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FOREIGN EXCHANGE AND FOREIGN BILLS IN THEORY AND IN PRACTICE

BY

WILLIAM F. SPALDING

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PREFACE TO ELEVENTH EDITION

THERE are, it is said, three main causes which dispose man to madness, namely, love, ambition, and the study of currency problems, the last being the worst of the three. Indeed, the rapidity with which monetary units, currency standards, and bases of exchange have been altered in recent years is enough to try the sanity of the most stolid man. When the previous edition of this book was published a year ago, one considered that something like finality had been reached; but, alas, further adjustments continue to take place. What these are will be seen in the chapters dealing with devaluation in France and various other countries, all of which have been revised to admit of the incorporation of the latest details concerning new parities, alteration in the methods of quoting rates, and so on.

Other parts of the book have been revised to keep it up to date, and the opportunity has been taken to make some adjustment in the pages for the convenience of readers.

W. F. SPALDING.

AUTHORS' CLUB,
2 WHITEHALL COURT,
LONDON, S.W.1.
November, 1937.

PREFACE TO TENTH EDITION

THE theory and practice of foreign exchange has been the subject of much alteration since this book was first published twenty-one years ago, and in each of the nine succeeding editions many interesting developments have been explained. Times change, however, and we change with them, and the foreign exchange operator of to-day has to deal with a far greater diversity of problems than fell to the lot of his prototype in 1915 to solve. Monetary standards have changed; methods of quoting have altered; new parities have been evolved; few countries are on the gold standard, while even the age-old silver-using countries have dropped the silver mooring from their currencies. Managed currencies are, in fact, almost universal. The day of general stabilization of currencies is not yet, and until that day comes we have to take things as they are, not as they ought to be.

The object, then, of this edition is to present the position of the foreign exchanges of *to-day*. A large part of the book has been rewritten, out-of-date matter discarded, and much new material added. Practical examples, wherever possible, have been given to illustrate current methods of operating, and these, together with new pages on the drawing and negotiation of bills of exchange, it is hoped will prove useful both to students and to commercial men.

New chapters on the China Exchanges and on Exchange Restrictions have been added. An Appendix on the

Devaluation of the French franc and other currencies in October, 1936, has been added and the Appendix on the Foreign Exchanges and the Great War has been retained owing to its proved utility to bankers and others for reference purposes.

The author records his grateful thanks to the many foreign and colonial bankers who have freely placed their expert knowledge at his disposal, and to the editors of *The Times*, *Trade and Engineering*, and *Bankers' Magazine* for permission to use, where necessary, extracts from special articles he has contributed to those journals.

W. F. SPALDING.

AUTHORS' CLUB,
2 WHITEHALL COURT,
LONDON, S.W.1.
October, 1936.

PREFACE TO FIRST EDITION

THE object of this work is to present in a concise and simple form the theory and practice of Foreign Exchange. At first sight some apology may appear to be due for adding to the long list of books on monetary science, but reference to the table of contents will show that special attention has been paid to that more practical part of the subject—foreign bills. The drawing and negotiation of foreign bills are matters which concern not only bankers, but all commercial men, and, bearing this in mind, an endeavour has been made throughout the book to intersperse the practical with the theoretical points.

To explain the working of foreign exchanges in a simple manner is not easy, and the frequent dislocation of the principal exchanges during the war has not conduced to the simplicity of the task. The erratic movements in rates have, however, furnished abundant material from which to draw the necessary illustrations in support of the theories I have tried to make plain.

Exchange with the silver-using countries of the East seems to be a general source of trouble to people dealing with those centres, and in deference to many requests, I have taken the opportunity to include one or two chapters on the Eastern exchanges, which I hope will serve to remove the difficulties which appear to surround this part of the subject.

My thanks are due to the managers and agents of the various foreign and colonial banks in London for much valuable advice and assistance, more particularly, perhaps, to Mr. R. W. Jeans, of the Bank of Australasia, Mr. E. J. Osborne, of the National Bank of Australia, Mr. F. S. C. Norman, of the Standard Bank of South Africa, and to my friend, Mr. H. C. Sonne, of Denmark.

Government Departments have, as usual, been ready to help wherever possible by facilitating reference to trade statistics, and in this respect I am specially indebted to the Right Hon. Sir George H. Reid, P.C., K.C., G.C.M.G., and Mr. G.H. Knibbs, of Australia, and to His Excellency Don Vicente J. Dominguez, of the Argentine Republic.

Throughout this book free use, where necessary, has been made of the details contained in the various articles and reviews I have contributed from time to time to the *Journal of the Institute of Bankers*, the *Bankers' Magazine*, and the *Economic Journal*, and acknowledgment is hereby made of the courtesy of the respective editors for the consent to utilize such material.

WILLIAM F. SPALDING.

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FOREIGN EXCHANGE AND FOREIGN BILLS

CHAPTER I

INTRODUCTORY AND EXPLANATORY

THE pathway of international exchange is always a thorny one, and in the past writers have been apt to expound theories on the subject too abstruse to be intelligible to that illusive friend of the politicians—the man in the street. Technical dissertations on the exchanges may, and possibly do, interest bankers, money brokers and the like, but the general student who has to commence the subject from its very alphabet, so to speak, sometimes finds himself unable to grasp the intricacies of the problem set before him. Indeed, the method of working the foreign exchanges has been so little understood in these Islands, that when we see a person setting out to tackle the subject, it is difficult to know whether to pity or to envy him.

He is understood to be about to dabble in a branch of economics, the principles of which are interesting only to painstaking foreigners or much-abused university professors, the sort of thing, in fact, immortalized by George Eliot in her inimitable description of the Reverend Casaubon's heroic, dry-as-dust researches.

It need hardly be said that the dust surrounding the subject is more apparent than real, and if the reader will boldly cast aside this hypothetical covering, he will find the study of exchange in relation to monetary affairs to be both interesting and fascinating.

It is only in recent years that education authorities have

included this branch of science in their curriculum. Why the subject was for so long neglected, it is hard to say. Possibly it was due to that insular prejudice which regards anything off the beaten track as unworthy of attention, but the fact remains that while we had been content to relegate the study to the chosen few whose business it was to direct the banking operations of the country, large numbers of Continental students had been industriously acquiring a thorough theoretical knowledge of the foreign exchanges, with the not unnatural result that when practical problems in connection with international finance came to be solved, the British bank clerks and the like often found themselves ousted by the foreigner.

It was not until the Great War that people began seriously to interest themselves in the foreign exchanges. There was a desire to be informed as to the reason why one country's monetary unit should depreciate while that of another appreciated. In the autumn of 1915 there was found to be no definite course in any of the commercial colleges in foreign exchange, and with the object of removing that reproach, the writer was requested by the Educational Adviser to the City of London College to deliver a series of lectures on the subject. Early in the course it became necessary to explain to university students the importance of the exchanges to those who contemplated the adoption of a commercial career.

"Why," it was asked, "is it necessary to acquire a knowledge of the principles underlying foreign exchange?" Briefly stated, the reply was that the trend of events following the outbreak of the Great War had amply demonstrated the necessity for something more than a passing acquaintance with the subject. For the rest, the attention of students is directed to the words of one, Thomas Mun, who wrote a small treatise in the year 1664. This old writer set down what he termed the excellent qualities required in a perfect merchant. These are his words:

"He ought to know the measures, weights, and monies of

all foreign countries, especially where we have a trade, and the monies not only by their several denominations, but also by their intrinsic values in weight and fineness, compared with the standard of this Kingdom, without which he cannot well direct his affairs. He ought to understand, and to be a diligent observer of the rates of exchanges by bills, from one State to another, whereby he may the better direct his affairs, and remit over and receive home his monies to the most advantage possible."

If this advice was pertinent in 1664, how much more applicable is it in the year 1936?

A person who has attained a reasonable degree of proficiency in the study of the foreign exchanges is able to understand clearly why a heavy Continental demand for gold adversely affects the price of money on the London market: he is in a position to comprehend why the breaking off of diplomatic relations between two nations causes wholesale dislocation on the stock markets of other distant countries: without soaring to prophetic heights he will be able to forecast the effect of a fall in the price of silver in London on the operations of those whose trade is with the Far East, and, in addition to grasping the significance of these panoramic changes, he will appreciate the real methods of liquidating international indebtedness.

The reader must not conclude from the foregoing that it is an easy matter to master the intricacies of the subject, but it is desirable to add that the seeming difficulty of understanding the technicalities of foreign exchange, and likewise foreign bills, is largely the result of a neglect to study the business in a workmanlike and systematic manner. Emphasis is laid on this point, because it has come to be considered in some circles that a thorough theoretical and practical knowledge of the exchanges is obtainable from a passing acquaintance with commerce, coupled with a cursory perusal of a few haphazard articles on this branch of monetary science. In many public examinations, too, it is considered sufficient to include one

or two questions on exchange in a general economics paper: widespread confusion is the result.

Most persons with commercial training are perfectly entitled to form and maintain opinions concerning their own trade and the monetary operations connected therewith, but in default of continuous study, or of special experience, no man is competent to discourse upon the theory and practice of foreign exchange.

Throughout this book, then, the author imagines himself in the position of the person with no previous knowledge of the subject; and while every endeavour is made to demonstrate the various divisions step by step in a manner capable of being understood by the veriest tyro, it is hoped that the arrangement of the work will meet the needs of the more mature students.

It is the practice of many economic writers to commence their treatises with a definition of the particular part of the science with which they propose to deal, and in deference to that useful custom, we may by way of introduction attempt to explain the term "foreign exchanges."

Meaning of Foreign Exchanges.

As a mode of expression the words "foreign exchanges" form one of those meaningless phrases which have filtered down to us through the dust of antiquity. To the lay mind the words convey nothing, and unless one is a diligent reader of the money article, or has connections with the banking world, foreign exchange might very well mean the exchange of a London pig for a Chinaman's opium bowl. It is all very well to say: "Oh! foreign exchange is merely the mechanism by which the money of one country is sold in another," when Tom, Dick or Harry is but dimly aware of the fact that money, as such, is ever bought and sold.

We may get to the root of the matter if we go back to the old system of barter;¹ only, in this case we barter, not

¹ The subject of barter is dealt with fully in the author's work on *The Functions of Money*. (Sir Isaac Pitman & Sons, Ltd.)

goods, but the value of goods, expressed in most cases by credit instruments—money substitutes. Consequently, the term signifies the practice prevailing among bankers, financiers and merchants in different centres or countries of regulating their mutual indebtedness without the transfer of metallic money from one country to the other. The trouble, risk, and expense of sending actual gold or silver from place to place is avoided as far as possible, by making use of money substitutes, or, to use an economics term, "representative" money. These money substitutes may be in the form of telegraphic transfers, mail transfers, bills of exchange on demand, at sight, or at so many days after date or sight. Representative money used in foreign exchange may even be in the shape of coupons, bearer securities, dividend warrants on foreign investments, and a hundred and one other things which will have to be discussed in the course of this book.

The final operations are carried out by bankers and their foreign agents, but special note should be taken of the fact that it is the transactions of merchants upon which the wheels of international finance principally depend for their motive power.

In its simplest form, foreign exchange embraces the many operations connected with the buying and selling of the substitutes for metallic money, and we shall arrive at a better understanding of the subject if we treat this money from the outset as a commodity, controlled by the same great laws of supply and demand as those that govern any other commodity.

The reader is advised to dismiss from his mind for the moment the fact that he is dealing in the moneys of foreign countries, and instead, to regard bills of exchange as representing a definite commodity—a debt. In a word, it is debts or some form or other of indebtedness, which are bought and sold in foreign exchange, and the price of these follows exactly the same laws as any other article of commerce.

MacLeod, in his *Theory of Banking*, compares them with corn, and although he was not propounding the theory of the foreign exchanges, yet his analogy is so remarkably applicable to the case we have before us, that no apology is needed for quoting his words—

“If money is scarce,” he says, “and wheat very abundant, the price of wheat must fall: if money is very abundant, the price of wheat will rise. The price of debts obeys the same rules. If money becomes very scarce, the price of debts must fall. . . . If specie becomes abundant, the price of debts will rise. . . . The price of debts, then, must follow the same great laws of nature that the price of wheat does.”¹

That, in a nutshell, is the basis of the business of foreign exchange, which, as will be shown in later chapters, principally comprises the purchase and sale of foreign debts in the guise of bills of exchange.

As we have said, very little attention was paid to the course of the foreign exchanges prior to the War. The principal nations of the world enjoyed the benefits of a gold currency, with actual gold coins in circulation. Few had experienced the evils arising from the circulation and over-issue of inconvertible notes. Still fewer suffered from the burden of excessive taxation, inflicted upon nations to meet heavy indebtedness to countries more favourably situated or whose finances had been more carefully managed. In the light of recent events, it seems that many of us were living in a fool's paradise, and it has been demonstrated over and over again that indebtedness internal and external has a very important bearing on the course of the foreign exchanges. The price of one country's monetary unit in terms of that of another country is affected by many factors, the investigation of which brings one back each time to the starting-point of indebtedness. But perhaps we are

¹ *Theory and Practice of Banking*, Book II, page 278.

going ahead too quickly and in order not to cause the reader too furiously to think, we had better tackle the riddle of the exchanges in easy stages, and as a fitting conclusion to this introductory chapter, we give a further excerpt from Thomas Mun's *England's Treasure by Forraign Trade*. In writing to his son he says: "It is true that when the wealth of a Kingdom consisteth much in ready mony, and that there is also good means and convenience in such a Kingdom to trade with the same into forraign parts, either by sea or land, or by both these ways; if then this trade be neglected, the King shall be defeated of those profits: and if the exchange be the cause thereof, then must we learn in what manner this is done; for we may exchange either among ourselves, or with strangers; if amongst ourselves, the Commonwealth cannot be enriched thereby; for the gain of one subject is the loss of another. And if we exchange with strangers, then our profit is the gain of the Commonwealth. Yet by none of these ways can the King receive any benefit in his customes. Let us therefore seek out the places where such exchanging is used, and set down the reasons why this practice is permitted." Well, readers all, that is what we are going to try to do in this book.

CHAPTER II

THE BASIS OF FOREIGN EXCHANGE

WE have stated that foreign exchange arises from indebtedness ; it covers a multitude of operations involved in the settlement of overseas debts. In the home trade, but an insignificant portion of payments for goods and services is made in cash, whether of metallic money or notes. Resort is had to bills of exchange, which, although frequently designed to postpone the date of payment, are utilized to raise ready money in the commercial world. So let us be sure first of all that we start our study with a clear comprehension of what a bill of exchange is.

The definition given in the English Bills of Exchange Act of 1882 is precise and to the point. It reads—

“ A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer.”

It is this piece of paper, so succinctly described, that plays what is probably the most important rôle in the world of commerce and finance. Through its intermediary, numberless transactions take place, and that is perhaps why it is surrounded by a whole host of legislative enactments. The study of the legal side is indeed a valley of dry bones, and as a great judge once said, an informing spirit is needful that they may live. Whether he had in mind the exchange problems that arise from the passing of bills of exchange from one person to another, we know not, but an examination of the transactions will show that there is little that is dull in the business.

How do bills concern the banker ? Well, when a banker discounts a bill for a client he buys what is, in effect, a debt owing, or to become due, to that client : the operation may

correctly be described as a transfer of indebtedness, but it should be borne in mind that there is no ground for the popular statement that the act of the banker is to lend money to his customer. He buys the right to receive a sum certain in money.

If we dismiss from our minds for the moment the foreign side of the problem, it will be plain that a large number of the operations of a banker are purely local. They relate to the transfer of money between place and place in the homeland. For example, Jones of Ulster wants Smith of Liverpool to send to him certain goods. The cost is, say, £100—he writes to Smith to inform him that he may draw a bill on him for £100. Smith agrees; he draws a bill of exchange, payable on demand on Jones. He wants the money at once, so he takes the bill to his own banker in Liverpool who, knowing that Smith and Jones, called the drawer and drawee respectively, are honest fellows, discounts the bill. That is, he buys this piece of paper, which is evidence of Jones's indebtedness to Smith, for an agreed price. This the banker sends to Ulster for presentation to Jones, who, we will assume, pays the bill on demand.

This is a simple exchange transaction on the home market, typical of many that take place daily between any of the large towns, say London and Manchester. It is what the Americans call in plain language "domestic exchange."

Buying and Selling of Debts.

From our standpoint the banker really buys a definite, marketable commodity, and if the reader has literally interpreted this simple definition of monetary exchange, he will realize that the commodities bought and sold in foreign exchange are nothing more or less than international debts. Much confusion has been engendered by regarding these debts as being transferred from one to the other, not sold, and in the process people quite lose sight of the fact that each transfer or exchange is in itself an actual sale of a tangible article of commerce. It will tend

to simplicity, therefore, if we regard foreign exchange as the buying and selling of debts between countries.

In its most elementary form this buying and selling of foreign indebtedness is usually represented as being carried out by one piece of paper transferred between four principals, thus: A and B are two persons residing in one locality different from the domicile of C and D: A in London, we will say, sells goods to C in Paris, while D in Paris sells produce to B in London. To satisfy the four dealers engaged in these two transactions, obviously there must be a sale and purchase of two debts, or, to put it in another way, one payment in Paris will be exchanged for one payment in London, and the manner in which the indebtedness is cancelled is almost ridiculous in its simplicity. London creditor A has a claim for French francs and centimes on C, while D has a similar claim on B for the sterling equivalent. If it is assumed that each transaction is equal in value, then A will sell C's debt to him to B: B, being under the necessity of remitting funds to Paris, buys this claim on C in order to send it to D, who will finally claim the cash from C. In this manner four parties are satisfied, and, to state the case more explicitly, the claim of Paris on London and London's claim on Paris are both settled through the instrumentality of a bill of exchange, which A is assumed to have drawn on C; and the trouble, risk and expense of sending actual coin or bullion from place to place are avoided.

If the exchange could thus be satisfactorily disposed of, there would be little difficulty in comprehending the operations which take place; but, unfortunately, there are other points to consider. In our example we have assumed that A drew a bill on C, and that after travelling round its allotted sphere this piece of paper found a resting place in D's portfolio until the date of payment. Then again, we have taken it for granted that the two debts were of equal value. In actual practice, however, such conditions rarely prevail. What really happens is that

A will draw a bill on C, D will also draw on B, and as each party will require to be paid for his produce in the money of his own country, the exchange is effected through the medium of a banker. Finally, it is the banker who will adjust any balance which may arise owing to the different and varying proportion of the value of the currency of one country in the other.

If, then, as in this hypothetical case of two debts arising from the transactions among four traders, the total claims of any two countries are not in a state of equality nor fall due for payment at the same time, it is apparent that this is the point at which the real exchange problem arises, since owing to the lack of coincidence in the total debts of the two nations there will remain a balance to be liquidated.

This exchange of money or representative money is carried on under various guises and in many different ways for the ultimate purpose of paying and being paid debts incurred in connection with operations in foreign countries—but it is usually a banker who is the intermediary in the business.

If the reader will remember that the relatively unimportant transactions are but the prelude to large exchange deals; that small operations will frequently be carried on between debtor and creditor respectively; and that the larger operations will call for the assistance of the banker or exchange dealer, he will have advanced far in his comprehension of the working of international exchange, than which there is no more interesting study in the whole science of monetary economics.

Basis of International Indebtedness.

The basis of this international indebtedness is foreign trade, and although the question naturally resolves itself into a consideration of the amount of exports and imports, it is not necessary in this book to enter into an extended discussion on international commerce. It will suffice if

brief reference is made to the particular imports and exports which have a direct bearing on the subject under review.

The payments for imports and exports are undoubtedly among the most important with which the writer on exchange has to deal in examining international indebtedness, but there are other items of national expenditure which have an intimate connection with the exchanges, and of these we shall take due cognizance when studying the exact points at which they affect the various rates.

Each trading nation has at times remittances to receive or to make in respect of its entire balance, and the principles involved in the discharge of this mutual indebtedness in no way differ from those seen in the settlement of debts between two individuals. The operation is similar, whether it be an isolated transaction between a London merchant and one on the other side of the world, or whether it be the transfer of a huge sum exacted from a conquered foe as a war indemnity. In each case the ultimate settlement is made in the actual currency of the creditor country, but the rate at which the exchange is effected is governed by the relative state of indebtedness between the nations concerned at the time the transfer is made. That exports pay for imports is undoubtedly true, and it is equally certain that the excess of the one over the other always creates a claim which influences the rate at which the final payment is calculated; but, having got thus far, we are face to face with the fact that there is no sure standard by which we can determine on which side the balance between any two countries lies, or, as Adam Smith shows, which of them exports to the greater value.

If it were possible for a country to find out by how much its exports exceeded its imports, it would be a comparatively easy matter to show the exact sum the importing country owed on balance, and when the money came to be sent out from the centre at which the debits exceeded the credits, the exchange could be calculated with some degree of accuracy, since the course of the exports and

imports between two countries is considered to regulate the course of exchange between the two places. However, this course of exports and imports cannot be accurately gauged. For one thing, we cannot always set off goods against goods; sometimes imports or exports of commodities are paid for in kind; at other times they are exchanged for services, or *vice versa*. Italy, for example, in exchange for the money brought into that country by the tourist may be said to give him the opportunity to risk his life in climbing the Alps, or France may permit him to view her invaluable art treasures at the Louvre in return for the cash he has imported into Paris. There is a direct import and export in each case, but no trace of either will be found in the trade returns of the various countries.

Then, again, in making remittances for shipments, merchants do not always send bills on the creditor country, but make use of other forms of remittances. For instance, they will pay a debt owing in France by means of bills on Switzerland; or one due in Italy by a bill on Paris. All these operations tend to obscure the real rate of indebtedness between the countries concerned, and serve to show that the foreign exchanges in practice do not always conform to the principles which in theory they are expected to. Consequently, although the relative indebtedness, or balance of trade between two countries, does exercise a potent influence over the exchanges, it is entirely misleading to consider the excess of exports over imports, as shown in trade statistics, as the one and only factor to be taken into account. The components which constitute the final balance of payments are much more complex, and to these we shall make further reference when examining the variations in the exchanges. For the present we must concern ourselves with the way in which the money of one country is exchanged into that of another country for the purpose of settling this final balance.

Quite early in our study we would like to impress upon the reader the importance of viewing the exchanges as a

whole—foreign exchange is not confined to one country alone. It is international in the widest sense. True, it needed a Great War in which half the world was engaged to bring that great truth home to us in our island home, but a writer on exchange would be failing in his duty did he fail to impress the importance of it upon his readers. The exchanges of the various countries are so closely interconnected that of recent years it has become plain, mainly through the necessity to stabilize the monetary units of so many countries, that all exchanges are part and parcel of one great machine. It needs only one link in the chain to become strained for the effect to be patent in all other parts of the machinery of the exchanges. Falling trade, depreciated state of the internal currency medium, due both to indebtedness and to the over-issue of inconvertible paper money, political unrest, all disorganize the exchange between one country and another. As we hope to show, no country can hope to escape altogether from a break in the chain. Exchange is international in the most extended sense.

We have spoken of trade ; trade exercised one of the most powerful influences upon the world's exchanges. Not long ago an American banker said that exchanges go on only so long as they are mutually profitable, and that is quite true. It is fair exchange that is no robbery. The meaning is that the goods and services which one country furnishes to other countries will represent goods and services of equal value furnished to that country by other countries. The one country's exports of merchandise will seldom exactly balance its imports of merchandise, but its exports of merchandise, plus the services that it renders to other countries—including all those "invisible" services, such as loans of capital, interest, immigrant remittances, and other such items—all these will equal in value the imports of merchandise, plus the services that the other countries render to the first country. "There is no escape from such a conclusion," said the American banker, "unless

men are to quit exchanging things of equal value and begin giving things away." One hears much about the export trade, and many entirely overlook the fact that an export trade also involves an import trade. The nation that will not buy, neither shall it sell. It is as true to-day as ever it was, that exports pay for imports, and amidst all the talk of preferences, drawbacks and tariffs, it is as well if we remember that the nation that endeavours to lock, bar and bolt its doors against foreign imports by uneconomic devices is really destroying one-half of the exchange. In a word, it is seeking to prevent the other nation from providing the wherewithal to pay for the goods and services exported, and sooner or later the effect is seen in adverse exchanges.

Trade is thus a vital factor in the exchange problem. The liquidation of the indebtedness arising from foreign trade is, as far as merchants are concerned, carried out by means of bills of exchange, and, in carrying through the operations, each party avails himself of the services of a banker, who is the connecting link between the various interests. The banker in fact may be regarded as the wholesale dealer, carrying the stock of demand drafts, bills and cable payments which form international currency on the principal financial centres of the world; and, ignoring for the moment the question of competition, supply and demand, etc., the prices at which he buys or sells his wares in the several currencies are settled by certain well-defined rules, which we must now proceed to investigate.

CHAPTER III

INTERNATIONAL CURRENCY—THE BILL OF EXCHANGE AS AN EXCHANGE INSTRUMENT—ITS ANTIQUITY—THE HYPOTHETICAL PAR OF EXCHANGE AND THE MINT PAR OF EXCHANGE—THE PRACTICAL PAR OF EXCHANGE AND THE RELATIVE PAR OF EXCHANGE

As we have invested the banker with the mantle of the wholesale dealer, let us examine the stock of international currency he is supposed to be carrying for the benefit of those wishing to deal in foreign exchange.

The first essential in any form of international currency is that it shall be convertible into the money of the country to which we wish to send it, at the will of the holder.

Forms of Remittance.

The instrument above all others endowed with this quality is the bill of exchange, under which generic term are included demand drafts, cheques, and bills of exchange payable at so many days after sight or date.

The origin of bills of exchange is obscure. Something akin to our present-day instruments frequently crops up in ancient records, but no definite period can be assigned for the first appearance of the bill of exchange, and no nation can with certainty claim the exclusive right of its invention. The Romans, it is true, had a highly-developed system of exchange for facilitating the remittance of money from one part of their empire to another. For conducting their immense volume of financial and mercantile business, and for transferring sums to and from the republican chest, *Permutationes*, a type of demand bill of exchange, were used. Then they had a more advanced form of bill, called a *Syngraphae*, which, on investigation, seems to have been copied from the nimble-witted Greeks. Of considerable interest, too, is the old Roman *receptum argentarii*, which

may be likened to the modern bank acceptance. It was in effect an engagement of a banker, on behalf of a client, to meet the claim of a third party to a sum of money.

Bills of exchange, however, as we know them to-day, appear first to have been used by the Florentines in the twelfth century. There is in existence, in fact, a document dated 1160, in Genoa, which is to all intents and purposes a true bill of exchange. Bills of exchange were certainly freely used by the Venetians in the thirteenth century, and from the Venetians they drifted to other parts of the Continent and to England. In the first instance bills of exchange were pieces of paper containing a record of one person's indebtedness to another. They were used merely to transfer trade debts from one place to another and by that means to avoid sending gold or silver ; in that respect they are akin to the bills in use to-day. However, as will be seen in the course of this book, bills of exchange have now developed into a sort of international currency, and although we still regard them as evidence of indebtedness, there is no doubt that most people look upon them mainly as instruments of credit, and such they are in nearly all cases.

Of legal definitions there are many, according to the lights of the people in the country in which the bill is drawn, but for all practical purposes we may take the definition laid down in the English Bills of Exchange Act of 1882, Section 3 (1), to which we have already referred.

A bill of exchange is an ideal instrument for transferring or settling international indebtedness, but suppose there are no bills available for sending abroad, what is the would-be remitter to do ? It is necessary for him to look round for some other form of remittance, and one wonders in what way his demand will be met.

The indebtedness can be cancelled equally well by purchasing another species of debt in the shape of coupons, bonds and the like. For example, if it is desired to make a remittance to Paris, in the absence of bills of exchange,

coupons of the French Loans may be dispatched to France; or, should it be necessary to pay a creditor in New York, any of the standard securities which are due for payment may be sent. Warrants and coupons of the Canadian Railways, and other well-known stocks, although not so much in evidence as the bill of exchange, are constantly being dispatched across the Atlantic in liquidation of indebtedness.

In making special mention of this mode of remittance, it may be thought that the author is going dead against the theories advanced by the leading economists, who have hitherto regarded the purchase and sale of coupons and other international securities as arbitrage business, pure and simple. This is not the case. If we bear in mind that the instruments bought and sold in foreign exchange are foreign debts, it is plain that coupons come within that category, and although for various reasons it is considered to be more simple and preferable to purchase a bill of exchange, yet if bills are not available, the remitter can pay his debt quite as well by sending coupons payable in the creditor country. It is true that, as a rule, commercial men do not resort largely to this form of finance, but there is no doubt that bankers frequently make use of coupons for the purpose of transferring the actual balance of indebtedness. In fact, large remittances of coupons of the internal Japanese loans are periodically sent from London to the East, and the foreign banks are quite as ready to purchase these coupons as they are to encash bills of exchange. Similar transactions take place in connection with dividend and interest payments on foreign loans of many countries. Hardly a day passes without the large foreign and colonial banks in London being asked to purchase these instruments, or evidence of debts due by overseas companies or foreign Governments to the stock- or shareholder. The fact remains, therefore, that coupons of the well-known foreign stocks and shares are really a form of international currency, and there is no reason to mystify

the student by referring to the buying and selling of these claims to a portion of the money of another country as unfathomable arbitrage operations. While it is no doubt the case that the bankers do most of the professional business of remitting funds from one country to another, yet it is within the power of any person who is under the obligation to send a sum of money abroad, himself to remit by first-class coupons of the foreign country if he so desire.

Then there is the paying or getting paid by means of telegraphic transfers, also known as cable transfers. If Smith, in London, has a balance at his credit in Jones's Bank, New York, he can sell the right to those funds to Robinson's Bank, London, who, in turn, may dispose of it to Walker of New York. It is all a transfer of indebtedness from one to the other.

Having made this digression, we may return to a consideration of the rules which are said to enable us to calculate to a nicety the value in one country of the debts payable in others.

In primeval days the question of barter must have caused much heart-burning among our ancestors. To settle, for instance, the number of pigs to be exchanged for a cow, was a problem well designed to bring out the qualities of a haggler until some definite standard of exchange could be decided upon. The inclination to haggle over every exchange is irresistible even at the present day, and nowhere is this trait more prominent than in settling the terms for the transfer of indebtedness. The main problem, however, in foreign exchange, is to a great extent simplified by the fixing of a basis upon which the metallic money of one country can be converted into that of another.

Mint Par of Exchange.

This basis of exchange between two systems of coinage is known as the Mint Par of Exchange, and may be best described as the rate at which the standard coin of one

country is convertible into that of another country according to the terms of their respective Mint laws. This power of exchange can be established only between two countries whose legal currency unit is of the same metal: the relationship thus expressed must be between the standard coins of two gold-using countries, or between the silver coins of two silver-using countries. We cannot stress too strongly the point that the exchange is between gold and gold or silver and silver. Between two countries having legal tender coins of a different metal, say, of gold in one country and silver in the other, there is no par of exchange, and the reason that a comparison cannot be made is that the exchange between gold and silver cannot be definitely fixed. The gold price of silver, as we shall see when we come to discuss the Eastern exchanges, varies from day to day, according to market conditions and other fluctuating elements.

In contradistinction to the Mint Par of Exchange, we may briefly refer to what is known as the Ideal or Hypothetical Par. The designation seems to have been handed down by writers on economics, who were wont to use the term to describe the state of affairs which was supposed to exist when the opposing claims of two trading countries exactly balanced. Exchange, it was argued, will be at par when the total payments to be made to and from any two countries within a specified time exactly balance each other. As we have seen, however, the many and varied factors which have to be taken into account in measuring a country's foreign trade, make it impossible to say with any approach to accuracy, when the exports and imports between two countries do exactly balance: consequently, it is not possible to state at what precise moment the opposing claims, being equivalent, can be set off the one against the other.

In point of fact, the Hypothetical Par is of no practical significance and the only reason for mentioning it here is to show that people who are not well versed in the subject,

tend to confuse it with Mint Par. Both indicate a state of equality, but the one is greatly different from the other.

The Mint Par of Exchange, although it is only a nominal par of exchange, does enable us to get at the exact rates for the interchange of currency by giving us a definite point from which to calculate the price of debts payable on demand or at some determinable future time. It is also useful as a sort of jumping-off ground or basis from which to calculate the fluctuations in the exchange value of a country's currency.

The Mint Par being adduced from the metallic content of the respective coins as laid down by the coinage laws of the various countries, we are thus in a position to show how the relationship is established between any two of them whose standard is the same. Between any two such countries exchange would be at par, when, by paying a certain amount of the metallic money or its equivalent in one country, one could purchase the right to receive an equal amount of the same metal in the other country, but it does not follow that this ideal state will often, if ever, prevail.

In the foreign exchange market, as with all other markets, much jargon and many loose expressions are employed. The word "par" means "equality," but its use does not always imply that. For instance an expression has crept into use on the London and New York markets that, in default of explanation, may be puzzling to the general reader who has no acquaintance with or chance of seeing operations in actual exchange practice. We refer to the term "Practical Par of Exchange." The Mint Par, as we have said, indicates equality, that is to say, in the exchange of one country's gold unit for that of another country; it is the exact number of grains of pure gold in the respective coins that counts. The "Practical Par," however, is used sometimes by bullion operators to describe the exact cost of sending gold coin from one country to another and exchanging it for the gold equivalent of the foreign country's money, all expenses of shipment, to wit, freight, packing,

insurance, and other such troublesome items, being taken into account. With these the general student has no need to be bothered in the early stages of his initiation into the entrancing exploration of the working of the foreign exchanges.

Then, to add to the reader's perplexity, others have made free use of the term "Relative Par of Exchange," and have left inquirers somewhat in the position of Mahomet's coffin—suspended between the heaven of desire to learn and the earth of barrenness. Well, a short explanation may help the reader to surmount the difficulty caused by the jargon of markets.

The term "Relative Par" owes its origin to a desire for some fixed words expressive of the connection between the exchange of one country having a gold standard monetary unit and one adhering to a silver unit of exchange. At best, "relative par" is an abstract expression, because it indicates that an exact ratio between the two monetary units cannot be fixed. The reason is that, in the silver standard country, gold will be treated as a commodity, while in the gold standard country, silver similarly will be treated as merchandise. It follows, then, that each will have a variable price that will be governed by the same rules as apply to any other commodities.

We shall refer further to these points when we come to discuss the silver exchanges, but for the moment let us examine the fixed basis of exchange, the Mint Par, as established between Great Britain and other countries, which have pinned their faith to the Gold Standard, or something akin to it.

This is rather a long story, and, as it will involve a detailed explanation of the figures used in exchange formulae, may well form the subject of our next chapter.

CHAPTER IV

IN WHICH THE READER IS INITIATED INTO THE MYSTERIES OF MINT PAR CALCULATIONS—THE PRINCIPAL PARS OF EXCHANGE BETWEEN ENGLAND AND FOREIGN COUNTRIES—THE NEW AMERICAN GOLD PARITY

AT the risk of reiteration, we emphasize that the important point to remember in any discussion on the Mint Par of Exchange is, that it is governed by the respective mint or coinage laws of any two countries, the value of whose currencies it is desired to compare. The pure gold content in a country's monetary unit is laid down by its own laws, not those of another country. Further, there can be no variableness or shadow of turning in the mint parity so long as there is no alteration in the law which enacts that a monetary unit must contain so many grains or grammes of pure gold.

In comparing the relative value of any two currencies for finding the Mint Parity, it is essential, therefore, that the pure gold content of the respective monetary units should be definitely known, and at this point we had better at once dispose of an expression that is a regular bugbear to exchange students. We refer to the term "fine" gold. "Fine" is simply a bullion market word used in describing pure gold or pure silver. It means pure metal as distinct from "standard" metal, that is, gold or silver which contains a certain proportion of alloy.

Hitherto, it has been the custom for writers on exchange to show how Mint Par is evolved by working out a whole series of equations, giving the weight and fineness or degree of purity of the metal contained in each country's gold monetary unit, and the number of these units coined from a given quantity of gold. There is, however, a much simpler and quicker way of arriving at the same conclusion.

Given that the grains or grammes of gold contained in the two currencies is known, the one has merely to be divided into the other, and the result is the mint par of exchange. For instance, the number of grains of pure gold contained in the British sovereign is laid down by the English Coinage Act of 1870 to be 113·0016. The American Act of 12th February, 1873, decreed that the standard weight of the American gold dollar should be 25·8 grains, ·900 fine, that is 23·22 grains of fine or pure gold; so 23·22 divided into 113·0016 should give us the desired result—

$$\frac{113\cdot0016}{23\cdot22} = \$4\cdot8665 = \text{£}1,$$

which until 29th January, 1934, was the Mint Par between England and the United States, that is, the number of dollars and cents that were the exact equivalent of one gold sovereign of full weight. The gold standard in the U.S.A., however, was suspended on 19th April, 1933, and a Gold Bullion Standard was adopted on 31st January, 1934, under which the gold in the dollar was reduced to 59·06 per cent of its former content. The dollar, therefore, now contains only 13·713732 grains of fine gold, and, working on the same principle,

$$\frac{113\cdot0016}{13\cdot713732} = 8\cdot24$$

and the new parity is therefore \$8·24 for one sovereign.

England, unlike most of the Continental nations, does not use the metric system, and the bullion content of her coins is consequently given in grains, whereas many other countries give the equivalent of their monetary units in grammes. The student should, therefore, be careful at the outset not to mix grains with grammes in his Mint Parity calculations.¹ He must, before working out the comparison with the unit of a Continental nation, convert the grains contained in the British sovereign into grammes, or turn the contents of the Continental unit into grains. In other

¹ 1 Grain Troy = 0·064798949 gramme
1 Oz. „ = 31·10349552 grammes

words, he has to divide grains into grains, or grammes into grammes. To attempt to divide grains into grammes, or vice versa, is to spell disaster. It may seem unnecessary to labour this point, but in his capacity as an exchange examiner, the author has seen many remarkable calculations worked by examination candidates, which can only be described as strange and devious devices for solving an extremely simple problem.

By way of further illustration, then, we may take the comparison between the British and the Netherlands coinage.

For exchange purposes, the Netherlands gold standard unit is the 10-florin piece, which is ordained to weigh 6.048 grammes of fine gold. One florin must therefore contain .6048 grammes of fine gold. One gramme equals 15.43235 grains, and as the British sovereign contains 113.0016 grains of fine gold, converted into grammes it is equal to 7.322382 grammes, and to get the Mint Parity between England and Holland, we have the fraction—

$$\frac{7.322382}{.6048} = 12.107 = \text{£}1 = \text{Mint Par.}$$

Then there is the Mint Par of Exchange between England and France. France, prior to the Great War, was one of a group of countries known as the Latin Union, whose par of exchange with England was the same, viz. 25.2215 francs, lire, drachmae, etc., to the £1. In the post-War years, however, some of these countries have stabilized their currencies by adopting a new monetary unit, or by otherwise writing down the value of their monetary units. This has involved the setting up of new exchange parities.

France has decreed that the franc shall have a gold basis of 65.5 milligrammes, nine-tenths fine. That is to say, nine parts of the metal contained in the gold franc are of pure gold, while the remaining one-tenth is composed of alloy. The pure gold content of one franc is thus .05895 grammes, and if we divide this into the grammes contained

in the sovereign, we shall get the new Mint Parity of 124·2134 francs to the £1. Thus—

$$\frac{7\cdot322382}{\cdot05895} = 124\cdot2134 = \text{£1} = \text{Mint Par.}$$

We need hardly say that the milligramme is $\frac{1}{1000}$ of a gramme, so to arrive at the divisor ·05895, we take one-tenth from 65·5 = 58·95, and divide 58·95 by 1,000 = ·05895.

One other point to be borne in mind in these Mint Par calculations is, that in dividing the gold content of a foreign country's monetary unit into that of the sovereign, the answer will always be in the currency represented by the *divisor*.

We have mentioned in passing that the French gold currency is $\frac{9}{10}$ ths fine. In the Coinage Acts of most countries, equivalents are expressed as in millesimal fineness, and here a word of warning is necessary. All coins, whether of gold or of silver, are made of so many parts of pure gold or silver and so many parts of alloy, and the term "fineness," therefore, expresses the number of parts of pure gold or pure silver contained in a thousand parts of the combination, say, of gold and alloy. The British sovereign is usually described as being $\frac{11}{12}$ ths fine, that is, 11 parts are of pure gold and one part alloy; but in millesimal fineness it is ·91666 (or 916 $\frac{2}{3}$ fine). Nearly all other countries, as we have said, make use of the $\frac{9}{10}$ ths fine quality, i.e. 9 parts of pure gold to 1 of alloy. Expressed in millesimal fineness, this is called ·900 fine, i.e. 900 parts of pure gold to 1000 parts of alloy.

This particular system of expressing the quality of gold in millièmes, taking 1000 fine as the absolutely chemically pure gold, is now generally adopted. As the English standard on this basis is ·916 $\frac{2}{3}$ fine, it is nearly 2 per cent more valuable than the ·900 fine gold. However, in coin or bullion transactions, this makes no difference in the account, since the gold alone is paid for. The alloy, as we have indicated, is merely used to make the coin harder, and, as a matter of fact, the ·900 fine quality coins have

been found in practice to wear better than the $\cdot916\frac{2}{3}$ fine coins. It is interesting to note, too, that the copper alloy in the $\cdot900$ fine coin is worth rather less than the one-thousandth part of a penny per coin.

Since we have mentioned Coinage Acts, it may be as well to show the old method of calculating Mint Par by reference to the details given in the Acts of two countries, England and the Netherlands.

The British sovereign contains 7.98805 grammes of standard gold, while the Netherlands gold ten-florin piece weighs 6.720 grammes, $\cdot900$ fine, and thus contains 6.048 grammes fine gold. Given these particulars, we find the equivalent of the one unit to the other by using Chain Rule.

Chain Rule is a simple method of reasoning, mechanical, it is true, but much used in foreign exchange work, and the student will be well advised early to make himself familiar with it. The rule consists of a series of equations arranged in two columns, each equation expressing the sequence or relationship between two quantities. We start the first equation, which is merely a statement of what we want to know, i.e. how many dollars equal £1, or how many francs equal £1, and so on. Then we continue to express a definite relation between that and the second, the second and the third, the third and the fourth, and so on. There need be no difficulty in mastering the rule if the reader will remember to commence each equation in the terms of the preceding quantity or currency, and to conclude the chain in terms of the answer required. Thus, if the equation commence on the left-hand side with dollars, then the final currency on the right-hand side must also be in dollars. The last point to remember is that the quantities on the right-hand side form the numerator and those on the left-hand side the denominator. The product of the numerator divided by the product of the denominator will then give the answer. Careful reasoning, and, above all, careful working are essential.

Let us see how this works out from the particulars we have given of the coinage laws of England and the Netherlands. We require to know the exact number of gold florins and cents that are equivalent to one gold sovereign. The chain then, is this—

$$\begin{array}{rcl}
 ? \text{ Florins} & = & \text{£}1 \\
 \text{If } \text{£}1 & = & 7.98805 \text{ grammes standard gold} \\
 \text{If standard gold 12 grammes} & = & 11 \text{ grammes fine gold} \\
 \text{If 6.048 grammes fine gold} & = & 10 \text{ florins} \\
 \hline
 \frac{7.98805 \times 11 \times 10}{12 \times 6.048} & = & 12.107 \text{ Florins}
 \end{array}$$

12.107 is therefore the gold Mint Par between England and the Netherlands.

In 1936 there seems but little hope of a general return to the Gold Standard by the large number of countries that have departed from it. Notwithstanding the comparative stability of the pound sterling, there also appears no immediate prospect of Great Britain's stabilizing her currency, and in the circumstances the mint parity is more than ever theoretical as far as this country is concerned.

CHAPTER V

THE MINT PAR AND GOLD OR SPECIE POINTS IN THEORY AND IN PRACTICE—THE PRE-WAR POINTS COMPARED WITH THE POST-WAR POINTS—THE GOLD BULLION STANDARD AND THE GOLD SPECIE STANDARD—AMERICA'S NEW GOLD POINTS—THE BASIS FOR THE SPECIE POINTS—THE DIVERGENCIES IN THEORY AND IN PRACTICE—THE POSITION IN 1936

As the result of the problems elucidated in the previous chapter, the mundane business in foreign exchange has perhaps been divested of half its terrors, and the painstaking inquirer begins to perceive the reasons for establishing a definite comparison between the currencies of those countries which adhere to the same metallic standard.

In point of fact, the amount of metal of the standard unit of one country contained in that of another country is of academic interest only, since the greater number of the operations in foreign exchange are carried out by means of bills of exchange, and the actual transfer of coin or bullion scarcely concerns the average man. The fixing of the Mint Par, however, is necessary as a basis upon which the latter can calculate the worth of the bill of exchange he has to buy or sell, as the case may be. If a debt equivalent to £100 has to be paid by a merchant in England to a creditor in France, the parties to the transaction must have an agreed rate at which the exchange is effected, and the Mint Par will be the starting-point for their calculation. Nowadays it also affords a useful point from which to calculate the depreciation or appreciation in the various monetary units.

Let us trace an operation step by step.

Suppose Messrs. Peter Robinson & Co., London, owe Pierre Rocher, of Lyons, £100, for silk purchased. The silk merchant does not want payment in English pounds,

shillings or pence, as our currency will be practically useless to him in Lyons ; he requires a remittance to be in francs and centimes, the recognized medium of exchange in his native town. How, then, will the debt be settled ?

Peter Robinson, in consultation with his banker or other financial luminary, will find out that according to the legal enactments laid down by the two countries, £1 in England is worth francs 124·2134 in France ; he can, therefore, buy a bill of exchange for francs 12421·34 ($124\cdot2134 \times 100$), and send it to his creditor at Lyons in settlement of the debt.

These facts, baldly stated, indicate what happens, in theory ; in practice, the business does not work out quite so simply. For one thing, in saying that the sum was transferred from London to Lyons, we have assumed that the amount of indebtedness between two countries is at " par " —that is, equal. In other words, the one nation has to receive the identical amount which it has to pay to the other, and, consequently, the total indebtedness is cancelled by that simple expedient, a set-off ; in the same manner, in fact, as two opposing claims are sometimes satisfied in an inland town. Needless to say, this ideal parity, or point of equilibrium, in foreign exchange rarely exists. Rates will be governed by a variety of circumstances, and in general, the price at which debts can be bought and sold will be largely influenced by the supply of, and demand for, bills of exchange, through the intermediary of which the transfers are usually effected.

There is another point to bear in mind. It must be evident that the British debtor is under the obligation to send a bill of exchange for a sufficient sum to outturn the exact amount of the debt which he owes to his creditor, neither more nor less ; and it matters not whether his bill is payable at sight or at some fixed or determinable future time, the piece of paper must give the foreign creditor a claim to that amount of the currency of his own country which will quite clear off the debt on the day it is received.

As illustrating the case where the opposing claims of two countries are not in this state of equality, let us take an operation between New York and London. We will suppose in this instance that an American dealer owes a merchant in the City of London £3,000. At the particular time the money becomes due, exports from Great Britain to the United States largely exceed Great Britain's American imports, consequently on this side of the Atlantic we shall have more money to receive than to pay; in a word, New York is under the obligation to remit to London, and there will be more buyers of bills of exchange on the New York market than there are sellers. Now, if the reader has remembered the closing words of the first chapter, he will know that he is dealing in "debts." The bills of exchange sold on the New York market, drawn on England, are debts owing by some one in England; the selling of them in the United States by the holders is merely a convenient way of collecting the amount from the creditor. Very well, then, if, owing to the cause indicated, these debts are scarce, it is obvious that they must be subject to the same rules as those governing commodities: they will rise in price. The exchange between the two countries is, therefore, no longer at par, and the debtor who is under the painful necessity of putting his creditor in funds, will, failing his being able to put off the evil day until a more propitious season, have to pay more for the claim to a few of the British sovereigns, or one-pound notes, which alone can satisfy the person in London.

When this state of affairs obtains, the American is supposed to have arrived at the point at which he will have to send to the creditor a certain quantity of gold to cancel the indebtedness. But, to avoid the many troubles and anxieties attendant upon gold shipments, there is still another way open to him. We, imagining for the moment that we are all bankers, will manufacture a bill for him. This calls for explanation.

Bank Paper.

If the bills for sale on the New York market have been purchased by the fortunate few who were early in the field, the reader, not unnaturally, wonders whence emanates the supply for the late comers. Here again, the conditions are closely akin to those ruling in the produce markets. In the ordinary commercial or manufacturing centres increased demand always results in increased supplies, prices and other things being equal. So it is with the bill markets; when the bills on offer have been exhausted, there will generally be found a number of bankers and exchange dealers ready to "manufacture a bill" to order—at a price, be it noted.

In order to make such operations possible, the bankers arrange to have funds available in the hands of foreign houses or correspondents, and when it suits their purpose, they will be prepared to draw on the correspondent, that is, they will draw a bill of exchange, either on demand or at so many days date or sight, according to the exigencies of the case. As the banker has deposited the necessary funds at some previous date with his correspondent, these bills may be said to represent the whole, or part of that correspondent's debt to the banker drawing the bill, and for the purpose of remittance these bills are as good as any other bills, the supply of which, as we have seen, was insufficient to meet the demand. They are better, in fact, than the ordinary trade bills. In the latter case, what the market calls the "personal equation" enters into the matter, that is, we take into consideration the greater or less confidence which may be placed in the signature of the drawer. The lower price paid for the commercial bill involves what is in reality an allowance or compensation for this extra risk, however small, the buyer takes.

The merits and demerits of the two classes of paper will be seen when we come to discuss rates of exchange, but having taken note of the difference, we may proceed

to examine the manner in which Penrod, the New York debtor, finally liquidates his debt with Jones, the London creditor.

As we saw in Chapter IV, the Mint Par New York—London, is $\$8.24 = \text{£}1$, but as the demand for remittances to London has exceeded the supply of bills, the exchange between the United States of America and Great Britain will be above this parity: it is favourable to this country, unfavourable to America, and instead of getting his bill for $\text{£}3,000$, which is the currency he must send to Jones, at the Mint Parity, Penrod will be obliged to pay the higher rate which the banker exacts for manufacturing him a bill of exchange. The price he will pay for this banker's bill will be commensurate with the demand for "Bank Paper," the term used to describe this class of remittance, and the greater the demand the higher will be the cost. If the exchange be fixed by the banker at $\$8.28$ to $\text{£}1$, the draft will cost $\$24,840$, which will be $\$120$ more than the price of a bill at the Mint Parity. In short, Penrod has paid $\$24,840$ for the right to have paid to him, or to his creditor Jones, the sum of $\text{£}3,000$ in London, and it is apparent that we did not vary the price by adding to the amount of the bill for $\text{£}3,000$, but secured the difference by varying the rate at which the American currency was converted into sterling.

Limit of Price of Bills.

It is at this stage the rules governing the purchase and sale of commodities diverge from those which govern the dealings in debts. In ordinary trade, the production of goods will continue as long as there is a demand for them, and the price will tend to rise in proportion to the excess of the demand over the supply: prices will rise until a point is reached when, through excessive production or other cause, the demand is satisfied; then the reverse action will take place.

The operations in bills of exchange are confined within

much narrower limits, and to appreciate the extent of these limits it will be well to refer to the reasons for sending bills of exchange in settlement of international indebtedness.

In inland transactions, we use, for convenience and in order to economize gold, cheques, which are bills of exchange payable on demand; similar considerations influence the using of bills of exchange in foreign commerce, only the saving of time, trouble, risk and expense is very much greater. If the debtor can procure a bill of exchange, neither he nor the creditor will wish to be bothered about getting the coin converted from the currency of one country into that of the other, more especially so when by remitting a bill both are relieved from the anxiety which the shipping of gold coin or bullion always entails.

The point at which the augmentation in the price of commodities will stop is, to some extent, problematical, but it is not so with the price of bills of exchange. Here we would interpolate the remark that we are ignoring at the present stage of our study all the perplexing problems that have arisen from Great Britain and so many other countries departing from the Gold Standard in the year 1931, and since.

The debtor in normal times will buy bills of exchange for remittance in settlement of his foreign indebtedness only so long as their cost does not exceed the cost of shipping gold, and the point at which it is just as cheap to send the metal to his creditor will in normal times mark the limit of the premium on the bills of exchange. If the sellers of bills ask a price above this point, the New York merchant will send gold or cause gold to be sent rather than pay the enhanced premium.

As these lines are being written the gold standard in England is suspended. It is therefore not possible to give the gold or specie points. It will, however, conduce to a better understanding of their meaning if the position both before and after the war is described.

As far as New York is concerned, the charges for shipping gold to London, in pre-war times, was reckoned as .024 cents, and by adding these charges to the Mint Par we arrived at the outgoing gold point from New York.

The Mint Par is	\$4-866
Add—Freight, insurance, commission, etc., at 5 per mille . . . . .	.024
	<hr/>
	\$4-890

The \$4-890 was assumed to be the limit beyond which the American debtor would not go in buying bills of exchange on London.

In the case of the supply of bills on the New York market exceeding the demand, the opposite state of affairs prevailed: the price for the paper fell away until the limit was reached at which the holders of the bills, the American creditors in this case, would rather withdraw gold from London than sell bills at a lower discount. To find this point, we deduct the shipping charges from the Mint Par, 8 per mille.

Mint Par	\$4-866
Less Shipping Charges . . . . .	.039
	<hr/>
	\$4-827

New Gold Points.

From these calculations we gather that at \$4-89 to £1, gold would be sent from New York to London in preference to sending bills of exchange, and that at \$4.827 to £1, it was more profitable for the New York creditor to draw gold from London than to sell bills in sterling.

When the Gold Standard was restored in Great Britain under the Gold Standard Act of April, 1925, and gold commenced to move more or less freely, it was found that the "practical" gold points were rather different. The expenses attaching to the shipping of gold from London to New York were approximately 3-757 per mille, which gives

an outgoing gold point of \$4.84828; the costs of shipping gold from New York to London, on the other hand, were about 3.683 per mille, giving an incoming gold point of \$4.89233. In practice the gold points are capable of considerable variation, and for these reasons shipping costs vary with the size of the shipment involved; with the speed of the steamer by which gold is consigned; with the rates of insurance charged by the insurance companies, and with the competitive charges for handling, packing, and carting gold to the ships. All these factors at times enter into the computation. However, as illustrative of the way in which the gold points are built up, the following details of shipping costs will enable the reader to get an insight into the business.

EXPORT GOLD POINT—LONDON TO NEW YORK

Cost of packing gold . . . . .	.030	per mille
Freight to New York	1.500	"
Insurance . . . . .	.500	"
Interest, say 8 days at 4½ per cent per annum . . . . .	.988	"
Handling charges in New York . . . . .	.062	"
Assaying and melting or refining charges in New York . . . . .	.179	"
Commissions and allowance for con- tingencies . . . . .	.500	"
	<hr/>	
	3.757	per mille
	<hr/>	

The allowance of .179 per cent for assaying and refining in New York, perhaps calls for some explanation, as theoretical calculations on gold points frequently omit this factor. In actual practice, however, it is necessary to include this item, small as it is, notwithstanding the fact that it is sometimes possible to sell gold to the Federal Reserve Bank in New York on production of guaranteed assay certificates. Most operations, therefore, work on the assumption that the charge will be made.

Then for commission and contingencies, our computation includes .5 per mille. The commission requires little explanation: it is the broker's charge for attending to the shipping.

Contingencies includes a small charge for unforeseen happenings, and for this reason: insurance does not cover any risk of delay on the voyage, which might easily occur through a variety of causes, such as bad weather, assisting another vessel in distress, or minor mechanical difficulties arising from the ship's machinery. For example, the writer calls to mind a case when gold had to be transferred from one steamer to another owing to a damaged propeller. Then some operators include an infinitesimal charge for "margin of safety"—that is, for the risk of gold being less valuable on arrival than when it left the port of dispatch. However, after taking all such factors into consideration, our total charges amount to 3.757 per mille, and if we deduct these from the old Mint Parity ruling before the U.S.A. devalued the dollar we get the rate of exchange at which ordinarily it was more profitable to ship gold than to purchase other forms of remittance, viz.—

Mint Par with New York	\$4.86656
Less expenses at 3.757 per mille	-01828
	<u>\$4.84828</u>

Then we have the other side of the question, that is, the

IMPORT GOLD POINT—NEW YORK TO LONDON

The practical gold point, including the safety margin, was approximately \$4.89233, based on the following charges—

Cost of packing . . . . .	.076 per mille
Freight	1.500 ..
Insurance . . . . .	.500 ..
Interest, 8 days at 4½ per cent per annum . . . . .	.986 ..
Assaying at Bank of England . . . . .	.121 ..
Commission and allowance for contingencies . . . . .	.500 ..
	<u>3.683 per mille</u>

Now if we suppose that America will adhere to the gold content to which she has reduced the dollar, and that Great Britain, for her part, when she does return to the Gold Standard will still maintain the gold sovereign at its present gold content, the theoretical gold points would be as follows—

EXPORT GOLD POINT—LONDON TO NEW YORK

Mint Par with New York	\$8.24
Less expenses at 3.757 per mille	-0.0095
	<hr/>
	\$8.20905

IMPORT GOLD POINT—NEW YORK TO LONDON

Mint Par	\$8.24
Plus expenses at 3.683 per mille	-0.0034
	<hr/>
	\$8.27034

In normal times, with both countries in full adherence to the Gold Standard, when the gold exchanges reached approximately these levels, the bullion or exchange operator would begin to contemplate shipping gold to or from New York rather than bid for other forms of remittance.

These rates are what are known as Gold Points, or, as some people prefer to call them, Specie Points, and, in order to impress them upon the reader's mind, we may repeat that the outgoing specie point of a country is the rate at which gold in normal times leaves, and the incoming point is the rate at which the gold enters a country.

As the result of our investigation, three facts are now prominently before us. First, we see that the principal, if not the only reason, for our using bills of exchange in international commerce is to save the expense, risk and trouble incidental to the dispatching of gold. Secondly, when the merchant or other debtor has arrived at the parting of the ways, and is forced to choose between paying a price for the bills of exchange higher than the cost of sending gold to his creditors, he is said to adopt the latter

alternative. Thirdly, when the seller of bills of exchange finds the price offered for his paper to be lower than the expense of importing gold, he will elect to take the gold from the debtor country. We thus get two gold or specie points between two countries, the import specie point being found by deducting the shipping charges from the Mint Par, and the export specie point by adding the shipping expenses to the Mint Par. Needless to say, these specie points are only applicable when the countries concerned are on the Gold Standard and the metal is allowed to flow freely to and from any two countries.

In practice the solitary debtor, or even body of debtors, is little concerned with these specie points, and although for the sake of simplicity we have assumed gold shipments to be carried out by debtors, yet in reality it is the bankers who ultimately carry through the transactions. The banker serves as the connecting link between buyers and sellers of exchange, and in the same way acts as the necessary intermediary for buying and selling gold: but this does not affect the theory one whit, since the banker merely takes upon himself as it were, the load of debts from one particular centre, and forthwith proceeds to liquidate them in the manner most profitable to himself. We will therefore transfer our attention to the banker and endeavour to trace the steps by which he arrives at the disagreeable necessity for shipping gold.

We saw that in selling paper to his client, the banker draws the drafts on funds which he had previously deposited with his foreign correspondent: but it may happen, in view of the profitable exchange, that the banker has sold bills which in the aggregate far exceed the sum at his disposal with the correspondent, or, as not infrequently occurs, he has made arrangements with the latter to accept or pay his drawings up to a certain specified limit. In either case the banker will be obliged to cover his drawings, that is, he must see that the correspondent is put in funds to meet the bills in good time. In many cases this will be

done by the banker's sending bills which he, in his turn, has purchased from various sellers on his own market. In New York, he may have bought bills drawn on London during the interval between the departure of one mail and another, and perhaps, on the very mail day the banker expects to remit the bills to London for encashment, a client is forced to buy a draft from him. The banker will sell this draft, usually at a fair profit, and it is not unusual for the customer to send it to London in settlement of some debt or other by the same steamer which carries the batch of bills previously purchased by the banker. The British correspondent will in due course collect the bills sent him for encashment, and with the proceeds he is in a position to meet the bill, sold at the last moment by the New York banker, which bill we may suppose is for an amount equal to the total of the other drafts remitted to him by the American. The profit on such an operation is apparent. In any case, the banker endeavours to cover his sales by purchasing other bills on the cheapest market, but he cannot always work the exchange in such a convenient manner as that we have just described. If the banker is unable to buy bills direct on London to cover his sales of drafts, he will resort to purchases of bills on a third, or even fourth country. These bills he will dispatch to his accredited correspondent in each centre, with instructions to remit the proceeds to the credit of this account with the banker or other correspondent in London upon whom he has drawn the bills which comprised his sales in New York. In course of time he finds he has burnt all his bridges, exchange will go against him on the other markets, and in default of cover at reasonable rates, as a last resource he will be obliged to ship gold and sell it on the London market at the price fixed by law, and with the proceeds replenish what, in banking parlance, is called his oversold gold account.

It is also the banker who is ultimately responsible for the gold shipment which is drawn from a debtor country

when the import specie point is reached in the creditor country. Theoretically, the ordinary seller will not dispose of his bill, but will prefer to send it direct to the creditor for payment, and so draw gold from the country the exchange is against. In practice, however, the selling will still go on as in the converse case, and it is the bankers who will arrange the gold shipments; they themselves will be the buyers of the bills from the holders at or about specie point, and will subsequently send the bills over to the country with the unfavourable exchange.

The object of the bankers' remitting these bills to the debtor country is obviously to recoup themselves for their outlay on the purchase of gold, which must still be sent to cancel the indebtedness between two centres, but it should be noted that the bankers' action in taking these surplus bills off the market, while not stopping the gold shipments, *does* serve to prevent the exchange falling far below gold point.

Finally, in each case, that of the gold coming into the country, and that in which it goes out, the ultimate effect is the same as is seen in the importation and exportation of any other commodity: the relative balance of indebtedness between the two countries will soon be turned, and when once the equilibrium is restored, assuming trade conditions to be normal, the ordinary buying and selling of bills of exchange will recommence. With the abandonment of the Gold Standard in so many countries, the ordinary gold points will, of necessity, be in abeyance, or at times will entirely disappear.

We see, therefore, that in ordinary circumstances, the exchange student is not directly concerned with the actual shipping of gold, which is a business in the hands of specialists, but it has been necessary to enlarge on the subject in order that a correct understanding be reached in regard to the gold points, the true significance of which we are now in a position to appreciate.

In discussing the Mint Par, we ascertained that there

were a number of countries the interchange of whose currency could be calculated on a fixed basis laid down by their own laws, and in view of the foregoing explanation, it is now quite easy to realize that the gold points are those rates of exchange which will be produced by buying gold in one country, and selling it in one or other of those countries with which we have a Mint Par. The rate at which these countries will exchange the gold into their own legal tender is definitely stated, and we have only to add or deduct the cost of shipping the gold in order to see which exchange is for us and which against us.

Our real difficulty in regard to these specie points is, that even in normal times with the Gold Standard in full operation, they do not in practice conform to the limits which, in theory, are assigned to them: between each centre we often find the rates varying, according to the distance from London. Unlike the Mint Par, which is invariable as long as the coinage laws of Great Britain and other gold standard countries remain the same, the specie points are affected by variations in the cost of freight, insurance, packing, and commission, and in many cases interest has to be taken into account. Then, as was evident during the Great War, shipping risk and other circumstances affect gold movements.

