FOREIGN EXCHANGE AND FOREIGN BANKING OF AMERICA AS IT IS
RELATED TO AMERICAN BUSINESS

by

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SUBMITTED IN PARTIAL FULFILMENT OF THE
REQUIREMENTS FOR THE DEGREE OF
MASTER OF ARTS

in the

GRADUATE SCHOOL

of the

UNIVERSITY OF MISSOURI

1918

approved
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FOREIGN EXCHANGE AND FOREIGN BANKING OF AMERICA AS IT IS

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INTRODUCTION

The purpose of this thesis is to investigate our present system of foreign banking and exchange and to discuss its relations to American business. I propose in Chapter I to outline the situation that confronted us at the beginning of 1914, including banking provisions that aided or hindered us in our foreign exchange, and instruments of exchange that were used. In Chapter II I will take up the provisions of the Federal Reserve Act that relate to foreign trade and discuss their potency for giving us greater facilities and privileges and therefore greater opportunity in the foreign exchange field. In my third chapter I will deal with the effects of the present war on the exchange situation and will use our present relations with South America to illustrate the effects. The conclusion will be a summation of the present situation and a discussion of the possibilities for using the factors in hand to the advantage of American business in the future.

At a time when the state of business is so cataclysmic and when so little can be guessed as to what the resumption of more normal conditions will mean, it behooves us

to consider our system of foreign exchange and banking. Our commercial status after the war will depend largely on the way that we meet the situation. If we can furnish the accommodations desired as well as or better than our competitors then we can hope to maintain the commerce that we have and gain more. If not, we may lose some of the more desirable commerce that we now have. If our facilities as an exchange market compare favorably with London's we may hope to retain a share of the exchange business of the world with the resulting advantages to America; if not, we may expect it to be reestablished in London. An investigation of our machinery to care for the financing of foreign trade, therefore, has a direct bearing on American business and is now opportune.

CHAPTER I

THE BANKING AND FOREIGN EXCHANGE SYSTEM AT THE BEGINNING OF
1914

Before beginning a discussion of the foreign exchange and banking situation as related to American business, a definition of terms will prove useful. A bank includes among its properties facilities for the transmission of funds by drafts or bills of exchange. In our business relations with foreign countries, that property of banks rather than the custody, loan, exchange, or issue of money is the function of importance. In speaking of a bank, therefore, in most of this discussion we will consider it as an establishment for the transmission of funds and disregard its other functions. Foreign exchange is the process of settling debts or accounts between different countries whose trading centers are at a distance from each other, without the intervention of money, by exchanging orders or drafts called bills of exchange. The banks by handling the bills of exchange are instrumental in making foreign exchange easy or difficult. Since we shall only consider foreign exchange in this paper, the shorter term exchange will hereafter be used as synonymous with it.

Before banking was developed and our present methods of exchange worked out, payment for goods was

largely direct. A debtor paid his creditor in acceptable media and in case the distance was great between the traders the mere act of payment was expensive. Such a method made the expense attached to buying goods so great that the margin at which exchange took place was lowered; hence fewer things were offered and less exchange of goods took place. This mere fact of expense of payment acted as a barrier to trade and caused people to produce goods under less advantageous conditions near at hand rather than to take the risk and trouble of paying persons at a distance. This barrier may have been slight, but it was certainly operative. In case there was no simpler method now the cheapness of transportation and safety of travel would reduce this expense very much, yet the difference between the current rates of exchange and the points of exporting and importing gold show that the expense involved would still be a barrier that is not negligible. Whatever facilities our banks offer to make shipment of specie less necessary between countries, therefore, reduce the barrier to trade, thus aids American business and comes within the scope of this chapter.

There are three sorts of banks in the United States that are concerned with exchange: (1) national banks that receive their charters from the federal government and which are regulated and inspected by it. They act as the largest unit for they comprise the largest body of banks that are

under a single regulating hand. Therefore, the powers granted to them have a greater significance than in the case of the other sorts. Then, too, since they are under federal supervision, they acquire a certain prestige from the government which would be of special significance abroad.

(2) State banks that receive their charters from the state and which are inspected by state officials. Though their deposits are not so far behind those of national banks in the aggregate, their effect is dissipated because they are regulated from forty-eight centers instead of one.¹ New York State whose banking influence is greater than that of any other state has greater deposits in the state banks than in national.² (3) Private banks which are organized under various state provisions as investment banks, foreign exchange banks, etc. The first type of bank found no

1. Resources of state banks about June 30, 1916, 5,552 million
Resources of national banks Sept. 12, 1916, 14,411 million
Deposits of state banks of same date 5,203 million
Deposits of national banks of same date 8,445 million

American Economic Review, Vol. 5, part I, page 414.

2. The 278 state banks of deposit and discount and trust companies have aggregate deposits in excess of those of the 479 national banks in the sum of \$281,786,000.

Annual Report of the Supt. of the Banks of the State of New York, Jan. 6, 1915, p. 33.

provision in the national banking code which permitted it to accept bills or establish foreign branches. When banks did these things as test acts they were declared unlawful. Thus the national banks had no chance to aid in the development of foreign trade. Likewise the various state laws were either silent or prohibitive as to the part that state banks should take in exchange dealings. Private banks could establish branches though they had not availed themselves of the privilege extensively. The only aid that a bank could offer to exporters or importers, therefore, was the discounting of paper. Since the handy acceptance was not used here this aid usually consisted in discounting promissory notes. The proceeds were used to pay the obligations of the foreign traders. Since this purchase of paper did not happen in the open market the maker did not get the benefit of the discount that would come from competitive buyers and the proceeds of the note was less. Thus none of our banks had available machinery to really aid our trader in foreign fields.

Since payment by bills of exchange became recognized, London has been the exchange center of the world. She came to this place of importance from the fact that her currency very early became stable because she was isolated from the continent and took a comparatively small part in continental wars.¹ Thus it was more definite to say that

1. Walter Bagehot: Lombard Street. pp. 90-92.

payment would be made in so many pounds sterling than in so many francs or marks because the purchasing power of the pound was pretty sure to remain stable, while the franc or mark would possibly change before collection could be effected. So it became a custom to keep balances there or at least to have arrangements with London bankers so that one could draw on them for payment for one's purchases and thus get a more advantageous price than was otherwise possible, for a trader will trade much more readily for a price that is sure to be constant than for a price whose purchasing power may fluctuate. Since it was advantageous for traders to make London their banking city because of the more advantageous bargains they could drive, they were willing to pay London bankers a commission for their trouble. In case London had more drafts on a given country than that country had on London, English investors were anxious because of low rates of exchange to take securities of that country in settlement, thus preventing a shipment of gold into London. England thus became a great creditor nation and entrenched herself more firmly as the financial center of the world because of the obligations of other nations to her.

Of course the conditions that caused London to become the banking city of the world have long since disappeared and continental Europe is able to care for its own exchange. Great exchange markets have grown up at Paris, Berlin, and Amsterdam so that bills on them in their own

currency are quite as safe as bills on London. So when countries are dealing with them it has become the custom to draw on them directly instead of through London. The bill can be sold in their markets and realized on quite as quickly as though through London.¹ They draw on each other instead of remitting London exchange. But the world outside of Europe abides by its old custom in exchange between its parts. In paying for purchases between nations of the western hemisphere and the orient, it is still common to pay by remitting London exchange.² The reason for this is that conditions have not been good for establishing exchange markets and the banking laws were not adequate, so that European exchange was the only possible solution. Since London exchange had always been standard and sterling was more universally known than other systems, it is quite natural that London should still hold the bulk of the world's banking business.

