net rate per single mark at quotation of $95\frac{1}{4}$ - 1-16. If fraction were plus 1-16, the equivalent of this fraction of 1 per cent would be added to rate per single mark, making same .2382738. Where the amount to be converted is small it is unnecessary to use all the figures here used in the decimal of a cent.

EXAMPLE 30

CONVERSION: MARKS INTO DOLLARS AT RATE PER SINGLE MARK.

To find the cost of marks 2050.50 at rate 23.82 cents per mark.

$$\begin{array}{r}
 \text{Operation:} \quad 2050.50 \text{ marks} \\
 \quad \quad \quad \underline{.2382 \text{ rate per 1 mark}} \\
 \quad \quad \quad 410100 \\
 \quad \quad \quad 1640400 \\
 \quad \quad \quad 615150 \\
 \quad \quad \quad \underline{410100} \\
 \quad \quad 488.429100, \text{ or } \$488.43 - \text{ANSWER}
 \end{array}$$

EXPLANATION. — Multiply amount in marks and pfennigs by rate per single mark.

EXAMPLE 31

CONVERSION: DOLLARS INTO MARKS AT RATE PER SINGLE MARK.

What amount in marks and pfennigs will \$488.43 bring at rate 23.82 cents per single mark?

Operation: $.2382)488.4300(2050.50 \text{ marks} - \text{ANSWER}$

$$\begin{array}{r}
 \underline{4764} \\
 12030 \\
 \underline{11910} \\
 12000 \\
 \underline{11910} \\
 900
 \end{array}$$

MONETARY SYSTEMS OF THE WORLD'S PRINCIPAL COUNTRIES

(U. S. Government Figures)

UNITED STATES

The weight, fineness, etc., of the coins of the United States are as follows:

GOLD

DENOMINATIONS	WEIGHT	FINE-NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou-sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
Double eagle (\$20)	33.4370	900	30.0933	516.0000	464.4000	\$20.0000
Eagle (\$10)	16.7185	900	15.0466	258.0000	232.2000	10.0000
$\frac{1}{2}$ eagle (\$5)	8.3592	900	7.5232	129.0000	116.1000	5.0000
$\frac{1}{4}$ eagle (\$2.50)	4.1796	900	3.7616	64.5000	58.0500	2.5000
1 dollar ¹	1.6718	900	1.5046	25.8000	23.2200	1.0000

SILVER

Dollar	26.7301	900	24.0570	412.5000	371.2500	\$1.0000
$\frac{1}{2}$ dollar	12.5000	900	11.2500	192.9000	173.6100	.5000
$\frac{1}{4}$ dollar	6.2500	900	5.6250	96.4500	86.8050	.2500
Dime	2.5000	900	2.2500	38.5800	34.7220	.1000

MINOR COINS

DENOMINATIONS	WEIGHT	COMPOSITION	WEIGHT	LEGAL TENDER	VALUE
NICKEL	<i>Grams</i>		<i>Grains</i>		
5 cents.	5.0000	75 per cent copper and 25 per cent nickel.	77.1600	To the amount of 25 cents.	\$0.0500
BRONZE					
1 cent.	3.1104	95 per cent copper, 4 per cent tin, and 1 per cent zinc.	48.0000		.0100

¹ Monetary unit (no longer coined).

The act of June 9, 1879, made the subsidiary silver coins of the United States legal tender to the amount of \$10. The minor coins are legal tender to the amount of 25 cents.

PHILIPPINE ISLANDS

The coinage of the Philippine Islands is authorized by the acts of Congress of the United States approved March 2, 1903, and June 23, 1906, and by the decrees of the Philippine Islands government proclaimed March 23, 1903, and December 6, 1906.

The weight and fineness of the coins are as follows :

SILVER

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE SILVER CON- TAINED	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
Pesos ¹	20.0000	800	16.0000	308.6400	246.9120	\$0.50000
50 centavos . .	10.0000	750	7.5000	154.3200	115.7400	.25000
20 centavos . .	4.0000	750	3.0000	61.7280	46.2960	.10000
10 centavos . .	2.0000	750	1.5000	30.8640	23.1480	.05000

CUBA

Cuba is without a national currency, paper money, gold, silver, or copper, of any kind.