Apart from these factors, the manner in which the points will diverge from the fixed limits in practice will often depend upon the peculiar advantages within reach of each shipper. One consignor, for instance, may have special facilities for packing, another may be offered concessions by the Mint authorities in the receiving country, while a third shipper, being able to send the gold forward in larger quantities than the rest, gets a reduction in the freight. In recent years this has been particularly noticeable with gold shipments from New York. Owing to competition between shipping companies, freight rates have been cut, and interest charges also reduced. This in turn has altered the specie point for gold from the U.S.A.,

and has emphasized the fact that in practice the gold or specie points tend to vary with times and particular circumstances. All or any of the concessions to which we have referred materially alter the ultimate rate. When shipping coins, too, there must also be considered the allowance which will have to be made for any gold pieces worn and under full weight.

The reader will therefore perceive that it is difficult to fix these specie points with absolute precision, and although they are theoretically correct, recent events following the suspension of the Gold Standard in Great Britain and other countries have demonstrated all too clearly that we must not take them as definitely established.

The standard put into operation in England under the Gold Standard Act of 1925 is what is known as the Gold Bullion Standard. In the post-war period, England was the first country to adopt this standard, and several other European States that have subsequently stabilized their currency have, in the main, adopted a system that conforms closely to the gold bullion standard. France, for instance, in re-linking French currency to gold, has given that country a gold bullion standard somewhat analogous to that of Great Britain.

The gold bullion standard was really a device or discovery of the old economist Ricardo; it is not new to England, since it was adopted in 1819 under the Act for the Resumption of Cash Payments, though it did not on that occasion come into practical operation. The effective working of the Gold Bullion Standard really depends on the obligation of the Central Bank to buy and to sell gold bullion without restriction at prices fixed by law. By the British Gold Standard Act of May, 1925, the bullion standard was made effective. Under the Bank Charter Act of 1844, the Bank of England is obliged to buy gold at 77s. 9d. per standard ounce (i.e. gold $\frac{1}{16}$ ths fine); this corresponds to a price of 84s. 9d. per fine ounce. The Act of 1925 also makes it obligatory for the Bank to sell gold bullion to

all comers at 77s. 10½d. per ounce standard, which again is equivalent to a price of 84s. 11·4545d. per fine oz. In passing, we may mention that the gold market has abandoned the pre-war practice of dealing in terms of "standard" gold—all operations are now conducted on the basis of "fine" or pure gold. It should be noticed, too, that the Gold Standard Act of 1925 suspended not only the free coinage of gold, but also the convertibility into gold coin of both Currency notes and Bank of England notes. As the reader is aware, the Government's note issue has since been amalgamated with that of the Bank of England, and we shall refer to this at a later stage.

The gold sold by the Bank of England is in bars of not less than 400 oz. each, and at the Bank of England's selling price of gold before Great Britain again abandoned the Gold Standard on 21st September, 1931, a bar of that weight was worth approximately £1,700.

The object of the Act of 1925 was to ensure for Great Britain the free convertibility of gold into credit and credit into gold, and it will be realized that by limiting the sales of gold to bars of a minimum weight of 400 oz. the demand for gold for internal circulation was effectively prevented. Thus passed the Gold Specie Standard that had been in operation in the United Kingdom for so long. It was a sound system, but its successful operation depended upon a free and unlimited coinage of gold and the use of gold coin as a medium of exchange. One regretted the necessity for its replacement by the Gold Bullion Standard—but the load of indebtedness left by the Great War left no other course possible; the demand for economy was all-powerful. The considered opinion of many currency experts as well as statesmen was that with the adoption of the Gold Bullion Standard something like finality had been achieved. But, as we shall see later on in this book, after a six-years' fight against an unparalleled combination of adverse economic forces, Great Britain was forced to abandon the Gold Standard. She has been followed in that

action by many other countries, and so to-day the movement of gold from one centre to another is governed by many factors other than rates of exchange. Gold countries, like France and America, have absorbed the metal, no matter what its price on the open market.

Now to return to the consideration of gold points. As we have said, to a great extent the old gold points have proved more or less theoretical. Under the Gold Bullion Standard in operation in England and elsewhere, however, it seemed certain that in practice gold would flow to or from the United Kingdom when rates of exchange were such as to make the import or export of gold profitable. While the standard was functioning, none of the bankers were content to execute exchange operations by means of bills of exchange or other forms of transfer when rates were at such levels as to make shipments of gold (all expenses, such as freight, packing, insurance, and loss of interest being taken into consideration) a more paying proposition.

The points were thus tending to become more "practical" gold points than had hitherto been the case. The main point the student of exchange has to bear in mind is that if the Gold Standard is in full operation, when the exchange of country A on country B falls to so low a rate that it will pay better to send gold than to buy exchange on the market, the export gold point will emerge; when the rate of exchange of country A on country B rises to so high a level that it will be more profitable to draw gold from B, then the import gold point to A will arise. In other words, if exchange is adverse to B, that country may be said to export gold, while if exchange is adverse to A, then A will have to export gold. Thus, what is the import gold or specie point to the one country will be the export point from the other country. It follows then, that if the free flow of gold between countries is at some future time permitted, the upper and lower limits of exchange will be marked by these bullion points. For example, when a former edition (the seventh) of this book was being written,

after due cognizance of all expenses attendant on gold shipments between England and France, it was estimated that when the rate of exchange between London and Paris was so unfavourable to France that she had to surrender francs 124·55 to the £1, gold should commence to flow from France to England. If, on the other hand, the rate moved adversely to London and reached francs 123·92½ to the £1, than it was considered likely that London would send gold to Paris. Viewed from England's standpoint: 124·55 francs to the £1 was the gold import point; 123·92½ francs to the £1 was the gold export point.

It is of importance to remember that the gold export point from a country is the Mint Par of exchange *less* shipping expenses and interest and commission, if any; the import gold point is the Mint Par of exchange *plus* similar expenses. No fixed import or export specie points, however, can be calculated unless the gold standard is in full working order between the various countries concerned.

Then, to add to the perplexity of the exchange student who may wish to familiarize himself with the theory of gold points, there is yet another factor that has to be taken into consideration. We refer to the transport of gold by air. The movement of the precious metal by aeroplane to the more distant centres is as yet in its infancy. But the science of foreign exchange, like any other science, does not stand still, and we are on the eve of great developments that may yet cause us to revolutionize our gold point theories. The carrying of gold across the Atlantic is not yet a feasible proposition, but in the light of modern achievements, who shall say that it is impossible? However, between some of the Continental centres gold is already being sent freely by air transport, and if the business develops with other countries, as it surely will, the saving of interest alone will make it worth while.

The position at present is that the gold or specie points in this country are inoperative. They are, in fact, in-

tangible, even though some people still persist in considering them to be effective. In reality they are non-existent.

On reflection, however, it will be plain to the veriest tyro that as England is not on the Gold Standard and as since 21st September, 1931, the Bank of England, on the one hand, has been relieved of its obligations to sell gold at the fixed price of 77s. 10½d. per standard ounce, and, on the other hand, no one is likely to sell gold to the Bank of England at the fixed price of 77s. 9d. per standard ounce when the open market price is so much higher, there is no basis for the calculation of the points.

A further obstacle is the constant variation in rates of exchange between the various centres, and even if one were able to take the fixed price of gold as a starting point, it would be impossible to calculate with precision the import or export specie points at a particular time. When, therefore, the newspapers state at the present time that exchange with a certain country is at gold import or gold export point, the implication is, that exchange is at such a point that it would be profitable to purchase gold at the open market price, and taking into account expenses of shipment, send it to or from the country indicated, and exchange it into local currency. Most of such statements, however, overlook the fact that it is a physical impossibility to set up gold points between one country on an inconvertible paper currency standard and one on a gold standard. What really happens nowadays is that in the event of the exchanges between any of those countries still on the gold standard, say, France and America, moving to the level at which gold is profitable to export, the metal frequently will be purchased on the London market by the country whose exchange is adverse, and shipped to the country which has the favourable rate of exchange.

CHAPTER VI

THE FOREIGN EXCHANGE QUOTATIONS OF TO-DAY—FIXED, MOVABLE, DIRECT, AND INDIRECT EXCHANGE RATES —PRICES FOR FOREIGN MONEY BEFORE AND AFTER SUSPENSION OF GOLD STANDARD

THE industrious reader who has successfully surmounted the obstacles, in the shape of Mint parities and gold points, that have hitherto barred the way to a correct understanding of the working of the exchanges, is now in a position to appreciate the fare served up to him each morning with his tea and toast by the city editor of his daily newspaper. It will be an easy transition to pass from the study of the bases for the quotations to the rates of exchange themselves.

As a matter of fact, the record of foreign exchange quotations given in the Press has undergone considerable alteration since the days of the Great War, 1914–1918. The pre-war rates had outlived their usefulness, and the foreign exchange markets have had to adjust their ways of dealing, so we need waste little time in examining the past practice.

Prior to the Great War, and for some time afterwards, the newspapers used to give a daily list, headed "Foreign Exchanges," and this table of rates was supplemented, twice a week—on Wednesdays and Fridays—by a second table, called the "Course of Exchange." The latter record of rates was discontinued in February, 1921, though some newspapers still give occasionally a list of rates under the heading "Course of Exchange." It is by no means an official set of prices, but represents various quotations, gleaned from banks and brokers, at which bills of exchange drawn on the named foreign centres have changed hands. Up to 1921, however, a certain amount of dignity was accorded to the Course of Exchange. In banking parlance,

it was known as the "On Change" table, and the rates quoted in the newspaper represented those in force on the preceding business day in London. Every Tuesday and Thursday a number of exchange dealers, foreign branch bankers, and a few others, used to meet within the hallowed precincts of the Royal Exchange, and their dealings in bills took place on the ground floor of that building. "Change," as a rule, lasted only a few minutes, and immediately following, a list of the bargains was drawn up for issue to the Press. As we have said, it gave the prices or rates of exchange at which bills on the various countries changed hands. Even had no war occurred, it is doubtful whether the "On Change" meetings would have been continued, as the number of interested persons attending was becoming fewer and fewer. By February, 1921, the business had become more and more a matter of bargaining over the telephone, and with all the joint-stock banks well equipped for conducting foreign exchange operations the consensus of opinion was that meetings at the Royal Exchange were no longer necessary.

In case the reader may wonder why the London Course of Exchange quotations were not more frequently issued, we may say at once that London, having pride of place as the monetary centre of the world, has very many more bills drawn upon her than she draws on other countries, consequently the persons interested in these "wretched, wrinkled, scrawled over, blotchy, frowsy pieces of paper" (Mr. Lloyd George's name for them) are concerned in a far greater degree with the rates quoted in foreign cities than they are with those settled in London.

The foreign exchange table still appears daily in the Press, and though more attention is paid to it by bankers than in pre-war days, the quotations still seem to be regarded by the average man somewhat in the same way as the schoolboy regards the signs of the Zodiac—to him they are incomprehensible. However, there need be no mystery about the rates if the principles upon which they

are based are systematically investigated ; and in the hope that the mastering of these exchange technicalities may lead the student henceforth to regard the Money Article of his daily newspaper as at least as attractive as, and certainly of more importance to him than, say, the daily record of cricket or football results, we proceed without misgiving to another useful stage in our inquiry.

All the newspapers now give a list of the foreign exchange quotation issued under arrangements made by the London Clearing Banks. The list of rates shown on page 51 appeared in *The Times* of 25th October, 1937, and, as will be observed, it indicates the range within which business was done on the two preceding business days (24th October being a Sunday). The figures that appear in parentheses are the bank rates ruling in the various centres, reference to which will be made later. For the present let us endeavour to see what we can read into the rates.

London, as we have said, is still the principal exchange centre of the world, and the cosmopolitan operators that comprise the foreign exchange market are a busy lot of people. They keep in constant communication with all the important foreign centres, and, by means of telephones, telegrams, and cables, maintain intercourse with their overseas correspondents. Views are exchanged daily, even hourly, and as the denizens of the exchange market keep in close touch with the trend of foreign markets and the operations that take place therein, they are in a position to know the latest rates ruling for all the important foreign currencies.

In any one day several lots of rates will be received. Far off centres like those of India, China, and the Far East, send only one rate per day ; from the more adjacent countries several rates will be received, by telephone or otherwise, during the course of the day. There is no real bourse in London in which foreign exchange operations are carried on. The business tends more and more to be conducted by means of telephone and cables, and even the

QUOTATIONS OF TO-DAY

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Place	Method of Quoting	Par of Exch'ge before Sept. 20, 1931	Oct. 23, 1937	Oct. 22, 1937
New York	(1) % \$ to £	4.86½	4.94½-95½	4.95-95½
Montreal	§ to £	4.86½	4.95-95½	4.94½-95½
Paris	(3½) Fr. to £	124.21	146½-146½	146½-146½
Brussels	(2) Bel. to £	35.00	29.35-29.38	29.33-29.39
Milan	(4½) Lire to £	92.48	94.½-94½	94.½-94½
Switzerland	(1½) Fr. to £	25.22	21.48-51	21.48½-51½
Athens	(6) Dr. to £	375.00	540-555	540-555
Helsingfors	(4) M. to £	193.23	225½-226½	225½-226½
Madrid	(5) Pts. to £	25.22	60-100	60-100
Lisbon	(4½) Escu. to £	110.00	110-110½	110-110½
Amsterdam	(2) Fl. to £	12.11	8.95-96	8.95½-96½
Berlin	(4) M. to £	20.43	12.31-12.34	12.31-12.34
Vienna	(3½) Sch. to £	34.59	25½-27½	25½-27½
Budapest	(4) Pen. to £	27.82	24½-25½	24½-25½
Prague	(3) Kc. to £	164.25	141½-141½	141½-141½
Danzig	(4) Gul. to £	25.00	26-26½	26-26½
Warsaw	(5) Zloty to £	43.38	26-26½	26-26½
Riga	(6) Lats to £	25.22	24½-25½	24½-25½
Bucharest	(4½) Lei to £	813.60	665-685	665-685
Istanbul	£T. to £	—	6.20	6.20
Belgrade	(5) Din. to £	276.32	211-221	211-221
Kovno	(6) Lit. to £	48.66	29-30	29-30
Sofia	(6) Lev. to £	673.66	390-420	390-420
Tallinn	(4½) E. Kr. to £	18.16	17½-18½	17½-18½
Oslo	(4) Kr. to £	18.16	19.85-19.95	19.85-19.95
Stockholm	(2½) Kr. to £	18.16	19.35-19.45	19.35-19.45
Copenhagen	(4) Kr. to £	18.16	22.35-22.45	22.35-22.45
Alexandria	(4) Pst. to £	97.50	97½-97½	97½-97½
Bombay	(3) Per rup.	1s. 6d.	1/6½-½	1/6½-½
Calcutta	(3) Per rup.	1s. 6d.	1/6½-½	1/6½-½
Madras	(3) Per rup.	1s. 6d.	1/6½-½	1/6½-½
Hong-Kong	Per dol.	—	1/2½-1/3½	1/2½-1/3½
Kobe	(3-285) Per yen	24.58d.	1/11½-2½	1/11½-2½
Shanghai	Per dol.	—	1/2-1/2½	1/2-1/2½
Singapore	Per dol.	2s. 4d.	8/4½-2/4½	2/4½-2/4½
Batavia	(3) Fl. to £	12.11	8.91½-95½	8.91½-95½
Rio de Janeiro	Per mil.	590d.	2½-3½d.	2½-3½d.
Buenos Aires	Paper			
	pes. to £	11.45	16.60-65	16.58-65
Valparaiso	Pesos to £	40.00	124	124
Montevideo	Per peso	4s. 3d.	27½-½d.	27½-½d.
Lima	(6½) Soles to £	17.38	18½-19½	18½-19½
Mexico	Per peso	9.76	17½-18½	17½-18½
Manila	Per peso	24.66d.	2/0-2/0½	2/0-2/0½

ubiquitous broker is not so much in evidence as he was a year or two ago. Banks nowadays attend to a good deal of their own exchange business, and more often than not get their own rates direct.

The first list of quotations usually appears about 10.45 a.m., that he who runs may read, though the foreign exchange coterie are busy long before that hour. The second list is available about 12 noon; a third appears after the dealer has lunched, say 2 p.m., and the final list is published about 4.30 p.m. It is this last list which makes its appearance each morning in the city article of the Press.

One used to get a curious conglomeration of quotations in this list a few years ago. Cable transfer rates rubbed shoulders with demand rates; bills payable from 30 to 90 days' sight jostled short sight quotations, and, to puzzle the man in the street, telegraphic transfer rates were often in close proximity to sight rates. However, times change and we change with them, and the exigencies of war and post-war finance have led to greater simplicity, since the bulk of the rates now appearing are telegraphic rates, and we are thus saved from confusion; a few of the quotations, like those of Valparaiso, are still for 90 days' sight bills. A glance at one list of rates will reveal one or two curiosities. It will be seen that some rates are in foreign units to £1, while others are in pence or shillings and pence to the foreign unit. We have thus two distinct methods of quoting, known respectively as movable and fixed exchange.

Movable exchange is where rates are quoted in foreign units to the home currency; thus, the first quotation in the list, that of New York, and all the rates down to Alexandria, are in dollars and cents, francs and centimes, pesetas and centimos, and so on to the pound sterling. Fluctuations, or movements in exchange, are expressed in terms of the foreign currency, so plainly the higher the quotation, the lower will be the cost of the foreign unit

—we get more pengós and fillers, lats and santimes, or florins and cents for each pound sterling we hand over.

It seems an unscientific method of quoting or expressing exchange variations, and these little idiosyncrasies do make things difficult of comprehension for the beginner.

Fixed exchange, however, seems to be a regular *pons asinorum* to beginners ; it is even occasionally a stumbling-block to the hardened exchange dealer. Examples of *fixed* exchange are found in the quotations on Buenos Aires, Rio, and some of the Far Eastern centres, exchange on which is quoted in pence and shillings and pence to the peso, dollar, milreis, Chinese dollar or Indian rupee as the case may be. When the rate is given in this way, it is called *Fixed Exchange*, and the higher the quotation, the higher the cost of the foreign unit. If one is purchasing a currency that is quoted in this way, the fewer pence or shillings and pence given for the foreign unit, the more favourable will be the rate to him. On the other hand, if one is a seller, the greater number of pence that one can wrench from the buyer of the foreign unit, the better will be the rate. But in movable exchange, the brain has to jerk back again, and when buying, the less sterling given for the foreign unit, the more profitable will be the operation ; when selling, the fewer foreign units one parts with for each pound sterling the better will be the rate. We shall refer again to these idiosyncrasies at a later stage ; for the present let us probe a little further into the reading of the rates themselves.

From our list of the quotations ruling on 23rd October, 1937, it will be observed that for each centre two rates are quoted ; thus, for New York we get 4.95-95½, and for Paris, 146¼-146¾. Some little difficulty may be experienced at first in understanding the meaning of these figures, especially if the general reader be in a position similar to that of the author, and has to study the foreign exchange article in several daily newspapers. In London, until comparatively recently, there was nothing like uniformity

in the publication of the rates of exchange. Some newspapers, like *The Times*, for example, used to give the range of each day's rates; that is, the highest and lowest quotations at which dealings had taken place. Others, such as the *Morning Post* and the *Daily Telegraph*, purported to give the closing rates of the day. Some of the papers, again, gave what was termed the "mean rates," that is the middle rate between buying and selling, and this is the system adopted by those who, for statistical purposes, work out the weekly, monthly, and yearly average rates of the exchanges: the mean rate is taken. Now, owing to the anomalies in published quotations that followed the suspension of the Gold Standard in so many countries, an arrangement has been made under which the principal newspapers give the range within which rates have been quoted during the preceding day. However, for our purpose, these differences are not of any great importance, since, as we shall presently learn, very often the published quotations are not always those at which business has taken place.

It is the practice of the representatives of the newspapers to call in at the principal banks towards the close of each day and collect details of the rates that have been current during business hours, and as each reporter does not go to the same bank it is apparent that variations in some quotations will be seen in different newspapers.

Well, to return to the quotations in our list; generally speaking, they may be regarded as selling and buying rates. If the reader be a buyer of dollars, for example, \$4.95-\$4.95½ means that for each pound sterling he hands over to the bank he will receive 4 American dollars and 95 cents; but if he be a seller of American currency, he will have to surrender 4 dollars 95½ cents for each pound sterling the bank hands to him. It is the same with all the rates of exchange that are quoted in what we have described as "movable exchange"—in each case, if it be, say, francs, pesetas, kroner, lats, etc., the smaller number of foreign units will be received if one is a buyer,

and the larger number represents those one has to surrender if a seller.

When we come to fixed exchange, that is, pence or shillings and pence to the foreign unit, the reverse rule holds good. Bombay, for instance, has two rates $1/6s\frac{3}{4}-s\frac{1}{2}$, the former representing the bank's buying rate and the latter its selling rate. In other words, it will buy Indian rupees from the seller of that currency at $1/6s\frac{3}{4}d.$ for each rupee, but if one wants to buy rupees, then the bank will charge $1/6s\frac{1}{2}d.$ for each of that monetary unit it sells. Similar differences will be found in the other shillings and pence rates or pence—they are all fixed exchanges, and the rate fluctuates in terms of the home currency, whereas in movable exchange it fluctuates in terms of the foreign unit.

As if to confuse the issue, other terms are frequently used to describe the two methods of quoting. Movable exchange is sometimes known as "indirect" exchange; while "fixed" exchange is termed "direct." These expressions, however, are of no particular significance and tend nowadays to fall into disuse. They may be explained briefly in this way. Direct, or fixed exchange, is the quotation of a foreign monetary unit in terms of our own home currency. Thus, we quote the Indian rupee in shillings and pence, and the Brazilian milreis in pence. Indirect, or movable, exchange is the method by which we quote the number of foreign monetary units that can be purchased with the home currency. For example, we state how many francs, dollars, pesetas, reichsmarks, or lire can be purchased for £1 sterling.

With all these variations to remember, there is little wonder that the man in the street is oft-times inclined to tear his hair in desperation, and to consider that he had better leave the riddle of the exchanges for some other person to solve. Yet, a little practice in the reading of the quotations will soon put an end to his perplexities, and having introduced him to the list of the world's exchanges, in order not to tire him unduly, we close this

chapter with a few simple rules that may serve to aid his mental digestion.

First, then, a simple axiom for the novice in exchange to remember is that when dealing in fixed exchange, that is, in pence, or in shillings and pence per foreign unit, *buy low, sell high* or, to state it more plainly still, buy at the low quotation and sell at the high.

Secondly, for movable exchange, that is, francs and centimes, kroner and ore, and so on, to the pound sterling, the rule is, *buy high, sell low*. That is, always buy at the high quotation and sell at the low.

In the one case, the fewer shillings and pence surrendered for the foreign unit, the better will be the rate for a buyer ; while for a seller, the greater number of pence or shillings and pence that can be wrested from the banker for each foreign unit, the better will be the rate for the seller.

In the second case, the brain is given another twist back, and when buying, the more foreign units one can get for each pound sterling, the more favourable will be the rate ; when selling, the fewer foreign units surrendered for each pound sterling the better will be the rate for the seller and the worse it will be for the buying banker.

We admit these methods of quoting are unscientific and awkward in practice, but we have to take things as they are, not as we would like them to be. So to conclude this inordinately long description of rates, we leave with the reader a few lines of doggerel that exchange operators are fond of quoting—

Just sing this little chorus,
 And sing it every day ;
 " That *higher* rates are for us,
 And *low* the other way."

That is, when quoting units
 To every sterling pound ;
 But with pence to units foreign,
 It's the other way around.

For then you'll sing your chorus
 Every day, until you die ;
 " That *low* rates will be for us—
 While those against us will be *high*."

CHAPTER VII

THE ANALYSIS OF RATES OF EXCHANGE (CONTINUED)— COMPONENT PARTS OF A RATE OF EXCHANGE—THE TELE- GRAPHIC TRANSFER RATE AND HOW IT IS USED AS A BASIS UPON WHICH TO BUILD OTHER EXCHANGE RATES —THE DEMAND AND SIXTY DAY RATES—NOMENCLATURE OF THE FOREIGN MONETARY UNITS GIVEN IN THE DAILY LIST OF EXCHANGE QUOTATIONS

IN our previous chapter we gave the reader much food for reflection; in this one he is asked to perform further mental gymnastics, and we shall not blame him if at the end he uses the late Walter Bagehot's famous phrase: "It's awful to read on the currency!" Yet, as we have said, the study of the foreign exchanges is a fascinating pursuit, and doubtless those who have so far not fallen by the way, will feel in them the strongest possible urge to continue. Well, as thoroughness is the key-note of success in the understanding of the problems of exchange, we want here to introduce the reader to a few factors that are but dimly comprehended, even by those who affect to have something more than a passing acquaintanceship with the practical working of exchange. We refer to the question, "What is it that makes the rate of exchange?"

Here, we want the reader to work on the assumption that the Gold Standard is in full operation in the various countries, for we devoutly hope that by the time he has finished his studies a general resumption of gold payments will have taken place.

The Mint Par of Exchange we have shown is mainly the starting point for exchange variations, and in normal times it is the Mint Par around which rates will oscillate. We have also referred to the upper and lower limits known as gold points, but how do they all operate together to

form the rates? In this manner. On the assumption that we are dealing with gold standard countries, the rate of exchange charged by a bank or other exchange operator for a foreign bill will first of all represent Mint Par, or, in other words, the gold equivalent of the foreign monetary units. Yet, as we have endeavoured to explain, rates seldom stop at Mint Par. The rates quoted will also include a premium or be minus a discount on the Mint Par, greater or less, as the case may be, in proportion to the demand for bills or other forms of exchange on the market as compared with the supply. If there be a demand in excess of the supply, the Mint Par will be plus a premium; if the supply be in excess, the Mint Par will be less a discount. Then again, the rate will include the seller's commission, and be less an allowance for interest, according to the time the banker has the use of the money paid for the bill, or according to the time he is out of his money if he buys a bill. This interest allowance will be reckoned on the period of time taken for the passage of the bill between two points—the centre in which the bill is drawn or sold, and that in which it is paid. The remaining element in the rate will be the cost of shipping gold to the centre named, and after this last charge is taken into account, we have the whole of the component parts that really go to make up the rates of exchange as quoted in normal times, though it is probable that no one other than a banker worries about how a selling rate is made up.

The banker's buying rate is similarly calculated; it includes the Mint Par, plus a premium or minus a discount on the Mint Par, less, again, a commission covering the dealer's profit, and an allowance for his risk and trouble; finally, it is less a discount according to the period for which the draft has to run, and minus the cost of shipping gold.

On the face of it, it all seems very complicated, so, without in the least desiring to treat readers as babes and sucklings in the world of finance, we hasten to add that, reduced to the simplest terms, the explanation of the rates

is that the selling rates are in effect the rates at which the banks sell gold, the bills of exchange and other forms of remittance being claims to so much gold in the country in which they are paid, while the buying rates are the rates of exchange at which the banks buy gold, or, in other words, buy the right to receive so much of the gold currency, or its equivalent, of the country in which the bills will be ultimately paid.

Now, in practice, the writer has found that people understand very well all the constituents of a rate except the addition to the Mint Par of the cost of shipping gold in the one case, and the deduction of the cost of shipping gold from the Mint Par in the other case, so a further few words of explanation may be useful. We may presume that it is accepted first of all that the starting point in the rate is Mint Par, also that as the banker is not a philanthropist and does not work for nothing, no one will grumble about the additions and deductions of commissions and premiums or discounts. That being so, there remains the cost of shipping gold to consider. By way of example, let us take the exchange between London and New York.

Let us suppose that, owing to the balance of indebtedness being against England, London has to pay to New York much more than she has to receive from that centre. The position will be that merchants who have to remit to New York, in fact all who may be under the painful necessity of settling debts owing to that centre, will be searching the market for the wherewithal to remit. They or their agents, are eager buyers of bills of exchange. In such circumstances the demand will out-distance the supply; there will be competition to secure the bills in the market, and in proportion to the competition, the price of these bills will rise; that is to say, the dollar rate of exchange will move against London. The price (or the rate of exchange) will rise with the degree of the competition.

If the reader will dismiss from his mind for the moment

the interposition of the bill of exchange, and will remember that what in reality the American credit has to be paid in is gold dollars, he will understand that, failing any other way of getting gold into the hands of the American creditors, the English debtors' obligation is to send gold from London at his own risk and expense. That being so, he will be prepared to bid higher and higher for the bills until the rate of exchange includes the known cost of shipping gold to New York. So we see that more will be paid for the remittance than the Mint Par of exchange in certain circumstances, as few care to incur the risk, trouble and expense of sending gold if it can be avoided. The buyer is, in fact, assumed to be willing to pay such an amount for the bill as will represent the incidentals we have mentioned, and the cost of the movement of gold to the foreign centre (New York in the case we have considered), but in normal times he will not pay more, since if the quotation for exchange exceed the total factors which we have shown go to make up the rate of exchange, it would be more profitable to accept the inevitable and purchase the gold and ship it in settlement of his debt. Thus, we get back to the theory we have outlined in our chapter on the Gold Points.

The reverse aspect of the question will be followed easily—that is the point at which the supply of exchange, London on New York, exceeds demand. In this case the value, or the price of debts payable in New York, but sold in London, will fall, but for similar reasons to those we have discussed in the foregoing paragraphs, the costs incidental to the shipment of gold from New York to London will mark the limit of the discount, since rather than accept less the seller would elect to have gold remitted to him from the debtors in New York to London.

There is no particular magic or mystery about this process. When exchanges react in the manner indicated, all we have is a simple example of the working of the inexorable laws of supply and demand. Bills, the evidence

of debts, are in excess supply, their price falls ; the demand for bills, the evidence of debts, exceeds the supply, their price rises. That is the crux of the problem.

At this stage, the reader will commence to appreciate the fact that the record of rates of exchange is something more than a mere set of prices : it is a barometer of the financial commercial and political happenings in all the important centres of the world. Correctly interpreted, the exchange rates reveal the waxing and waning of the value of the money of nations, and, to carry the simile further, of their fortunes also. There are, of course, moments when the misfortunes of our friends are not altogether displeasing ; so if it is pounds sterling we have to sell, and we find by reference to the foreign exchange rates that the value, say, in terms of francs, pesetas, or any other currency, is rising by reason of the fact that our friends in each country are in the unhappy position of having to surrender so many more units of their currency for ours, then we conclude that our financial barometer is set fair. There is a tendency among exchange students to object to the burden of studying long lists of rates such as that we have given. The casual reader will argue, quite naturally, that every person who has bills in a foreign currency to buy or to sell, or has sterling to be converted into foreign money, will not bother much about any currency other than that in which he wants to deal. Yet, if he would be wise beyond his generation, we would urge him to study the differences in the number of, say, dollars and cents, pesetas and centimos, pengös and fillers, reichsmarks and reichspfennige, belgas, zlotys, lats, pesos, and escudos that will be given in exchange for British monetary units.

The Alpha and Omega of foreign exchange business is to get money transferred from one centre to another in the cheapest possible way, without resorting to the shipment of bullion and specie, which is at once both the most expensive and the most risky way of providing funds or of getting rid of them. It is a business best left in the

hands of skilled bankers or bullion brokers. However, apart from remittances in metal, money is transferred from one country to another in three main ways : by telegraphic transfers, by demand bills, that is bills payable on demand or at sight immediately they are presented to the bank or to the person upon whom they are drawn, and by bills payable at so many days after date or sight. Time was, before the Great War, when the list of exchange rates contained quotations for all these classes of remittance ; but the exigencies of war and post-war conditions led to the quoting of practically all the rates by telegraph, though a few, such as those on some of the South American centres, are still given as ninety days' sight quotations. For our purposes, it will tend to simplicity if we assume that all the rates quoted are for banking instruments.

First, there is the telegraphic transfer, or, as it is sometimes called, the cable transfer : the terms are synonymous. This particular quotation for exchange is easy to understand ; payments in the one country are usually made and received in the other country on the same day, and so the element of time is eliminated, and we can dispense with such disturbing factors as stamps, interest, commission and the like. Of recent days transactions by means of telegraphic transfers are large, but with the stabilization of foreign currencies, their volume may tend to diminish. In practice, this method of exchange is used when it is desired to settle foreign obligations immediately. Of the three ways of remittance we have mentioned, it is the most expensive, because it bridges the delays incidental to sending remittances by mail, and eliminates the risk of exchange fluctuations, so, necessarily, one has to pay for these privileges. There is no mystery about it. The person who has a debt to settle, or who wishes to send money abroad for some other purpose, simply pays his money, say, in London to a bank, and that bank sends an order by telegram to a foreign correspondent to pay the equivalent in the money of the foreign country to the named

person. By way of illustration, we may take a homely example ; we will use that ubiquitous person, the remittance man for the purpose. Poor, baffled paterfamilias in London has received an urgent request from his prodigal son in a far-off land for help. He decides to send him, say, the equivalent of £10, payable in Chicago. He trudges wearily to the Midland Bank, and asks that institution to transfer the money to the aforesaid lawless city by wire. The exchange man at the Midland Bank quotes the father the rate of the day, say, \$4.95 to the £1. The much-harassed parent accepts the rate without demur. He hands the Midland Bank £10, and that bank forthwith cables its Chicago correspondent bank to pay the said prodigal son \$49.50 (4.95×10). When the cable reaches the U.S.A. the Chicago Bank will at once notify the prodigal son, and he, on proper identification, will receive the money, and, unless he be tired of the husks, will proceed still further to dissipate his father's hard-earned resources.

In dealing in telegraphic transfers, it should be noted that for the remittance of small sums, the sender will have to pay for the cost of the telegram—a comparatively small matter in these days of extensive bank telegraphic codes ; but for large amounts, if the remitter be astute enough, he can usually prevail upon the bank to forgo the cost of the telegram.

In practice the rate at which a bank will sell telegraphic transfers is, to a certain extent, dependent upon the cost of laying down funds in the foreign centre upon which it is desired to sell. "Laying down" funds is banking parlance, meaning the accumulating of money with a correspondent in a foreign country for the purpose of exchange operations. It follows that the banker's purchases of telegraphic transfers will be governed by the greater or less need he has for funds in any particular centre, and the rate of interest he may expect to earn on the money there pending a more profitable employment of the money in exchange operations.

The second way of transferring funds from one country to another, to which we have referred, is by demand or sight bill. To illustrate the use of the demand draft, we may take the case of the person wishing to get money transferred from a foreign country to London. There is no immediate hurry, yet at the same time he does not want to wait for the cash after the draft has arrived in London. He will also desire to have some check on the rate of exchange at which the money is transferred by the foreign debtor. Well, here the element of time is introduced. We may take New York again as our objective. For exchange purposes, the time of the mail steamer is usually reckoned as about seven to eight days. The banker from whom the foreign client has purchased the bill has the use of the money for that period—it may be a little longer if, as not infrequently happens, the purchaser of the demand draft omits to post it for a day or two. The banker then can afford to take less dollars and cents in exchange for the sterling demand bill he sells than he would had a telegraphic transfer been sent. The difference between the rate for demand bills and telegraphic transfers is approximately the interest at about the ruling rate of interest for the money for the period the bill is supposed to be *en route* to London. The buyer will thus receive slightly more sterling, or will give fewer dollars and cents, which comes to the same thing. This difference between the rate for telegraphic or cable transfers and that for demand bills is called the "*Spread*" between the two rates. The higher the rate of interest and the slower the steamer the greater the spread.

It should be noted that in his calculations the New York banker will take the rate of interest ruling in London, the market *on* which the bill is drawn, not the rate of interest *in* New York the centre in which the bill is drawn. If the student will bear in mind that it is the time taken by the mail steamer between the two points involved and the current rate of interest at the place in which the bill is

payable that are the main factors involved, he will be able always to have a rough check on the rates charged. The calculation is simple. For example, given a rate at an exchange, of say \$4.85 to the £1 in New York, and a London market rate of interest at 4 per cent, and estimating the time taken for the bill to pass from New York to London at ten days, the demand rate, New York on London, would be—

Telegraphic transfer rate	\$4.85
Less 10 days' interest at 4% per annum . . . . .	.00532
	<hr/>
Demand Rate	<u>\$4.84468</u>

If it is desired to purchase a demand draft London on New York, and assuming that the same rate of interest, 4 per cent, was ruling in New York, then the interest would be *added* instead of being deducted, and the rate would be \$4.85532, since the buyer would expect to get, as we have said, more dollars and cents for each pound sterling he handed over to the bank.

We now come to the third instrument we have mentioned, that one payable at a certain period after date or sight. Suppose we require a sixty-day bill, that is one payable sixty days after the date it bears on the face. Here a further element of time is introduced. If by malice aforethought, or by business instinct, or by prior arrangement, a foreign debtor wants to delay payment to his creditor, he will send such a bill, and the recipient, always supposing that he acquiesces in the arrangement, will have to wait for sixty days after the date of the bill, plus any days of grace allowed by law, before he can get his money. He may, however, elect to get it discounted on his own market, but will be mulcted for the privilege by being charged the current rate of interest or discount prevailing on the market for the particular class of bill for the time it has to run before payment. It is a cheap form of remittance, because the purchaser, if he knows his business,

will see that he gets it at such a rate of exchange as will include, for all practical purposes, interest on the amount of money represented by the demand rate, plus the cost of the stamp. The point is, that as the banker has the use of the money for the additional time, he can afford to give the buyer more dollars and cents, francs and centimes, florins and cents, etc., for each pound sterling paid over. Theoretically, it is held that the creditor in the centre to which the bill is remitted gets the benefit, as the sender of the bill must put him in no worse a position than he would have been had a demand bill been sent. That is to say, one is supposed to allow him sufficient compensation for discount, or the charge for melting or turning the bill into cash in the market in which the bill is paid.

The rate or price of demand or sight exchange is, for all practical purposes, considered to be the basic rate on which all rates for time bills are calculated. This is proved by the exchange quoted when the rate of \$4.84468 was current for demand bills; the prevailing sixty-day rate, New York on London, was around \$4.80 $\frac{1}{2}$ to the £1. Let us see how it is worked out, bearing in mind that three days of grace are allowed in England for the payment of such bills after they arrive at maturity, and that the stamp duty is $\frac{1}{10}$ th of 1 per cent.

Demand rate	.	.	.	.	\$4.84468
Less 63 days' interest at 4%	:	:	:	\$-03349	
„ stamp $\frac{1}{10}$ of 1%	.	.	.	-00240	
				<u> </u>	-03589
60-day rate—New York on London	.	.	.		<u>\$4.80879</u>

Again, assuming that the same rate of interest was current in New York, the rate, London on New York for 60 day bills, would be—

Demand rate	.	.	.	.	\$4.84468
Add 63 days' interest at 4%	:	:	:	\$-03349	
„ stamp $\frac{1}{10}$ of 1%	.	.	.	-00240	
				<u> </u>	-03589
					<u>\$4.88057</u>

X:57
 £5
 11303

The rates for longer dated bills can be similarly calculated, so the reader, we hope, commences to see that foreign exchange calculations are not so very difficult after all.

The exchange brokers frequently pass lists of rates round, though more often than not they quote a rate, or make a price, over the telephone. Their method of quoting is simple: they make use of the double-barrelled quotations. For instance, if a broker quotes the rate on Paris as $146\frac{1}{2}$ – $146\frac{3}{8}$, he means that he is ready to sell French francs at $146\frac{1}{2}$ to the £1, but for buying he wants $146\frac{3}{8}$ francs for each £1 he surrenders.

Then, as a fitting conclusion to this chapter, we may surprise the reader by telling him that in actual exchange work, there are really two different rates for any particular currency, known among the select coterie that comprises the exchange market as the retail rate and the wholesale rate. It is something like admitting that things are not what they seem, when we say that it does not follow that the daily list of exchange quotations are those at which business is actually done; the real, or trading quotation lies somewhere between the highest and lowest prices, and the precise figure at which operations take place will depend a good deal upon the greater or less success of the parties concerned as hagglers or bargainers. If it be a bank dealing, for instance, its operations will, to some extent, depend on the amount of cover available, as exchange purchases must be balanced by a bank's sales of exchange, and vice versa.

In foreign exchange business, as in any other walk of life, it is generally the big operators that call the tune. The listed rates are more often than not those that serve for the settlement of comparatively small transactions. Frequently the rates at which large amounts are bought and sold are not divulged, and the exchange fixed is a matter of very keen negotiating. In the transfer of large sums from one country to another a good deal of finesse

and skill is displayed, and great care is taken by the operators in purchasing or selling the required amounts of foreign currency, or in arranging the necessary cover.

If six or seven million francs or dollars, for example, have to be transferred from one centre to another, a purchaser will not buy the whole amount or bid for it from one dealer; he will quietly buy some dollars or francs here, some there, until the whole purchase has been completed. The rate of exchange or the price of his francs or dollars will be the average rate for the purchases from the different dealers. Banks and others do the business in this way in order not to put the market up against themselves, or unduly to derange rates of exchange, and upon their skill in operating depends to a great extent the ultimate out-turn of profit on the transaction.

We have now examined the main points in the daily exchange list, and, as a fitting conclusion to this chapter, we give the names of the monetary units, together with the subsidiary units that appear in the exchange lists now issued.

New York	Dollars and cents to £1.
Montreal	Dollars and cents to £1.
Paris	Francs and centimes to £1.
Brussels	Belgas and centimes to £1.
Amsterdam	Florins and cents to £1.
Stockholm	Kronor and ore to £1.
Copenhagen	Kroner and ore to £1.
Oslo	Kroner and ore to £1.
Helsingfors	Finnish-markkaa and pennia to £1.
Riga	Lats and santims to £1.
Geneva	Francs and centimes to £1.
Italy	Lire and centesimi to £1.
Greece (Athens)	Drachmae and lepta to £1.
Madrid	Pesetas and centimos to £1.
Lisbon	Escudos and centavos to £1.
Berlin	Reichsmarks and reichspfiennige to £1.
Vienna	Schillings and groschen to £1.
Budapest	Pengos and filler to £1.
Prague	Czech kronen and heller to £1.
Kaunas Kovno	Litas and cents to £1.
Warsaw	Zloty and grosz to £1.
Moscow	Roubles and kopecks to £1.
(Note. As from 28th October, 1936, 1 rouble equals 4½ French francs)	
Bucharest	Lei and bani to £1.

Istanbul . . .	. Turkish pounds to £1.
Sofia . . .	. Leva and stotinki to £1.
Belgrade . . .	. Dinars and paras to £1.
Reval . . .	. Esthonian kroon and sents to £1.
Alexandria . . .	. Piastres to £1.
Mexico . . .	. Pesos and centavos to £1.
Buenos Aires . . .	. Pesos and centavos to £1.
Rio . . .	. Pence to one milreis.
Monte Video . . .	. Pence to 1 peso.
Valparaiso . . .	. Pesos and centavos to £1.
Lima . . .	. Soles and centavos to £1.
Bolivia . . .	. Bolivianos and cents to £1.
Colombia . . .	. Pesos and centavos to £1.
Ecuador . . .	. Sucres and centavos to £1.
Guatemala . . .	. Quetzales and pesos to £1.
Nicaragua . . .	. Cordobas and centavos to £1.
Venezuela . . .	. Bolivars and centimos to £1.
Bombay . . .	. Shillings and pence to 1 rupee.
Calcutta . . .	. Shillings and pence to 1 rupee.
Madras . . .	. Shillings and pence to 1 rupee.
Hong Kong . . .	. Shillings and pence to 1 Hong Kong dollar.
Shanghai . . .	. Shillings and pence to 1 Chinese dollar.
Singapore . . .	. Shillings and pence to 1 Straits Settlements dollar.
Batavia . . .	. Guilders and cents to £1.
Kobe . . .	. Shillings and pence to 1 Japanese yen.
Manila . . .	. Shillings and pence to 1 Philippines peso
Bangkok . . .	. Shillings and pence to 1 Baht (or tical).
Iraq . . .	. Dinars and fils (1000 fils = 1 dinar = £1).
Palestine . . .	. Palestine pounds (1000 mils = 1 Palestine pound = £1).

CHAPTER VIII

IN WHICH THE DISCUSSION ON RATES OF EXCHANGE IS CONTINUED—AMERICAN, SOUTH AND CENTRAL AMERICAN, SOUTH AFRICAN, AUSTRALIAN, AND RUSSIAN EXCHANGE QUOTATIONS

WE mentioned in our previous chapter that most of the rates of exchange that now appear in the Press are for telegraphic remittances, but there is no rule without an exception. The exception in this instance is seen in the South American quotations; the rates quoted for Rio de Janeiro, Valparaiso, and Lima are all for 90 days' sight bills, and show the number of pence per milreis, pesos to £1, and soles to £1 that were quoted for bills payable 93 days after sight, the additional days being the "days of grace"; allowed by British law. Then there is the Alexandria quotation, which is in Egyptian piastres to £1 ($97\frac{1}{2}$ piastres = £1), so applying our rule that "high rates are for us, low against us," we see that the quotation on 23rd October, 1937, was favourable to London. The quotation is also in this instance for sight bills, that is, for bills payable on sight immediately presentation is made to the bank on which the bill is drawn. As a matter of interest the student should note that the Egyptian pound is expressed thus: £E; its value in sterling is £1 0s. 6-1d.

There remains the Far Eastern Rates, which are all for telegraphic transfers. A word of warning may be uttered in regard to these quotations. Some of the papers affect to give the London prices; others follow the more correct method and give those communicated to them by the Eastern Banks. These institutions receive the rates from their branches in India, China, and the Far East daily; they are displayed on the boards in the various banks. Generally speaking, they are little more than a guide to the

movement in these exchanges. If a client wishes to purchase or to sell Chinese dollars, Indian rupees, or Java guilders, as the case may be, the Eastern exchange banks will, of course, quote rates based on those they receive from their foreign branches.

By this time the exchange notes written by the city editor of the daily newspaper will be shorn of half their terrors for the persevering reader, so, without further ado, we may now introduce him to another section, that dealing with financial happenings in New York. So important has the American money market become that considerable space is now devoted to it in the Press.

As a matter of fact, New York rates are usually honoured with a special table to themselves. Owing to New York's lying so far west, there is a difference in time of about five hours—it is noon in London when it is 7 a.m. in New York ; consequently, the work of the city editor of the great dailies is well advanced and most of the other financial matter has been arranged and printed before the American rates are received. This necessitates their being rushed into a separate page at the last available moment. However, should an important deal require to be negotiated during the day, we may say that the large London joint-stock banks, as well as the principal exchange banks, can now communicate with New York by telephone and execute transactions for their clients.

The importance of all New York rates renders it imperative to give the very latest quotations, and in this respect they differ from the South American prices for the various currencies, which, although appearing in our list on 23rd October, were really the prices current on the various markets on the evening of the 22nd October. They are thus a day old when received. The New York rates are also those ruling on the date given in the London papers.

The list shown on page 73 is taken from *The Times* of 25th October, 1937.

It will be observed that it is very complete, as the method of quoting is shown as well as the par of exchange between the various centres and New York. For comparative purpose, New York also follows the example of London and gives rates of the preceding business days. The reader is thus able to watch the movement of the exchanges and can see clearly whether the rates are moving in favour of or against New York.

The list is practically self-explanatory, but a few comments may make for easier reading.

First, we have the Montreal rate, which is for telegraphic transfers on London. Then we have the New York rates; the "sight" exchange is clearly the dollars and cents to the pound sterling, payable at sight in London on presentation of the bill by the receiver to the person or bank upon which it is drawn. The cable transfer rate is the selling price in New York for the sterling equivalent to be paid in London as soon as the message has been flashed across the wires to the paying banker. The sixty days' sight quotation indicates that the draft is not payable in London in sterling until sixty-three days after the draft has been received, presented, and accepted for payment.

The cable remittance commands the highest price because it is for prompt payment; in the sixty days' sight rate we have an allowance for interest, therefore it is sold at the lower price; the buyer in New York surrenders less dollars for each £1 sterling. Then we get grain bills. These being drawn on commercial firms are not such high-class paper as bank bills, therefore, although they are payable in London on demand, or at sight, the buyer gets them for $\frac{1}{2}$ of a cent cheaper than the bank bills. The seven day sight bills are cheaper still; as the buyer has to wait the longer period for his money, he gets the benefit in the lower rate charged. If the American be a seller, he, of course, surrenders the fraction of a cent or so more.

The Continental rates are easy to understand. The

EXCHANGE	Method of Quoting	Parity	Oct. 23	Oct. 22
MONTREAL on—		\$	\$	\$
London, cables . . .	£1	4-86½	4-95	4-95½
NEW YORK on—				
London, demand . . .	£1	—	4-94½	4-95
Cables	£1	4-86½	4-95½	4-95½
60 days' sight . . .	£1	4-85½	4-94½	4-94½
Grain bills, sight . .	£1	—	4-94½	4-94½
Seven days	£1	—	4-94½	4-94½
Montreal, cables . . .	\$100	100	100	100
Paris, cables	100 f.	—	3-38½	3-38½
Rome, cables	100 lr.	8-91	5-26½	5-26½
Amsterdam, cables . .	100 fl.	68-06	55-29½	55-29
Oslo, cables	100 kr.	26-30	24-87½	24-87½
Stockholm, cables . .	100 kr.	26-80	25-52½	25-52½
Copenhagen, cables . .	100 kr.	28-80	22-10	22-10
Prague, cables	100 kr.	4-18	3-50½	3-50½
Berlin, cables	100 mk.	40-33	40-18	40-16½
Brussels, cables . . .	100 bel.	23-54	16-86	16-86
Zurich, cables	100 f.	—	23-05	23-04
Madrid, cables	100 ps.	19-30	6-25	6-25
Vienna, cables	100 sch.	14-07	18-85	18-85
Budapest, cables . . .	100 pen.	28-61	19-75	19-75
Belgrade, cables . . .	100 din.	1-76	2-33	2-33
Athens, cables	100 dr.	1-29½	0-91	0-91
		Cents	Cents	Cents
Buenos Aires, paper . .	—	—	30-72	30-72
Market rate	—	—	29-77	29-77
Rio, cables	1 mil.	11-86	8-35	8-35
Yokohama, cables . . .	1 yen	59-83	28-83	28-83
Shanghai, cables . . .	\$1	—	29-55	29-60

Paris cables rate 3-38½ means that for three dollars, thirty-eight and one-half cents, the buyer is able to have sent by telegram a remittance to Paris for 100 francs. The Italian rate, again, is for cable transfers, \$5.26½ c. being charged for 100 lire payable in Rome. The other rates are similarly explained; in each case New York quotes in dollars and cents for 100 of the foreign unit concerned. But when we come to Buenos Aires and Rio, we see that another system of quoting is introduced. The rates are in American cents per peso and milreis respectively.

Before the city editor puts his paper to bed, as he says,

he has still another set of quotations to record. We refer to the rates from Latin America. These nowadays receive much more attention on the London market than was the case in pre-war days, and each of the newspapers is careful to obtain from the principal South American banks a list of the latest rates available.

The difficulty nowadays with these quotations is that, as exchange restrictions and one form or another of control exists in most countries, the rates are all more or less nominal. South American Banks, however, endeavour to simplify matters by issuing details relative to quotations for certain of the South and Central American exchanges, and these serve as a useful guide to those who are endeavouring to solve the riddle of the exchanges. It will be observed that most of the exchanges that follow are related to the United States dollar: the approximate sterling rates may be obtained by applying the dollar-sterling exchange rate. The following list was issued by the Bank of London and South America in October, 1937.

CENTRAL AND SOUTH AMERICAN EXCHANGE
RATES

BOLIVIA. ¹	Commercial banks' "free" selling rate was 100 bolivianos per £ on 20th August, 1937.
COLOMBIA. ¹	Sight selling rate on New York 175.77 pesos per 100 U.S. dollars on 23rd September, 1937. This rate applies to holders of permits buying in the "open" market.
ECUADOR.	Sight selling rate 13.15 sucres nominal per U.S. dollar.
GUATEMALA.	Sight selling rate on New York is maintained at one quetzal per U.S. dollar, but a commission of 1 per cent is charged by the Banco Central for the sale of drafts.
NICARAGUA. ¹	Sight selling rate on New York, including tax and commission, 2.16 cordobas per U.S. dollar on 17th September, 1937.
PARAGUAY.	Exchange is quoted on Buenos Aires; the sight rate was 70.50. Paraguayan pesos per Argentine "free" paper peso on 15th September, 1937.
SALVADOR.	Sight selling rate on New York 2.51 colones per U.S. dollar on 22nd September, 1937.
VENEZUELA. ¹	Sight selling rate on New York has been maintained at 3.19 bolivares per U.S. dollar since 27th April, 1937.

¹ Exchange controls are operative in these countries.

The list, on the whole, is self-explanatory, but to improve the reader's mental digestion, it may be of interest to work out an approximate sterling rate of one of them. For this purpose the sight rate with Salvador, which was 2.51 colones per one U.S. dollar, is taken. The New York rate at about that time was around \$4.96 to £1; therefore all we have to do is to give our brain another twist and ask this question: If one dollar is worth 2.51 colones, and 4.96 dollars are equal to £1, how many colones are equal to £1? Or, applying our old Chain Rule formula, here it is set out—

$$\begin{array}{l} ? \text{ colones} = \text{£}1 \\ \text{If } \text{£}1 = \$4.96 \\ \text{If } \$1 = 2.51 \text{ colones} \end{array}$$

and although no division in this case is required to make the Chain Rule computation complete, the calculation is shown—

$$\frac{1 \times 4.96 \times 2.51}{1 \times 1} = 12.4496$$

or, say, 12.45 colones are equal to £1.

These lists of South and Central American rates, read in conjunction with the list of London foreign exchange quotations, previously described, should form an interesting and useful study both for the man of affairs and for the student.

The foreign exchange dealer has to roam far and wide to earn the wherewithal for his daily bread, and, like the showman at the fair, what he gains on the swings he sometimes loses on the roundabouts. It is his business to buy low and to sell high, and between the two rates he makes his profits. To do this he has to be a man of wide and ready knowledge, and he has to be prepared to do exchange operations in the money of any country. Of recent years greater attention has been paid to what are now known as the Empire Exchange Rates, and these, we may at once admit, have often proved to be as much a bug-bear to the professional exchange dealer as to the student of international exchange.

Let us take a glance at these exchanges which have sometimes been considered as difficult to follow, but are really easy to understand if the student will pause a few moments to consider them systematically.

Australian and South African Rates.

Formerly the Australian and South African rates were somewhat confusing, as they were given in terms of premium and discount. Trouble, however, was encountered by the suspension of the Gold Standard, and practically by *force majeure* the market had to abandon this system of giving the rates. The list on page 77 is taken from *The Times* of 25th October, 1937. Let us see what we can read into the quotations there given.

The quotations given are those which the Australian Banks in London issue periodically. They are not daily rates: frequently, no alteration takes place for weeks at a time. They are, however, capable of easy comprehension, since the banks give us both their buying and selling rates on Australia and New Zealand.

The buying rates mean that if a person had, say, a demand bill drawn on Australia for £126 7s. 6d., the Australian bank in London would purchase it for 100 English pounds sterling. Similarly, if one had drawn a bill on that country for £126 17s. 6d. at 30 days' sight, then he would receive for it in London £100 in English pounds sterling, and so on with the rates for the other usances. The quotations, progress by 10s. for each 30 days, which is simply the rate of interest the banker charges for the time he is out of his money. Had the Australian banks been quoting for telegraphic transfers, it is possible that we should have seen that he was taking that rate as his basic quotation, and the same difference, or margin, between that and the demand bill would have ruled. If we take the margin between demand and 30 days' sight, it is plain that he is allowing 30 days from the time he hands over the money in London

EMPIRE EXCHANGE RATES¹

BUYING RATES

—	Demand	30 days' sight	60 days' sight	90 days' sight
	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Australia .	126 7 6	126 17 6	127 7 6	127 17 6
New Zealand ²	125 10 —	126 — —	126 10 —	127 — —
Do. ³	125 7 6	125 17 6	126 7 6	126 17 6

SELLING RATES

—	Telegraphic Transfers	Demand
	£ s. d.	£ s. d.
Australia .	125 — —	125 1 3
New Zealand	124 — —	124 1 3
	Closing Rates	
	Buying	Selling
	£ s. d.	£ s. d.
S.A. Union Territory (T.T.'s)	100 17 6	100 2 6
Do. (sight drafts)	101 3 9	100 2 6
Rhodesia (T.T.'s)	100 5 —	99 15 —
Do. (sight drafts)	100 11 6	99 15 —

¹ Per 100 London pounds. ² Ordinary mail rates.

³ Direct air mail rates plus postage.

and that at which he will receive cash for the bill in Australia, and that is roughly the time for mailing the draft. His charge is 10s., or, stated another way, $\frac{1}{4}$ per cent, or 6 per cent per annum. The difference between demand and 60 days' sight is £1., which again is 6 per cent per annum.

The New Zealand buying rates show that the New Zealand pound was more valuable than the Australian pound, since, to take the demand rate, for £125 10s. 0d. New Zealand pounds the banker was willing to give 100 English pounds. The rate of progression between the various usances, however, is 10s. A sign of the times is a rate, or rather series

of rates, that were not envisaged when previous editions of this book were written, viz. those for remittances by air mail. The buying rate on New Zealand per air mail for demand bills, it will be observed, is £125 7s. 6d. in New Zealand pounds for £100 London. It is only 2s. 6d. more expensive than that for demand drafts—the rates of progression, however, for 30 days, 60 days, and 90 days' sight bills are all 10s. each. Then on air mail rates, it will be noticed, there is an additional charge for postage by air mail.

For the selling rates only two types of exchange are given, that for telegraphic transfers and that for demand bills.

The first thing that will strike the reader is that, as the banks' selling rate for telegraphic transfers on Australia is only £125, they were not particularly anxious to sell on the Australian centre. For 100 London pounds, they would make available by telegram in Australia only £125 as against £126 7s. 6d., the buying price. Or, to put it another way, the Australian banks in London at the time our list was current, were evidently anxious to get money to Australia, and so were willing to pay more for it. Then it will be noticed that the margin between the selling rate for telegraphic transfers and that for demand drafts was only 1s. 3d., so the rate of interest allowed to the purchaser of a demand bill for making his creditor wait 30 days or so before he got his money in Australia was very small.

In the light of what we have said about the Australian rates, the New Zealand quotations will present no difficulties. It must not be inferred from these quotations that operations were not taking place in the reverse direction. Although none of the banks in Australia and New Zealand were particularly anxious to send money from either Australia or New Zealand to London, the quotations ruling in those countries were always ascertainable.

We now come to the South African quotations, which in these days are also not very informative. The rates given relate only to buying and selling operations, London on

South Africa. We see that the first quotation in the South African list was the South African banks' buying rate in London, and was given as £100 17s. 6d. for telegraphic transfers. This means that the banks on the day the rates were current would buy telegraphic transfers in London and would give 100 English pounds for £100 17s. 6d. South African pounds, to be made available, say, in Cape Town, as soon as a telegram reached that centre. The next quotation was for a sight draft, also drawn from London on a South African centre. The banks would pay 100 paper pounds in London for it, but as, perforce, they would have been out of their money during the time the bill was *en route* to South Africa, they required more in South African currency, so the rate was £101 3s. 9d. The difference between the telegraphic transfer rate and the sight rate, it is plain, is the bank's interest charge.

The selling rate was the number of South African pounds the bank would sell for 100 English paper pounds, and if the reader were in the position of wanting to make South African currency available in one of the South African centres just so soon as the bank could send a cable to its branch there, all he would get for his £100 paid in London would be £100 2s. 6d. South African pounds. As will be observed, the same rate applies to sight drafts.

The rates, South Africa on London, although not published in the Press, are likewise fixed from day to day, and are ascertainable from the banks in London each morning.

The Rhodesian rates, in the light of our explanation, will be plane sailing. They are all for 100 London pounds, and the differences between the rates are the interest charges made by the banks for the facilities they give in remittances.

Although the list published in the Press gives only the telegraphic transfer and sight rates, it should be noted that the South African banks also give quotations for other usances. For instance, on the date the rates appeared, the following were also current.

BUYING RATES IN LONDON ON SOUTH AFRICA

	Sight	30 Days' Sight	60 Days' Sight	90 Days' Sight
Union of South Africa per £100 British sterling .	£101 $\frac{1}{8}$	£101 $\frac{1}{4}$	£102 $\frac{1}{8}$	£102 $\frac{1}{4}$
Rhodesia per £100 British sterling .	£100 $\frac{1}{8}$	£101 $\frac{1}{8}$	£101 $\frac{3}{8}$	£102 $\frac{1}{8}$

The rate of progression, it will be observed, is 10s. for each usance starting from the sight rate. Thus the 30 days' sight quotation was 10s. above the sight rate, the 60 days' sight 10s. more than the 30 days' rate, and so on. In each case these differences represent in reality the bank's interest charge for the period it is out of its money before the bill is paid.

The United States of America.

The business of foreign exchange in the United States has received very much more attention since 1914, and most of the large American banks have now thoroughly well-equipped foreign exchange departments. The war taught the Americans a good deal. One great step forward has been the revision of the method of quoting the exchanges. Early in 1921 it was decided to give all American quotations in cents per foreign unit. This manner of quoting the rates greatly simplifies the mysteries of exchange for the uninitiated, and at the same time it makes calculation very much easier. The present American system of quoting, as shown in the following table, taken from the London *Economist* of 23rd October, 1937, has very obvious advantages, for it not only permits of fine shading where necessary, but the quotations can be read either as the dollar value of one hundred units, or the cent value of one unit. For instance, Brussels is given on 20th October, 1937, as 16.88 cents for 1 belga, and if we want to buy 100 belgas then the rate would be \$16.88 c.

As will be seen, the rates in all cases, except for remittances on London, are for cheques, i.e. demand remittances. With London, there are three rates, for 60 days' sight bills, cable transfers, and cheques. The difference between the rates is really interest on the money for the period the banker has the use of it before he has to pay it over to the person who has the bill. An examination of these quotations, New York on London, shows that the most costly method is that of cable transfers for which, on 20th October, 1937, \$4.9562 per £1 was charged. The next is the cheque rate \$4.95½, and the cheapest is the 60 days' sight bill, \$4.94½.