The United States is probably more dependent on London than any of the great nations of the earth.³ This

1. Lawrence Merton Jacobs, Bank Acceptances, p. 7.
2. Lawrence Merton Jacobs, Bank Acceptances, p. 14.
3. See Exchange in Encyclopedia Britannica for relative independence of Germany and France from London influence.

is, of course, explicable because of our early relations to England which were not broken economically until long after political dependence had ceased. When our banking laws were first formulated our commerce was slight and our need for capital was so great that we gladly delegated the financing of our foreign commerce to London bankers. We could not finance our trade because capital was so scarce and so desirable in other fields that the slighter though more certain returns of good commercial paper were not attractive to what capital we had. And London bankers were so largely financing our expansion that dependence in foreign trade was to be expected. So the custom grew up that we should draw on London when she owed us and remit London exchange when we owed her, and further that we should remit London exchange to the rest of the world for our debts. If London had drawn on us all that we could have offered would have been a single name note of unknown value to London investors. London traders would have had to hold such a note till maturity since investors would not have cared to take it at an attractive price because of the risk involved with an unknown name. It is not London traders that care to finance our foreign trade but English investors who desire prime paper with a moderate profit. So we were able to drive better bargains if we paid in London exchange that could be realized on immediately. We have always been a borrowing nation because we have been developing our country so fast. When we

bought more than we sold we had a great demand for London drafts, exchange on us would be low in London, and London investors would find our securities good investments so they would buy our securities and thus furnish us with the desired exchange. When we reached the point at which capital was plentiful enough so that we could profitably finance our own foreign trade, our banking laws lacked the necessary machinery and they were so stereotyped that it was for a long time impossible to change them.

This dependence on London was unprofitable to us in so far as it rose from custom, and not from lack of desire on the part of our bankers to finance foreign trade because of greater profit in other fields. If Americans could furnish accommodations more cheaply than London, the difference in the cost would be actual loss. In so far as this is true, the field of trade of Americans is restricted, for, as I stated in the beginning, anything that makes expense of exchange greater tends to restrict production to areas where expense of payment is not so great, even though the conditions for production are not so felicitious.

The form of the bill of exchange varies according to the time before it is due, the credit of the maker and drawee, and the use to which it was put. Bills may be classified according to the time before they are due as sight, short time, including any time up to thirty days, and long bills from thirty days upward. The longest time that a

bill runs is, as a rule, one hundred and twenty days, though in some cases six months is the limit.

Any of these bills may be classified as clean or documentary bills. A clean bill depends for value on the length of time before it is due, the slight expense incident to presentation, collection, etc., and the credit of its drawer and drawee. In case either the drawer or drawee is of unquestioned credit, the bill will bring its face value less interest and expense of collection. If, however, both are of unknown or doubtful credit, it may be heavily discounted to cover risk, or it may not be salable at all.

If the bill is documentary, it has attached to it papers indicating how the debt arose and agreements that the goods may be attached in case the debt is not settled by the drawer or drawee.¹ Such documents are a bill of lading indicating the goods were shipped to the consignee and an insurance certificate from an insurance company to indicate that they will be paid for in case they are partially or

1. A bill called "Uniform Bill of Lading Act" became a law August 29, 1916, which makes it unnecessary to agree that the goods may be attached in case the debt is not settled. The bill of lading, if made out to the order of some person, gives the person who has obtained it by lawful means absolute possession of the goods.

totally destroyed. When the seller and maker of the draft presents it for collection, he attaches to it these indications of debt and guarantees of delivery. In this case the buyer of the draft is assured of possession of the goods in case he does not receive payment. Though he may have no use for the goods and not desire to be bothered with disposing of them in case of failure to settle and though he may assume the risk of a falling market, yet the draft is of more value to him than such a draft without documents attached. Of course if he knows that the drawer or drawee is without doubt responsible, he will be willing to buy it for face less interest and expense, but with the documents attached he will pay almost as much for a bill of whose maker and drawee he know nothing. What he will deduct will be an amount to cover handling of goods in case of failure to pay the bill based on them and loss from a possible fall in the market. The nature of the goods involved would determine these deductions largely.

A documentary bill may be an "acceptance" or a payment bill. An acceptance is the bill that arises when a buyer of unquestioned credit or some one of such credit with whom he has arranged, usually a bank, accepts or acknowledges the debt by writing accepted across the face of the bill drawn and signing his name. The form of the bill in such transaction is an ordinary draft with documents

attached. It is sent to the person who agrees to accept and his credit is such that he can take charge of the documents and thus get possession of the goods. The acceptor, if the owner of the goods, takes charge of them; if another accepts for the owner, the acceptor turns the documents over to the owner of the goods who may now take charge of them. The owner of the draft sells it to investors and the price received equals face less interest and expense. Since there is a name of unquestioned credit on the bill, it is considered as prime paper and it brings the highest price, for nothing is deducted for risk. This is the usual sort of paper used between us and London. Our exporter requests his bank to draw a draft on the bank of his London debtor, the London bank accepts the bill, the bill is sold in the London market, and the balance is placed to the credit of the New York bank in a London bank. The New York bank does this for the small profit that he hopes to make. The exporter usually sells the draft to the bank when he requests the bank to draw it. For the draft he receives an amount slightly smaller than the bank expects to receive for it less expense charge. The balance which the New York bank secures in London is used as a basis for drafts on London which drafts are sold to individuals who desire to remit to London. The purchasers pay the bank a slight commission for the drafts. This commission and the difference between the price paid for the draft and the price received

in the London market compensates the bank for its trouble.

A payment bill has all of the characteristics of the acceptance except that of having an acceptor of unquestioned credit. Since the bill does not bear a name of unquestioned credit, the documents are held by the owner of the bill until payment is made. If payment is made before maturity, a certain discount is allowed, though not the current rate, for the present owner would demand something to recompense him for disturbing his investment. If the goods in question are perishable, the payment bill must necessarily be settled immediately. Such a bill can hardly be rediscounted because the owner of the goods may desire to settle and gain possession of the goods at any time before maturity, and in case it were rediscounted, locating it might be difficult.