Debts are payable in Cuba in the kind of money stipulated in the obligation, and usually call for United States currency, Spanish or French gold, or Spanish

¹ Legal tender in the Philippine Islands for all debts, public and private, unless otherwise specifically stipulated in the contract. Subsidiary silver coins are legal tender to the amount of \$10.

silver. United States national-bank notes are accepted, but not the notes of French or Spanish banks.

The bonds of the Cuban Government are payable in American gold, and likewise all taxes, duties, and postage are collected, and the accounts of the treasury and post office department are kept in United States money.

In the Provinces of Santiago and Camaguey, United States money is used almost exclusively.

In the Provinces of Santa Clara, Matanzas, Havana, and Pinar del Rio, custom dictates the use of the different kinds of money in a general way as follows:

Car fare, sales of railroad tickets, freight charges, real estate, tobacco in bulk, and cigar-makers' wages are settled in American money.

Retail prices of articles selling for less than \$10, including cigars and carriage hire, are quoted in Spanish silver.

All sugar transactions, and other transactions of importance, including the larger part of the loans made by the banks, are made in Spanish or French gold.

For the purpose of domestic exchange, the "luis" (Napoleon) and "centen" (Alphonso) are arbitrarily called \$4.24 and \$5.30 Spanish gold, respectively. As the gold value of the former is \$3.859, and that of the latter is \$4.8238 American gold, the parity of an American dollar is approximately \$1.09872 in Cuban "Spanish gold." This rate varies in the market from \$1.08 to \$1.10 $\frac{3}{4}$.

The Spanish silver coins in circulation are the "peso," "doble-peseta," "peseta," and "real," valued as \$1,

40 cents, 20 cents, and 10 cents, respectively. There are also 1 and 2-cent Spanish copper pieces in current use. The "reales" are quoted in quantities of \$5 or more at from 3 per cent to 5 per cent premium, and the copper pieces from 3 per cent to 10 per cent premium. Spanish silver is quoted in "Spanish gold" and fluctuates widely. During the past three years the rate has gradually approached 100, the present price being $99\frac{1}{4}$, or approximately $6\frac{3}{4}$ per cent discount from the arbitrary rate of 106 "Spanish gold."

All denominations and kinds of United States currency are in circulation.

In addition to the Alphonso and Napoleon, but not so generally used, also gold coins valued at \$17, \$4.25, \$2.12 $\frac{1}{2}$, and \$2.12, known as "onzas," "escudos," "medio-escudos," and "medio-luises," respectively, are in circulation.

GREAT BRITAIN AND COLONIES

The sovereign (pound sterling), the monetary unit, is a gold coin weighing 7.988 grams, 0.916 $\frac{2}{3}$ fine, containing 7.322 grams, or 113.0016 + grains of pure gold.

The silver coins of Great Britain are a legal tender for 40s. or £2, equal to \$9.732 in United States money. The present legal ratio between gold and silver in the coinage of Great Britain is as 1 to 14.28781.

The English colonies of Malta, Gibraltar, the South and West African colonies, the West Indies, and New Zealand use the coins of England. The Dominion of Canada, Commonwealth of Australia, and Nigeria have

special silver and nickel coinages, respectively, which are only current locally. Fourpences of special design are also struck for circulation in the West Indies and British Guiana. In Canada the gold coins of the United States and the pound sterling or sovereign are legal tender at the rate of \$4.86 $\frac{2}{3}$.

The coinage act of 1870 shall apply to and be in force in each of the colonies or possessions following and their dependencies, namely: Jamaica (including the Turks and Caicos Islands), British Guiana, the Bahamas, Trinidad and Tobago, Barbados, Grenada, St. Vincent, St. Lucia, the Leeward Islands, the Bermudas, the Falkland Islands, Malta, St. Helena, Sierra Leone, Gambia, the Gold Coast, Lagos, and British New Guinea.