The method of quoting as revealed in this table is known as "Fixed Exchange," and, in view of its simplicity, it

Rates of Exchange, New York on—		Par Level	21 Oct., 1936	6 Oct. 1937	13 Oct., 1937	20 Oct., 1937
London—		Old par				
60 days	Dollars for £1	4.8666	4.8812	4.9456	4.9512	4.94½
Cable		New par	4.8912	4.9543	4.9600	4.9562
Cheques		8.2397	4.89	4.9537	4.9587	4.95½
Paris cheques	Cents for 1 franc	6.63	4.65	3.20½	3.30½	3.38½
Brussels "	Cents for 1 belga	23.54	16.84	16.853	16.865	16.88
Switzerland "	Cents for 1 franc	32.67	23.98½	23.02	23.01	23.09
Italy "	Cents for 1 lira	8.91	5.26½	3.26	3.26	3.26
Herlin "	Cents for 1 mark	40.13	40.21	40.175	40.165	40.17
Vienna "	Cts. for Austr. shil.	23.82	18.73	18.88	18.88	18.88
Madrid "	Cents for 1 peseta	32.67	—	—	—	—
Amsterdam "	Cents for 1 guilder	68.06	53.86	55.30	55.29	55.30
Copenhagen "	Cents for 1 kroner		21.84	22.12	22.145	22.13
Oslo "		45.37	24.58	24.90	24.92	24.91
Stockholm "		25.22	25.52	25.575	25.56	
Athens "	Cents for 1 drach'a	1.29½	0.89½	0.91	0.91	0.91
Montreal "	Cents for Can. \$1	169.31	100.41	100.41	100.41	100.41
Yokohama "	Cents for 1 yen	84.40	28.58	28.89	28.91	28.85
Shanghai "	Cents for 1 dollar	—	29.62	29.75	29.62	29.56
Calcutta "	Cents for 1 rupee	61.80	36.965	37.44	37.47	37.46
Buenos Aires "	Cents for 1 peso	—	32.60	30.73	30.73	30.73
Rio de Janeiro "	Cents for 1 milreis	11.96	8.24	8.35	8.35	8.35

is much to be desired that London would follow the example set by New York. London quotes rates in both "movable" and "fixed exchange," and in this connection the difference between the two should be carefully noted, although it is only a reiteration of rules we have already demonstrated. For example, where we quote in, say, francs and centimes to the home unit—the pound sterling—the rate is called "movable" exchange, and the guiding rule for dealing is, buy high, sell low, the higher the rate

the more foreign money received for each £1, the better the bill the lower the rate. "Fixed" exchange is seen in those cases where London quotes in shillings and pence, or in pence per foreign unit, and here the rule is, buy low, sell high, the lower the rate the more foreign money received; the better the bill the higher the rate.

Viewed from the American standpoint, fixed, or, as some call it, "direct" exchange is seen where New York quotes the value of the foreign monetary unit in terms of American money, that is, their home unit. The cable transfer rate, New York on London, for instance, is given as \$4.9562. As our paper pound falls in value, the New York dealer would give less American dollars and cents for it; as it rises in value, he surrenders more American currency for the pound, say \$4.95. In other words, the American buys sterling as he would, say, a pair of boots, or any other article, that is, on the basis of what it is worth in dollars and cents.

Movable, or "indirect" exchange does not bother the American market, since, as we have shown in the American table of rates, New York now quotes in fixed exchange for all currencies, and Canada follows the same system.

Finally, we give the Moscow quotation, which is regularly published in London. The rate is now given in roubles to £1, the rate on 21st October, 1937, being 26.22½. The way the Russian rate has altered with the franc is interesting. In December, 1936, one chervonetz was equal to 30 francs. From 2nd April, 1936, it was decreed that the value should be 1 rouble to 3 French francs; and on 28th October, 1936, following the devaluation of the French franc, the rate was again altered to one rouble for 4½ francs.

CHAPTER IX

SHORT EXCHANGE, LONG EXCHANGE, AND TEL QUEL RATES

We have mentioned earlier in our study that city editors used to favour us with another table of rates known as the "Course of Exchange," the list of quotations itself being termed the "On 'Change Table." It is one of those things that have passed with the war, though in some quarters attempts have been made to revive it. Nowadays there is no set meeting-place for foreign exchange dealers. But, up to February, 1921, there were bi-weekly meetings within the hallowed precincts of the Royal Exchange. Various brokers, exchange dealers, and bankers used to meet each Tuesday, and their dealings in bills took place on the ground floor in the spacious hall, which city workers have come to regard as the sacred domain of the office boys, who, failing any other shelter, resort to the Exchange to eat the more or less frugal lunch which thoughtful mothers insist upon their carrying to the city each day. Practically the only paper which meets the eye of the general public is the newspaper wrappings of the mysterious parcels which daily emerge from the pockets of these diminutive city urchins.

The On 'Change Table, to call it by its vulgar name, gave the prices at which bills on the various countries had changed hands, and immediately the bargains were recorded the list was drawn up and issued to the Press, to be published the next day.

In a way one regrets the disappearance of the "On 'Change Table," as it was useful for business men to refer to in order to check the prices at which foreign bills of varying usance, that is, those payable at sight, or so many days or months after date or sight, were changing hands

in the London Market. However, that was at a time when the business in foreign exchange and foreign bills was not so well developed in London as it is at the present day. Now, if a man wants to buy or to sell a bill of any usance, be it a bill drawn on a foreign bank or on some firm or other at a foreign centre, the banks stand ready to buy or to sell for him ; and, unless diligent inquiry be made among the banks, few know at what price these instruments of credit are changing hands.

However, he who would be well versed in the dark mysteries of the foreign exchange business should know how rates for bills of the various classes and periods are built up.

Any banker who participates in the finance of a country's foreign trade will say that in the course of his business he has frequently to buy what are termed long and short bills. The former he terms " usance " paper, and the latter " demand " paper. He has, therefore, to deal in what readers of the old " On 'Change Table " knew as short exchange and long exchange. The term " short exchange " is generally used in referring to the rate of exchange paid for cheques and bills of exchange payable on demand or at sight ; and, by extension, in New York and some of the continental bourses, it includes bills having up to eight or ten days to run before reaching maturity. Short exchange is practically the Par of Exchange, plus the few slight differences, to which we have already referred, that go to the building up of the rates of exchange. They are what we call normal rates, that is, the prices for bills that rule provided there be no great balance of indebtedness between any two countries. In practice, as we have shown in our chapter on the gold points, bankers and exchange dealers will endeavour to avoid the shipment of bullion and specie when international debts have to be discharged ; and, as they will bid up for other forms of remittance, there are deviations, or fluctuations between the limits known as the gold points, and sometimes beyond

those points. In normal times, however, the quotations will not move very far in excess of the known costs of the transmission of gold, given that the metal is freely available for export.

By way of example, we may take exchange with Sweden : In normal times, with the Gold Standard in full operation in both England and Sweden—

At Kr. 18·23 to £1, it would pay to ship gold from Stockholm to London.

At Kr. 18·159 to £1, we have the Mint Par of Exchange.

At Kr. 18·07 to £1, it would pay to ship gold from London to Stockholm.

The usual range, then, within which in ordinary times the sight or short exchange with Stockholm should move, would lie roughly within these limits. Should for a day or two the exchange between London and Stockholm move beyond this range, say by 2 to 3 ore, it should tend to cause heavier shipments of gold, and the rate would move back to the normal level the sooner. In the case of crises, great political events, or of stoppage of gold supplies, the short rate of exchange may recede much more ; but normally Kr. 18·05 and Kr. 18·21, say $\frac{1}{2}$ per cent either way, or 1 per cent on the whole, would generally cover all contingencies. At the present time, of course, these rates do not apply, as there is an embargo on the export of gold from Sweden.

There is a good deal of academical reasoning upon the factors that affect the short rate of exchange, and even bankers and exchange dealers do not see eye to eye with each other as to what actually is the basis for the other rates of exchange. The arguments as to whether it is the short rate or the telegraphic transfer rate that forms the basis for the other exchange rates are endless. As a matter of interest, therefore, we give excerpts from one or two authorities on the matter.

One of the American banks, in its *Foreign Trade Bulletin*, writes—

" It is interesting to note that the cable rate of exchange is the real rate indicating what the United States dollar

is actually worth day by day in terms of each foreign currency."

Whitaker, in his *Foreign Exchange*, holds that the sight rate depends in the end upon the "totality" of the supply of and demand for all classes of foreign exchange as determined primarily by international commercial and financial traffic; and, secondly, by exchange investment, borrowing, speculation and arbitrage, and the export and import of specie. He disposes of the argument about calculating the buying rate for bills on the cable rate in these words—

"The thought that the cable rate is the 'real' exchange rate, unadulterated by discount or interest, so to speak, is an attractive idea to both the theorist and the banker. But, be this as it may, the various long rates (and also rates for merchants' sight bills, which are sometimes drawn) are tied to the rate for bankers' sight drafts in a way in which they cannot be connected with the cable rate. The spread between a long rate and the sight rate can be calculated at the time of the purchase of the long exchange from factors which are then all fore-known. Neither speculation nor investment enters in. But the purchase of any kind of bill cannot be counter-balanced by a sale of cables without both a speculation and an investment of funds being involved. And so a banker cannot base his buying rate for long bills upon the cable rate without putting into the spread one speculative element, or one factor that is guesswork. The point remains even if under very quiet conditions the degree of speculation may be slight.

"The rates for exchange which takes the form of written instruments that have to be transmitted by mail to the place where they are payable happen then to be more intimately connected with each other than with the rate for telegraphic transfers. The sight rate is basic among this larger group. The sight rate and the cable rate are related, but the spread between them contains an ineradicable speculative element. Whether the cable

rate is in some theoretical sense the basic one as between these two, is a question that it is practically idle to discuss. In point of fact, the sight rate is not determined by a calculation from the cable rate, but is forged out in the open market between the hammer and anvil of bid and offer. Under ordinary conditions, at least, the market would no more think of calculating sight rates from cable rates than the tail would think of wagging the dog."¹

Then Cross, in his *Domestic and Foreign Exchange*, gives an able summary of the working of the rate. He argues that in actual practice the sight rate is the starting point in all exchange calculations, whether they concern the purchase of short or long bills, or the exchange rate at which gold may be profitably imported or exported—

"A bank," he adds, "at any particular moment may be selling cables on London at 4·8715, sight drafts at 4·8675, 60 day drafts at 4·8305, and 90 day drafts at 4·815. In quoting the cable rate, the cost of the message itself is not included. Cables command a higher rate because they call for immediate payment. It takes but a few hours from the time a cable is sent until the sum it represents is deducted from the foreign account of the selling bank. From the standpoint of the dealer the sale of a cable allows no opportunity to earn interest on the transaction. If he sells a sight draft he has the use at home of the money which he receives for it and for the length of time that it takes the draft to reach London and be paid. In the meantime he also receives interest on an equal amount of money in his foreign account. Because he gains no interest on the sale of cables, he charges a higher rate therefor than for other kinds of exchange. From the standpoint of the purchaser it can be said that the cable enables him to wait until the last moment before making payment abroad,

¹ Cf. Whitaker, *Foreign Exchange*, pp. 273-4 (New York—Appleton & Co.).

and so makes it possible for him to retain the use of his money for that length of time. The purchaser is willing therefore to pay more for a cable than for other kinds of exchange. If money rates are high, the purchaser in buying a sight draft will lose more interest than when money rates are low, and vice versa. If he buys a cable when local money rates are high, he gains more interest on his money than when money rates are low. Money rates thus exert an influence upon the spread or difference between the rates paid or charged for demand bills on the one hand and those paid or charged for cables and long bills on the other.

“The rates charged by a bank for 60 and 90 day bills, as well as the rates at which a bank will purchase such bills, are less than the rates charged or paid for sight drafts because the bank gains interest on the funds in the case of long bills sold, and loses it in the case of long bills purchased.”¹

We have referred at length to these differences of opinion because it is desirable that readers should be in a position to view the question from all standpoints. However, the author is of opinion, and it is an opinion that is fortified by experience in long years of practical working in an exchange bank, that there is ground for the assertion that the demand, sight, or short rate has a connection with the rate for cable transfers. The rate for cable (or telegraphic) transfers depends, to a large extent, on the cost to a banker of laying down funds in a country upon which he desires to sell telegraphic transfers, though this rate, again, may be to some extent affected by the opposing elements of supply and demand—competition, in a word, enters into the question. But having a fixed rate for his telegraphic transfers, in practice the tendency will be for him to base his rates for demand bills on his telegraphic transfer rate. It is admitted, nevertheless, that, in practice, demand and

¹ Cf. Ira B. Cross, *Domestic and Foreign Exchange*, pp. 348-9 (New York—The MacMillan Co.).

supply, market conditions, and competition will also affect his rate of exchange for demand bills, that is, the short rate. Added to all this, the gold question also affects the rate, as we have shown.

Finally, we get back to this, that the rate or price at which a banker will sell short exchange will, in practice, be on an economic basis; that is to say, it will depend upon what profit there is in the transaction. This again, as we have said, must be governed by the cost to him of providing funds in the foreign centre upon which his bills are drawn and, in a less degree, perhaps, the rate of interest they are earning there in the hands of his foreign correspondent.

When we come to the other rate, long exchange, there is not so much dubiety of opinion. By long exchange is usually understood three months' bills, though sixty-day bills are sometimes included in the term.

Long exchange is always based on short exchange, so we may proceed to show its connection with the short rate without further ado.

Let the reader imagine he is buying a bill in London drawn on Geneva; he wants a long or three months' bill: the basic rate will be the short rate, since the long rate will be simply the short rate of exchange with the amount of interest for three months, plus stamp charge, added to it.

For instance, if short exchange were 21·48 c. to £1, and the market rate of discount in Geneva 2 per cent, then the buyer would expect to get the short exchange, plus three months' interest at that rate (21·48 plus ·1074), 21·5874 to which has to be added the charge for foreign stamp duty and, in some cases, a small charge for risk or contingencies, in all, say, ·0215 centimes, thus giving a rate of 21·6089 as the long exchange, or three months' rate for bank bills drawn, London on Geneva. We add interest and charges to the rate, because if a person has to wait three months before he gets his money, he naturally expects to receive some

compensation in the way of interest ; in other words, on a three months' rate we give the buyer so much more to the pound sterling than if he had bought a bill at the short rate.

If we are dealing in the reverse direction and are drawing bills, Geneva on London, and assuming the same rate of interest is current in the London market, instead of adding the interest, it must be deducted from the short exchange, and the result is the three months' rate on London in Geneva. For instance, given a rate in Geneva of 21·48, and deducting from it three months' interest at 2 per cent, say, ·1074, we get as the result 21·3726 ; or allowing stamp and charges, the three months' rate is 21·3511. The Swiss dealer, it will be observed, surrenders fewer francs and centimes for £1 payable in three months' time than he would if the bill were payable at once, and this to him obviously is the better rate. Strictly speaking, this addition to or deduction from the short exchange is merely another way of expressing the charges and the discount allowed for the time the bill has to run.

The question of adding to or deducting charges is easy enough when dealing with movable exchange, but not so plain when operating in fixed exchange. Yet all that has to be remembered is that a bill on demand or payable at sight is more valuable than one that is not due for three months. Hence the maxim, the better the bill the lower the rate, which applies to exchange quoted in foreign units to the pound sterling. When rates are quoted in fixed exchange, that is, in the home currency or, as the dealers say, "in local currency," the rule is, the better the bill, the higher the exchange rate. So if we have a rate on, say, Bombay at 1s. 6d., a buyer will give less shillings and pence for a bill payable at three months' date than we would for one payable at sight ; therefore the charges will be deducted. Similarly, if we are buying a bill in Bombay on London, to find the long rate of exchange, we add the charges to the short rate, not deduct them as we do when

dealing in foreign currency, say francs and centimes (movable exchange). The person selling surrenders more rupees for his bill payable at sight, or gets less sterling, which comes to the same thing.

Care is needed in this question of interest or discount on bills of exchange which are drawn payable other than at demand or at sight. When it is a case of turning the bill into immediate cash, the discount is calculated at the rate current on the market in which the bill is *payable*, not in the place in which the bill is *bought*. Moreover, the place in which the bill is payable is not always the centre in which the bill is accepted, since in numerous cases bills are drawn on and accepted in one country, but are made payable in another country. For example, bills may be drawn on and accepted in Paris, but made payable in London.

The points, then, to be emphasized are, that the rates for bills payable three months after date are better than for bills payable on demand. The reason is that the purchaser of a three months' bill will expect to get it at a rate which, after allowing for discount (i.e. the charge for melting or turning the bill into ready cash in the market in which it is payable), will put him in no worse position than if he had bought a bill on demand. The rate for these "usance" bills, as they are often called, is thus determined by the rate of discount current in the place on which they are drawn.

There is another point: given the long rate, the short rate can be calculated from it; for instance, given a long rate of, say, Fc. 21·54 for bills on Geneva, we can calculate the short rate as follows—

	Fcs. 21·54
Less 3 months' interest @ say, 1½% . . . . .	.08
	21·46
Less allowance for stamps, etc. . . . .	.02
	Fcs. 21·44

which will be the short rate.

Now, the long rate of exchange, being affected by the

rate of interest or discount, can and does move independently of short rate; but short rate cannot move unless the long rate moves also. To illustrate this, we may take the normal rate of exchange for short bills, say, on Geneva at three different dates (the par of exchange is 25·2215); and suppose it remains at 25·20 $\frac{1}{4}$, and suppose that on the same three dates the rate of discount in Geneva were 3 $\frac{3}{4}$ per cent, 4 per cent, and 5 per cent, the long rate on each occasion would be as follows—

	Fcs.		Fcs.		Fcs.
Short rate .	25·2025	Short rate .	25·2025	Short rate .	25·2025
3 $\frac{3}{4}$ % for 3 m/s	·2362	4% for 3 m/s .	·2520	5% for 3 m/s .	·3150
Stamp . . .	·0150	Stamp . . .	·0150	Stamp . . .	·0150
	<u>25·4537</u>		<u>25·4695</u>		<u>25·5325</u>

From a comparison of these rates, then, we see that neither a rise nor a fall in the short rate has occurred, but that the upward movement in the discount rate in Geneva has caused a widening in the difference between the short rate and the long rate of exchange.

We have worked on the assumption that the long bills in question are bank bills, and as such they have been discounted at the market rate of discount in the market on which they are drawn. In practice, there are two rates of discount in most well-organized money markets—market rate of discount and bank rate of discount; the former is the lower of the two, and is applied to the superior class of bill, viz. bank bills. If trade bills are sent, then the rate of discount taken would be the bank rate, i.e. the higher rate.

In most countries adjacent to London, the tendency since the Great War has been for the rate of exchange for long bills to fall into desuetude, owing to unstable rates of exchange. Its place has been taken by forward exchange rates, since no one who has a long bill would, in general, care to take the risk of a fluctuating rate of exchange; rather would he settle a forward contract with the banker. But in foreign countries farther afield, long bills, and bills

at various usance, are still very much in evidence ; and all banks, say, in India, China, and the Far East, South Africa, the Argentine, etc., still "make" rates for long bills and other usance paper.

The surest way to understand the intricacies of short and long exchange is to view the matter from the foreign standpoint. Let the reader imagine himself for the moment to be in Milan, Italy. He goes to a bank, say, the *Credito Italiano*, and informs the exchange man there of his desire to remit a sight draft to London. It will be obvious that the reader, the would-be remitter, is anxious to send to his creditor in London an instrument that will enable him to get his money as soon as the draft arrives in London and is presented for payment. He will, therefore, have to surrender to the *Credito Italiano* a greater number of Italian lire and centesimi per pound sterling than he would had he sent a bill deferring payment for, say, some three months. If, on the other hand, he desires to purchase a three months' draft, the exchange dealer at the *Credito Italiano* will quote him a lower rate, as that institution will have the use of the money for three months and three days before payment is due. A lower rate, in the case of the remitter from a foreign centre, means that the remitter will pay less lire and centesimi for each pound sterling. The rate will, therefore, be short exchange, minus the interest for the period of the bill, less the foreign bill stamp and less the small charge for contingencies, if any. We see, then, that when buying long exchange in the foreign centre, we take the short rate and deduct from it the charges.

But suppose we are operating in the reverse direction, London on Milan. The short exchange is again the dearer form of remittance ; one gets less lire and centesimi for each pound sterling handed to the exchange banker. It follows that if it be desired to send a long bill to Milan, we must add the charges to short rate instead of deducting them as we do if operating from the foreign centre. The

buyer obtains more units of the foreign money for each pound sterling he parts with. He sends to his creditor the larger number of lire and centesimi, since, as we have already shown, he must put him in such a position that if he desires to "melt" the bill or turn it into cash on his own market, that is, Milan, where the banker will charge him the prevailing rate of discount for giving him ready money, he, the creditor, will be in no worse a position than he would have been had a short bill been remitted to him.

Then we come to the pence and shillings and pence rates. Here a certain amount of care is needed. We will again take the person operating in the foreign centre. He is buying pence or shillings and pence for the money of his own centre; the more distant the time of payment of the bill in London, the more pence or shillings and pence will he get for each unit of his own currency, be it pesos or rupees. To the short rate, then, will be added the charges. On the other hand, if the remitter is operating from London, he will give less pence or shillings and pence for each of the units of the foreign country if he buys a long bill than he would if he bought a sight bill.

The position of the seller in each of the cases we have outlined will be the reverse. If one is selling lire, more lire for each pound sterling will be surrendered per pound sterling if the bill is payable at three months' date than if it were payable at sight—the additional amount being the charges we have mentioned: these will have to be added to the sight rate. For selling London on Italy, the seller would deduct the charges, as he will want more sterling for a sight bill than he would accept for a long bill; in other words, he would sell a greater number of lire for each pound sterling payable at three months' date than he would if the bill is payable on demand.

Then, again, we have the seller of rupees, or Hong-Kong dollars operating from London. If he has the demand rate, he will need to deduct the charges, discount, stamps, etc., to find the long rate, for he must charge

the buyer less pence, or shillings and pence for a bill payable three months hence than he would if he were selling demand exchange. The reason for this is, as previously stated, and here reiterated, that the purchaser of the three months' bill will expect to get it at a rate which, after allowing for discount (i.e. the charge for melting or turning the bill into ready cash in the market upon which it is drawn), will put him in no worse position than if he had bought a bill payable on demand.

We have dealt now with telegraphic transfer rates, "spot" rates, and short and long bills, and even then there are others in the "awkward squad," as a banker once described them—awkward because they are bills for broken terms for which there is no actual quotation. To fit such bills, we apply what is known as the "tel quel rate."

A "tel quel" rate of exchange is an adjusted rate, or a rate of exchange "such as it is." Just how the expression has crept into the London foreign exchange market is a little difficult to explain. In the view of most experts, the term should be "tale quale," which, again, is a corruption of the Latin *talis qualis*—of such a kind, or unchanged; that is to say, the actual rate of the bill is not affected.

A tel quel rate arises in those cases in which bills which were originally three months' bills have, by flux of time, become shorter usance paper. For instance, if a period of one month has elapsed since a long bill has been purchased, it obviously becomes a two months' bill, and is worth more, i.e. plus one month's interest at Bank Rate if it be a commercial bill, or plus one month's interest at market rate if it be a bank acceptance.

There are really two methods of dealing with such bills: the first is to calculate the month's interest and charge it to the buyer of the bill; the second is to adjust the rate. On the assumption that we have a three months' bill on Berlin, of which one month has elapsed, that the bill is for 1,500 Reichsmarks, the rate of exchange is 20-63 to

£1, and market rate of discount is 4 per cent per annum, the following are the two methods of calculation—

1,500 Reichsmarks at 20·63	£72·709
Plus 1 month's interest at 4%	·24236
	<u>£72·95136</u>

The second method is worked by adjusting the rate—

Three months' rate on Berlin	20·63
Less 1 month's interest at 4%	·06876
	<u>20·5612</u>

which is the tel quel rate ; and for Reichsmark 1,500 at 20·5612, we get £72·952, which is practically the same result as is arrived at by working in the first example.

But cases occasionally arise when bills may be for longer periods than three months. For example, a four or six months' bill might be offered for sale, and on the assumption that only the long or three months' rate of exchange were quoted, the seller would receive less for the longer usance paper, since the buyer has to wait longer for his money. The rates may, however, be adjusted in a similar fashion, though in all probability a higher rate of discount would be charged to compensate the buyer for the greater risk he theoretically runs by holding a long date bill.

In the first case, then, the one month's interest would be deducted, not added ; and in the second case one month's interest would be added, and not deducted.

The cup of the reader is, however, not yet full ; he has still one other rate to consider, and when he has learnt all about that he may consider himself in the way to becoming one of that reputable body that have representatives on every money market in the world. We have referred, in passing, to "Forward Exchange," which at the present day is one of the most important of all rates of exchange. That being so, it may well form the subject of our next chapter.

CHAPTER X

FORWARD EXCHANGE—HOW IT IS CONDUCTED AND THE
CONDITIONS UNDER WHICH THE MARKET FUNCTIONS—
HOW THE BANKER COVERS HIS OPERATIONS—SWAP
TRANSACTIONS IN FORWARD EXCHANGE—OPTION DEAL-
INGS—OTHER METHODS OF AVOIDING EXCHANGE RISKS

So far we have considered that all bills, etc., are bought or sold on the spot, but in countries having an unstable currency, there is a method by which both importers and exporters seek to remove some of the risks attendant upon the fluctuating exchange: they make forward contracts with the exchange banks for the purchase or sale of bills and telegraphic transfers as and when favourable opportunities present themselves. To the novice these operations may appear somewhat technical and involved, and it will therefore be well to set out separately one or two of the transactions as they occur in actual practice.

First of all take the case of the British exporter who has consigned goods to China. His agent there (the importer) has a ready market for the consignment, and is under agreement to put his principal in England in funds by a certain date; he knows approximately the amount he will be obliged to remit to Great Britain, and to avoid the exchange risks he makes a contract with one of the exchange banks in China, Shanghai for instance, for the purchase of a telegraphic transfer on London, deliverable on the date required, at an agreed rate of exchange. This is termed buying forward exchange, and the rate is called the "forward rate." When the date arrives the sum due is paid to the bank in Shanghai in Chinese dollars, and the remittance is forthwith sent by cable to the bank's London branch for payment to the British exporter, or whoever else is concerned, in sterling.

Forward contracts for the purchase of bills from exporters from a foreign country to England serve a double purpose. They eliminate the risks of exchange both for the exporters who wish to have a certain fixed sum paid in exchange for their bills, and also for the importers who are under the obligation to remit by mail to the British or other exporters. For example, the Chinese exporters of the tea which arrives in England during August, know as far back as April or May that they will have to draw sterling bills on firms in London, and if the exchange quotations are favourable they will endeavour to make forward contracts with the bankers to purchase the tea bills, deliverable, say, two or three months hence. So much for the Chinese exporter, but there is also the importer who desires to operate in the reverse way. In his case he may perhaps want to make a remittance by mail in payment of cotton goods he has imported from Manchester, and knowing the date the funds ought to leave China, he can contract with the bankers in advance for the remittances at any time the rate appears suitable. We are, of course, assuming in each case that the banker is willing to operate ; but it sometimes happens that the exchange dealers consider they have sufficient forward exchange commitments, and in that case they will refuse to make offers.

It now begins to dawn upon us how the astute banker can set one operation off against the other. He is under contract to pay the tea exporter, say, £1,000 on the 31st July: on the same date the Chinese importer is under contract to pay him £1,000 to remit to London. Further explanation is hardly necessary. With the funds received from the importer the banker pays the exporter for the bills the latter delivers, and, finally, the bills are sent to London to be turned into cash by the bank's London office, who will pay in good time the person to whom the Chinese importer has remitted.

As regards telegraphic transfers, forward contracts must

be covered by the bankers, and this is done by their purchasing bills of exchange drawn on the same centres as those upon which they have sold telegraphic transfers. For instance, if a banker has sold telegraphic transfers on London three months forward, he will endeavour to purchase bills of exchange to mature in London on the same date as that on which the telegraphic remittance will have to be paid. The proceeds of the bills falling due in London therefore form the fund out of which he pays the telegraphic transfers.

To avoid misconception, it should be noted that in the case of these telegraphic transfer contracts, no payments are made by the contracting parties until the date when the contracts are taken up, though a cash margin is frequently required as security for the carrying out of the contract.

Once the contract for forward exchange is made, the risk on exchange fluctuations is transferred from the exporters and importers to the banker, and the margin of profit which the latter has made on the rates will be increased or diminished in proportion to the rise or fall in the exchange. Events sometimes favour the one class of operator, sometimes the other, and while the traders say it is the bankers who always reap the gain, the banker solemnly avers that his margins are reduced to the narrowest possible point by the very good rates the traders exact when selling him their mercantile bills. However, like so many other operations we have investigated, the bankers' profits depend upon the rates at which they ultimately make purchases to cover their forward sales.

For the rest, the speculation being transferred to the bankers, it is they who stand to lose should exchange go against them, and it is they who will have to make shipments of the precious metals if for any reason there is a shortage of cover for the contracts they have entered into.

Forward exchange in London has grown considerably

of recent years. Prior to the war the two most important rates of exchange were the "Short" and "Long" Exchanges. The rate known as the telegraphic, or T.T. rate, was of less importance. The war and the financial upheaval that it brought with it in most countries necessitated resort to other means, in order as far as possible to cope with fluctuating values of the world's principal monetary units. Exchanges were settled on a "spot" or cash basis or on a telegraphic basis, and where merchants and others found it necessary to avoid loss by depreciation in foreign monetary units resort was had to "forward" exchange. In forward exchange persons make contracts with bankers to buy or to sell fixed amounts of foreign currency for delivery at a definite future date. The money may be delivered in one sum on a given date, or deliveries may be spread over a certain period of time. Money, as a rule, does not pass until delivery of the foreign currency; but in view of the risks involved, bankers, as in the case of forward contracts for telegraphic transfers, insist frequently on the deposit of a satisfactory margin as a guarantee against loss. When a margin on forward contracts is received, it is credited to the firm paying it in a "Margin Account." On the date the foreign currency is to be taken up the firm is debited with the amount of the margin and the appropriate foreign exchange account credited. Forward exchange is carried on only between those countries having active exchange markets, and the successful working of the business is dependent upon various factors, the principal of which are: easy transferability of funds and differences in the rates of interest on short-term loans, that is, a higher rate of interest in the one country than that ruling in the other country. Uncertain political and financial conditions in a country and depreciated monetary units are factors that militate against the successful working of forward exchange.

A hypothetical example of the way interest rates affect forward exchange may be useful. We may imagine the

rate of short-term loans in New York to be 4 per cent and in London 2 per cent. per annum. If a banker or exchange operator transferred his money to New York he would earn the higher rate of interest. To transfer his money, he will avoid sending gold ; he will find out those persons who have balances to their credit in New York and purchase in London the right to the New York funds. He has thus bought American dollars at the " spot " or ready exchange rate, and he can at once lend the money out on the New York market. That is one side of the transaction. But having this balance in New York, he can make a further use of it : he can sell dollars " forward " against his balances, or, as the market describes it, the banker has bought " spot " dollars and sold forward dollars against them. Apart from the ordinary rules of demand and supply, there will be in London a discount on forward quotations of so much per month, and this discount will be close to the difference in interest obtainable in New York for short money over that which could be earned in London at a lower interest rate. It does not follow that the difference will be exact, as in forward business competition enters into the question. With many operators in the market at a given time, covering operations are done at competitive rates. With such interest rates as we have noted—for instance, 4 per cent in New York and 2 per cent in London—a banker could sell forward up to a limit of, say, $\frac{2}{3}$ of a cent per month or $4\frac{1}{2}$ cents per annum. Take an exchange of, say, \$4.50 to the £1 : $4\frac{1}{2}$ cents on \$4.50 would be 1 per cent per annum. " Short " money in New York would, however, return the banker 2 per cent per annum more than in London, so he can safely cut the exchange rate to purchasers forward by, say, 1 per cent per annum by surrendering $\frac{2}{3}$ of a cent per month on the forward rate, and still net a profit of 1 per cent per annum on the transfer of his funds to New York.

If the position be reversed, and London be the market with the higher rate of interest on short-term loans, a

banker will not operate unless he can get a satisfactory margin between spot and forward exchange. There will be a premium instead of a discount on forward exchange. Or, to put it another way, the discount will be on spot exchange, and that discount must of necessity approximate to a higher interest than would be produced by the amount the banker nominally loses if he transfers funds from London to New York.

A prudent banker will always seek to cover his forward purchases and sales as soon as possible, and the paucity or plentiful supply of cover are factors that necessarily enter into the calculation. Frequently, too, a banker may be able to match or marry a forward sale with a forward purchase and vice versa. In any case, over a given period there comes the inevitable day when a banker finds it advisable to close his forward exchange commitments, and then the extent to which he is over-bought or over-sold, as the case may be, and the cost at which he has to cover his balance will largely influence his ultimate profit. However, as the Midland Bank pointed out in one of its monthly circulars, in the ordinary way, directly a bank enters into an engagement on account of forward exchange it immediately completes a compensating transaction. Where only small amounts are involved it might buy at spot to cover a forward sale, but in most cases it will buy or sell forward in the market to balance the original contract. In this way it ensures that at the date of delivery the dollars will be forthcoming at approximately the same rate as that at which they must be provided.

Most of the daily papers, especially those devoted exclusively to the money and stock and share markets, now give the forward exchange rates, but the manner in which the quotations appear are at first sight a little difficult for the novice to understand.

The following list of rates, current before troubles arose in regard to suspension of the Gold Standard, will serve to pave the way to an understanding of forward exchanges—

FORWARD EXCHANGE RATES

Paris	10-15 centimes over spot.
New York	$\frac{1}{2}$ -1 $\frac{1}{2}$ cents over spot.
Switzerland	par to 3 centimes under spot.
Italy	15-25 centesimi under spot.

It will tend to simplicity if we assume that all these quotations refer to the price of the various currencies per month forward and, being interpreted, the explanation is this.

An exchange operator is prepared to sell forward for delivery one month hence, French francs at 10 centimes, and dollars at $\frac{1}{2}$ cent over the selling rates for "spot" deliveries of francs and dollars. He will buy forward francs at 15 centimes and dollars at 1 $\frac{1}{2}$ cents over the respective spot-buying prices.

Then we have the Swiss and Italian rates; the meaning of these is that on Switzerland the operator would sell forward for one month at 3 centimes below its spot-selling rate, and buy forward at the same rate for spot. For Italy, the rates are 25 centesimi per month below spot-selling rates for forward sales, and 15 centesimi per month below spot-buying price for forward purchases.

Here, again, is an extract from a Money Article of more recent date, when the Gold Standard was no longer functioning in Great Britain.

FORWARD EXCHANGE RATES

For forward business the following rates were quoted—

Centre	1 month	2 months	3 months
New York (b)	$\frac{1}{2}$ - $\frac{3}{8}$ c.	$\frac{1}{2}$ - $\frac{1}{4}$ c.	$\frac{1}{2}$ - $\frac{1}{2}$ c.
Montreal (b)	$\frac{1}{4}$ - $\frac{1}{4}$ c.	$\frac{1}{4}$ - $\frac{1}{4}$ c.	$\frac{1}{4}$ - $\frac{1}{4}$ c.
Paris (a)	2 $\frac{1}{2}$ -2 $\frac{1}{2}$ fr.	3 $\frac{1}{2}$ -3 $\frac{1}{2}$ fr.	6 $\frac{1}{2}$ -6 $\frac{1}{2}$ fr.
Amsterdam (b)	$\frac{1}{2}$ - $\frac{1}{2}$ c.	1 $\frac{1}{2}$ - $\frac{1}{2}$ c.	1 $\frac{1}{2}$ -1 $\frac{1}{2}$ c.
Brussels (a)	7-9 c.	14-16 c.	22-24 c.
Zurich (b)	1 $\frac{1}{2}$ - $\frac{1}{2}$ c.	3 $\frac{1}{2}$ -2 $\frac{1}{2}$ c.	5 $\frac{1}{2}$ -4 $\frac{1}{2}$ c.

(a) Over "spot," i.e. discount. (b) Under "spot," i.e. premium.

In the light of our first explanation, the reader will have little difficulty in reading the correct meaning into these quotations. The New York quotations lettered (b) indicate that the forward exchange is at a premium as compared with the spot rate, and mean that the exchange dealer is prepared to sell forward one month dollars at $\frac{1}{4}$ of a cent under the ruling spot rate, while he is prepared to buy dollars for delivery one month forward at $\frac{2}{8}$ of a cent under spot; he is thus allowing a margin of $\frac{1}{8}$ of a cent between his buying and selling rates. Now from the buyer's point of view, when the New York exchange is quoted at a premium, or under spot, he will get less dollars for his pound sterling. For instance, if the spot rate be \$4.96, then for a purchase one month forward the rate will be \$4.95 $\frac{1}{4}$. If, on the other hand, the reader is a seller of dollars one month forward and the spot rate is \$4.96, he would have to surrender \$4.96 $\frac{2}{8}$ c. for each £1 paid to him by the bank or other exchange dealer. With this explanation we may therefore set out the dealer's rates in a more unequivocal way—

New York: Exchange dealer will sell at: or will buy at—		
1 month forward	\$4.95 $\frac{1}{4}$	\$4.95 $\frac{1}{8}$
2 months "	\$4.95 $\frac{2}{8}$	\$4.95 $\frac{1}{4}$
3 months "	\$4.95 $\frac{3}{8}$	\$4.96 $\frac{1}{8}$

The Amsterdam rate is also at a premium, i.e. under the spot rate by $\frac{3}{8}$ to 1 $\frac{1}{2}$ cents, according to the period.

The Montreal rates are similarly explained; they are all at a premium. The Paris quotations, on the other hand, are over spot, that is, at a discount, so given a spot rate of, say, 146, the one month's forward rate would be 150 $\frac{1}{2}$ selling and 150 $\frac{1}{2}$ buying.

Belgian rates present no difficulty in the light of our previous explanation of those other rates quoted at a discount, or over spot. When we come to the Zurich rate, however, another method is introduced: the rate is at a premium, that is under spot, and is thus less favourable to the buyer of Swiss francs and more favourable to the seller. The forward rate for one month means that an

exchange operator will sell Swiss francs at $1\frac{1}{2}$ c. under spot, while he will buy at $\frac{1}{2}$ c. under the spot rate. Plainly stated, then, with the spot rate at 23.05 francs to £1, the selling quotation for 1 month forward would be 23.03 $\frac{1}{2}$ c.¹

In the course of his work, the reader may have to deal with the practice of merchants who wish to avoid loss by making forward contracts in foreign exchange, and an example will serve to show how the business is done. We may take the case of an exporter who has quoted a price to a foreign customer, say, in March, for a shipment to be made in the following month. He does not want to take the risk of a loss owing to fluctuations in exchange, so he goes to his banker and seeks assistance. He says to the banker: "I am going to ship so many packages of woollen goods next April; the bills against the shipment will amount to so much. What rate of exchange will you quote me for delivery by me in April?" Suppose the shipment be to France, the banker knows he can sell, or perhaps has sold, to another client exchange for delivery in April, at, say, 146 francs to the £1. The present operation offered by the exporter is a buying transaction, so the banker quotes a buying rate of 146 $\frac{1}{2}$ francs to £1 to the exporter for his franc bills. The exporter accepts. The banker has really neither taken a risk nor tied up a penny of his funds; by what is called "marrying," that is setting off one transaction against the other, he has made a profit of 25 centimes per pound sterling on the total amount represented by the francs he has sold and those he has bought. When the time comes for delivery in April, the exporter hands his bills to the banker, and the latter will pay him sterling at the equivalent of 146 $\frac{1}{2}$ francs to the £1, and at the same time deliver his own draft against the contract he previously made for the sale of francs at 146 to the £1.

¹ The reader who may like to pursue the subject of "Forward Exchange" in its practical aspects is referred to the article on "Forward Exchange" in *A Dictionary of the World's Currencies and Foreign Exchanges*, by W. F. Spalding. (London: Sir Isaac Pitman & Sons, Ltd.)

In other words, the exporter surrenders 146.25 francs to the £1, and the banker under his other contract has to surrender only 146 francs to the person who bought francs under a forward contract.

We see, then, that the operations of an importer seeking to protect himself by a forward purchase, and of the exporter seeking to protect himself by a forward sale, are concluded through the banks, who thus act as clearing houses for forward exchange operations. On page 102 we have said that the prudent banker will always seek to cover his forward dealings, and at the risk of reiteration, a further explanation may be useful. It is not too much to say that in all cases the banks are careful to cover themselves. In many cases customers are required to deposit margins in sterling as cover against loss to the banker. For instance, where a bank has sold foreign currency forward to a client, it may, as we have shown, buy spot in the same currency and retain it until the contract date of sale. It may happen that if the customer could not meet his contract and the rate had moved against him, the banker would stand to lose had he taken no action to protect himself. As cover against such a contingency, therefore, the banker may require his customer to deposit a margin in sterling, ranging, say from 10 per cent to 25 per cent of the value of the currency for which the forward contract has been made. Just whether a margin is required or not, and the extent of that margin, depends upon the financial standing of the customer and the reliance the banker places upon him. With a large and influential client, the margin in practice is often dispensed with; in other cases the bank may insist upon it. Generally speaking, the question of margins may be said to depend upon the nature of the currency in which the forward contract is made, the size of the transaction, and the banker's confidence in the ability of his client to fulfil the bargain.

In 1936 when exchanges were very sensitive, and when

foreign nations were protecting their currencies by exchange restrictions, quotas, and so forth, covering transactions had become a fine art; but, to sum up, the ways by which the banks endeavour to protect themselves may be illustrated by four examples.

First, then, suppose a banker has concluded a three months' forward deal in one of the more active currencies, like French francs or American dollars, the bank might buy in the market three months' bills in those currencies to mature at about the date of the expiry of the forward contract, and by so doing cover itself against any adverse movement in exchange. The bank will not lose anything, and if exchange moves in its favour, may even make a gain over and above that which has been made on the contract.

Secondly, the banker might elect to buy in the spot market francs or dollars and have them put to his credit with one of his correspondents in New York or Paris, as the case may be. Of course, he could achieve the same result by getting his correspondent in either of those centres to sell sterling in exchange for francs or dollars. In such cases, he has obviously provided himself with the required currency, and so will avoid any loss by exchange fluctuations.

A third way will be for him to sell sterling forward to his correspondent in Paris or New York and so obtain the francs or dollars required to complete the three months' forward contract he has made with his client in London.

Finally, the banker may buy sufficient francs or dollars three months' forward to match with the sale contract in either of those monetary units he has made with his client.

The ultimate profit to the banker will necessarily depend upon the comparative economy of the method employed; but, let us examine these methods of covering a little further.

The first two transactions, it will be plain to the reader, will be likely to prove the more expensive, since the banker

will have to hand over spot sterling in exchange for the currency required. In practice, the choice of either of these two methods will to some extent be governed by the amount of interest received on the exchange of sterling into currency, say francs, which will be left on deposit with the foreign correspondent. In any case, the adoption of either of these two methods would involve the tying up of funds, which to an exchange banker, who above all, will seek to keep his funds liquid, may be undesirable, especially when monetary conditions are active.

Then, as previously shown, the large operators among the banks can adjust deals among themselves by matching one operation against another. Generally speaking, therefore, in practice it will be found that the banker will protect himself by making use of our fourth method: he will buy forward on the market an equivalent amount of the foreign currency which he has sold. This being so, it follows that the bank's profit arises from the rates at which he buys and those at which he sells.

The methods described are not the only ways in which cover can be obtained. There is another interesting method by which exchange operators cover themselves. In market parlance, it is called a "swap." A swap is the covering of a forward operation in exchange by a spot transaction. For instance, the operator may buy spot exchange and at the same time resell a similar amount forward; or, he may sell spot and buy the same amount forward. The usual periods for such transactions in the market range from one to three months, though usually business can be negotiated for any period up to three months, and sometimes for six months. It all depends upon the state of the market and the particular foreign currency in which dealings are taking place. Points the student should note carefully, are these—

If the market quotation for forward exchange quoted against sterling is under spot, then the forward rate for that exchange is said to be at a "premium"; if, on the other hand, the forward rate is quoted over the spot rate, then

forward is said to be at a "discount." This method of quoting involves many a mental twist, but one's brain becomes attuned to such gymnastics with practice. The position may be summarized in four sentences—

1. A sale of forward currency.
2. A purchase of spot currency.
3. A purchase of forward currency.
4. A sale of spot currency.

On examination it will be plain that operations 2 and 4 cancel out each other, so the final result is that the banker has sold forward and bought forward similar amounts of the foreign exchange, and so has adequately covered himself.

Another example will serve to make the position quite clear. Suppose that the rate for Dutch florins three months' forward is called 5-7 cents discount, then, it is possible to buy spot at, say 8-45, and resell them forward at 8-52, or to sell spot at 8-45 and re-purchase the florins forward at 8-50. If, however, florins were at a premium, these operations would be executed by 8-45 and 8-40, and 8-45 and 8-38 respectively.

Options in Forward Exchange.

Apart from swap transactions, there is another type of exchange that is often undertaken on the London foreign exchange market. We refer to operations in options. Here again, the business largely centres on the forward market, though rates are fixed in a different way from what are known as "options" in the ordinary sense of the word; they are quite dissimilar from options in stocks and shares on the Stock Exchange. The larger part of forward options in foreign exchange arise from the finance of imports and exports, and are therefore almost entirely undertaken by the banks. For instance, an importer who is due to receive, say, meat from the Argentine or grain from the United States, may not be certain of the exact date on which he

will have to make remittances in the foreign currencies in payment. The exporter, in turn, may be uncertain as to the date on which he will have to produce the foreign exchange which he has sold forward. In such circumstances, it is the banker who, as usual, is the intermediary in the transaction, and he stands ready to assist both parties by arranging forward option deals.

It should be clearly noted at the outset that these option contracts refer only to the delivery date in forward and swap operations; they do not mean that the buyer or the seller, that is the importer and the exporter, as the case may be, has the option to accept or to decline delivery of the foreign exchange bought forward from the banker. The sanctity of contracts is strictly enforced and observed in this business, and once having entered into a forward option contract, the seller is bound to deliver and the buyer to take the amount of currency covered by the contract. It is, as we have emphasized, the dates of delivery alone that are in question.

In all such contracts the banker has, of course, to cover himself, and with this object always in view, he works on the assumption that the date of delivery may be at the most disadvantageous time for him, so he quotes his rates accordingly. Suppose, for example, an exporter wishes to sell \$100,000 for delivery at his option three months' forward; the inference is that he has the option to deliver the dollars at any time within that period. He may elect to deliver the next day, the next week, or three months hence. Now, when the contract is being negotiated, forward dollars may be at a discount, that is, *over spot* rate, and that being so, the banker would assume that the American dollars will not be delivered until the end of the three months, as obviously, the exporter, who is frequently an optimist, will tend to hold off from delivering. He will quite well know that on the present rate he would have to surrender more dollars for each £1 he receives from the banker, than he would if, say, the dollars were at a

premium. The astute banker reads the exporter's thoughts like a book, and will therefore quote the full three months' rate over the quotation for spot dollars. If, on the other hand, forward dollars are at a premium, that is *under the spot rate*, the banker would visualize the worst: as the three months' forward rate is in favour of the seller, he would assume that that gentleman might deliver the dollars the following day. He would, therefore, quote the spot rate.

To take yet another example. Suppose spot francs are quoted 144 $\frac{1}{2}$ –145, and the three months' forward quotation is at, say, 1– $\frac{3}{4}$ centimes premium. As the forward rate is under spot, the forward quotations would thus be, 143 $\frac{3}{4}$ –144 $\frac{1}{4}$. The question at once arises, what rate should the banker quote? As we have shown, he envisages the worst contingency, and assumes that his client may exercise his option and deliver the next day, so he quotes the spot rate of 145, and thus covers himself against the possibility of the seller delivering the francs on the following day, when somewhere about that rate may rule. Naturally, if the client lets the option run on and does not deliver until the expiry date three months hence, the banker will net a higher profit, since, presumably, he will have covered himself at the selling rate of 143 $\frac{3}{4}$ to the £1. That is to say, working on the chance that the wily client would deliver promptly, the banker would almost certainly sell three months' forward the francs he receives at about the rate of 143 $\frac{3}{4}$.

It is because the banker has always to take into consideration that circumstances may be disadvantageous to him, that forward option rates are more expensive than out and out, or straightforward deals. In the case of the more active currencies, like dollars and francs, however, better rates are sometimes obtainable by limiting the period of the option. It might be arranged, for instance, that delivery can be made not earlier than, say, one or two months date, and not later than three months.

Apart from forward exchange, there are other methods

by which drawers of bills endeavour to avoid exchange risks. One more or less satisfactory way out of the *impasse* is to draw the bills with the clause "Exchange as per endorsement." The object of endorsing the rates of exchange on the bill is to transfer the liability for any loss in exchange on to the foreign importer, that is the person on whom the bills are drawn.

"Exchange as per endorsement."

The drawers of sterling bills on foreign centres usually insert the clause in bills before handing them to the bankers for sale, and hitherto it has been the practice for the bankers to complete the clause by endorsing on the bill the rate of exchange, and the drawer is then paid the amount of the bill less the usual commission and charges. This method has been found to work well so long as the rate of exchange was not too much against the foreign drawee when time for payment arrived, but at the present time, owing to the increasing number of cases in which the persons on whom bills of exchange are drawn refuse to pay the equivalent at the rate of exchange endorsed on the bills, the custom among some of the bankers is to quote the seller of the bill the rate and insist on his endorsing it on the bill himself. Under this arrangement any dispute which may subsequently arise when the bill is presented can be referred back to the drawer for settlement between the drawee and himself.

Another method sometimes adopted is to mark bills with the clause "Payable at bankers' buying rate for cheques on ——" (such and such a place). In this case the bill will have to be paid at the bankers' buying rate of exchange for demand bills or cheques on the centre from which the bill emanated, ruling on the day the bill is presented for payment.

In discussing the various ways of eliminating or providing against exchange risks, we have rather put the cart before the horse, as the reader may be but dimly aware of

the causes of exchange fluctuations. We have done this, however, of set purpose, the idea being to familiarize the reader with rates of exchange quotations, and all that appertain to their working. He will thus be in a better position to appreciate the many and varied factors that cause exchange fluctuations, which will be discussed at length in the next chapter.

CHAPTER XI

FAVOURABLE AND UNFAVOURABLE EXCHANGE—THE CAUSES OF THE FLUCTUATIONS IN THE FOREIGN EXCHANGES ANALYSED—INVISIBLE IMPORTS AND EXPORTS, HOW THEY AFFECT THE EXCHANGES—OTHER INFLUENCES—ARBITRAGE OPERATIONS

IN the course of our inquiry we have demonstrated that with the debts between two countries exactly balanced we have what is known as the par of exchange, a state of equivalence which rarely exists, but that all the same, we have fixed a point with the gold standard countries which is taken to record par.

When we apply this to bills of exchange, which are the outward and visible sign of indebtedness between nations, we take it to mean that a bill for £100 on France, for example, would on any particular day sell in London for £100, no more and no less, and that a similar state of affairs would exist in France. With France, the par of exchange, until France decrees otherwise, is £1 = Fcs. 124·2134, and if the debits and credits between the two countries were at any time equal, a bill of exchange for £100 would be worth Fcs. 12421·34 in either country. When, however, the balance of indebtedness is against France, that is to say, she owes us more than we owe her, exchange will be below par, that is at a discount. Conversely, if England's debts to France are greater than her French credits, exchange will be above par, and at a premium.

The true effect of this can easily be seen by referring to the settlement of debts by means of bills of exchange.

When our exports to France exceed our imports from that country, bills of exchange drawn on France will be in excess supply here, consequently the bill for Fcs. 12421·34 will fetch less than £100—it will be at a discount.

On the other hand, where our French imports exceed British exports to France, there will be a greater demand for remittances to pay for the French imports, and in consequence of the scarcity of paper, the bill for Fcs. 12421-34 will be worth more than £100 on the London market, that is, at a premium.

In practice, of course, it will be necessary to remember what we have said before, that the difference in the rate is not found by adding to or deducting from the bill, but by altering the rate at which the exchange is calculated. For example, in the latter case we said the rate was at a premium, or above par, and in paying the seller of the bill the proceeds in sterling, instead of calculating the bill for Fcs. 12421-34 at exchange of Fcs. 124-2134, the par of exchange between England and France, we would allow the seller the premium by charging him a lower rate, say, Fcs. 124-00 and if the reader cares to convert the Fcs. 12421-34 into sterling at this rate, he will see that the British equivalent of the bill will be more than £100. In the former case, the difference would be obtained by charging a higher rate, say, Fcs. 124-25, and the bill would outturn less than £100.

Favourable and Unfavourable Exchange.

This habit of quoting a rising exchange as at a "discount," and a falling exchange as at a "premium," has in the past made confusion worse confounded, and for the sake of the exchange student, we are glad to see that the practice has of late years fallen into desuetude. But one cannot say that the present-day usage of the terms "favourable" and "unfavourable" in regard to the exchanges is less misleading.

When we find that bills of exchange drawn from London on foreign centres are at a premium, we say that exchange is against us, or unfavourable to the country. For instance, take the case we examined just now. Inasmuch as the par of exchange with France is Fcs. 124-2134, if we are forced to pay more than £100 in London when buying a bill for

Fcs. 12421·34, it is plain that £100 here are worth less than the fixed equivalent of French currency: hence the reason for saying the exchange is unfavourable to London. Similarly, if it takes less than £100 in London to buy a bill on Paris for Fcs. 12421·34, French exchange is said to be "favourable" to England.

The indiscriminate use of such terms is a real pitfall in foreign exchange, and a moment's reflection will show that a favourable or unfavourable exchange applied to the country is one thing, but when applied to individuals, it is another.

Briefly, exchange is unfavourable to a country only when that country is obliged to send bullion in liquidation of its indebtedness, and favourable when bullion is received from a debtor country. However, lest we be charged with a leaning towards the fallacies of the old Mercantile Theory, we hasten to say that this sending or receiving of bullion is important only in so far as it affects the banking situation. The mercantilist theory was the product of the brain of one Thomas Mun in 1664. The system he and later economists developed gave an exaggerated importance to the possession of gold and silver by a country. It was held that as the precious metals were in universal demand, they were always acceptable in payment of goods, and wealth was commonly estimated in terms of money. Under the delusion that a country profited by increasing its stock of gold and silver, nation struggled against nation to obtain possession of the precious metals, and their commercial regulations were framed with this object. It is at least a question whether the Great Powers at the present day, in their desire to obtain large stocks of gold, are not falling back into the old fallacies underlying the mercantilist theory.

It is the banks which will part with the gold, and with each fall in their reserves they will tend to restrict the credits of which gold forms the basis, or rates for accommodation will become dearer, which amounts to the same

thing; and it is easy to comprehend that any restriction in credit facilities by this means will check commerce, and so ultimately prove adverse to the country. It will be perceived that we refer to the raising of the rate of discount as a means of stopping the outflow of gold. On the other hand, with a reasonable influx of gold, the banks' reserves reach that point when a low bank rate can be put in operation, and it follows that with cheap capital, there is an impetus to a country's trade and production.

As far as individuals are concerned, we may say it is the debtors to whom the terms "favourable" and "unfavourable" apply: they must buy the bills to send to their creditors, and the question of how much of the foreign currency units they can get in exchange for each unit of the home currency is of vital importance to them; and where the buyer of a bill can procure Fcs. 124·25 to the pound sterling, that rate will be more favourable to him than if the seller parts only with Fcs. 124·21 per sovereign. But, obviously, what is favourable to the merchants who have to buy bills in London, will be unfavourable to those who have money to receive from France, since this second class will be the sellers of the bills which the former class buy, and the more francs and centimes surrendered by the seller for each sovereign received, the more unfavourable will be the rate of exchange.

This, by the way, is the usual illustration of the manner in which two debts are cancelled: the importer pays his foreign creditor, and the exporter obtains payment from the foreign debtor. We may be pardoned for again referring to the subject, but a little repetition will serve to fix the principles in the student's mind. Exporter A, we will suppose, has sent to France goods to the value of Fcs. 1,000, while importer B has received from Paris produce of a similar value. A draws a bill for Fcs. 1,000 on the merchant in France, and finds an easy way to obtain the equivalent by selling it to B, who is under the necessity of remitting

that sum for the French imports. Thus, it is to A and B that the terms "favourable" or "unfavourable" will apply, the one being the receiver and the other the remitter.

From these remarks it follows that to the buyer of the bill in this country, high rates are favourable, low rates unfavourable, when quoted in foreign units to the pound sterling; but, when the rates are quoted in shillings and pence to the foreign units, high rates are unfavourable and low rates are favourable. For selling paper the maxim is the reverse: with rates quoted in foreign money to the pound sterling, the seller must bear in mind that low rates are favourable, high rates are unfavourable; and, if he is selling bills based on rates which are quoted in shillings and pence to the foreign units, high rates will be favourable, low rates unfavourable.

Before leaving this part of the subject, it may be well to refer to what is in the minds of the economists when they say that an unfavourable exchange is an encouragement to exporters and a discouragement to importers.

It has been remarked that when the value of the imports from a country exceeds the value of the exports to that country, bills are at a premium. It follows, therefore, that the greater the amount of the premium, the higher will be the profits exacted by the exporters. They draw bills for the cost of their shipments to the foreign country, and in selling the bills obtain the premium in the rates of exchange. Plainly, this indicates a diminution in profit to the importers, who not only have to pay the invoice price of the goods, but also pay a premium for the remittances they require to send to the foreign exporter.

In practice, the exporters are hardly likely to obtain the full extent of the premium quoted; a proportion, sometimes the whole of the premium, would go to the bankers who negotiate the bills.

To complete the examination of this part of our subject, it is important to refer to the fluctuations in the rates of exchange.

Fluctuations in Rates of Exchange.

We have seen that a nominal part of exchange exists between two countries which have the same metal as the basis of their currency. Some reference was also made to the specie points, which mark the limits within which the premium on bills rises or falls. Between these points exchange will fluctuate, sometimes above, sometimes below, the par of exchange, and the best statement of the theory the writer remembers to have seen is that laid down by Bastable in his *Theory of International Trade*. He concludes that the limit of exchange fluctuations, in either direction, may be fixed by the cost of the passage of specie, and the statement is summarized as follows—

“The upper limit of exchange fluctuations is par, plus the cost of transmitting specie: the lower limit par, minus the cost of transmitting specie,” and twice the cost of remitting specie, as he rightly maintains, is the whole space within which fluctuations can take place under normal conditions.

The movements, which are incessant, are affected by a variety of conditions, but generally speaking, we may say they are governed by Supply and Demand (for bills), which in turn are determined by the relative indebtedness resulting from the course of trade between countries. If it were only with trade influences we had to deal, the problem of fluctuations would not be difficult to trace, but there are other elements to consider: thus we have to take account of the currency conditions in various countries. Some have a debased currency, others, supposed to be on a gold basis, are continually in the throes of a depreciated paper currency; and, lastly, we have those countries whose money is of metal different from that of others, say, gold in one country and silver in another, and in addition to the ordinary movements in exchange, it is necessary to say how much of the silver currency shall be paid in the silver-using country in order to confer the right on a trader to receive an agreed gold equivalent in one of the

gold centres—a problem of no little difficulty when we remember that it necessitates our comparing the silver price of gold and the gold price of silver at any particular time.

We will leave the currency problem alone for the present, and discuss the causes upon which depend the demand for and supply of bills.

In the first place we might emphasize the fact that the total indebtedness of a nation has practically no effect on the exchanges; it is only when the debts come to be liquidated that movements are apparent, and even then it will be the balance of indebtedness which will influence rates.

Trade Conditions.

Trade conditions, of course, exercise the most potent influence upon the exchanges, since, as we have seen, it is from the exports and imports of a country, as shown by its trade statistics, that the supply of bills principally emanates. Nevertheless, in dealing with the subject from the British point of view, we must be careful to remember that we as a nation draw few bills in comparison with the vast number drawn on this country, and the reason for the excess drawings is easily shown. Merchants and financiers all over the world know that a bill of exchange on London is readily negotiable; it is in fact the recognized international medium of exchange, and, so far, the bills of no other country can claim this unique quality. Bills on France, Germany and other European nations are also drawn and negotiated, and, collectively, their number is not small, but they principally represent remittances for direct shipments of produce and manufactures from foreign countries, and are consequently used only in connection with the trade between those countries, and hitherto they have not been able to compete with the bill drawn on London.

It must not be supposed, however, that bills drawn on London are solely on account of our own foreign trade. In reality, they are drawn in connection with the trade

and commerce of almost every civilized country in the world. Take, for example, the shipments of tea between Shanghai and New York. Payment is usually made by means of a bill on London and if an importer in France orders coffee from Rio, or cotton from New Orleans, he will, in ninety-nine cases out of a hundred, make payment through the medium of the London money market. Many of the French merchants who send goods to China or Japan, will, in a like manner, finance their operations through London in preference to any other financial centre. In any important foreign commercial market the names of the London accepting bankers are as well known as in Great Britain, and the exporter has only to take his bills to a local bank to realize a better rate than for bills on, say, France, Holland, Germany, or the United States of America.

Bills on London are drawn, not only for goods, but in connection with securities also. This was evidenced in the late rubber "boom," when bills representing enormous sums came forward from foreign capitalists who had invested money in shares, the payment for which had eventually to be made in London.

The fact of London, prior to the suspension of the Gold Standard on 21st September, 1931, being a free market for gold has already been referred to, but what we might term the gold basis of bills on London is not the only reason why banks, financiers, merchants, and others in the far distant parts of the world prefer to negotiate them: they buy the paper because there is everywhere a ready market for it. The bills can always be transferred to other buyers on foreign markets who want them to remit in payment of indebtedness to England or some other country. It does sound rather like a truism to say that this remarkable free market in bills on London exists because there is always a supply; still the fact cannot be explained away, and in the meantime the demand continues from every part of the world, despite our temporary departure from gold.

After this rather long explanation, it will be quite manifest that it is the export and import trade of our own and other countries which exercises the dominating influence on the foreign exchanges.

Invisible Imports and Exports.

Closely allied to these trade conditions, we have another important influence which affects exchanges in a marked degree: we refer to what Sir Robert Giffen described as "Invisible Imports and Exports"—"invisible" because they are not shown in the usual Board of Trade statistics. In the term "invisible imports and exports" are included all such items as income from overseas investments, freight and insurance, remittances for the purchase or sale of ships at foreign ports, the hire of vessels, the drawings of captains and masters of ships; expenses and remittances of foreign residents (including military, consular and Government servants); bankers' commissions, and so on.

The British Board of Trade has of recent years drawn up an interesting statement showing how an apparent adverse balance of trade is cancelled by the invisible exports. We give the table published in February, 1936, by the *Board of Trade Journal*, and it shows in a striking manner what effect the invisible items have on the trade of the country. In 1931, it will be observed, the balance of payments was £104,000,000 against the United Kingdom.

The year 1931, it may be remembered, was a difficult one for Great Britain, and, as we shall show later, in September of that year, we were reluctantly forced to suspend the Gold Standard. However, by dint of tightening our belts, and economizing in all directions, we were able to show a better result the next year, when the adverse balance was practically halved at £51,000,000. The year 1933 saw our accounts balanced; but in 1934 we slightly outran the constable and ended with a debit balance of payments amounting to £2,000,000. Then a better position

was evolved, and improving trade enabled the United Kingdom to end with a favourable balance of payments, amounting to £37,000,000. All students of the foreign exchanges should take careful note of this country's balance of payments, and a few words, explanatory of the position, will enable readers to appreciate the working of the accounts.

It will be observed that on the actual oversea trade there is each year an apparent adverse balance, the excess of imports over exports ranging from £408,000,000 in 1931 down to £263,000,000 in 1935. These figures do not include movements of gold bullion and specie, the reason being that imports and exports of gold are held to represent movements of capital as opposed to income. In practice, especially in these uncertain days, gold tends to move from one country to another without actual change of ownership. In 1936, for instance, there was a flight of capital from various Continental countries to England, which largely took the form of gold to be held on account of foreigners. Silver is another matter, and in recent days that metal has been treated as a commodity. Unlike gold, its ownership changes frequently, and for a considerable time the U.S.A. has been the principal purchaser.

Now, at the risk of entering into one of those dry-as-dust descriptions which the average student abhors, yet which are most necessary to his digestion of the foreign exchanges, let us examine the items in the table of the United Kingdom Balance of Payments, *seriatim*.