Just here should be mentioned a device used by bankers in manipulating bills which prevents much shipping of gold. It is the use of finance bills in caring for the different rates of demand for London exchange. Since our purchases from Europe are largely manufactured articles, we have a continual stream of them coming into our country and a more or less continual demand for London exchange with which to settle. At the customary settling periods of January first and July first there is an added demand because Europe has ~~invested~~ so largely in American

enterprises that a great amount of interest is due at interest payment periods. On the other hand, Europe buys from us chiefly agricultural products which are sold in the period from August first to December thirty-first. Our bills on Europe come chiefly in that five months' period. If exchange took its natural course, we should be shipping gold to Europe regularly from January first to August first. Then this same gold would come rolling back to us from that date until December thirty-first. Instead, our bankers arrange with London bankers early in the year to accept bills for them for from three to five months. On the balance secured from the sale of these bills in London, they sell sight drafts to the persons wishing to remit to London. In order to have the privilege of drawing on London, New York bankers agree to pay a certain commission. At the time when they draw, exchange on London is scarce and they can sell the sight drafts for a high price. When these bills fall due, the season has come for exchange on London to be low because our agricultural products are pouring into London and the drafts are plentiful with no unusual demand for them. The banker who drew on London now buys up these and settles with the London banker who accepted his bill. He has made his profit from the difference of the prices of the drafts that he sold and bought. The exporters and importers have been benefited because the banker prevented the exchange rate from rising to the gold shipping point in the early part of the year, and

from falling to the gold importing point in the fall.

Bankers prevent shipment of gold from one European country to America, and exportation of gold from America to another European country by a process known as foreign exchange arbitrage. An example will serve best to make this clear. Exchange on London is low, exchange on Paris is high. A New York bank will buy up the exchange that is low and sell it at a slightly higher price to the person who wishes to remit to Paris. This sterling will be sent and if gold has to be shipped from London to Paris, the expense will be much less than if the double exchange of gold had taken place across the Atlantic.

In the foregoing chapter I discussed first the necessity for foreign exchange and the inadequacy of our banks in furnishing facilities to Americans such as banks of other great countries furnish to their citizens. I next discussed London as the financial center of the world and our method of dealing through her. The disadvantage to America of this financial dependence on London was pointed out. Finally, came a discussion of the instruments of exchange used, their advantages and disadvantages to American traders, as well as their adequacy in preventing the flow of gold between countries. From this chapter we will look to the next for a discussion of the Federal Reserve provisions that affect exchange to see how our mechanism of exchange has been modified and to discuss whether this exchange

places American business men in the same advantageous position that the business men of other great commercial countries occupy.

CHAPTER II

THE EFFECT OF THE FEDERAL RESERVE ACT ON FOREIGN BANKING AND
EXCHANGE

The Federal Reserve Act of 1914, with its amendments to date, has completely revolutionized the banking system of the United States. The laws under which national banks operated were completely changed. The National Act was supplemented by the Federal Reserve Act which reorganized and unified the system and placed a Federal Reserve Board in control to regulate it as the need arose. All national banks were compelled to join the system or else to forfeit their charters, and any state bank, trust company, or bank organized under a special state law ¹ was permitted to join if willing to comply with the conditions of the Act and the regulations of the Board. Any state bank that joins is free to exercise all corporate powers granted by the state in which it was created.² All banks that have joined the system are designated as member banks, and all outside the system are called non-member banks. This Act attempts to furnish member banks with facilities for handling foreign exchange and the mechanism for developing foreign banking as the need arises. The establishment of foreign branches and foreign agencies or correspondents is permitted only with the consent of the Federal Reserve Board.³ This limitation will tend to prevent any

1. Federal Reserve Act with amendments to June 21, 1917, Sec. 2, Par. 7.
2. Same Act, Sec. 9, par. 5.
3. Act cit. Sect. 14e, P. 103.

mushroom growth of facilities for foreign banking which our needs would not justify and which might easily hamper future development by seeming unprofitableness.

The provisions concerning foreign exchange and banking may be grouped under three headings: (1) the permission to accept paper; (2) the permission to buy and sell commercial paper in the open market; and (3) the power to establish foreign branches and agencies.

The acceptance of paper may come under two headings: acceptances for a person, company, firm, or corporation to furnish a readily salable paper with which to settle a debt; and acceptances for a bank or banker in a foreign country or dependency, or insular possession of the United States to furnish dollar exchange.

Taking up the first sort of acceptance, we find in Section 13, paragraph 92¹ the following, "Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months' sight to run exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods; -----no member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than 10 percentum of its paid-up and unimpaired capital stock and surplus unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction

1. Act Cit.

as the acceptance; and no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus.....Provided, however, that the Federal Reserve Board under such general regulations as it may prescribe, which shall apply to all banks alike regardless of the amount of their capital stock and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred percentum of its paid-up and unimpaired capital stock and surplus;....." This will permit American importers to bargain for goods in terms of dollars. They can furnish to their creditors paper in terms of dollars which is of prime value and which will command, therefore, a price equal to face less current rate of interest. Of course, if an open market (which I shall discuss later) does not develop, the paper may not be sold in a competitive market and the discount rate may not approach very nearly the rates in the great discount markets because of this lack of competition. The American importer will pay a commission to an American bank for accepting his paper instead of remitting paper for the acceptance of which an English bank received commission. Then, too, since he is bargaining in terms of dollars, he knows exactly what he must pay, and he takes no risk of fluctuating exchange, so that he can drive a closer bargain than under the former system. The exporter will trade under the same conditions as formerly when dealing with European countries that have well established systems of exchange,

but when dealing with countries from which he formerly received sterling in payment, he will now probably receive dollar exchange. In dealing with those countries that had been tendering sterling in lieu of their own bills of exchange, he will be bargaining at a greater advantage than formerly, because he will not be taking the risk of fluctuating exchange and the trouble of a three-cornered transaction. It seems that the use of acceptances should be advantageous to American business, therefore, if business men make use of them extensively.

In paragraph 97 of the same section, we read that, "Any member bank may accept drafts or bills of exchange drawn upon it, having not more than three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Federal Reserve Board by banks or bankers in foreign countries, or dependencies or insular possessions of the United States for the purpose of furnishing exchange as required by the usages of trade in the respective countries.... Provided, however, that no member bank shall accept such drafts or bills of exchange referred to in this paragraph for any one bank to an amount exceeding in the aggregate ten percentum of the paid-up and unimpaired capital stock and surplus of the accepting bank unless the draft or bill of exchange is accompanied by documents conveying or securing title, or by some other adequate security. Provided, further, that no member bank shall accept such drafts or bills in an amount exceeding at any time the aggregate of one-half of its paid-up and

unimpaired capital and surplus." The regulations of the Federal Reserve Board states that this 50 percent limit is separate and distinct from, and not included in, the limits placed upon the acceptance of drafts and bills of exchange as described in paragraph 92, section 13, of the Act. This provision will serve to prevent the flow of specie from the United States at one season and back again at another, just as the finance bills discussed in Chapter I do by furnishing sterling exchange at seasons when there is a demand for sterling and no supply. This ability to secure dollar exchange will be very useful in dealing with a country that has no established system of exchange and which has depended on Europe for exchange. If such a country is being developed so fast that it continually buys more than it sells, then dollar exchange may be furnished them thus and our investors will find it advantageous to buy their securities from them to settle the balance. **Then, too,** the goods that we would buy from such a country would be largely raw materials which flow seasonally, while they would buy from us manufactured goods which flow regularly. Under such conditions they will continually need dollar exchange to settle with us, while we will have a fluctuating demand for bills on them. With the machinery thus provided, bankers in foreign countries may avail themselves of the privilege to secure dollar exchange through long bills for which they will settle with sight exchange when bills on us begin to accumulate. It is possible, though not probable, that American bankers in European countries will draw bills to

furnish dollar exchange. Europe has a constant supply of bills on us, and we have a fluctuating supply, because we are the buyers of manufactured goods and they, the buyers of raw materials. As business has been conducted, it is natural for us to draw finance bills on Europeans when we have more demand for exchange than they and to settle with them when we have more bills than they. Since capital has been more plentiful in Europe than in America, we have allowed them to finance our trade with them and used whatever surplus we had at home or in even less developed countries such as those of South America. It would be quite possible, however, for our agents in Europe to draw bills to provide dollar exchange at a season when we have many bills on them and to sell this exchange to Europeans to settle with us. When our exports had decreased to the extent that they had more bills on us than we had on them, our agents could buy up the surplus and pay off these time bills drawn earlier. It is probable if our dollar exchange becomes popular that our dealings with Europe will be a synthesis of the two methods: sometimes dollar exchange will be furnished to tide over discrepancies; sometimes sterling exchange will be provided, according to the particular circumstances.