The weight, fineness, etc., of the coins of Great Britain now issued are as follows:

GOLD

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
5 pounds . . .	39.9411	916 $\frac{2}{3}$	36.6127	616.3723	565.0080	\$24.3325
2 pounds . . .	15.9764	916 $\frac{2}{3}$	14.6451	246.5489	226.0032	9.7330
Sovereign . . .	7.9882	916 $\frac{2}{3}$	7.3225	123.2744	113.0016	4.8665
Half sovereign .	3.9941	916 $\frac{2}{3}$	3.6612	61.6372	56.5008	2.4332

SILVER

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
Half crown . . .	14.1382	925	13.0779	218.1818	201.8181	\$0.6083
Florin	11.3106	925	10.4623	174.5454	161.4545	.4866
Shilling	5.6553	925	5.2311	87.2727	80.7272	.2433
Sixpence	2.8276	925	2.6155	43.6363	40.3636	.1216
Fourpence (groat)	1.8851	925	1.7437	29.0909	26.9090	.0811
Threepence . . .	1.4138	925	1.3077	21.8181	20.1818	.0608
Twopence	.9425	925	.8718	14.5454	13.4545	.0405
Penny	.4712	925	.4359	7.2727	6.7272	.0202

CANADA

The Dominion of Canada, including the Provinces of Prince Edward Island, Nova Scotia, New Brunswick, Quebec, Ontario, Manitoba, British Columbia, Alberta, Saskatchewan, Yukon, and Northwest Territories, has a monetary system established under "The Currency Act, 1910," assented to by Edward VII, May 4, 1910, by and with the consent of the Senate and House of Commons of Canada.¹

The standard is gold, and coinage upon the decimal system in dollars and cents. United States gold coins and the British sovereign are legal tender, the latter at the rate of \$4.86 $\frac{2}{3}$.

The weight, fineness, etc., of the coins of Canada are as follows:

¹ The currency act, chapter 25, of the Revised Statutes, 1906, is repealed.

GOLD

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
20 dollars . . .	33.4370	900	30.0933	516.0000	464.4000	\$20.0000
10 dollars . . .	16.7185	900	15.0466	258.0000	232.2000	10.0000
5 dollars . . .	8.3592	900	7.5232	129.0000	116.1000	5.0000
2½ dollars . . .	4.1796	900	3.7616	64.5000	58.0500	2.5000

SILVER

Dollar	23.3281	925	21.5784	360.0000	333.0000	\$1.0000
50 cents . . .	11.6640	925	10.7892	180.0000	166.5000	.5000
25 cents . . .	5.8320	925	5.3946	90.0000	83.2500	.2500
10 cents . . .	2.3328	925	2.1578	36.0000	33.3000	.1000
5 cents	1.1664	925	1.0780	18.0000	16.6500	.0500

LATIN UNION COUNTRIES

France, Belgium, Switzerland, Greece, and Italy

(Spain has the same gold and silver coins as the Union.)

The actual value of the French gold franc in the money of the United States as declared by the director of the United States mint is 19 and 3-10ths cents (\$0.193). Francs are the currency of the countries forming the Latin Union, a union formed for the adoption of a uniform monetary system, comprising France, Belgium, Switzerland, Greece, and Italy. France, Belgium, and Switzerland call their unit the "franc." Greece calls its unit the "drachma," and Italy the "lire." The free

circulation of gold and silver coins issued by the countries named was further ratified at the convention held at Paris, France, November 15th, 1893. By this convention, ratifying the original arrangement, the gold and silver coins issued by each of the above-mentioned countries were granted free and unlimited circulation at face value in the countries forming the Latin Union.

The weight, fineness, etc., of the coins are as follows :

GOLD

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
100 francs ¹ . . .	32.2580	900	29.0322	497.8054	448.0249	\$19.2947
50 francs . . .	16.1290	900	14.5161	248.9027	224.0124	9.6475
20 francs . . .	6.4516	900	5.8064	99.5610	89.6049	3.8589
10 francs . . .	3.2258	900	2.9032	49.7805	44.8024	1.9294
5 francs . . .	1.6129	900	1.4516	24.8902	22.4012	.9647

SILVER

5 francs . . .	25.0000	900	22.5000	385.8000	347.2200	\$9.9647
2 francs . . .	10.0000	835	8.3500	154.3200	128.8572	.3858
1 franc . . .	5.0000	835	4.1750	77.1600	64.4286	.1929
50 centimes . . .	2.5000	835	2.0875	38.5800	32.2143	.0964
20 centimes . . .	1.0000	835	.8350	15.4320	12.8857	.0385

GERMAN EMPIRE

The fundamental law of the present monetary system of Germany is that of June 1, 1909, abrogating the law

¹ In Italy, lire and centesimi. In Greece, drachmas and lepta. In Spain, pesetas and centimos.

of December 4, 1871, regulating the striking of gold coins in the Empire, the monetary laws of July 9, 1873, June 1, 1900, and May 19, 1908, modifying the monetary system. All references to the arrangements of the abrogated laws are replaced by the corresponding arrangements of this law.

