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THE MONEY MARKET

IN RELATION TO
TRADE AND COMMERCE

By

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PREFACE TO SECOND EDITION.

Since the First Edition of this Book was published, conditions of the Money Market have changed very considerably owing to the European War; and while at the present day, owing to the control of Governments, some of the rules of Political Economy which govern international finance seem to be dormant or inoperative, it is essential that the student of finance should understand them, and for that reason I have thought fit to deal with the subject very largely from its normal aspect.

In the last Chapter a section has been given dealing with the operations of the Dollar Securities Committee showing the remarkable work that Committee did during the European War in connection with the stabilisation of the American Exchange.

I take this opportunity of acknowledging the great assistance I have received in the preparation of this book from my Partner, Mr. A. F. Saunders, F.C.A., and Mr. A. L. Boddington, to both of whom I tender my grateful thanks.

ERNEST EVAN SPICER.

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THE MONEY MARKET.

SYNOPSIS OF CHAPTER I.

THE FINANCE OF TRADE AND COMMERCE.

- § 1. CAPITAL.
- 2. INTEREST.
- 3. VALUE.
- 4. DEMAND AND SUPPLY.
- 5. TRADE AND COMMERCE.
- 6. COMMERCIAL FINANCE.

CHAPTER I.

THE FINANCE OF TRADE AND COMMERCE.

§ 1. CAPITAL.

Capital is accumulated saving, and it is only by saving that Capital can be built up. It is usual to consider Capital as money, since, when Capital is required, it usually reaches the business or enterprise wanting it in the form of money; but it will generally be found that any man with capital has a very small proportion of it in this form.

If an individual were suddenly cut off from civilisation, and found himself alone on an island not inhabited by human beings, he would realise that he had three great needs. The first of these would be food and water, the second clothing, and the third shelter. He might find that water was easily accessible, but he would have to work very hard in order to provide himself with food, and it would require infinite labour on his part to obtain even rough clothes, or any element of comfort about the place that he chose for his habitual dwelling.

In all probability he would live from hand to mouth as far as food was concerned, but if he wanted to devote any appreciable portion of his time to other necessities or comforts, he would first have to lay by in some form or other a stock of food, and be ensured of a supply of water, so that he could turn his attention to these other matters without too great a risk.

This hypothetical stock of food is Capital in its most primitive sense, but it illustrates the most important function of Capital, which is the provision of means for the carrying on of new production or enterprise.

The three important agents in production are Land, Labour and Capital. Material things in their raw state are either grown on or extracted from the land, and are then fashioned or worked into the finished product by means of the labour expended upon them. Capital provides the means of production, apart from labour, since by its means the necessary buildings, tools and machinery are obtained. In addition, it provides a fund for the maintenance of labour during the period required from the commencement of manufacture till the marketing of the finished article, and it also provides a fund for the purchase of Raw Materials until the same have been worked up into finished articles and sold.

Capital can therefore be divided into Fixed Capital, which is represented by Factories, Machinery, Implements, etc., and Circulating Capital, which is :—

1. Raw Material of the product ; and
2. The goods required by workpeople for subsistence during the course of their production.

The three agents which are necessary for production each receive a reward for their portion of the enterprise. The reward for the use of Land is termed Rent ; that for Labour is termed Wages ; and that for Capital, Interest.

• There is a further factor in production known as Enterprise (or Organisation), and this is in most cases introduced by the Capitalist. The incentive to enterprise is Profit, and Profit may therefore be said to be the reward of enterprise.

§ 2. INTEREST.

In all new enterprises it will be found that Capital is necessary to enable the undertaking to be started ; and if a man possesses sufficient Capital of his own he will not put it into the new enterprise unless he is fairly confident that he will get at least such a return on the Capital as he would get if he lent it out to interest, together with an additional profit.

If Capital is lent, the person lending it deprives himself of the use of his savings for the period of the loan, that is to say, he defers his own ability to use the Capital during the term he has agreed to lend it. For this deferment a reward in the shape of Interest is exacted, the rate of which will vary with the law of supply and demand in its application to money.

The rate of Interest will, of course, also vary with the security which is given by the person borrowing the Capital, and the standard rate of interest, generally known as Net Interest, is that which applies where there is no risk, and the lender is not put to any trouble. Where the interest rate has to cover risk of loss or involves work to the lender, it will naturally be higher than the standard rate, and this higher rate allowing for risk and trouble is known as Gross Interest.

The Capital Value of future payments varies with the rate of interest, falling as the rate of interest goes up, and rising as the rate of interest goes down.

If a man invests £100 at 5 per cent. in a security for which no redemption date is fixed, the current rate of interest for that class of security will be 5 per cent., otherwise he would have got more, or would have had

to be content with less ; and while the rate of interest continues at 5 per cent. he will always be prepared to sell his investment for 20 years' purchase since this will return him his invested Capital.

If the rate goes up to 6 per cent. a person investing £100 in a similar security would be ready to sell his investment for $16\frac{2}{3}$ years purchase since this would give him back his capital; and owing to the increase in the rate of interest the investment made when the rate was 5 per cent.

will only have a market value of $\frac{16\frac{2}{3}}{20} \times £100 = £81 \text{ } 10\text{s. } 0\text{d.}$

Conversely, if the rate of interest went down to 4 per cent. the number of years purchase to restore the Capital would be 25, and an investment yielding 5 per cent. would be valued in the market at 125.

It is in accordance with this rule that an advance in the rate of interest sends down the price of Consols and other such securities, and *vice versa*.

It does not follow that a rise or fall in interest rates will produce this effect with undeviating accuracy. There are other factors attaching to the Capital sum, *e.g.*, redemption dates, premiums, freedom from taxation. In addition there are other Economic Laws which may partly or wholly neutralise the effect of the Rule, such as the Law of Supply and Demand.

§ 3. VALUE.

The value placed upon any article is a money value, and the factors which cause a money value to be placed upon any such things are Utility and Scarcity, which, combined together, form Desirability.

Utility alone does not create value, since there is nothing more useful than air and water, which are so abundant that they can be had without payment; and when food or iron are compared with precious stones it is clear that if Utility alone created Value they would be much the more valuable articles, which is well known not to be the case.

It is therefore the Desirability of things which gives the Value to them, and this Desirability depends on Utility and Scarcity; and the value itself will vary from time to time in accordance with the supply of, and the demand for, such articles.

All over the world there are continual processes of production being carried out resulting in the supply of goods in all forms and shapes. The people who produce these goods make their livelihood by selling them to people who desire them, and people who desire them are generally anxious to get them at the most reasonable price. The demand may call for more than the supply can provide, in which case there will be com-

petition amongst buyers and prices will tend to rise. On the other hand, the supply may be greater than can be absorbed by orders resulting from demand, in which case the price will tend to fall.

If a man contemplates purchasing some desirable article he considers the various uses which he could make of the money which would be given for the article, and if the price goes beyond a certain point he would probably prefer to spend his money in other directions from which, on balance, he would obtain greater utility or pleasure ; therefore the value of anything is really determined by its marginal utility.

Marginal Utility is estimated by the satisfaction which a man will receive from the acquisition of a particular thing. Thus if a man removed from civilisation had several sacks of corn, he would, after putting aside a certain amount of grain as seed, regard the sacks of corn in the following way : One sack he would regard as of absolute importance to enable him to support life ; the second sack he would regard as of not quite so much importance, but as still desirable, as it would give him a more comfortable existence ; the third sack he might devote to the feeding of birds or to extended agricultural operations, and so on, the result being that whereas all the corn is of the same Utility, the sack required for supporting existence is more desirable in his eyes than that which constitutes a surplus.

In the same way, if a private individual possesses a copy of Shakespeare, he would not be particularly desirous of possessing another copy of exactly the same edition, or if he did it would not possess twice the desirability of the original one.

§ 4. DEMAND AND SUPPLY.

The price which has to be paid for commodities will vary in accordance with the supply and demand relating to the commodity. If there is an excessive supply, and the owner desires to sell, he will have to attract buyers by reducing his price, since there will be competition amongst sellers to dispose of their goods. This might reach such a point that production of the particular article will be reduced since it may not provide the manufacturer or producer with a sufficient return for his exertions, and the eventual result of this will be that the supply will be reduced, and the price will subsequently tend to rise.

In the converse case, when the supply is limited and the demand is not turned into other channels, the buyers will be in competition, and prices will go up, and this, if it continues, will bring into existence further producers and manufacturers anxious to take advantage of the high market prices for the particular commodity. The introduction of

further manufacturers or producers for the particular article will increase the supply and introduce competition again among the sellers, thereby causing prices to fall.

It will thus be seen that there is a constant interplay of forces together forming the Laws of Supply and Demand, all tending to adjust the price at which human wants can be satisfied, and this applies to money as well as to any other commodity.

§ 5. TRADE AND COMMERCE.

The primitive method of trading was the exchange of goods between persons, but this, owing to the division of trades even in a primitive state of society, was very inconvenient, since in order to satisfy human wants, number of different exchanges would have to take place.

For instance, if a farmer required clothing, and was prepared to barter a sheep for what he required, it is unlikely that the man who was prepared to offer clothing would want a whole sheep; and further, it would be difficult to measure the value of clothing in terms of sheep, or sheep in terms of clothing. This led to the creation of money as a measure of value and medium of exchange; and trading and commercial transactions in civilised countries are generally dealt with in terms of money, a cash settlement being involved.

Trade is the buying and selling of goods within the limits of one country; Commerce is the buying and selling of goods between one country and another. Trade is carried on between manufacturers and merchants who sell, often through middle-men, to retailers, who finally dispose of goods to the ultimate consumer. Commerce is carried on by manufacturers, merchants, importers and exporters.

Any business requires a certain amount of capital, which may be the actual capital of the person conducting the business, or borrowed capital obtained from private sources or from a banker.

In every trade there is usually a recognised term of credit which enables the person buying the goods to dispose of them within a reasonable time, and so provide means of paying for them in addition to earning his own profit; but capital is necessary very often to buy the goodwill of the business, and, in the case of a new business, to establish it in such a way that it can earn profits, *e.g.*, providing tools, furniture, etc. If a person acquiring or starting a business has a sufficiency of working capital he will have a surplus after providing for these necessities by means of which he can pay for his goods before the term of credit has expired, and obtain a discount by so doing.

In large undertakings the principle of joint stock enterprise has enabled Companies to be formed to take over prosperous existing businesses or to establish new businesses for the purpose of large scale industry. Capital in these cases is often obtained largely from the public, a prospectus being issued giving information required by Statute and such other information as is considered desirable. The Capital is generally offered in the form of shares in the enterprise, which may be Ordinary shares or Preference shares of various forms.

In the case of a Limited Company the Company has a distinct entity apart from the members who compose it, and no member can be called upon, except in the case of a note-issuing Bank, to contribute to the Company's funds after his shares are once fully paid. The limited liability is therefore the limited liability of the members, but the Company itself is answerable for its obligations to the full extent of its assets, and if the shares are not fully paid it can have recourse to the shareholders for the balance due upon such shares in order to meet its obligations.

Another way in which money is obtained by Limited Companies is by the issue of debentures, carrying a fixed or floating charge upon the assets of the Company. Debenture holders do not usually participate in profits, but receive interest upon the amount of their debt, and their interests are generally looked after by Trustees appointed for the purpose.

Limited Companies often make their offers to the public through an Issuing House, who for a consideration take charge of the offer to the public, being responsible for the amount and form of the issue, the advertising, and arrangements for Underwriting and Commissions. In the case of Limited Companies, the terms of the prospectus must comply with Statutory requirements, and certificates are usually included from Accountants and other Experts. The names of the Board and of the Company's advisers are usually such as to carry weight with the public.

If the Issue as offered is more than fully applied for, it is termed oversubscribed, and the underwriters, if any, are relieved of liability; if sufficient applications are not received from the public, the underwriters, if any, take up the proportion of the undersubscription according to their contracts.

§ 6. COMMERCIAL FINANCE.

The acquisition or establishment of any business will in most cases, as has been stated, require a Capital fund to be provided, but the financing of trade and commerce, though generally requiring some working capital, is very largely carried on by means of credit transactions,

and in order to show how this is done a series of operations necessary to produce a woollen coat may be considered.

A Sheep farmer in Australia sends his wool to a merchant in Australia, who forwards it by steamship to a merchant in Liverpool, by whom it is sold to a Woollen Manufacturer and turned into cloth. The Woollen Manufacturer sells to a tailor, the tailor turns it into a coat and finally sells to the ultimate consumer.

The sheep farmer will have to pay his wages and other expenses week by week before the wool is ready to be sheared, and unless he has a sufficient margin of working capital he may have to get advances against the clip from a local bank.

When the clip is ready for sending to the merchant it will probably be forwarded to a broker, who will sell to the Australian Merchant at current prices. The Merchant pays the Broker, the Broker deducts his commission, warehousing, freights, etc., and remits the net proceeds which will be applied by the Sheep farmer so far as is necessary to liquidate his debt to the bank.

The Merchant in Australia, having sold to an English Merchant, arranges for shipment, and receives from the Shipping Company the Bills of Lading. To these, with a copy of the invoice and the Insurance Policy, he attaches a Bill of Exchange drawn on the English Merchant, the whole constituting a Documentary Bill, which can either be discounted or lodged with the bank for collection.

The goods being shipped, the Australian Banker forwards this Documentary Bill to his English Agent debiting him with the amount of the Bill. The English Agent of the Banker on receiving the Documentary Bill presents it to the English Merchant, and he either accepts it "Cash against Documents," or pays it immediately in exchange for the documents.