That the providing of dollar exchange will be welcomed by some foreign countries seems certain from a statement in the Chronicle to the effect that the South American merchant has often found it difficult to do business with American merchants because exchange through London frequently did not figure up the same

as the price in terms of dollars. Besides there was the expense of a three cornered transaction. If a South American banker had exchange on New York for sale, he was compelled to hold it for a slightly higher price than other exchange, because it was a rarely called for article. With exchange quoted in dollars, the purchasing would increase; and this would cause dollar exchange to be more universally desirable, with a consequent fall in price because of the competition.¹

In connection with this power of member banks to accept should be noted the provisions relating to foreign exchange in the New York State Bank Act that was passed in 1914. It empowers any state bank to "accept for payment at a future date drafts drawn upon it and to issue letters of credit authorizing the holders thereof to draw drafts upon it or its correspondents at sight, or on time not exceeding one year."² This does not limit the amount that state banks may accept, and it gives them a chance to compete at an advantage with member banks. Since New York banks are the most important banks in the country from the standpoint of foreign trade, and since the New York State banks have deposits of 281 million more than the national banks of the state, the Federal Reserve Board will have to make the most liberal conditions possible so far as safety in banking will permit in order that

1. See The Commercial and Financial Chronicle, Sept. 19, 1914, Vol. 99, p. 789.
2. Economic Review, Vol. 5, pp. 413-21 Article by Everett W. Goodhue of Colgate U.

the growth in this field of member banks in the state may compare favorably with non-member banks.

The second division of this chapter is concerned with the power of Federal Reserve Banks to deal in acceptances, bills of exchange, etc. In paragraph 91, section 13, we find that "any Federal Reserve Bank may discount acceptances of the kind hereinafter described which have a maturity at time of discount of not more than three months' sight, exclusive of days of grace, and which are indorsed by at least one member bank." This will make acceptances and other forms of exchange very liquid assets which member banks will be glad to possess because they will be assured of being able to re-discount them should the need arise.

In paragraph 107, section 16, we find a use that reserve banks may make of the exchange on hand. "Any Federal Reserve Bank may make application to the local Federal Reserve agent for such amount of the Federal reserve notes as it may require. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances....." In time of financial stress the permission to use exchange thus makes the exchange a very desirable form of investment. This fact makes the Federal Reserve Banks avail

themselves of the privilege of paragraph 98, section 14, that "any Federal Reserve Bank may under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank." This power of Federal Reserve Banks to buy or to sell eligible paper in any market is of value both to the selling banker who has paper on which he wishes to realize, and to the business man. Formerly the only method of using surplus funds that might be needed was to put the money out to speculators at call loan rates. The fault of this method was that when conditions were normal the banker did not need the money, and when abnormal he could not obtain it. Furthermore, as H. Parker Willis¹ says: "So long as surplus funds are invested in loans on stock, so long must a country necessarily be without the resources it stands in need of to meet any sudden demand or claim upon it for funds to liquidate international balances. So long as the surplus is invested in acceptances of bankers, just so long is it in position to meet obligations to foreign countries by offering claims upon bankers in those countries, or upon bankers in other countries with which such creditors

1. H. Parker Willis, The Federal Reserve, p. 289.

are engaged in trade. This is an easy and natural way of liquidating and equalizing international balances."

The power of Federal Reserve Banks to buy and sell eligible paper is of advantage to the business man because the competition for prime paper in an open market will bring the discount rate in the United States down toward the current rate of the world, and the American business man has not had the advantage of such a low rate in the past. The discount rate will be brought down to the current rate because there is a comparatively free flow of funds between countries possessing great discount markets. The country which offers the highest rate attracts money to its market, and this increased amount of money will bring the rate down. An exact equality of rates is not reached because there is not an equally free flow of gold from all exchange markets. Certain governmental restrictions on the shipping out of gold in Germany and France prevent an absolute adjustment of rates.¹ Our traders were compelled to confine their borrowing to American capital either through the discounting of their paper with their local bankers or through its sale to note brokers. All but the strongest and largest are practically excluded from the benefits of foreign competition for their paper.²

The Chronicle³ says that our bankers should take pains to develop an open discount market by refusing to discount

1. Lawrence Merton Jacobs, Bank Acceptances, p. 7.
2. Lawrence Merton Jacobs, Op. Cit., p. 9.
3. See Commercial and Financial Chronicle, Jan. 22, 1918, Vol. 102, p. 299.

the bills that they accept and instead put them on the open market. Developing the field will result in (1) setting the export market free from some of the handicaps it has suffered; (2) developing the most flexible system of financing; (3) making our system conform to the one which has been found best in the world outside the United States; (4) creating a high grade paper for the second line of reserves.

The third division of the chapter deals with the establishment of foreign branches or agencies to assist trade. Paragraph 103, section 14, gives any Federal Reserve Bank power to ".....open and maintain accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may be deemed best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell, with or without its indorsement, through such correspondents or agencies, bills of exchange or acceptances arising out of actual commercial transactions which have not more than ninety days to run, exclusive of days of grace, and which bear the signature of two or more responsible parties, and, with the consent of the Federal Reserve Board to open and maintain banking accounts for such foreign correspondents and agencies....." Federal Reserve Banks, through this provision, have the best of facilities for handling the business of member banks in foreign countries and have the mechanism to give American paper the benefit of a world market.

Paragraph 156, section 25, provides that any national

banking association possessing a capital and surplus of \$1,000,000 or more mayestablish branches in foreign countries, or dependencies, or insular possessions of the United States for the futherance of the foreign commerce of the United States....." The next paragraph continues that such a national banking association may, "invest an amount not exceeding in the aggregate ten percentum of its paid-in capital stock and surplus in the stock of one or more banks or corporations chartered or incorporated under the laws of the United States or of any state thereof, and principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions." Paragraph 162, same section, further states that, "any director or other officer, agent, or employee of any member bank may, with the approval of the Federal Reserve Board be a director or other officer, agent, or employee of any such bank or corporation above mentioned in the capital stock of which such member bank shall have invested as hereinbefore provided, without being subject to the provisions of section eight of the Act approved October fifteenth, nineteen hundred and fourteen, entitled "An Act to Supplement Existing Laws Against Unlawful Restraints and Monopolies, and for Other Purposes." From the portions of the Act cited above it can be seen that we are permitted to establish whatever

banking facilities in or with foreign countries seem necessary. Branch banks will be of especial aid to trade in large centers in territory where we hope to develop American trade. Such centers are Buenos Aires and Rio de Janiero. An American bank could establish a branch there and cooperate with manufacturers of the United States in every line in establishing a great distributing point for American goods. On the other hand, banks that do not feel the necessity or the ability to establish one or more branches may invest in a bank that deals principally in foreign banking and thus secure the benefits of its facilities for its customers. Since the Act concerning interlocking directorates is not operative, a very strong institution could be organized and officered by a number of banks in conjunction. Such an institution would be of benefit in countries where we desire facilities for transmitting and receiving money as in European countries. In developing a field for American goods it would not be so serviceable as a branch bank, because the latter has the welfare of a single bank and its customers especially in mind.