We have already referred to the excess of imports. Then we have the Estimated Excess of Government Payments made Overseas. It is of no great importance from the point of view of affecting the ultimate balance. The amount includes items on loan accounts under a variety of headings, which, though they may have caused the Government statisticians many a bad headache, need not worry the reader. It is generally understood that payments and receipts on account of India's Home Charges figure largely

in the excess. Other Government departments' disbursements and receipts to and from overseas are included. It may be of interest to note for historical purposes that the rather large excess payment of £24,000,000 in 1932 was due to the instalment paid on Great Britain's war debt to America which was not balanced by payments of war debts from other countries to us. One is optimistic enough to hope that it is the last time the item will appear.

To pass on—the item of interest in the Excess of Government Receipts from Overseas is that of £7,000,000 in 1934. This arose from the payment by South Africa in respect of War Debt: it is non-recurrent, and the next year there was no such windfall. Instead, it will be observed that the Government's *payments* oversea were estimated to be £2,000,000 more than its receipts from other countries.

So, to the next item—Estimated Net National Shipping Income. This includes income from shipping services, and, as one of the banks has said in a review of the position,¹ it is not necessarily a guide to the profits of our shipping companies, or even to the movements in their earnings. It is the "net" income from the national point of view, and represents only an estimate of the amounts payable to this country in respect of shipping and allied services, less similar amounts payable by persons resident here and the disbursements of our ships in foreign ports. Costs incurred by shipping companies within this country are quite irrelevant to the calculation.

The next item that follows in the table is the most important of the Invisible Exports that enabled the country to show a favourable balance of payments for 1935.

It should be noted that the net income from overseas investments consists in the surplus income accruing to residents in the United Kingdom from investments in other countries (whether these are in Government loans, in public companies, or in private undertakings) over the income

¹ *Westminster Bank Review* for March, 1936.

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UNITED KINGDOM BALANCE OF PAYMENTS

(In million £'s)

Particulars	1931	1932	1933	1934	1935
	£	£	£	£	£
Excess of imports of merchandise and silver bullion and specie	408	287	263	294	261
Estimated excess of Government payments made overseas ¹	—	24	2	—	2
	<u>£408</u>	<u>£311</u>	<u>£265</u>	<u>£294</u>	<u>£263</u>
Estimated excess of Government receipts from overseas ¹	14	—	—	7	—
Estimated net national shipping income ²	80	70	65	70	75
Estimated net income from overseas investments	170	150	160	175	185
Estimated net receipts from commissions, etc.	30	25	30	30	30
Estimated net receipts from other sources	10	15	10	10	10
Total	<u>£304</u>	<u>£260</u>	<u>£265</u>	<u>£292</u>	<u>£300</u>
Estimated total credit or debit balance on items specified above	- 104	- 51	—	- 2	+ 37

¹ Including some items on loan accounts.

² Including disbursements by foreign ships in British ports.

accruing to persons not resident in the United Kingdom, from similar investments in British property or securities, or from the employment of their balances in the United Kingdom.

Commissions or payments for services rendered in the United Kingdom on behalf of persons resident abroad, include acceptance credits' commissions, discount on foreign bills, bank interest (i.e. short interest and commissions), commissions and other charges on new issues paid by overseas borrowers, merchanting commission on overseas produce, brokers' commissions, insurance remittances from

abroad, and earnings on exchange transactions. Payments have also to be made by us to foreigners for similar services.

Of these, one of the principal items is that connected with the shipping trade. Owing to the ramifications of its great mercantile fleet, Great Britain holds a good part of the world in fee for the carrying trade, and is, of course, a creditor for all its maritime services, although these to a very slight extent may be offset by the amount for which she is debtor for the use by her of a proportion of the foreign ships. The drawings for the purchase and sale of ships affect the exchanges in accordance with the centre from which the bill is drawn, or by what means the settlement is finally made. The drawings of captains refer to the arrangements under which the cost of re-victualling or coaling vessels is carried out. In many cases a bank at a foreign port is authorized to negotiate the bills of the captain drawn on a London house, and the total of those bills goes to swell the demand for or supply of paper affecting the exchanges.

The final item, Estimated Net Receipts from Other Sources, comprises a variety of miscellaneous receipts, in themselves, too small to merit separate headings. Expenditure by tourists and payments for film royalties are considered to be two of the largest classes of expenditure included in this total. Tourist expenditure is now an important item, and from time to time it has a noticeable effect on the exchanges, since their currency requirements tend to grow larger each year as the popularity of foreign travel increases. He, then, who would wish to solve the riddle of the exchanges, must always view this item with interest. To take the last year in the table, 1935, British visitors to the Continent numbered 790,000, while there were 240,000 continental visitors to this country. Added to these figures there go to swell the total, visitors to and from the more distant countries that do not come under the heading of "The Continent."

Such, then, are the principal items in this very useful

summary that shows how with an apparent adverse balance of trade year in and year out, the United Kingdom is still able to show a favourable balance of payments. In other words, the table reveals what an important part the "invisible" factors play in our national prosperity. Without these invisible items it is obvious that the course of the exchanges would be constantly adverse to this country.

Bankers' Commissions.

Further reference at this point may be made to bankers' commissions, which sometimes are regarded as a negligible item, but as, in the writer's opinion, that idea is erroneous, brief mention may be made of them. The more important commissions are those paid to bankers by foreign governments and others for carrying out what is termed the "service of loans," that is, the paying of the foreign governments' coupons on bonds for loans issued, and attending to the multifarious duties which the issue of the loans and subsequent control of the transfer of the funds entail. It is apparent that the sums involved may, in the aggregate, amount to large figures, and when they are remitted the exchange is influenced to that extent.

More than once it has been asked how a bill can possibly be drawn in connection with the service of these loans. A familiar example is seen in the case of international loans. Say three countries, England, France, and America, lend money to China, and it is arranged that the payment of coupons belonging to certain American residents shall be paid in London. To do this the London bank must be put in funds, and America, if desirous of so doing, can remit the amount by means of a bill of exchange purchased in Wall Street, New York, which, of course, affects the exchange between New York and London. China, on the other hand, may at certain periods of the year arrange to put the British, French, and American banks in funds for paying the service of the loans in each country. The remittance may be made by means of a telegraphic transfer

or by the sending of a demand bill, whichever may be cheaper or more convenient, and in any case the transfer of funds from China to Europe will ultimately affect the exchanges between China and the countries named.

Stock Exchange Influences.

The mention of Chinese borrowings brings us to a very important influence on the exchanges, namely, foreign loans, but perhaps before we trace the effect of foreign loans on exchange, we had better deal with what are called the Stock Exchange influences, to which international borrowings properly belong.

The accumulation of capital in England and other European centres renders it a matter of difficulty to invest surplus funds, that is, if a relatively high rate of interest is to be obtained, and consequently, the operations carried out by bankers and the Stock Exchanges combined, frequently affect foreign exchange rates when we least expect it. The various stocks and shares are to a large extent internationalized, and the business is constantly done by the aid of telegram and cable: a slight variation in price will often mean a stream of orders to buy or sell, as the case may be, from one country to another, and as a result, the heavy demands for cheques or sight bills to pay for the heterogeneous mass of securities are at once reflected on the exchange quotations. If London has been investing in French Loans, for example, the purchase of demand bills drawn on France to pay for the securities will depress exchange on Paris; thus, the rate for cheques on Paris may be Fcs. 75.25, but as there are so many persons desiring to remit, there will be competition for the drafts, and the sellers, emboldened by the demand, will offer only Fcs. 75.20 to the pound sterling, which is obviously an adverse rate to the remitters.

A striking example of this was witnessed in the spring of 1928. The President and Economist of the New York Stock Exchange visited London and, after protracted

negotiations, arranged for the listing of British Funding Loan and certain other British stocks on the New York Stock Exchange. The immediate result was a heavy investment demand for these stocks from America. Considerable remittances were sent from New York to purchase British Funding Loan, and as a direct result the rate of exchange between New York and London moved sharply in favour of England.

Some idea of the magnitude of the business in this country alone in foreign and colonial securities may be gathered from the following table of capital issues made on the London Market during the years 1928 to 1935. The figures are taken from the London *Economist*.

CAPITAL ISSUES IN THE UNITED KINGDOM
(In million £'s)

Calendar Years	BRITISH				Empire	Foreign	Total Issues
	Govt.	Home Corporations	Others	Total Home			
1928	83.0	14.9	164.8	263.6	63.2	42.3	369.1
1929	65.4	8.3	124.3	198.0	61.0	26.2	285.2
1930	65.6	41.7	63.3	170.6	61.4	35.7	267.8
1931	10.7	8.0	35.8	54.4	38.5	9.1	102.1
1932	102.7	28.8	31.6	163.1	25.5	0.3	188.9
1933	150.8	24.5	34.9	210.2	29.2	5.4	244.8
1934	44.1	36.1	57.5	137.7	29.9	1.5	169.1
1935	88.0	51.1	81.6	220.7	15.2	0.2	236.1

The interest on these investments has a very considerable effect on the exchanges: when the payments are remitted, or coupons sent for collection, as the case may be, exchange will turn in our favour. On the other hand, as the late Viscount Goschen was careful to point out in his book on the Foreign Exchanges, a country which annually has large sums of interest to pay abroad, must import so much the less or export so much the more.

The issue of a loan on the London market will turn the exchange of the country borrowing against this country at the time the money is paid over to the foreign nation.

The immediate effect is to increase Great Britain's indebtedness by the amount of the loan, but this influence may be neutralized where a large part of the proceeds is used for the purchase of British manufactures. An illustration of this is seen where a country is raising money abroad for the avowed purpose of building railways in its own territory. The lenders will make great efforts to secure in the loan agreements the insertion of clauses stipulating for the purchase of at least a part of the constructional materials in the country in which the loan is being floated. The influence on the exchange, plainly, may be offset to the extent of such purchases.

The contention of the economists, with which we need not quarrel, is, that a loan acts in precisely the same way as an import to the lending country and an export to the borrowing country. The reverse is true when the coupons or interest on such loans is paid: the coupons will represent an export from the lending country, and are always regarded as an immediate liability of the borrowing nation. As far as the exchanges with this country are concerned, they exercise a permanent influence in our favour.

Most foreign government loans are repayable by means of sinking funds, and with each repayment of principal the effect on the exchanges will be the same as that occasioned by the export of the interest coupons, since the lending country exports the drawn bonds in exchange for the remittance of their value by the borrowing nation.

Finance Bills.

Before leaving the subject of the Stock Exchange influences we ought to refer briefly to one of the methods by which speculators raise funds to enable them to carry through operations which promise a profitable return. Here we have a case where a bill is actually drawn by a banker on his correspondent, who is also a banker, and the instrument is known as a finance bill. We shall refer at length in a later chapter to the drawing of finance bills,

but the following very simple instance of what occurs between London and New York will serve for the moment to show the effect on exchange.

A broker in New York sees an opportunity of making money by speculating in some of the well-known stocks or shares. He goes to his banker and arranges to deposit securities against which the banker advances him up to, say, 80 per cent of their value, and the custom is to place these securities in the safe keeping of one of the big Trust Companies, who will act for both parties. The banker himself, obviously, does not want to lock up his money for any period of time, so under arrangements previously made, he draws a bill, usually at sixty or ninety days' sight, on one of the London bankers or finance houses. He sells this bill on the New York market and thus recoups himself for the amount lent to the stockbroker. When the bill arrives in London it is accepted by the London banker or other correspondent, who has now incurred the liability to pay it at maturity if the American banker does not put him in funds in time to meet it. Needless to say, however, it is to the American's interest to see that his London correspondent is put in funds in time to meet the bill, and if by chance it is inconvenient for him to remit the wherewithal to pay the bill at due date, what he does is to draw another bill of the same kind, and again sell this on the Wall Street market, and thus procure the necessary funds to buy a demand remittance to send to the London banker.

As may be supposed, this business is carried on only between banks of high standing, and in many quarters it is thought that the commission charged for the service is not commensurate with the risk involved should a monetary crisis ensue between the date of drawing and maturity of the bills.

It will be fairly plain to the student by this time that the effect of the drawing of any quantity of these finance bills on London will be to weaken American exchange with London.

Letters of Credit.

In referring to finance bills, we have almost imperceptibly touched on one of the most familiar influences which affect the foreign exchanges, namely, the Banking Influences. Under this heading are included all the international operations of bankers which in any way affect the exchanges.

One of the results of the extension of foreign branch banking is the increased use of credit instruments. Bankers finance foreign trade, and we may go a step further and say they finance the foreign traveller also. In fact, some of the fluctuations in the exchanges are the direct result of the drawing of bills under the various credits issued by bankers. Most of us know that when a person is about to take a journey abroad, he first goes to his banker and procures either a letter of credit or a quantity of circular notes. These latter when negotiated abroad are sent back to London for encashment, and there is no practical difference between the circular notes and bills of exchange drawn in the ordinary way. The same may be said about the drafts encashed by foreign bankers against letters of credit.

Travelling letters of credit and circular notes are, however, not the only form of credit which affects the exchanges: as we shall see when we come to deal with foreign bills, bankers grant letters of credit in connection with the shipment of manufactured goods, produce or securities, and all give rise to the drawing of bills, which in one way or another exercise an influence on the foreign exchanges. Yet, taken by themselves, the sale and transfer of these bills drawn under credits cannot be said to exercise a marked effect, but with the amalgamation of existing banking interests, and the practice of setting up banks or banking agencies in the remote parts of the earth, the bills drawn under bankers' credits are beginning to constitute an item of much greater relative weight in the scale of the exchanges than was formerly the case.

Arbitrage.

Of far greater import, however, is the way the exchanges are manipulated by means of Arbitrage Operations. Arbitrage is a subject which calls for special treatment, and we shall have to discuss its working at a later stage in our inquiry. Here, however, we may be permitted to make brief reference to it in so far as it affects rates.

A simple form of arbitrage is seen when a stockbroker in London, by means of a liberal expenditure on telegrams, is able to buy Canadian Pacific Railway shares on one market and sell them on another : he may operate between London and Paris, or London and New York, or even carry through transactions with all three centres. If the dealing is between this country and America, he buys the shares in Throgmorton Street, London, when they are cheap, and sells them in Wall Street, New York, when they are dear.

In dealing with bills of exchange for arbitrage purposes that is what happens in some cases, but more frequently the operation may be rather different. When a banker is selling bank paper, the price at which he is willing to sell depends on the price at which he can cover his operation, that is, provide the funds necessary to meet the bills he has drawn. He may do this in several ways, the only consideration being the comparative economy of the method employed. Suppose a London banker has sold three months' bills on his Paris correspondent ; to meet these when the date of maturity comes round, he may cause Dutch bills drawn on Paris to be remitted to his correspondent there ; he may even resort to Belgian bills for cover, or, as not infrequently happens, send the Paris banker an assortment of paper drawn from various countries on France. It is simply a case of purchasing cover in the cheapest market.

As the effect of arbitrage is to restore the equilibrium of the exchanges, it partakes somewhat of the nature of a levelling operation. It will be apparent that bills can be bought cheaply only in those countries where there

are surplus supplies of paper offering, owing to the foreign credits exceeding the foreign debits, and by purchasing the surplus bills not needed by the importers, the operators do much to preserve the normal ebb and flow of the exchange between commercial centres. To take an extreme case, suppose Swiss exchange, after being at par, Fcs. 25·2215, for a few days, goes up by one per mille in our favour, Geneva can soon offset this small balance in favour of London by remitting bills drawn on London or other European centres.

Dealers in arbitrage have been described as persons spending their time at the telephone with the object of following the movements of exchange on the various markets, and there is an element of truth in the matter, judging by the way they watch the fluctuations in rates and take advantage of every small deviation.

Arbitrage operations in a great measure account for the fact that the exchanges between the chief monetary centres tend to keep on a level. Short exchange on Geneva, for example, may move from Fcs. 25·16 to Fcs. 25·30 to £1, and almost immediately the rate in Geneva on London will move in unison. The reason is to be found in the very free use of the cable ; and, nowadays, wireless telegraphy is being utilized. If we quote a better cheque rate than Geneva, there will always be exchange dealers on the alert to take prompt advantage of the favourable exchange. With the longer usance paper, however, there is often a suspicion of speculation in the dealings ; with cheque rates the outcome is fairly certain, as the following example will show. An operator in exchange, being desirous of making a turn on the rates, and judging the present to be an opportune moment, wires to his Geneva friend : " At what rate can you draw cheque £10,000 on London ? " The answer comes back : " 25·20." If the rate in London is favourable, say, Fcs. 25·16 = £1, the Londoner wires the reply, " Draw," and immediately the Swiss draws a cheque for £10,000 on London and sells it on the Swiss

Bourse for Fcs. 252,000 (£10,000 at exchange 25·20). At the same time the London operator himself draws a draft on Geneva for Fcs. 252,000 and sells it on the market here, or, as is often the case, he has a client wishing to buy demand on Geneva Fcs. 252,000. Now the person buying the draft for this amount in London will have to pay sterling calculated at the London rate, Fcs. 25·16 = £1, say, £10,015 18s. ; therefore when the draft for £10,000 arrives from Geneva, the London banker has £15 18s. over and above the amount required to meet it, and this balance, minus the small charge for stamp and his correspondent's commission, will represent his profit on the transaction.

Similar operations will be carried out by other dealers, and, other things being equal, the immediate effect of the total drawings will be to equalize the rates between the two countries.

The cases we have quoted are, it should be noted, merely hypothetical, but they correctly describe the principles, and when the operations are extended over two or three centres, it is easy to perceive the influence on the rates of exchange.

Arbitrage is, however, a difficult business and one which really requires special study. The student who has mastered the fundamental principles of foreign exchange will be well advised, therefore, to supplement his reading by reference to one or other of the standard works on the subject.¹ In view of the importance of this branch of foreign exchange no apology is needed for quoting the following extract from a recent article in the *New York Financier*: it is a useful summary, and shows that our American friends are fully alive to the importance of arbitrage transactions—

“ In conducting such operations it is essential that the

¹ Two useful works are: *Arbitrages et Parités* (O. Haupt) and *Bank Notes, Monnaies et Arbitrages* (E. Kauffmann); and a special article on the subject will be found in the *Dictionary of the World's Currencies and Foreign Exchanges* and The Centenary Edition of *Tait's Modern Cambist*. (W. F. Spalding—London: Sir Isaac Pitman & Sos, Ltd.)

banker shall be advised, through the cable, of the varying conditions of the markets abroad. In such markets as Paris and London, where the exchange transactions are always large, rates often fluctuate sharply, and conditions change frequently. Therefore, though the situation may be favourable one day it may suddenly become adverse, necessitating some modification of the method of arbitraging. Moreover, it frequently happens that after a successful negotiation has been effected by a banker as the result of private information, his competitors may be advised of the favourable conditions prevailing and they also may draw in a similar manner. Hence each operator seeks to obtain for himself alone all possible information regarding changes which are likely to affect his business. Sometimes a banker may find, upon calculation, that it will be profitable to conduct arbitraging of exchange between three or more points; in such cases the conditions at each of the points must first be ascertained and calculations have to be made with the utmost care. Occasionally in drawing bills the banker, in order to take advantage of arbitraging operations, will transfer credits, through the cable, from an adverse centre to a point favourable for his purpose. Indeed, there are very many ways by which arbitraging can be profitably conducted by bankers having the requisite facilities and the necessary skill for such operations. It will be observed that operations in arbitraging of exchange require the services of men of the largest experience, and hence the business can be conducted to advantage only in the most thoroughly equipped offices. The exchange student who enjoys opportunities for practice in such offices and has the determination to qualify himself for this branch of exchange work by acquiring a knowledge of all of its intricate details will have no difficulty after such qualification in securing advancement. The field for operations in arbitraging of exchange is continually and

rapidly broadening, and there will probably always be a demand for the services of men capable of taking positions as managers of exchange houses or departments."¹

The following summary from the author's larger work (*Tate's Cambist*) will serve to give the student a general insight into the business.

Arbitrage operations may be done in spot and forward exchange, or by swap transactions. As we have said, it is a business requiring the greatest skill, and in practice it is one for the specialist; that being so, the operations are conducted by experienced professional operators representing the numerous banks and financial houses that are included under the general heading "The Foreign Exchange Market." Except in the case of America, for which, despite the transatlantic telephone, the telegram is the most convenient method of operating, most arbitrage transactions are conducted by telephone. The fundamental basis of arbitrage is the taking advantage of any disparities in the value of foreign currencies that may exist between two or more centres at the time of operating. A point to be noted is that, apart from the quotations for American dollars and pounds sterling, most active exchange centres quote so much of their own currency against 100 units of the currency of the foreign centre. For instance, the quotation in Amsterdam of 58.96 on Berlin, means that 58.96 Dutch florins are equal to 100 Reichsmarks. Only by long practice can the student familiarize himself with these quotations, and in default of operating, or want of opportunity, his best plan is to study the daily financial papers that give the continental and other rates of exchange. However, an example of simple arbitrage will give the aspirant an insight into this highly technical business.

We may suppose that a dealer in the London market calls up one in Berlin on the telephone, and, on inquiry, is

¹ Quoted by F. Escher in Canadian edition of *Modern Business* (vol. viii). "Banking Practice and Foreign Exchange."

informed that dollars there are quoted 4.2175–4.2180. By that he will understand that the Berlin dealer is a buyer of \$1 for 4.2175 Reichsmarks, while he is a seller of \$1 for 4.2180 Reichsmarks. Now the London operator will know that the rates in his market are Dollars/Sterling $4.85\frac{3}{8}-\frac{1}{8}$, and that Reichsmarks/Sterling are $20.46\frac{1}{2}-\frac{1}{4}$. By quick calculation he then finds that a disparity exists between the two centres. Needless to say, he does not arrive at this conclusion by pencil and paper—the life of a foreign exchange operator is too short for that. He does the calculation by quick manipulation of his “Loga”—an ingenious cylindrical machine specially made for the purpose of rapid multiplication and division. By a quick turn of his machine he finds that Berlin’s buying price for dollars against 4.2175 Reichsmarks, based on the London price at which he can dispose of Reichsmarks in London— $20.46\frac{1}{2}$ —gives him a Dollar/Sterling rate of 4.8530. With the sure knowledge that he can buy dollars in London at $4.85\frac{3}{8}$, he promptly sells dollars to his Berlin *confrère* at 4.2175, buys a similar amount of dollars in London at $4.85\frac{3}{8}$, and uncovers the Reichsmark equivalent in London by selling at $20.46\frac{1}{2}$. A similar result could be achieved, by reducing the London rates of $4.85\frac{3}{8}$ and $20.46\frac{1}{2}$ to the direct Berlin parity of 4.21684, and then placing this price against Berlin’s buying rate for 4.2175 dollars. The unit of profit would thus be 0.0066 Reichsmark, and, assuming the amount of the transaction to be \$100,000, then the profit to the London operator would be 66 Reichsmarks, less, of course, expenses. We mention expenses, since on active markets, operating expenses, such as telephone calls, telegrams and brokerage, are by no means negligible, and these items necessarily have to be taken into consideration.

We have mentioned this as a “simple” arbitrage operation, and in practice, arbitrage is not always so straightforward. For instance, it is possible that, in the above illustration, as the London dealer is on the point of selling his Reichsmarks the latter come on offer, and he is unable

to undo this side of the transaction at the rate anticipated. In a few moments a call from Zurich may come through, and by operating in Reichsmarks against Swiss Francs he completes the sale at the desired price and uncovers the Swiss Franc equivalent in London without loss.

Arbitrage transactions can, of course, be conducted from London with two foreign centres simultaneously without covering in the London market, as professional operators are usually prepared to quote most exchanges against any currency in which there is an active market. By far the greater proportion of deals done in London with Europe, however, are against sterling.

Among the banking influences there is one other factor, which is perhaps the most important of all in view of its far-reaching effects on the principal European and American exchanges, that is, the bankers' investments in bills.

Bankers' Investments in Bills.

As far as London banks are concerned, bills of exchange form one of the principal items on the assets side of their Balance Sheets. The bills are an admirable liquid security, and the reason they are in favour with the bankers is, that they may be held in proportions to mature at certain fixed dates convenient for the cash requirements of the banks.

An examination of the contents of a London banker's portfolio would reveal two classes of bills, (*a*) those arising from the purely internal transactions, (*b*) those emanating from the foreign trade of the country. The first class is well known to those engaged in the home trade of the country. A merchant may receive from a customer in payment of goods an acceptance at, say, three months' date, and if he and the acceptor be in good repute, the banker will discount the bill for a small charge, place it in the bank's portfolio, and there it will remain until maturity, since it rarely, if ever, happens that a British

banker re-discounts such paper. The second class embodies those bills drawn from abroad on this country and accepted here by London or other British firms. When completed the bills are sold to the bankers, who hold them in the same way as the other bills.

Now while British bankers in London invest in bills payable in this country, they are generally averse from holding bills payable on other European centres: some even go a step further, and refuse to have anything to do with paper bearing the names of acceptors whose principal place of business is abroad, or the major part of whose assets are not available in Great Britain.

The bills in which the London bankers invest, once they find their way into the bankers' portfolio, can have very little effect on the foreign exchanges, but the case is different where foreign bankers are concerned. They, for various reasons, are content to risk funds in the purchase of what are, to them, foreign bills, and at most periods of the year they hold an assortment of bills on all the principal European centres.

Their operations may be divided into two sections, (1) the investment in bills as a means of attracting gold to the country in which the bankers are domiciled, (2) investments in bills for the purpose of obtaining an interest yield higher than can be had if bills on their own country are purchased.

As regards the first class, the reader will readily understand the power conferred on the holder of bills drawn on one or other of the gold centres: assuming the bills to be payable in London, if the bankers of the foreign nation resolve to draw gold from us to replenish their reserves, nothing is more simple than to send the bills to London and sell them on the market in exchange for cash. With the money gold may then be purchased on the open market in London. The gold is then packed and shipped to the country that formerly held the bills. As an alternative, the bills may be sent here for encashment at maturity, and

funds then withdrawn from London ; and, as we have seen, it does not always follow that the rate of exchange is against London when gold is withdrawn from us.

As a matter of fact, a number of central banks in various countries are now specially empowered to invest a proportion of their assets in foreign bills, both as part cover for their note issues and as a ready means to influence the foreign exchanges in their favour when the need arises.

Among countries empowered to hold foreign bills as cover for the note issue of their central banks, are Austria, France, Germany, Greece, Italy, Czechoslovakia, and the Netherlands. The system of holding "gold bills," that is, bills of exchange on gold standard countries, has such obvious advantages, that when there is a general return to the gold standard, it will doubtless become general in course of time. For example, given a well-organized discount market on any foreign centre, should exchange with that centre become unfavourable to the country holding the bills, it is a comparatively simple matter to send the bills there to be discounted, and then to draw the resulting funds, or, alternatively, to utilize them in settlement of indebtedness to the creditor country. Thus the exchange may be influenced in favour of the debtor country, and equilibrium be again restored.

The foreign investment in London bills in order to obtain a high rate of interest is more of an ordinary commercial banking operation. The operations are usually seen when the rate of discount for first-class paper is higher in London than in the foreign centre. If the market rate of discount here is 4 per cent, and in Berlin or Paris 3 per cent, bankers on the Continental markets will at once seek to obtain the higher yield on their funds by making purchases of bills on the London market. The foreign banker in this case takes the place of the London banker as a discounter, but in the converse case British bankers show no inclination to occupy the Frenchman's or German's position. It seems to be the golden rule in London to refrain from

embarking funds in the purchase of Continental bills, no matter how attractive the rate of return. For instance, if the market quotation here is 2 per cent, and in Paris 3 per cent, the reader may look in vain for large British investments in bills on France.

Apart from the higher interest, the chance of making a little extra profit on the exchange is always an attraction for the foreign dealer. Although the bills are said to be for investment, yet, if the banker sees a favourable opportunity, he is quite ready to dispose of them, and in some cases, notably where the rate of interest in London falls before the bill has matured, it may suit him to realize his profit by selling the paper at once. It will be apparent to the reader that we are referring to the purchase of three months' bills, or, in the language of the market, long exchange. A concrete case will elucidate this matter.

In a previous chapter we saw how the long and short rates were calculated, and by an application of the rules there given we can show how the dealer makes his profit.

If the cheque rate, Geneva on London, be quoted about Fcs. 25.17, the long rate for bills on London will be approximately Fcs. 24.92, since if we are in the foreign centre where currency is quoted in foreign units to the pound sterling, interest at the London rate is deducted from the short quotation (say, 25.17 minus three months' interest at 4 per cent . . . 24.92), showing that less is paid for a three months' bill than for one payable on demand. At this rate a three months' bill for £100, Geneva on London, would cost Fcs. 2,492, and if we assume that during the tenor of the bill there is no alteration in the cheque rate, Geneva on London, at maturity the Swiss banker could sell it as a cheque, or sight bill, at the short quotation, say, Fcs. 25.17 to £1, and thus net twenty-five francs as his profit, or, as we prefer to call it, interest on his original outlay at the rate of 4 per cent per annum for three months. In comparison with this, Swiss bills held over the same

period would show 1 per cent less, as the rate was only 3 per cent per annum.

There is, however, an element of uncertainty about the quotations, which to the more cautious British bankers, makes the operation savour of speculation. There is just the chance that the cheque rate may alter a point or two, or the rate of interest in London change. For example, when the bill fell due, our Swiss friend might find short exchange quoted at Fcs. 25.14, and all the bill would fetch on the market would be Fcs. 2,514, which brings his interest down to 3.13 per cent. On the other hand, if the short rate goes up before the maturity of the bill, the return increases proportionately. When Continental exchanges are low and London interest rates high, there is thus an inducement for the foreigners to invest in our bills. The prospect of higher interest, plus a chance profit on the exchange is obviously an incentive to those bankers willing to take the risk, and long years of dealing have demonstrated that they are fairly safe in buying bills under the conditions indicated. Only in exceptional circumstances will the quotations fall considerably; in ordinary times, in fact, the chances are against rates going below export specie point, and, appreciating this, the bankers rest secure in the hope that a slight rise in the rates may occur, and so enhance their profits.

This, then, is why, when our interest rates are above those ruling in foreign centres, and the exchanges on those countries are low, a heavy investment demand for bills sets in from the Continental banking and finance houses.

The manner in which these operations affect the exchange with London is rather a long story; therefore, it will be convenient to discuss the subject in the next chapter in connection with Bank Rate and market rate of discount.

CHAPTER XII

BANK RATE AND MARKET RATE OF DISCOUNT IN CONNECTION WITH THE FLUCTUATIONS IN THE FOREIGN EXCHANGES—THE PRE-WAR AND POST-WAR POSITION—THE AMALGAMATION OF THE GOVERNMENT CURRENCY NOTES ISSUE WITH THE NOTE ISSUE OF THE BANK OF ENGLAND—CONDITIONS ANTECEDENT AND SUBSEQUENT TO THE SUSPENSION OF THE GOLD STANDARD IN GREAT BRITAIN—THE GOVERNMENT'S EXCHANGE EQUALIZATION FUND

IN the previous chapter we laid no special emphasis on the fact that in the purchasing of bills on London it is the market rate of discount which is taken into account by the foreign dealers, and one imagines the student's saying, "Why is it that the Bank of England Rate is not utilized in the calculation?"

Bank Rate.

The reason is this. In most of these transactions, the foreign banks buy only first-class bills, and if at any time it becomes necessary to turn the bills into cash, they will be discounted on the London market at the lower rate, which is invariably the market rate. Bank Rate, which is the Bank of England's minimum rate for discounting bills, is usually a trifle higher than the market quotation; not because the Bank declines to discount, since in practice bills will generally be discounted for its clients at about the same rates as can be procured on the open market, but because the Bank of England is the custodian of the nation's principal gold reserve, and its minimum rate is based on the greater or less need there is to protect this reserve from the inroads which may be made into it. We have seen how these encroachments are possible, when

foreign bankers sell the bills they have previously purchased on the London market. On the other hand, the joint stock banks, the bill-brokers, and the discount houses, are not at present under the liability to keep large tangible gold reserves; consequently they are able to work on lower rates. Nevertheless, they are all more or less dependent on the Bank of England, and the premier institution is usually in the position to exert its influence when needful. How this is done is best seen by examining the effect of an increase in Bank Rate upon the other operators in the market.

In the first place, it should be borne in mind that the Bank of England allows no interest on money deposited with it; the joint stock banks for their part, allow interest on funds deposited with them for fixed periods, while the colonial and foreign branch banks, bill-brokers, discount houses, and the like, pay a rather higher rate of interest than the joint stock banks.

There are other rates of interest in the money market which bear a direct relation to Bank Rate,¹ but the three we have enumerated are sufficient for our purpose.

As most people are aware, the bill-brokers work on capital borrowed from the joint stock banks, which also lend large sums to the Stock Exchange on similar terms to those governing loans to the bill-brokers and discount houses, namely, at call or short notice. The amount lent out in this way is that obtained by the banks from customers' deposits, and whenever the Bank Rate is raised, the interest allowed by the joint stock banks also rises. If, then, the banks are obliged to pay more interest to their clients who deposit funds for varying periods, it is only natural that they should exact the difference from the dealers to whom they lend their surplus cash. The incidence of this charge will finally be shifted by the brokers on to the persons for whom they discount bills, much in the same way as taxation on commodities is shifted on to the consumer.

In practice the process does not always work out so

¹ Cf. *The London Money Market*, by W. F. Spalding (Fitman).

smoothly, and it is then that the Bank of England resorts to other expedients.

When gold is leaving the country, and further exports of the metal are threatened, it sometimes happens that the market rate of discount does not respond to the increase in the Bank's official minimum: the Bank of England then takes steps to compel the other interests to follow its lead, simply by stopping, or limiting the supplies of loanable capital which are available for bill discounters, stockbrokers, and other borrowers on the short loan fund of the London money market. There are various ways of doing this, but in principle they all come to the same thing: that is, the Bank of England by depleting the amount of loanable capital on the money market, forces the joint stock banks to call in the loans from the brokers. The market is then said to be in want of money, or, to use a colloquialism, "in the Bank." There will be difficulty in selling bills of exchange, or in borrowing on securities, and as at such periods most financiers consider it advisable to increase their stock of money, they will call in all the loans they conveniently can. The banks, for their part, feel it incumbent upon them to hold less securities and more cash, consequently the brokers and discount houses are for the moment at the end of their tether. As all else has failed, they are practically obliged to go to the Bank of England for assistance. The Bank then supplies them with funds by discounting short bills, with not more than fifteen days to run, and by lending them amounts of money against the deposit of satisfactory security; as the Bank insists on borrowers taking these loans at a fixed rate of interest for a week, a more or less effective control is exercised over the market for the time being.

In such circumstances, the Bank of England is able to exact suitable rates, and as the borrowers are made to pay a higher price for accommodation, the natural sequence is for the market rate of discount to go up, as the bill-brokers are pretty sure to recoup themselves for the

additional cost of the funds which they employ in the market. However, in 1915 there was an instance of this manipulation of the London money market, *without an increase in the Bank Rate*. During the second week in March, 1915, the Bank of England's gold reserve, although large, was in danger of having calls made upon it owing to the huge purchases of war material by this country from neutral states, and with the low discount rates ruling there is no doubt gold would soon have left the country in large quantities. Immediate action was therefore taken to effect a scarcity of money here, and so by causing higher interest rates, make it more profitable to leave money for employment in London than to draw it away to foreign countries. In the case under discussion the Bank of England and the clearing banks were jointly concerned in the operation of reducing the existing credits on the market. The Bank of England took large sums of money off the market, and the joint stock banks called in their loans to brokers. Then when the bill-brokers required to borrow again, higher rates were exacted for loans at call, and the result was seen in a sharp rise in the value of short money, to which discount rates quickly responded.

The inter-connection of Bank Rate and market rate now being apparent, it is easy to see how closely the Bank Rate is allied with the question of foreign exchange. The higher the interest rates ruling in London are above those in the foreign centre, the greater will be the investments in bills from Continental bankers, and, what is perhaps more important, the less incentive will there be for foreigners to send long bills to London for discounting. As every foreign purchase of paper means the provision of funds, the outflow of gold will be checked, and the exchanges turned in our favour.

The Continental investment in bills on London may continue for some time, more or less spasmodically, it is true, until exchange rates rise, or until there is an influx of gold into London. Then we see the reverse action: with

exchange rising and interest or discount rates low here, the foreign bankers generally realize their holdings of London bills, and almost immediately the exchange drops or the rise is checked, and gold imports cease.

Movements in our Bank Rate are always closely noted abroad, and the following comment, brought to the author's notice as this chapter was being written, is interesting, as showing how thoroughly the Americans are in accord with Goschen's expression of the theory:

" Much is said of the influence on the rate of exchange and on the flow of gold, of the Bank of England discount rate. If the Bank of England, because of too rapidly expanding loans or because of depletion of reserves, raises its rate of discount, being followed in this move by the other English banks, its doing so has a tendency to lower the rate of exchange in England on the United States and other countries, and to raise the rate in the United States and elsewhere on England. It has this effect because the increased interest in England tempts to investment there rather than in the United States. English banks are more likely to invest current funds at home, and may even draw on debtor banks in the United States and other countries. American and other banks may be tempted to make short term loans in England or to hold, or to have held until maturity, long bills which they would otherwise have immediately discounted. This holding of drafts until maturity will compel them to buy more drafts on England than otherwise would be necessary, in order to maintain their usual balances. The general result of a high discount rate in England is, therefore, a high rate of exchange on and a flow of gold to England. Similarly, a sharp rise in the discount rate in New York would tend to produce elsewhere a high rate of exchange on New York, and would tend to cause a flow of gold to New York."¹

¹ *International Trade and Exchange*, H. G. Brown (New York), page 134.

From a consideration of these facts, we are able to appreciate the intimate connection a change in the Bank Rate has with the movements of foreign exchange: the effect of raising the Rate, and the subsequent manipulation of the money market, is to create an artificial scarcity of money and at the same time cause a depreciation in the value of bills of exchange on the London market. A fall in the price of bills attracts investors from abroad, and as the result of their purchases of paper, an adverse exchange is turned into a favourable one—using the word in its widest sense. Indeed, the ultimate outcome of dealings of any magnitude, is to draw gold from the foreign centres to London, and without entering into the question whether or not the accumulation of huge gold reserves is the fetish that some cavillers claim it to be, we have always before our eyes the indisputable fact that normally when the Central Reserve is adequate the monetary position of the country is more satisfactory.

We need not go further into the question here, but sufficient has been said to enable the reader to understand that, other things being equal, the adjustment of interest rates in practice aids and abets, or rather brings into being the compensatory influence of the investment business in bills of exchange, a business which is so well known to those who watch the monetary movements, that its action has come to be regarded as a sort of pendulum of the foreign exchanges: it steadies the fluctuations and exercises a most powerful effect on the import and export of gold.

Apart from the benefits said to accrue from the manipulation of the Bank Rate of discount as a corrective to an unfavourable exchange, the economic effects of a too frequent alteration in rates have sometimes been called in question, so perhaps an extract from the First Interim Report of the Committee on Currency and Foreign Exchange, of January, 1918, may be of interest.

In the course of their Report, the Committee said—

“ Since the passing of the Act of 1844 (Bank Charter

Act), there has been a great development of the cheque system. The essence of that system is that purchasing power is largely in the form of bank deposits operated upon by cheque, legal tender money being required only for the purpose of reserves held by the banks against those deposits, and for actual public circulation in connection with the payment of wages and retail transactions. The provisions of the Act of 1844 as applied to that system have operated both to correct unfavourable exchanges and to check undue expansion of credit.

“ When the exchanges were favourable, gold flowed freely into this country, and an increase of legal tender money accompanied the development of trade. When the balance of trade was unfavourable and the exchanges were adverse, it became profitable to export gold. The would-be exporter bought his gold from the Bank of England and paid for it by a cheque on his account. The Bank obtained the gold from the Issue Department in exchange for notes taken out of its banking reserve, with the result that its liabilities to depositors and its banking reserve were reduced by an equal amount, and the ratio of reserve to liabilities consequently fell. If the process were repeated sufficiently often to reduce the ratio in a degree considered dangerous, the Bank raised its rate of discount. The raising of the discount rate had the immediate effect of retaining money here which would otherwise have been remitted abroad and of attracting remittances from abroad to take advantage of the higher rate, thus checking the outflow of gold and even reversing the stream.

“ If the adverse condition of the exchanges was due not merely to seasonal fluctuations, but to circumstances tending to create a permanently adverse trade balance, it is obvious that the procedure above described would not have been sufficient. It would have resulted in the creation of a volume of short-dated indebtedness to foreign countries which would have been in the end

disastrous to our credit and the position of London as the financial centre of the world. But the raising of the Bank's discount rate and the steps taken to make it effective in the market necessarily led to a general rise of interest rates and a restriction of credit. New enterprises were, therefore, postponed, and the demand for constructional materials and other capital goods was lessened. The consequent slackening of employment also diminished the demand for consumable goods, while holders of stocks of commodities carried largely with borrowed money, being confronted with an increase of interest charges, if not with actual difficulty in renewing loans, and with the prospect of falling prices, tended to press their goods on a weak market. The result was a decline in general prices in the home market which, by checking imports and stimulating exports, corrected the adverse trade balance which was the primary cause of the difficulty.

"When apart from a foreign drain of gold, credit at home threatened to become unduly expanded, the old currency system tended to restrain the expansion and to prevent the consequent rise in domestic prices which ultimately causes such a drain. The expansion of credit, by forcing up prices, involves an increased demand for legal tender currency both from the banks, in order to maintain their normal proportion of cash to liabilities, and from the general public for the payment of wages and for retail transactions. In this case also the demand for such currency fell upon the reserve of the Bank of England, and the Bank was, therefore, obliged to raise its rate of discount in order to prevent the fall in proportion of that reserve to its liabilities. The same chain of consequences as we have just described followed, and speculative trade activity was similarly restrained. There was, therefore, an automatic machinery by which the volume of purchasing power in this country was continuously adjusted to world prices of commodities in

general. Domestic prices were automatically regulated so as to prevent excessive imports ; and the creation of banking credit was so controlled that banking could be safely permitted a freedom from State interference which would not have been possible under a less rigid currency system.

“ Under these arrangements this country was provided with a complete and effective gold standard. The essence of such a standard is that notes must always stand at absolute parity with gold coins of equivalent face value, and that both notes and gold coins stand at absolute parity with gold bullion. When these conditions are fulfilled, the foreign exchange rates with all countries possessing an effective gold standard are maintained at or within the gold specie points.”¹

We have said that the economic effects of a too frequent alteration in Bank Rate has sometimes been called in question, but as Sir Charles Addis (a Director of the Bank of England) said in an address to the Institute of Bankers, London, in the Bank Rate, whether for a rise or fall, we have an instrument . . . whose efficiency for ultimately producing the financial result remains unimpaired by anything that has happened during or since the Great War.

They are not without grounds, he said, for their belief who hold more strongly than ever that in the suppleness of the Bank Rate lies its chief virtue, and that its efficacy, especially in the way of prevention, would be increased to the great advantage of the community if it were more frequently and, above all, more promptly applied. There is a sentimental prejudice against changes in the Bank Rate which has no real economic justification. In any case, the disadvantages attaching to frequent changes in Bank Rate are as dust in the balance when weighed against the supreme advantage to trade of comparative stability of prices.

¹ Cf. pars. 2 to 7 of “ First Interim Report of Cunliffe Committee on Currency and Foreign Exchanges after the War.”

Certainly, until comparatively recently, there seemed to be no disposition to make frequent or sudden changes in Bank of England Rate. A rate of $4\frac{1}{2}$ per cent was, in fact, maintained from 21st April, 1927, to 7th February, 1929. No one, of course, could have envisaged the pass to which the country would be brought by September, 1931. Further, with the amalgamation of the Government's Currency Notes with the Bank of England's note issue, our monetary and exchange barometer seemed set fair. Then the currency system of Great Britain under the Gold Standard Act of 1925, which placed the country on the Gold Bullion Standard, as far as the foreign exchanges are concerned, was working much the same as the pre-war system did. Gold was freely available for export, for under the Act the Bank of England was bound to sell to any person who made a demand at the head office of the Bank during business hours, and paid the purchase price in legal tender, gold bullion at the price of £3 17s. 10½d. per ounce troy of gold of the standard fineness prescribed for gold coin by the Coinage Act of 1870, though only in the form of bars approximately 400 oz. troy of fine gold.

Currency and Bank Notes Act, 1928.

The Act giving effect to the amalgamation of the Government's currency note issue with that of the Bank of England received Royal Assent on July 2, 1928. It is an important measure, both from the point of the currency system of the country and from that of the future effect on the foreign exchanges; and as the Westminster Bank said, in a review of the Act, its nature and object cannot be too widely appreciated. These may best be learned from a study of the speech in which Mr. Arthur Michael Samuel, M.P., Financial Secretary to the Treasury, moved the second reading of the Bill which was precursory to the Act, in the House of Commons. The speech is such a clear and lucid exposition, that it is desirable that all students should follow it closely as a fitting adjunct to this chapter.

We, therefore, reproduce it, with certain emendations of wording made by Mr. Samuel for the sake of additional clarity.

Mr. Samuel said—

This Bill proposes, in accordance with the policy laid down by my right hon. friend, the Chancellor of the Exchequer, in his Budget speech, to give effect to the long foreshadowed amalgamation of the Treasury currency note with the Bank of England note. The House will not wish that I should trace at any length the past history of our note issues. The House is aware that the Bank of England note issue, for seventy years before the war, from 1844 to 1914, was governed by the provisions of Peel's Bank Charter Act of 1844. The basic effect of that Act was that it established a fixed fiduciary issue, beyond which no notes could be issued except in exchange for gold. With the outbreak of war, however, face to face as we were with a catastrophe and difficulties of unforeseeable magnitude, it was necessary for us to abandon, and, as time has proved, fortunately only temporarily, some of the most vital principles of the 1844 Act. May I refer to some of the vital principles which had to be abandoned?

In the first place, the paper currency, which in England and Wales was limited, up to the outbreak of war, to Bank of England notes of £5 and upwards, was, at the outbreak of war, supplemented by an issue of £1 and 10s. currency notes. There was no statutory regulation as to the amount of the issue; nor was there any statutory provision as to the gold reserves to be held against those currency notes. Secondly, power was given to the Treasury to suspend temporarily the fiduciary limit of the Bank of England note issue. The gold standard itself was maintained in operation until the end of the war. But, in the meantime, gold movements were so hampered, and the world market in gold so disordered, that the gold standard had ceased to work. In 1919 the export of gold was prohibited; that prohibition was continued until 1925. But it had been all along the policy of His Majesty's Government to restore the whole organization of credit—an organization which had been temporarily impaired by the war—at the earliest possible moment.

The action of my right hon. friend, the Chancellor of the Exchequer, brought us back to gold in 1925 by the Gold Standard Act. It now only remains for us to take the final administrative step which he foreshadowed in 1925; we, therefore, propose to amalgamate the Treasury currency note issue with the Bank of England note issue. I will, later on in my remarks, if the House will grant me its patience, say a few words upon the clauses of the Bill, and the manner in which provision is to be made for variations in the tides of

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ierce. But, perhaps, it might be acceptable to the House were to turn aside for a moment and endeavour to answer a question which may possibly rise to the minds of hon. Members. It may be asked, why not leave the Treasury note issue, or, if not, why amalgamate it with the Bank of England and note issue? I will try to give the reasons why Treasury notes are to be handed over to the Bank of England.

The existing system of our paper currency is the outcome of the emergency of 1914. But certain wide powers then granted by Parliament to the Treasury are no longer used. The Treasury was empowered by law to issue and control the Treasury currency notes. As a matter of fact, only the Bank of England issues these notes, and they can only be obtained by drawing upon a deposit at the Bank of England. There is an alternative method, which was necessary at the crisis in the early part of the war, namely, that of direct advances to the Treasury to banks. That method, however, soon fell into abeyance, and in 1919 was abrogated.

Then, again, in the Treasury Minute of December, 1919, the Treasury issued the fiduciary issue of Treasury notes in accordance with the recommendations of the Cunliffe Committee. Thus the actual maximum fiduciary issue reached one year became the allowed maximum for the next. This was avowedly a temporary measure. Consequently the law governing the Treasury currency notes was unsatisfactory in itself, although the measure was good and sound. As neither the law nor the practice has any claim to remain permanent, we seek to regularize the position, and therefore bring in this Bill.

There are further reasons. As I have already explained, Treasury currency notes can only be obtained by drawing upon deposits at the Bank of England. For that reason the position is that the regulation of the volume of the currency has become dependent upon—and solely dependent upon—the regulation of credit. Now the regulation of credit has rested with the Bank of England. It must rest with the Bank of England, and will continue to rest with the Bank of England. The Bill merely proceeds to the logical conclusion. It places legal responsibility for the note issue where the actual responsibility already lies, and must continue to lie, with the Bank of England, because the Bank of England controls credit. Even in 1844 the desirability of central control over the note issue was recognized. If hon. Members will turn to the speech of Mr. Robert Peel on 6th May, 1844, they will see that the desirability of placing the note issue under the control of a central bank was dealt with on that occasion. I derived great pleasure myself last week from re-reading that Bank Charter Bill when thinking out my speech for to-day. It was recognized, as I say, as long ago as 1844, that the note issue

should be in the hands of a central bank, and one may say that the Bank of England was the first of all central banks.

Since the American crisis of 1907, this principle of central control has been more widely accepted, and the American Federal Reserve Act, 1913, was based upon that principle. Since then, too, we have had the Brussels Conference of 1920 and the Genoa Conference of 1922. Both of these conferences emphasized the desirability of placing the control of currency and credit in the hands of central banks. Both recommended that central banks should be made completely independent of political interference. This Bill recognizes those principles. Before I pass from the reasons why we are entrusting the Treasury currency note issue to the Bank of England, I hope the House will give me permission to read a passage out of the Bank Charter speech of Sir Robert Peel—one of the most remarkable speeches ever delivered in the House of Commons. He said on 6th May, 1844—there had been negotiations on the subject then under discussion, with the Bank of England—

“I must, in justice to the gentlemen who have conducted negotiations on the part of the Bank, namely, the governor and deputy-governor, declare that I never saw men influenced by more disinterested or by more public-spirited motives than they have evinced through our communications with them. They have reconciled their duties as managers of a great institution, bound to consult the interests of the proprietors, with enlightened and comprehensive views of the public interest.”

Although nearly a century has elapsed since those words were spoken, there have been occasions time after time which have proved their complete truth. No man who has studied the economic development of Britain during the nineteenth century can have failed to notice the position which the Bank of England has established for itself in the respect of the nation. The country is very proud of the Bank of England. It is with complete confidence that His Majesty's Government have decided by this Bill to entrust the management of the currency note issue to it.

But while the Bank of England must assume responsibility for the currency, Parliament, in legislating, as it is now, on the subject of currency, lays down the principles which will guide the Bank of England in carrying out its duties. One such principle is absolutely beyond all dispute. Convertibility into gold in accordance with the Gold Standard Act, 1925, must be maintained. The credit policy of the Bank must always be governed by this obligation. This principle is essential.

Circumstances to-day, in relation to note issues, are in several respects very different from those which obtained during the period of seventy years up to the outbreak of war. The

fiduciary issue of the Bank of England, which is even now only £19,750,000, could hardly have remained so low as it did during the seventy years before the war but for the extension of the use of the cheque. The effect of the enormous economic and financial expansion of the country upon the active circulation of bank notes was offset by the growth of the use of the cheque. But it is not certain that the need for an increase in currency will always be met so adequately by other developments of banking methods.

A further new circumstance is this. It is now generally recognized that no country can either absorb, or set free, gold for monetary purposes, without affecting its neighbours. A rigidly fixed note issue, therefore, might fetter the Bank of England in a manner inconsistent with the resolutions adopted at the Genoa Conference in 1922. We are keeping the resolutions of the Genoa Conference well in mind, together with the two considerations of natural alterations in the currency needs of the community, and the adaptation of our reserve limits to the state of the world markets in gold and gold currency.

Consequently, provision is made in the Bill for variations in the fiduciary issue, either downward or upward, by the action of the Treasury, at the instance of the Bank. By variation upward I mean, of course, expansion; and by variation downward I mean reduction. Variations downward are authorized because they may be needed to enable the country to absorb an abnormal inflow of gold without the evils of an excessive expansion of credit. It will be authorized, under the Bill, to vary downward by permission of the Treasury acting at the instance of the Bank of England, and the Treasury can impose limits as to extent and period. Variations upward of the fiduciary issue cannot be authorized for more than six months at a time, and they cannot be renewed to cover a total period of more than two years, without the direct authority of Parliament. To sum up, the existing emergency system has lasted long enough. It will make way in future under this Bill for a fixed fiduciary issue variable upward only on good cause by the Bank and the Treasury acting in unison. The ultimate word will rest with Parliament. In this manner we seek to obtain the advantages without incurring the dangers of elasticity.

I have dealt with the transfer of the legal responsibility for the note issue to the Bank of England and the provision for a fixed fiduciary issue, subject to variation, by the joint action of the Bank and the Treasury. May I now proceed to explain the clauses of the Bill?

At the present time, the Bank of England has no power to issue notes of a smaller denomination than £5. Clause 1 empowers the Bank to issue notes of £1 and 10s. and makes bank notes legal tender for all payments in England and Wales

instead of only for payments of £5 and over. It also makes the £1 and 10s. notes legal tender in Scotland and Northern Ireland as well as in England and Wales. Subsection (3) provides that so long as the Gold Standard Act remains in operation, the new notes for £1 and 10s. shall be legal tender in payments by the Bank itself. The Gold Standard Act relieved the Bank from any obligation to pay in gold coin, but required it to sell gold bullion at the coinage price. In order that that arrangement may continue in force, the Bank must have the same right to pay its depositors and creditors in its own notes as it now has to pay them in currency notes.

Clause 2, which is probably the most difficult clause in the Bill to explain, defines the future fiduciary note issue and fixes it at £260,000,000. This £260,000,000 is arrived at in this way: Following the recommendations of the Cunliffe Report, the Treasury has fixed the actual maximum of 1927 to be the permitted maximum fiduciary issue of currency notes for 1928. The maximum of 1927 was £244·94 millions. To that should be added the Bank of England fiduciary note issue of £19·75 millions. The total is thus £264·69 millions. The amount of our currency notes in use in the Irish Free State is estimated, roughly, at £6,000,000. The Free State is about to replace our notes by an issue of Free State notes; therefore, £6,000,000 should be deducted from our total. That reduces our total to £258·69 millions, which has been rounded up to £260,000,000, the figure in the Bill. The clause proceeds to give power to the Treasury, at the request of the Bank, to reduce the fiduciary issue. In Clause 8 power is given to increase the fiduciary issue.

Clause 3 deals with the cover for the fiduciary issue. It requires the Bank to hold securities in the Issue Department sufficient to cover the fiduciary issue. Up to a limit of £5,500,000 it allows silver coin, which has for some years been held in the Currency Note Account, to be held as a security. The limit is fixed with reference to the amount of silver now held by the Currency Note Redemption Account. The figure has come down from £7,000,000 to £5,500,000, and is in course of reduction, which will continue. Clause 4 provides for the transfer to the Bank of the responsibility for the currency notes outstanding on the appointed day. Clause 5 provides for the transfer of the securities held against the outstanding notes. As the securities held in the Currency Note Redemption Account exceed by a good margin the value of notes outstanding, provision is made for the disposal of the balance. The clause directs that the surplus securities be realized and the proceeds, estimated at £13,200,000, paid into the Exchequer in conformity with the announcement made by my right hon. friend, the Chancellor of the Exchequer, in his Budget speech.

Clause 6 provides that the whole profits of the issue, both

the profits on the new £1 and 10s. notes and the profits on the notes for £5 and upwards issued by the Bank of England, shall accrue to the State. In Clause 8 power is given to increase the fiduciary note issue. Clause 8 (3) provides that—

"Any minute of the Treasury authorizing an increase of the fiduciary note issue . . . shall be laid forthwith before both Houses of Parliament."

The remaining clauses, except Clause 11, deal with subsidiary matters. Clause 11 has been framed for the purpose of ensuring the concentration of the gold reserves of the country in the hands of the Bank of England. The clause enables the Bank to buy compulsorily any holding of gold coin or bullion in excess of £10,000, with the important exception of gold "which is *bona fide* held for immediate export or which is *bona fide* required for industrial purposes." This exception is devised to leave the activities of the London bullion market entirely untouched.

Such are the provisions of the Bill. It returns to the principles of the Bank Act of 1844, but by the use of methods more adjustable to the needs of change and development. The whole essence of the Bill is recognition of the importance of providing the nation with an adequate volume of currency and of maintaining its value stable. No State can exist and remain solvent, and least of all a State like ours which depends for its livelihood upon overseas trade, without a safe, stable currency. The measuring rod of commerce must be stable. In our case the measuring rod is the pound sterling, which has already been linked to gold by the Gold Standard Act of 1925. It has, however, been proved that the internal circulation of gold coins is in these times both unnecessary and wasteful. This Bill, therefore, will lay down for the Bank of England limits and safeguards subject to which it may issue notes to replace and represent gold coins for internal circulation. The return to gold has been a potent factor in the restoration of British international credit. Marked though it has been by economic jolts and jerks, the return to gold has, on the whole, been beneficial to us. It is evident on all sides that the trade of the country is now steadily and surely on the upward grade. It needs a stable currency in support of it. The restoration of the national wealth destroyed by the war, and the re-filling by savings of the reservoir of capital, so indispensable to industrial recovery, will be assisted by the provisions of this Bill, following on the return to gold. I can, therefore, with confidence, recommend its favourable acceptance by the House.

It only remains to be added that the Currency and Bank Notes Act, 1923, was brought into force on 22nd November, 1923, and on that date the new Bank of England notes

for £1 and 10s. were put into circulation. The transfer of the British Treasury's Issue to the Bank of England was skilfully accomplished, and even the keenest critics could discover no hiatus.¹

With the accomplishment of this momentous step, it was considered that something like finality in bringing back the country to the Gold Standard had been reached. For two or three years, indeed, the new system worked well, and, but for the world crisis that intervened, a near approach to the pre-war conditions would have been achieved. However, as Mr. Samuel said, no country can either absorb or set free gold for monetary purposes without affecting its neighbours, and had Great Britain's efforts to maintain a free gold market been supported by other nations during the dismal months of 1931 it is possible that she would have been able to continue on the Gold Bullion Standard. Other countries, however, drew heavily on London's funds and took gold, with what results we may now see.

To be precise, it was on 21st September, 1931, that this country, after a struggle against an abnormal combination of forces announced to the world the suspension of gold payments. The story of the stages by which the strain on London reached intolerable limits has been told and re-told, and the whole position was ably summarized by the Chairman of one of our great banks² in a speech in which he said: The catastrophic fall in commodity prices; the proportionate aggravation of debt burdens, and all fixed contractual obligations; the consequent development of the need, starting in Central Europe and spreading north, south, east, and west of country after country to repatriate the resources held on their behalf by London, the great

¹ For a full description of the method by which the amalgamation of the note issues was accomplished, and the effect on the Bank of England and the London Money and Discount markets, see *The London Money Market*, by W. F. Spalding (Sir Isaac Pitman & Sons, Ltd.).

² The Hon. Rupert E. Beckett, Westminster Bank, 27th January, 1932.

banking centre of the world; the birth of realization abroad that London, living by international trade, and short-term debtor to the world, was vulnerable to the abnormal economic forces; the fostering of nervousness among London's creditors by foreign propaganda; the disclosure by the reports of successive Government Committees of weaknesses in the monetary position and of a large prospective budget deficit—all these developments, superimposing distrust of the pound sterling upon our short-term creditors' need for cash at home, merged into a tide so formidable that neither the formation of a National Government and the balancing of the Budget, nor the assistance of New York and Paris in furnishing the British Treasury and the Bank of England with large credits, could prevent the pound sterling from being swept from its gold moorings.

Let us examine briefly the factors to which this banker refers in his summary of the position of Great Britain.

In the first place, it may be taken as axiomatic that the primary conditions that induce favourable exchanges are a balanced budget and a satisfactory balance of trade. In 1931 Great Britain had neither of these desiderata. Prior to the autumn of 1931 she had indulged in a huge expenditure on social and other services, and had shown but little disposition to put the brake on, though it was plain to all thinking persons that the country was spending more than she was receiving. In a word, we had spent and not counted the spending, and, as a result, our country was faced in 1931 with a huge estimated budgetary deficit of some £120,000,000. What had not been appreciated was that, for some years, since 1920, our balance of payments had been growing steadily worse. Imports were largely in excess of exports, and, added to this, the invisible trade balance upon which we had hitherto depended to square our position had heavily declined. For the three years, 1928-30, in fact, the state of Great Britain's finances had been growing steadily worse; the adverse balance in the visible trade of the country, that is, the excess of imports

over exports, in that period had increased by some £30,000,000, while in the invisible items the loss was around £69,000,000. Our net credit balance on external transactions had been diminished, therefore, by the large total of £99,000,000. An examination of the position by the Macmillan and May Committees revealed the unpalatable truth that, possibly for the first time in its history, Great Britain would have a balance of payments against her. Instead of being a creditor on income account, she would be a debtor.

As a matter of fact, in February, 1932, the Chancellor of the Exchequer gave convincing figures in regard to Great Britain's balance of trade, or, more properly, the balance of payments. He showed that there are three sets of figures in question: those of the imports of merchandise, those of the exports of merchandise, and the figures of the invisible exports. Invisible exports comprise the income of the United Kingdom from shipping, the income from foreign investments, the receipts from interest on short-term loans, commissions, and other sundry items. The calculation is made by deducting the value of the imports, leaving a surplus against which is set off the value of the invisible exports.

By taking the statistics of the two years 1929 and 1931, we get an eloquent illustration of how rapid and how disastrous had been our descent from a creditor to a debtor basis. In 1929 the value of the United Kingdom's imports over exports was £382,000,000. The value of the invisible exports was £482,000,000, leaving a favourable surplus of exactly £100,000,000. In 1931 the surplus of imports over exports was £409,000,000, but our invisible imports were only £296,000,000, thus leaving an adverse balance against the country of £113,000,000. In two years, therefore, the balance of trade had moved against us to the extent of £200,000,000.

This, however, is not the whole story, since the value in the prices of imports fell off far more than the values

of the exports. In order, therefore, to make a proper comparison, the figures of 1929 must be valued at the prices of 1931, from which it appears that, while the imports remained practically stationary for two years, the volume of the exports declined by nearly 38 per cent. The disquieting fact was that the diminution in the invisible exports amounted to no less than £186,000,000, nearly the whole of the difference.

What were the steps taken to deal with this unsatisfactory position in the autumn of 1931? By ruthless economy and the heavy increase in taxation and other self-sacrificing measures in which the whole country was called upon to participate, budgetary equilibrium was assured. But the crisis had gone too far, and the vital fact in the history of 1931 was that the breaking-point had arrived. Super-human efforts were made to stem the tide and to maintain the gold standard in Great Britain. In an endeavour to support the rates of exchange between London and the principal gold centres of the world, huge credits, giving the country power to draw on other countries, were arranged. They failed in their purpose. The times and circumstances were against Great Britain. In normal times, relief from the strain might have been to some extent obtained by calling in balances from our creditors, since London for some time previously had been lending Germany and other impoverished states in Central Europe money on short-term account. Yet, when the need came, instead of being able to bring these funds back to London, in the same way as bankers call in their short-term loans from the London money market, when requiring to meet expectant calls, Great Britain found herself faced with defaulting creditors on all sides.