The English Agent of the Australian Banker credits the latter with the proceeds of the bill, and they settle accounts between themselves in due course.

The English Merchant, if he has sufficient working capital, will have discharged the Bill, Shipping and Warehousing Charges out of his own moneys, but if not he will obtain financial assistance from his own Bank on the security of the goods until they are sold.

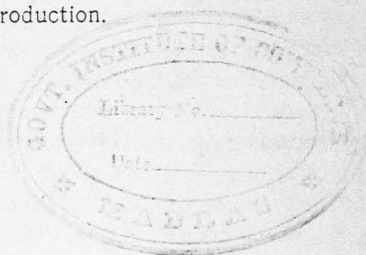
In due course the English Merchant will sell a portion of the wool to a Woollen Manufacturer, who may pay either cash under discount or take the usual term of credit before payment. The wool having been made up into cloth after many processes, involving the use of machines and varying divisions of labour, the Manufacturer is ultimately able to

offer it for sale to the tailor, who in his turn will either pay cash under discount or take the usual term of credit allowed.

Finally the consumer buys a coat from the tailor, paying therefor ready money, or taking as much credit as the tailor is prepared to give him.

All these people—and there are often other intermediaries—employ clerks, travellers and workmen, and have capital employed in their businesses apart from the credit they obtain or the bank loans they may get. The Shipping Companies, Railways and Warehousemen have also large amounts of Capital sunk in their enterprises, and large staffs whose wages have to be found week by week.

The labour involved, and the many people concerned in the making of a simple article from start to finish, is remarkable, but not more so than the amount of benefit which many Capitals confer during the operations carried out to give effect to the production.



SYNOPSIS OF CHAPTER II.

THE MONEY MARKET.

§ 1. MARKETS.

2. EVOLUTION OF THE MONEY MARKET.

CHAPTER II.

THE MONEY MARKET.

§ 1. MARKETS.

A Market is a public place set apart for the buying and selling of commodities, and on market day in any established market the people who are prepared to sell their goods carry them thither and offer them for sale to others who attend for the purpose of buying them. The price which any commodity will fetch in open market will generally tend to be constant in that market, since if A, B and C were to offer similar goods at different prices the buyer would naturally purchase from that one whose goods were cheapest; and therefore the market generally will tend to one level of prices for any given commodity, the main factor in determining which will be the law of supply and demand.

Markets are often restricted to dealings in special commodities, *e.g.*, Smithfield Meat Market, Covent Garden Market, etc., but in any such market the dominant factor is the offer of goods for sale by sellers to buyers.

In England the purchase of goods in open market, or "market overt," carries with it, generally speaking, a good title, notwithstanding a defective title on the part of the seller, but to get this protection the goods must have been purchased in the market on a market day between the hours of sunrise and sunset from a trader who usually deals in that class of goods. If, for instance, a watch were purchased from a Butcher the doctrine would not apply.

In the City of London every shop on the ground floor is market overt between sunrise and sunset on a week day.

An Exchange is a special form of Market where business men meet to carry through transactions, *e.g.*, the Stock Exchange, Metal Exchange, etc. It differs from the ordinary market since only those persons admitted to membership or their authorised representatives can attend to do business, and goods are not exposed in bulk for sale. In these cases also the price at any given date tends to be constant in the Exchange for the same reason as in the case of the ordinary market, and will be affected in the same way by the law of supply and demand.

The term "Market," however, has a wider significance than its application to particular Markets or Exchanges. The "Market" for

commodities is a general term for that portion of the existing stock of any commodity which is available for purchase, whether actually exposed or offered for sale or not ; and it is in this sense that the Money Market of London is to be understood, since there is no special place or building set apart for it. In any such Market the same conditions exist as to the constancy of prices and to the effect of the law of supply and demand ; but while these features may be slower in their operation in the case of a general market in commodities, in the London Money Market they operate as quickly as in an established market place, owing to the great use made of the telephone by the money dealers, and the comparatively small area in which their offices are situated.

§ 2. THE EVOLUTION OF THE MONEY MARKET.

The term Money Market indicates the collection of all dealers in money on a large scale, and includes Bankers, Issuing Houses, Bill Brokers, Accepting Houses, Discount Houses, the Stock Exchange, Insurance Companies, Foreign Banks, and Financial Houses. The Indian Government and also the British Government operate in the Money Market from time to time, and, in order to obtain an intelligent idea of national finance, it is essential to consider the bearing of each of these factors upon the Money Market as a whole.

London has been for centuries the headquarters of finance. Other cities have increased, and are increasing considerably, in importance ; but, nevertheless, London still remains the most important centre of Exchange between one country and another.

It is interesting to consider the causes which have led to this effect :—

1. The natural energy and spirit of the people must be taken into account. Great Britain owes these characteristics largely to her early history, to the Roman Invasion, to the blending of the ancient Saxon and Norman races subsequent to the Norman Conquest, and also to the advantages of her temperate climate.

2. The geographical position of the country is an important consideration. The Northern Hemisphere shows the greatest development of trade and commerce, and as the British Isles occupy a situation practically in the centre of the land area of this part of the world, close to the mainland of Europe, and has the sea for its frontiers, with numerous well situated harbours, it has an enormous advantage over other countries. In Great Britain there is no important town at a greater distance than sixty miles from the sea coast ; this facilitates the mode, and cheapens the cost, of transport.

3. Great Britain in very early times recognised that a command

of the sea and of the shipping industry was essential to her future prosperity. This led to commerce with foreign centres, and a consequent expansion of trade. Colonies were founded and markets established in all quarters of the world.

4. Continual wars and religious intolerance on the Continent drove to these shores many of the most skilled of the foreign merchants and craftsmen, who laid the foundations of many of the industries to which Great Britain largely owes her wealth and importance.

Three times has France given us of her best, and each time we have benefited accordingly. The Normans have already been mentioned. The Huguenots came over to the number of over 50,000 shortly after the Revocation of the Edict of Nantes in the reign of Louis XIV. They established themselves in various centres as silk workers, cotton spinners, wool carders, weavers, and as workers in many other industries. It is no exaggeration to say that their presence materially assisted in building up the trade and commerce of the Empire. Lastly we have the Emigrés, many of whom fled to England at the time of the Revolution.

5. Of all the Great Powers of Europe, Great Britain alone extended a more or less open hand to the Jews. As the Jews have from very early times been intimately connected with Banking and monetary transactions, this policy has unquestionably assisted materially in building up our commercial prosperity.

These, with many other causes which are apparent to all readers of history, have been the foundations upon which Great Britain has built. The intimate relations with foreign markets and the command of the sea further assisted in the work by making it convenient for foreign merchants to send their goods through London to be re-shipped and despatched to their ultimate destination. We derived a profit from handling the goods, and British ships earned the freight.

The settlements for these transactions were also effected through the intermediary of this country by means of Bills of Exchange. This mode of payment was the most convenient for the foreigner, because England had direct dealings with all nations, whereas until comparatively recent years reciprocal transactions between foreign centres were extremely rare.

The gradual evolution of the science of Banking has further assisted in the firm establishment of England's financial supremacy. The strength of the great Joint Stock Banks, the general adoption of the cheque system, and the conservative policy of English Bankers generally, have provided safety and utility for the Banking transactions so necessary for Trade and Commerce.

The English Money Market has thus been evolved, slowly but surely, out of a variety of circumstances ; but its greatest strength has been the wide radius of British Commerce and the general integrity of British Merchants from almost immemorial times. ✓

SYNOPSIS OF CHAPTER III.

MONEY AND CREDIT INSTRUMENTS.

- § 1. THE MEANING OF MONEY.
- 2. LEGAL TENDER.
- 3. COIN.
- 4. BANKING ACCOUNTS.
- 5. CHEQUES.
- 6. PROMISSORY NOTES.
- 7. BILLS OF EXCHANGE.
- 8. BANK NOTES.
- 9. POSTAL ORDERS, ETC.

CHAPTER III.

MONEY AND CREDIT INSTRUMENTS.

1. THE MEANING OF MONEY.

It is desirable before proceeding further to consider what is meant by Money in the sense of the Money Market. Occasionally money is used for buying Money, as when English Money is paid for foreign coin, or Gold is given for silver. But dealing in money involves something more than a dealing in coin, and it is well therefore to enquire as to what forms money, in the widest sense of the term, can take.

Money is regarded by the average person as Metallic Money, but from the viewpoint of the Money Market the term includes all instruments or credits which can be converted into legal tender.

§ 2. LEGAL TENDER.

By Legal Tender is meant the form in which payment can legally be required for the proper discharge of a debt. In England Legal Tender consists of :—

Bank of England Notes to any amount for sums over £5

(except at the Bank of England).

Gold to any amount.

Silver not exceeding 40/-.

Bronze not exceeding 1/-.

And since August, 1914, Treasury Notes to any amount.

It must be noticed that the majority of business payments, apart from Wages, Salaries, etc., are made by cheque, but this is because it is convenient, and the right to acquire Legal Tender on presentation of the instrument is presumed. When payment is offered in respect of a disputed amount it should be in the form of Legal Tender; and where apart from dispute there is no trust on the part of the payee, he is under no obligation to accept payment in any other form but that of legal tender.

§ 3. COIN.

The Metallic Money of this country consists of Gold, Silver and Bronze Coins, but the Silver and Bronze is token money only, and is legal tender only to a limited extent. The Gold Coinage of any country is of universal value according to its fineness and weight; but this feature

is not shared by the Coins of other Metallic substances, since they are not always actually worth their face value compared with the Gold Coins.

Bank of England Notes and Treasury Notes are Legal Tender by Law, but these are convertible into Gold at the Bank of England at the option of the holder.

§ 4. BANKING ACCOUNTS.

The relation between a Banker and his customer is that of Debtor and Creditor, the Customer having the right to draw Cheques against the Account to the extent of the balance in his favour. The Banker is required to honour cheques so drawn either by paying out Legal Tender against them, or by transferring a corresponding amount of credit to some other banker.

Deposit Accounts as distinct from Current Accounts bear Interest, and money so deposited is, as a rule, only withdrawable after a specified notice.

§ 5. CHEQUES.

In the majority of cases where money has to be paid immediately by one person to another, the payment is effected by means of Cheques. As a substitute for money this is only valuable on the assumption that it can be turned into actual Legal Tender if required, though as a matter of practice the use of a Cheque is mostly limited to a transfer of Credit from one Banking Account to another.

A Cheque is a Bill of Exchange drawn on a Banker, payable on demand.

Most persons are acquainted with the form of a Cheque, which, with possible variations in particular cases, is as follows :—

Illustration.

CHEQUE.

Stamp.

LONDON.

2d.

1st Nov., 1920.

THE LONDON JOINT CITY AND MIDLAND BANK,
LONG STREET, LONDON.

Pay John Jones.....or order
one hundred and five pounds.

£105 0s. 0d.

W. REDMOND.

In the above case the person who has signed his name is the Drawer, the Bank is the Drawee, and the person to whom the Cheque is made payable is the Payee.

The words "Not Negotiable" do not have the effect of restricting the commercial negotiability of the instrument, since a cheque with these words upon it can still be passed from hand to hand, and will transfer any title that is good; but the transferor is unable to give a better title than he himself possesses, and therefore if his own title is bad he cannot pass a title at all.

The Bills of Exchange Act, 1882, provides that the holder of a cheque may cross an uncrossed cheque, may turn a general crossing into a special crossing, or may add the words "Not Negotiable"; while a Banker may cross an uncrossed cheque, or a cheque crossed generally, specially to himself; or if crossed specially to himself he may cross it specially to another Banker for collection.

The words "A/C Payee only" are sometimes placed in the crossing, and operate as notice to the collecting bank that the account of the payee only is to be credited. This is not a statutory provision, and does not affect the liability of the paying Banker, unless he is also the collecting banker; but it is the custom of Bankers to give effect to such a crossing.

An Open Cheque, *i.e.*, one without a crossing, can be exchanged for Legal Tender over the counter of the Bank on which it is drawn. A crossed cheque can only be paid across the counter of the Paying Bank if the Drawer signs an order, "Pay Cash," which is written in the crossing. At one time it was sufficient to get this initialled by the Drawer, but owing to numerous forgeries Bankers now insist on the full signature being given.

It must be remembered that although a Banker is bound to know the signature of his customer, and cannot charge the customer with an amount paid away on a forged signature, yet he is not bound to enquire into the validity of any endorsement, and is not responsible if the cheque is paid to a person not entitled to it.

A cheque is not Legal Tender, and it will be apparent from the foregoing that the value of a cheque as money depends on the stability of the Drawer, *i.e.*, on the assumption that it will be honoured on presentation by the payment of Legal Tender or the transference of a credit against which the person credited may draw his own cheque to obtain Legal Tender if required.

The volume of transactions settled by means of a transference of credit under the cheque system is remarkable, as will be seen in the Section dealing with the Bankers' Clearing House. The settlement of insular transactions by this means is convenient, and is a great saving to all concerned, as it obviates the transfer or transmission of valuable Legal Tender.

A crossed order cheque is a safer form of instrument than a bearer cheque, since the former passes by delivery and endorsement, and the latter by delivery only. The greater safety is provided by the necessity of endorsement, since no title can be obtained if this is forged, and in such a case, although the Banker is not liable, the person receiving the proceeds is. The words "Not Negotiable" are desirable even in such an instance, in case the cheque is stolen after being validly endorsed.