The standard is gold monometallic, and the monetary unit the mark of 100 pfennigs. Silver is legal tender to the amount of 20 marks.

The weight, fineness, etc., of the gold coins of the German Empire are as follows:

GOLD

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
Double crown (20 marks) . . .	7.9649	900	7.1684	122.9151	110.6236	\$4.7641
Crown (10 marks)	3.9824	900	3.5842	61.4575	55.3118	2.3818

SILVER

5 marks . . .	27.7777	900	25.0000	428.6655	385.8000	\$1.1909
3 marks . . .	16.6666	900	15.0000	257.0971	231.4800	.7143
2 marks . . .	11.1111	900	10.0000	171.4650	154.3200	.4762
1 mark . . .	5.5555	900	5.0000	85.7325	77.1600	.2381
50 pfennigs . .	2.7777	900	2.5000	42.8663	38.5800	.1190

NORWAY, SWEDEN, AND DENMARK (Scandinavian Union)

The Scandinavian Monetary Union embraces Norway, Sweden, and Denmark, and the value of the gold krone

or crown in the money of the United States, as declared by the director of the United States mint, is 26 and 8-10th cents (\$.268). The commercial value of the krone (plural kronor) in the United States fluctuates according to the demand for checks, drafts, and bills of exchange on these countries, and the supply of such exchange in the market for sale. Silver coins are legal tender as follows: The 2-kronor and 1-krone pieces to the amount of 20 kronor; the 50, 40, 25, and 10 ore pieces to the amount of 5 kronor. The money in circulation consists of paper currency and gold, silver, and bronze coins, the weight, fineness, etc., of coins and the equivalent value in the money of the United States, being as follows:

GOLD

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
20 crowns . . .	8.9606	900	8.0645	138.2799	124.4513	\$5.3596
10 crowns . . .	4.4803	900	4.0323	69.1399	62.2240	2.6797
5 crowns . . .	2.2401	900	2.0161	34.5699	31.1124	1.3398

SILVER

2 crowns . . .	15.0000	800	12.0000	231.4800	185.1840	\$0.5359
1 crown . . .	7.5000	800	6.0000	115.7400	92.5920	.2679
50 ore . . .	5.0000	600	3.0000	77.1600	46.2960	.1339
25 ore . . .	2.4200	600	1.4520	37.3454	22.4072	.0669
10 ore . . .	1.4500	400	.5800	22.3764	8.9505	.0267

NETHERLANDS

Holland is usually classed as a double-standard country. It would be more correct to say that it has a gold standard conjointly with the circulation, as a legal tender, of the rixdaler, gulden, and half gulden.

The fundamental monetary law of the Netherlands at the present time is that of May 28, 1901, altered by the law of December 31, 1906.

A bill was passed in 1875 (June 6) opening the mint to the public for the coinage of gold, making the new standard coin a 10-florin gold piece, weighing 6.048 grams of fine gold, thus establishing the ratio in coinage of gold to silver of 1 to 15.625.

The monetary system of the Dutch colonies is the same as that of the mother country.

The weight, fineness, etc., of the coins of the Netherlands are as follows :

GOLD

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
10 florins . . .	6.7200	900	6.0480	103.7030	93.3327	\$4.0195
Ducat ¹	3.4940	983	3.4346	53.9194	53.0027	2.2826

SILVER

2½ florins . . .	25.0000	945	23.6250	385.8000	364.5810	\$1.0048
Florin	10.0000	945	9.4500	154.3200	145.8324	.4019
½ florin	5.0000	945	4.7250	77.1600	72.9162	.2097
25 cents	3.5750	640	2.2880	55.1694	35.3084	.1004
10 cents	1.4000	640	.8960	21.6048	13.8270	.0401

¹ Trade coin.

AUSTRIA-HUNGARY

The fundamental text is the law of August 2, 1892. The new monetary system is gold, monometallic, and the legal monetary unit is the crown (0.3387533 gram fine), which is divided into 100 hellers (farthings).