The main cause of this state of affairs was the crisis of first-rate magnitude which had supervened in Austria, Germany, Hungary, and elsewhere. Large banking institutions in Central Europe got into difficulties and had to close their doors. This engendered nervousness in other

countries more fortunately situated; France, the Netherlands, Belgium, Switzerland, to name only a few, commenced to withdraw their floating balances from London, and, as is usual in critical periods, the movement gained impetus with the progression of time.

Our own central institution, the Bank of England, made heroic efforts to impart confidence and to stem the tide of adverse exchange by utilizing the gold corrective, that is by shipping gold to various centres. In July, 1931, over £30,000,000 of gold was released by the Bank for export. Then, on 23rd July, the Bank's rate of discount was raised from 2½ per cent to 3½ per cent, but without effect. On 30th July, 1931, a further increase in Bank Rate to 4½ per cent was made, and, shortly afterwards, an exchange credit of £50,000,000 was arranged with Paris and New York—£25,000,000 in each centre. Later, the British Government itself negotiated a credit for £80,000,000 with France and the United States of America, but all to no purpose. Gold continued to flow from the Bank of England, and by the third week of September, 1931, so heavy had the drain become, that the Bank's stock of the metal was reduced by £40,000,000. No nation could stand such demands and yet continue to maintain gold payments. Just how great was the strain will be realized when we say that in the two months, 20th July to 20th September, 1931, which was the acute period of the crisis, the grand total of the withdrawal of funds from England was £200,000,000.

During all this time anxious deliberations had been taking place between the Government and the Bank of England, but even when it became known on 19th and 20th September, 1931, that the British Treasury, the Bank of England and the principal bankers of London were in conference, the country, much less the world, was hardly prepared for the worst. Even so, those in the City of London, who had appreciated the extreme gravity of the situation, could not have been much surprised when they opened their morning papers on Monday, 21st September, 1931,

to find that the Government had decided to suspend Sect. 2 of the Gold Standard Act of 1925, which required the Bank of England to sell gold at the fixed price of 77s. 10½d. per standard ounce in bars of approximately 400 oz. troy of fine gold. Thus was the Gold Standard suspended in Great Britain, and, to make assurance doubly sure, the Bank of England raised its discount rate to 6 per cent.

These were stern measures, yet, as the Chairman of the Westminster Bank pointed out, criticism was made abroad that, by a bolder banking policy, and by the sterner use of the Bank Rate weapon, the pound sterling might have been saved, and the comments of the banker in question are to the point. He said—

I do not believe that such criticism has any validity. Indeed, it seems certain that to have raised the Bank Rate to an emergency figure would have been to make a useless and wholly ineffective gesture. A steep increase in the rate would have accentuated the nervousness already apparent among foreign creditors, whilst any fresh balances attracted would have been so precariously held as to serve no useful purpose. In my judgment, what has been called the "gold crisis" arises in a large measure from the fact that gold has been required to fulfil a purpose for which it was never designed. Gold is a token of exchange; it is an international counter, accepted by nations as a standard, through which variations in the quantity and value of goods and services passing from country to country can be adjusted. Gold should, therefore, be the instrument of commerce. It should not be regarded as a *commodity* of commerce; yet in these post-war years, nations have tended so to treat it. In effect, country A says to country B: "You owe me many millions; please pay, but I will not take payments in goods—indeed, I have erected tariff barriers on purpose to prevent your goods from coming into my country. I will not take your paper or your promises to pay, because I do not think they are good enough, so you must give me the only other means of payment which you have, namely, gold itself." Obviously, if this process were made to settle international war debts and reparations in gold, the stocks of the metal would be entirely insufficient for the purpose, and if there were gold in sufficient abundance, then I anticipate that gold itself would depreciate in value.

The Bank Rate, as we have said, was raised to 6 per cent on 21st September, 1931. It was maintained at that level

until 18th February, 1932, when easier monetary conditions and a more stable course of exchange with the principal monetary centres on London made it safe to reduce the rate to 5 per cent. Since then, with the betterment of the financial position of the country, further reductions were made, the alterations being—

- On 10th March, 1932, to 4 per cent.
- „ 17th March, 1932, to 3½ per cent.
- „ 21st April, 1932, to 3 per cent.
- „ 12th May, 1932, to 2½ per cent.
- „ 30th June, 1932, to 2 per cent.

The consequences of Great Britain's departure from the Gold Standard have, of course, been far-reaching. As indicative of how closely reliant were other nations on London, the international monetary centre of the world, we may just briefly say that country after country, after wandering in the wilderness of inquiry in an endeavour to surmount the effects of the world crisis, have had willy-nilly to follow Great Britain, and one after another they have suspended the Gold Standard. The return to the Gold Standard by Great Britain in 1925 was the signal for the principal countries of the world to do likewise, and one after another they gradually returned to something like the full Gold Standard. With the suspension of the Gold Standard by Great Britain in 1931, the pendulum swung the other way, and so great was the slough of despond into which world trade and finance had sunk that the departure from gold has been almost universal. In fact, it may be said that there are now only two countries truly on the Gold Standard—France and the United States of America.

It is, perhaps, a dismal comment on the workings of currency systems described so far in this book to say that our own monetary system is not now an entirely unmanaged one. From what we have said about the raising of credits, it will have been plain to the reader that the value of sterling with reference to the American dollar, and, to a less extent, the French franc, had been maintained to a great extent by deliberate action of the Bank of England,

through the utilization of the drawing powers arising from these credits. However, it is some satisfaction to note that the whole of the credits were promptly repaid to France and the United States. We may, therefore, conclude this inordinately long chapter by reference to an interesting innovation made by the British Government in its determination to keep the exchanges at a stable level. In his Budget Statement made on 19th April, 1932, the Chancellor of the Exchequer, Mr. Neville Chamberlain, made the momentous announcement that the Government were setting up an Exchange Equalization Account at the Bank of England. There had been in existence in connection with the credits we have mentioned earlier a dollar exchange reserve account. In that account there remained some £25,000,000, and this was taken as the nucleus of the new Exchange Equalization Account. Further powers were taken to borrow up to £150,000,000, as required, thus bringing the new fund to be utilized in support of sterling exchange up to £175,000,000.

The position that made this step necessary was, briefly, this. In the early part of 1932 the exchange position of Great Britain had been one of some difficulty. Mainly as the result of loss of confidence abroad, there had been large accumulations of liquid capital, and a subsequent flow of funds to this country. The effect of the transfer of this liquid capital to London exercised a disturbing effect upon the exchanges, particularly upon sterling exchange, which is no longer linked to gold. Since Great Britain had been so successful in repaying the credits which were raised abroad in 1931, and in balancing the national accounts, the tide of liquid capital had been setting very strongly towards our shores, and, in the absence of any steps to safeguard ourselves, it might have given rise to dangerous developments. No one could say with certainty that the ebb might not set in and money begin to flow the other way. The Government decided, then, that to avoid violent and perilous fluctuations in our currency, especially those due to speculative operations, and to enable Great Britain to

function effectively as the main international centre of the world, certain steps were necessary. It was considered essential for the country to hold adequate reserves of gold and foreign exchanges to enable it to meet any sudden withdrawal of short-dated capital and to check and repel speculative movements. The setting-up of the Exchange Equalization Account at the Bank of England was for this purpose.

In the first instance, no details were published of the assets to be held in this account; it was stated that they may comprise gold, sterling securities, or foreign exchange. There is no secret as to the primary use of the funds. Mr. Chamberlain made it clear that there is no intention to peg exchange, or to link sterling to the gold dollar at any particular level, yet there is no doubt that the assets will be used to keep the exchange value of sterling in due bounds with the gold monetary units of, say, France and America. For instance, on signs of any continued appreciation in exchange likely to react to the disadvantage of Great Britain, dollars would be purchased in sufficient quantity to bring down the rate. If the pound sterling depreciated too far, exchange operations would be conducted in the reverse direction; dollars or other exchange would be sold. The whole question is somewhat technical in character, but the student should realize that, by a careful handling of the opposing forces of demand and supply, an endeavour will be made to keep exchange at something approaching the point of equilibrium, until it becomes plain at what level stabilization can be effected; whether *de facto* or *de jure* need not be discussed. Let it suffice to say that, by means of the funds held, the Government, through its agent, the Bank of England, has an effective weapon with which to circumvent the activity of foreign speculators. It is now able to check any unwanted inflow of foreign capital, and, should occasion arise, can prevent the outflow of money from the country. In the absence of such a weapon, the well-being of the country

would be exposed to sudden exchange fluctuations, to which, in theory, there are no limits. With the Exchange Equalization Fund in existence, the Government has an effective defence against such dangers, and it will be an interesting study for readers of this book to follow the money articles in the daily press, and endeavour to see how the exchange value of the pound sterling is maintained until the great day comes when stabilization is attempted.

As a matter of fact, since the above lines were written, a very effective use has been made of the Exchange Equalization Fund. In the case of several of the European countries, the past few years have witnessed a flight from local currencies to sterling. To check a too sudden and extended rise in the value of sterling, the foreign currencies have been heavily purchased from time to time. More than once London, in fact, has been in danger of becoming too large a receptacle for the world's short term floating funds, so the Exchange Equalization Fund was utilized to preserve an equilibrium between a flight to the pound sterling and a flight from it.

The Exchange Equalization Fund has proved to be of great utility. It undoubtedly saved American dollars from a bad collapse in 1933, and since then has been used on many occasions to support the value of the franc, and so prevent too great a flow of unwanted short-term capital to the London market. In practice the fund has proved to be far more efficacious than exchange restrictions, and in view of the necessity for making the fullest possible use of the power it gives, the Government increased it in May, 1933, by £200,000,000 to £375,000,000.

Experience in the working of the Exchange Equalization Fund has proved that in the hands of the Government it is a very effective weapon against exchange speculators, and its importance has been demonstrated by the fact that several other nations have copied the example of Great Britain in setting up such funds.

On the 25th June, 1937, it was announced by the Chancellor of the Exchequer that the Fund was to be increased by a further £200,000,000 to £575,000,000, and the reason for the increase was dealt with at length when the resolution for this increase was moved in the House of Commons on 28th June.

Whilst emphasizing the need for secrecy with regard to the current operation of the Account, the conclusion was reached that there would be no harm in lifting the veil of secrecy by indicating at a date after the event the amount of gold and all other assets held by the account every six months, the information made public being three months in arrear. It is proposed henceforth to publish at the end of June and December the position at the end of the preceding March or the preceding September. In accordance with the proposal, it was stated that the gold held in the Exchange Account on 30th March, 1937, was 26,674,000 fine ounces and the amount held in the Issue Department of the Bank of England on the same date was 73,842,000 fine ounces, making a total of 100,516,000 fine ounces.

On 30th December, 1937, the British Treasury announced that the gold held in the account on 30th September, 1937, was 39,854,000 fine ounces, and that held in the Issue Department of the Bank of England was 76,843,000 fine ounces. The total amount was 116,697,000 fine ounces, which at £7 per ounce would represent in round figures, £815,000,000. If the gold held on 30th March, 1937, was taken at the same price its value would have been £703,612,000, so the increase between March and September, 1937, was £113,267,000.

CHAPTER XIII

EXCHANGE RESTRICTIONS AND CLEARING AGREEMENTS

FROM exchange equalization to exchange restriction is perhaps not a very wide jump. A short survey of the subject will not, therefore, be out of place at this stage of our inquiry.

Happily, exchange restrictions are unknown in the United Kingdom, though unfortunately they have of late years become the *bête noire* of those engaged in the oversea trade of the United Kingdom, who, on one hand, are constantly beset with difficulties in obtaining payment for their exports to foreign countries and, on the other, are often harassed in finding the wherewithal to make the required remittance in payment of foreign imports to this country.

The imposition of exchange restrictions is the outcome of a diversity of factors. Though usually ascribed to inability to procure the necessary amount of foreign exchange for the payment of external obligations, they arise in the first instance from fear for the exchange value of the currency in those countries, which, even eighteen years after the War, are still haunted by memories of uncontrolled inflation or by the apprehension of a flight of capital. Over-valuation of the currency, of which there have been so many examples in recent years, is frequently the cause of such fears, and though, as Mr. Runciman pointed out in a speech in the House of Commons on 15th July, 1936, in this country there are no such fears, in other countries they have been constantly present since 1931. It is more or less correct to say that such countries, having no currency that can be freely exported, are driven back upon kinds of barter trade of greater or less rigidity, but the extension of exchange restrictions is also due to

the endeavour of countries to protect themselves from other nations which have first instituted exchange restrictions, or, as one writer has said, to make sure that they are not left behind in the race.

Clearing agreements Mr. Runciman regards as the modern sophisticated form of barter, their object being to get over exchange restrictions or to secure a balance of payments. Presumably, he was recognizing the difference between exchange agreements and exchange clearing schemes, though he did not emphasize the fact; but it is a point of some importance to note that traders in the respective countries are not necessarily obliged to make use of an exchange agreement. When a clearing arrangement, however, is in force, importers and exporters in both countries are compelled to make use of it, whether they like it or not. Payments into the clearing account are made by importers on one hand, and it is on the clearing account that the exporter has to rely for payment on the other.

Whether or not clearing agreements are designed for circumventing exchange agreements and restrictions, the fact remains that most nations claim that their object is the development of trade with other countries, and that they go some way towards the achievement of this desire is probably true. Other clearing agreements are quite obviously negotiated for the purpose of securing payment of outstanding indebtedness. Behind all, however, there is a certain goal for which each of the interested nations is striving, though few will admit it, and that is to secure a favourable balance of payments, and thus, by artificial means, influence the foreign exchanges in their favour. Mr. Runciman clearly recognized that fact, for he stated the British Government believed that payments could only be made to balance by artificial means at a lower level of trade all round. This country, in self-defence, has been compelled to resort to clearings, or agreements in the nature of clearings, in the case of countries having exchange

restrictions where it was essential to secure the liquidation of outstanding commercial debts and to provide more hopeful conditions for modern trade.

The criticism economists have against clearing agreements and the like is that they tend to drive trade into unnatural and uneconomic channels, the idea being that a creditor country by becoming a party to a clearing agreement, ceases to buy in the best market. Instead it tends to buy where it hopes either to sell or to collect outstanding debts. Such criticism is clearly justifiable in many cases, but that Great Britain is not altogether influenced by these considerations is plain, and the President of the Board of Trade was at some pains to show that the British import market, which is by far the best in the world, has been kept open for the goods not of one nation but of all nations on fair and equal terms through these difficult years. He admitted that the control of the market for the purpose of buying from those who buy from us is a temptation to those who believe that clearings really provide the foundation for a system of balanced trade. Upon certain countries and for a certain period, he said, we can no doubt force a greater quantity of United Kingdom goods, but the British Government did not believe that such a policy of force would prosper for long. It would lead to the impoverishment of Great Britain's customers and of third parties in whose prosperity this country is interested, and eventually to a fall in our own oversea trade. The power of our great import market has been used, therefore, with great caution to promote the sales of our goods abroad rather than to compel artificially enhanced purchases.

CHAPTER XIV

HERE THE READER ENTERS THE REALM OF CONTROVERSY ENGENDERED BY SUCH ECONOMIC DOCTRINES AS THE QUANTITY THEORY OF MONEY, THE PURCHASING POWER PARITY, AND THE EVIL INFLUENCE EXERCISED BY PAPER MONEY ON THE FOREIGN EXCHANGES, AND THEN PASSES BY GENTLE STEPS TO A CONSIDERATION OF THE STABILIZATION OF THE PRINCIPAL CURRENCIES OF EUROPE AFTER THE GREAT WAR

THE reader with an argumentative turn of mind who has survived the rocks and shoals so far strewn over the course of the foreign exchanges, will probably find in this and the following pages something after his own heart. That he will discover material for debate we do not doubt ; but we dare even hope that he may be encouraged to think for himself, and so be led on to propound new theories with which to enliven the pages of future writers on currency and foreign exchanges.

The excuse, if excuse be needed, for introducing the problems underlying the quantity theory of money in this book is that it has yet to be disproved. True, there is no part of monetary science capable of so much misunderstanding, of so much controversy, or of so great difference of opinion ; yet, so important is the theory, that a study of it is well worth while.

In its simplest sense, the quantity theory affirms that the value of money varies inversely with its quantity, or, to put it in another way, an increase in the monetary circulation causes a corresponding rise in the price level of commodities.

In endeavouring to propound this theory to students and business men, the author has always considered it advisable to treat money as a commodity ; for money, as Marx says, is a " universal commodity." It is really this

that gives it its peculiarity and its important part in economics. Money, being a universal commodity, may be at any moment converted into any other concrete commodity. With a limited amount of money, whether of gold, silver, or paper, in circulation, its value will be correspondingly high—that is, its purchasing power will be extensive. With every increase in the quantity of money put into circulation its value will decline; it will be exchangeable for fewer other commodities. In the one case the price level of commodities will be low, in the other case high.

Money being a commodity, it will, in general, follow exactly the same laws as those governing other commodities, so perhaps a homely example may not be out of place.

In the early days of the War the humble potato was comparatively scarce, and the price of potatoes was high. Tom, Dick, and Harry were therefore encouraged to cultivate allotments, and everyone who could use a spade or turn a clod of earth grew potatoes. As a result, in due course the supply increased tremendously, and the value of potatoes fell proportionately.

The commodity, money, follows much the same course. At the commencement of the Great War there was in circulation a limited amount of money or money substitutes, the price of commodities was relatively stable, and variations were mainly influenced by the ordinary laws of supply and demand. The foreign exchanges, too, fluctuated within comparatively narrow limits, especially where the currency circulation, as in gold standard countries, was well managed.

The exigencies of war, as we shall presently see, changed all that, and not only did the principal countries concerned lose all sense of proportion in their attempts to meet the currency demands of their nationals, but all the preconceived economic principles were thrown by the board, and all such doctrines as the quantity theory were cast into oblivion.

Great, however, as were the war currency problems, it

has since become apparent that post-war problems have been even greater. The quantity theory was put to the test, and, on the whole, we can safely state that its truth has been amply demonstrated. The value of money *does* vary inversely with its quantity, though account has to be taken of certain other phenomena. For one thing, the exact ratio of the variation cannot be fixed definitely. What is called the "velocity" of circulation has to be considered. The monetary supply may or may not be turned over quickly, or, again, a certain proportion may be retained or hoarded by the populace, and this may to some extent obscure the working of the quantity theory. Examples of this were seen in most of the belligerent countries, and the United Kingdom was no exception to the rule, for on several occasions currency notes were hoarded. Then, as one writer (de Bordes)¹ has said, the connection between the monetary circulation and the price level was difficult to follow. As he showed, an increase in the quantity of money in actual circulation could, and did take place, without any perceptible influence on the average price of goods. Deposits in the hands of the banks, credit, amounts retained for payment of wages, the quantity of goods in circulation, all had to be taken into account, and investigations revealed the fact that the various elements interacted the one on the other. From a study of the various factors, it seems, therefore, that the quantity theory assumes the form that an increase in the average quantity of money in circulation will cause a corresponding increase in the average price of commodities, unless, as is probable, some modification takes place by the intervention of one or other of the factors we have enumerated. Limits of space do not permit of our examining the working of the theory in detail, though we may say that inquiries by economists have shown that it is impossible, with the available data, to arrive at any correct statistical proof of the working of the quantity theory. In a general way,

¹*The Austrian Crown*, J. van Waldré de Bordes, pp. 157 *et seq.*

however, the events of recent years have given eloquent testimony of the validity of the theory.

The purchasing power parity theory of exchange, however, is even a more contentious one, and, as Sir Henry Strakosch has said, the "violent deviations of the exchanges from their purchasing power parity in recent years clearly demonstrate that it is unsafe to regard the theory as anything more than a statement of a tendency."

The old economist, Ricardo, may be said to have discovered that there was a close connection between the price level of commodities and the foreign exchanges. But it was left for Professor G. Cassel, of Sweden, to develop it during the Great War, and he has written at length on the theory of the purchasing power parity.

We quote his own words—

"What is the principal reason for a currency being in demand, and what effect has an alteration in the intrinsic value of that currency upon the demand for the same? . . . Our willingness to pay a certain price for foreign money must ultimately and essentially be due to the fact that this money possesses a purchasing power as against commodities and services in that foreign country. On the other hand, when we offer so and so much of our own money, we are actually offering a purchasing power as against commodities and services in our own country. Our valuation of a foreign currency in terms of our own, therefore, mainly depends on the relative purchasing power of the two currencies in their respective countries."¹

The theory is of absorbing interest, though its practical application is somewhat difficult to follow. However, Professor Cassel's examples of its working are apposite of present-day conditions. He says—

"Given normal free trade between two countries, A and B, a certain exchange rate will establish itself between them, and apart from slight fluctuations, this

¹ *Principles of Political Economy*, pp. 151 *et seq.*

rate will remain unaltered so long as no variations take place in either of the currencies' purchasing power, and no obstacles are placed in the way of trade. Now, should an inflation of A's currency take place, and consequently its purchasing power be reduced, the value of A's currency in the country B will necessarily fall in like proportion. Should at the same time B's currency have undergone inflation and its purchasing power have been reduced, clearly the valuation of A's currency in B will, as a consequence, rise in a corresponding degree. If, for instance, the inflation in A has reached the ratio of 320 to 100 and the inflation in B the ratio of 240 to 100, the new exchange rate (taking the quotation of A's currency in B's currency) will be three-quarters of the old rate. Thus the following rule: When two currencies have undergone inflation, the normal rate of exchange will be equal to the old rate multiplied by the quotient of the degree of inflation in the one country and in the other. There will naturally always be found deviations from this new normal rate, and during the transition period these deviations may be expected to be fairly wide. But the rate that has been calculated by the above method must be regarded as the new parity between the currencies, the point of balance towards which, in spite of all temporary fluctuations, the exchange rates will always tend. This parity I call the purchasing power parity."¹

The formula for calculating the purchasing power parity is simple, and a single example will suffice.

Let England and Germany be the two countries under review. Given that the index number of England is at 68, and the index number of Germany at, say, 142, and the mint par of exchange between England and Germany 20·43 reichmarks to the £1, then the theoretical purchasing parity of the reichsmark would be

$$\frac{142 \times 20\cdot43}{68} = 42\cdot66$$

¹ *Money and Exchange after 1914*, Gustav Cassel, p. 138.

The purchasing power parity is an ingenious theory, but in practice it does not work out quite so simply as might be inferred. For one thing, it pre-supposes free commercial intercourse between nations, and, as the reader may imagine, any interference with the free passage of goods and commodities, the imposition of tariffs and customs dues, or a lag in demand and supply, will impede the true working of the purchasing power parity. Then, as is well known, hardly any two countries have the same method or basis for calculating their index numbers for commodities, and this renders it difficult of application. Speculation in foreign exchange, again, has been proved to upset the working of the theory, and the foreign exchange market may be so completely dominated by this speculation and subsequent movements of capital, that the rates of exchange will tend to move altogether independently from the purchasing power parity, i.e. from the price levels.

The writer to whom we have previously referred has proved by reference to the Austrian crown during the war period and after, that, while there does exist a tendency for the rate of exchange and the purchasing power parity to coincide, in cases of deviation between the two factors, sometimes the one and sometimes the other will prove the stronger.¹

We have said that the purchasing power parity has been termed a statement of a tendency. Sir Henry Strakosch goes even further; he traces the influence of the human element, to wit, the almost overpowering attraction of the cheapest market. Therefore we cannot do better than quote his words. He says—

“ The purchasing power parity should be looked upon merely as the centre of gravity towards which exchanges

¹ Cf. *The Austrian Crown*, J. van Waldré de Bordes.

For examples of the working of the purchasing power parity in its theoretical and practical aspects, the reader is referred to the special article on the theory in “*A Dictionary of the World's Currencies and Foreign Exchanges*,” by W. F. Spalding—London, Sir Isaac Pitman & Sons, Ltd.

tend to move because of the ever present desire of people to buy in the cheapest market. It is around this centre of gravity that the exchanges oscillate. In conditions of monetary and economic disequilibrium and of the many hindrances to international trade, such as have prevailed in many countries since the War, the forces causing these deviations are often far more powerful than the forces tending to drive the exchanges to the centre of gravity."¹

Now let us turn to an examination of some of the effects of an unchecked issue of paper money.

Paper currency is one of those necessary evils which have been handed down to us from our forefathers. Its origin seems to be wrapped in obscurity, but there have been plenty of writers other than economists who have viewed with singular foresight and misgiving the whole-hearted way in which impecunious States have adopted it. For instance, in the drama of *Faust*, said to have been written about the end of the sixteenth century, the author makes the Devil the inventor of paper money. It is but a satire, yet perfectly applicable, but if Mephistopheles had stopped with the invention of paper money, his work would have been only half done! In the light of the experience of the past few years, the reader may be inclined to agree that, in the centres in which the printing press had taken the place of the Mint, and depreciated currency had in consequence become common, the supreme spirit of evil seemed to have gone a step further, and had taken possession of the minds of those entrusted with the administration of public financial affairs.

We refer to the overwhelming issues of inconvertible notes, and, what comes to practically the same thing, the over-issue of notes without the necessary metallic reserves—all are, in reality, forced issues.

The effect of such issues, or, indeed, of any emission of paper currency, is to drive gold out of circulation, but the

¹ Cf. Foreword to *The Austrian Crown*, by Henry Strakosch.

currency of the country does not depreciate, or, to put it another way, prices of commodities do not begin to rise, until the paper exceeds the actual quantity of the metallic currency which has been superseded. When we get to that stage, prices, generally speaking, tend to rise in proportion to the increased issues, so that in course of time more money, in terms of the paper currency, will have to be given for the same articles which were previously purchaseable for a less sum of the metallic currency; which is equivalent to saying that the currency of a country has depreciated. It is here we see the application of the quantity theory, for the rise in the price level of commodities demonstrates that the value of money has varied inversely with the quantity. Curiously enough in the early stages of this depreciation, this does not affect a country's foreign trade, for importers will still import foreign products, and although the creditor in the foreign centre will get no higher price for the goods, yet the importer will have to part with more of his notes to cover the premium upon the gold necessary for the remittance. Exports also will command just the same price in the foreign country as they did before prices rose in the exporting country. Thus, if in a country with a depreciated paper currency the price of an article had risen from £1 to £1 10s., and that article was exported to a foreign centre, it would still be worth only £1, and yet exports would continue, for the reason that in the foreign country the currency not having depreciated, the exporter will receive payment in gold or silver as the case may be. The metal can then be brought to the country with the depreciated paper and exchanged for notes to cover the price and the extent of the premium—10 shillings—for bullion will have risen in the same proportion as other commodities. It is therefore plain that gold, assuming it to be a gold standard country, is at a premium.

Although at first the depreciation of the currency does not affect the foreign trade of the country, it does affect

the foreign exchanges. To explain this action, we may take the exchange between two countries, one with a full metallic currency, and the other with a depreciated paper currency. Suppose Germany to be the latter country ; exchange on London would rise in proportion to the premium on gold in Germany, if the premium were 2 per cent., and the exchange M. 20.40 to £1 ; then a bill of exchange drawn in Berlin on London will be worth more than M. 20.40, since it is payable in gold in Great Britain : the bill of exchange will cost the German remitter M. 20.40, plus the premium on gold, 2 per cent., equal to M. 20.80 to £1, meaning that the person who has to purchase sterling will have to surrender a greater amount of the native currency than he would if that currency were not depreciated. It follows that the rate of exchange is always against that country which maintains a depreciated currency.

Several European nations, Italy, for example, had experienced considerable trouble with paper currency before the Great War, and practically all the States of South and Central America had been in the throes of a depreciated currency arising from the over-issue of inconvertible notes. Their troubles, however, were but as dust in the balance as compared with the dire results of paper money issues during and after the Great War of 1914-1918.

Paper Money and the War.

This history of paper money during the period in question is both interesting and instructive. There were vast emissions of notes, not only by the belligerent nations but by others, and it is almost axiomatic that where, owing to the increasing financial embarrassment, nations are compelled to have recourse to the creation of a forced paper currency, and that currency is not convertible into gold, it is sure to suffer considerable depreciation.

The effect on the foreign exchanges of the depreciated notes is easily perceived. The exchanges are already adversely affected by the interference with the foreign

trade, and the advent of the inconvertible paper is merely a further disturbing influence. It accentuates the evils which already exist and its effect is that foreign creditors must either expressly stipulate for the settlement of their claims in gold, or, if payment be accepted in the depreciated medium, to avoid loss, traders must safeguard themselves by a proportionate rise in the exchange.

The full story of the continual watering of the currency and its adverse effects is told in many books that have since been written, each dealing with the disastrous experiences of those countries that were too far sunk in the slough of despond to place a check on the output of paper notes. To the patient student who is interested enough to peruse them, they afford convincing proof of the correctness of the quantity theory of money.

It will be of interest to record the final results of unchecked issues of notes in three countries: Russia, Austria, and Germany.

Before the War the State Bank of Russia had the right to issue notes unbacked by gold to a limit of 300 million roubles, and any additional emission had to be covered by gold, rouble for rouble. Only in exceptional circumstances, however, did the State Bank make use of its power to issue notes unbacked by gold. The gold position of Russia was always a strong one. On 1st January, 1914, for instance, bank notes were secured by gold to the extent of 92 per cent. and on 16th July, 1914, the eve of the declaration of war, the gold backing to the notes was 92.2 per cent. There were, in fact, 1,604 million roubles of gold in the State Bank of Russia, against a circulation of 1,633 million roubles of notes.¹

Following on the declaration of war, however, the convertibility of the notes into gold was suspended, and the State Bank was given power to issue 1.2 milliard roubles of notes, without the obligation to cover them with a

¹ Cf. *Russian Currency and Banking, 1914-1924*, S. S. Katzenellenbaum, p. 7.—London, P. S. King & Son, Ltd.

reserve of gold. This was in addition to the 300 million roubles which the bank had the right to issue without a gold backing, so by the law of 27th July, 1914, the note issue not covered by a metallic reserve was increased to $1\frac{1}{2}$ milliard roubles. Once she had embarked on the course of issuing inconvertible notes, Russia's descent to financing the war, and afterwards finding State revenue, by forced paper issues was rapid. Conditions became worse under the Soviet regime, and by the end of October, 1918, the uncovered note issue of the State Bank had increased to 50 milliard roubles. In May, 1924, it is estimated that there were in circulation in Russia notes to the value of 740,236 millions, though it is probable that this total did not include many of the monetary tokens which appeared in the country from all directions. Some idea of the growth of the paper issues is given by a Russian writer, who shows that, whereas in 1914 the notes were increased by 1,317 million roubles, in 1923 the augmentation of the issues was 176,505,500,000 million roubles.

Needless to say, with the increase of the circulation of paper notes the value of the rouble depreciated remorselessly and the price of commodities rose to unprecedented levels. From 1914 to 1922 it is recorded that the index of prices of commodities for the whole of Russia increased by 7196·9 per cent. Prices, in fact, in course of time even outstripped the rate of increase of the note issue, and the depreciation was seen to become much faster than the advocates of the quantity theory had ever thought possible.

With the fall in the internal value of the rouble, rates of exchange with Russia, or the external value of the currency, quickly followed. In September, 1914, the rate on London was 122·5 roubles for £10, three years later it had fallen to 322·5. The next year the rate had again depreciated to about 650 roubles for £10, and by mid-summer, 1920, 10,000,000 roubles were exchanged for £10. Depreciation continued apace, until roubles were practically worthless, for in October, 1923, the quotation in Moscow

was 5,040,000,000 roubles to the £1. Finally, after getting back to a state of direct barter, a new currency system had to be established in Russia, and by stages something like an ordered monetary standard was built up.

The first step of importance was taken by the Soviet State Bank which, by a Decree in October, 1922, was authorized to issue notes in terms of a new currency called "Chervontsi." The decree laid down that 1 chervonetz should be the equivalent of 10 roubles of the former gold currency. Then, according to an order issued by the People's Commissariat for Finance, from 1st July, 1924, 10 roubles were announced as being equal to 1 chervonetz and 100 copecks to 1 rouble, while in official calculations 9·47 roubles were to be taken as the equivalent of £1 sterling.

By December, 1935, operations were taking place on the basis of 1 chervonetz = 30 francs.

On 1st March, 1936, a decree was again issued, under which the gold rouble of the Czarist currency was abolished, and in its place a new gold rouble, based on the French franc, at the rate of 3 francs = 1 rouble, or 24·89 roubles to the £1 sterling, was substituted. On 28th October, 1936, following a devaluation of the French franc, it was announced that currency transactions in the U.S.S.R. were in future to be conducted at the rate of 1 rouble to 4½ French francs.

In October, 1937, the exchange quotation in London was about 26·24 roubles to £1.

The history of Austria's currency ills is somewhat similar, though only the briefest account of it can be given here.

Prior to the Great War, Austria's monetary unit, the krone, had been maintained at a satisfactory level with the currencies of gold standard countries. The system in vogue was the gold exchange standard. Only a small amount of gold was in circulation, the principal medium of exchange being the notes of the Austro-Hungarian Bank. In January, 1913, the bank-note circulation stood at

2,644 million kronen, the average for the year being, approximately, 2,300 million kronen, to which must be added 250 million kronen for the gold, silver, and subsidiary copper coins in circulation, the total monetary circulation thus being around 2,500 million kronen. By the end of 1914 the bank-note circulation of the Austro-Hungarian empire had grown to 4,970 millions, and as the krone continued to depreciate, the whole of the metallic coins disappeared from circulation. Subsequent years revealed a stupendous increase in the notes in circulation. By the end of 1916, the total was around 10,782 millions, and still the pace continued unchecked until, in December, 1918, the bank-note issue had reached 34,889 million kronen.

The Austro-Hungarian Bank was liquidated on 11th September, 1919. At that date the note circulation of the bank was 44,464 million kronen, while the note circulation of the new Austrian Republic was 9,383 million kronen. By the end of 1923 the total circulation of the Austrian Republic had grown to 7,125,755 million kronen, and at that period the index number of the wholesale prices for food alone had risen to 16,216.

With the internal depreciation of the krone, following the wholesale printing and emission of paper notes, it is not surprising to find the external value depreciating in an unprecedented degree. The American dollar quotation in Vienna in July, 1914, was 4.9535, by the end of 1918 the rate was 16.160, and by December, 1922, a quotation of 70.025 was recorded. From July to December, 1923, the rate was 70,760.

Dr. Richard Reisch, a former Austrian Minister of Finance, records that on 1st September, 1919, 1,000,000 Austrian crowns were equal to \$24,000 U.S. dollars; on 1st September, 1920, their value was \$4,167; 1st September, 1921, \$908; while by 31st December, 1922, the equivalent of 1,000,000 Austrian crowns had declined to 14 American dollars. He estimated further that the notes outstanding rose from 31,000,000,000 crowns on 31st

December, 1920, to 174,000,000,000 crowns on 31st December, 1921, and to 4,080,000,000,000 crowns on 31st December, 1922, the purchasing power of the crown and exchange rates moving correspondingly—the correlation being sufficiently high to satisfy even radical exponents of the quantity theory.¹

Finally, the flight from the Austrian crown was so great and continuous that the Republic, in effect, was on a dollar exchange standard, and it was left to the League of Nations Committee to reorganize the finances of the Republic, and to work out for it a stable system of currency and finance. This was chiefly achieved by the granting of large credits by Great Britain and other Powers, and eventually the way was paved for Austria to introduce, in December, 1923, a new monetary unit, the silver schilling (divided into 100 groschen), with a monetary value of 10,000 paper crowns. The intention was to adopt the silver schilling as a temporary expedient, but as in practice it proved to be a popular and useful unit, in December, 1924, the schilling definitely took the place of the old crown, and under the new law, the gold schilling is provided for with a fine gold content of 0.21172086 gramme.

Germany's inflation of her currency by the over-issue of inconvertible notes was amazing, and, just as in the case of Austria, the "flight" from the mark was pronounced.

Prior to the Great War the gold standard was in full operation in Germany, and the gold mark was the unit of currency. The note issue of the Empire in August, 1914, was computed to be approximately M. 2,000,000,000, but as the War progressed, inflation of the currency by the issue of inconvertible notes was probably even more pronounced than in any other country in the world. By December, 1914, notes in circulation totalled 5,046,000,000 marks, and at the end of 1918 the total had reached

¹ European Currency and Finance Commission of Gold and Silver Inquiry, United States Senate.

22,188,000,000 marks ; while issues of Treasury notes grew similarly, the total in December, 1918, being 10,465,600,000 marks. The figures of the Reichbank's note circulation by 15th November, 1923, are almost incomprehensible, the total circulation being 92,844,721,000,000,000,000 marks. Commodity prices rose enormously, and by October, 1923, the wholesale price index number had reached the high level of 709,483,656,000, or, to quote from the Report of the United States Commission on European Currency, something worth 1 mark in 1913 cost a decade later, 5,095,000,000 marks.

Subsequent developments are summarized at the end of this chapter; here we need only say that in 1919, the Government had to face the fact that devaluation must be undertaken, and finally, after various devices had been tried, the annihilation of the value of the paper mark was completed by the establishment of the Renten Mark. In October, 1923, a decree was passed which had for effect the establishment of the Rentenbank, with power to issue notes on the security of the whole of German production, industry, and trade. The paper mark was devalued to one-trillionth of its pre-war value (1 Renten mark = 1,000,000,000,000). Ultimately, as we shall see presently, a return to the gold standard was possible in August, 1924.

Rates of exchange during the inflationary period reached unprecedented levels ; the flight from the mark continued at such a pace that quotations in marks to the £1 and to the U.S. dollar moved up by leaps and bounds. From 10,000 marks to the £1, the rate moved up and up. On one day in May, 1923, quotations were around 300,000 marks to the £1 and 60,000 to the U.S. dollar, and finally, so fantastic had rates of exchange become, that even German nationals turned from the mark currency in despair, until finally the principal money used in commerce comprised foreign bank notes, and until the Government took definite steps, in 1923, to reform the currency, foreign bank notes took the place of other domestic money as instruments of payment.

We have written at length in order that the reader may appreciate the pass to which some of the great nations of the world were reduced by resorting to paper money. At first sight it may seem that we have laid too great stress on the evils of inconvertible paper issues, but to the student who has patience enough to pursue the investigation of the results, of which we have but touched the fringe, we may say that he has an absorbing study before him. No period in the world's monetary and economic history has provided such a wealth of material for his edification. Let us hope that nations have learnt the lesson and that future generations may be saved from similar tribulations.

Stabilization of Currencies.

Having examined the debacle in the exchanges arising out of the Great War, a short description of how the principal countries resurrected their currencies from the slough of despond into which they had sunk will be of interest.

First, let us be clear about the meaning of stabilization. Stabilization indicates the act of fixing the exchange value of a country's currency at a particular level and keeping it there. Some countries have achieved their object by throwing overboard the pre-war monetary standard and adopting a new monetary unit altogether. Others have re-valued their currency by fixing it at a discount with reference to the gold monetary units of Great Britain and the United States. This method of stabilizing currencies at a fixed discount was the one generally recommended by the currency experts, and principally adopted by European countries. There is no part of monetary economics on which there is more difference of opinion than the stabilization of currencies; but we need not spend time on the examination of diverse views. It will suffice to say that the statement on the subject made by one of the delegates to the Genoa Conference clearly established the fact that before the trade of the world can be fully restored there must be

established a general convertibility of currency into gold or its equivalent—convertibility of liquid assets lodged in the banks of a country maintaining a free gold market, and this involves revaluation of the currency. What matters, it is held, is stabilization at a figure that can be maintained.

In most countries, the condition precedent to real stabilization is what is termed *de facto* stabilization. *De facto* stabilization should arise from the free play of economic forces. A level at which it is expected the exchange value of the currency can be maintained naturally is agreed upon, and then a period of trial or testing at the new level is entered upon, during which time the movements in exchange, above and below the new parity with gold countries whose monetary units are stable, is carefully watched. In achieving the desired object, resort is sometimes had to something approaching Government maintenance or manipulation of exchange, which by degrees is withdrawn. However, if after a more or less protracted waiting period, it is found that exchange has found its equilibrium without undue interference or support from Government, *de jure* stabilization takes place. That is to say, the exchange value of the new monetary unit is fixed by law, and, for better or worse, every endeavour is made to keep it at the legal ratio.

With these preliminary observations, let us see how the principal countries have achieved stability.

FRANCE. French currency reached its lowest point of exchange value on 21st July, 1926, when the quotation was 244 francs to £1. We need not here dilate on the vicissitudes of French exchange; suffice it to say that the advent of the Poincaré Ministry in the autumn of 1926 coincided with a change for the better in the monetary situation of France, and the country emerged from its troubles to enter upon a period of *de facto* stabilization. To accomplish stability, the French Government adopted extra taxation and curtailed expenditure. The floating

debt was also slowly but steadily curtailed. Then, the Bank of France exercised a close control over exchange operations, and assisted in the maintenance of the exchange value of the franc by the use of its accumulated credits in foreign centres; these amounted to about £200,000,000. The Bank also built up in readiness for *de jure* stabilization large reserves of its own. From the commencement of 1927, exchange between Paris and London had been maintained at around 124 francs to £1, and it was this rate which was used as a basis for devaluation of the currency. Finally, on 25th June, 1928, the French Stabilization Act was brought into effect. It fixed the new monetary unit, the franc, at 65.5 milligrams of gold, 900 thousandths fine. This gave the franc a content of .05895 gramme of fine gold, and the parity with London was equivalent to 124.2134 francs to £1.

France adhered to this parity until the end of September, 1936, when the exchange value of the franc had again depreciated heavily. After a vain endeavour to maintain the exchange value of the franc at about 75 to £1, the Government was forced to announce on 26th September, 1936, that provisional devaluation would again take place; and on 1st October, 1936, the French Devaluation Bill was passed. The gold value of the franc was fixed provisionally between the limits of 43 and 49 milligrams of gold, 0.900 fine, as compared with its former gold value of 65.5 milligrams. Provision was also made for an Exchange Equalization Fund of 10,000,000,000 francs. Following this devaluation, the rate of exchange between London and Paris opened on 2nd October, 1936, at 103½ francs to the £1, the quotation later moving to about 105.

Mainly as a result of this devaluation, an important step was taken. A monetary agreement was entered into between the Governments of Great Britain, the United States of America, and France, under which the three Governments undertook to use their appropriate available resources to avoid, as far as possible, any disturbance of the

basis of international exchange resulting from the French devaluation. Other European Governments (Belgium, Switzerland, and Holland) subsequently announced their adherence to the principles of this Tripartite Agreement.

One of the principal objectives of this Tripartite Agreement was to permit of the orderly devaluation of the franc from about 75 francs to about 105 francs to the pound sterling. All in vain, however; barely nine months afterwards, the exchange broke down again, and provisional devaluation again had to be faced. Under a decree of 30th June, 1937, the limits established by the Law of 1st October, 1936, were suppressed, and the new gold content of the franc, it was announced, will be fixed at some future date by Government decree. Whether the franc has yet reached its proper level in exchange, it is impossible to say. What the French were aiming at was apparently a rate of about 127 francs to £1, but exchange has since been back to 150, and it remains to be seen at what rate *de jure* stabilization will be effected.

AUSTRIA. The steps taken to achieve stabilization in Austria are too long to recount here, more especially as the financial position is still far from good. Just briefly, however, it may be said that on 20th December, 1924, a new Federal Law was passed with a view to the stabilization of currency and exchange. As we have seen, an entirely new unit of currency was adopted, called the gold schilling, enacted to contain 0.21172086 gramme fine gold. The parity with London of this basis is 34.585 schillings to £1, and with New York 1 schilling equals 14.07 American gold cents. When the alteration from the krone unit to the schilling was made, exchange between London and Vienna was quoted at 339,000 kronen to £1. The schilling is divided into 100 groschen, and 10,000 of the old kronen were taken as the equivalent of one schilling.

GERMANY. By force of circumstances, Germany had to recognize the complete annihilation of the value of the paper mark, and, here again, we must be brief. On 15th October,

1923, a definite commencement was made by a decree which set up a Rentenbank to issue notes, called Renten Marks. These were issued on the security of the whole of German production, industry, and trade. By the Renten-mark decree, as we have seen, the old paper marks were devalued to one-trillionth of the pre-war value (1 Renten Mark = 1,000,000,000,000 paper marks). The real security for Renten Marks took the form of first mortgages in gold marks on the whole of German landed property, and gold obligations with first priority on industry, trade, and the banks. The establishment of the Rentenbank was but a step in the stabilization of the currency, yet gradually the ship of commerce began to shape a better course. On 19th March, 1924, a gold discount bank was established by law, and its function was the provision of foreign exchange for German business. Then came the Currency Law of 30th August, 1924, which came into force on 11th October, 1924. This law was in accordance with the provisions of the Dawes Reparations Plan, and it signalized what was, in effect, *de jure* stabilization. The law provided for the withdrawal gradually of all the old notes, as well as the Renten-mark notes, and it definitely gave German currency a gold basis, with the Reichsmark, equivalent to $\frac{1}{100}$ kilogramme of fine gold, as the monetary unit. The Reichsmark is equal to 100 reichspfennig. The parity with London is Reichsmarks 20.429 to £1, and with New York, 100 Reichsmarks equal \$40.33.

BELGIUM. In October, 1925, Belgium attempted *de facto* stabilization at 107 francs to £1, but the plan proved to be abortive, and by July, 1926, exchange with London had fallen to 232 francs to £1. However, a fresh start was made, and assistance was derived from the issue of a large international loan for the equivalent of \$100,000,000. Credits were also arranged by the principal central banks of the world, and on 25th October, 1926, Belgium was enabled definitely to abandon her old monetary unit. After an interval of 14 years she re-linked her currency to gold

by making all notes of the National Bank payable in gold or its equivalent, and adopted a new monetary unit, the Belga, equal to 5 paper francs. The new parity with London was fixed at 35 belgas to £1, and the belga was ordained to contain 0.209211 gramme of fine gold. It should be noted that the franc currency is retained for internal circulation, and 35 belgas are the equivalent of 175 francs. On 31st March, 1935, still further devaluation was announced. The National Bank was relieved of its obligation to redeem its notes in gold as laid down in the Stabilization Law of 25th Oct., 1926. The Decree of 1st April, 1935, laid down that one belga should be the equivalent of 0.150632 gramme of fine gold, and on this basis, 48.611 belgas equal one sovereign.

ITALY. In July, 1926, when a number of European countries were attempting stabilization, the Italian lire had fallen to the low level of 144.91 to £1, and a good deal of trouble followed before the country was ripe for a change. However, by adopting various measures for the improvement of trade and production, and by the conservation of the finances of the country, a gradual appreciation in the value of the lira was achieved. By June, 1927, a rate of 84 lire to £1 was reached, and exchange was kept fairly steady throughout the year at from 89 to 90 to £1. A period of *de facto* stabilization had been entered upon. The next step was to effect *de jure* stabilization, and with this end in view, on 17th December, 1927, negotiations were completed with the Bank of England and the Federal Reserve Bank of New York, as the result of which large credits were opened to assist Italy. Fourteen central banks of the world participated in these credits, and, in addition, a further credit was arranged with eight English banks and an American institution for use should occasion arise. Stabilization *de jure* was accomplished on 21st December, 1927, when, by Royal Decree, the new parity of the lira was fixed at 92.46 to £1, and at 19 to one United States gold dollar. The lira was ordained to contain 0.07919 gramme of fine gold, or 7.919 grammes to 100 lire.

Following the devaluation of the French franc, the Italian Government announced a further devaluation of the lira on 5th October, 1936. The new basis is 4.677 grammes of fine gold for 100 lire, as compared with the previous gold content of 7.919 grammes, equivalent to a devaluation of about 40 per cent. Power is also reserved to depreciate the lira, if required, by a further 10 per cent. By this step, the lira was made equivalent to about 90 to the £1.

Earlier in this book, reference was made to the U.S.A. devaluing the gold dollar by reducing its gold content to 59.06 per cent of its former weight. That was on 1st February, 1934, and it, of course, changed the relation of the exchange value of the lira to the dollar. The interesting point is that by Italy's latest devaluation she has now intentionally brought back the equivalence of her monetary unit to the U.S. dollar to the same level as it was in 1927. The former relation between the lira and the dollar has been thus re-established.

France's devaluation in October, 1936, brought to an end what was known as the "Gold Bloc," a group of countries in Europe that had in common with France continued to adhere to gold.

On 26th September, 1936, Switzerland announced that the gold content of the Swiss franc would be reduced to between 190 and 215 milligrams of fine gold, as compared with its former fixed gold content of 290.3225 milligrams of fine gold. This represented a devaluation of between 25.94 per cent and 34.5 per cent. Provisionally a depreciation of 30 per cent was adopted. The rate of exchange on 1st October, 1936, was 21.42½ francs to £1. No further alteration was made when France again devalued in 1937, and at the end of October, 1937, the rate was around 21.46.

The monetary unit of Holland is the florin or guilder (gulden), representing a fine gold content of 0.6048 gramme of fine gold. Following the devaluation of the French

franc on 26th September, 1936, Holland placed an embargo on the export of gold. On 30th September, 1936, one Bill was passed by the Dutch Chambers providing for the prohibition of the export of gold, and another for the establishment of an Exchange Equalization Fund of Fl. 300,000,000. It will be observed that no alteration in the gold bullion content of the florin was made, but what Holland did was to institute a managed system of currency. Based on the rate of exchange ruling prior to this alteration, the Dutch monetary unit was, in effect, depreciated by about 15 to 20 per cent. The rate of exchange on 1st October, 1936, was Fl. 9.08 to £1, but by the end of October, 1937, exchange with Amsterdam was approximately 8.98 florins to £1.

The effects of the French devaluation of 1936 were far reaching, and other countries farther afield found it expedient to bring the exchange value of their monetary units somewhat in line with the changed conditions.

Greece, for instance, on 28th September, 1936, announced that she had decided to base the exchange value of the drachma on the pound sterling. The buying price was, in fact, fixed by the Governor of the Bank of Greece within the limits of 540 and 550 drachma to £1, and it has been kept near to those limits since. The price of other currencies, it was stated, would be fixed on the basis of their parity to sterling on the London exchange.

Latvia also on 26th September, 1936, announced that its currency would be devalued and attached to the pound sterling, instead of being linked with the French franc as formerly. Immediately prior to this step, the rate in London was 15.50 lats to £1, the new rate was 25.22 lats to £1. At the end of October, 1937, the rate was $24\frac{1}{2}$ to $25\frac{1}{2}$.

Then Turkey on 28th September, 1936, made an alteration, the Turkish Government announcing that it had adopted the pound sterling as the basis for its currency instead of the French franc. It was stated further that

the rate would be £T. 6.35 to £T. 6.38 to £1. This compared with a rate of £T. 6.34 quoted on 25th September, 1936. The rate at the end of October, 1937, was £T. 6.21.¹

Czechoslovakia in turn announced on 4th October, 1936, its decision to devalue the crown. The gold content of the crown was accordingly fixed at between the limits of 31.21 milligrams and 33.21 milligrams of gold, as compared with a previous gold content of 37.15 milligrams of fine gold. In effect the measure of devaluation was between 10.6 and 15.98 per cent.

¹ Note £T. means Turkish pounds.

CHAPTER XV

EASTERN EXCHANGES—THE GOLD EXCHANGE STANDARD AS IN OPERATION IN INDIA AND OTHER SILVER-USING COUNTRIES—EXCHANGE REMITTANCES BY MEANS OF INDIA COUNCIL BILLS AND TELEGRAPHIC TRANSFERS—VARIATIONS IN THE EXCHANGE VALUE OF THE RUPEE—THE ADOPTION BY INDIA OF THE GOLD BULLION STANDARD—INDIA'S POSITION FOLLOWING GREAT BRITAIN'S DEPARTURE FROM THE GOLD STANDARD—INDIA'S GOLD EXPORTS

FOR reasons which will manifest themselves to the reader who has survived the difficulties of the European exchanges, and has the temerity to enter upon the study of what are known as the "Silver Exchanges," we propose to devote this chapter to a study of the gold exchange standard, leaving the fuller discussion of exchange with those countries in the Far East whose currency is purely silver, to be dealt with in the next chapter.

Silver Exchanges.

The uncertain factor with which all concerned in Eastern commerce until comparatively recently have had to deal was the gold price of silver. Wherever there is this fluctuating silver medium of exchange, foreign trade becomes invested with a speculative element far beyond the ordinary chances and changes of the markets: besides the usual risks of trade, account had to be taken of the risks in exchange caused by the movements in the quotations for silver, and in consequence business operations became converted into gambling transactions, wherein neither expert opinion could guide nor caution protect the shippers. On the one hand, there were the exporters to such countries who found difficulty in calculating the exact amount which would be realized by the sale of their consignments of goods; on

the other, there were the importing merchants of the silver-using countries, who were rarely able to estimate the cost in their local currencies of the remittances in gold or its equivalent which they were called upon to make in settlement of purchases made from gold standard countries. The greatest uncertainty prevailed among both sections of the community, for every movement in the price of silver was at once reflected in the exchange between the silver-using countries and those on the gold standard.

That is why silver has come to be regarded as a depreciated metal unduly subject to sentimental influences of all kinds, and as its price fell from 60½d. in 1872 to about 26½d. in 1914, and then, during the war, rose to 89½d. per oz., only to fall again to 19½d. per oz. in 1936, there was good reason for the dis-esteem in which silver was held as a monetary standard. As we shall see later, silver seems likely to be abandoned as a monetary standard. For the moment let us turn to India, with which country there have been many interesting currency and exchange experiments.

India and the Silver Problem.

The adverse effects upon the trade and commerce of the Indian Empire as the result of the continued fall in the gold value of the rupee, due to the variations in the price of silver, led the Government to consider by what means the evil could be obviated, and much trouble was taken with a view to the establishment of a stable rate of exchange. In brief, the plan the Indian authorities followed was what amounts in principle to a contraction of the existing currency: they closed their mints to the free coinage of silver, and, in 1893, after a somewhat heavy coinage of rupees, the Government ceased to add rupees to the circulation, with the natural consequence that as soon as circumstances led to an increased demand for the coin, the exchange value of the rupee began to rise, and in the

course of a few years it became profitable for those who had remittances to make to India to take advantage of a standing offer made by the Government of India to give rupees at the Calcutta or Bombay mints, or to issue notes at the paper currency offices, in exchange for gold at a rate of exchange equivalent to 15 rupees for £1 sterling. Once the exchange value of the rupee had reached 1s. 4d., the Government's aim was to maintain it at that level with slight variations similar to those seen in the currency between gold-using countries, and after many lengthy and solemn deliberations in Commission, the authorities seemed to have eliminated the disturbing factors in relation to the exchange between London and their own country by the adoption of a standard of currency closely akin to the gold standard.

The system adopted for India was one which has been termed the half-way house in the matter of currency. That is to say the country had a sort of one-sided convertibility in its own favour. The system, however, which, with minor alterations and improvements, continued in operation in India some twenty years, is better and more correctly described as the "Gold Exchange Standard." This standard for many years worked more or less satisfactorily in quite a number of countries. Up to August, 1914, in actual practice the currency systems of Russia, Austria, Hungary, the Philippines, Japan, and Holland all resembled India's system. The fearful pass to which the war brought Austria, Hungary, and Russia, led those countries to abandon all pretence at maintaining metallic standards of currency. As we have seen, their currency degenerated into a mass of inconvertible notes. But with regard to those countries in which the gold exchange standard is still operating, it may be said that if they conform strictly to the standard, the preponderant medium of exchange may be notes or token silver coins, and these, being permanently established, are kept near a fixed par in relation to gold by Government control of the foreign exchanges. With the gold exchange

standard, it is not really necessary for gold to be in circulation in the country at all, but what the Government must have is the power and ability to sell foreign exchange at a fixed price, and this necessitates their maintaining a reserve in gold, or, what comes to much the same thing, being in possession of foreign exchange resources readily convertible into gold. The silver currency received from the sale of exchange is retained by the Government, and the effect of its being kept out of circulation is the same as that produced by exporting gold. The export of gold turns the exchange in favour of the country exporting, and if the silver-using country is able to supply and maintain the price of bills of exchange with a gold standard country, this will serve the same purpose, and the approximate parity with gold is, *ipso facto*, maintained.¹

It has been proved by experience that gold actually in circulation is of very little value in maintaining exchange, and the internal medium of circulation, whether it be silver or notes, is largely dependent for its value in exchange, not on its bullion content, but on the possession of adequate gold resources. These resources need not necessarily be kept in the home country: the gold reserve of the Philippines, for instance, is maintained in New York, while Japan, prior to her departure from the gold standard in 1931 constantly held a large proportion of her gold resources in London, Paris, and other monetary centres. India's Gold Standard Reserve, as is well known, is held in London at the Bank of England.

The currency in the Philippines is manipulated in a similar way, the silver pesos or coin certificates being maintained at the par of exchange within the limits of variation that apply in the case of the exchange between countries whose currency is mainly gold. It is rarely possible to obtain gold coin for silver in the Philippines, except in small quantities, but as telegraphic transfers on New York are always procurable from the Government at par, plus the

¹ Cf. *Purchasing Power of Money* (Irving Fisher), pages 131-2.

usual charges for exchange between gold standard countries,¹ these are equivalent to gold exports, and serve to keep exchange steady.

Besides the maintenance of satisfactory resources, the system therefore calls for the contraction of the currency by the retirement of a sufficient amount of the silver coinage whenever it is apparent that more is in circulation than the demands of trade require. Expansion of the currency is produced by the release of this currency to circulation, or by the issuance of new currency whenever it is seen that there is a shortage of the currency medium.

It seems to be an essential part of this system that the intrinsic worth of the silver coins should be fixed by law above the value of their silver content: without such proviso the power to control the circulation would exist in one direction only—contraction: with the margin between the coin value and the bullion value, the power exists to expand as well as to contract, and it will be seen that in countries where the gold exchange standard is in operation, care has been taken to divorce the value of the silver coins from their bullion content.²

As is well known, by reason of the enormous export trade from India, the balance of her international credits and debits is nearly always in her favour, which accounts to some extent for the large amount of precious metals annually imported into India. This was also the case before the adoption by India of what was, in reality, the Gold Exchange system of currency; but whenever there was a falling exchange, the adverse effects on the silver currency made themselves felt. Events went to prove, in fact, that, in saying that where a country is upon a silver standard, it is as well to maintain that standard if it is desired to stimulate the development of the country in regard to its exports, currency experts lost sight of one important point.

¹ The actual charges are $\frac{1}{4}$ % both ways: the premium may be temporarily increased or decreased should circumstances call for the alteration.

² Cf. *Purchasing Power of Money* (Irving Fisher), page 338.

Where the currency is depreciating as compared with gold, exports do increase, but the increase is partly due to the larger volume of goods which must be exported in order to liquidate the country's debts to gold-using countries. If silver is at 30d. per ounce and falls to 25d. per ounce, the silver currency unit falls with it, and the difference in value has to be made up by sending more goods, or in some other way.

This was precisely what happened with India, and, consequently, the fluctuating value of the rupee made trade both uncertain and unsatisfactory.

There have been several changes in the value of the rupee, so a brief review of the position, starting from the time when it was rated at 1s. 4d., will be necessary. With the divorce of the value of the rupee from that of its silver content, fluctuations in exchange due to the fall in the gold price of silver were removed. There still remained the danger, however, that if ever the balance of indebtedness was against India, the value of the rupee would depreciate unless steps were taken to prevent this. It was apparent in seasons of ordinary prosperity that no effort was needed for the maintenance of the rupee at 1s. 4d., since the favourable balance of trade would ensure a sufficiency of foreign bills being forthcoming for those who required to make remittances. When the favourable balance was seriously diminished, or the balance became temporarily unfavourable, it is clear that India's claim on foreign countries in the shape of bills of exchange would be relatively scarce, and those who were under the obligation to remit sterling to Great Britain would be forced to pay a larger number of rupees for each sovereign the bill of exchange represents. This indicates a falling exchange, and as we have seen, in such circumstances exchange continues to fall until it reaches that point when it is more profitable to send gold than to remit bills to the creditor country. So far the procedure was simple, but the difficulty, more apparent than real, was that in practice no gold might be available for export, since, although formerly there

was a legal obligation to issue rupees in India in exchange for sovereigns, there was no corresponding legal obligation on the Government to give sovereigns in exchange for rupees. Consequently, if no safeguard existed, the rupee would fall till it was worth no more than its silver value at the rate of the day. To meet this contingency, there were available, besides the general resources and credit of the Government of India, the gold held in the Paper Currency Reserve, and, more particularly, in the Gold Standard Reserve, which was specially constituted for this purpose. These reserves are kept in London and India, and at the present time amount to a very substantial figure, and although there was no statutory obligation on the Government of India to take special measures to maintain the value of the rupee at 1s. 4d., the Government had expressed their determination to support exchange up to the limit of their resources.

When exchange between India and Great Britain showed signs of falling below 1s. $3\frac{2}{3}$ d., the Indian Government intervened by selling sterling bills on London at this rate. They took action in this way in 1907-08 and 1908-09, when sterling drafts on London to the extent of £8,058,000 were sold at 1s. $3\frac{2}{3}$ d. per rupee to assist in the balance of trade, and again when exchange dropped as the result of the financial disturbance which accompanied the outbreak of the recent hostilities in Europe. On the latter occasion the Government offered these "Reverse Councils," as they are called, in the shape of telegraphic transfers on London as an alternative to bills. This action had for effect the maintaining of exchange in the neighbourhood of the gold export point from India, and the fact that this value was maintained throughout August, 1914,¹ while the currency of other countries more favourably situated abnormally depreciated, is a striking testimony to the

¹ In August, 1914, the Government announced that they were prepared to sell drafts on London at 1s. $3\frac{1}{4}$ d. and telegraphic transfer at 1s. $3\frac{1}{2}$ d., to the extent of £1,000,000 weekly, in support of exchange until further notice.

efficacy of the Indian arrangements. Moreover, it demonstrates the wisdom of keeping a part of the gold reserves in London.

Council Bills and Telegraphic Transfers.

This chapter would be incomplete without some explanation of the manner in which the sales of Council Bills and telegraphic transfers on India by the Secretary of State in London were carried out. Prior to the stabilization of the rupee at 1s. 6d., these sales were considered to be the central feature of the machinery by which the Indian finance and currency system was managed. There were, so to speak, two bodies in the open market : on the one hand, the Indian Government requiring English currency for the purpose of paying for its purchases of bar silver, interest on loans contracted here, pensions due, and services rendered ; on the other, a group of bankers, financiers, and importers of Eastern produce, desirous of settling their indebtedness to India in rupees. The Indian Government required sterling in London to pay their home charges, while the bankers and others needed silver rupees or paper currency in India. This latter class knew that there were only two ways of procuring rupees from the Government in India : a banker or merchant would present Council drafts, purchased in England at varying rates per rupee, or he could tender sterling in exchange for rupees at the fixed rate of 1s. 4d. In ordinary times it suited the remitters to send out these bills purchased in London.

As far as the Indian Government are concerned, they inherited this method of drawing funds from India from the old East India Company, and as the system was found to be a convenient one for all parties, although at present (August, 1936) it is in abeyance, it is possible that a reversion to it may be made at some future time. The practice in principle amounts to the selling of rupees to the highest bidder, and the Indian authorities in London have made arrangements whereby would-be remitters may make

definite offers, through the medium of the Bank of England, for so many lakhs of rupees—a lakh being equal to 100,000 rupees.