§ 6. PROMISSORY NOTES.

A Promissory Note is an unconditional promise in writing, made by one person to another, signed by the maker, engaging 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.

The following are forms of Promissory Notes :—

PROMISSORY NOTES.

	LONDON.
£50.	1st February, 1920.
	<i>Three months after date I promise to pay John Brown or order</i>
Stamp	<i>the sum of Fifty Pounds for value received.</i>
6d.	WILLIAM WHITELEY.

JOINT PROMISSORY NOTE.

	LONDON.
£1,000.	1st February, 1920.
	<i>On demand we promise to pay to James Smith the sum of</i>
Stamp.	<i>One Thousand Pounds for value received.</i>
10s.	ARTHUR THOMPSON.
	F. WILMOT.

JOINT AND SEVERAL PROMISSORY NOTE.

	LONDON,
£1,000	1st February, 1920.
	<i>Three months after date we jointly and severally promise to</i>
Stamp.	<i>pay to the order of J. Lockhart the sum of One Thousand Pounds</i>
10s.	<i>for value received.</i>
	W. SCOTT.
	R. BURNS.

The Stamp duties on Promissory Notes are the same as on Bills of Exchange, except that the duty is an *ad valorem* Duty, even though the Promissory Note is payable on demand.

There are only two parties to a Promissory Note : the Promissor, *i.e.*, the person making the promise and signing the note, and the Promisee, *i.e.*, the person to whom the promise is made. There may be two or more Promissors, in which case the liability undertaken by them may be either *joint* or *joint and several*. If the liability is joint, any judgment, even without satisfaction, against one of the makers of the Note is a bar to proceedings against the other maker or makers ; while if the liability is joint and several, judgment without satisfaction will not bar proceedings against the others.

The rules as to endorsement on Promissory Notes are the same as those relating to Bills of Exchange.

§ 7. BILLS OF EXCHANGE.

Where goods are sold or services are rendered on credit the debt so created does not constitute money to the person to whom it is due, the only debt which can be so regarded being the debt due by a Banker to his customer.

A manufacturer generally allows his customer a certain period from the delivery of goods, say three months, in which to pay his account, this period being known as the term of credit. If full advantage is taken of the three months' term of credit the manufacturer has to wait for that period before being able to utilise the capital which is represented by the goods sold ; but as when he gets that capital back he can again start using it profitably, he generally allows a discount for payment before the term of credit has expired.

He might, however, arrange with the purchaser of the goods to accept a Bill of Exchange, payable at the expiration of the term of credit. This involves no hardship on the purchaser of the goods, who would in normal circumstances pay the debt at the expiration of such time, but it does, of course, make it necessary for him, for the sake of his own credit, to meet the bill when it becomes due. Where the manufacturer can arrange with the purchaser to accept a Bill of Exchange, he can either hold the bill till maturity, and then collect it, or if he prefers to do so he can discount it, and so obtain a smaller sum of money immediately in exchange for another sum which is due at a future date.

It will, therefore, be seen that one of the advantages that a system of Bills of Exchange confers upon the business world is to enable the person who is entitled to receive money at a known fixed date to provide himself with liquid assets, should the necessity arise, or should he think it advantageous.

Bills of Exchange are also of the greatest use in settling transactions between one country and another. If A in London buys goods from B in France, B sends the goods over, and in the ordinary course of things we should expect A to send B their value in money. But to do so presents certain difficulties, one being that the money which is legal tender in England is not legal tender in France; and another, that to send such valuable commodities as gold or bullion is an expensive process.

Now suppose that A in London buys goods from B in France, and C in France buys goods from D in London, both purchases being of equal value. B in France draws a bill on A in London, and sells it to C in France who sends it to his creditor D in London. D thereupon collects the money represented by the bill from A, and the whole set of transactions is settled; for B has received his money from C, and D has received his money from A, and both A and C have paid their debts.

Inland Bills of Exchange, in the same way as cheques, can be used on this principle also; thus if A owes money to B, he can pay him by bill or cheque; B owes a corresponding amount to C, and can therefore transfer the bill or cheque to him. C can transfer the bill or cheque to D, and so on until the person to whom the cheque is last negotiated collects it, or the person in whose hands the bill is upon maturity presents it for payment.

A Bill of Exchange is an unconditional order in writing, given 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.

INLAND BILL.

Illustration.

	£100	LONDON,
		1st February, 1920.
Stamp	<i>Three months after date pay to F. White or order the sum of</i>	
1s.	<i>One Hundred Pounds for value received.</i>	
To W. BROWN & Co.		J. BLACK.
Liverpool.		

FOREIGN BILL.

	£1,000	CEYLON,
		1st February, 1920.
Stamp	<i>Three months after sight pay this First of Exchange (second</i>	
10s.	<i>and third of even tenor and date unpaid) to A. Johnson or</i>	
	<i>order the sum of One Thousand Pounds for value received.</i>	
To C. CLARK & Co.,		R. GREEN & Co.
London.		

SOLA OF EXCHANGE.

LONDON,

10,000 Francs.

1st February, 1920.

Stamp *On demand, pay this Sola of Exchange for Ten Thousand*
 2d. *Francs to A. Wells or Order for value received.*

J. ORDER.

To MM. LE BLANC ET CIE.,
 Paris.

FOREIGN BILL DRAWN AND PAYABLE OUTSIDE THE UNITED
 KINGDOM, AND STAMPED WHEN NEGOTIATED IN THE
 UNITED KINGDOM.

CAPETOWN,

£500

1st February, 1920.

Stamp *Three months after sight pay this First of Exchange (second*
 2s. 6d. *and third of even tenor and date unpaid) to J. Smith or order*
 the sum of Five Hundred Pounds for value received.

To EMILE LEBLANC,
 Paris.

J. RHODES.

The person signing the order in the first instance, J. Black, is the drawer; the person to whom it is addressed, W. Brown & Co., is the drawee, and if he accepts it by writing his name across the face of the instrument he becomes the acceptor. The person to whom the same is made payable, F. White, is the payee, and in the case of an order bill he must endorse it by writing his name on the back before he can transfer it to any other person.

The drawee is not liable on the instrument until he accepts it, but when he does so he becomes primarily liable. If the acceptor does not pay, the drawer is next liable, and after that the various endorsers; but any person who has made himself liable on the bill by accepting, drawing, or endorsing can, if proper notice has been given on dishonour, be made to pay the bill, and if there are others liable antecedently to him, he will have the same right against such persons.

A Bill of Exchange on sight or demand is due immediately, and can be presented at any time; but on all other Bills of Exchange three days are allowed for payment, and in calculating the due date, three days must be added as an allowance for these days of grace; thus the first bill illustrated above will be due on the 4th May.

The following are the stamp duties on Bills of Exchange—

£ s. d.

Bill of Exchange payable on demand, at sight, on presentation, or within three days after date of sight .. 2

(This stamp may be adhesive.)

Bill of Exchange of any kind whatsoever, and Promissory Note of any kind whatsoever (except a Bank Note), drawn and expressed to be payable, or actually paid or endorsed, or in any manner negotiated, in the United Kingdom (except as above) :—

Where amount or value of money for which bill or note is drawn or made does not exceed	£10	2
Exceeds £10 and does not exceed	£25	3
„ £25 „ „	£50	6
„ £50 „ „	£75	9
„ £75 „ „	£100	1 0
Exceeding £100 for every £100 or fraction of	£100	1 0

(Special impressed Stamps must be used.)

Bill of Exchange drawn and expressed to be payable out of the United Kingdom, when actually paid or endorsed or in any manner negotiated in the United Kingdom :—

Up to £50	As above
Where the amount exceeds £50 and does not exceed £100	6
Where the amount exceeds £100, for every £100 or fractional part of £100	6

(Special adhesive Bill Stamps must be affixed.)

It has already been pointed out that in the case of an order bill the holder, before being able to negotiate it, must endorse it by writing his name on the back. In addition to this the bill must then be delivered to the transferee, endorsement and delivery both being necessary.

In the case of a bearer bill, no endorsement is required, the instrument passing from hand to hand by delivery only. The ordinary form of endorsement is known as an "Endorsement in Blank," which consists of a mere signature of the payee in the first instance, or of an endorsee to whom the bill has been specially endorsed. The effect of an endorsement in blank is to turn the instrument into a bearer bill—in other words, a bill endorsed with a blank endorsement will subsequently pass from hand to hand by mere delivery.

A special endorsement is one that specifies the person to whom, or to whose order, the bill is to be payable. Thus, taking the first bill illus-

trated above, F. White is the payee, and he must endorse the bill before he can negotiate it to any other person. If he merely wrote his name on the back of the instrument this would be an endorsement in blank ; but if, before transferring the bill to Edward Moss, he wrote on the back of the bill "Pay Edward Moss or order," and then added his signature, this would be a special endorsement, and the result would be that Edward Moss himself would have to endorse the bill, either specially or in blank, before he in turn could negotiate it.

A restrictive endorsement as "Pay D only" puts an end to the negotiability of the instrument, only D being entitled to receive the money.

An endorsement "*sans recours*" negatives any liability on the part of the endorser. It indicates that he will not be answerable on the bill to any subsequent holder. The transferee is not, of course, bound to take this endorsement, but if he does so he is bound by it.

A "facultative" endorsement is one which waives some right to which the endorser is entitled ; such as, for instance, "Notice of dishonour waived."

When the bill is negotiated by special endorsement so frequently that there is no room for further signatures on the back, a strip of paper may be gummed thereon, in order that further signatures may be added. This is known as an "Allonge."

Bills are frequently put into circulation before acceptance, but it is advisable to present a bill for acceptance as soon as possible ; it has already been indicated that the drawee is not bound to accept a bill, and is in fact under no liability on the instrument until he does so. Moreover, when a bill is payable so many days after sight acceptance is necessary to fix the date of maturity.

The holder may take a qualified acceptance, that is to say, an acceptance which varies the bill as drawn. A qualified acceptance may be :—

1. Conditional, *e.g.*, accepted payable on giving up Bills of Lading.
2. Partial, *i.e.*, accepted for part only of the sum specified.
3. Local, *i.e.*, payable *only* at a particular place.
4. Qualified as to time, *e.g.*, accepted payable in six months instead of three months.
5. Acceptance by some only of the drawees.

The holder is not bound to take a qualified acceptance, and if he does not obtain an unqualified acceptance he may treat the bill as dishonoured by non-acceptance.

When the bill becomes due, it must be presented for payment, and if payment is refused, the bill is said to be dishonoured by non-payment.

Immediate notice of dishonour must in either case be given to all parties antecedently liable on the bill.

The usual cause of a Bill of Exchange being drawn is to obtain payment for Goods either immediately or at a future time. Bills are not always drawn against Goods, and, therefore, a Bill against Goods is regarded with somewhat more favour than a Finance Bill or Accommodation Bill. The value of a Bill, however, as in the case of a cheque, lies in the assumption that it can be turned into Legal Tender at its Due Date; and the credit of the Names on the Bill, particularly that of the Drawee who on acceptance becomes the Acceptor, is the ordinary means by which this assumption is measured.

For this reason many firms arrange to have Bills which are drawn on them accepted by their Bankers, or by an Accepting House. The acceptors receive a Commission for thus becoming liable on the Bills so dealt with, and are as a rule covered against this liability by Collateral Security being deposited by the party on whose behalf the Acceptance is made. The persons for whom such Bills are accepted are under obligation to put the acceptor in funds to meet the Bill at the due date.

The usual acceptance of the Banks or Accepting Houses is in respect of Bills drawn against Goods; but the Accepting Houses often accept Bills in respect of future trading transactions, the Bills then being known as Finance Bills. Thus an American House having large Interest Payments to make in London may draw on a London Accepting House at three months in June when Bills on London are not abundant, and therefore dear, and forward the draft to their London Agents, who, after the Bill is accepted, can discount it, thus obtaining the means of paying the Interest in question. When the Bill is about to mature for payment the American House will buy a Bill on London, drawn perhaps against Grain Shipments, and forward it to the Accepting House, which is thus put in Funds to meet its acceptance.

The value of the acceptance of the Accepting House lies in the strength of the firm and its known capacity to meet obligations undertaken, which renders the Bill more easily negotiable, and therefore it can be more readily discounted.

When the seller of goods to a customer abroad wishes to obtain payment before the goods are actually delivered, he will draw a Bill upon the Consignee for the value of the goods, and attach to the draft a copy of the Invoice, the Bills of Lading, and the Insurance Policy.

These documents he will hand to his banker, who in turn will forward them to his own correspondent, at the place where the Consignee of the goods resides. The Bill is then a "Documentary Bill."

The Consignee, to enable him to get the goods, must have the Bill of Lading, and he cannot get this unless he meets the Bill. As a general rule, the fact that the Bill has been drawn upon him is notified, and if he accepts such Bill before the arrival of the goods, he will accept conditionally "Cash against Documents."

The English Banker, upon receiving notification from his correspondent that the Bill has been met, will credit the Seller of the goods therewith, subject to his collecting charges.

The Banker may arrange to purchase the Bill outright, in which case he will require the further Security of a letter of Hypothecation, on the strength of which he is enabled to sell the goods if the Bill is not met.

A similar procedure is adopted by Foreign Merchants selling goods to this country.

Even where the Bill is payable at a future date the documentary bill is frequently used to ensure acceptance being obtained before the goods are dealt with, the Bill and documents being forwarded to a correspondent for presentation to the Drawee.