American business men have long questioned whether Americans needed the mechanism for establishing branches abroad to develop American trade. Such statements as the following are found frequently in our commercial magazines:

"The highest financial authorities of this country and Europe now admit that the United States is the greatest borrowing nation in the world, and as long as we occupy that unenviable position, we can never maintain branch banks in

foreign countries; for, if we had the credits abroad which make it possible to establish such branches, where would be the need of all this borrowing?....." 1

Quite contradictory is this statement which appeared more than a year later:

"Surely, such an exhibit of accumulated wealth (that exhibit of wealth which we displayed when our bankers lent so much to European governments in 1915, and our investors bought so many American securities offered for sale in belligerent countries) and the readiness of the public for investing it in securities of domestic enterprise or in loans to foreign governments does not justify the oft-repeated statement by our men of finance that we are still a debtor nation, and therefore cannot hope, at least for some time to come, to be in a position to finance the needs for individual and commercial enterprises of Latin America."

The first statement is too emphatic when it says that branch banks are not necessary, for that has not been conclusively proven; and the second may be wrong when it suggests we are no longer a debtor nation. At the time it was made it was certainly wrong, for we had not loaned enough then to balance the foreign holdings of American securities. It is just now doubtful whether our debts exceed in amount the money we have loaned. A combination of the statements would be more nearly

1. Moody's Magazine, June 1914, Vol. 17, pp.316.

true. Though we may be a debtor nation, we can afford to invest a part of our capital in foreign countries to secure trade. In order to develop side by side with the great European nations, we must reach out for commerce in undeveloped fields, even though Europe still has large investments here. Should we wait to expand until we have accumulated enough capital to finance our own enterprises, we will have been shut out from the very desirable trade of less developed territory. Of course we will be paying interest to foreign investors, but at the same time we will be receiving more interest from our foreign investments. Mr. Willis doubts the need of provision for the establishment of foreign branches in the Federal Reserve Act. He says, "Under the laws of various states it would have been possible to organize banks authorized to establish branches abroad had that been desirable. Moreover, private banking houses in the United States have not only been able to, but have, in fact, established such foreign branches." He thinks, moreover, that Americans can get as good accommodations in South America from banks of the various European countries as the people of those countries can get, that is, an American can, for example, get as good accommodations from an English bank in Brazil as an Englishman.¹ Mr. E. N. Hurley² denies this, and says that though banks established by

1. H. Parker Willis, Op. Cit., pp. 278-279.

2. See Bankers' Magazine, Vol. 89, pp. 348-350.

Europeans and South Americans do accommodate business men of the United States, they give preference to their own countrymen. The credit service of these banks is not open to Americans in the same degree that it is open to others. Many of the South American governments own public utilities whose bonds are largely held in Europe. This gives the European influence with South American governments, and he frequently dictates the channels along which South American purchases shall go, thus restricting America's field of competition. Banks should be established with American connections, whether they are branch banks, banks established by Americans, or banks purchased by Americans.

The Federal Reserve Act furnishes Americans an excellent mechanism with which bankers may aid the development of foreign trade. Just how foreign banking will develop, depends on circumstances. The development has certainly been much faster than expected, because of the Great War which began before many of the measures had become operative. The first application for a branch bank was made June thirtieth, 1914, and permission was granted September second.¹ The first bill drawn in Argentine on a New York Bank in dollars was shortly before October twenty-fourth, 1914.² This Act furnished the mechanism for the development of extensive foreign banking relations, and in the light

1. World's Work, Vol. 29, pp. 190-192.

2. The Commercial and Financial Chronicle, Vol. 99, p. 1199.

of succeeding events the provisions for foreign banking and exchange seem very necessary. Just how necessary they would have seemed had the war not occurred is a question that cannot be answered. In the next chapter I will discuss the effect of the war on foreign exchange and banking.

CHAPTER III

THE EFFECT OF THE WAR ON FOREIGN EXCHANGE AND BANKING

The effects of the Federal Reserve Act and of the war on foreign exchange and banking are so closely bound together that it is difficult to say where those of the former end and of the latter begin. We must recognize that the Federal Reserve Act gave us a mechanism with which to take advantage of the opportunities offered, and without which our facilities for handling the situation growing out of the war would have been hopelessly inadequate. Moreover, there would have been some development had the world situation remained normal. But the maneuvers of numbers of agents of American banks would have been required to establish even a slight demand for dollar exchange, and every bit of ingenuity that Americans possessed would have been required to make a field for American investment abroad, if the war had not begun at the time it did, while as things turned out, these opportunities and many more come to us in greater number than we can embrace. It is a fundamental principle of human behavior that the customs of a people largely determine their actions, and that when they show a decided change some cause that is violent enough to upset the custom must be back of it. And this war is surely the cataclysm which will account to a large degree for the change

in the seat of the world's banking from London to New York, and the increased importance of the United States in world trade. It is not inaccurate, therefore, to ascribe any marked development of foreign banking and exchange to the world war.

Our expansion of trade has been in two directions: in one that is clearly abnormal; and in another that we hope will be permanent and normal. To the first belongs our increased trade with Europe, which consists largely of foodstuffs and munitions. Since the abnormal demand will cease when the war is over and the demand for goods to rehabilitate devastated regions will gradually diminish, we cannot count gain in that direction as permanent. Of course, if we finance the war to the extent that we become a great lending nation, such as Britain is and has been, we will have gained much in Europe. To the second belongs our expansion into South America, the orient, and other great undeveloped fields. Since these regions are undeveloped and will need manufactured goods and foreign investments for a very long time, we can count whatever relations we establish there as permanently advantageous. We are more concerned with the development of South America than other regions, because it is relatively less remote, and because the common ideals that have been fostered by our similar positions to Europe have wiped out racial differences and make friendly relations desirable to both parties. Our efforts at expansion have

been chiefly concerned with these southern neighbors, and whatever is true of their growing dependence on us is true in a lesser degree of the other places of earth where we might establish permanent relations. So a fairly general view of the situation will be given if in discussing the permanent effects which will come out of the war, I use South America as an illustration.