The plan followed was this : each Tuesday a notice was exhibited at the Bank of England stating the aggregate amount which would be allotted, and tenders were invited for the bills of exchange and telegraphic transfers on the Indian Government authorities at Calcutta, Madras, and Bombay. There was no obligation to allot the whole amount stated, and, as a rule, applications at prices lower than 1s. 3 $\frac{1}{2}$ d. per rupee for the bills and 1s. 3 $\frac{1}{2}$ d. for transfers received no allotment. Each applicant specified at which place he desired to receive rupees, and if it was necessary for him to have funds immediately available at one or other of the centres named, the remitter would apply for telegraphic transfers ; but if a remittance by mail would suffice, he tendered for the drafts, and in the latter case, as the India Council had the use of his money for two or three weeks before rupees were paid over in India, a lower rate would be paid for the drafts than for the transfers, due allowance having to be made for the interest on the money. As a matter of fact, the price charged for telegraphic transfers was ordinarily higher by $\frac{1}{2}$ d. per rupee than that charged for bills, but when the Calcutta or Bombay Bank Rate exceeded 8 per cent, tenders for transfers ranked for allotment with tenders for bills only if they were $\frac{1}{2}$ d. higher. Allotments, of course, were made to the highest bidders, the price varying in proportion to the intensity of the demand ; the more the remittances were needed the higher would be the rates offered, and as in such times the total amount tendered for exceeded the amount offered, allotment was made *pro rata*.

Each Tuesday, as soon as the tenders had been examined, a statement was issued giving the total applications, the allotments, and the amount to be offered the following week. These particulars were available on Tuesday afternoons.

Remittances could also be purchased on other days in

the week, and the price charged was fixed by the India Office at not less than $\frac{1}{4}$ d. higher than the lowest prices at which allotments had been made on the preceding Tuesday. Bills and transfers obtained in this way were termed "Intermediates" or "Specials," and the exact rate chargeable, together with the maximum amount to be sold, was fixed for the week each Tuesday.

The primary object of this Government dealing in bills of exchange and telegraphic transfers was really the laying-down of funds in London to provide for the Secretary of State's Home Charges, but with the efflux of time and the necessity for maintaining the exchange value of the rupee, the system was extended to meet other requirements. It was temporarily suspended when the Government decided to force the exchange value of the rupee up to 1s. 4d., and later, in 1898, sales were resumed as a means of altering the location and disposition of the general resources of the Government of India, and thus provide the means, in time of monetary stringency, whereby currency could be readily and quickly expanded. Finally, the sales of these bills were so regulated as not only to meet the requirements of the Secretary of State for India, but also to satisfy the demands of trade up to such an amount as would enable the balance of trade in India's favour, over and above the amount of the home charges, to be settled without the export to India of more gold than was actually required there for absorption by the public.

Despite a good deal of political agitation, the course of India's currency machine moved along fairly satisfactorily until the outbreak of hostilities in Europe. India, like every other country in the world, had her currency system severely tested by the Great War. Silver, for which India has always a voracious appetite, was in demand by all nations, with the inevitable result that its price rose by leaps and bounds. The full tale is told in the author's *Eastern Exchange, Currency and Finance*, and it must suffice here to say that, in the untoward circumstances

arising out of the war, India had to pay more and more for the silver of which she is so great a user. The heavy cost of the silver rupee thus caused the Indian Government to raise its exchange value, in order, chiefly, to prevent silver rupees from being melted and exported. On 20th December, 1916, the Secretary of State for India raised the rate of exchange for immediate transfers to 1s. 4 $\frac{1}{2}$ d., and for deferred transfers and bills to 1s. 4 $\frac{1}{4}$ d. On 10th January, 1917, it became necessary to raise these rates again to 1s. 4 $\frac{1}{4}$ d. per rupee for the telegraphic transfers, and for the Council Bills and deferred telegraphic transfers to 1s. 4 $\frac{1}{2}$ d. per rupee. No other alteration was made until 27th August, 1917, when, owing to the world-wide demand for silver, the Indian authorities were obliged to raise the value of the rupee again by making the exchange for immediate telegraphic transfers 1s. 5d. and that for Council Bills 1s. 4 $\frac{3}{4}$ d. The only alternative before the Government was to go on coining rupees, which, at the price of silver then ruling, would have meant an enormous loss to be borne by the Indian taxpayers. No further alteration was made until 10th April, 1918, when, owing to the continued rise in the price of silver, it became incumbent upon the Indian Government to protect its currency unit by once more raising the exchange value. Accordingly, immediate telegraphic transfers were made available at 1s. 6d. per rupee, while the charge for the deferred transfers and bills was fixed at 1s. 5 $\frac{3}{4}$ d. per rupee. Steps were taken, too, to reduce drastically the amount of "councils" to be sold. In the meantime the demand for silver by all nations showed no signs of abating; supplies were short, and the price soared higher and higher. For a time it was under control, both in England and in America. Consumers were, in reality, rationed. Later, control was taken off, and immediately the price started rising. The Indian authorities were reluctant to make more changes, but the force of circumstances was against them. No Indian would part with a rupee on a 1s. 6d. basis when he knew

perfectly well that its bullion value was much higher ; he would much rather add the coin to his hoards, or seek to melt and smuggle it out of the country—no matter how strict the law on the subject. Consequently, the Government had once again to raise the exchange value of the rupee, and this time they advanced it far higher than the market expected—they were allowing for a margin of safety. On 12th May, 1919, the price for immediate telegraphic transfers was fixed at 1s. 8d., and for deferred telegraphic transfers and bills at 1s. 7½d.

At these levels it was hoped the limit of the rise had been reached, but finality had not been reached.

On 12th August, 1919, the ever upward movement in the price of silver necessitated a further rise in exchange to 1s. 10d. for immediate telegraphic transfers, and to 1s. 9½d. per rupee for deferred telegraphic transfers and bills, and as silver continued to soar in price, on 16th August, 1919, the rupee was put on an effective 2s. basis by making exchange for immediate telegraphic transfers 2s., and that for deferred transfers and bills 1s. 11½d.

On 25th November, rates were again altered to 2s. 2d. for telegraphic transfers, and 2s. 1½d. for deferred telegraphic transfers and bills ; and on 16th December, 1919, it was found necessary to raise rates once more to 2s. 4d. for telegraphic remittances, and 2s. 3½d. for deferred telegraphic transfers and bills.

In the meantime a Committee which had been appointed by the Government on 30th May, 1919, to examine the effect of the war on Indian exchange and currency, had come to the end of its labours. The Report of this Committee was issued on 22nd December, 1919, and among its principal recommendations was the following—

(a) That the balance of advantage was decidedly on the side of fixing the exchange value of the rupee in terms of gold rather than in terms of sterling.

(b) That the stable relation to be established between the rupee and gold should be at the rate of Rs. 10 to one

sovereign, or in other words, at the rate of one rupee for 11·30016 grains of fine gold both for foreign exchange and for internal circulation.

These recommendations were accepted by the Government, and in putting them into operation a divorce was effected between the rupee and the paper pound sterling. As it subsequently transpired, however, the linking of the rupee with gold and not with the depreciated paper pound sterling did not stabilize exchange, notwithstanding the fact that the Government sold "Reverse Councils" (bills and telegraphic transfers, India on London) to a considerable amount in support of exchange. Exchange broke away badly, and the rupee fell from over 2s. to 1s. 3d. The root of the trouble was to be found in the adverse trade position. Early in 1921 the balance of trade was heavily against India, and with few buyers for her products, the export market became crowded with goods; the result was that the exchange value of the rupee fell to the level stated. Yet the Indian Government did not depart from the 2s. gold basis it had fixed for the rupee, and nominally 10 rupees remained exchangeable for one sovereign, as compared with the former ratio of 15 rupees, which had been in force for nearly twenty years.

The selling of council bills and telegraphic transfers, London on India, ceased on 5th January, 1920, and was not resumed until 9th January, 1923, when the Secretary of State for India announced that a limited amount of council bills and telegraphic transfers (deferred and immediate) would be offered for sale by competitive tender. The resumption of the sale of council drafts, it was stated had been decided upon with a view to strengthening the Secretary of State's sterling resources against his requirements in 1923-24. The holding of further sales, and the amounts to be offered, it was further announced, would be dependent on conditions of exchange.

The amount offered on Tuesday, 9th January, 1923, was fifty lakhs of rupees, payable at Calcutta, Bombay, and

Madras. The result of the tendering, after the lapse of over three years, is interesting ; only a small amount of the bills was applied for at an exchange of 1s. $4\frac{1}{2}$ d. per rupee ; but at this rate none was allotted. Seven lakhs of rupees (Rs. 7,00,000) in deferred telegraphic transfers were applied for at 1s. $4\frac{1}{8}$ d. per rupee, and were allotted in full. For the immediate telegraphic transfers the applications were very large, the total amount for which tenders were received being Rs. 455,00,000, at rates varying from 1s. $4\frac{3}{4}$ d. to 1s. $3\frac{3}{4}$ d. No tenders, however, below 1s. $4\frac{3}{4}$ d. were accepted. Tenders at 1s. $4\frac{1}{8}$ d. received about 9 per cent., while those applying at 1s. $4\frac{3}{4}$ d. received allotments in full. The total allotment of immediate telegraphic transfers was Rs. 43,00,000, which, with the Rs. 7,00,000 of deferred telegraphic transfers, made up the total of fifty lakhs offered by the Secretary of State.

Councils continued on offer until April, 1925. But by that time exchange had entered a new phase—the rupee kept fairly firm at around 1s. 6d. Demand for bills and transfers at satisfactory rates fell away, and on 17th April, 1925, the India Council announced that sales would be suspended until further notice.

It should be noted that at this period, when council bills were allotted, the allottee filled up a form with particulars of the bills desired, and left this at the Bank of England before 12 o'clock on the day preceding that on which the bills were required ; the bills were then delivered the next day on payment in cash not later than 2 o'clock.

When a telegraphic transfer had been allotted the necessary telegram authorizing payment in India on demand was sent on the day on which payment for the transfer was made at the Bank of England. Immediate transfers were payable in India on the day following the issue of the telegram ; deferred transfers were payable sixteen days after the issue of the telegram.

The position from April, 1925, was that the exchange value of the rupee had, to all intents and purposes, become

stable at 1s. 6d. It was prevented from rising above that rate by free purchases of sterling by the Government of India ; and as the gold basis of sterling had again become effective by the placing on the Statute Book of the Gold Standard Act of April, 1925, the exchange value of the rupee has been kept definitely within the gold points corresponding to 1s. 6d. ever since.

Then came the Hilton Young Commission, which was appointed on 25th August, 1925, to examine the existing currency system of India, to determine its advantages and defects, and to make proposals for remedying the latter. The Committee's Report was made on 1st July, 1928. We are not here concerned with points in the Report, except that dealing with the currency and exchange, to which we may make brief reference.

The Committee recommended the adoption for India of the Gold Bullion Standard, which we have described earlier in this book. But the essence of it in the case of India is that the ordinary medium of circulation in India should remain the currency note and the silver rupee ; further, that the stability of the currency in terms of gold should be secured by making the currency directly convertible into gold for all purposes, but that gold should not circulate as money. It was also recommended that an obligation should be imposed by statute on the currency authority to buy and to sell gold without limit at rates determined with reference to a fixed gold parity of the rupee, but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold is required.

Finally, it was recommended that stabilization of the rupee should be effected forthwith at 1s. 6d.

There was a good deal of discussion in financial and political circles when the Report of the Hilton Young Committee was published, but ultimately the Government accepted the principal recommendations dealing with currency and exchange, and the Gold Bullion Standard, with the rupee at a gold value of 1s. 6d., was adopted and

under the Currency Act (No. 4) of 1927 became law on 1st April, 1927. The rupee has been maintained at around that level ever since, the fluctuations being practically confined within the gold points, which, with London, are—

Export gold point to London, 1s. 5·76555d. per rupee.

It should be noted that the option of giving gold bullion or sterling exchange lies with the Indian Currency authorities, and, generally speaking, it is always the practice to endeavour to sell sterling rather than gold.

Import gold point from London, 1s. 6·20893d. per rupee.

Since the stabilization of the rupee at 1s. 6d. there have been no sales of Council Bills or telegraphic transfers in London, but the Government of India has sold freely in India sterling bills and other transfers on London.

The position is that when the Indian Government decides to purchase sterling it calls for tenders just in the same way as was done in England, and states the amount for which tenders will be received.

As Mr. N. Sankara Aiyar says in his comments on the situation,¹ the Controller of Currency first scrutinizes the tenders and then decides whether the rate applicants offer is justified by market conditions. If he is satisfied that this is so, allotments are made to each of the banks tendering in proportion to the amount applied for if the total exceeds the Government's requirements. It sometimes happens that the banks tender at different rates as for various reasons they do not wish to run the danger of being allotted the whole amount for which they have applied at a higher rate. For instance, if the banks desire to secure a net rate between 1s. 6½d. and 1s. 6¼d. they might tender, say, for £800,000 at the former rate and £1,200,000 at the latter. On the other hand, if they wanted a rate somewhat better they might tender for £1,200,000 at the former rate and £800,000 at the latter rate.

The Controller of Currency, after scrutinizing such tenders accepts sufficient for his requirements at the higher rate

¹ *Foreign Exchange in India.*

of 1s. $6\frac{1}{8}$ d. and if he still requires more, he would buy at 1s. $6\frac{3}{8}$ d. Before allotting at the lower rate, however, he would obviously absorb all the tenders at the higher rate.

As in the case of Council bills, purchases are made at weekly intervals and tenders accepted every Tuesday. If in the meantime banks are eager to sell to the Government, they are allowed to do so at a rate of $\frac{1}{4}$ of a penny higher than the best rate of the previous week's tenders. This rate is usually known as the "intermediate" rate.

It will thus be seen that the system follows closely that which formerly ruled in London.

There remains to be added a few words concerning India's position following the departure of Great Britain from the gold standard on 21st September, 1931.

Following the suspension of the gold standard by Great Britain, the Governor-General of India issued an Ordinance on 21st September, 1931, temporarily relieving the Government of India from the obligation under Clause 4 of the Currency Act of April, 1927, to sell sterling or gold. It was also announced that the three days, 22nd September to 24th September, 1931, inclusive, would be public holidays. As all the banks in India were closed on these days, the rupee was left somewhat like Mahomet's coffin, suspended in mid-air, since it was linked neither to gold nor to sterling. The position was, however, immediately made clear by the Secretary of State for India announcing in London on 21st September that the rupee was to remain linked to sterling, and thus all doubts ought to have been removed regarding the future movements of rupee exchange. Subsequently, the first Ordinance was repealed by a second Ordinance on 24th September, 1931, which provided, *inter alia*, that sales of sterling or gold by the Government would be available for financing—

1. Normal trade requirements, excluding imports of gold, or silver coin or bullion.
2. Contracts completed before 21st September, 1931.
3. Reasonable personal or domestic purposes.

It was also made clear in the Ordinance that the Government would not sell gold or sterling for the purpose of liquidating the oversold exchange position of any bank in respect of any month subsequent to the month in which the demand for gold or sterling was made. Although it would seem that this second Ordinance was free from ambiguity, some uncertainty apparently existed because the measure did not specify whether the Indian Government would buy sterling at the upper limit of 1s. 6.208932d. per rupee. The Ordinances did not affect the Government's statutory obligation to *buy* gold at a rate equivalent to Rs. 13½ per sovereign's weight; this obligation remained technically in force, though, of course, in practice no one was likely now to tender gold for exchange at such a rate. However, ultimately all confusion was removed by the Secretary of State for India explaining that the rupee was definitely linked to sterling. He said that for all practical purposes the stability of Indian exchange had been based on sterling, and Indian trade, both export and import, was financed through sterling; further, that the greater part of India's external obligations was also in sterling.

As usual in Indian currency and finance, there were not wanting critics of the Government's policy; but, again, most of them overlooked the fact that the obligation of giving gold bullion or sterling exchange rested with the currency authorities. In any case, despite the Government's relieving itself of the obligation to supply finance for the importation of gold and silver bullion or coin, its bold action in offering to sell sterling or gold to meet the other legitimate requirements of the country proved to be a wise one. It allayed all semblance of panic and assisted in the transition to the new order of things. As a matter of fact, the call on the Government to sell sterling proved negligible, and ceased altogether within two days. In fact, the exchange situation so strengthened that within a few weeks the Government itself became a large buyer of sterling. Finally, all restrictions were removed on the 30th

January, 1932, by the repeal of the Ordinance in question, and ever since the rupee exchange has been quite free from restrictions, and Indian exchange has been linked with sterling.

India's Gold Exports.

There remain to be said a few words about the phenomenal export of gold from India since September, 1931. The release of both the pound sterling and the rupee from their gold mooring, and the resultant high price of gold has attracted large quantities of the metal from the Indian hoards. There is now a regular export business from India in the metal. Gold in the shape of small bars and ornaments is regularly dispatched from up country to Bombay, where it is refined and shipped to London and elsewhere. Various estimates of the amount exported have been given from time to time, but actually the exports from September, 1931, to 19th November, 1937, on private account were valued at approximately £235,864,000.

This gold movement has been of inestimable value to India; it has enabled the Government to remit large sums to England, and thus to obtain sufficient sterling to meet its home charges, as well as to pay off a good deal of maturing debt. Further, as a large amount of the gold has been shipped to America and the Continent of Europe, it has been of material aid in the maintenance of sterling as well as Indian exchange with other gold countries.

So widespread has been the attention given to the movement of gold from India, especially in regard to its international aspects, that it is desirable to paraphrase the remarks of the high Indian officials on the subject. The extracts reproduced below, it may be added, deal more particularly with the significance of these gold exports in relation to the economic and financial position of India itself.

As regards the exports of gold, what really are the facts? In his address to the Members of the Indian Legislative

Assembly, delivered on 25th January, 1932, the Viceroy of India outlined the position in this way. Those who sell gold do so because they can make a profit on their holdings. They have made an investment which has turned out well. Why should they be deprived of the opportunity to take advantage of it? He said: "There is no public ground on which this could be justified, for the export of gold at that stage was definitely and decisively to India's advantage." Most countries who, like India, rely on primary agricultural products for maintaining their balance of international trade and payments are now labouring under acute difficulties, which force them to adopt extremely stringent measures for the control of exchange, which greatly hamper the commerce of the country. At such a time India is able to tap a portion of her own vast resources' and by parting with a very small fraction of her immeasurable stores of gold to realize a favourable balance of international payments. The Viceroy further pointed out that the good results of this were already apparent—Indian exchange was strengthened, the bank rate was eased, and the accumulation of sterling resources enabled India to pay off £15 millions sterling without borrowing, thus relieving the country of a capital charge of Rs. 20 crores, and a recurrent charge of Rs. 110 lakhs per annum. The amounts exported are negligible in relation to India's total holding of gold. What the total holding may be no one knows; but the Viceroy reminded the Legislative Assembly that India's net imports of gold during the last 30 years alone amounted to no less than 550 crores worth as valued at the time of import, or well over 700 crores if re-valued at the prices ruling in 1932. Against this, exports since September, 1931, to January, 1932, amounted in value to no more than 40 crores at the prices then current. It will be realized that this volume is of no appreciable importance compared with what has been imported into India in recent years alone, and without taking account of the vast stores which must have been accumulated before 1900.

Finally, the Viceroy said that the export of gold is no new feature in India's commercial life. Large quantities have always moved in and out, and on special occasions India has tended to realize gold as a means of adjusting the balance of payments, or in order to take advantage of profitable opportunities of selling gold against rupees. It is plain that the export of gold from India in 1931-32 has been of great benefit to both public and private interests, and goes to prove that there are at least some occasions in an economic cycle when India's ancient tradition of investment in gold can prove to be of direct economic advantage to the country.

In his Budget Speech on 7th March, 1932, the Finance Member of the Government of India also drew attention to the popular misapprehension of the significance of what was happening. He corrected it in these words:

"The phenomena of the last few months should not be viewed by themselves, but as one phase in a process of many years. India requires a certain flow of exports to balance her imports of merchandise and external payments. In the past few years the volume of this flow has been more than is required, and has been stored up, as in a reservoir, by being put into gold. Now that the volume has shrunk owing to the immense fall in the prices of India's exports (a fall which has been far greater proportionately than for India's imports) the flow is being supplemented by drawing to a moderate extent on the reservoir of gold. Thus the 'reservoir' is performing exactly its proper function of equalizing the flow, while the quantities being drawn off are negligible in comparison with the quantities stored."

NOTE: 1 rupee = 1s. 6d.; 1 lakh of rupees = a hundred thousand rupees = £7,500; 1 crore of rupees = a hundred lakhs = £750,000.

CHAPTER XVI

THE EASTERN EXCHANGES (CONTINUED)—CHINA AND THE SILVER PROBLEM

INDIA, as we have seen, has had a chequered currency career; but it is when we come to China that we find problems that are really as perplexing to the monetary experts as they are to the man in the street. Time was when both China Proper and the British Crown Colony of Hong-Kong were on the Silver Standard, and as the price of silver rose in terms of gold (or sterling), so the exchange value of the monetary units of the two countries moved more or less in unison. If the quotation for silver remained steady, movements in the exchange rate with Hong-Kong and Shanghai were also negligible. The exchange business was always a problem, however, for both merchants and bankers, as there was ever a sort of double coincidence in every transaction. Not only had the values of goods to be taken into account, but also the value of the silver in terms of which settlement was made. Now, as we shall presently see, all that has been changed, and Hong-Kong and China are on a managed currency, with rates of exchange kept stable by Government control. In effect, what they have is a silver bullion standard. But let us go back a little.

Of China and its currency it may be aptly said *Omnia mutantur et nos mutamur in illis* (all things change and we change with them), for of late years the changes in the currency and of the accommodation of the people to them have been rapid and remarkable. As we have indicated, until comparatively recently China was on the silver standard, with a plentiful supply of copper coins and a mass of paper notes down to the most minute denominations thrown in to leaven the whole. That was not so curious as at first sight it may seem, since, historically,

Chinese currency dates back a very long way, and right down through the ages are to be found traces of token money of one sort and another. Such things as skins of animals, pieces of pasteboard, cloth, iron, all at times have been found to be doing money's work in China.

Then, researches and records have demonstrated beyond all doubt that gold, silver, and copper were in circulation in the country as far back as 2953 years B.C. Traces are also found of an actual monetary circulation during the Hsia dynasty, 1900-1558 B.C., the coins then being in the shape of bell money, knife money, sword money, etc. In fact, for a good many centuries the pieces of money in circulation were symbolic of domestic articles or utensils in daily use.

In such circumstances, it is difficult, if not impossible, to designate the position of currency at any period under any of the heads known to currency experts. Even in more modern times, when silver was held to be the standard of currency, and the real measure of value of commodities was said to be expressed in silver both for purposes of internal trade and for external trade, things were not what they seemed to be. Silver was not a measure of value in the same sense as gold is in European and other countries of the world. Silver in China was quite as much a commodity as rice, wheat or anything else, and for every occasion on which it was profitable to ship gold, say, from one European centre to another, it was usually many times more profitable to move silver in China from one province to another. That being so, it is not surprising that the value of silver rose and fell quite as often, if not more often than that of other commodities. The exchange value of the tael and dollar also rose and fell with the price of silver.

Short of writing a book, it is not possible to go too deeply into the intricacies of the currency and exchange, interesting as they are; but to the reader who is wishful to pursue the subject, we may commend a summary of the position given by the Commission appointed by the Secretary of State for the Colonies to inquire into and advise

upon the question of Hong-Kong currency. In their report on the currency of Hong-Kong, issued in May, 1931, reference, of necessity, had to be made to the monetary system, or rather systems, of China Proper. The first noticeable feature that struck the Committee was that there was no uniform currency medium for the whole of China. They found in existence an extraordinary variety of silver, mixed metal, and copper coins and bank-notes, of which few were accepted throughout more than a limited area, and all varied continually in their exchange value with each other. It was admitted that the general standard of value was pure silver, with an inveterate tendency to rate the value of a coin by its pure silver content, that is, bullion value. Thus, the value of a silver coin could not, in general, fall much below that of its metallic content, since it could at any time be turned into lump silver, which was an acceptable object for hoarding even if it could not be used as currency. As a matter of fact, most Chinese merchants were quite as adept in buying and selling silver as any other commodity; the rising and falling of the value of silver and exchange may have been something of a burden to them, and it may have added to the complexity of trade, but a good deal of profit was made in the process. In practice, the merchant not only bought or sold goods, but also bought or sold the silver which he had to receive or pay, hence there was the double transference to which we have referred in every transaction.

To return to the Report of the Hong-Kong Commission; they found that the market value of Chinese bank-notes was by no means always the same as their face value. There is, they said, "a tendency to prefer notes for their superior portability and ease of concealment, but the degree of credit enjoyed by the issuing authorities is also a consideration." Emphasis was also laid on the fact that, owing to the diversity of its currencies and the inadequacy of its banking system, China has no dominating financial centre such as most European capitals provide for their trading

and industrial areas. In China almost every important town and many towns of little importance are separate centres for exchange purposes, each having its own rates of exchange on other centres. Comment was also made on a system of Government money orders as forming a weak connecting link, in so far as remittances could be made through the post office to and from a certain number of these centres, though the volume of this business was relatively small.

Reference, again, was made to the huge network of loan and mortgage banks and exchange shops throughout China in addition to the foreign (non-Chinese) and Chinese "foreign-style" banks established in the larger centres, most of these institutions having correspondents or agents at neighbouring centres of which a merchant at any centre who wishes to settle an account at some other centre may take advantage. The margins between the bullion points were found to be wide, since the transport of specie from one place to another is often a hazardous undertaking except between places with safe rail, sea, or river communications. The weight of Chinese coin also made the business expensive.

Now, although Hong-Kong is outside the political boundary of China, the two are attached to each other by such close economic and financial connections that Hong-Kong is in fact one of the principal exchange centres of China (Shanghai is another). Actually, the Commission found that Hong-Kong's bank-note currencies is one of the currencies of China, and instances were given of the important part played by Hong-Kong bank-notes in areas outside Hong-Kong, even in transactions in which that Colony had otherwise no part. Anything, as we shall see later, that affected the currency of China as a whole, was bound to have a repercussion on Hong-Kong, and, as to all intents and purposes, the basis of the present problem is to be found in silver, and its vicissitudes, it is to silver that we must now turn. Indeed, he who would understand the currency position of China, must perforce study silver.

Prior to the Great War, the depreciation in the price of silver, or, to put it in another way, the constant fluctuations in its gold value with the resultant effect upon the exchanges of Far Eastern countries, had given much food for reflection to currency experts. In the ten years before the War the price of silver had varied between $23\frac{1}{8}$ d. and $30\frac{1}{2}$ d. per standard ounce, the average price for the decade being only 26.81d. As is well known, the War gave a great impetus to the demand for the metal and caused the price to soar to record levels. The peak was reached in February, 1920, with the price of 89 $\frac{1}{2}$ d. per standard ounce, and a quotation for the Hong-Kong dollar of 6s. 2d., and for the Shanghai tael, 9s. 3d. Thereafter, for a considerable time the price of silver and the exchange value of the monetary units of China and Hong-Kong fluctuated widely and prices fell steadily. A comparison with 1914 is interesting; for that year the average price of silver was $25\frac{5}{8}$ d. per standard ounce. On 9th February, 1931, the quotation in London for the metal was 12d. per standard ounce, representing a decline in value of over 50 per cent in fifteen years. The average price for 1931 was only $14\frac{1}{8}$ d. During 1932 the lowest price was 16 $\frac{1}{2}$ d. and the highest $20\frac{1}{2}$ d., the average for the year being $17\frac{3}{8}$ d. per standard ounce. The year 1933 gave a little better result, the price being $18\frac{3}{4}$ d. The fall in the price of silver between 1931 and 1933 caused a good deal of concern; as it brought the exchange values of the currencies of Hong-Kong and China down with it, various projects were mooted for the rehabilitation of silver. Many conferences and discussions on currency questions took place, but only two important points emerged with a direct or indirect influence on the world price of silver. In 1933 the agitation for something to be done in support of silver began to take effect. In June of that year the U.S.A., by arrangement, took about 23,000,000 fine ounces of silver on War Debt account, under the authority of the Thomas Amendment Act. Then, at the World Economic Conference held in London, in July, 1933, a four-year agreement was

reached between certain silver-producing countries and others who were important holders of silver. The project had really emanated from the efforts of Senator Pittman of the U.S.A., and the idea behind it was that silver would be protected until there was a sufficient recovery in world trade, to the accompaniment of a rise in the price of commodities, which would enable the silver consuming countries of the East to dispose of their exports on a more profitable basis. With America, of course, the question was largely a political one engendered by silver-producing interests there.

Eight nations were concerned in the Agreement in question: America, Mexico, Canada, Australia, and Peru as producing countries, and China, India, and Spain as holders of silver. This agreement provided that Indian Government sales should be limited to an average of 35,000,000 fine ounces per annum for four years, and that the five above-mentioned producing nations should take an equivalent amount of their own production off the market, the U.S.A. bearing the major share of the burden. On 22nd December, 1933, President Roosevelt ratified this silver agreement. At the same time it was announced that the U.S.A. mints were authorized for a period of four years up to 31st December, 1937, to buy at 64½ cents per ounce the annual silver production of that country, or 50 per cent above the then current market price. Then, in the spring of 1934, considerable pressure was brought to bear by the U.S.A. silver bloc, and, finally, President Roosevelt compromised with them by authorizing the Silver Purchase Act of 1934, which provided for the purchase of silver on the world's markets until the proportion of silver in the monetary stocks of the U.S.A. was 25 per cent silver to 75 per cent gold, or until the price of silver should reach the monetary value of \$1.293 per fine ounce.¹ Thereafter, America took

¹ Actually, from 25th April, to 2nd January, 1937, the American Treasury had been buying domestic mined silver at 77.57 cents. On 2nd January, 1937, the price was reduced to 64.64 cents per fine ounce.

its place as the principal buyer of silver in the London market. The U.S.A. silver buying programme commenced in June, 1934, and the effect on China's stocks of silver was quickly apparent. Between May and December of that year there was a decline of Chinese \$260,000,000 in the silver stocks of the Chinese and foreign banks in Shanghai, and there ensued considerable nervousness in China as to the possibility of either a nationalization of silver and a Government issue of inconvertible paper currency, or a devaluation of the Chinese dollar.

We have mentioned the Chinese dollar. By a sort of irony of fate, only a few months before the American silver programme had been put into force, the Chinese Government had announced that the silver tael was to be superseded by the silver dollar as the only legal currency of the country. At the same time an export duty on silver of 2½ per cent was imposed with the object of inducing the banks to have their silver holdings converted into the new standard dollars, the new duty being roughly equivalent to the cost of minting.

The effect of the constant silver purchases by America was soon experienced; they caused a wide disparity between the world price and the price in China, and large profit-making possibilities quickly influenced Chinese operators to sell silver abroad, the exports of silver from China between July and October, 1934, being valued at over Chinese \$200,000,000. The Chinese Government, in order to prevent a crisis and to stop further exports of silver, imposed an export duty of 10 per cent, and a variable equalization exchange charge on silver as from 15th October, 1934. These measures were at first effective, and the net export of silver from China was reduced in November, 1934, to \$11,328,000, and in December to \$11,975,000.

It was hoped that the imposition of the duty would have a stabilizing influence on the monetary and financial situation. Moreover, the Chinese Government had been at some pains to explain to the U.S. Government the harmful effects

on the financial position of China of its silver purchasing policy, with the result that early in 1935 there were indications that the American policy was to some extent being modified, since the Americans, as the year went on, made it apparent that they were not prepared to pay exorbitant prices for the metal, would only purchase silver for cash, and were not interested in the two months' forward silver price.¹ Their purchases, nevertheless, went on as silver came quickly available.

The harm had been done; large quantities of silver continued to leave China up to November, 1935. The export duty and the equalization charge which had at first been a deterrent, and certainly prevented the export of silver from Shanghai, was circumvented by the action of smugglers, who got silver out of the country by the overland route of Manchuria. The Chinese took various measures to stop this; but still the outflow continued, and, at long last, to stop the denudation of the country of silver, the Chinese Government on 4th November, 1935, decided to peg the dollar at an exchange rate of 1s. 2½d. and, in addition to other measures, to prohibit the use of silver dollars or bullion for currency purposes. Thus was a managed currency substituted for China's historic silver standard, and this action dealt a severe blow to silver—may be it has sounded its death knell, since China for long generations had absorbed large quantities of the metal. There is another point, not only has it brought practically to an end the long history of silver as a monetary standard, but it has left the United States Treasury the principal buyer of a metal which other nations do not want.

China, of course, like so many other countries, had been struggling for a considerable time against the evils of an over-valued currency, and the failure of her attempts to adjust her internal prices to the world level has been merely

¹ There are two prices quoted for silver in London—that for cash and another for silver deliverable in two months time, called the "forward" price.

aggravated by the silver problem. Now, it is to be the Government's endeavour to maintain stability of exchange at or near the level of 1s. 2½d. per dollar. For this purpose, it is stated to be the intention of the Chinese to buy and sell exchange in unlimited quantities, for which purpose the accumulation of adequate reserves will obviously be required. With this object in view all holders of silver are required to exchange their silver for legal tender notes, and all silver will be nationalized on somewhat similar lines to those followed by the U.S.A. in its nationalization of gold.

It has been stated that China's currency is to be independent and not linked to any foreign unit, and evidently arrangements are being made to accumulate large reserves abroad to assist in the stabilization of China's managed currency. For instance, on 18th May, 1936, it was announced that an agreement had been reached whereby the U.S.A. would purchase considerable amounts of silver from China, the proceeds of which are to be maintained chiefly in New York for China's account.

Then on 9th July, 1937, it was announced in Washington that an agreement had been concluded between China and the United States of America under which China would buy a substantial amount of American gold and America would buy silver from China, in addition to that already being acquired under an agreement entered into in May, 1937. The statement added that the policy of the agreement was to assist in stabilizing currency relationship and to augment the gold reserve of the Chinese Central Bank.

Brief mention may be made of Hong-Kong, as it has been shown that anything that affected Chinese currency as a whole would affect the currency of Hong-Kong. As with China, the British Crown Colony of Hong-Kong had to face the evils of an over-valued monetary unit, following the rise in the price of silver, and the heavy adverse balance of trade which had been experienced for two or three years was only met by continued exports of silver. Following the demonetization of silver by China on 4th November,

1935, the exchange value of the Hong-Kong dollar dropped within a few days from 1s. 11d. to 1s. 4d., and steps to stop the rot were vitally necessary. It was a relief, therefore, rather than otherwise, when on 9th November, the Hong-Kong Government placed an embargo on the export of silver, whether in bars or coin. On the same date it was announced that to fill the void occasioned by the scarcity of silver dollars and sub coin there would be an issue of one-dollar Treasury notes. This was quickly followed by a further proclamation authorizing the issue of nickel 10- and 5-cent pieces in substitution of the existing subsidiary coins. The Government also called for the delivery of silver holdings in the possession of both banks and the people. In exchange for the coins it was stated that currency notes would be given at par, while silver bullion would be received at a rate of 128 cents per fine ounce. Further, for the maintenance of exchange, it was announced that a fund would be set up, and that the Government would henceforth control exchange. The rate for the Hong-Kong dollar was, in fact, pegged at 1s. 3½d.

The position, as it now stands, is that both China and Hong-Kong are definitely off the silver specie standard, and are on a managed currency system, and it remains to be seen whether either or both will be able to manage their currency on a silver bullion standard, or by some other form of managed currency yet to be devised.

The rates of exchange quoted by Hong-Kong and Shanghai, the principal exchange centre for China, are both those for telegraphic transfers, and the rates given are from those centres on London. The Eastern Banks, however, all quote rates in the reverse direction, London on Hong-Kong, or London on Shanghai, as the case may be. Other usances, such as those for demand bills and three months' sight bills, are given, the differences usually being the interest allowed for the time the banker has the use of the funds in the one case, or charged by him in the other case for the period out of his money.

CHAPTER XVII

ON CREDITS—TRAVELLING LETTERS OF CREDIT—THE SIMILARITY AND DISSIMILARITY OF CONFIRMED AND UNCONFIRMED CREDITS, IRREVOCABLE CREDITS, CLEAN CREDITS, DOCUMENTARY CREDITS, LONDON ACCEPTANCE CREDITS, OMNIBUS CREDITS, AND REVOLVING CREDITS¹

THE wisdom the reader has acquired, or which we hope he has acquired, from a study of the preceding pages will be of little avail unless the acquisition be coupled with understanding. Experience and knowledge are both excellent qualities, but either or both are of small utility unless their possessor has the power of applying them critically or practically. The drift of this thin attempt at moralizing is that we shall have spent our time to little purpose unless we are sufficiently conversant with the instruments which serve as the international media of exchange to be able to explain their place in that great fabric, the world's credit system. To arrive at a correct understanding of the many and varied foreign bills of exchange in existence, then, we must start by investigating the forms of authority under which they are drawn.

Travelling Letter of Credit.

Since the ordinary travelling letter of credit is familiar to most people, we may take that as a starting-point. It may be defined as a request from a banker to his foreign correspondents to cash on demand the drafts of the holder of the letter of credit on the issuing bank, the latter undertaking to meet the drafts when presented. Persons purchasing these letters of credit from the banks usually pay cash down, plus a commission of about $\frac{1}{2}$ per cent. on the total amount of the credit, although if the credit is

¹ The subject of Bankers' and Commercial Credits is exhaustively treated in *Bankers' Credits*, by W. F. Spalding (Sir Isaac Pitman & Sons, Ltd.).

desired by a good and influential customer of the bank, it is not unusual to issue it free of commission. It sometimes happens, too, that a bank or finance house of high standing purchases a letter of credit from a bank with foreign branches, and where the amount is paid at the time of issue, the credit would be granted free of charge.

If a travelling letter of credit is granted for use on one centre only, the banker will immediately on issue advise his correspondent, and at the same time send him a specimen signature of the beneficiary. In most cases, however, travellers require money to be available in a large number of cities, and as it would not be possible to advise and distribute specimen signatures *ad infinitum*, the credit is drawn up in such a form that it bears a space for the accredited party's signature, which can be compared by the banker with the signature of the person who subsequently presents the letter of credit.

Each letter of credit has with it a list of the bank's branches or correspondents in foreign towns, and when the holder is abroad reference to this list will show him where he can obtain cash. Payments under the letter of credit are made in exchange for either a signed receipt or a draft drawn to the order of the paying banker: some correspondents prefer one form, some the other, although in practice both documents are really treated as demand bills. Each instrument bears, besides the usual particulars, the number of the credit and the date. It is the foreign correspondent who hands these bills for signature to the presenter of the letter of credit, and after he has satisfied himself that everything is in order, the correspondent enters the amount drawn on the back of the credit, and then pays the equivalent in local currency at the rate of the day for demand bills on London. The draft or receipt is subsequently dispatched to London for payment by the issuing bank, and on arrival it must be stamped with a two-penny stamp—the Inland Revenue duty on cheques or bills payable on demand or at sight.

Sometimes foreign banks charge a small commission for encashing drafts under letters of credit, but more frequently they obtain their profit in the rate of exchange at which the amounts drawn are converted into local currency.

Confirmed Banker's Credit.

Another form of credit often issued by home, foreign and colonial banks, is what is known as a confirmed banker's credit.

A confirmed banker's credit may be defined as a credit opened by a banker, setting forth certain conditions and stipulations under which he agrees to accept the bills drawn by a foreign shipper, as and when presented to him, up to a certain specified sum. This document is largely used in financing foreign trade, which need not necessarily be confined to this country: although the credit may be opened from London, it may refer to shipments from the foreign country to Continental centres.

The commission charged is usually about $1\frac{1}{2}$ per cent. per annum on the amount drawn under the credit, but varies, of course, in different institutions, according to the standing of the firms requiring the accommodation, and the risks involved. It should be noted that the banks do not like to issue these credits for more than six months; they prefer to limit their risk to that period.

A confirmed banker's credit will be better understood if it is pointed out that the credit is generally opened by a bank or finance house on this side, at the request of an importer, for the purpose of enabling a merchant or shipper abroad to draw bills on the bank against shipments, say, to London. The bank granting the confirmed credit undertakes to honour the shippers' bills, if drawn in accordance with the various stipulations in the credit, and the credit often contains a clause similar in form to the following: "and we hereby undertake to accept bills as drawn on presentation by a *bonâ fide* holder."

In the face of this clear and unequivocal clause, it is plain that drafts drawn under the confirmed bank credit

must be accepted provided the provisions of the credit have been carried out correctly. The position, however, is not so clear in the case of the revocation of such a credit. It is a moot point whether it is politic or even admissible to revoke such a credit after confirmation by the issuing bank to the beneficiaries, the foreign exporters. Some authorities go so far as to say that confirmed bank credits cannot be revoked or cancelled when once the exporters have been notified of their issue, and in this country at least, judicial rulings seem to uphold the contention that even if notice of cancellation has been sent and received, a bank is still under the obligation to accept the bills drawn upon it if the exporter elects still to draw.

Unconfirmed Banker's Credit.

In contradistinction to a confirmed banker's credit, we have what is known as an unconfirmed banker's credit, a term which hardly merits the inclusion of the word "banker's" in it, for in many cases the banker is merely the intermediary through whom it is advised. In fact, it is often merely an authorization by the importer to his principal, the exporter, to draw bills on a certain bank, on the understanding that the banker may, but does not, guarantee in advance that he will accept the bills drawn under the credit.

To explain the working of these credits, we will suppose that A, the British importer, asks one of the London banks, say the Midland Bank, to arrange for the National Bank of India in Calcutta to buy the Indian exporter B's bills drawn on the Midland Bank for account of A. The Midland Bank here sends advice of this to the London office of the National Bank of India, at the same time asking that bank to advise its Calcutta office that it may negotiate B's bills drawn on the Midland Bank, but it should be noted that there is no actual undertaking on the part of the Midland Bank to accept the bills, although in practice, acceptance is not generally

refused. The following specimen will give some idea of the form of such a credit.

Credit No. 69. Blanktown, 26th May, 19...
To A B.

Somewhere in the East.

By this letter we beg to open with you an Unconfirmed Credit in favour of C D & Co. for an amount of £ available by drafts drawn at months date or sight, against delivery of the following documents—

Bill of Lading issued "to order" and blank endorsed.

Policy of Insurance.

Invoice.

Certificates of Origin.

(Signed) E F & Co.

The banker negotiating the bills has the documents of title to the goods against which the bill is drawn, attached to the draft, and these he will not part with until the bill is accepted.

It will be seen, therefore, that in opening unconfirmed credits one is given to understand that a bank may, and will accept the bills if in order, but at the same time no definite undertaking to accept is given. Moreover, there seems to be an unwritten law that such credits may be cancelled by the bankers at any time it appears advisable so to do, which may be all right as far as the banker is concerned, seeing that he has never really bound himself to accept the bills. The view taken by the banker seems to be that morally he is liable, legally he is not, but the writer is of opinion that by causing the credit to be advised to the exporter, the banker does get very near giving an implied warranty to accept the bills. The case of the exporter or manufacturer who has acted on the strength of the advice of the issue of the credit seems to be on a different plane, and there is reason to suppose that if ever cancellation forms the cause for legal action, the decision will be that

unconfirmed credits are subject to revocation only to the extent that they shall not have been acted upon when notice of revocation or cancellation is received by the exporter or whoever the user may be.

It may be noted in passing that third parties, that is foreign banks or exchange dealers, purchase bills drawn under confirmed banker's credits on the security of the drawee bank: the credit which the exporter produces when offering bills for sale is proof of his right to draw, and is the agreement of a first-class London banker to accept the bills. With bills drawn on the strength of the issue of an unconfirmed bank credit, the foreign or colonial banker relies to a certain extent upon the possibility of the London banker's accepting them, but knowing the risks attendant upon the business, he also pays special attention to the standing of the other parties to the transaction—the importer and exporter.

Drawers of bills under these unconfirmed credits have constantly endeavoured to eliminate their responsibility by insisting on the credits being issued "without recourse," the effect of which is that the drawer of the bill, once he has negotiated it through the London bank, or, if abroad, through a foreign bank, and provided the bill itself bears the words "without recourse," has no further responsibility on it, and if anything is wrong the banker can look only to the drawee for repayment of his advance. For this reason bankers are very chary about advising credits "without recourse."

Irrevocable Credit.

Shippers sometimes protect themselves by insisting on what is termed an irrevocable credit. Cases have come under the writer's notice where a manufacturer or shipper has refused to take orders from abroad, unless he is quite sure of obtaining payment immediately the goods are ready for shipment. With a credit of this nature the exporter is perfectly sure, too, that the opener cannot

cancel it until the contract for the sale of the goods it is intended to finance is completed.

Clean Credit.

The next instrument to be considered is what is called in market jargon, a clean credit. To the uninitiated the name is no clue to the real nature of the credit; the appellation is derived from the fact that bills are drawn under the credit without documents in any shape or form being attached, in other words, absolutely clean. Clean credits are generally opened by firms abroad in favour of shippers or merchants in this country, or, conversely, may be opened by importers in London in favour of foreign exporters, and the procedure followed when opening the credit is this: A B goes to a bank in his own city and informs them of his desire to open a clean credit. The banker then gives him a form to fill up and sign: in it A B states that he wishes the credit to be in favour of C D, whom he thereby authorizes to draw bills on him to the extent of so many pounds sterling, at so many days' or months' date or sight, as the case may be, and in consideration of the bank's buying (the banker calls it "negotiating"), C D's drafts, A B engages to accept and pay them at maturity, provided they do not exceed in the aggregate the sum named in the credit. The credit is available only for a certain period, usually not exceeding six months, and to preserve his recourse on A B, the drawee, the banker must not allow C D to draw bills after the date indicated in the credit.

In most cases drafts drawn under clean credits represent *bond fide* shipments, the documents for which have been sent direct to the consignees, but in some instances it is quite manifest that the bills are drawn by persons or firms speculating in exchange, and for this reason banks opening the credits exercise a wide discretion in granting the accommodation. The risks involved are obvious; if for any reason the drawee does not accept or pay the

bills in accordance with the undertaking he has signed, there is no security in the shape of documents of title to goods for the bank to fall back upon, and the only remedy is to seek out the drawer of the bills and endeavour to obtain repayment of the amount advanced—often a difficult and unsatisfactory task. Clean credits are, therefore, generally advised by the bankers only for firms of the highest standing, and if a banker has any doubt about the position of the parties to the credit, he insists upon a margin being deposited with him, consisting of actual cash or securities, and he sometimes secures protection by obtaining a suitable guarantee from a third party.

Documentary Credit.

Another form of credit which is familiar to most persons dealing in foreign exchange is that known as a documentary credit, which it will be seen is merely a variation of the unconfirmed credit previously referred to, although in this case it is usually a mercantile firm which accepts the bills ; not a bank.

As a rule, a documentary credit is opened at the request of an importer, who approaches the bank, either here or abroad, according to which side is shipping, and having acquainted the bank with his desire to open the credit, he is handed a form to fill up and sign. In this form he states that he wishes to open a documentary credit in favour of the foreign exporter, A B, of Blanktown, mentions the total sum for which the credit is to be made available, and states whether one or a series of drafts is to be drawn. He also gives a few particulars of the merchandise to be shipped, and agrees to effect the marine insurance on the goods. In consideration of the bank's agreeing to make advances on the bills which A B may draw on him up to a certain specified amount, he, the importer, engages to accept and pay them at maturity if drawn in accordance with the terms of the credit.

This credit has the two-fold advantage of enabling the

exporter to obtain payment for his wares immediately they are ready for shipment, and the foreign importer to obtain delivery of the goods at the port of destination on acceptance or payment of the bill.

Each bill drawn under the credit is accompanied by a full set of shipping documents, usually invoice, bill of lading, and insurance policy, all duly hypothecated to the bank as security for the due payment of the bills, and by examining these documents of title to the goods, the banker is able to see that the conditions of the credit are complied with.

Very often the exporter is allowed to draw for the full value of the goods as invoiced, but if shipments represent speculative merchandise, it is customary to permit only a percentage to be drawn for.

The difference between this credit and a confirmed bank credit is emphasized when it is remembered that the notice of the opening of a documentary credit which is served on the exporter often contains a clause pointing out that it is not to be considered as a bank credit, and does not relieve the exporter from the liability usually attaching to the drawer of a bill of exchange. Further, that although the credit is to be considered as open for, say, six months (the exact time is specified), it may be cancelled by the bank upon giving notice to the parties concerned. The name "documentary credit" would therefore appear to be a misnomer: it is more correct to regard a documentary credit as an authorization by the importer to the banker to make certain advances to the exporter, on the joint responsibility of importer and exporter.

London Acceptance Credit.

The exigencies of modern commerce have called into being still another form of credit, a variation of the confirmed banker's credit, which, although not encouraged in some quarters, tends to become more common every day. Where a British exporter is held in high esteem, a

foreign branch bank may open what is called a London acceptance credit, which entitles him to draw bills on the London branch of the bank up to a certain limit, previously arranged between the parties.

A credit of this nature is more particularly used where exporters are consigning goods to a foreign branch of their own firm, although it may be, of course, utilized if the goods are consigned for sale to agents.

When a London acceptance credit is opened there will often be no formal document exchanged; the matter is often settled by the exchange of letters. However, as soon as the details of the transaction have been agreed to, the shipper prepares his bill of exchange, attaches the requisite shipping documents, and presents the complete set to the banker. The bill, it should be noted, is drawn at three or six months' date on the London banker, who if everything is in order, detaches it from the other documents, accepts it, and returns the bill completed to the drawer, the British exporter. The shipping documents are then forwarded by the banker to his own branch abroad for delivery to the consignees. A small commission is charged for this accommodation, and in reality the trader pledges his goods with the banker, for he signs a letter of hypothecation giving the banker a lien over the shipment, and also undertakes that the proceeds of the consignment shall be remitted to London through the foreign branch bank at or before maturity of the bill, upon which the banker has now become liable as acceptor. The completed bill in the hands of the drawer is now a bank acceptance, and as such it can be turned into cash immediately at the best rates on the London discount market.

The shipper does not always draw for the full value of the shipment, as the banker will sometimes accept for only 75 per cent. of the invoice value, but in all cases the banker's accepting bills under these credits is considered as an advance on the security of the *whole* of the shipment.

Moreover, he does not lose his recourse on the drawer by the mere fact of his delivering the produce to the foreign consignees, since in the Letter of Hypothecation the exporter signs in London, he specially undertakes that when the documents of title to the goods are delivered to the consignees, the latter are to hold them until realization, and the proceeds of sale after realization, in trust on behalf of the banker. A further point to be noticed is, that if for any reason sufficient funds should not be forthcoming to repay the banker for the amount of his advance, as represented by the bill or bills he has accepted and will have to pay at due date, then the exporter engages to make up the deficiency forthwith.

Omnibus Credit.

London banks and finance houses sometimes enable shippers to obtain prompt payment for their produce by issuing an instrument called, in the language of the Money Market, an "omnibus credit." This credit is generally granted to firms of high standing, who give the banks a general lien over their goods and, in return, are permitted to draw round amounts against them.

The comparative economy of the various methods employed in financing foreign trade by means of the various credits we have described, will be further explained when we come to examine the actual bills drawn.

Revolving Credit.

In conclusion, it may be stated that most of the credits which are opened for the purpose of enabling exporters to obtain payment for goods as and when ready for shipment, can be made into revolving credits, and in order to dispel the misunderstanding which often exists as to the exact nature of revolving credits, some explanation is necessary.

There are really three forms of revolving credit, and the first and most familiar form is one which permits the

exporter to draw drafts up to, say, £1,000 outstanding at any one time: the bills, of course, will be drawn at various intervals, as the goods become ready for shipment. In due course the £1,000 limit is reached, but as soon as sufficient time has elapsed for the first bill to be paid, or for advice of payment to reach home whichever may be arranged, the credit becomes automatically re-available until the actual amount outstanding again reaches £1,000.

The second form of revolving credit is one which enables the accredited person to draw, say, £500 at any one time in one draft. When that bill has matured and been paid, he is at liberty to draw a further £500.

In the third case, the revolving credit is opened for, say, £500, and as soon as that amount is drawn the credit is again available for the original amount. In point of fact this last form is practically a credit for an unlimited amount but with this restriction, that the sum for which the credit is opened must be drawn in a single bill.¹

The benefits conferred upon the trading and mercantile community by the issue of commercial letters of credit will now be patent to the reader. As far as the exporters are concerned, as soon as their goods are ready for shipment they are given the power to draw bills for the cost of their commodities, and the banker pays the whole sum due, or a large proportion of it, without its being incumbent upon the exporter to wait for the return of his money. He is practically saved interest on his money for the lengthy period which must elapse between the dispatch and receipt of the goods abroad, plus the time the bills drawn have to run after acceptance by the foreign drawee. A manufacturer or merchant is thus able to turn his money over much quicker than would otherwise be the case, and this economy of time and money not only

¹ For full information in regard to credits, the position of the beneficiary and the banker, together with legal cases relating to credits, the reader is referred to *Bankers' Credits*, by W. F. Spalding (Sir Isaac Pitman & Sons, Ltd.).

lowers the cost of production, but facilitates further production.

The importers in their turn have the advantage of being able to deal with the goods some time before it is necessary to pay for them, and the period between their acceptance of bills and payment is in most cases sufficient for them to realize the merchandise and have the proceeds in hand ready to pay the bills at due date, without its being necessary for them to touch a penny of their own capital.

CHAPTER XVIII

BILLS DRAWN UNDER VARIOUS CREDITS—SHIPPING DOCUMENTS ATTACHED TO FOREIGN BILLS—BANKER'S SECURITY WHERE DOCUMENTARY BILLS ARE NEGOTIATED—CURRENCY BILLS

THE demand bills to which travelling letters of credit give rise call for no further comment, beyond the fact that they are one of the constituents of that great mass of foreign bills which constantly exercises an influence on the exchanges.

Bills drawn under Confirmed Banker's Credit.

To arrive at a correct understanding of the bills drawn under the confirmed banker's credit we will trace a supposed transaction. A in Spain is an importer of hides, B is the exporter in Calcutta. The operation will be financed in the following way: A in Spain would request his bankers, the Bank of Spain, to instruct their correspondents in London, say, Lloyds Bank, to issue a confirmed credit in favour of B, and the credit is drawn up and forwarded to B. When B has the hides ready for shipment, he draws his draft, say, at sixty or ninety days' sight on Lloyds Bank, London, for the invoice cost, takes it, together with the complete shipping documents, to a local banker in Calcutta, say, the National Bank of India, who, after proper examination, will purchase the bill and endorse the amount on the letter of credit, which is then returned to B for future use. The bill of exchange and the shipping documents are then sent to London by the National Bank of India for presentation to Lloyds Bank, who in due course will accept the bill for account of the Spanish Bank and receive the shipping documents, which will subsequently be forwarded to Spain. The

bill itself will be retained in London, and will probably be sold on the discount market by the National Bank.

The Bank of Spain, or its agents, will care for the shipment when it arrives, or will arrange that A takes delivery of the hides under certain agreed conditions, payment finally being made to the bank in one or other of the methods described in the preceding chapter.

We might have chosen a direct operation between Great Britain and India, but our object in giving this three-cornered transaction as an example was to emphasize the fact that the bills are often drawn on London for shipments which do not enter this country at all.

One other point calls for attention in regard to the bills drawn under confirmed bank credits; as they are drawn on first-class London bankers, there is not the slightest difficulty in disposing of them, and immediately the letter of credit is produced, foreign bankers and exchange dealers will be glad to purchase the bills, as they know that the risk is practically infinitesimal. Drafts drawn under confirmed bankers' credits can always be sold at a more favourable rate of exchange than those bills drawn on merchant firms. That is really the *raison d'être* of a banker's credit. Bills drawn on foreign importers, of whom the bank to which they are offered for sale knows nothing, would receive scant attention, and the most the banker would offer to do would be to send them for collection; but with the name of a first-class London bank or accepting house on the bills as drawee, the whole aspect of the transaction is altered, and the seller is able to exact the finest rates from bankers purchasing the paper.

Bills under unconfirmed banker's credits were discussed at some length in the last chapter; it only remains to add that, although readily negotiable, they do not command quite such good rates as those drawn against confirmed banker's credits.

We mentioned the case in which bills drawn on a London

banker against unconfirmed credits without previous arrangement might be refused acceptance. The reasons for the banker's refusing to lend his name to the bills are diverse, but generally it will be found on investigation that, having already accepted other bills for the clients, the banker considers the amount for which he is liable as acceptor is sufficient in view of the customer's financial responsibility. He therefore declines to add to the risk until some of the bills have been provided for. In such circumstances it is incumbent upon the importer to get some other bank to accept the bills drawn, and the London office of the foreign or colonial bank holding the bills may subsequently be asked to present the bills for acceptance elsewhere. As an alternative, if the importer can get no other bank to accept for him, he will have to provide the necessary funds to take up the bill and so procure the documents for the goods he is anxious to obtain.

We might mention here, what ought perhaps to have been emphasized earlier, that in most cases where a banker agrees to accept bills for a client, he obtains some satisfactory written undertaking from that client to provide funds to pay the bills by the time they arrive at maturity.

Bills under Clean Credits.

Bills drawn under clean credits are in some respects unsatisfactory documents to deal with, since in the event of anything happening to the parties operating, there is no collateral security upon which the banker or his agents can foreclose. The reason given by most exporters who do adopt this method of finance is, that by sending the shipping documents for their produce direct to the consignees much time and trouble is saved, and the importer is often placed in the position to deal with the goods long before the bills arrive if passed through the bank. The custom in some trades of selling commodities forward is presumably what is referred to, as in the ordinary course, bills and documents sent by mail often arrive before the

steamer carrying the goods, in which case there would appear to be no object in sending the documents in advance to the consignee. However, the point is that such bills are drawn, and as we mentioned, they are often taken from first-class firms of high financial responsibility. Where a clean credit is opened, all the exporter has to do is to present his bill to the bank, generally in duplicate, and if properly drawn, the banker buys the bill and sends it to his foreign branch, agent, or correspondent, who presents it for acceptance and at maturity remits the proceeds to the banker who had purchased it from the exporter in London, or abroad, as the case may be.

Bills under Documentary Credits.

Bills drawn under documentary credits form one of the principal items in a foreign exchange banker's business, and the paper is known by various names; documentary bills, documentary paper and hypothecation paper, all refer to the same class of bill. These bills are drawn by the exporter on the importer, and it is necessary in all cases for the former to have the shipping documents relating to his goods to attach to his bills. They must be sent in to the banker in complete sets; besides the bills of exchange in duplicate or triplicate, there will be the bills of lading, marine insurance policy, certified invoice, and in many cases a certificate of origin or consular certificate is required, also in duplicate or triplicate. With these documents in his possession it is then time for the exporter to present the bills to the bank for sale. After examination of all the documents, if everything is in order, the banker will pay the drawer the agreed amount and will then remit the bills and shipping documents to their destination.

It depends on the terms of the credit whether or not the shipping documents are delivered to the drawee against acceptance or against payment. If it is intended that they shall be handed over on acceptance of the bill, there will be a statement to that effect in the documentary

credit ; in the absence of such a clause, it is always understood that the banker must hold the documents, and, for the time being, the goods, until the drawee pays the bill. As a rule, the clause, " Documents on Payment," does not appear in the credit.

Now let us examine a few of the essential points in the documents which accompany these bills.

The bill of lading, being the actual document of title to the goods, is the most important, so we will take that first.

Most bankers negotiating documentary bills insist that the complete set of bills of lading which accompanies these drafts must be made out " to order," and blank endorsed. A blank endorsement, as the reader is probably aware, is formed by the person in whose favour the bill of lading is made out endorsing his name on the instrument : thus, if the bill of lading is to the order of John Jones, he simply writes on the back " John Jones." The effect of such an endorsement is to make the goods deliverable to the holder, and as long as the bank or its agents retain possession of the bills of lading, their title to the merchandise is unimpeachable. It is obvious that a bill of lading to the order of the consignees would defeat the bank's claim to the goods until the consignee had endorsed the bills of lading ; consequently, in such a form they should not be accepted.¹

It is customary also to require the bills of lading to be marked by the shipping company " Freight Paid," otherwise the bank purchasing the drafts to which these are attached, might find itself mulcted in heavy charges, which would considerably detract from the value of the security they hold. In some cases the freight receipt is attached. Too much care cannot be taken in regard to

¹ " Chapter 31, Sub-section 4 of the Customs (War Powers) Act, 1915, made it obligatory in certain cases for the exporters to insert the names of consignees in bills of lading. To meet the requirements of the Act, and also those of the negotiating banks, the bills of lading were therefore being made out in the following form : ' Shipped unto A B (the consignee) at the order of C D (the shipper).' C D endorses the bill of lading and the bank's security is intact."

bills of lading, especially where the freight is concerned. As is well known, the captain has a lien over all the cargo for his freight, and if this is not paid when the ship arrives at its destination, the bank negotiating the bill may be faced with serious loss. The goods will not be held over indefinitely awaiting the settlement of the dispute between the consignee and the bank, but will promptly be placed in the care of the port authorities by the captain, and should the banker find it necessary eventually to take charge of the goods, he will be saddled with other heavy expenses besides the freight, all of which he may have difficulty in recovering. Incidentally, it may be pointed out that care should be taken to see that all copies of the bill of lading come into the possession of the banker who purchases the bill of exchange, for the reason that as one copy has no priority over the other, delivery is made to the person who first presents a duly authenticated copy.

When a bill of exchange having the relative documents attached is presented for acceptance, the drawee has no property in such documents until he either accepts or pays the bill, and the Sale of Goods Act specially recognizes the importance of the bill of lading in this connection. Section 19, Sub-section 3, definitely enacts that the person to whom one of these bills of exchange is sent cannot retain the bill of lading unless he honours the bill, that is, either pays or accepts it on the spot.¹

The marine insurance policies, or certificates for insurance which accompany the draft, should be in favour of the bank, or if drawn out in favour of the drawers, then blank endorsed by them. The reason for this proviso is to ensure the value of the shipment being paid to the bank

¹ The following is the actual wording of the sub-section in question—

“Where the seller of goods draws on the buyer for the price, and transmits the bill of exchange and bill of lading to the buyer together, to secure acceptance or payment of the bill of exchange, the buyer is bound to return the bill of lading if he does not honour the bill of exchange, and if he wrongfully retains the bill of lading the property in the goods does not pass to him.”

in the event of loss : the bank, or the person to whom it has transferred the policies, would claim on the insurance company.

Certificates of insurance are those declarations which represent part only of the sum insured under a larger policy. Where a number of shipments are made it is usual to have one general policy, called an open or floating policy, under which declarations for the various consignments can be made from time to time. The insurance companies in such cases grant separate certificates for each shipment, and as the risks they purport to cover should conform to those set forth in the floating policy, it is wise for the banker to have the terms and conditions of the latter document (including the total amount covered) confirmed to him by the insurance company.

Reference should be made to the shipper's invoice to see that the goods invoiced are not of a lower value than the amount represented by the bills of exchange. Merchandise of a speculative nature is generally avoided by bankers.