In order to obviate any damage to the drawer's credit by reason of the dishonour of a bill by the drawee, the drawer may insert thereon the name of some person to whom application may be made in case of need. If then the bill is not accepted by the drawee, the holder will take it to the "case of need" and he will accept "supra protest" for the honour of the drawer.

An Accommodation Bill is one upon which a person has made himself liable, either as Drawer, Acceptor or Endorser, without valuable consideration, for the purpose of accommodating some other party, who desires to raise money by the negotiation of the Bill. The party accommodated agrees to find the funds necessary to meet the Bill at its maturity.

As the use of such Bills involves the creation of credit which is not founded upon valuable consideration, Bankers do not care about discounting them, and although it may be difficult to determine by mere inspection that a Bill is an Accommodation Bill, yet if this does appear they will in most cases decline to deal with it.

A Banker would be suspicious of any Bill which is drawn against the normal course of trade, e.g., if a Builder were to draw on a Brick Manufacturer. This might reasonably be considered to be *prima facie* an Accommodation Bill, since it would be expected that the Brick

Manufacturer would draw on the Builder, and not the Builder on the Brick Manufacturer.

The discounting of an Accommodation Bill is colloquially known as "flying the kite."

It must be remembered that as between the Parties to an Accommodation Bill there is no right to enforce payment of the Bill, since no consideration has been given; but in the hands of other parties, so long as value has been given for the Bill, it is enforceable in the same manner as if it has been originally issued for valuable consideration.

Finance Bills are in a sense Accommodation Bills, but these are readily negotiable owing to the known financial strength of the parties to them.

§ 8. BANK NOTES.

A common form of Promissory Note is a Bank Note. This is a Promissory Note by a Banker, payable on demand. The stamp duty is higher than in the case of ordinary Promissory Notes, since the Bank issue the note, and after payment re-issue it from time to time as they think fit. The only Bank Notes which are Legal Tender in England (except at the Bank of England or its Branches) are those of the Bank of England.

§ 9. POSTAL ORDERS, ETC.

Other forms of money instruments are Postal Orders, and Money Orders, both of which are issued for Exchange purposes by the Post Office; letters of Credit and Circular Notes issued by Banks to enable the holders to obtain money from their Foreign Correspondents in named places. None of these are negotiable instruments, but like Bills of Exchange, Cheques, and Promissory Notes, they are instruments of Credit which are presumed to be convertible into Legal Tender.

SYNOPSIS OF CHAPTER IV.

BANKING.

- § 1. BANKS AND THE MONEY MARKET.
- 2. THE ORIGIN AND DEVELOPMENT OF BANKING.
- 3. MODERN BANKING.
 - (a) HOW THE BANKER OBTAINS HIS FUNDS.
 - (b) HOW THE BANKER USES HIS FUNDS.
- 4. BANKERS' CLEARING HOUSES.

CHAPTER IV.

BANKING.

§ 1. BANKS AND THE MONEY MARKET.

The business of Banking is the most important of the factors in the monetary supply and demand. So great is the confidence in the stability of the great Joint Stock Banks, and so important are the facilities afforded by them to all classes of society, that they are now regarded as an indispensable element of modern life and business. The result is that most of the surplus money of the country is deposited with them, and they hold many millions, the great bulk of which is repayable on demand.

The Bankers thus control an important part of the supply, and in the course of business they also meet the demand ; either by honouring the drafts of their customers, or by financing Merchants, Bill Brokers, Stock Brokers and others. All operations of the Money Market ultimately tend to affect the position of the Banks, either through the attraction or loss of actual coin or notes to them, or through the adjustment of accounts as between one Bank and another. It is therefore interesting to trace the origin and development of Banking in this Country.

§ 2. THE ORIGIN AND DEVELOPMENT OF BANKING.

Banking owes its origin to Trade ; and Trade dates back to the dawn of civilisation.

In remote times Trade was carried on under a system of barter, but as civilisation advanced it was found necessary to adopt some more convenient mode of settling transactions, and this resulted in the evolution of a definite coinage.

The Jews, who came over to this country at the time of the Norman Conquest, were the first to start business in monetary transactions. They made advances to the Kings and Nobles on the security of land, property, jewels, etc. They charged high rates of interest, but to a large extent this was forced upon them through direct and indirect persecution. Their importance declined somewhat in the early part of the fourteenth century, when the Lombards, who were skilled Italian Goldsmiths and Moneylenders, came over to this country, settled in that

part of London which still bears their name, and started a primitive Banking business.

The Commerce and Trade of the country expanded considerably during the succeeding 300 years, and the importance of Banking increased accordingly. The Tower of London was utilised as a Safe Deposit, to which Merchants sent their surplus funds for safe custody. This continued until Charles I. appropriated £200,000 of the money so deposited, and, although it was shortly afterwards repaid, the feeling of security disappeared, and the practice was not renewed. Then followed a period when the Merchants acted as their own Bankers, but this proved unsatisfactory, owing to the very unsettled state of the country, which was at that time harassed by the Civil War.

Consequently another scheme had to be devised to meet the situation. The Goldsmiths, who for years had combined moneylending with their recognised trade, came forward, offering the Merchants a small rate of interest on all Deposits entrusted with them, and thus the beginning of a definite Banking business was evolved. The Goldsmiths made their profit by lending the money obtained from the Merchants to the King on the security of the revenue, at a considerably higher rate of interest than they paid for it. In 1672, however, Charles II. suddenly ordered the Exchequer to be closed, refused to repay any of the sums deposited (which amounted to approximately £1,300,000, a very large sum for those days), and in consequence ruined half the Banker Goldsmiths and many of the Merchants who had deposited their surplus funds with them.

This extraordinary conduct so exasperated the public that Charles was forced to pay interest on the amount thus seized at the rate of six per cent. per annum. The interest was paid until the closing year of his reign, when an arrangement was made whereby the claimants were allotted Stock to an extent of about 50 per cent. of the actual amount in full satisfaction of their debts.

In this way the National Debt of Great Britain first came into existence.

In the reign of William and Mary considerable difficulty was experienced in raising the necessary funds for carrying on the war with France, and in the year 1691 a scheme was put forward by William Patterson, a Scottish Merchant, to establish a public Joint Stock Bank, which, in consideration for certain powers and privileges, should advance money to the Government. This scheme was opposed by the Goldsmiths and Moneylenders, who recognised that their business would be considerably endangered by the establishment of such a Bank, but

in spite of all opposition a Bill was eventually passed through Parliament establishing the Bank of England.

The original basis of the Bill was that the public should be asked to subscribe a sum of £1,200,000, and that a Corporation should be formed, to be known as the Governor and Company of the Bank of England. The whole of the money thus subscribed was to be lent to the Government at 8 per cent. interest, and in addition to this the Government was to pay a sum of £4,000 per annum for management and expenses. Further, the public were to be invited to subscribe a sum of £300,000 to form the working capital of the Bank, for which the contributors were to receive terminable Annuities. The Charter was for ten years, and contained certain restrictions as to the borrowing of money, which limited the note issue to the extent of the Capital of the Bank.

The early history of the Bank of England was attended with many difficulties, and many obstacles were thrown in its way with the object of hampering its success. The Directors, however, were men of considerable energy and intelligence, and by their united efforts gradually succeeded in establishing the Bank on a more or less firm foundation. The Charter was renewed from time to time. The powers and privileges of the Bank were altered, sometimes in favour of the Bank, sometimes against it.

In the year 1708, an Act of Parliament was passed granting, to all intents and purposes, a monopoly of Joint Stock Banking to the Bank of England.

By this Act it became unlawful for "any body politic or corporate whatsoever, created or to be created (other than the said Governor and Company of the Bank of England), or for any other persons whatsoever, united or to be united in covenants or partnership, exceeding the number of six persons, in that part of Great Britain called England, to borrow, owe or take up any sum or sums of money on their 'Bills or Notes, payable on demand, or at a less time than six months from the borrowing thereof.'"

The direct consequence of this Act was the establishment of large numbers of small Private Banks. They issued notes, and prospered in good times. As soon as a financial crisis came about, however, they failed one after the other.

Towards the end of the eighteenth century a financial crisis arose owing to the threatened invasion of this country by Napoleon I. This caused a steady drain on the Bank's reserves, and, in the year 1797, the Bank of England found it necessary to place their position before the Government. This resulted in an Act of Parliament being passed which

enabled the Bank to refuse payment of its notes in gold, and it was not until the year 1821 that the Bank resumed paying in cash on demand.

In 1826 the Bank of England gave up its monopoly of Joint Stock Banking, except within a radius of sixty-five miles of London, and at the request of the Government established branches in various parts of the country.

In the year 1833 the monopoly of Joint Stock Banking was wholly surrendered, although no Bank with more than six partners was allowed to issue notes within a radius of sixty-five miles of London. This did not restrict Joint Stock Banking apart from the question of note issue, but at that time it was considered almost impossible to carry on a Banking business without a note issue.

The Act of 1833 constituted Bank of England Notes legal tender for any amount over £5, except as far as the Bank itself and its branches were concerned.

In the year 1834 the London and Westminster Bank was started, and, being successful from the first, was quickly followed by several others. These Joint Stock Banks laboured at first under very considerable disadvantages. They were prohibited from accepting Bills of Exchange having a less date to run than six months; they were not allowed to be represented in the London Clearing House, which was started in the year 1775 by the Private Bankers, and which for many years they kept entirely to themselves; and other difficulties were thrown in the way of their advancement. But they forged ahead; slowly at first, as it was not for some years that any of them realised the possibilities to be derived from Branch Houses.

The Act of 1844 relieved the Joint Stock Banks of many of their initial troubles, and from that date they have continued to grow in magnitude and importance.

The altered and improved conditions of Banking are almost wholly the work of the great Joint Stock Companies.

Deposit Banking has extended to every class of society, and the system of Cheques has largely superseded the usefulness of Bank Notes. The advantages of cheques over Bank Notes is undoubted, and there are but few who would care to return to the old system.

Prior to the establishment of the Bank of England there were many Private Bankers, of whom Messrs. Child & Co. and Messrs. Hoare may be mentioned as the longest established and most important.

In the Provinces large numbers of comparatively small private Banks having less than six partners were formed after the monopoly of Joint Stock Banking had been granted to the Bank of England.

Many of these came into existence through the gradual evolution of country shopkeepers into bankers, one of the most notable examples being the firm of Messrs. Smith, Payne and Smith, now merged into the National Provincial and Union Bank of England. Some of these country Banks were admirably managed, and but for amalgamation with large Joint Stock Banks would have successfully continued to the present day. The larger number, however, were swamped by the periodical crises, and failed with heavy liabilities.

In the year 1833, after the renewal of the Charter of the Bank of England for ten years, the Directors decided upon a definite course of action to guide them in their future operations, which was that at least one-third of their liabilities should be retained in Cash and Bullion, and the balance in first-class securities. These principles were thoroughly sound, and should have been acted upon throughout, but owing to the curious position in which the Bank of England stood in relation to the State, and taking into consideration the fact that it derived its special privileges solely through this connection with the State, it is not surprising that the Directors allowed their desire to accommodate the Government to override their discretion, and consequently on many occasions the proportion of Cash and Bullion fell to a very much lower level than the proposed ratio.

In the year 1839 the Securities stood at nearly £29,000,000, whereas the Cash and Bullion was reduced to less than £3,000,000. This state of affairs necessitated large borrowings in Paris and Hamburg. The weakness of the Bank's position was fully recognised by the Government, and in the year 1844 an Act was brought in to place the Bank on a more solid foundation, and to regulate the issue of Bank Notes by the Provincial Banks throughout the country.

§ 3. MODERN BANKING.

Banking may be defined as the business of dealing in money, and is founded on the principle that although a very large proportion of the amounts deposited are repayable on demand and without any notice whatsoever, yet a Bank will never be called upon at any one moment to pay out the whole of its liabilities. This fact alone enables Banking to be carried on at a profit; and as soon as a Banker is in a position to know approximately what percentage of cash to liabilities it is essential for him to keep on the premises, and at the Bank of England, to meet current demands, and at the same time to leave an ample margin for unknown contingencies, his next consideration is how to use the balance profitably.

(a) HOW THE BANKER OBTAINS HIS FUNDS—

The Banker obtains his money from a variety of sources, *viz* :—

1. *The Paid-up Capital.*

This is received from persons who subscribe for the shares of the bank.

It is interesting to know that the Bank of England alone of all the Joint Stock Banks has no Uncalled Capital. This, in the case of other Banks, is of considerable importance, as it forms an additional security to the depositors. It should be noted that in certain cases the Shareholders cannot be called upon for this money unless the Bank goes into liquidation, in which case the amount concerned is known as the "Reserve Liability."

2. *Deposits at Interest.*

Bankers receive large amounts from customers who, though forced by circumstances to keep money in readiness to meet known or unknown demands, yet desire to see some return upon the same in the meanwhile. These deposits are usually made subject to definite notice of withdrawal, and the rate of interest given varies according to the length of this notice. In the case of Deposits at seven days, the usual rate of interest is 2 per cent. below the official Bank Rate, special arrangements being made as regards Deposits at greater rests. The value to the Banker of the money so deposited is always greater than the interest given by him therefor, and in consequence this source of revenue is very valuable.

3. *Current Accounts.*

By far the larger proportion of the amounts deposited are credited to Current Accounts, and for these the Banker pays little or no interest whatsoever. The Banker, on the other hand, uses this money continually, and thus is enabled to make large profits at practically no cost to himself.

To a large extent these deposits on current accounts are brought into existence, as will be shown later, by the creation of Credits against Security.