Since the question of banking development depends so largely on custom and attitude, it is important to note at the outset the attitude of citizens of the United States toward South America and vice versa. To start with, South Americans are temperamentally different from us, and we shall have to learn the difficult lesson that in trading with them we must conform to their ideas and practices. The hustling Yankee who insists on an immediate decision is very offensive to them. The South American likes to take his own time in a trade, and the American who wishes to cultivate his goodwill and thereby his permanent trade, must permit him to do so. The Europeans have dealt in a rather shiftless manner with their South American debtors in that they have granted longer commercial credits to them than business practice justifies. As we go into the field we must bow to this custom, for any attempt to change it will prejudice them against us.¹ Not only must

1. See The Financial Chronicle, Vol. 99, p. 789. Also Scientific Ans. Vol. 114, p. 349; also p. 553.

we provide methods of financing but ratings of their firms must be established so that our granting of credit will be prudent.¹ Our goods must be properly prepared for shipment and in the form to which the purchasers are used. 2

In the early years of the war there was much dissatisfaction because the supplies which South Americans were compelled to buy from us frequently reached them in an unsalable condition. If this had happened in time of peace when they were not compelled to buy from us, it would have taken years to have regained their confidence and to induce them to try our products again. A discussion of our attitude towards South America is largely a question of what our attitude should be, for we are the aggressive nation that is seeking new fields of commerce in competition with other commercial nations and our attitude is largely an outcome of our desires.

On the other hand, South America is in a passive condition and waits to choose with whom she will trade. From the nations competing for her trade, she will choose the one which offers the greatest relative advantages. Her attitude towards us is much discussed in commercial publications. At first, public opinion was against us, for her people thought that we were exploiting them in their helplessness which grew out of war conditions; in the last two years they have become more

1. The National City Bank is preparing such a table of the ratings of S.A. firms under the direction of U. P. Austin, former chief statistician of U. S. Foreign Office. See World's Work, Vol. 29, p. 190-192.
2. The Commercial and Financial Chronicle, Vol. 99, p. 789.

friendly and more attached to American goods. Leo S. Rowe, Secretary General of the International High Commission, basing his opinion on personal observations, says that America is taking advantage of the predicament of South America by charging high prices and by making financing difficult. He thinks that the Latin Americans resent this and long for the opportunity to resume trade with the belligerents, especially with Germany.¹ George E. Briggs, Jr., the consular representative attached to Buenos Aires, says, on the contrary, that at the beginning of the war Argentine was very well satisfied with European treatment and was sceptical of ours, so that winning a market would have been very difficult for us. For a time after the war broke out, the people of Argentine thought we were exploiting them because some few persons were unscrupulous; but in the last two years they have taken our goods over thoroughly and are using quantities of them. It is doubtful if European competitors could now win many of our customers away from us.² From the discussion that follows, it will be evident that South Americans are coming into more sympathetic relations with us continually.

The establishment of branch banks and foreign agents has not been encouraging. Our bankers do not seem to see the advisability of establishing them, and with our entry into the war they have limited such expansion still further. Up to

1. See Commercial and Financial Chronicle, Vol. 104², p. 422.

2. See The Americas, November, 1917. p. 25.

January 1916, one American bank had five branches abroad; and one corporation, whose chief purpose was the financing of foreign trade¹, had been organized with \$50,000,000 capital. A corporation with \$10,000,000 capital was formed in April, 1918, to carry on foreign banking.² To illustrate how insignificant our foreign banking ventures are, attention should be called to the fact that we had in January, 1917, \$7,000,000 invested as capital in branch banks abroad with \$3,400,000,000 invested in capital and surplus of banks, trust companies, and loan companies at home. At the same time England had similarly invested abroad \$500,000,000 which is more than the total investment in her domestic banks exclusive of the Bank of England. The disturbed condition of the financial world that has accompanied the war accounts for this slow development on our part, up to 1918. Though the needs of the countries outside of Europe for banking accommodations are very marked now, and in spite of the fact that there is now less competition in the field than we can hope for again, our financiers have been so busy with domestic and European problems, and the expense and consequent risk of developing a foreign field is so great that the attempt to follow a program for developing branch banking has not been very energetic.

Following a discussion of the development of branch banks, naturally comes the question of our investments abroad. In the last chapter I stated that the United States was probably

1. See The Annalist, Vol. 7, p. 120.

2. See Bankers Magazine, Vol. 94, p. 59.

no longer a debtor nation, and that we have the capital to invest abroad to attract trade, if we so desire. Practically all that we have invested abroad so far has been lent to the Allied Powers. Most writers on the subject of our investments abroad voice the opinion that, since Europeans have ceased to pour capital into South America, we have the opportunity to do so, and that we must do so if we hope to gain their trade. In an article on the Relations of Investment to South American Trade,¹ already cited, the thought is advanced that capital must be poured into South America before her people can resume industrial development. It is very important to get financial control of industries and districts, for only so can a growing market be assured. Investment with the complementary buying will do more to make trade permanent than treaties or banking facilities, for those who use the goods will induce others to use the goods, who in turn will induce others, until a permanent demand has been established. Our commercial stability is coming more and more to depend on the stability of our trade in neutral countries, and the best way of assuring ourselves of this market is through investment. In another place I find the statement made that the American people are not willing to put money into developing South American trade. They consider it waste. A central bank must be established with branches everywhere to give the long time credits necessary, and money must be invested in

1. Proceedings of Academy of Political Science, Nov. 12, 1915, pp. 138-46.

2. Proceedings of Political Science, Nov. 12, 1915, pp. 138-46.

business enterprises of various sorts backed by the slogan of "American Made Goods." ¹ In a discussion of Latin American affairs, an English publication says that the entrance of the United States into the ~~war~~ has caused a stoppage in the flow of capital to South America, though even before this, Americans did not seem inclined to become the general bankers of their neighbors for their investments had been very meager. Since the outbreak of the war, Latin American governments and municipalities had received less than \$100,000,000. ² We have loaned several billions of dollars to our allies and only \$100,000,000 to these people. Of course, since our entrance into the war, our chief business is to exert all energies to end it. But before we entered we could have lent ten times what we did to our neighbors and would have lost nothing by the transaction, and our position in foreign trade would have been incalculably strengthened.

One of the most phenomenal things that has happened to us as a result of the war is the popularizing of the use of dollar exchange. Sterling exchange was used so extensively before the war that the breaking of the custom seemed impossible. However, when war conditions developed, sterling became such a fluctuating standard that some other means of payment became necessary in non-European countries. Since other European exchange was as uncertain at the time as sterling, non-European

1. Scientific American, Vol. 114, p. 553.

2. The Economist, Aug. 11, 1917, p. 197.

were compelled to turn to the United States with its recently improved facilities for handling their business.¹ The war not only gave us the opportunity to furnish dollar exchange, but it compelled us to.² The European war has put us on a footing with sterling, mark, and franc exchange such as twenty years of ordinary activity would not have done.³ Dollar exchange was first asked for in October, 1914, in Argentine.⁴ Mr. Leopold Frederick, an American living in Chile, who is director of the American Smelting and Refining Company, has taken great interest in creating a demand for dollar exchange. Several millions of dollars worth of dollar exchange had been used in the eighth months previous to April, 1915, and much more would have been used if official quotations had been made. The Chileans welcomed his suggestion that official quotations be made.⁵ By the first of the following June, arrangements were made for the quotation of dollar exchange on the Valparaiso Stock Exchange. Arrangements were made so that Mr. Leopold's company could deal with the United States as they formerly had with London: a part of the export duty is paid by 90 days sight drafts on New York; the rest is paid in gold. The rate