Besides the pieces of the crown system there may be coined, for individual account, gold ducats and silver thalers (Maria Theresa type of 1780), but these pieces have no lawful currency. The gold coins of the crown system may be coined for individual account and have unlimited currency.

The weight, fineness, etc., of the coins of Austria-Hungary are as follows :

GOLD

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	Grams	Thou- sandths	Grams	Grains	Grains	
100 crowns . . .	33.8753	900	30.4878	522.7636	470.4872	\$20.2623
20 crowns . . .	6.7750	900	6.0975	104.5218	94.0696	4.0524
10 crowns . . .	3.3875	900	3.0487	52.2759	47.0483	2.0262
4 ducats . . .	13.9636	986 $\frac{1}{2}$	13.7696	215.4862	212.4933	9.1508
Ducat (Austrian) ¹	3.4909	986 $\frac{1}{2}$	3.4424	53.8715	53.1233	2.2877

SILVER

5 crowns . . .	24.0000	900	21.6000	370.3680	333.3312	\$1.0130
Florin . . .	12.3457	900	11.1111	190.5188	171.4664	.4052
2 crowns . . .	10.0000	835	8.3500	154.3200	128.8572	.4052
1 crown . . .	5.0000	835	4.1750	77.1600	64.4286	.2026
Maria Theresa thaler ² . . .	28.0668	833 $\frac{1}{3}$	23.3889	433.1268	360.9375	.8545
20 kreutzers . .	2.6666	500	1.3333	41.1509	20.5754	.0810
10 kreutzers . .	1.6666	400	.6666	25.7189	10.2869	.0405

¹ Trade coin, equivalent to 11.29 crowns.

² Trade coin.

RUSSIA

The Russian monetary system is based on gold (law of June 7-19, 1899). The monetary unit is the gold ruble, 0.774234 gram fine, containing 17.424 doli. The ruble is divided into 100 kopecks.

Only the gold coins have unlimited lawful currency, and the coinage of gold alone is free.

The weight, fineness, etc., of the coins of Russia are as follows:

GOLD

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
15 rubles (im- perial) . . .	12.9039	900	11.6135	199.1329	179.2195	\$7.7183
10 rubles . . .	8.6026	900	7.7423	132.7553	119.4791	5.1455
7½ rubles (½ im- perial) . . .	6.4519	900	5.8067	99.5657	89.6089	3.8591
5 rubles . . .	4.3013	900	3.8711	66.3776	59.7388	2.5727

SILVER

1 ruble	19.9957	900	17.9961	308.5736	277.7158	\$0.5145
50 kopecks . . .	9.9978	900	8.9980	154.2860	138.8571	.2572
25 kopecks . . .	4.9989	900	4.4990	77.1430	69.4285	.1286
20 kopecks . . .	3.9992	500	1.7996	55.5429	27.7714	.1029
15 kopecks . . .	2.6994	500	1.3497	41.6571	20.8285	.0771
10 kopecks . . .	1.7996	500	.8998	27.7714	13.8857	.0514
5 kopecks . . .	.8998	500	.4499	13.8857	6.9428	.0257

JAPAN

By a law which went into operation October 1, 1897, Japan adopted the single gold standard. The coinage

unit is 2 fun (11.574 grains of pure gold) — that is, one-half of the former unit.

The former 1-yen silver coins, although at first given unrestricted currency at the value of the new gold yen, have since been retired.

The notes of the bank of Japan compose the paper currency. The gold standard is maintained.

The weight, fineness, etc., of the coins of Japan are as follows :

GOLD

DENOMINATIONS	WEIGHT	FINE- NESS	FINE WEIGHT	WEIGHT	PURE GOLD OR SILVER	VALUE IN UNITED STATES MONEY
	<i>Grams</i>	<i>Thou- sandths</i>	<i>Grams</i>	<i>Grains</i>	<i>Grains</i>	
20 yen	16.6666	900	15.0000	257.1989	231.4800	\$9.9689
10 yen	8.3333	900	7.5000	128.5994	115.7400	4.9844
5 yen	4.1666	900	3.7500	64.2997	57.8700	2.4921

SILVER

50 sen	10.1250	800	8.1000	156.2400	124.9992	\$0.2492
20 sen	4.0500	800	3.2400	62.4996	49.9996	.0996
10 sen	2.2500	720	1.6200	34.7220	24.9998	.0498

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