4. *Bank Notes.*

There still remain a few Banks who enjoy the right of issuing Notes besides the Bank of England. Where these Notes are issued against coin or bullion it follows that the Bank in question makes no profit out of the transaction, but, on the contrary, sustains a loss to the extent of the cost of the Note itself, and the precautions necessary to guard the gold.

On the other hand, where Notes are issued against Securities, the Banker obtains the use of the money as well as enjoying the interest from the securities. In the case of the Bank of England, the issue of Notes against Securities is limited by law at a fixed amount, but this is not exactly the case with other Banks. The right of issue in these cases is based upon the average amount of the issues of Bank Notes for the twelve weeks preceding the 27th April, 1844, and it was provided that no Banker should in future exceed on an average of four weeks the amount of this average of twelve weeks, under a penalty of forfeiting an amount equal to the excess. The number of other Banks allowed to issue by the Bank Act of 1844 was 279, with an authorised issue of £8,631,647, whereas the return for the week ending 10th January, 1920, showed that only four Private Banks and one Joint Stock Bank retain the right of Note issue, and that the average amount of notes in circulation for that period only amounted to £178,993.

5. *Bankers' Drafts.*

These are ordinary Bills of Exchange, usually drawn by one Banker on another. They are used extensively, especially in the country, by persons who have either no Banking Account or who wish to remit money abroad. The country Banker usually draws on his London Agent, and charges no commission unless the Bills are on demand or at sight.

These drafts form an important element in banking, as the Banker receives the money over the counter and makes his profit either from the use of the money for the specified number of days or in respect of the commission charged.

Bankers' Drafts are often used by travellers in much the same way as Letters of Credit; and are frequently accepted instead of Bank of England Notes in the settlement of dealings in property.

The above are the more important sources from which a Banker obtains his money, and it is now necessary to consider what use he makes of it.

(b) HOW THE BANKER USES HIS FUNDS—

A banker employs the bulk of the money deposited with him profitably, but not the whole thereof.

1. *Non-Profitable.*

(a) A Banker is obliged to invest a considerable sum in Buildings, Leases, Office Furniture, and Effects. This class of asset, being unproductive and unavailable in times of pressure, is usually written down in

the books out of Revenue to a figure largely below its real value. It is interesting to note that the Bank of England apparently takes no account whatever of the value of its Head Office Buildings in London, though they stand on the most valuable site in the world.

(b) Joint Stock Bankers are forced to keep a certain amount of Cash in Hand and at the Bank of England to meet current demands. To a large extent these demands are known and recurrent, and in consequence cause little or no disturbance in the Money Market. The balance at the Bank of England, upon which no interest is allowed, serves a double purpose—

- (1) Under the Clearing House rules it is imperative for each Banker therein represented to keep at the Bank of England an account to which the balance of the daily settlements of the Clearing House may be debited or credited, as the case may be. It is impossible to over-estimate the facilities afforded to Bankers by the Clearing House.
- (2) The Bank of England makes large profits from the use of the Bankers' Balances, and consequently the Bankers themselves feel that they have very sound claims upon the Bank of England for assistance in times of financial pressure, to which the Bank of England has never failed to respond in proper cases.

2. Profitable.

(a) Investments.

A very large proportion of Banker's Investments are gilt-edged, and are depreciated in the books to a value considerably below the normal market price. Both the holding of this class of security, and the under valuation thereof in the books, are vital factors of importance in the administration of a great Bank. In times of panic only the highest class of investment is readily negotiable, and as the existence of a Bank depends upon being able at all times to meet the demands made upon it, it is all important to have a large reserve of first-class securities. As to the valuation of these, it follows that if in times of pressure they have to be immediately used as a means of raising ready cash, the market value of the securities will rise or fall in value according to the state of the Money Market. Any sudden demand on the Banker is, therefore, likely to adversely affect the current quotations owing to the necessity for

realisation, and if the Bank was not forearmed the loss arising through a forced sale would fall wholly upon the period in which the crisis took place. This might upset the confidence of the public in the particular Bank, and materially damage its credit.

(b) *Bills of Exchange.*

Not only do Bankers discount Bills of Exchange for the convenience of their customers, but they also buy large numbers of first-class Bills from the Bill Brokers. This forms a most useful and profitable outlet to the Banker for his superfluous funds. In his transactions with the Bill Brokers he has the advantage of their experience in choosing the Bills, and he has their personal guarantee; he is able to regulate his cash reserves to suit his own convenience by stipulating for Bills which mature within a specified number of days; he makes a quick profit and the security is good. The advantage of dealing with the Bill Brokers is apparent, especially when it is remembered that a Banker cannot know from day to day what Bills he may be asked to discount by his regular customers.

In considering the profit which a Banker makes on discounting Bills, it should not be forgotten that he charges interest on the nominal value of the Bill, and not on the money advanced. Thus the real interest charged is at a higher rate than would appear from the discount quotation.

(c) *Loans and Advances.*

The Banker usually invests over 50 per cent. of his assets in Loans and Advances against security. A considerable proportion of this is repayable on demand and at short notice, and includes *inter alia*—

- (1) Advances to Bill Brokers repayable at call.
- (2) Advances to Stock Brokers repayable at short notice.
- (3) Loans to Customers, Insurance Companies and Financial Houses.

A Banker has to exercise the greatest discrimination in deciding what he will accept as cover for these loans. He not only has to guard against lending too much on any one class of security, but also to avoid locking up a portion of his funds for too long a period. These Loans and Advances will appear in the Bankers' Balance Sheet under the headings of Money at Call and at Short Notice, and Advances on Current Accounts, Loans on Security, etc. It is largely by means of these

advances that the gigantic structure of credit operations carried by the English Money Market is created. When a Banker advances money to a customer on security he does not immediately pay out Coin or Notes, but against the Customer's debt to the Bank a credit is passed to the Customer's Account, the effect being to create simultaneously an Asset and a Liability.

The Customer in all probability will draw against the credit, and pay the cheque so drawn to another person, who in turn will increase his credits with his own Bank. The result is that the obligation to repay the lending Bank is represented by increased credits in the books of one or more of the Banks.

The amount of deposits due by the Joint Stock Banks has largely been created in this way, and it is clearly a most advantageous proceeding for the Banker. He generally takes the most ample security, and charges interest on the advance or Loan, while paying nothing on the credit; so that the earning capacity of the Bank is increased without any apparent difficulty by a mere book entry. The process might be carried on indefinitely, were it not for the fact that the liabilities incurred in the process are repayable on demand, for which reason the ratio of available legal tender must not be reduced to too great an extent.

In a somewhat similar manner the Banks accept Bills for customers, creating at the same time an Asset in the obligation of the customer to provide the necessary funds, on or before maturity, covered by Collateral Security.

§ 4. BANKERS' CLEARING HOUSES.

These are institutions, of which the London Clearing House is the principal, which exist to enable Banks which are members to settle their mutual transactions by means of Accounts instead of actual payments.

The operations of the London Clearing House is divided into three sections, *viz.* :—

- (1) Town Clearing, for Banks within a small area of the Bank of England.
- (2) Metropolitan Clearing, for those Banks outside the Town Clearing, but within the bounds of the Metropolis.
- (3) Country Clearing, for all Banks outside the above areas.

Those Banks which are not members of the Clearing House make arrangements for a Clearing Banker to act on their behalf.

There are two daily clearings for Town Cheques, and one for each of the other clearings.

Each Bank sends its representatives with separate lists of cheques which are collectable from other Clearing Bankers for the various clearings, and receives in return those cheques which other Bankers have to collect from them. As all cheques which are dealt with are credits to the Banks sending them to the Clearing House, and debits to the Banks from whom they are collectable, the net result of each clearing is that certain sums amounting to a definite total stand to the credit of certain of the Banks, while certain sums to an equal total stand to the debit of others. At the end of the day each Bank summarises its clearings, both "Outward" and "Inward," and arrives at the amount due to, or by, it on "General Balance," and this amount is settled by Transfers between the various Bank Accounts and an Account known as the "Clearing Bankers' Account" in the Books of the Bank of England.

The following example may serve to make the procedure clear. Assume that four Banks, A, B, C and D, are members of the Clearing House, and pass the following sums through one or all of the sections:—

Banks passing Cheques in	Banks on which the cheques were drawn.				Total.
	A	B	C	D	
A		£38,000	£79,500	£106,500	£224,000
B	£23,000		68,000	91,000	182,000
C	69,000	25,000		70,000	164,000
D	39,000	59,000	56,000		154,000
Totals	£131,000	£122,000	£203,500	£267,500	£724,000

The following Statement shows the amount due to, or from, each of these four Banks:—

BALANCES DUE FROM:				BALANCES DUE TO.				
A	B	C	D	Balances	A	B	C	D
£131,000	£122,000	£203,500	£267 500		£224,000	£182,000	£164,000	£154,000
93,000	60,000						39,500	113,500
£224,000	£182,000	£203,500	£267,500		£224,000	£182,000	£203,500	£267,500

It will be seen from this Statement that C and D owe £39,500 and £113,500 on General Balance, while there is £93,000 and £60,000 due to A and B respectively. C and D will therefore transfer the amounts

due from them from their Accounts with the Bank of England to the credit of the "Clearing Bankers' Account," and this account will in turn be debited and the Accounts of A and B credited with the amounts which are due to them. As all these accounts are kept in the books of the Bank of England, the transactions are settled by means of Book entries only.

The scope of the London Clearing House operations is gigantic in normal times; and when it is considered that for the week ending 28th January, 1920, the total amount of cheques so cleared was £768,876,000, the saving of labour and economy of the legal tender currency of the Country, which the Clearing House confers can be realised.

During the year 1919 the following were the amounts cleared :—

Town Clearing	..	..	..	..	£23,214,685,000.
Metropolitan Clearing	..	..	..	..	1,813,929,000
Country Clearing	..	..	..	..	3,386,768,000

Grand Total .. £28,415,382,000

these figures constituting a record.

There are also ten Clearing Houses situated in the principal Provincial Trading Centres of England. These in no way rival the importance of the London Clearing House, and are used for purely local purposes, and assist therefore to relieve the Central Institution in London. They are by no means insignificant, for during the week ending January 24th, 1920, Cheques to the total value of £69,296,800 were passed through these Clearing Houses.

Though both Ireland and Scotland have their own Clearing systems there is at present no link between these countries and England so far as Clearing is concerned, and consequently cheques on Banks in these centres are presented direct by the collecting Banker, who charges a commission for his trouble.

SYNOPSIS OF CHAPTER V.

THE BANK OF ENGLAND.

- § 1. THE BANK OF ENGLAND AND THE MONEY MARKET.
- 2. MANAGEMENT.
- 3. STATE PROTECTION.
- 4. FUNCTIONS OF THE BANK OF ENGLAND.
- 5. THE BANK ACT, 1844.
- 6. SUSPENSION OF THE BANK ACT, 1844.
- 7. CHIEF PROVISIONS OF THE BANK ACT, 1844.
- 8. THE BANK RETURN.
 - (a) ISSUE DEPARTMENT.
 - (b) BANKING DEPARTMENT.
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CHAPTER V.

THE BANK OF ENGLAND.

§ 1. THE BANK OF ENGLAND AND THE MONEY MARKET.

The Bank of England came into existence on the 25th April, 1694. It is not, and never has been, a State Bank, although it was founded directly for the advantage of the State, and received whatever benefits it enjoys or has enjoyed at the hands of the State. It acts as the State Banker, and in that capacity it calls for and receives a limited amount of State protection.

The Bank of England is the strong room of the British Banks, and the custodian of the nation's gold reserve. Nearly all the Bankers keep large balances with the Bank of England, and depend on the Bank of England for any extraordinary demand that may be made upon them.

Thus, when money is scarce and consequently in demand, the Public depends on the Banks, and the Banks on the Bank of England. When the Bill-Brokers, Stock Brokers, and others requiring money, fail to obtain what they need from the Banks, they too fall back upon the resources of the Bank of England; consequently the whole Money Market moves round the Bank of England, and stakes its existence on her power to satisfy the nation's requirements.

The Bank of England, in the same way as other Banks, creates large credits by means of its advances, and these Credits remain either in its own books or get transferred to other Banks. The principal difficulty of the Bank of England in this matter arises from the fact that when the other Banks are refusing or restricting accommodation, borrowers fall back upon the Central Institution, which is practically bound to give assistance in proper cases to the detriment of its own Reserve.

In times of stringency this is a serious matter, and amounts to the Bank of England shouldering the duties of the whole Banking Community. In such times, however, the Bank has normally an effective control of the Discount Rate, and so can employ this weapon to restrict the demand for accommodation by making it more costly.

§ 2. MANAGEMENT.

The Bank of England is managed by a Governor, Deputy-Governor and twenty-four Directors, none of whom are connected with the Joint Stock Banks. They meet every Thursday and fix the Bank Rate, thus in effect giving a basis for determining the current value of money for the time being.

They also consider the Weekly Return, and this is published immediately after the close of the meeting.

§ 3. STATE PROTECTION.

It has been shown that the extensive privileges formerly granted to the Bank of England were from time to time gradually curtailed. There still remain traces of State protection, however, chiefly in the matter of the note issue, *viz.* :—

(1) The Bank of England holds the monopoly of issuing notes within sixty-five miles of London, and will eventually have the monopoly of all England. This was clearly the intention of the Act of 1844. The monopoly is valuable from the point of view of prestige, and profitable to the extent to which notes are issued against securities.