1. The Commercial and Financial Chronicle, Vol. 99, p. 1575.
2. Publication cited in 1, Vol. 100, p. 1555.
3. Publication cited in 1, Vol. 101, p. 2039.
4. Publication cited in 1, Vol. 99, p. 1199.
5. Publication cited in 1, Vol. 100, p. 1409.

of exchange in dollars is fixed weekly along with the fixing of the gold premium¹ to be charged when duties are paid in Chilean currency.² During the four months previous to January first, 1916, seventy-five percent of the business of this company was conducted with dollar exchange, ninety days sight, and the other twenty-five percent was conducted with sterling because of previous contract. The American Smelting and Refining Company is extending its business into Bolivia, and Mr. Frederick is taking steps to create a market for dollar exchange there.³ Up to 1918, his company has used \$50,000,000 in dollar exchange altogether. Chili through his efforts has accepted dollar exchange in part payment of all port duties. There is a great exportation of nitrate of ammonia, because of its uses in the war, and the customs duties on this alone will be very great. New York bankers consider this concession of great significance in the popularizing of dollar exchange.⁴ This illustrates how the war has made possible the extension of the use of dollar exchange with comparatively small effort, and it also shows the sort of work Americans must do to win a foreign field.

Dollar exchange is becoming known and used in Europe too. In order to establish the Italian exchange market and thus

1. Chilean currency is a depreciated paper currency which fluctuates around 25 % below par. The value in terms of gold is announced weekly.
2. The Commercial and Financial Chronicle, Vol. 100, p. 1883.
3. Publication cited in 1, Vol. 102, p. 11.
4. Annalist, Vol. 11, p. 228.

prevent speculation in Italian exchange, the Italian government has decreed that payment for American goods shall be made exclusively in dollars.¹

The effect of the war on the rate of exchange in New York on other exchanges has been very marked. Up to the beginning of the war the flow of gold had been largely unrestricted, and the rates on London, Paris, Berlin, and Amsterdam could not vary widely. When the rate rose on one market, arbitrage or shipment of gold from other markets soon brought it back to a rate not far from par. In no way could it vary much beyond the gold points. Russia, Scandinavia, and Austria banked through Berlin; and Italy, Switzerland, Belgium, and Spain through Paris, much as we did through London;² and their rates did not vary far from the rates of their respective banking cities. Not until long after the war had started were the rates of any exchanges but sterling, marks, and francs generally quoted in New York. During the two months preceding August second, 1914, the rates of marks, francs, and sterling had not differed at any time one-half of one percent. Reference to the graphs of the weekly change in rates from May, 1914, to the present (which are added at the end of this chapter) will prove this and the further statements that I make on the exchange rate. After the war began all the markets were temporarily paralyzed, but one by one they resumed business.

1. Annalist, Vol. 10, p. 312.

2. See Encyclopedia Britanica: Exchange.

When business was resumed, the rates were very high for a few weeks, because of uncertainty in the situation, then all dropped very low. The rate was low in marks because of restricted gold shipments and Germany's isolation; it was low in francs and sterling because submarines menaced shipments of gold abroad, investors were unwilling to sell securities of non-European countries, and arrangements for financing other than by shipments of gold had not been made. Then, too, France and England placed restrictions on the exportation of gold, because they needed this gold to support their credit fabrics.¹ After war became a recognized factor, the different exchanges took on as normal an aspect as possible under war conditions. The countries that had been dependent on London, Berlin, and Paris came to conduct their own exchange business because remitting exchange of a belligerent was too uncertain. Practically all of the European and some of the South American exchange rates are now quoted in New York. Up to the time we entered the war, the tendency for neutral exchange was to be slightly above par. From that time forward this exchange has risen steadily until now Spanish pesetas are quoted at 36.7 percent above par. The Central Powers have been so isolated and have placed such restrictions on outflow of gold that their rates steadily declined up to the time when we entered the war and severed all relations with them. The rates of the Allies vary as the financial strength of the particular country varies

1. See The Commercial and Financial Chronicle, Vol. 101, pp. 501. and 1422.

and also according to the fortunes of war. Russian rubles have been very low, and since the revolution have declined to 71 percent below par. Lire also are low, being now about 42 percent below par. In Italy, particularly, the fortunes of the army are mirrored in the rate of exchange. When the Italian army showed great strength, the rate of exchange would rise, or at least hold, when the army suffered losses, a decided decline in rate would result. The fluctuations of exchange with the fortunes of war are explicable in that as the armies lose, the chances that the nation will survive and its debts which in war time comprise a large part of the bills on it in other countries will be paid decreases. Creditors present their bills in great numbers and no one cares to purchase such uncertain paper, so the rate goes down. If, on the other hand, the armies have success, the holders of bills do not fear for their value and do not present them in such numbers, and persons who have money to invest seek to buy these bills because with the chance of good fortune the exchange rate will rise and they make money from the speculation. Now the demand is greater than the supply, and the rate rises. Francs dropped as low as 19 percent below in 1916, but have since recovered to and for the last year varied slightly on either side of 10 percent below. Sterling went to 5 below in 1915, but recovered to 2.2 percent below about January first, 1916, and has varied less than .2 of one percent since. At the beginning of the war the rate in New York of exchange on Brazil dropped very far below par,¹

1. Cosby, American Monetary Systems & Exchange Conditions, p. 5.

and it has remained much below ever since. The entry of Brazil into the war on the side of the Allies does not seem to have had any effect on the rate. None of the warring nations has attempted to bring the rate to par by shipment of specie. The risk of shipment because of submarines, the need of gold at home as a basis for credit, and the lack of gold even though it were feasible to ship it, are some of the explanations for this. Even England seems to prefer to deal at a disadvantageous rate rather than to bring her rate to par by use of loans at the high rate she would be compelled to pay. The reasons for the trend of the rate in belligerent countries, and, therefore, since it is a reciprocal relation, in other countries, are not hard to find. The belligerents are, of course, the heavily buying countries. They continually have fewer bills on other countries and these other countries have more and more against them. Moreover, the threatened collapse of credit through military losses and possible annihilation of national integrity, as in Russia and Italy, causes creditors to reduce their accommodations rather than to expand them to meet increasing needs. And because of this trend in the rate, the belligerents have to pay progressively more for what they buy and receive less for what they have to sell, which makes financing the war increasingly difficult.

The development of an open market has been very encouraging. The use of acceptances became important very

soon. By November 27, 1915, the twelve Federal Reserve Banks held a total of \$13,510,000 in acceptances.¹ Most of these were held in New York, Boston, and Philadelphia. The form of the report consulted did not indicate how they had been acquired. The growth of the market for salable paper is indicated by the following figures:

April 10, 1915, bills on hand including paper discounted	\$16,420,000
April 15, 1916, " " " bought in open market	42,116,000
April 12, 1917, " " " " " " "	80,604,000
April 12, 1918, " " " " " " "	318,887,000

The amounts held by the various reserve cities April 12, 1918, are approximated to millions, as follows:

New York, \$123,000,000	Kansas City \$13,000,000
Chicago, 46,000,000	Richmond 12,000,000
Cleveland, 26,000,000	St. Louis 11,000,000
San Francisco 25,000,000	Minneapolis 10,000,000
Philadelphia 21,000,000	Atlanta 9,000,000
Boston, 13,000,000	

This shows that open market dealing is being generally developed as was desired by the framers of the Act and that the rate of paper all over the country will tend toward a common rate which competition determines.