Certificates of origin or consular certificates depend upon the Customs regulations and requirements of the various ports in the countries to which the goods are shipped, and it is impossible to indicate any hard and fast rules concerning such documents : the banker negotiating the bills is expected to acquaint himself with the conditions before operating.

There is one other document which bankers require persons from whom they purchase these documentary bills to sign ; it is called a letter of hypothecation. At one time it was customary to insist upon a letter of hypothecation's accompanying each set of bills drawn under a documentary credit, but in order to facilitate business this rule has of late years been relaxed, and it is now usual to obtain a general letter of hypothecation covering all the bills which may from time to time be purchased from the exporters.

The terms of this general letter of hypothecation are

fairly comprehensive, and give the banker full power to deal with the relative collateral security at the port of destination. He is empowered, if circumstances render it necessary, to insure the goods against both fire and sea risk, store them, and take all such care of the goods as he would if they were his own property, all, be it understood, at the expense of the drawer of the bill. Provision is also made to cover cases where conditional acceptance is taken. Finally, if the freight remain unpaid, or if the acceptor of the bill default, the banker is authorized to sell all or such part of the goods as may be necessary to liquidate the amount he has advanced, and if the proceeds of sale be insufficient to pay the amount of the bill or bills, he has the power to draw for the deficiency on the persons who signed the general letter of hypothecation. It will be realized, therefore, that the banker seeks to protect himself to the utmost; yet in spite of all these precautions losses are made, especially where the parties concerned become insolvent and the goods do not realize the amount for which the bills have been drawn.

Bills under London Acceptance Credits.

Now we come to the bills drawn under the London acceptance credits. In this instance, the bill is not sent out of the country, but is accepted in London by the banker who has opened the credit: with the documentary credit the bill is drawn on the importer abroad and accepted by him when presented there by the banker, who then retains it until date of maturity or else gets it discounted on the market. The bill accepted by the banker under the London acceptance credit is returned to the drawer, who, of course, promptly turns it into cash in England.

There is no difference in the actual shipping documents which form the basis for the drawing of a bill under the London acceptance credit; they are similar in all respects to those which accompany a bill drawn under a documentary credit, but it should be noticed that a letter of

hypothecation is required for each shipment financed through the bank in London: a general letter of hypothecation covering a series of shipments is not usually taken in the case of the London accepting credit. It must also be remembered that where the bills are negotiated under a documentary credit, the proceeds of the bills are under the control of and actually obtained by the banker or his agent; consequently he is able to secure the exchange profit on the homeward remittances. It is not so with the London acceptances. Although the goods are more or less under the control of the banker, and the consignees are said to hold the proceeds of sales in trust on behalf of the banker, it by no means follows that the banker ever secures control of the funds, although in theory he is supposed to do so. All the consignee is bound to do is to see that the remittances are sent home to London in time to reimburse the banker for the amount of the bill he has accepted and will have to pay at due date. For this purpose the consignee is bound in most cases to remit the amount by telegraphic transfers or approved bank bills of exchange on London, and these he may purchase abroad where he likes; the business generally goes to the exchange banker quoting the finest rates for making the remittance. Although the accepting banker in London tries to stipulate when making the contract that the resulting exchange shall be passed through his foreign branch if rates are equal to those quoted by his competitors, it frequently happens that the remittance even then is made through other channels.

Sometimes, however, the banker is able to obtain control of the counter remittance. He gets the exporter to draw two bills: the first will be the bill which is drawn on and accepted by the banker in London; the other is drawn by the exporter on the importer, and is attached to the shipping documents. It is sent out through the bank for collection, and the proceeds are eventually used by the bank in retirement of the bill it has previously accepted.

The various methods just described are those in force

with the foreign and Colonial branch banks in London, but the practice adopted by the London joint stock banks who accept bills in London for their clients is very similar. In the case of a London bank with no foreign branches, however, the only thing to be done is to send the documents to the foreign centre through one or other of the foreign banks established in London. If two bills are drawn, the procedure will be simple, for the foreign banker will merely collect the one attached to the documents for account of the London bank and remit the proceeds in due course. Where documents are sent forward without a bill, the instructions to be followed by the foreign bank will be embodied in a letter, and in this latter case there is obviously not the same control over the collateral security as there is where a second bill is drawn and sent for collection.

A practice to be condemned is that by which some London banks finance their clients' foreign shipments by accepting bills in London, and then allowing the exporters themselves to send the shipping documents forward to the consignees. By losing control of those documents the banker has absolutely no security for the payment of the bills he has accepted, and if funds are not forthcoming at maturity, the banker will have to pay the bills himself.

Currency Bills.

All the bills we have referred to in this chapter are understood to be in sterling. Currency bills come under a different category. They are both purchased and sent for collection by the bankers. If sent for collection, the drawer awaits advice of payment from the banker, who will ultimately remit him the proceeds. The currency bills the banker purchases outright are taken on the joint security of the drawer, drawee, and endorsers, if any, and the banker will pay due regard to the financial standing of all parties: they are all jointly and severally liable on the bill until payment has been made to the banker.

CHAPTER XIX

METHODS BY WHICH EXPORTERS OBTAIN PAYMENT FOR THEIR PRODUCE—PARTIAL DELIVERIES; MARGINAL DEPOSIT RECEIPTS AND TRUST RECEIPTS—BILLS ON THE FAR EASTERN COUNTRIES

RICHES, it is said, are like sea-water: the more you drink the thirstier you become. We may with reason apply the simile to the exporter, for the greater the credit facilities he gets from the banker, the more eager will he become to find a cheaper way to finance his produce: it matters not what credit system the banks evolve, the trader will always be ready to offer suggestions for a more economical way of carrying out the bankers' proposals. The outcome of all this bargaining is that the large firms are able to get their business done at the very lowest rates, while the smaller houses have to be content with less advantageous terms: the smallness of the exchange banker's profit in the one case is offset by the magnitude of the operations he puts through, and in the other he looks upon the higher return as a compensation or insurance for the greater risks he runs. Financial standing and responsibility count for everything. We have seen how the transactions in a general way are carried out, and we may now proceed to examine more closely the various methods by which the exporters to the more important countries seek to obtain payment for their commodities at a minimum cost to themselves.

Opinion Lists and Credit Lists.

It is apparent that this bill finance is a business which requires expert and extensive knowledge, not only of money-changing, but also of men and things. The foreign banker, or for that matter, any other banker who does exchange business, is bound to keep at his finger-ends the

standing and *morals* of every firm for whom he accepts bills, or to whom he makes cash advances on the security of bills of exchange, and this necessitates the keeping of special books, or card indices, called "Opinion Lists," which form, so to speak, the financial history of his clients. In the old days such confidential records giving the financial position of the various firms were never kept in written form; each exchange broker or banker preferred to rely solely upon such facts as he could keep in his own mind. The system did not exactly cause chaos, but it led to trouble when the man whose sound knowledge of the parties to bills of exchange happened to be away from the office, and in the event of his retirement or death, his successor usually experienced difficulty in picking up the threads of this very essential part of the business. In the course of time, therefore, most banks and finance houses found it expedient to start these special reference books, and the practice is now a very general one. They do not replace the well-known credit lists, such as "Seyd's," or "Bradstreet's Ratings," but are supplementary to those useful compendia of commercial information. Each banker gets to know what reliance may be placed on his own clients, and a comparison of notes between the banks enables each one to make a clear estimate of the amount of accommodation which can safely be given to exporters and importers. In the bankers' opinion lists each customer is accorded a certain classification, or credit worth, and the banker is guided by these details when dealing with the sellers of foreign bills. Naturally, the financial standing of a merchant governs to a large extent the credit facilities he enjoys, and when he applies to a banker to finance his shipments, or to buy his bills, the relative soundness of his position not only influences the rates of exchange at which his bills will be bought, but also governs the total amount which the banker will buy or accept. The position of the drawee also must be taken into account. When the drawers of a bill of exchange are financially strong

and the drawees prompt in settling their engagements, the banker will pay more for the bills than he would where the parties are comparatively weak.

These, then, are a few of the reasons which prompt the bankers to keep properly chronicled, up-to-date information as to all persons who may be expected to come to them for accommodation ; and bearing these points in mind we may continue our investigation into the methods of finance peculiar to the different classes connected with the export trade.

Financing Outward Shipments.

LONDON BANKERS' ACCEPTANCES. There has been a marked tendency of late years to finance outward shipments by means of London bankers' acceptances, and the reasons the exporters prefer this method to the more direct plan of drawing bills on the importers are soon explained : in a word, it is cheaper. When the London banker accepts a bill, the merchant or exporter can sell it under discount forthwith and so receive his money for the shipment ; he wants liquid capital in his business, and consequently cannot afford to keep the bill until maturity, since by so doing he would defeat the whole object of the operation, which is the saving of interest. If he sends a documentary bill for collection he must wait until the bill has arrived at its due date abroad before he can hope to receive the amount due to him, but a banker's acceptance, if he can get it, obviates that delay. Even where the banker makes an advance on documentary bills, it often suits the exporter better if he can prevail upon the banker to accept bills in London. It is, of course, the saving of interest which really makes the business attractive, and it follows that financing by means of bankers' acceptances will be resorted to only when money is cheap on the London market. For example, if a merchant can get a four months' banker's acceptance discounted in London for about 2 per cent., that will be much cheaper finance than drawing a bill on

the importer at three months' sight, as in the latter case the exporter will be out of his money during the time the bill is on the water, plus the period it will be running after acceptance, to say nothing of the exchange charged and the bankers' commission. These charges are also a factor to be reckoned with in the case of sterling bills against which the banker makes an advance under a documentary credit.

The most striking instance of the comparative economy of the two methods is to be found in the case of shipments to India, China, and the East. Documentary bills upon which the bankers make advances in London contain a clause to the effect that they are payable at the various banks' buying rate for demand bills on London, plus interest at, say, 6 per cent. from the date of the bill until the approximate date of arrival of the proceeds in London. These are called interest bills, and the following is a specimen of the kind of bill drawn.

EXCHANGE FOR £100.

22, Anchor Street,

London.

10th June, 19....

At sixty days after sight pay this first of exchange (second unpaid) to the order of the Indian Bank, the sum of £100 (one hundred pounds sterling) Payable at the Indian Bank's drawing rate for demand bills on London with interest at 6 per cent per annum added thereto from the date hereof to approximate due date of arrival of the remittance in London—value received.¹

A. Buggins & Co.

*To C. Dollar & Co.,
Calcutta.*

¹ The interest clause sometimes reads: "Payable at drawee's option at the A B Bank's drawing rate for demand drafts on London or at their telegraphic transfer rate on London, with interest," etc.

A comparison between the charges on one of these bills and those on a banker's acceptance in London, shows the advantages of the one over the other. Take for example a documentary bill bearing the interest clause, drawn on Madras for £500 at three months' sight. The interest may be calculated approximately for 120 days, which allows for the tenor of the bill and the time taken to get the proceeds back to London. Assuming interest to be at the rate of 6 per cent.

the 120 days at 6% on £500 would equal	£	s.	d.		£	s.	d.	
			9	17			3	
to which must be added the Indian stamp duty.				5			0	
						10	2	3

A bill drawn under an acceptance credit on a London bank would be for the same period—

120 days, say, 4 months' sight; the accepting commission may be taken as 1½% per annum—	£	s.	d.				
1½% per annum on £500 for 4 months			2	10	0		
Discount on £500 for 4 months, say, 2%			3	6	8		
Stamp duty				5	0		
					£6	1	8

This shows plainly how much cheaper the business can be financed by taking a London banker's acceptance. When money is dear, however, and the rate for discounting a four months' sight bill is, say, 4 per cent, firms will revert to interest bills, as there will be no appreciable saving on the acceptance transaction.

As far as the foreign banks are concerned, they, of course, prefer the interest bills, but although there is a higher yield on such paper, we have still to remember that a banker often advances the greater part of the amount represented by a documentary bill, while with an acceptance he advances nothing. His only risk is that proceeds may not be forthcoming at maturity, and it is for this risk he charges the small commission of 1½ per cent. The commission, small though it is, returns a very satisfactory profit if operations run into large figures, but even taking

that into consideration, one may still be inclined to ask why it is that the banker is prepared to make himself liable on acceptances for such a trifling commission. We have already shown that a bank's foreign agents are, in most cases, fully empowered to control the collateral security, and as in practice they keep a sharp eye on the disposal of the merchandise the risk is reduced to a minimum. There is, however, a further point to be considered, which is not present in the ordinary inland bills—the question of exchange. The foreign banker expects to make a profit on the exchange in the currency of the two countries when remittances are sent here to meet bills maturing. If, therefore, the banker does not get a share in the exchange business, the return on the operation hardly seems commensurate with the risk involved, small though it be.

Apart from these *soi-disant* London acceptances, there are several details which call for attention in the documentary bill business with the East. Bills on Eastern countries are drawn at various usances, from one to six months' sight, and it never seems to be clear to some people why a banker should prefer bills bearing the interest clause to be drawn for short periods only. If, it is argued, a bill is drawn at six months' sight, and it bears 6 per cent interest from the date of the bill until the counter remittance arrives in London, surely that is better for the banker than if the bill is running for a much shorter time, say, one month. Long dated paper is, however, unsuitable to the exchange banker. Suppose he buys a bill on Shanghai at one month's sight, the bill takes one month on its journey out, and if accepted will be paid in Shanghai two months after leaving London. The funds received from the encashment of the bill at maturity must be remitted by the banker to his client, and this remittance takes, say, another month, which will have to be added to the other period to be charged, thus making three months in all as the time for which interest at 6 per cent will be added to the amount

of the original bill drawn from London on Shanghai. The reason the banker would rather take these bills at short usance in preference to the long-dated paper is now easily explained: the banker must keep a proportion of his funds liquid for the purpose of purchasing homeward remittances, and if his money were locked up in bills payable six months after sight (eight months in all), there would be a difficulty in meeting demands from those wishing to send money to England. To tie funds up in long usance bills would, in fact, defeat one of the first principles of exchange banking, which is to keep funds liquid. It is also manifest that the exchange profit to be derived from an investment in homeward remittances will generally be greater than the return obtainable if the money is left in six months' interest bills.

MARGINAL DEPOSIT RECEIPT. As we have said before, a banker is not always prepared to advance the full amount of the bills. It often happens that exporters to the East, and also the importers upon whom bills are drawn, are not of sufficient standing to merit extensive credit facilities, and although bankers are willing to negotiate a fair amount of the exporter's bills, in the case we are considering they usually endeavour to limit their risk by retaining a margin on each bill negotiated. Suppose the drawer offers a bill for £100, the banker will advance 75 per cent and issue a marginal deposit receipt for the remaining 25 per cent, and a similar deduction will be made from each bill passed through the bank. Interest, at an agreed rate, is allowed on these margins from the time the bills are received by the bank until the net proceeds are remitted from abroad, and then, if all bills running are duly honoured and there is no deficiency, the full amount of the margin, plus interest, will be paid over to the client.

Where interest bills are drawn it is customary to allow interest on the marginal deposit at the same rate as that called for in the bills. It would obviously be unfair to collect and retain, say, 6 per cent on a bill for £100 from

the drawee, when only £75 had been advanced to the drawer in London, so what the banker really does is to obtain the full interest on the £100 from the drawee abroad, and then when the proceeds are remitted to England, make over to the drawer the interest on the £25 which he holds as margin against the payment of the draft.

It is usual to stipulate in the marginal receipts that the deposits are held against "bill or bills running," and in general the amount will not be released until all bills have been met.

On the face of it this system appears to afford sufficient, if not ample security to the bankers who advance against the bills of exchange, but where unscrupulous persons are concerned it is open to abuse. Once an exporter knows the amount which will be advanced against his paper, there is nothing to prevent his invoicing the produce at a price to cover the 25 per cent margin, and then drawing his bill of exchange in conformity. Unless the banker has an expert knowledge of the commodities shipped, he cannot tell the exact price, and although he advances what purports to be 75 per cent of the invoice value, it is plain that he is actually paying the exporter the full amount of the bill, as the goods are invoiced at 25 per cent. in excess of their real value. For the successful operation of this malpractice, some collusion between importer and exporter is probably necessary, though it by no means follows that the importer is always a party to the deception, which sooner or later is bound to come to light.

BILLS FOR COLLECTION. In the case of bills, documentary or clean, sent for collection, there is no risk to the banker. He merely sends the paper forward to his Eastern branches and follows the instructions given in the letter which accompanies the documents when delivered to him in London by the drawer; if the documents are to be handed over to the Eastern importer against acceptance, he will pass them on to the drawee when the bill is completed, but if his instructions are not to part with them until

payment is made, the bill is simply presented for acceptance, and if not then paid, is held attached to the documents until it suits the importer to take them up. In the meantime the goods will be warehoused, and when the importer eventually retires the bill and takes delivery, the proceeds will be remitted to London, either by mail or by telegraphic transfer, at the option of the drawer of the bill, and finally paid to him less the banker's commission and charges. If the exporter's instructions are "all charges to be paid by the drawee," the banker will collect them at the time the bill is paid in the East, and in that case the exporter will receive the net amount for which his bill is drawn.

In connection with the documentary bills drawn under the various forms of credit we have previously discussed, there are one or two customs which seem to be entirely for the benefit of the importer, and it is as well to mention them here.

DOCUMENTS ON PAYMENT. We will take first the case of a bill drawn on an importer for, say, £300, at three months' date, marked "documents on payment." If on presentation the importer is not in a position to pay the bill, he merely accepts it and returns it to the banker. What the banker then does is to warehouse the goods either in his own warehouse, or in some neutral storage place, and here they are supposed to remain until the bill is paid. In the East, however, and often elsewhere, it is customary to allow the importer to take delivery of a portion of the goods against part payment of the bill: these partial deliveries continue until he has sold the whole shipment, and when the last portion is taken away the banker is supposed to have received the total amount due on the bill.

This practice might be very simple and satisfactory if only one bill were drawn, but where, as is frequently the case, a number of drafts are running and a large amount of produce is in the hands of the banker, the danger is that the acceptor of the bills may pay for and take delivery

of those goods which command a ready market. If allowed to do this, he sometimes retires the bill drawn against the particular consignment of which he wishes to obtain possession; at other times the proceeds of sales will be placed against the first bill maturing, and as a result the banker may finally find himself left with a depreciated and inadequate security, which by no means represents the value of the bills of exchange he has still on his hands. The confusion becomes worse confounded if the respective shipments are not kept strictly separate, as there will be a tendency for partial deliveries to be taken of a number of consignments, and no matter whether the first or last bill be retired, the bank will eventually be left with a conglomeration of merchandise of doubtful marketable value.

No matter how careful the banker or his agents are, they cannot always tell whether the importer is taking out goods in proportion to the payment he makes. For example, a bill might be drawn for £500 against 100 cases of goods; if the banker is asked to deliver fifty cases and receives payment of half the amount of the bill, £250, it is possible for the importer to take cases, the contents of which are worth £350, and leave the banker with the remaining fifty cases, which, although they are supposed to be security for the balance of the bill, are in reality worth only £150.

There is then the case where the banker delivers the complete set of shipping documents on acceptance of the bill by the importer: here he undoubtedly parts with the whole of his collateral security, and, apart from the safeguard which the several letters of hypothecation we have mentioned are to him, the banker's only means of protection is to obtain from the importer a trust receipt. The mere mention of this document is a reminder that it is one of the instruments used in foreign exchange banking which ought to be thoroughly explained to the reader.

TRUST RECEIPTS. Shorn of all its technicalities, the trust receipt is simply an undertaking which the acceptor of a "Documents on Payment" bill in a foreign port signs in order to obtain delivery of the goods before he has paid the bill. He recognizes the bank's lien on the merchandise, and undertakes to sell it and to pay the proceeds into the bank as soon as received.

In many cases the drawees are permitted to store the collateral security in their own warehouses, but in some places the banks have their own storage accommodation ("go-downs," they are called in the East), which enables them to exercise some sort of a check on the deliveries.

The custom of delivering goods under trust receipt seems to have originated in America, where the law recognizes to a far greater extent than elsewhere the bank's property in the goods after they are given up to the acceptor of a bill. As a matter of fact, a drawer of a bill from this side will rarely authorize delivery under trust receipt, and the banks abroad more often than not take the responsibility themselves, which means in effect that they part with the goods contrary to the instructions of the drawer, to whom they are then, of course, responsible for the ultimate payment of the bill representing the value of the shipment. The whole thing in principle amounts to this: the difference between having a five-pound note in your pocket and another man's owing it to you; and although the system is good enough where the acceptor is perfectly trustworthy, yet, so long as human nature is what it is, difficulties will always arise, and from the standpoint of British banking we have no hesitation in saying that trust receipt facilities are open to grave objection.

The fact remains, however, that with bankers abroad the trust receipt is a *pis aller*. It frequently happens at a foreign port that there is no public storage accommodation, and if the bank does not possess its own warehouses it is practically obliged to deliver the merchandise to the

acceptor of the bill against his signature to a trust receipt. Even where public warehouses or go-downs do exist, the system of storing the collateral security in them is not liked, since in many places there is nothing to prevent one dealer's inspecting the other person's property and so getting a clue to the quality of produce shipped and the source of supply. However, as we have pointed out, the banks do sometimes surmount this difficulty by building or leasing their own warehouses, and if they desire to avoid the disputes which occasionally arise when trust receipt facilities are given, the remedy is obvious.

There is this much to be said for the system : it enables the importers to deal with merchandise immediately it arrives ; sometimes, too, the bank does not run great risk, as the importer has frequently sold the goods against payment on delivery. In this case he will give the bank details of his sale and will sign a trust receipt agreeing to collect the proceeds from his buyer and pay them over to the bank immediately. But if the merchandise is not sold and the banker allows it to be stored in the importer's own warehouse in exchange for a signed trust receipt, he is in a similar position to a person walking through a great wood : the walker cannot see the leaves of the trees, and the banker cannot see the goods over which he ought to have control, consequently the importer is at liberty to deliver how, when and where he likes. To guard against this contingency some bankers only deliver the relative documents against trust receipts to enable the importer to store the commodities in a neutral warehouse in the bank's name. The receipt, which the owners of the store issue, is held by the bankers, and subsequent deliveries can then be made only under the cognizance of the bank.

The financial responsibility of the importer is the factor which counts in all trust receipt facilities, and unless the banker has confidence in the position of the importer the accommodation cannot safely be given.

The several practices we have just enunciated are in

operation in many countries besides those Eastern centres we have indicated. The trust receipt system, for example, is said to have been evolved in the United States, but something akin to it is seen in the cotton and woollen manufacturing districts of England, where it is no uncommon thing for the raw material to be delivered on the signature of a trust document before the bills of exchange are paid. As one of the bankers remarked to the writer, it would be a clever banker who could pick out his own security once the shipment had reached the mills of the manufacturers.

Needless to say, there is always a vast quantity of merchandise also stored in the London dock warehouses, and the same difficulties which arise abroad occasionally present themselves here. Bills of exchange drawn on London importers are constantly arriving from foreign countries, and if the banker is instructed not to deliver documents except on payment, he will have to take delivery of the goods and warehouse them until the drawee is in a position to pay the accepted bill. If the importer who has accepted a "documents on payment" bill, desires to obtain possession of the merchandise before maturity of the instrument, he can, of course, do so by paying the bill, and in that case the banker will allow him rebate on the amount of the bill for the unexpired period at $\frac{1}{2}$ per cent. above the London joint stock banks' rate of interest for short deposits.

PARTIAL DELIVERIES. Partial deliveries, except in rare instances, are not made in London, but some bankers do permit the importer to have the documents of title to the goods on the deposit of satisfactory security or against the guarantee of other parties of repute. However convenient this system may be to the importer, it cannot be regarded as suitable to the exchange banker, who, by his own act, ties up funds which could have been utilized to better advantage in financing any outward business offering. It is plain that as long as the banker holds the accepted bill with documents attached, there is some

incentive for the importer to make early payment in order to be able to deal with the shipment, but once he is allowed to obtain possession of the documents against the deposit of security, the incentive to take up his bill is gone, and the chances are that he will make no effort to pay it until the date of maturity ; the banker will thus be out of his money during the whole time the bill is running, for, as we shall see later on, these " Documents on Payment " bills are not usually discountable.

CHAPTER XX

DOCUMENTARY BILLS ON AUSTRALIA, SOUTH AFRICA, THE UNITED STATES OF AMERICA, SOUTH AMERICA, CENTRAL AMERICA, AND OTHER COUNTRIES

WITHIN the limits of this volume it is obviously impossible to describe the bills drawn on every country, but it will be sufficient for all practical purposes if we confine our attention to the paper current between London and some of the more important foreign and colonial centres. We have seen how business is transacted with the East; let us here extend our operations to the Australian continent.

Australasia.

The period for which bills are drawn varies from sight to 120 days' sight, but nowadays the majority are drawn at sight.

The Australian and New Zealand banks purchase or negotiate for the full value bills drawn on Australia and New Zealand. Most of the bills of exchange negotiated in London are drawn in sterling and contain the clause, "Payable with exchange and stamps as per endorsement." The exchange is fixed at the time of negotiation and not, it should be noted, at the time of payment of the bills. In view of the misunderstanding that sometimes arises, banks at the present time endeavour to get their customers to amend this clause to: "Payable with exchange at time of negotiation and stamps as per endorsement," and where this is done disputes are avoided.

Bills for collection are usually drawn in sterling with a clause "Payable with all charges for a sight draft on London." Occasionally the homeward remittance is made by currency draft, that is, in Australian pounds, but this

method is rarely used at the present time. The general practice, where no instructions are given regarding proceeds of bills, is to remit to London by sight draft.

The Australian and New Zealand banks do not make advances in London against bills forwarded for collection.

A few words may be said in regard to bills drawn in the reverse direction, that is, Australia on London. Most of these bills are purchased outright by the banks, and a very large number of them are drawn under the authority of credits established in London and advised out to Australia. The bills are invariably drawn in sterling, with an exchange clause added; they are not drawn in Australian pounds.

It is the general practice, too, where bills are drawn on London, to deliver documents against payment only, except of course, to banks and accepting houses.

There has been an interesting innovation of late years which is worth noting. It arises in connection with wool shipments, which are now financed by means of telegraphic transfer drawings under the authority of Letters of Credit established in London. This is probably due to the fact that importers in the United Kingdom have money lying idle, or perhaps earning only a very low rate of interest. The usual procedure is to have a Letter of Credit opened, which provides for drawings either by telegraphic transfer, or by sight bills, or 30 or 60 days' sight bills. In the case of telegraphic transfer operations, the drawer or shipper in Australia hands the documents to a bank there, who pay him the Australian funds required forthwith. The bank then telegraphs to its London office to collect the necessary sterling from the importer in London. The documents of title to the wool follow by ordinary mail, and are, of course, handed to the importer in London immediately on receipt.

RATES OF EXCHANGE

Exchange rates are now fixed by the Commonwealth Bank of Australia, and the following examples may be noted. All transactions are based on £100—in London.

SELLING RATES ON AUSTRALIA—

	Demand Drafts and Mail Transfers by Air Mail or Ordinary Mail	Cable Transfer
£100 London =	£125 1s. 3d Australia	£128 Australia

BUYING RATES ON AUSTRALIA. Bills on Australia are purchased on the basis of £100—London, as follows—

	<i>If sent by Ordinary Mail.</i>	<i>If sent by Direct Air Mail.</i>
Demand . . .	£128 7s. 6d. Australian.	£128 2s. 6d. Australian, plus postage.
30 days' sight . . .	£128 17s. 6d. Australian.	£128 12s. 6d. Australian, plus postage.
60 days' sight . . .	£127 7s. 6d. Australian.	£127 2s. 6d. Australian, plus postage.
90 days' sight . . .	£127 17s. 6d. Australian.	£127 12s. 6d. Australian, plus postage.

BILLS FOR COLLECTION (CLEAN AND DOCUMENTARY). In addition to exchange between Australia and London, commission at 7s. 6d. per cent, minimum 1s., is charged.

EXCHANGE RATES—AUSTRALIA ON LONDON

BUYING	Cable Transfer	Sight	30 days' sight	60 days' sight	90 days' sight
Direct Air Mail . . .	£ s. d. 125 - -	£ s. d. 124 16 3	£ s. d. 124 10 -	£ s. d. 124 5 -	£ s. d. 124 - 6
Ordinary Mail . . .	£ s. d. 125 - -	£ s. d. 124 13 9	£ s. d. 124 7 6	£ s. d. 124 2 6	£ s. d. 123 17 6

The banks bear the cost of British and Foreign Bill Stamps on bills purchased in Australia.

SELLING . . .	£ s. d. 125 10 -	£ s. d. 125 8 9	£ s. d. 125 6 3	£ s. d. 125 3 9	£ s. d. 125 1 3
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LETTERS OF CREDIT. No charge is made for establishing Letters of Credit to finance shipments from Australia. Bills are purchased in Australia at the rates of exchange quoted above.

South Africa.

Our survey would not be complete without some reference to South African banking procedure. The South African banks both buy and sell exchange in South African currency, the rates quoted, as we explained in a previous chapter, being from sight up to 120 days' sight.

In some cases it is the custom for various clauses to be inserted in bills of exchange. For example, on Beira bills are required to contain the clause "British sterling payable in local currency at the bank's current selling rate for demand drafts on London plus stamps."

Then, suppose an exporter's bills on Elizabethville are negotiated through the Standard Bank of South Africa, they would be required to contain the following clause: "Payable at the Standard Bank of South Africa, Ltd., current selling rate for demand drafts on London with interest at 6 per cent per annum from the date hereof to approximate date of arrival of the remittance of proceeds in London, plus stamps."

The South African banks negotiate exporters' bills drawn under the various credits we have previously enumerated: they also purchase bills offered purely on the standing of the names appearing on the paper, each bill being judged entirely on its merits. If staple articles of merchandise are shipped, and the drawer and drawee are first-class people, the banker will advance the whole amount of the bill, but if he considers their financial responsibility does not warrant the full extent of the accommodation, or goods of a perishable or speculative nature are being exported, only about 75 per cent of the amount for which the bill is drawn will be advanced.

It should also be noted in the case of these African bills, that it is the custom for the exporter to include the exchange in his invoice for the shipment, and then draw his bill for the full amount of the invoice.

When bills are sent for collection through the South African banks, sometimes the drawee pays the extra exchange and charges, and on other occasions they are borne by the drawer; it is generally a question which is settled by the importers and exporters themselves, and the banker either collects the amount of his commission, etc., from the drawee, or else deducts it from the remittance which is made to the exporter in final settlement of the bills at maturity.

In each class of bill documents are given up on acceptance or payment on the usual conditions.

The proceeds of bills negotiated, or, as some banks call them, bills remitted, are utilized by the banks for the purchase of paper and telegraphic transfers offering in South Africa drawn on London.

As regards bills for collection, the proceeds are remitted home at the current rate for demand bills and/or telegraphic transfers on London, according to the arrangements made between the various operators.

The following specimen gives in a convenient way some idea of the form homeward bills take.

No..... Pretoria, 1st May, 19.....

EXCHANGE FOR £200.

Three months after sight of this first of exchange (second of the same tenor and date being unpaid) pay to the order of the A B Bank the sum of £200 (two hundred pounds sterling) value received, and place the same to account of thirty boxes of ostrich feathers shipped per s.s. "Union Castle" to London.

*To Messrs. Blank & Co.,
Nile Street,
London.*

J. C. Kruger & Co.

It should be noted that all the African banks now publish lists of rates at which bills will be negotiated, and as these may be had on application, they form a useful guide to merchants and traders with South Africa and adjacent countries.

U.S.A.

We now come to the American Continent, and as conditions with the United States are so well known, little need be said about the practice there. American banks until quite recently were precluded from opening branches in other countries, and in consequence the bill business was almost entirely in the hands of the British and Colonial

banks and finance houses. This restriction has, however, now been removed, and we now have American banks in active competition with our institutions in London. The issue of dollar credits and dollar bills, however, has not been an unqualified success. There is still an overwhelming preference for the "bill on London," which is the international medium of exchange "par excellence."

Apart from demand bills the most common usage for bills drawn from Great Britain is sixty days' sight, although ninety days' sight bills are also constantly seen. The principal centre upon which the bills are drawn is New York, and documents are given up both on acceptance and on payment, subject to the conditions we have mentioned with other centres. There is, however, a very large number of bills drawn and negotiated under the several credits mentioned, which never reach the United States: arrangements are made for the issue of the commercial credits from London, and when shipments are sent to the United States from many foreign countries, the relative bills are drawn on and accepted in London by London banks and accepting houses. To these institutions the drafts with shipping documents attached are sent, and if everything be in order, the bills are accepted and retained in London, while the documents are at once sent forward to New York to reliable agents of the London banks. It is then a question whether to deliver them to the American importers on or before payment. Generally speaking, if the bank's correspondents are satisfied as to the financial responsibility of the importers, the documents will be handed over on an undertaking to pay to the bank the proceeds of sales as soon as received. Trust receipt facilities in the United States, we need hardly say, are the rule rather than the exception, and as the trust deliveries are extensively practised, it is often found difficult to discriminate between particular firms.

Bills are, of course, drawn direct, and not infrequently bear the clause "documents on payment," and if a client's instructions to this effect are ignored and documents are

delivered on acceptance, the banker practically takes the responsibility on his own shoulders. As a matter of fact, trust receipt facilities have become so much a part and parcel of the American system that it is doubtful whether the practice will ever be eradicated. The custom doubtless originated when few bills were drawn on New York: the majority of the drafts for American shipments from all over the world were drawn on London first, owing to the fact that no discount market existed in New York, and, secondly, because the names of American drawees were so little known abroad that even where bills were drawn direct they were hard to negotiate. In these circumstances, the banking authorities in the United States seem to have instituted the trust receipt system to save themselves the trouble of carrying the heterogeneous collection of bills of lading and other documents which were constantly arriving from other centres without bills in any shape or form being attached. The extension of discount facilities under the Federal Reserve system in America of recent years, has brought New York more into line with London and other monetary centres. Bill and discount finance may in time, therefore, militate against the trust receipt system.

The counter remittances to Great Britain are often made by means of sixty days' sight bills, but both demand and telegraphic transfer remittances are largely in evidence.

South and Central America.

The following is a brief summary of the exchange conditions at present obtaining in the various centres of South and Central America.

ARGENTINE. It is essential for importers to procure a preliminary Import Permit from the Exchange Control Board, which must be produced in order to obtain official exchange for payment of the goods. If this permit is not obtained, payment can be effected only at the free market rate, with a surcharge equivalent to 20 per cent of the official rate.

The usual term of credit is 90 days and bills are invariably paid at the sight rate on London. Documents relating to usance bills are delivered against acceptance and of sight bills against provisional payment in local currency, pending the issue of exchange by the Control Board, which is available after the goods have been cleared from the Customs.

Protest of bills of exchange for non-payment must be effected, at the latest by 3 p.m. the day following maturity.

URUGUAY. Importers are required to apply for a permit before placing their orders abroad, and when this permit is granted they must deposit 20 per cent of the value of the goods within fifteen days, failing which the permit lapses.

Prior payment must be effected either in cash or by means of a forward exchange contract before the goods can be withdrawn from the Customs. The permits usually stipulate the type and percentage of exchange which will be allowed for the payment of the goods.

The usual term of credit is 90 days' sight and documents against acceptance, and in the case of sight bills, documents against payment. Bills are invariably paid at the sight rate on London.

Protest must be effected within 24 hours after due date.

PARAGUAY. All official exchange is in the hands of the State Bank, and it is essential to obtain permit for liquidation of imports at that rate.

Permits are only given for the importation of goods of prime necessity and goods which do not come into this category must be paid at the free rate.

The usual term of credit is 90 days' sight, although under the present conditions bills at sight are frequently drawn.

Bills should contain a clause that they are payable at the sight rate by bankers' draft on London. Protest must be effected within 24 hours of due date.

CHILE. All exchange is in the hands of a Control Commission, and it is essential to obtain a permit for remittances abroad. The Control Commission will only grant permits

for the payment of current imports which consist of articles of prime necessity. For other imports considerable delay is experienced in obtaining permits.

Bills are generally paid at the sight rate on London, and it should be noted that the majority of bills are drawn at sight.

BRAZIL. There are no restrictions limiting the importation of goods, but importers must obtain a permit for payment by presenting to the Fiscalization Authorities viséd Commercial and Consular Invoices and Customs receipt for duties. There are no undue difficulties in obtaining exchange, providing these documents are approved.

The usual credit allowed in this market is 90 days' sight, 120 and 150 days' date, and the return remittances are made at sight or 90 days' sight according to the terms of the order—the latter rate, however, predominates.

Protest of an accepted bill can be effected against the acceptor at any time within five years of due date, but if it is desired to retain recourse against drawers or endorsers, protest should be effected within 24 hours of due date.

COLOMBIA. Recent regulations provide that importers must obtain previous licence from the Exchange Control. Such licence will be appended at the foot of the respective orders which should be presented to the Exchange Control in duplicate. One copy of the order is for the use of the Colombian Consulate at the place of dispatch of the relative goods, and it will not be possible in future, to obtain a consulate signature to the Consular Invoice unless the corresponding import licence, duly authenticated, is presented at the same time.

Exchange for payment of the goods will be given after they have been cleared from the Customs and on presentation of the Consular Invoice and Customs Manifest.

The usual terms of credit vary between 90 days' sight and 180 days' sight and remittances are effected at the sight rate on London. In the case of usance bills a certain

period elapses before exchange is available, and it is not customary for drawees to deposit currency in guarantee; pressure to do so might lead to drawees lodging currency in payment with a consequent loss in exchange for the exporters.

Protest should be effected within 24 hours of due date, but this is seldom resorted to unless it is desired to seek payment by legal means.

PERU. There are no exchange restrictions, and foreign exchange for the payment of imports can be obtained without difficulty. It is advised that bills should contain a clause stating that they are payable by means of bankers' draft on London at sight.

NICARAGUA. Due to the scarcity of available exchange, there is a pronounced delay in the payment of imports. It is expected, however, that the position will show an improvement in the near future.

SALVADOR, VENEZUELA, ECUADOR, GUATEMALA. There are no restrictions in foreign exchange at the moment, and exchange for the payment of imports is regulated by the amount available on the open market.

Bills are invariably paid at the sight rate on London, and it is recommended that this should be stipulated on the bills, by means of a clause to this effect.

Spain, Italy, France, etc.

The bills described in this chapter by no means represent the whole of the foreign paper seen on the London market, neither do they account for all the return remittances in the shape of foreign drafts which circulate on the London market; Spain, Italy, France and other European countries all utilize London for financing their import trade, and the credits they open from time to time give rise to a good many of the bills found in the portfolios of London bankers.¹

¹ Cf. *Finance of Foreign Trade*, by W. F. Spalding (London, Sir Isaac Pitman & Sons, Ltd. Price, 7s. 6d.).

CHAPTER XXI

ON FINANCE BILLS, GENUINE AND OTHERWISE—KITE-FLYERS—HOUSE PAPER—ADVANCES FOR CROP REQUIREMENTS—PACKING CREDITS AND THE RISKS INHERENT IN THEM

IN Chapter XI we discussed one of the most potent influences on the exchanges—finance bills. But, although it was shown that such paper is largely drawn in connection with arbitrage operations in international stocks and shares, we must not lose sight of the fact that this paper is constantly in evidence in other transactions. Some confusion seems to exist on the market as to what really constitutes finance paper, but among exchange writers there is a consensus of opinion that the term should be restricted to all long bills drawn by the banks and accepting houses of one country on those of another, bills, that is to say, which are "manufactured" for the express purpose of raising money at an opportune moment. There is no particular magic in the process; all that happens is for the recognized accepting houses of one centre to grant facilities to foreign operators to draw bills on them whenever it is apparent that ready money can be profitably employed on the foreign market. The long, or three months' bill is sometimes drawn against a standing balance with the correspondent, but more often than not the banker abroad is allowed to draw bills on the understanding that he shall put the acceptors in funds before maturity. These bills, bearing the names of first-class banks or finance houses, are readily saleable at the best rates, and immediately they are offered the drawer receives funds to indulge in what other operations he likes. In due course the bill arrives, say, in London, is accepted, and then sold under discount on the open market, upon

which it will circulate until the date of maturity, and, as we have seen, neither the drawer nor the acceptor need put down a single penny until the time for payment arrives. When the bill does fall due to be paid, the drawer must see that funds are in the hands of his friend the acceptor, and it is customary to remit the amount of the bill so that it shall be in the hands of the London acceptor at least one day before the presentation of the finance bill. A sight draft is generally purchased on the foreign market and sent forward for this purpose, and the effect of this sight draft on the exchange between two countries is the reverse to that occasioned by the drawing of the finance bill: the latter would tend to depress the exchange, but the former would elevate it, if one may use such an expression. It is not that the first drawing of these finance bills, or even of the remittance of the sight drafts, has a marked influence on the exchange at once, but it seems inseparable from such accommodation that there should be a constant renewal of the facilities. If the three months' bills were merely renewed at maturity, the influence would not be great, but when we see that further bills are drawn the final effect becomes more plain.

This is how the matter works in practice.

We may presume the A B Bank in New York has drawn a ninety days' sight bill on the Blank accepting house in London; towards the end of the period in question the A B Bank perceives that it will be inconvenient to find the wherewithal to purchase the remittance which must shortly be sent forward to London to meet Blank's acceptance, so what it does is to draw yet another bill of the same tenor and sell it on the New York market, and by this means procure sufficient funds to remit in cover of the previous bill drawn.

It may appear at first sight that the creation of these finance bills can go on indefinitely, but that is not so. The amount of paper running on the market for any one bank, finance house or individual, can generally be pretty

well gauged, and if at any time the market deems the sum total to be sufficient, there will be a tendency to discriminate against the bills. Takers of bills do not exactly decline to receive more of the paper of the firm in question, but higher rates will be charged as an insurance against the extra risk: it is as if the buyers say, "We do not refuse to take more of A B's bills, but we would rather not be asked to receive more," and a continuance of this state of affairs soon causes trouble in the quarters concerned. Consequently, further bills will not be drawn as a rule until a portion of those circulating has run off. In practice operators do not usually go to the extent of drawing more than the foreign discount market will readily absorb without comment—they know that once discounters eye their paper suspiciously, they become, what is termed "talked about," and, as we all know, nothing is more damaging to a financial firm's credit than to be in such a position.

As we have referred to the discount market in passing, it may be well to give the student some idea of the way in which the price of these "long" finance bills is calculated. Briefly stated, it is the *market rate* of discount ruling in the city upon which the bill is drawn that governs the price. If the reader will refer to Chapter XII, he will see that the rate at which bank paper is discounted is considerably less than that charged for trade bills, from which it follows that as these finance bills come under the category of bankers' bills, they can be sold, as soon as drawn, subject to the lower charge, namely, the market rate of discount. It is this rate of discount, then, which principally affects the drawing of finance bills; the higher the market discount quotation in London, and the lower the price of money on the foreign market, the fewer such bills will be drawn, and *vice versa*.

An additional point to be borne in mind is, that there are certain seasons which favour the drawing of these finance bills, as they affect the supply of exchange upon

which the drawer is dependent for covering his operations. In the United States, for instance, the exports of cotton, wheat and other grain are principally made during the autumn, and bills drawn against the cargoes will be offering in large quantities at that period of the year ; consequently exchange will be low. The drawers of finance bills on Great Britain know this, and if they were selling such paper, say, in May or June, the possibility of their being able to buy demand exchange at low rates for remittance to London to meet maturing finance bills will to some extent influence their drawings.

" Kite-Flyers."

As against the foregoing, which may be called the more legitimate form of finance bills, we get another variety, dignified by the name of finance bills, it is true, but referred to on the market as "kite-flyers." Kite-flying operations are seen where a firm, not necessarily a financial house, trades on its reputation and induces other people to accept bills, the sale of which is a means of furnishing the drawers with funds. Such bills are accommodation paper, pure and simple, but no one ever realizes that fact until the drawing house signifies its inability to provide the acceptors with the money to meet the bills at maturity.

It is never easy to tell when kite-flying operations are in progress ; the bills are often drawn by reputable trading concerns, public companies, and even by foreign banks on banks and finance houses in London, and when a series of renewal bills is drawn the practice may continue unchecked for a long period.

Probably the worst instance of kite-flying in recent years was that which came to light upon the failure of the Bank of Egypt. The investigation undertaken by the liquidator proved conclusively that the bank had been obtaining extensive credits on the London money market simply on its name: it had in fact been living entirely on its credit for a considerable time, and the moment the bank's

bills became unsaleable it failed. Whenever liabilities seemed to be pressing, funds were raised by drawing and selling three months' bills against cash in Egypt, and when these bills matured, the money to meet them was obtained from further sales of drafts.

"House Paper."

There is yet another variety of finance bill, which comes under the category of "House Paper." House paper, so called, comprises all those bills drawn by the foreign branch of a firm on its London house, or *vice versa*, that is, bills bearing identical names as drawers and drawees. Here we must, as it were, separate the dross from the fine paper: we cannot rightly describe a firm's documentary house paper as finance bills, for, although the exchange dealer does not really get the security of two names to his bills, he still has the documents for the merchandise they represent. The risk comes in where a firm draws these bills clean, that is without documents in any shape or form attached: such are finance bills of doubtful value, and when the paper makes its appearance firms are said to be drawing "pig on pork." There would not be much trouble if the circumstances were known to the market, but as it often happens that the two branches of a firm work under different names, it is sometimes extremely difficult to discern which bills come under this appellation. However, the bankers do scrutinize very carefully any paper which is suspected to be pig on pork, and the discovery that a trader is indulging in this method of finance is the signal for the banker to go carefully with him.

Advances for Crop Requirements.

Finally, we get those bills which are loosely described as finance paper, but which the bankers know all the time to be nothing of the sort: we refer to the bills drawn in connection with crop requirements. The transactions from which they arise are somewhat involved, but may be

roughly divided into two classes. First, there are the bills resulting from "up-country advances." In this case the bankers abroad, having satisfied themselves of the respectability, position, etc., of certain merchants, make them advances in order to enable them to purchase crops up country. Frequently, credits to cover the drawing of bills up to a named amount within a given period will have been sent out from England or other country. These are termed "Packing Credits," and it is really on the strength of these that the bankers in the country from which the produce is to be shipped make advances. With the funds advanced by the bankers the merchants buy the produce from the agriculturists, and when the arrangements are completed for export they deliver the bills drawn against the shipments to the banker. In the second case, advances are made direct to the farmers for the purpose of moving the crops, and when the grain, or whatever it be, is ready for shipment, the bills naturally go through the banker who has given the accommodation.¹

It will be realized that the term "Packing Credit" applies not so much to the credit itself, as to the advances made on the strength of the credit. Actually the advances made by bankers against such a credit to the beneficiary are on the strength of that instrument's having been provided by a bank or finance house to cover the drawing of certain documentary bills, by which shipments of goods, produce or commodities are to be financed. When one of these credits is issued it is frequently common knowledge that it is to be available for future shipments. Equally common is the practice of bankers in foreign countries to make advances prior even to the drafts being drawn or the shipping documents available. There are obvious risks in such business since the banker gets no protection under the letter of credit,

¹ For a description of the Banking Credits under which these bills are drawn, see *Bankers' Credits*, by W. F. Spalding (London, Sir Isaac Pitman & Sons, Ltd.); and article on "Finance Bills" in the *Dictionary of the World's Currencies and Foreign Exchanges*, by W. F. Spalding (London, Sir Isaac Pitman & Sons, Ltd.).

unless that document specially authorizes the granting of advances in the manner indicated. Difficulties sometimes occur, too, regarding cancellation, and it seems clear that, both for their own protection and that of their clients, negotiating bankers should insist upon the credits being made irrevocable. Particular attention, too, must be paid to the terms of the credit; any deviation from which, whether the credit be irrevocable or not, may involve the negotiating banker in serious loss.

The implication is, that unless extreme care be taken, packing credits may prove a weak rod upon which to lean. Another example, illustrative of the risks, may be of interest. Sometimes in China an exporter uses his own funds for the purchase of goods. They are placed in his own "go-down" (an Eastern name for a warehouse), but possibly the exporter may not have sufficient capital to pay for packing and preparation of the goods for shipment. The banks at this stage come to his aid. They issue to him a "packing credit," or allow an overdraft in current account, secured on the goods in the go-down. The reputation of the exporter for fair and honest dealing is the main element upon which the bankers rely in this business. But the weakness of the system lies in the fact that unscrupulous exporters may at times secure packing credits from more than one bank against the somewhat indefinite security of "goods in go-down." In such cases the bank which has the credit secured on specific items such as, say, 1,000 tons of hides, 500 piculs of wood oil, etc., has the first claim on the goods over the bank whose security happens to be on general unspecified goods in go-down. Another weakness is that firms have been known to ship goods on consignment to their representatives in another country, and if the market dropped in the meantime the representatives may fail to take delivery of the merchandise. The banks are then left very probably with unsaleable goods on their hands for the money advanced to the exporter.

CHAPTER XXII

THE DISCOUNT MARKET—THE BILL-BROKER

WE now arrive at the final stage of our enquiry, and having considered the circumstances under which the various bills are brought into being and how they are bought and sold, we may proceed to an examination of the way in which they are discounted. The discount market, we need hardly say, is one of the most interesting and at the same time one of the most important from the exchange banker's point of view: he is bound to watch its movements, and must also be careful to keep himself *au fait* with all the little changes constantly occurring.

Bill Discounting.

Let us be sure before we go further that we really know what discounting a bill actually means. Merchants, bankers, commercial men, and even some of the text-books have got into a slovenly and ambiguous way in their employment of the terms "discounting" and "discounted." Some years ago the writer happened to be present at a law lecture given by Sir John Paget, K.C., when attention was called to this very point. The word "discounting," as this eminent legal luminary remarked, is used indiscriminately to describe either the position of the person negotiating a bill for value prior to maturity, the amount the seller of the bill receives being less than the value in proportion to the unexpired term of the bill; or, to designate the position of the party who takes over the bill giving such reduced value to the transferor. In view of this existing ambiguity, it will be well to bear in mind that to discount a bill is to buy it, or, as Sir John Paget says, to become the transferee of it by having it endorsed or transferred by delivery by the holder, for a price settled either by agreement or by the current

market rate of discount. The discounter, obviously, is the person who buys the bill, while the one who gets the bill discounted, that is, sells it, is the transferor.

Now let us examine the practice on the London market.

In the first place we may say that there is a good deal of discounting done first hand by the joint stock banks, the country banks, and the private banking and financial houses. The gentlemen connected with these concerns are always willing to oblige a good customer by finding him cash when he wants it—at a price. A banker, we have seen it stated, is a man who takes care of other people's money and lets them have it as and when required, that is, if there is no obstacle (e.g. a moratorium) in the way. That, however, is only one side of the picture: the banker is really a distributing agent; he receives a flow of money from the quarters in which it cannot be usefully employed, and forthwith proceeds to direct it into other and more profitable channels. It is in this bill finance, or, as some prefer to call it, advances on bills, that part of the capital for which the banker is the custodian, is invested. In fact, it is an important part of the banker's business to lend money in such a manner and on such securities as will enable him promptly to keep the implied promise he has made when receiving the cash, to repay it whenever called upon to do so. These bills which he buys or discounts for his ordinary customers arise more often than not out of the genuine trade transactions, although, of course, it is no uncommon thing for accommodation paper to find its way into the bank's hands. Take the case of the merchant engaged in the internal trade of our country—a timber merchant, for instance, who sells a parcel of timber to his customer in Shoreditch. As the cabinet-maker there who buys the wood cannot get a return on it until he has manufactured various articles of domestic furniture, he will pay the timber merchant with, say, a three or six months' date acceptance. That is to say, the timber merchant draws a bill on the cabinet-maker, who accepts

it. At the end of the period the latter expects to have sold his furniture and have the cash in hand to pay the bill. The timber merchant in his turn cannot afford to wait until the maturity of the bill for payment, so he takes it to his banker, say, Barclays Bank, and if the acceptor be in good repute, the banker will discount the bill for a small charge, or, in other words, he buys the bill from the timber merchant and keeps it until maturity, when it will be presented to the acceptor for payment. In this case there is no need for the intervention of a bill-broker; the parties concerned carry out their own transaction and no middleman is necessary. As we have mentioned earlier in this book a banker seldom re-discounts these bills: they invariably remain in his portfolio until maturity. He has the drawer's and acceptor's names on the bill, and as long as a watchful eye is kept on the course of the various trades and the standing of the parties concerned, the risk on such paper is more or less nominal. The reason the bankers do not re-discount these bills is, that were they found to be doing so the market would look askance at the operation, and jump to the conclusion that something was wrong with the bank, which would be presumed to be short of funds and not able to pay its way easily. The amount of such paper offering, however, is negligible as compared with other bills. In fact, it represents but a small proportion of the huge volume of bills circulating on the London market. What interest the bankers most of all are the bills which arise from the exporting and importing operations.

The Bill-broker.

When it comes to discount operations the London banks, as a rule, do not deal direct with the sellers. In the banking world, as in every other progressive commercial community, there exists a class whose function it is to act as middlemen between the producer and the consumer, and the growth of this class has sometimes led critics to

consider that the profit made by the middleman is an unnecessary charge upon the commodity. The intermediary who has caused all the heart-burning and discussion among bankers is the bill-broker. His operations are constantly under observation, and the system which permits of this middleman's deriving a profit from business which in other countries is in the hands of the banker has been widely criticized. Bankers and financiers tacitly acquiesce in the presence of the bill-broker on their markets, but when under modern conditions he succeeds in attracting funds which ought to have come their way, they are apt to disclaim against their folly in permitting the birth of a competitor whose like does not exist on the Continental money markets. At first sight it does seem strange that bankers should have allowed this business to pass out of their hands, but we believe that at the outset the profession of bill-broking, if we may use such an ugly word, was brought into being by the failure of the old private bankers to encourage the discount operations of their clients. There was no eagerness to afford cheap credit facilities, and unless the customer was of the highest standing, high rates were exacted. It has been said that the idea of the old private banker was, that if a man had a bill to discount, he should adopt a sufficiently humble demeanour and approach his banker, and the man of pounds, shillings and pence would then be pleased to discount it. The idea that a banker should run about after a man who had a bill, or, as one of the bankers put it, that a large body of accomplished gentlemen should run all over London to find a man who had got a bill in order to compete for the honour of discounting it, never entered into their heads in that charming, good old-fashioned time. Now, it is manifest that that blissful state of affairs is altered, and we find the man with bills of exchange compared with Penelope, pestered with many suitors, while the bill-brokers are the men who run the streets to ferret out the possessors of drafts. It seems, then, that owing to the sins of the

bankers of bygone days, the commercial men began to look elsewhere for accommodation, and almost imperceptibly there sprang into existence a number of dealers, who were willing to undertake the business at very fine rates. No discount transaction was considered too small, no trouble too great, and these bill-brokers were always ready to avail themselves of a slight profit, either by discounting the bills themselves, or by finding discounters for the paper of respectable merchants and traders.

It is not, however, wise to lay too much stress on the shortcomings of the older generation of bankers; due regard must be paid to the nature and complexity of our present-day finance. If we remember to what a fine art the financing of commercial operations has been reduced, the extent to which our joint stock system has grown, and the conditions under which the modern bank manager in Great Britain works, we shall better understand the need for an individual with specialized skill in the particular branch of finance with which we are dealing. Not the least important of the operations with which the banker is concerned is the acceptance, collection and discounting of bills of exchange, and although the banker exercises a careful control over the main part of the business, yet his multitudinous duties allow time neither for personal visits to the dealers in bills, nor for his attendance on the open market; therefore, the major portion of the discount business has found its way into the hands of the bill specialists.

The bills with which the bill-broker has to deal emanate from various sources; chiefly they are those which enter Great Britain from other countries. At every foreign centre there are always merchants ready to export their wares, and it naturally follows that the funds the bankers receive abroad by the encashment of the drafts sent from London will be utilized for purchasing bills offered by exporters at the foreign cities. The exporters obtain payment for their produce by drawing on London in the

same way as the shippers here draw on foreign countries, and the net result of the two operations is the influx of bills into England for ultimate circulation on the London discount market.

Documentary bills are not the only ones received from abroad. In any financial centre there will always be a certain number of people desiring to draw bills for services rendered or debts due, and others equally desirous of settling indebtedness to England; consequently many clean bills will also be drawn and sent to London for collection.

To the total of the documentary and other foreign bills seen on our markets has to be added a large number of bills accepted by the finance houses and the London branches of foreign and colonial banks under London accepting credits, and then we have the principal paper with which the bill-broker is concerned in his efforts to meet the investment demand, always in evidence, for this form of bank security. For discount purposes bills may be divided into two great classes—bank paper and trade paper. Bank paper comprises all those bills drawn on and accepted by the great London banks and finance houses. Trade or "white" paper, includes all bills drawn on ordinary merchants and traders, accompanied by documents to be delivered on payment or acceptance. Clean bills are also included in this category, the general criterion being that the bills should bear on their face a statement that they are drawn against specific shipments. Bills without any such statements are not undisable, but the market exercises a wide discretion, will only take them on certain well-known names, and tends to regard the bills as finance paper of the pig on pork variety.

Bank bills are always discountable at the best rates, but the rate for trade paper is, generally speaking, about $\frac{1}{2}$ per cent higher than that charged for bank bills of similar usance. If bank paper is discountable at 3 per cent for a three months' bill, the merchant selling trade

bills would be charged $3\frac{1}{2}$ per cent ; consequently, if the bill were for £100, the banker would pay £100 less $3\frac{1}{2}$ per cent per annum for three months. There is no definite ratio for longer dated paper ; with four and six months' bills, the question of credit enters into the calculation, and the rates paid will depend largely on the probable trend of the market and the standing of the persons whose names appear on the bills.

To return to the bill-broker. In order to be in a position to make or invite definite offers for any of these bills, it is necessary for him to visit daily the offices of those dealing in such paper. At the London offices of the foreign branch banks, for instance, he walks in about eleven o'clock, reports on the likely trend of the discount market, and if there is any business doing, he will procure lists from the foreign bank which give the class, amount and maturities of the bills, and with these in his hands the bill-broker proceeds to the offices of his other clients, the London joint stock banks, finance houses, and Continental bankers, and endeavours to negotiate business. Three months' bills are now the most popular class, but discounters used to stipulate for an assortment of acceptances, that is to say, a proportion maturing at three, four and six months' date. All London bankers have come to know by experience the dates at which calls will be made on their cash balances, and unless anything untoward happens, they can so arrange that payments are made in accordance with their requirements: they simply let their bill portfolios automatically run out, and then when there is a surplus of cash again, further investments in bills may be made.

Theoretically, a bill-broker is supposed to take all good bills offered to him, or, what amounts to the same thing, find purchasers for them, and in practice he rarely declines to do business for his clients.

Just at this point we can see more clearly another reason for the banker's preferring to work through the intermediary of the bill-broker. Owing to his intimate knowledge

of the parties to a bill, the broker is able to guarantee the genuineness of all acceptances discounted, and although his own name does not appear on the bills, yet it is his business to see that all acceptances passing through his hands bear the endorsement of the bankers disposing of them, and that they are otherwise in order. A discounteur will seldom take these bills without a bank endorsement, and it is the practice of the Bank of England to stipulate for the names of two British firms, one of which must be the acceptor's, on all paper it discounts. When dealing through the bill-broker, too, it is easy for the banks to refuse bills bearing the names of firms which they do not like, or of whose bills they consider they have a sufficient amount in portfolio.¹

When a purchase has been satisfactorily arranged, the holder of the acceptance simply transfers his title by endorsement, and hands the bills over to the bill-broker against payment of the agreed price. These bills bearing the banker's endorsement are discounted at moderate rates, as the buyer has recourse on the banker in the event of non-payment at maturity.

The major portion of the bills discounted on the London market are, as we have seen, those which have been drawn by foreign exporters on and accepted by British importers, or by the banks who have arranged to accept for them in London, and so it is comparatively easy to get at the respective parties to the bills if anything is wrong, such as refusal to pay at maturity, or anything of that sort. However, the trouble is that among each lot of bills received in London from abroad, there are a number of what are called "foreign domiciles." A foreign domicile bill arises in the following manner. Out abroad there will perhaps be a French or Italian shipper who draws for his produce under arrangement with the bank that the bills shall be

¹ For a full description of practical discount operations, the reader is referred to *The London Money Market*, by W. F. Spalding (Sir Isaac Pitman & Sons, Ltd.).

made payable in London. On arrival in London the bills will be sent for acceptance, say, to Paris; they will be accepted in that city, but made payable in London, and will be sent here to the agency of the bank which negotiated them abroad. These bills, being the acceptances of Continental firms and others, are not liked on the London market, and neither the joint stock banks nor the finance houses care to carry them in their portfolios in ordinary times. In recent months foreign domiciles have become undisable on the London market, so the foreign and Colonial banks who have received them, are practically obliged to retain them until maturity, which naturally means a bad lock up of funds. Prior to the war a certain proportion was taken in parcels of bills discounted by some of the finance houses; the rest the brokers and discount firms used to take, and in all cases the person disposing of them had to pay a higher rate to those discounters who were agreeable to have them. The Bank of England has consistently refused to receive such paper, and never would discount foreign domiciles in any shape or form, not even when the bills were endorsed by first-class Continental banks.

The determination of the banks to discourage the circulation of foreign domiciles on the London market led dealers to extend the ban to bills which are termed "Foreign Agencies." Under this heading fall all bills accepted by the London branches and agencies of Continental or other foreign firms established in London, but having the greater part of their assets in foreign centres. The assets, presumably, cannot be considered available in the event of bills being dishonoured; consequently, there is a marked tendency to discriminate against the paper. These foreign agency bills are discountable to a limited extent only, and those selling the paper are penalized in the rates charged, which are usually $\frac{1}{8}$ per cent to $\frac{1}{4}$ per cent higher than those for which first-class English domicile bills can be sold.

Before we leave this subject of discounting there is one

question to which special reference ought to be made. When discussing documentary bills, we saw that two kinds were drawn—the one is called a “D/A” bill, the other a “D/P” bill—and in either case, whether the bills are drawn from London on a foreign port, or from the foreign centre on London, the D/A bill, bearing the clause “documents on acceptance,” is much more useful to the banker; in each discount market the buyers of bills under discount know that the parties to the instrument must be of fair financial standing, and consequently, the banker has no difficulty in getting the bill discounted through the broker at a good rate. The D/P bill, which either contains the clause “documents on payment,” or has a slip attached bearing those words, is obviously not good for discount purposes, and the banker is generally compelled to hold it until maturity, or until the acceptor retires it under rebate. It is not exactly a matter of caprice whether the drawee pays the draft one day after acceptance, or whether he lets the bill run its full term; it all depends on whether he can sell the relative goods promptly. If a quick sale is made, the acceptor will be only too glad to take up the bill under the usual rebate.

The rebate rate is usually $\frac{1}{2}$ per cent above that allowed by the joint stock banks for short deposits.