(2) The enactment making Bank of England Notes legal tender created a permanent demand, not so much by the Public as by the Bankers. It is clearly more convenient for the latter to keep a part of their Cash in Hand in the form of Notes, rather than being obliged to keep the whole of it in coin.

(3) The State supplies a military guard every night to protect its own deposits and the property of the Bank.

§ 4. FUNCTIONS OF THE BANK OF ENGLAND.

The Bank of England in its capacity of State Banker receives the National Revenue, and meets the National Expenditure. It issues Exchequer Bills for the Government; any State Loan which may be brought out; manages the Consolidated Debt; and generally advises the Government in all financial matters.

The Bank of England maintains the gold reserve of the country by means of the Bank Rate; it maintains the National currency by the withdrawal of defective coins; and it maintains the commercial credit of the country by lending its support to the Money Market in times of financial pressure.

§ 5. THE BANK ACT, 1844.

The Bank Act, 1844 was framed by Sir Robert Peel, but to a very large extent the credit of its success is due to Lord Overstone, who advised Sir Robert Peel throughout, and who was at the time the greatest authority on Banking in the country. The Act is particularly interesting inasmuch as it still remains in force, despite the fact that the whole character of Banking has changed.

In the year 1844 it was considered almost impossible to carry on Banking successfully without a note issue. At the present time Cheques have almost entirely superseded Bank Notes in settling commercial transactions, and Deposit Banking has reached gigantic proportions. It is estimated, that in January, 1920, the Bankers of Great Britain were liable on deposits to the extent of over £2,000,000,000, a fact which alone proves how greatly the stability of the Banks is bound up with the interests of the nation.

The Bank Act, 1844, would have been obsolete years ago, however, had it not been for the Bank of England's duty of maintaining the gold reserve of the country, and also for the indemnity granted by the various Governments against the illegal expansion of the Note Issue on those occasions when that course became imperative owing to financial crises. The Act of 1844 made no provision whatever for an expansion of the Note Issue in times of pressure, and it has been necessary to break the law in this respect on several occasions.

§ 6. SUSPENSION OF THE BANK ACT, 1844. • •

(1) In the year 1847 a serious financial crisis arose through speculation in railway undertakings. Parliament was called upon to give sanction to the formation of a large number of railways and similar schemes involving considerable capital. The price of the shares rose in the Market and great speculation ensued. A bad harvest and potato crop caused heavy imports of corn, and the consequent export of gold. The result was that financial panic ensued, and the reserve at the Bank of England fell to under two millions. The Bank Act was suspended, and the issue of notes against securities permitted to an unlimited extent. This quickly restored public confidence, although advantage was not actually taken by the Bank of the additional powers temporarily given.

(2) In the year 1857 America was in considerable financial difficulty, and many of the large Banks had stopped payment. A continual drain of gold from this country ensued, with the result that credit was largely curtailed. Heavy failures took place amongst Banks and Financial Houses, including one of the largest Discount Houses in London. The trouble was in a certain measure accentuated by financial disturbances in Scotland and Ireland, and, added to this, the Bank of England had allowed the reserve to fall to a dangerously low point. It was found necessary to apply to the Government for powers to suspend the Bank Act, and full advantage was taken thereof. During the whole of the crisis the Bank Rate remained at the abnormally high rate of 10 per cent., but even this remedy failed for a long time to attract sufficient gold to restore public confidence.

(3) In the year 1865 the Civil War in America caused a shortage in the cotton supply, which necessitated large purchases at high prices from other parts of the world. The Bank Rate was raised to 8 per cent., and credit was everywhere curtailed. Everybody tried to sell their securities, but nobody was ready to buy them; and this resulted in the failure of several large financial houses, the most important being that of Messrs. Overend Gurney & Co., who failed with liabilities of over ten millions sterling. The failure of this house was reported on Friday, the 11th May, 1866, which has since been known as "Black Friday." Several Banks suspended payment, and although most of them subsequently resumed business, for the time being the panic was intense.

(4) The crisis of August, 1914, is dealt with in Chapter IX., but although the Government empowered the Bank of England to suspend the Bank Act, no advantage was taken of this power.

§ 7. CHIEF PROVISIONS OF THE BANK ACT, 1844.

The chief provisions of the Bank Act, 1844, are as follows:—

(1) The separation of the Issue Department from the ordinary Banking Department of the Bank of England.

(2) The transfer from the Banking Department to the Issue Department of the Government debt, amounting to £11,015,100, together with other securities to the value of £2,984,900, in all £14,000,000; also sufficient Gold Coin and Bullion to make the whole amount equal to the nominal value of the notes outstanding.

(3) The fixing of the proportion of Silver Bullion which might be held by the Issue Department to an amount not exceeding one-fourth part of the gold held. It may be mentioned that the Issue Department of the Bank of England keeps no Silver Bullion at the present time.

(4) The fixing of the value of gold of regulation fineness at £3 17s. 9d. per standard ounce, and providing that any person might demand notes in exchange for gold at that rate.

(5) Providing that when any Note Issue was relinquished the Issue Department should be allowed to increase its own issue of notes against securities to the extent of two-thirds of the issue so relinquished. All the profits, however, on such increased issue were to belong to the Government.

(6) Enabling existing Banks of Issue to continue issuing their own Notes, but preventing any lapsed issue from being resuscitated.

(7) Providing for the weekly publication of a statement by the Bank of England showing the position of both the Issue and Banking Departments in prescribed form.

(8) Granting power to Banks consisting of more than six partners within sixty-five miles of London to draw, accept, or endorse Bills of Exchange not being payable on demand.

§ 8. THE BANK RETURN.

The following is a specimen of the Bank Return which the Bank publishes weekly in conformity with the provisions of the Act of 1844.

BANK OF ENGLAND.

48

AN ACCOUNT pursuant to the Act 7th and 8th Victoria, cap. 32, for the week ending on Wednesday, the 31st day of December, 1919.

ISSUE DEPARTMENT.

Notes issued	£108,748,260	Government Debt	£11,015,100
		Other Securities	7,434,900
		Gold Coin and Bullion	90,298,260
		Silver	—
	<u>£108,748,260</u>		<u>£108,748,260</u>

Dated the 2nd Day of January, 1920.

E. M. HARVEY, *Chief Cashier.*

BANKING DEPARTMENT.

Proprietor's Capital	£14,553,000	Government Securities	£92,469,207
Rest	3,272,195	Other Securities	106,777,576
Public Deposits (including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts)	19,213,209	Notes	17,398,270
Other Deposits	180,637,913	Gold and Silver Coin	1,043,895
Seven Day and other Bills	12,631		
	<u>£217,688,948</u>		<u>£217,688,948</u>

Dated the 2nd Day of January, 1920.

E. M. HARVEY, *Chief Cashier.*

(a) Issue Department.

The Division of the operations of the Bank of England into two parts, *i.e.*, the Issue and the Banking Departments, was specified by the Bank Charter Act, 1844, which at the same time regulated the issue of the Notes. It is interesting to note that Lord Cunliffe's Committee on Currency and Foreign Exchanges after the War have reported that in their opinion this division should still be maintained. The Issue Department when formed took over as a liability the Bank of England Notes then in circulation, and as assets, Securities (including the Government Debt) to the extent of £14,000,000, and coin or bullion to the amount of the balance. The Bank Note issues of other Banks were limited to the average amounts they had issued in the early part of the year 1844, and no additional issues by such Banks or any other institutions were permitted. The Bank of England were allowed to issue Bank Notes to any amount in excess of £14,000,000, provided that Gold or Silver Coin and Bullion (Silver not to exceed a quarter of the amount of the Gold) to the face value of such additional Notes was held by the Bank; but should any bank of issue lose their right to continue to issue Notes, then the Bank might issue additional Notes to a total of two-thirds of the defunct issue by depositing securities to the same value.

Government Securities, £11,015,100, represents a debt due to the Bank from the Government. It is merely a Book debt, and now stands at the same figure as in 1844.

Other Securities have increased from £2,984,900 in 1844 to £7,434,900 at December 31st, 1919, and this increase is due to the privilege of additional issue granted to the Bank, as mentioned above.

The total of these two items, *i.e.*, £18,450,000, is known as the "Fiduciary Issue."

The remaining item of this account "Gold Coin and Bullion" represents the actual Reserve to meet the liability of the Bank on its notes, and this item regulates the circulation of Notes beyond the Fiduciary Issue. It is really the cash held to meet any notes that are presented, and when such presentment takes place the coin or Bullion would be decreased and the issue be reduced accordingly. It is interesting to note that no silver is held, although power is given to do so. This is probably due to the fact that Silver is not legal tender for £5—the lowest denomination of note issue by the Bank.

The German Reichsbank in pre-war days had an issue on similar lines to that of the Bank of England, but had the power to exceed the

amount issued against securities at any time on paying to the Government a penalty of 5 per cent. of the excess issue. Lord Cunliffe's Committee in their Interim Report suggest that legislation is desirable authorising the Bank to exceed their fiduciary issue in the case of emergency, and they suggest that any profits made on the additional issue against securities should be surrendered by the Bank to the Exchequer. This would automatically check any tendency to over issue. It must be borne in mind that on the Fiduciary issue the Bank makes a Profit from the income from investments, although the Profit on the securities in excess of £14,000,000 (the amount of the Fiduciary issue authorised by the Bank Act, 1844) belongs to the public. Prior to the war this public profit was computed at 2 per cent. per annum.

Not only is the Bank compelled to pay Gold for its notes, but the Act also compels it to give Notes for Gold, since the Issue Department is obliged to purchase any Gold Bullion offered to it by giving Bank of England Notes in exchange at the rate of £3 17s. 9d. per oz. of Standard Gold. The holder of Gold Bullion, however, is not obliged to take his bullion to the Bank, for it will be minted for him free of charge by delivering it in sufficient quantities to the Royal Mint. Standard Gold is eleven-twelfths fine, *i.e.*, 11/12ths pure Gold to 1/12th of alloy or 22 carat Gold, and 480 ozs. of this standard metal will be minted into 1869 sovereigns, which works out to £3 17s. 10½d. per oz. Although a higher return may be obtained by taking Gold to the Mint, in practice the Gold finds its way to the Bank of England, the apparent loss being counter-balanced by the fact that Cash is available on delivery, whereas a delay arises before the specie can be obtained from the Mint.

In pre-war days the Bank was always prepared to cash its notes in bar-gold (or bullion) if desired, and occasionally when the demand was great, charged £3 17s. 11d. per oz. for it, and this slight extra charge would often deter an export of Gold, for the profits on transactions in bullion were very small, owing to the fact that the value of the Gold was a steady and certain quantity. It was found necessary to restrict the export of Gold in 1919, a step taken much earlier by most of the belligerent nations, and this fact accounts in a large measure for the unfavourable Exchanges with America, but it seems that it was the only step which could be taken as otherwise our Gold would have rapidly disappeared, owing to our large indebtedness to America, and there would have been no opportunity of replenishing it. The amount of Gold Coin and Bullion has shown a marked increase during the War, and this is in some

measure due to the withdrawal of Gold from circulation. The following figures show how the issue of notes against the deposit of Gold has grown :—

1st Jan., 1891.	17th Aug., 1904.	21st Jan., 1914.	31st Dec., 1919.
£22,743,345.	£33,746,935.	£40,885,915.	£90,298,260.

The operation of this Department is entirely automatic, as gold is passed into the Banking Department through deposits, and from there transferred to the Issue Department, or comes direct to the latter Department from outside sources by means of purchases, and the Note Circulation increases by a like amount. As notes are returned Gold is issued against them and the circulation falls.

(b) Banking Department.

This section of the Bank's activities is similar to the operations of any other large Joint Stock Bank, and only in one respect does it differ from them, and that is in the item "Public Deposits." This represents the account of the Government, and it is for the reason that the Bank is the depository of Government funds that a weekly return is required for this Department, as well as for the Issue Department. During the War the Government often had to resort to advances from the Bank of England, and when these took place the item "Public Deposits" would be increased, and a corresponding increase would take place in "Government Securities." This portion of the return is to all intents and purposes a Balance Sheet, and only differs from those issued by other Banks in the fact that it gives fewer details.

The Capital of the Bank is large, and though its profits are of considerable volume, it has never paid more than 10 per cent. per annum, while other large Joint Stock Banks show a much larger return to their Shareholders.

The item "Rest" is the reserve which has been accumulated out of profits. This fluctuates from time to time, but is never allowed to fall below £3,000,000. The Capital and Reserves therefore amount to over seventeen and one half million pounds Sterling. Before the war inflated the deposits, this immense Capital bore a very high ratio to the Deposits. In addition, there is a large secret reserve, equal to the value of the premises of the Bank's Head Office, which does not appear in the Return.

Other Deposits, except for the small liability on Seven Day and other Bills (often referred to as Bank Post Bills), represent the total liability to the public. This item is more closely akin to the liability which other

Banks show as "Current Accounts" rather than "Deposit Accounts." It consists of the Balances due to customers, among whom it must be remembered are all the larger Banks.

The balances of the Accounts of the Banks are regarded by the Banks themselves as a part of their Cash Reserves, and if a Bank experiences a heavy demand from its customers its account with the Bank of England will be depleted, either to meet the demand or to replenish the amount of Cash it keeps in its own vaults. It will thus be seen that any abnormal demand for cash in any part of the country will affect the Bank of England. When the market for gold was unrestricted this item would also fluctuate with any foreign demand for gold, for Foreign Banks made a point of keeping Accounts in London so that gold could be obtained without delay when required. If the exchanges were against us, and gold was being exported, this item would show a heavy fall.