1. The Chronicle: Report of Federal Reserve Banks, Vol. 101, p. 1784.

New York is not, as might have been expected because of her importance in America's financial world, developing out of proportion to her size. Her proportion of the holdings of paper bought in open market, was approximately equal to her proportion of the total resources of the twelve banks. The bills bought in open market comprise more than a third of all the bills held. On April 5, 1918, \$326,503,000 worth of bills held had been bought in open market, and \$573,883,000 worth had been discounted for member banks. The importance of open market purchases by the Federal Reserve Banks is, therefore, great.

On the whole, the effect of the war on our foreign exchange and banking has been very beneficial. By breaking down the customs of the people with whom we wished to gain a trade foothold, the war has given us advantages that with continuous peace we probably would never have gained. The great effects have been: an opportunity to seek to establish trade relations with desirable prospective customers freed from the keen competition of other peoples; an almost unlimited field for branch banking and foreign investments; a demand for dollar exchange in all parts of the world with which we trade; the upsetting of the exchange market of the world; and finally, the rapid development of a great open market in the United States. This last is probably a more remote effect than the others; yet it has been so marked that the great change in our business habits that grew out of the war situation must be a partial

explanation of it. Our opportunities in branch banking and foreign investments have probably not been embraced to the fullest extent, and yet even in those lines we will be on a level with European nations or above when the war is over. E. W. Kemmerer, Professor of Economics and Finance at Princeton University, says, "....To this movement (a movement to make New York play a role in the international money market) the European war gave a strong impetus, and today New York clearly holds the premier position in the field of international finance, although at a time when national finance in the lending countries of Europe has assumed proportions never before dreamed of. The European exchange markets have been demoralized, and special payments among the belligerent countries of Europe have become little more than a name. On the other hand, 'dollar exchange' is now quoted in the principal cities of Latin America, the orient, and Australia; and the American trade with those sections, which was formerly financed chiefly through London, is now being financed directly and in dollars....."¹

1. The Annalist, Vol. 7, p. 120.

May 17, 1914 to January 3, 1915

Tables showing weekly variations of the different exchanges quoted in New York by percents from May 1914 to April 1918. Up to January 10, 1916, material from quotation of rates in The Anna List. From then to date from article on exchange in same.

January 3, 1915 to January 3, 1916

See supplemental file for unfolded version.

See supplemental file for unfolded version.

CONCLUSION

The situation in foreign banking and exchange at the beginning of 1914 is given in Chapter I of this thesis; the modification of the situation by the operation of the Federal Reserve Act and by the world war now in progress is discussed in Chapters II and III respectively. A brief summary of the chapters will give us a basis for relating the situation to American business.

At the beginning of 1914, the banking system of the United States, in so far as the different sorts of banks could be said to compose a system, offered little aid to foreign trade. Our exporters and importers had always been dependent on London because London has long been the greatest exchange market and financial center of the world, and also, because we had been financially dependent on English interests since colonial days. Even though Americans might have been able to finance foreign trade for some time past, the banking facilities offered by our banks were so cumbersome that it was impractical. Continental European countries had gradually drawn away from London influence and were more or less independent of her, but outside of Europe sterling exchange was still the standard. The dependence of the United States on London was a slight barrier to trade if it resulted from custom and not

from the superior service that London offered over what New York could have offered under similar laws. Bills of various sorts are used in settling international debts which render the shipment of gold unnecessary. Of the bills that arise out of commercial transactions clean bills vary according to the credit of the drawer and drawee, while documentary bills vary less according to the credit of the drawer and drawee because the documents attached indicate the source of the bill and make collection more certain. Until a recent law was passed the documents usually included power of attachment before delivery in case of failure to pay, but the lawful possessor of the bill of lading now has first claim on undelivered goods. Of the documentary type of bill acceptances are of prime value because the acceptor is of unquestioned credit, but payment bills which are accepted by persons of questionable or unknown credit depend largely on the character of the goods out of which the bill arose for value. Since the goods for whose payment a payment bill is used are not delivered until the bill is settled, the value of the paper depends largely upon whether the goods if sold in the market would realize the face of the draft. A bill that does not rise out of a commercial transaction, but one that prevents the shipping and reshipping of gold is the finance bill which affords exchange on a given place, usually London,

in a season when exchange on that place is scarce, and which is settled for when exchange on the same place is plentiful. A method of leveling the exchange rates of all countries is foreign exchange arbitrage which means that exchange on a country whose exchange is plentiful is sold to an individual desiring exchange on a country whose exchange is scarce.

The Federal Reserve Act attempts to furnish American facilities for financing foreign trade through our Federal reserve system. Americans trading in, or with foreign countries may, if the provisions relating to foreign banking are taken advantage of to the fullest extent, find American banking accommodations wherever they go. If the country with which the trader is concerned depends on its own capital to finance its commerce and has a well developed system of banking of its own, the accommodations will probably be through an agency established by an American bank. This agency acts only on orders from the bank of which it is an agent. If the country depends on other countries for the financing of its trade and if it has no native banking system, the accommodations will be probably through a branch bank which will extend credit and develop all phases of banking quite independently of the parent bank. This Act also provides Americans with power to furnish prime paper by permitting member banks to accept paper. Since prime paper brings the highest price and is, therefore the most

acceptable paper when sold in a competitive market, and since there has been a need for an opportunity to invest ready money more safely than in call loans, Federal Reserve Banks are permitted to buy and sell in open market at home or abroad certain types of bills of exchange that are of prime value. By so doing an exchange market may be developed here which will permit importers and exporters to conduct their business under the most advantageous circumstances. The value of this Act depends upon the extent to which its provisions can be put to use. If the provisions concerning foreign trade become effective, Americans in their dealings with foreign peoples will enjoy the same privileges that Europeans have enjoyed for many years.

The war brought about a situation such that Americans had to use the provisions of their Federal Reserve Act in order that they might continue in foreign trade. The extension of the use of these facilities has been so rapid that we question whether the gain will be permanent. The use of these facilities in financing war orders of Europeans is certainly an abnormal extension which will cease after the war. The use of these facilities in non-European countries, for instance in the countries of South America, is just as much an outgrowth of the war as is their use in Europe because the war so deranged the facilities which these countries had been accustomed to employ that our facilities

were much superior. The continued employment of American facilities by non-Europeans depends largely on whether the new custom of trading through us becomes fixed through satisfactory service rendered to them. The development of the foreign banking and exchange field has been especially great in the directions of popularizing dollar exchange, and creating a great open market for exchange.

E. W. Kemmerer says that "New York now holds the premier position in the field of international commerce".¹ To the American business man, this statement means that he may trade almost anywhere in the world with the assurance that the price he pays is the lowest possible because the exchange he offers in payment is of prime worth. This statement does not yet mean that the American trader can go anywhere in the world, and receive accommodations from a bank controlled by Americans.

1. E. W. Kemmerer, The Annalist, Vol. 7, 1916, p. 20.

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