The position in regard to the documents on acceptance bill is rather different. As we have seen, as soon as a banker receives a D/A bill he presents it for acceptance to the person or firm upon whom it is drawn, and immediately the bill is completed by acceptance the documents of title attached to it are promptly delivered to the acceptor. Now, the banker to whom the bill is returned may or may not desire to keep it in his portfolio until maturity. If he is one of the exchange bankers, the probability is that he may desire to sell it under discount on the London market. On the assumption that the banker does sell the bill to the discount market, what is to happen if the acceptor comes along later and desires to pay the bill

before maturity? On the face of it, the banker is in a quandary; having sold the bill, he might as well hunt for the proverbial needle in a haystack as to try to trace the bill on the market. What the banker does in such circumstances is to allow the acceptor to pay the amount of the bill, less discount for the unexpired time at about the ruling rate for discounting bills of the class applicable to the one the acceptor desires to pay. When the rate of discount to be allowed is arranged, the banker receives the cash, and as he cannot produce the bill, he does the next best thing, he hands over to the acceptor a letter guaranteeing that, in consideration of the acceptor's having retired the bill under discount, the said bill not at the time being in the bank's possession, he, the banker, will hand the acceptor at due date a cheque for the full amount required to meet the acceptance. In effect, as the banker has been prepaid for the sum represented by the bill, he shoulders the acceptor's liability and guarantees to meet the acceptance at due date.

In all this bill business the services of the broker are in constant request, and the fact that he is at the beck and call of nearly every bank in the kingdom is perhaps responsible for his being dubbed the Jackal attendant upon the King of Beasts, the King of Beasts, according to the broker, being the banker. We have also seen the bill-broker described as the dog which ate of the crumbs, while in other quarters he is styled the aristocrat of the money market. When we find all these epithets levelled at the head of the inoffensive broker, we might expect him to be exacting a large tribute for his services; but that is not the case. For his extensive knowledge and responsible work the bill-broker receives but a trifling commission; why, then, is he prepared to act as an intermediary in this business, and is it worth his while? The answer is a simple one. The smallness of the broker's commission is no criterion of his profit: rapidity of turnover is one prominent factor; the total amount of each parcel of bills

is another. A $\frac{1}{2}$ per cent or even $\frac{1}{8}$ per cent, added by the broker to the rate charged for discounting a single bill is infinitesimal, but when reckoned on a large number of acceptances the commission is not inconsiderable.

Then as to his capital. It has been cynically remarked that all the bill-broker's capital consists of, is a pair of boots and a bill case. He does not need a large initial capital, it is true, but his position is not quite so bad as that. There is no doubt, however, that every bill-broker is indebted to the bankers for a large proportion of the capital used in his business, and as such funds are loaned out to him by the bankers very cheaply, we see how it is he is able to work at very low rates. The money is lent to the bill-broker at "call"—sometimes merely over-night, and it is his practice to find out each morning which banks are lenders and which are likely to call in funds; he is then in a position to base his operations on the amount of money available in the market. Where the broker is able to borrow easily, he offers a low rate of interest, but if the banks are not well supplied with cash he has to pay more for the accommodation, and in case of need he may be forced to resort to the Bank of England, who will supply funds by discounting the cream of the bills for him.

As security for "call" loans the bill-broker deposits with the banks bearer stocks of the "floater" or "terminal" type, such as Treasury Bills; or he may, in some cases, deposit batches of first-class acceptances.

In view of the fact that the bill-broker is a constant user of surplus funds held by the banks, it is safe to assume that he contributes largely to the profits made by the bankers, and, for the rest, those who are inclined to gird against the profits the bill-broker in his turn makes on discount transactions, have but to make a cursory examination of his operations on the London money market to be convinced that the intricacies of the business are ample justification for his presence in their midst.

At the present day centralization of interests is no less apparent in bill-broking than in banking. There is an increasing tendency to divert business from the bill-broker, who works solely on commission, to the dealer who buys bills outright and sells them on his own account : it is the latter class, in fact, that is mainly responsible for borrowing " call " money from the banks. To carry the competition still further, companies have been formed to deal exclusively with this discount business, and, to judge by the dividends paid, they have found a profitable field for their operations. Unlike the ordinary brokers, however, the discount companies are not wholly reliant on funds borrowed from the banks ; they receive money on deposit from outside sources, and as, by offering higher rates of interest, they sometimes obtain cash which, but for their existence, would have gone into the banks' coffers, it is they rather than the " running " broker, who must be looked upon as active competitors in the banking world.

Treasury Bills.

In conclusion, we may refer to the Government measures for financing the Great War by means of Treasury bills. Before the war these bills were issued by tender. Treasury bills have since been consistently used by the Government. A certain specified amount was announced as being for sale, and the bills were allotted to those charging the lowest rate of discount. This was the practice in vogue until the 14th April, 1915, when the British Government suddenly announced in the *London Gazette* its intention to issue three, six, and nine months' Treasury bills until further notice at fixed rates of discount. In the first instance, the rates published by the Treasury were : for three months' bills, 2½ per cent ; six months' bills, 3½ per cent, and nine months' bills, 3½ per cent. Subsequently, twelve months' bills were announced to be available at the same rate as for nine months' paper. The Government, however, reserved to itself the right to vary these rates whenever

considered advisable so to do, without previous notice to the market. As a matter of fact, the "price" held good until 9th August, 1915, when the discount was suddenly put up to $4\frac{1}{2}$ per cent for all usances. On 27th October, 1915, rates were again raised to $4\frac{1}{2}$ per cent for three months' paper, $4\frac{1}{2}$ per cent for six months', and 5 per cent for nine and twelve months' bills. Then, on 12th November, 1915, the rate was again changed to 5 per cent for all classes of Treasury bills. This 5 per cent level for all maturities was maintained until 4th March, 1916, when the rate for three months' bills was lowered to $4\frac{1}{2}$ per cent, and the rates for six and nine months' to $4\frac{1}{2}$ per cent. The discount on the twelve months' bills was left unchanged at 5 per cent.

Three and six months' Treasury bills continued to be offered by the Government at $3\frac{1}{2}$ per cent discount until 31st May, 1919, when sales were suspended. The total amount then outstanding was £1,036 millions. Sales were resumed on 14th July, 1919, at $3\frac{1}{2}$ per cent discount for three months bills and 4 per cent for six months' bills. Treasury bills at two months' date were also offered at $3\frac{3}{8}$ per cent, but sales of bills at this usance were discontinued on 14th August, 1919. By October the demand for the Government paper had fallen off considerably, consequently on 6th October, 1919, it was deemed advisable to offer more attractive terms, so the rate for three months' bills was raised to $4\frac{1}{2}$ per cent and that for six months' bills to 5 per cent. The total amount of Treasury bills outstanding on 4th October, 1919, was £853,068,000.

On 6th November, 1919, the Directors of the Bank of England decided to raise the official rate of discount from 5 per cent to 6 per cent, and this was but a prelude to the raising of the rate of discount on Treasury bills once more. The next day, as a matter of fact, it was announced that until further notice sales of this class of paper would be made on the basis of $5\frac{1}{2}$ per cent discount for both three and six months' bills. On these terms the cost of

the bills worked out at £98 12s. 7d. for three months' paper and £97 5s. 1½d. for six months' paper. Sales were made on this basis until 19th March, 1920, when the issue of six months' bills was discontinued. About a month later, on 14th April, with the raising of Bank of England rate to 7 per cent, it became necessary to alter the Treasury bills rate, and an announcement was made that three and twelve months' date bills only would be issued at 6½ per cent discount. On 29th April, 1920, the sale of 12 months' bills was suspended and a minimum of £5,000 each fixed for the issue of Treasury bills at 6½ per cent discount. Then, on 11th March, 1921, the Chancellor of the Exchequer decided that the time had come when a reduction could safely be made in the rate of discount for Treasury bills, and it was decided to fix the rate at 6 per cent for the three months' paper and also to put on sale twelve months' bills at the same rate.

On 11th April, 1921, the Chancellor of the Exchequer announced in the House of Commons that the system of keeping Treasury bills "on tap" at fixed rates would be suspended so far as three months' bills were concerned as from 21st April. The three months' bills have always represented the bulk of this class of paper issued by the Government, so actually, after about six years, an attempt was made to return to pre-war conditions. The first issue by tender was made on 21st April, 1921, and the announcement governing the sales was in the following terms.

TENDERS FOR TREASURY BILLS

"The Lords Commissioners of His Majesty's Treasury give notice that tenders will be received at the Chief Cashier's Office at the Bank of England on Thursday, the 21st inst., at one o'clock, for Treasury Bills to the amount of £50,000,000.

"The Bills will be in amounts of £5,000 or £10,000. They will be dated at the option of the tenderer on any date from Monday, the 25th inst., to Saturday, the 30th

inst., inclusive, and will be payable at three months after date.

"The Bills will be issued and paid at the Bank of England.

"Each tender must be for an amount not less than £50,000, and must specify the date on which the Bills required are to be dated, and the net amount per cent (being an even multiple of one penny) which will be given for the amount applied for. Separate tenders must be lodged for Bills of different dates.

"Tenders must be made through a London banker, discount house, or broker.

"The persons whose tenders are accepted will be informed of the same not later than the following day, and payment in full of the amounts of the accepted tenders must be made to the Bank of England by means of cash or a banker's draft on the Bank of England not later than two o'clock (Saturday, twelve o'clock) on the day on which the relative Bills are dated."¹

Tenders are now made on Fridays before 1 p.m., and the result is usually known the same day.

The student will frequently see references in the Money article of his newspapers to the sale on the London Money Market of "Hot" Treasuries. These are bills, of the current week's issue, i.e. "Hot" off the press, which some of the allottees for one reason or another sell.

The presence of these Treasury bills on the market must necessarily affect the price of all other bills sold under discount; the purchase of the Treasury paper tends to absorb the excess supply of floating money on the short loan fund of the London money market, and consequently helps to keep up the bankers' rates for money at call and short notice, which in turn affect the discount rates for

¹ In practice bills are paid for during the following week, or any working day at applicant's option. When normal length is 92 days, bills paid for Saturday are 91-day bills and there are no Monday maturities. When normal length is 90 days, bills paid for Monday are 89-day bills. (cf. *Economist*, 8th January, 1938.)

both trade and bank bills. The reader has only to refer to the various illustrations we have given throughout this book to see how the various influences react the one on the other. Finally, the market finds itself committed to rates for bank paper from which it is practically impossible to depart as long as the Treasury bills are on offer at fixed prices; by force of the Government competition it is bound to work at practically the same rates of discount for three months' bank bills as those charged by the Treasury for its paper, as obviously no buyer is likely to pay a higher price for a bank acceptance than that at which he can get a Treasury bill issued on Government security. In such circumstances, the market is thus, to all intents and purposes, under the direct control of the Government, and as long as the sales of Treasury bills are continued, the free play of the usual factors is restrained.

It seems a curious termination to this book to have to admit this fact in face of the theories we have expounded, but there it is, and all we can do is to recommend the reader to continue to examine for himself the varying effects of the British Treasury's experiment with the London discount market: the study should prove an interesting one, and to enable the reader better to follow the movements in money and discount rates, both before and after the advent of war, we attach at the end of the book three extremely useful charts, illustrating the course of money and discount during each of the years 1913, 1914, and 1935. The charts were prepared by Messrs. Page & Gwyther, the well-known discount brokers, to whom the author is much indebted for permission to reproduce them.

APPENDIX

THE FOREIGN EXCHANGES AND THE GREAT WAR

THROUGHOUT this book we have referred from time to time to the effect of war on the course of the foreign exchanges. In deference to the wish of many bankers and economists we reproduce, as an Appendix, a special account of the effect of the war on the money markets and the foreign exchanges of the world. It is hoped that it will prove useful for historical and reference purposes.

"War is hell," wrote one of the active service men, face to face with the awful devastation wrought by the Germans in their advance through Belgium. The expression is a strong one, but applies with equal force to the financial havoc brought about by the war, and in no direction is the ruin, the disgrace, the woe of war more faithfully reflected than in the world's money markets and the foreign exchanges. So delicate, in fact, is the mechanism of the money markets, and so close is the relationship between them and the foreign exchanges, that the latter may always be taken as a trustworthy index to the monetary condition of the various markets. It will be interesting, therefore, if we now examine some of the effects of the war in the light of the monetary problems with which we have been dealing, and endeavour to see how far the results confirm the theories we have enunciated.

One of the first signs of the imminence of a war between two nations having intimate commercial relations, is the speed with which the merchants and financiers of the respective countries try to realize their opposing claims. There is an eagerness to collect foreign debts, and to dispose of all tangible securities in exchange for gold, and the more strained the tension between the two countries becomes,

the more pronounced will be the desire to convert foreign claims into cash—at a greater or less sacrifice. This liquidation of claims will grow in intensity until diplomatic relations are broken off between the respective nations: it will not even cease at that point, for immediately war is declared and hostilities commence, the claims of the belligerent nations will be dumped upon neutral markets for realization, until all are surfeited with the many and varied forms which foreign indebtedness takes. At this stage, having reached the limit of their receptive powers, the neutrals become involved in the financial strain which at first merely affected the countries which are at war.

Gold Movements.

The great European conflict, as it happened, came at an awkward moment for all the Continental centres. A certain amount of depression had been evident as far back as 1913, and even at that period the financial condition of the world's markets was far from satisfactory. Continental markets were in general overloaded with securities, and a great many more issues had been floated on the London market than the British investors were able comfortably to absorb. During the early part of 1914, however, a turn for the better took place; gold flowed into Paris from New York as the result of French realization of securities, and the Bank of England, for its part, was able to procure a sufficiency of the precious metal. Money rates dropped correspondingly and ease prevailed in most centres for some time. But, towards the end of May, the tide began to turn, the Bank of England's reserve fell to a lower level than was liked, and at the same time a great demand for gold sprang up from the Continent. French exchange was against England during the whole of May, while that of Berlin was favourable to London, yet, according to *The Times* Financial Review of the year, out of the gold arrivals in London amounting to nearly £26,000,000 sterling, the Bank of England secured less than

£7,000,000. The amount sent to France and Germany was about equal to the exports to the Continent for the whole of 1913, and although it was reported that Russia was the ultimate destination of a portion of these Continental purchases, there is no doubt that the greater part found its resting-place in the vaults of the Central Banks of France and Germany.

The influence of these gold shipments was soon reflected in the exchanges. The quotation, Berlin / London, moved from one per mille in our favour (M. 20·44½) on 4th April, 1914, to 3½ per mille in our favour (M. 20·49½) on 30th May; on 23rd May, it might be remarked, the quotation was M. 20·50½, very near the rate at which the Bank of England should gain gold at the expense of the Reichsbank, namely, M. 20·53.

French exchange, examined over the same period, showed several variations, but towards the end of May was only slightly against this country.

American rates were persistently in our favour the whole time, and at one period New York's excess imports were being paid for by gold, the adverse exchange being due, partly to the failure of the main crop, and partly to the fact that speculation was then at a very low ebb in the United States.¹ There is little doubt that the European demand for gold was making itself felt in the United States, for it has to be recorded that during the first half of the year 1914, the Continental demand for gold was greater than during any one of the three preceding years, and the intensity of the demand for the metal, coming at the same time as other adverse circumstances in the United States, caused rates on the three principal European centres to go against New York. Exchanges generally were against America, and the rate, New York-London, on or about 13th June was quoted \$4·89½ to £1, that is, six per mille in our favour.²

¹ Cf. *Economist*, 6th June, 1914.

² It is interesting to note that New York-London Exchange was quoted by the *Economist* at par on 4th April, 1914.

Despite this almost unprecedented ingathering of gold by the Continental nations, there does not appear to have been any actual uneasiness until the turn of the half-year. Then the Austro-Servian imbroglio began to take definite shape, and the influence of the strained relations between the two countries was immediately seen on the London market by the hardening of discount rates.

Then, on the 18th July, the news leaked out that the Dresdner Bank was selling its securities and advising its clients to act similarly. This, as the late Sir Edward Holden remarked,¹ was considered to be the first semi-official intimation of a probable European conflict.

The climax was reached on 28th July, when the fear of war gave place to certainty, and discount quotations at once jumped to 4 per cent for three months' bills.

The foreign exchanges all along had indicated the drain of funds, and the real gravity of affairs on the Continent was shown by the rates current on the 28th July. Paris cheque, for instance, was quoted 25 f. 11-12 c., Brussels, 25 f. 28-30; Berlin sight, 20 m. 53-55 pf.; Vienna, sight, 24 kr. 30-40 h.; Amsterdam, 12 fl. 14½-15½ c.; while New York wired "Cable Transfers, \$4.90-4.93 c."

Before going further, we may be permitted to make a digression and refer briefly to the situation in which the principal money markets found themselves on the outbreak of hostilities.

Condition of Money Markets.

Paris, it is evident, was caught between Scylla and Charybdis: she was embarrassed by her holdings of short-dated securities as the outcome of operations financed for Turkey and the Balkan States, and before she could rid herself of this incubus, she was caught by the serious effects of the monetary crisis which had spread to all classes of society in France. Gold disappeared as if by

¹ In his speech to the shareholders of the London City and Midland Bank, 29th January, 1915.

magic, and heavy calls were made on all the banks in France for cash. To stem the tide, on the 31st July, the Bank of France raised its rate from $3\frac{1}{2}$ per cent to $4\frac{1}{2}$ per cent, and its rate of interest on advances from $4\frac{1}{2}$ per cent to $5\frac{1}{2}$ per cent.

Berlin evidently anticipated the worst: there was great pressure everywhere for gold, the banks were literally besieged, and what may be termed as "a great run" took place on the Reichsbank, which was said to have parted with gold to the value of Mks. 200,000,000. The exact figures were not forthcoming, but tantamount to admitting that the withdrawal of gold had been on a gigantic scale, was the fact that a measure was soon passed prohibiting the Bank from paying out more of its gold for notes. On 31st July the Reichsbank was forced to raise its rate of discount from 4 per cent to 5 per cent, and its rate of interest on advances from 5 per cent to 6 per cent.

How far foreign exchanges went against Germany may be gauged from the remarks of the *Economist's* Berlin correspondent, on 30th July, 1914. "London and Paris cheque rates," he says, "have risen to an almost unprecedented height, and gold could now be exported with profit to both England and France. Movements of exchange are attributed partly to the fact that England and France are withdrawing their balances from Germany, Austria, and Russia, while the capitalists of these latter countries are sending money abroad, especially to England, in considerable amounts."

As far as the Berlin Bourse was concerned, it is interesting to recall that, by order of the President, from 31st July no prices were fixed on the bourse, and although it was announced that "transactions were confined to cash basis," there was no business at all in securities.

Of our own position it is necessary to speak more fully. It goes without saying that London early became involved in the great financial cataclysm. Immediately after the outbreak of war between Austria and Servia, discount

rates were quite nominal,¹ and owing to the great difficulty in placing bills, the market was temporarily paralysed for want of funds. Dealers on the open market were all the more crippled by the banks calling in their loans, and as a result, the bill-brokers were forced to seek accommodation by borrowing from the Bank of England and selling to it "short" bills. This was on 29th July. By the 30th July the London Stock Exchange was in the toils, finding itself unable to absorb the large quantities of securities which had been forced on the market from all quarters, and the severity of the strain led to the closing of the Exchange on the following morning, until further notice.

The drain on the Bank of England's stock of gold has already been referred to, and on 30th July it became necessary to take precautionary measures by raising the official rate from 3 per cent to 4 per cent. The demand on the joint stock banks, however, continued unabated, and in consequence, loans were called up in all directions, which simply meant that the discount brokers were again obliged to go to the Bank of England for assistance. At the outset the Bank discounted their short bills at 6 per cent, but as the day went on, the pressure increased, and in proportion to the borrowings the Bank raised its charges, until 10 per cent was charged for discounting bills with about fifteen days to run. On loans for a week, the rate was still higher, as much as 10½ per cent being charged and paid. The rot had set in, and to check it drastic measures obviously were necessary, therefore the Bank took the unusual step of altering its Rate on a Friday, advancing it to 8 per cent. London borrowings were not the only reason for this action; it was quite as much due to the heavy withdrawals of gold from the Bank for foreign account, for during the day (31st July), no less than £1,204,000 was taken for shipment to the Continent.

¹ Rates on 29th July were: Bank bills, 3, 4, and 6 m/s. 4½-5%; fine trade bills, 3 m/s. 5%, 4 m/s. 5½%, 6 m/s. 5½%.

As *The Times* remarked on the following day, 8 per cent is by no means an unexampled rate in the history of the Bank of England, and the table, given by that paper, is interesting as recording the dates on which 8 per cent or more was fixed by the Court of Directors.

<i>Period.</i>	<i>Rate.</i>	<i>Period.</i>	<i>Rate.</i>
Oct. 25th, 1847 . . .	8%	Aug. 4th, 1864. . .	8%
" 19th, 1857 . . .	8%	Sept. 8th, " . . .	9%
Nov. 5th, 1857 . . .	9%	Nov. 10th, " . . .	8%
" 9th, " . . .	10%	Jan. 4th, 1866. . .	8%
Dec. 24th, " . . .	8%	May 8th, " . . .	8%
Feb. 14th, 1861 . . .	8%	" 11th, " . . .	9%
Dec. 3rd, 1863 . . .	8%	" 12th, " . . .	10%
Jan. 20th, 1864 . . .	8%	Aug. 16th, " . . .	8%
May 2nd, " . . .	8%	Nov. 1st, 1873. . .	8%
" 5th, " . . .	9%	" 7th, " . . .	9%
" 19th, " . . .	8%	" 20th, " . . .	8%

Bank Rate, during 1914, was at 3 per cent from 29th January to 29th July, it was raised to 4 per cent on 30th July, to 8 per cent on 31st July, to 10 per cent on 1st August, reduced to 6 per cent on 6th August, and to 5 per cent on 8th August, 1914.

Not taking into account Sunday, 2nd August, and the Bank Holidays from 3rd to 6th August, we may say the actual crisis lasted four days only. We use the word crisis advisedly, in preference, in fact, to the much stronger term "panic," which is held by some people correctly to describe the situation.

Government Action.

The consensus of opinion, outside banking circles, seems to be that the action by the banks in calling up all their loans from the discount brokers and other similar borrowers, to some extent precipitated the crisis, inasmuch as that course of action enhanced the already heavy demands on the Bank of England for accommodation. The London banks, however, were not alone in their ultra-cautious policy. Practically the whole Continent, from Paris to Petrograd, and from Amsterdam to Vienna and Rome,

was seeking to convert paper into cash, added to which the great banks in Paris and Berlin were hoarding gold against emergencies.¹ Fortunately, the prompt measures taken by the Government in consultation with the Bank of England authorities were effectual in staying the timidity with which a large section of the community had begun to view the abnormal financial situation: that even stronger measures would have been taken had circumstances called for them, is evident by the frank way in which the Press were allowed to announce, on 1st August, 1914, that proposals were under consideration for obtaining the Government's assent to the suspension of the Bank Charter Act of 1844, the effect of which would have been to enable the Bank of England, if necessary, to issue notes without holding gold against them. To paraphrase the leading article of *The Times* of 1st August, in the opinion of the Government that course was not then actually necessary, but the Chancellor of the Exchequer was understood to be ready to give the Bank authority to act, merely by the issue of an official letter from the Treasury, and the announcement that should the situation require, he *would* issue the necessary letter, no doubt went far to restore the confidence of the City and all connected with it.

Of the American money market we need say little at this stage. With the outbreak of war the other centres turned their attention to the New York Stock Exchange for the realization of their securities. The increased business was too much, even for American ideas; within a few hours the extensive liquidation completely demoralized the market, and, after holding up bravely as the world's dumping ground for the sale of stocks and shares, the Exchange bowed to the inevitable and closed its doors on 31st July, until further notice.

In the New York money market proper, the position, although not "panicky," was uncomfortable: call money was unobtainable—"no quotation," the papers announced;

¹ Cf. *Economist*, 1st August, 1914.

international exchange operations were at an end, and the discount market was in a state of paralysis.

Having briefly considered the effect of war on the principal monetary centres, we may pursue the matter a step further, and examine the manner in which the foreign exchanges fluctuated owing to the economic pressure on the world's markets, commercial as well as financial.

Foreign Exchanges.

When we realize that for a period following the outbreak of war the credit system of the principal markets of the world had broken down, it is not surprising to find that the foreign exchanges went literally to pieces, too. Their condition from the end of July to the second or third week in August, 1914, almost beggars description. The state of the money markets was chaotic, that of the principal foreign exchanges—if there be degrees of chaos—even more so, and the complete disorganization of the exchanges did much to intensify the shock which the credit of practically every country in the world had sustained in the early days of August.

The following table drawn up by the *Economist* in

Cheques : Telegraphic or Mail Transfers	Rate just prior to War	Since War		Rates Current : 19th Dec., 1914
		Lowest	Highest	
Paris	25-16	24-00	25-50	25-06
Switzerland	25-17	24-00	26-00	25-50
Brussels and Antwerp	25-29	24-00	27-50	—
Amsterdam	12-15	11-70	12-60	12-00
Italy	25-50	24-00	28-50	25-57
Madrid	26-10	24-45	26-70	25-92
Lisbon	46½	35½	41	37½
Petrograd	97-20	110	120	118½
Christiania	18-30	18-30	19-20	19-27
Copenhagen	18-30	18-30	19-20	19-27
Stockholm	18-30	18-30	19-20	19-27
Berlin	20-53½	—	—	—
Vienna	24-32	—	—	—
New York	4-93	4-93	5-00	4-83

	Extremes quoted about 1st August, 1914	Rates quoted 19th Mar., 1915
Paris	24-00-25-00	25-25-25-45
Switzerland	Nominal	25-92-26-18
Brussels and Antwerp	24-00-26-00	—
Amsterdam	11-90-12-60	12-08-12-13
Italy	26-00 sellers, no buyers	27-80-28-10
Madrid	24-00-25-90	24-30-24-45
Lisbon	42	34-35½
Petrograd	125 sellers, no buyers	113-115
Christiania	about 18-50	19-25-19-45
Copenhagen	" "	"
Stockholm	" "	"
Berlin	21-00 sellers, no buyers	—
Vienna	24-60	—
New York	about 6-50 "	4-79½-4-80½

December, 1914, gives the position in a convenient form. We have added a column giving the actual rates in operation at the time this appendix was written, March, 1915.

The rates shown in this table testify to the severity of the breakdown, and the universal way in which the foreign exchanges collapsed was one of the worst features of the problem with which the bankers and financiers had to deal.

At the commencement the stagnation in rates was to a very great extent the result of the wild movements in quotations for the various forms of capital. The enormous monetary claims which had been in process of liquidation left exchange markets in a debilitated condition, and when markets did begin to recover, operations were insufficient to put the financial machinery in motion again. Let the reader just imagine the position. Business, speculation and investment all over the world were in a state of inanition: not only were the principal stock exchanges and bourses closed *sine die*, but the majority of the commercial

exchanges were in a like position. In Great Britain it became necessary to cease dealings on the London Metal Exchange, the Coffee Market at Mincing Lane, and the Seed and Oil markets on the Baltic Exchange, and most of the wheat and grain centres were similarly affected. There is no need to multiply instances, but an examination reveals the fact that markets throughout the entire world were in no better state.

Such events demonstrate in a striking degree the close relationship between money and the exchanges: they show that the different forms of money in one part of the world are affected by occurrences on other markets, and the fact that there ensues a stoppage of trade and speculation in commodities such as grain, coffee, meal, oil, cotton, etc., may be taken as proof positive that the world's credit facilities are part and parcel of one great fabric—any weakening or dislocation at one point must, in consequence, react on other parts of the machinery. In such circumstances, London, as the greatest exchange centre in the world, is the first to feel the effects, and the more exchange facilities are restricted in London, the greater will be the loss in other centres, for, as Mr. Lloyd George cogently remarked, in the absence of exchange facilities, goods can neither be imported nor exported in any appreciable quantity.¹

Apart from the interruption of communication between certain countries, and the subsequent cessation of arbitrage business with the chief centres, it is a matter of some

¹ In its issue of 12th September, 1914, the *Economist* rather dissents from this view, preferring to take the state of the exchanges and the difficulties of the bill market more as a symptom than a cause. "The bill market cannot make trade which does not exist," says the editor, "and the absence of bills merely testifies to the absence of trade."

In some cases, this was no doubt true; but many instances came under the author's notice during the first few weeks of the war, when bills were offering in fair quantities, but exchange banks and dealers refused to take them, owing to the uncertainty of their being able to procure return remittances from the countries for which shipments were destined.

difficulty to place the finger on the exact cause of the movements in rates; all we can do is to examine the exchanges of the more important countries and endeavour to trace the reasons for the rise and fall, as the case may be.

Effect on Foreign Exchanges.

FRANCE. Reference to our table will show that just before the war Paris cheque was quoted at 25 f. 16 c. to £1, but immediately the fear of war became definite, France proceeded to replenish her exchequer by realizing securities, clearing out portfolios of London bills, and calling in all balances held in this country. As a result, remittances in London on Paris were rapidly exhausted, and when the scarcity became pronounced, those who were under the obligation to remit, bought gold to send to France. These, very briefly expressed, are the reasons for the fall to 24 f. to £1.

In New York, the quotation on Paris was even worse than the London rate, dealers being willing to give only one dollar for Fcs. 3·25c.

GERMANY. German exchange, from the commencement of the war to the end of the year 1914, is a complex subject to enlarge upon, and most people have preferred to study the course of the exchange with that country from data obtainable in New York. From the various rates cabled by *The Times* and other correspondents, it is possible to get some idea of the movements.

The par of exchange, New York/Berlin, was approximately 95½ cents to 4 marks, and New York quoted Berlin exchange in cents to 4 marks. At the end of August the rate was 96½; by the end of September it had depreciated to 94½, and continued to fall rapidly for the next two months. The Royal Statistical Society's correspondent gave the quotation at the end of November as 85½ cents, or 9·7 per cent. discount on the gold parity. In the early days of December, there was rather a remarkable recovery, the rate being quoted on 8th December at 92½ cents to

4 marks ; but, as the same authority indicates, the upward movement did not last long, and towards the end of the year *The Times* quotations on an average represented a discount of about 7½ per cent.

It is said that earlier in the year 1914 the German financiers had sold a considerable part of their American investments, and the fund created by these sales was estimated to have provided a certain amount of credit against which drafts could be drawn. Certainly, the recovery in Berlin exchange in New York early in December may be attributable to credits raised by the realization of securities on the New York market, since, "the restraints on German trade hindered the export of goods in quantities sufficient to provide the means of payment for desired supplies."¹

By way of a further corrective to its unfavourable exchange with Continental countries, Germany sent gold to Holland and other Scandinavian countries, but the improvement in every direction was merely temporary ; exchange soon fell to its former low level, and by March, 1915, the quotation, worked through Holland, indicated that German exchange with London had depreciated to about 12 per cent.

There is a tendency in some quarters to discredit the statement that Germany was compelled to part with gold in order to pay for imports from Holland and Scandinavia, but facts which came to light go to prove that she certainly did export gold. Of the war indemnity exacted from France in 1872, £6,000,000 was allocated for the special war chest to be kept in the Julius Tower at Spandau. This reserve was known to consist of a large proportion of British sovereigns, and during the first week in March, 1915, a considerable number of these coins found their way back to London via Scandinavia. The sovereigns were those bearing the Victoria effigy and the "Shield" reverse, of which a large number was minted during the years 1838

¹ *Journal of the Royal Statistical Society*, January, 1915.

to 1874.¹ Consequently, when the bankers in London, to whom the gold from Scandinavia was consigned, found it to consist of many new sovereigns bearing the date 1872, it was at once apparent whence the shipment had originated. Further evidence of their having been taken from Germany's war chest was found in the fact that some of the coins were actually received in the identical bags and boxes in which they had been packed when leaving the Bank of England forty-three years previously, and no little surprise was evidenced in banking circles when it became known that no effort had been made to conceal the place of origin by removal of the old Bank of England labels.

The heavy increases registered in the gold reserve of the Netherlands Bank from time to time during the war, may also be taken as indisputable evidence that Germany was forced to export gold to Holland in support of exchange and to pay for supplies.

In the month of March, 1915, the direct rate, New York on Berlin, steadily depreciated: the quotation on 1st March was 82½; on 18th March, 84; 19th March, 83; and on 20th March, 4 marks were worth only 82½ cents. On the last quotation, therefore, German exchange with New York showed a depreciation of 13 per cent—a percentage which made foreign imports very dear for Germany, or, conversely, depreciated the value of her exports, if any were possible via neutral countries.

SPAIN. The other European rates all present features of interest, the fluctuations in most cases being directly traceable to increased foreign trade due to the war. Spain, for instance, derived considerable benefit from the commerce which was diverted to that country from France; in fact, during the early days of the war the Spanish exchange achieved a record, being equal at one time to

¹ From 1838-70, 128,208,324 "shield" sovereigns were minted; from 1871-74, "shield" and "dragon" designs were used concurrently.

about 48½d. to 5 pesetas, as against the normal quotation of slightly over 45d.

HOLLAND. The par of Exchange, Amsterdam / London, is Fl. 12·107 to £1, the extremes reached on the outbreak of war, Fl. 11·90 to Fl. 12·60, and the quotation, 19th March, 1915, Fl. 12·08–12·13c., from which it may be gathered that, although the fluctuations were fairly wide, the rate on London was, generally speaking, well maintained. The quotations with Holland were, of course, affected by the exports, and a decline of nearly one florin from the high rate quoted at the commencement of the war, recorded by the *Economist* in October, was obviously due to the greatly enhanced exports. The fall, however, was only temporary, and rates soon recovered.

ITALY. Italian exchange fluctuated widely for a time, and was quoted at the beginning of August, 1914, Lire 26 to £1, the gold parity then being L. 25·2215 = £1, approximately 3 per cent against Italy. This was in part due to large imports of coal, payment for which was rendered extremely difficult owing to the existing financial strain. On 19th December the rate had improved to L. 25·57, but by 19th March, 1915, it was given in the foreign exchange quotations as L. 27·80 to L. 28·10, a quotation considerably in favour in England.

RUSSIA. The Russian sight exchange on London was quoted on 17th July, 1914, Rbl. 95·75 to £10, and the extent of the depreciation of the rouble may be gauged from the quotation on 1st August, 1914—Rbls. 125, which indicated that the rouble had depreciated about 32 per cent, taking the gold par as 94·58 to £10.

The reason for this heavy fall in the value of the rouble, in the first instance, was presumed to be due to the large purchases of gold which Russia had made just prior to the outbreak of war, payment for which exhausted all available sterling remittances. Some improvement in values was apparent by the middle of September, when the quotation was 107½, but by the beginning of October, viewed

from the Russian standpoint, the rate fell again to 120; nearly 27 per cent depreciation in Russian currency. By the end of the year 1914, the rouble was quoted 117 to £10 sterling, and, as we see by our list, on 19th March, 1915, the Petrograd quotation came through as 113-115.

In common with other countries, Russian exchange was dependent to a great extent on her foreign trade, and in March, 1915, she was sorely handicapped. Her exports of grain, provisions, sundry raw materials, and semi-manufactured products of Russian agriculture, etc., were restricted by the closing of the Dardanelles, and the cessation of trade with Germany and other countries via the Baltic ports and the railways over the west frontier. The closing of the Dardanelles was bad enough, since that definitely precluded Russia from exporting from the ports on the Black Sea and the Sea of Azov, but when a considerable portion of her exports and imports ceased through the suspension of navigation in the Baltic, matters became serious. Then, there was another not unimportant factor to be remembered. Many of the ordinary commodities she habitually exported were consumed by the enormous army she was obliged to maintain in the field. The upkeep of this army, in fact, also entailed the importation of a vast amount of produce and commodities from other foreign centres.

Summarized, the difficulty in principle was this: imports in Russia's case could not be paid for by exports, and the importers consequently were unable to procure the drafts by means of which, as we have shown, foreign indebtedness is liquidated. The trouble was all the more acute because many importers had purchased commodities from abroad, which they were perfectly willing and able to pay for, but short of sending gold, no method of remittance was available, for no exporters' drafts were to be purchased. But here, again, the would-be remitter was estopped; he could not send gold, because for the time

being, under the law of 10th August, 1914, the exchange of bank notes for gold was suspended in order to protect the gold reserves of the State Bank of Russia.

The adverse position, as Professor Migulin¹ rightly pointed out, was due entirely to the fact that with the cessation of Russian export trade, the demand for Russian currency had been sharply curtailed, while, as the outcome of Russia's need for an entire series of foreign commodities, the demand for foreign currency had increased. As the result of all this, Great Britain's trade with Russia had almost ceased, for with such a high level of exchange, it was practically impossible for traders in Russia to remit to London except at ruinous rates.

How, then, was the problem to be solved ?

The first expedient Russia hit upon for assisting the exchange position, was the very natural one of shipping gold, of which £8,000,000 worth was sent to England in November, 1914. In order still further to ameliorate the adverse exchange, the British Government provided Russia with an additional credit of £12,000,000, proceeds of an issue of Treasury bills on the London market. The provision of this credit rehabilitated the exchange in a limited degree—the depreciation dropped to 14 per cent—but as the credit was largely used for financing the Russian Government's own expenditure on war materials, the increase in the credit did not assist much in restoring the normal exchange, and the problem consequently remained a serious one for the commercial community. Further provision therefore became necessary, and as a result of the historic conference between the allied Finance Ministers in Paris, the amount to be raised in Treasury bills on the London market was increased by £20,000,000 to £32,000,000,² and the effect of this was to bring down

¹ *The Times* Russian Supplement, 15th January, 1915.

² The arrangement was announced in the following terms on 4th December, 1914—

“ His Majesty's Government agreed with the Russian Government, in consideration of the shipment of £8,000,000 in gold from

the exchange to the more workable figure of Rbl. 113 to £10.

The interest this operation created in circles outside the sphere of banking is shown by the comments which the *Spectator* made on the occasion of the issue of the Treasury bills, and as the analogy drawn in that time-honoured periodical is a very excellent one, it is worth while quoting.

“To understand how the difficulty is to be met,” says the writer, “it is only necessary to realize that, though international commerce is primarily a matter of the exchange of goods against goods, it is secondarily a matter of the exchange of goods against permanent securities. If, for example, the Argentine railways want a fresh supply of rolling stock from Great Britain, they can obtain it by issuing new capital which will be taken up by British investors, whose money will go to pay for the rolling stock, and who in return will acquire a permanent lien upon the profits of the railway. Exactly the same method is being employed to meet the temporary commercial difficulties of Russia. The Russian Government are now raising money upon the London market by means of Treasury bills. The

Russia to London, which took place a few weeks ago, to arrange with the Bank of England to discount, under a guarantee of His Majesty's Government, Russian Treasury Bills to the further amount of £12,000,000, the rate of discount to be on the basis of the rate at which the British Government has been from time to time able to borrow for its own needs.

“By these means, the Russian Government obtains funds in England to the total amount of £20,000,000. Out of these, £8,000,000 is to be applied by the Russian Government for the purpose of providing exchange for Anglo-Russian trade. This exchange will be available for new transactions, as well as for the discharge of existing indebtedness.

“The balance of £12,000,000 is to be used for paying the coupons of the Russian external debt and the interest upon other external obligations of the Russian Government which are payable in London, and for financing Russian Government purchases in the United Kingdom. It will not be applied to financing purchases outside the United Kingdom, except after consultation with His Majesty's Government, in cases where the British market is unable to supply the article required, and orders have consequently to be placed in the United States or Canada.”

money thus raised is used to pay for produce that Russia requires to buy, and the investors in Treasury bills acquire a permanent claim upon the Russian Government. Simultaneously, the Russian Government are collecting from merchants in Russia, money owed to England, and giving in exchange Russian Treasury bills, which are handed over to the persons in England to whom the Russians owe the money. By this means the Russian Government are able both to assist their subjects to pay debts in London and to acquire the cash for carrying on the war."

The whole procedure is a striking instance of the manner in which Continental nations hold tight to their gold when the odds are overwhelmingly against them, and it seems to be a moot question whether Russia would not have done better to meet her foreign indebtedness by the release of gold, of which metal she was reputed to have immense stores.¹

AMERICA. The position in regard to American exchange was analogous with that of Russia. Following the outbreak of war, American exchange, like that of Russia, became utterly disorganized, and the extent to which the dollar depreciated was even more pronounced than the depreciation of the rouble. There were two chief causes for this disorganization in the United States currency: (a) the abnormal liquidation of stocks and shares on the New York Stock Exchange, which commenced in July, 1914, and grew in intensity until the commencement of hostilities; (b) the almost unprecedented indebtedness of America to Europe, estimated at about \$250,000,000 (£50,000,000, taking \$5 to £1). In such circumstances foreign exchange was reported to have disappeared, which is true, theoretically, since quotations were unworkable.

A few words, taken from *The Times* correspondent's dispatch, summarize the position. Sight exchange on

¹ On 21st July, 1914, the Imperial Bank of Russia held gold to the value of £174,509,000.

London, normally \$4·86, seldom higher than \$4·89, rose to \$5·00, to \$6·00, and, finally, to \$7·00—a rate never before witnessed.

In the ordinary course of things, New York could have corrected this abnormal position by shipments of produce, following her usual autumnal procedure, when she exports enormous quantities of cotton, grain, meat, and other food-stuffs to Great Britain and other European countries, and takes back gold for any excess balance due. As she was debarred from making these shipments on the outbreak of war, however, the usual means of cancelling her indebtedness to foreign countries was denied her, and the results were disastrous in the extreme.

Gold had been leaving the States in large quantities, and more would have been shipped but for the suddenness of the crisis. It will be within the reader's recollection that the *Kronprinzessin Cecilie* had sailed from New York on 28th July, 1914, with a consignment of gold to European banking houses, valued at about £2,000,000, but to avoid capture, she put back into the Bar Harbour, Maine, U.S.A., on the 4th August.

In war time New York might conceivably consider it inexpedient, or even undesirable to ship gold; she would prefer to send cotton, wheat, etc., in payment of indebtedness, but with that means of settlement cut off, and *pari passu*, the bills of exchange, one's thoughts naturally turn to gold. Here, again, adverse factors crept into the calculation. In normal times it was safe to estimate the cost of shipping gold to London from New York in large quantities at about \$2 per £100; the par of exchange, New York/London, is \$4·8665 = £1, or \$486·65 = £100; par, plus the cost of shipping gold, would be \$488·66, and whenever the exchange was higher—say, \$489·00, gold shipments usually commenced. In the early days of the Great War, however, there arose exceptional circumstances, largely a matter of history now, but which were similar to those cases which economists have constantly referred to

in alluding to the theoretical gold points. We have in mind the special circumstances which cause shipping charges for gold to exceed the amount prescribed in calculating the gold points. In the case of the European war, insurance rates from New York to London rose as high as 1 per cent on 30th and 31st July, 1914.¹ One per cent increased shipping charges by approximately \$5 per £100, making the outgoing gold point \$491.65, and accounted to some extent for the unparalleled exchange which existed.

In view of this remarkable situation, foreign exchange, if not at an end, was almost *in extremis* between New York and other monetary centres. True, towards the end of August, some sort of New York rate on London, as the *Economist* remarked, was re-established at a little over \$5 to £1, and quotations of a sort were also obtainable with Holland, France and Spain, all, however, quite nominal.²

With characteristic energy, New York soon set to work to remedy this serious menace to her commerce. Loans were raised, aggregating \$182,000,000 (£36,400,000), of which \$82,000,000 was applied to meeting New York's European indebtedness, and \$100,000,000 to assisting in the rehabilitation of the foreign exchanges. In each case, the amounts raised were in gold, which, under an arrangement with the Bank of England, was shipped to Ottawa, in instalments, and received by the Canadian Finance Minister at an agreed exchange of \$4.90 to the pound sterling. This, as the Americans point out, was a high exchange for debtors to pay, but shipping conditions made it cheaper than forwarding gold to London.

The effect of this Ottawa arrangement was equivalent to opening a huge credit in London; against the deposit of gold the bankers were placed in the position to draw bills on London, thus providing a means of remittance to those who were under the necessity to settle indebtedness.

¹ Cf. *International Trade and Exchange*, H. G. Brown (New York), page 107.

² *Economist*, 22nd August, 1914.

A similar arrangement was made by the French Government, which deposited \$6,000,000 in New York with Messrs. J. P. Morgan & Co., for the purpose of re-establishing exchange between France and the United States, which, on 31st July, 1914, reached the record rate of fr. 3.25 to the dollar.

We have now to examine the other side of the picture, the case where rates, instead of being in favour of London were against us. In March, 1915, the exchange New York/London, touched the lowest point on record—\$4.79 to the pound sterling, or 5½ cents below the import specie point, \$4.84½: but gold did not leave England for America, notwithstanding the fact that the rates demonstrated Great Britain to be debtor to the U.S.A. The reason, of course, was that shipping charges, insurances, etc., during the war were prohibitive: but then there was the stock accumulated at Ottawa, which might possibly have been released. As a matter of fact, some of it was sent to New York,¹ and one of the largest banks, the National City Bank of New York, commenting on this gold held by the Bank of England in Canada, acknowledged the British right to retain the metal, even at some sacrifice. The Bank of England was not, as they said, obliged to receive gold at Ottawa during the autumn of 1914 in lieu of payment in London, but to relieve American distress; it agreed to do so at the rate of \$4.90, in itself a high rate, yet, in the light of the adverse circumstances, cheaper than shipping gold to London.

In the case just described, the cause of the rate's being so much against Great Britain was our heavy debit balance. During August, 1914, there was a balance of approximately \$19,400,396 (£3,880,079) against New York, but with the re-establishment of exchange and the enormous improvement in America's foreign trade, the monthly balances

¹ The National City Bank, New York, say a large amount was released at the rate of 77s. 3d. per ounce for gold Eagles, equal to \$4.81 to £1.

against London advanced by leaps and bounds, and were given as, September, \$16,341,722; October, \$57,305,074; November, \$79,299,417; December, 1914, \$131,863,077; January, 1915, \$145,536,103.

In dealing with American exchange we have thus examined two extremes; one where exchange went far above the outgoing specie point, and the other where exchange fell below the incoming specie point, and the question arises: how are the sellers of bills affected in such cases? Briefly, with the high rate, say \$6 to the pound sterling, the seller of sterling bills could only sell his bills at that price to the person who was obliged to remit to Great Britain, and as the latter found it impossible to send gold, he was faced with a heavy loss; consequently, such conditions spread over a vast number of transactions meant ruin to a large section of the American public, hence the action taken to remedy the trouble.

In the other case, it is the seller of sterling who would suffer. Low exchange indicates, among other things, a large supply of bills, and in times of crisis holders of bills are unduly anxious to obtain cash, even at a sacrifice, and there will thus be a large mass of creditors selling bills at the lower rates rather than wait for the gold which must come sooner or later.

The same principle holds good when it is the banks operating: the high interest rates prevailing at such times, make it unprofitable for either side to be out of its money, even for relatively short periods, as the interest charges will speedily absorb any profit which might be obtainable by importing gold from abroad: the time taken for the gold to arrive is the adverse factor in the case. Some account must also be taken of the increased risk and other adverse factors which we have mentioned, all of which militate against the influx of gold.

In this appendix, it has been possible to touch on but a few of the complex monetary problems arising out of the abnormal situation in which the world found itself during the Great War, but sufficient has been said to indicate the

force of the economic pressure resulting from the war upon centres both near to and far removed from the scenes of conflict, and all things considered the advantages to any particular country are infinitesimal.

Since these remarks were written, the principal rates of exchange between this country and foreign centres fluctuate in a remarkable manner. In some cases the levels reached broke all previous records, and although various remedies were applied, their cumulative effect was not sufficient to counteract the adverse influences which subsequently arose. Most of the European nations except Great Britain appeared to have abandoned all pretence at maintaining the gold standard; many also prohibited the export of gold, and in default of gold shipments no one was in a position to perceive, much less discuss, the final effects of the other correctives which the great financiers of two Continents were seeking to evolve. The following tables, which appeared in early editions of this book, will give the reader an idea of how rapid was the depreciation of currency.

TABLE OF FOREIGN RATES OF EXCHANGE ON LONDON

		Rate Mar. 8, 1921	Rate Oct. 31 1919	Rate Dec. 28, 1917	Usance	Par
Paris	francs to £1	53.85	36.75-25.96½	27.19-21	Cheques	25.22½
Berlin	marks to £1	243.	128	..	Sight	20.40
Vienna	kronen to £1	18.00	..	..	Sight	24.08
Amsterdam	florins to £1	11.36	10.09-11.14	20.94-98	Cheques	12.107
Christiania	kroner to £1	24.60	18.36-16.83	14.37-44	Sight	18.159
Stockholm	kroner to £1	17.43	17.42-16.24	14.13-23	Sight	18.159
Copenhagen	kroner to £1	23.50	19.58-17.36	15.20-30	Sight	18.159
Petrograd	roubles to £10	—	..	357-364	Sight	94.57
Italy	lire to £1	106	45.15-30.25	39.75-80	Sight	25.22½
Switzerland	francs to £1	23.25½	21.35-22.85	20.70-80	Sight	25.22½
Madrid	pesetas to £1	27.99	21.83-23.64	19.55-65	Sight	25.22½
Lisbon	pence to escudo	6d.	26½-33½	20½-30½	Sight	53½d.
Alexandria	piastres to £1	97½	97½-97½	97½-97½	Sight	97½
New York	dollars to £1	3.90d	4.16½-4.76½	4.76½-78	Cable	4.86½
Montreal	dollars to £1	4.44	4.31½-4.83½	4.78-78½	Cable	4.86½
B. Aires	pence to mls.	48½	55½-51½d.	53½-54½	T.T.	47.50d.
Rio de Jan.	pence to mls.	9½	143½-13½d.	13½	90 days	16
Mont'vid'o.	pence to doia.	48½	58½-59½d.	61½-62½	T.T.	52
Valparaiso	pence to peso	9½	11½-10½d.	14½	90 days	..
Calcutta	ster. to rupee	1/3	22.0½d.-12.6d.	22.5-3½d.	T.T.	12.6d.
Bombay	ster. to rupee	1/3	22.0½d.-12.6d.	22.5-3½d.	T.T.	12.6d.
Madras	ster. to rupee	1/3	22.0½d.-12.6d.	22.5-3½d.	T.T.	12.6d.
Hong-Kong	ster. to dollar	2/2½	42.6½d.-22.1½d.	22.0d.	T.T.	..
Shanghai	ster. to taai	2/11	62.9d.-22.2d.	22.0d.	T.T.	..
Singapore	ster. to dollar	2/3½	22.4½d.-22.4½d.	22.4-4½d.	T.T.	..
Yokohama	ster. to yen	2/5½	22.5½d.-22.1½d.	22.1½-2½d.	T.T.	24½d.

War Exchanges.

The tendency of the newspapers during the war was to refer to the rates between the belligerent countries and neutral nations as War Exchanges. The *Economist*, for instance, gave some useful figures showing, *inter alia*, the value on the money markets of New York, Amsterdam, and Switzerland of the unit of exchange from Germany, Austria, Russia, France, Italy, and Great Britain. Such details are of unusual interest both for purposes of comparison and for future reference; consequently, we give tables showing the movements during the war and after. The quotations are the sight rates which were in operation in each market on the dates indicated.

NEW YORK

	Par.	Dec. 31, 1914	Dec. 31, 1915	Mar. 3, 1921	
any	95.28 cents to 4 marks	88½	76½	1.615	.. cents for 1 mark
ria	20.26 " 1 crown	17.40	12.05	.023	.. cents " 1 krona
ia	32.45 " 1 krona	41.50	20½	—	
ce .	3.18½ francs to 1 dollar	3.16½	5.84½	7.22	.. cents " 1 franc
ritain	3.18½ lire to 1 dollar	3.31½	6.61	3.66	.. cents " 1 lira
	4.8666 dollars to £1 ¹	4.85½	4.73½	3.8375	.. dollars " 1 pound sterling

¹ (Cable transfer rate.)

AMSTERDAM

	Par.	Dec. 31, 1914	July 1, 1915	Dec. 31, 1915	Mar. 9, 1916	Dec. 29, 1917	Dec. 31, 1918	Mar. 3, 1921
	50.26 florins to 100 marks	54.50	50.60	42.35	41.85	45.25	50.00	4.65
	30.41 " 100 crowns	42.75	37.50	20.00	20.15	—	—	—
	128.00 " 100 roubles	102.44	95.65	62.24	67.00	—	—	—
	48.00 " 100 francs	47.05	44.94	38.75	40.15	—	—	—
	42.00 " 100 lire	46.50	41.05	32.06	—	—	—	—
in	12.10 " £1	12.90½	12.952	10.85	12.26	10.94	12.24	15.6

SWITZERLAND

	Par.	Dec. 31, 1914	July 1, 1915	Dec. 31, 1915	Mar. 9, 1916	Dec. 29, 1917	Dec. 31, 1918	Mar. 3, 1921
	125.45 francs to 100 marks	114.50	102.40	99.70	92.87½	84.80	50.25	9.56
	105.01 " 100 crowns	91.00	81.00	67.11	62.32½	—	—	—
	206.64 " 100 roubles	175.50	160.00	156.60	164½	—	—	—
	100 " 100 francs	101.06	97.09	89.67	82.50	—	—	—
	100 " 100 lire	98.65	82.87	70.75	72.10	—	—	—
in	25.22 " £1	25.48½	26.00	24.29	24.97½	20.75	22.25	25.56

We have added a column giving some of the latest rates ruling on 3rd March, 1921.

Satisfactorily to explain the reasons for the striking movements in exchange revealed by these quotations would require a book by itself; but, in brief, we may say that in those countries with rates heavily against themselves, the depreciation was due to two chief causes: first, failure to ship gold in support of exchange; secondly, excess note issues.

We have referred to the fluctuations in the value of the pound sterling in New York, and, as we have shown, immediately preceding the war, the rate for cable transfers on London in New York was abnormally high. It was, in fact, quoted at \$7 to £1 on 1st August, 1914, though it is doubtful if much business was done at the price. At the end of 1914 the rate was down to \$4·86½, and it continued to fall, until in July, 1915, the quotation was \$4·77c. for £1. Then the British Treasury took action to support exchange, and they instructed the Bank of England to purchase American Dollar Securities in London and to transmit them to New York for sale. These operations were continued until the close of that year, by which time some \$233,000,000 worth of securities had been purchased. The range of fluctuations was from \$4·77c. to \$4·51c. On 15th December, 1915, Insurance and Trust Companies were invited to sell or to loan to the Treasury the American dollar securities they possessed; and on 31st December, a similar invitation was issued to the general public, and a Committee was appointed by the Chancellor of the Exchequer to direct and control the various operations on behalf of the Treasury.

Various methods of inducing the public to sell or to loan their securities to the Government were carried out from time to time, but ultimately, as the amount placed at the disposal of the Treasury fell short of that required for support of exchange, other means were adopted. In May, 1916, there were no fewer than 909 securities which the

Treasury was willing either to purchase or to accept on loan. A special request for increased support was issued and, on 29th May, a resolution of the House of Commons provided for an additional income tax of 2s. in the £ on such securities as the Treasury, by means of special lists, declared its willingness to purchase. This resolution was subsequently embodied in Section 27 of the Finance Act, 1916, which imposed the tax on securities to be specified, which were not placed at the disposal of the Treasury. These steps were very effective and induced a large increase in both sales and deposits. Additional securities were added to the published lists from time to time and various plans carried into effect for disposing of them on terms fair to the owners. Then, on 11th May, 1917, the acceptance of securities on deposit was discontinued, except as regards such securities as were subject to the additional income tax of 2s. in the £, but the purchase of securities was retained.

During the time the operations of the Committee continued the nominal amount of securities deposited was: Sterling securities, £307,607,063, dollar securities, £648,314,720, other currencies, £21,096,800.

Other securities were purchased for the purpose of maintaining to a modified extent the exchanges between London and Holland and the Scandinavian centres.

The scheme came to an end by the abandonment, on 6th April, 1919, of the additional income tax on bonds retained by holders, and the cessation of purchases on 23rd April, 1919. The return of registered stocks (£67,615,000) had been commenced on 1st April, 1919.

The result of the endeavours to maintain the New York exchange, to which the operations of the Committee contributed, was that practically a uniform rate of $\$476\frac{7}{8}$ c. to £1, was maintained until 21st March, 1919, when the control of exchange was removed, and the market left to follow its own course.

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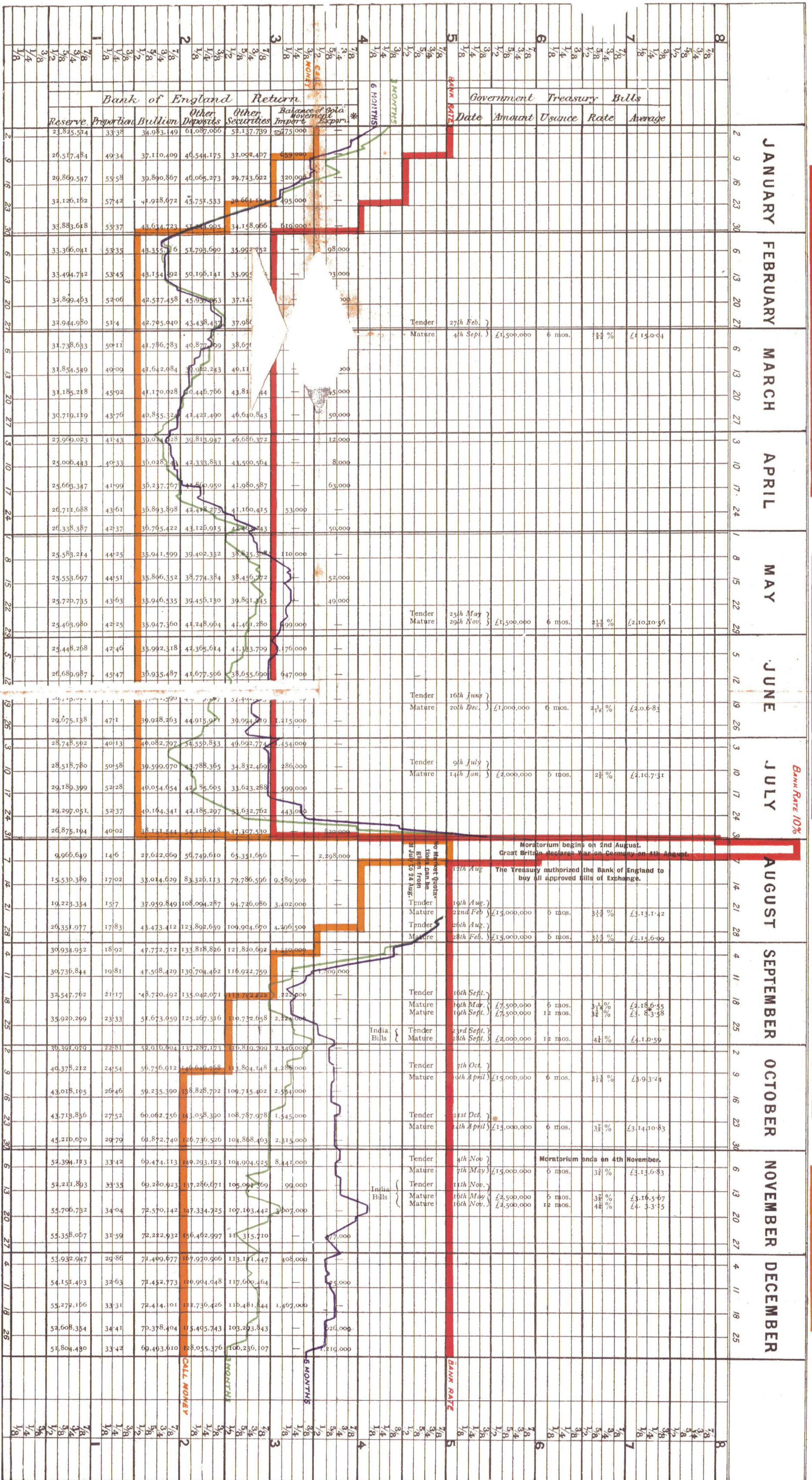
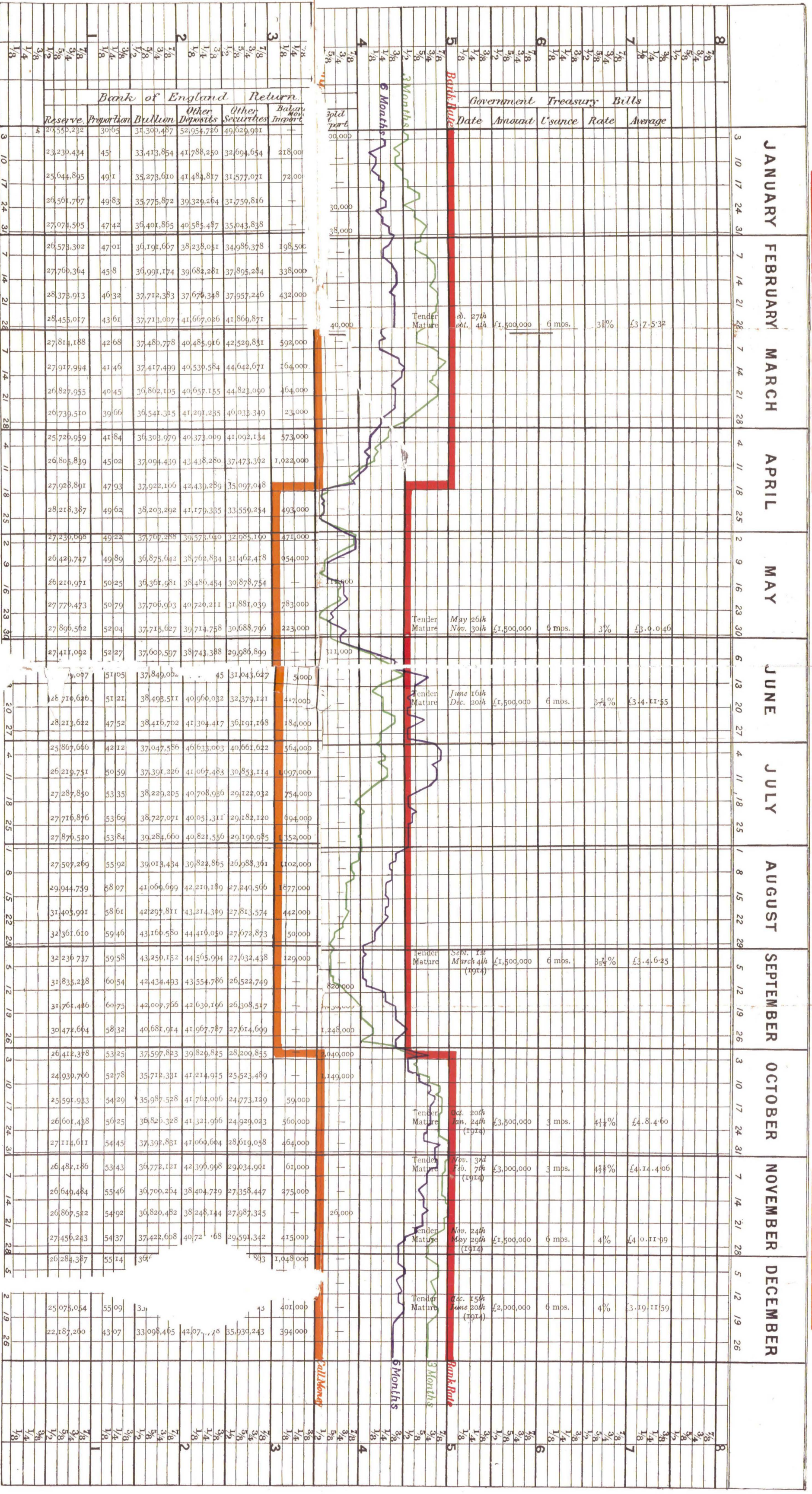


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