When a new loan is made by the Government "Other Deposits" will fall heavily, since all drafts on Bankers for the purpose of investment will find their way through the Clearing House to the Paying Bankers' Account in the Bank of England. At the same time the item "Public Deposits" will increase as the Bank will act as Receivers for the Government. Similarly when the Government made heavy payments to contractors "Public Deposits" would fall, and "Other Deposits" would be increased though not necessarily by the same amount, since the Banker will probably utilise some part of his additional deposits in investments or making loans.

This item will tend to increase when credit is shaken, since Bankers will then act cautiously and increase as far as is possible their Cash Reserves by restricting loans and realising suitable investments.

It may be said that "Other Deposits" is to a large extent the money which is available for loans, and when the amount is low the Bank Rate has a tendency to rise and attract money here. As this money comes in the "Other Deposits" increase, and the Bank Rate tends to fall, for as "Other Deposits" increase so does the Cash Reserve which the Bank holds to meet demands on the part of its customers.

On the other side of the Statement we find the assets held by the bank against the liabilities already enumerated. The first two items, *i.e.*, "*Government Securities*" and "*Other Securities*," represent the investments made by the Bank out of its surplus funds. The first of these two shows a tendency to fluctuate considerably from time to time. For instance, in normal times towards the end of the year when payments are made by the Treasury in excess of its income, the item "*Government Securities*" will increase as the Treasury will borrow the amount of the

deficit from the bank; and in January when large receipts from Income Tax are received, and the Government repays its debt, this item will be reduced considerably.

The "Other Securities" represents the general investments of the Bank, and comprises Indian, Colonial Government and Corporation Stocks, Railway Debentures, etc., Bills under discount, and the amounts due from customers in respect of loans and overdrafts. It also includes the value of the branch premises of the Bank. No details are given as to the various classes of Securities as is done in the case of the ordinary Banks, though previous to 1875 the Bank made a return to Parliament differentiating between loans, discounts and securities. Most of the Bank's loans are for "short" terms, made against the deposit of first-class security.

During the war this item was swollen by the Bills of Exchange which had been accepted prior to the 4th August, 1914, and which the Bank were authorised to meet on behalf of the Acceptors, holding such bills as security against the repayment of the advance, the Bank being guaranteed against loss by the Government. Though the Bills so to be dealt with were limited to those of the class generally discounted by the Bank, and to Good Trade Bills, and to acceptances of such Foreign and Colonial firms and Bank Agencies as were established in this country, the volume of Advances was very large, and would thus increase both "other Securities" and "other Deposits."

The remaining items on this side of the Return, *i.e.*, Notes and Gold and Silver Coin, represent the "Reserve" of the Bank, and are really the most important figures of the whole of the Return. Since the items "Public and Other Deposits" represent liabilities which must be met on demand the ratio which this Reserve bears to the total of the Deposits is a very important figure, and during the war the ratio has fallen very heavily. The following comparisons are instructive:—

Dec. 31st, 1890, Total Deposits £39.8 millions, Reserve £14.8 millions.

Percentage of Reserve to Deposits 37.

Aug. 17th, 1904, Total Deposits £46.76 millions, Reserve £25.6 millions,

Percentage of Reserve to Deposits 54.6.

Jan. 21st, 1914, Total Deposits £59.9 millions, Reserve £32.1 millions.

Percentage of Reserve to Deposits 57.4.

Dec. 31st, 1919, Total Deposits £199.8 millions, Reserve £18.3 millions,

Percentage of Reserve to Deposits 9.15.

At the outbreak of the war in 1914, the Reserve fell in one week from £26,875,194 to £9,966,649, while "Other Securities" had risen from £47,307,530 to £65,351,656. The decrease in the first case was due to withdrawals, while the increase in the second case was due to loans made by the Bank with the object of meeting legitimate demands, and of allaying the panic. However, the ratio of the Reserve to liabilities fell heavily and finally stood at 14.6 per cent., whereas at the end of July it was 41 per cent. The diminution of the Reserve in the Banking Department was accompanied also by a fall in the Gold Coin and Bullion held in the Issue Department of £10,630,335, notes to that amount having been presented for payment in gold.

Since the Bank of England under normal conditions holds so large a percentage of its liabilities to Depositors in the form of cash it follows that it is not in so favourable a position to make profits as other Joint Stock Banks, who usually maintain a Cash Reserve of under 20 per cent. of their obligations to customers, and consequently utilise a larger percentage of deposits for making loans and investments, and thus earning profits. It is necessary also to bear in mind the fact that a portion of this Reserve of the Joint Stock Banks is represented by their balances in the books of the Bank of England, and hence the Bank's Reserve is in effect partly earmarked as the Reserves of other Banks. It can, therefore, readily be seen that any uneasiness among depositors will have a very marked effect on the Reserve of the Banking Department, which will be called upon to meet the aggregate demands, as each Bank experiencing an unexpected demand will replenish its tills by drawing on its balance with the Bank of England. This fact accounts for the enormous fall which took place in the amount of the Reserve at the end of July and beginning of August, 1914.

It will be realised what is meant by saying that the Reserve of the Bank of England is the Reserve of the Country, and it is this fact which caused the Bank to maintain so large a percentage of its liabilities in Cash, although it must be remembered that the Bank does not admit that it is the custodian of the Country's Reserve, and fixes the amount of Reserve it will retain in relation to its own liabilities only. It is the peculiar position which the Bank holds as the Banker of Bankers as well as of private individuals that makes its reserve the ultimate resource for all unprecedented calls.

Heavy borrowing at high rates of interest is a usual feature of any financial upheaval, and it might be argued that the Bank might adequately protect its reserve by withdrawing credit facilities; but this argument is a fallacy, for in that case people hard pressed will use every endeavour

to stave off ruin, and will pay exorbitant rates for loans to meet their obligations, and if they bid high enough can usually succeed in obtaining accommodation. When such is the case the ultimate result will affect the Bank through the Bankers' Clearing House, and the Reserves will be reduced, but the frenzied efforts of the Borrower to raise the money will have only assisted to spread the uneasiness, and the final result is worse than the first evil. While reckless lending will ultimately bring down the structure of Credit, judicious loans against good security tend to restore confidence and allay uneasiness. The fact that in recent years this policy has been recognised has doubtless had a marked effect on finance—since the cycles of disaster which were a common feature in the middle of the nineteenth century seem to have disappeared. This was undoubtedly the case in 1890, when Baring's suspended payment. In the normal course a suspension by so important a house would have caused widespread panic, but the Bank of England in conjunction with other Joint Stock Banks came to the rescue, guaranteed the liabilities of the firm, and the crisis was over before the majority of the public were aware of anything being wrong.

§ 9. THE BANK RATE AND THE MARKET RATE.

The Bank Rate may be defined as the Official Minimum Rate charged for the time being by the Bank of England for discounting first-class Bills and for granting Loans for short periods on approved security.

It is fixed in the ordinary course every Thursday morning by the Directors of the Bank of England, who take into account the supply of, and demand for, gold in the country, and also the general conditions of the Money Market at home and abroad.

It must not be supposed, however, that the Bank Rate is the lowest rate at which Bills can be discounted or Short Loans obtained on any particular day. Competition amongst the various Bankers to lay out their surplus funds profitably creates a Market Rate, which is usually somewhat lower than the Bank Rate. In normal times even the Bank of England will make advances to regular customers at "Market Rates."

The Market Rate generally varies directly with the Bank Rate, and the Bank Rate with the Market Rate; so that when the Bank Rate goes up the Market Rate usually follows suit. If it does not, the Bank of England may consider it necessary to take steps to compel the Market to advance its rate, especially if the Gold position is unsatisfactory; and the usual method of doing this in normal times is for the Bank to sell Securities for Cash, and buy for the Account. This operation reduces for the time being the available funds with the Bankers,

and compels them to charge more for loans. As the resources of the Bankers decrease, so the Market Rate advances, the demand for money being greater than the supply. Thus a point is reached when the Bill Brokers, Stock Brokers, and others needing funds are forced to have recourse to the Bank of England, who charge the full Bank Rate. If the demand for accommodation continues to increase, the Bank Rate is advanced, and borrowers are obliged to pay more for their money.

A high Bank Rate, however, tends to attract money from other countries, and as the gold comes in so the supply in the Market becomes greater. Thus matters tend to right themselves, and the Bank Rate is eventually reduced so as to keep in touch with the Market Rate. It will be seen, therefore, that the principal factor affecting the variation of the Bank Rate is Supply and Demand.

The Bank Rate is usually high—

- (1) When trade is good, because at such times there will be a brisk demand for money.
- (2) In times of financial crisis when credit is curtailed, and there arises an increased demand for legal tender as a means of settling transactions.
- (3) When the balance of indebtedness as regards other countries is against us, and exports of gold from this country are threatened or actually taking place.

The Bank Rate is usually low when trade is stagnant, and the demand for money declines.

It is important to note that the interest allowed by the Joint Stock Bankers on Deposits generally varies with the current Bank Rate. This is again on account of Supply and Demand. As demand increases so the Bank Rate advances; money becomes scarcer, and therefore more valuable; the Bankers are able to use their funds more profitably, and are therefore willing to pay more for them. The effect of the custom itself, however, certainly increases the importance of the Bank Rate, and is largely responsible for its effectiveness; since even if the Bankers decline to raise the Market Rate until compelled, their customers will require their interest raised immediately the Bank Rate advances.

The objects aimed at in the alteration of the Bank Rate from time to time may be summed up as follows:—

- (1) To regulate the charge for accommodation, according to the supply of and demand for money.
- (2) To restrict unnecessary borrowing in times of financial panic.
- (3) In normal times to remedy "Unfavourable Exchanges," thus preventing gold exports and attracting gold imports.

SYNOPSIS OF CHAPTER VI.

THE FOREIGN EXCHANGES.

- § 1. THE SETTLEMENT OF FOREIGN TRANSACTIONS.
- 2. BALANCE OF TRADE AND BALANCE OF INDEBTEDNESS.
- 3. BILLS ON LONDON.
- 4. INDIA COUNCIL BILLS.
- 5. MINT PAR OF EXCHANGE.
- 6. SPECIE POINTS.
- 7. THE OPERATION OF THE SPECIE POINTS.
- 8. THE BANK RATE IN CONNECTION WITH THE EXCHANGES.
- 9. ARBITRAGE OPERATIONS.

CHAPTER VI.

THE FOREIGN EXCHANGES.**§ 1. THE SETTLEMENT OF FOREIGN TRANSACTIONS.**

It would be clearly impossible as well as inconvenient to settle all commercial transactions in actual coin ; for not only would the supply of precious metals in the world be totally inadequate to meet the requirements, but also the expense and risk attaching thereto would be such as to entirely disorganise trade. The difficulty is overcome by the use of Bills of Exchange.

The nature of Bills of Exchange has already been considered, and it is only necessary here to consider Foreign Bills which are used for settling international transactions.

When a Foreign Bill of Exchange is purchased the transaction resolves itself into buying for a sum of money payable in one country the right to a certain amount of currency in another country, either immediately or at a definite future date. It has been indicated that Great Britain has commercial transactions with all foreign countries and therefore at any given moment there are merchants in this country who owe money to merchants in foreign countries and *vice versa*. If the imports exactly balance the exports it is clear that the one could be set off against the other.

But even this could not be done without recourse to Bills of Exchange, as no actual connection would exist between the various debtors and creditors. The connecting link is the Exchange Broker, who by buying and selling Bills of Exchange enables such transactions to be satisfactorily settled.

§ 2. BALANCE OF TRADE AND BALANCE OF INDEBTEDNESS.

The Imports of Goods of Great Britain invariably exceed the Exports by a very large amount, and it is necessary briefly to consider how it is possible that such a state of affairs can continue without ruining the country financially.

It appears on the surface that the Balance of Trade at any given moment is largely against Great Britain, but it should be remembered that the phrase "Balance of Trade" implies not only the net difference between Imports and Exports, but also between Services received and given. These Services are represented by Freight, Carriage, Insurance, etc., and when the extent of British Shipping and Insurance is considered, it will be seen that they form no mean item in adjusting the unfavourable trade balance.

The Balance of Trade, however, must not be confused with the Balance of Indebtedness, upon which the question of supply and demand for Bills actually turns.

The Balance of Indebtedness is very largely affected by the Balance of Trade; but it is also influenced by other important factors, including Foreign Capital invested in this country; English Capital invested abroad; Interest due by and to this country in respect of these International investments; money held by foreign Bankers in this country; Settlements between other countries by means of Bills on London; and various other transactions.

§ 3. BILLS ON LONDON.

With regard to Settlements through London, it has already been shown that England has mutual dealings with all parts of the world, but there are foreign countries whose commercial transactions with other countries cannot be paid for by goods or services owing to the absence of reciprocity of trade. The settlement of these is effected therefore through England by means of Bills on London.

The following illustration gives a general idea of the methods adopted to bring about this result:—

A Firm in Norway exports goods to Chili and draws on a London Agent for payment, notifying the firm in Chili thereof. The firm in Chili buys a Bill on London and remits the same to the Agent in London, who, in due course, collects the money in respect of the Bill purchased by the Chili Merchant, and thus meets the Bill drawn on him by the Norwegian firm.

§ 4. INDIA COUNCIL BILLS.

India Council Bills afford another illustration of the usefulness of Bills of Exchange as a mode of settling international obligations. The Indian Government has from time to time borrowed large sums of money in England, and the interest thereon is payable in London in Gold. India, however, has a silver coinage, and in consequence the

taxes of the country are all payable in that metal. If, therefore, the Indian Government wished to transmit Gold to England to meet the interest on the loans, they would first have to purchase the Gold in India, at the current market rate. This would involve considerable loss, and the cost of shipping and insuring the gold would add to the expense. The difficulty is overcome by means of India Council Bills.

The Secretary of State for India receives information periodically as to the state of the Exchequer in India, and invites tenders accordingly for Bills payable in currency in India. Applications for these are made by Bankers and Merchants having accounts to settle in India, and in this way the Secretary of State obtains the necessary Gold in London to meet the Interest on the loans. The Merchants make a profit by purchasing the Bills at a discount; and the Indian Government sustains a corresponding loss, but, at the same time, is relieved of the expense of transmitting the Gold. If the price offered for the Bills is low and shows a greater loss to the Indian Government than the loss entailed by remitting Gold, the offers are, of course, declined, or only Bills for a small amount issued.

The Merchants remit the Bills to their Creditors in India, who in due course present them for payment at the Exchequer; the Bank of England pays the Interest on the loans, and thus the matter is satisfactorily settled without any gold passing between the two countries.

§ 5. MINT PAR OF EXCHANGE.

If the supply and demand for Foreign Bills were equal as between two countries, and there existed no other disturbing factors, the exchanges would stand at par.

There is, however, no *actual* Par of Exchange between two countries using different systems, and therefore it becomes necessary to establish a theoretical substitute, and this is known as the *Mint Par*.

This is simply a conversion of the terms of the Standard coinage of one country into the terms of the Standard coinage of another, having regard to the weight and fineness of the metal contained in each.

The relative value of English and French money, for instance, depends on the composition of the gold coinage of each. In England 480 troy ounces of gold, 11 parts fine, 1 part alloy, are coined into 1,869 sovereigns. In France, 1,000 grammes of Gold, 9 parts fine, 1 part alloy, are coined into 155 Napoleons.

A Napoleon being equal to 20 francs, and one troy oz. being equal to 31.1035 grammes, it can easily be calculated by Chain Rule how many francs are equal to one sovereign at Mint Par.

CHAIN RULE.

x Francs	=	1 Sovereign.
1,869 Sovereigns	=	480 oz. Gold, English Coinage Standard.
1 oz. Gold, English Coinage Standard.	=	11/12 oz. Pure Gold.
9/10 oz. Pure Gold	=	1 oz. Gold, French Coinage Standard.
1 oz. Gold, French Coinage Standard.	=	31.1035 Grammes.
1,000 Grammes	=	155 Napoleons.
1 Napoleon	=	20 Francs.

$$\text{Thus } \frac{480 \times \frac{11}{12} \times 31.1035 \times 155 \times 20}{1869 \times \frac{9}{10} \times 1000} = 25.221$$

The Mint Par between England and France is therefore 25.22 Francs to £1; signifying that, in the same place, one full weighted English Sovereign is the equivalent of 25.22 francs in full weight French Gold coinage.

§ 6. SPECIE POINTS.

Specie point is the term applied to a point above or below Mint Par in the Exchange rate with any country, at which it is more advantageous to settle a debt by remitting gold than by the purchase of a Bill of Exchange.

The price charged for a Bill of Exchange on any country will vary directly with the supply and demand. If the supply is insufficient to meet the demand the cost of those available will tend to increase, and the Exchange will in consequence drop. The lower the Exchange quotation falls, the smaller will be the amount of the currency of the country concerned which can be obtained for the £. It follows therefore that normally when the Exchange quotation reaches a certain point it will be cheaper to remit Gold, in spite of the cost of carriage and insurance, than to purchase a Bill of Exchange. This point is known as the *Export Gold Point*.

Conversely, when the supply of Bills on any country exceeds the demand the rate of Exchange will tend to advance. This is to the advantage of the English Creditors who have accounts to settle with the country in question, for they can obtain a greater amount of currency for every sovereign expended. On the other hand, a high rate indicates a loss to the Foreign Debtor, who has to pay a greater amount of currency

for every sovereign purchased, and consequently a point is reached when it is normally more profitable for him to remit gold than to purchase a Bill of Exchange. This point is known as the *Import Gold Point*.

Before the war the Specie Points in the Exchange with France were as follows:—

Mint Par	.. .. .	25.221.
Export Gold Point	.. .. .	25.125.
Import Gold Point	.. .. .	25.325.

but as the expenses of remittance (*e.g.*, Freight and Insurance) have greatly increased, these points will need adjustment when the export of Gold is again permissible.

Assuming the charges of remitting Bullion to Paris to be equal to $\frac{3}{8}$ ths per cent. of the value thereof, it would normally be cheaper for an English Debtor to forward Gold rather than to purchase a Bill of Exchange on Paris at the Export Gold Point of Exchange.

Illustration.

252,210 Francs could be settled for £10,000 =

$\frac{3}{8}$ ths per cent. thereof = £37 10 £10,037 10 0

Whereas a Bill of Exchange on Paris for 252,210

Francs at Exchange 25.125 would cost £10,038 4 0

The Import Gold Point renders it in like manner to the advantage of the Foreign Debtor to send Gold rather than to purchase a Bill of Exchange on London.

When Exchange quotations are in Foreign Currency high rates of exchange are said to be advantageous to this country, as they generally indicate a favourable balance of indebtedness; they tend to attract an inflow of Gold, and they enable more currency to be purchased for a sovereign. Low Rates of Exchange are said to be unfavourable to this country for converse reasons.

§ 7. THE OPERATION OF SPECIE POINTS.

While it may be true in theory that fluctuations past the Specie Points would cause Gold movements, in practice this was not always the case, for another important factor enters into the transaction. Before shipping gold a person must obtain it, and in many countries to find gold for export was by no means easy. "Specie Points" have in the past been regarded as rigid limits, but these points depended primarily on the cost of sending the gold with proper security. If shipping or insurance rates increased for any reason the "Specie Points" would have to be adjusted to meet the new conditions, while if the gold was

unobtainable for the time being they would be inoperative, and the price of Bills would only be subject to the economic restriction due to the law of Supply and Demand.

Before the war gold was always obtainable without difficulty in London, since all the exporter need do was to go to his bank, obtain Bank of England Notes for his cheque, and present them to the Issue Department of the Bank of England, who would give him gold coin or bullion in exchange. This being so the theoretical rule worked in practice, since when the exchanges fell and the prices reached the "Outgoing Specie Point" gold would be immediately shipped. In America gold could usually be obtained without any difficulty, and when the American Exchange moved in our favour, and the "Inward Specie Point" was reached we generally found gold flowing into this country. Paris, however, usually demanded a premium on gold for export, and consequently the theoretical Specie Point which should have marked the export of gold from France did not correspond with the actual one, since this latter would depend upon the amount of premium exacted.

Germany was nominally a free market for gold, but while the Reichsbank did not actually refuse gold for export, it raised difficulties and put barriers in the way when it was desirous of preventing it.

During the war the Exchanges have fluctuated to a degree undreamed of twenty years ago, partly of course due to the vastness of the financial operations which had to be carried out, and largely through the fact that most countries found it expedient to prohibit the export of gold.

Throughout the war London remained a free gold market, and gold could be obtained from the Bank of England when required—and yet we find that in many cases the rates of exchange were constantly below the outgoing specie points. In the case of the American Exchange, in spite of the operation of the American Dollar Securities Committee, the rates of exchange on New York were constantly below the theoretical point when Gold should have been exported. The Outward Specie Point for London on New York was normally \$4.83 to the £1—while the American Dollar Securities Committee report shows that the rate for 1916-17-18 was practically constant at $4.76\frac{7}{16}$ or $6\frac{9}{16}$ cents below the normal. The reason is not far to seek, for during the war not only were freights extremely high, but the dangers of the sea were greatly increased by German submarines; and the British Government, who took over the writing of Marine War Risks, refused to issue policies to cover the risks of enemy actions on shipments of gold. The risk was too heavy for the exporter to bear, and consequently shipments stopped—except for those made by the Government itself.

After the conclusion of hostilities other countries which were heavily indebted to us found it wise to retain the embargo on gold shipments, and though exchanges moved in many cases very strongly in our favour (notably in the case of France), and the old Specie Points were left a long way behind, no gold from these sources reached our shores. We, on the other hand, were very heavily indebted to some other countries, and particularly to America, and their exchanges moved against us. The old Specie Points were then quite inoperative, for heavier freights and charges necessitated a revision of these prices; but even after necessary adjustments the point was speedily reached where gold would flow out of this Country. The adverse balance of indebtedness was not a temporary one, but largely of a permanent nature, and the rush of imports to this country with increased shipping facilities only made matters worse, particularly as for a long time many ships outward bound were used for repatriating the armies and the necessary stores and equipment, and the space for other exports was extremely limited. If the gold had left England it would not have returned, and consequently as the only means of replenishing our store would have been by purchase from the producers on a rapidly rising market, it was considered expedient to forbid the export of gold. Since gold could not be obtained it followed that Specie Points no longer existed—for their operation depends on the gold being obtainable—and exchange being only subject to the law of Supply and Demand had no checks placed on their fluctuations.

During the latter part of 1919 it was found advisable to allow gold to be exported under licence—but this privilege was confined to that gold which was imported, and not to that held by the Bank of England. This permits the gold to be sold to the highest bidder, but owing to the premium now obtained on gold this has very little effect on the Exchanges, for the supply is limited and the demand great.

§ 8. THE BANK RATE IN CONNECTION WITH THE EXCHANGES.

In normal times, when the Export Gold Point is reached, it is certain that Gold will leave this country, for two reasons:—

- (1) Because it becomes cheaper to remit Gold than to purchase Bills.
- (2) Because the State Banks of the principal Continental countries grant special facilities to Gold Importers.

If the Exchanges set unfavourably against England, an outflow of Gold will naturally result, and it becomes necessary to adopt measures such as are likely to prevent the Reserve of Gold from being dangerously reduced. This is brought about by an increase in the Bank Rate of the

Bank of England. An advance in the Bank Rate does not necessarily depend upon the Foreign Exchange quotations only ; as the Bank of England must clearly take into consideration the Gold Reserve, and the monetary conditions generally. The fact remains, however, that the true correction of adverse Exchanges lies in an increase in the Bank Rate.

If the Discount and Interest Rates ruling in London are higher than those ruling in other cities, Capital will be sent to London, in order that the greatest return possible can be obtained for its employment.

The Foreign Banks will buy up the available Bills on London at the low rate of Exchange ruling abroad, and will either hold them till maturity, or sell them before maturity as the rate goes up.

Foreign Banks with Branches in London will also employ more Capital in England, and this will be used in the discounting of first-class English Bills at the high rate of discount ruling in London.

The Capital so invested will be obtained by drafts on Continental Banks, which will be sold in the London Market.

Thus Bills on London in Foreign Countries will tend to become more scarce, and Bills on Foreign Countries in London will tend to become more plentiful ; the result being that the price in London for a Bill on a country concerned in these operations will become cheaper and the Exchange quotation will gradually rise. In any case the Export of Gold will be stopped ; and the continuance of a high Bank Rate may attract such an inflow of Gold as to alter the whole complexion of the Foreign Exchanges.

§ 9. ARBITRAGE OPERATIONS.

Arbitrage operations are those which have for their object the acquisition of profit by taking advantage of the difference between the Exchange quotations in each of two countries.

Illustration.

Assuming London quoted Paris at 42.10, and Paris quoted London at 42.20, and Arbitrage Operator could sell a £1,500 Bill on London in Paris for 63,300 francs, by telegraphing to his agent in Paris instructing him to draw on him for that amount ; and at the same time he could sell a Bill for 63,150 francs on Paris in London for £1,500. His Arbitrage Account would exactly balance, for it would be credited with the proceeds of the sale of the Bill on Paris, and it would be debited with the cost of meeting the Bill on London.

On the other hand, his Arbitrage Account in Paris would show a profit of 150 francs, for it would be credited with the proceeds of the

salé of the London Bill, *viz.*, 63,300 francs, and it would be debited with the Bill on Paris for 63,150 francs.

An operation of this kind seldom takes place, as differences between the rates as quoted by each of the two countries are generally corrected before any such advantage can be taken.

Another object is the minimising of losses on Exchange by remitting an amount abroad by means of a Bill of Exchange drawn on a third country.

Illustration.

Assuming a London Merchant has to remit 3,752 dollars to his Agent in New York, and the following rates of Exchange are current at the date of the remittance.

The price in *London* of a Bill on New York is 3.73 dollars to £1.

The price in *London* of a Bill on Madrid is 19.70 pesetas to £1.

The price in *New York* of a Bill on Madrid is 19.05 cents for 1 peseta.

The Arbitrated Exchange in London on New York *via* Madrid is :—

X Dollars	=	£1 Sterling.
£1 Sterling	=	19.70 pesetas.
1 Peseta	=	.1905 Dollars.
$19.70 \times .1905 = \$3.752 \text{ to } £1$		

It is therefore cheaper for the London Merchant to remit to his Agent in New York a Bill on Madrid, which that Agent can sell in New York at the ruling rate of exchange, than to purchase a Bill on New York in London. In the former case he obtains the right to 3,752 dollars for every sovereign, whereas in the latter he obtains the right to 3.73 dollars only.

The cost of each method would be as follows :—

(1) *Bill on New York.*

3,752 Dollars at 3.73 = £1,005 17. 10.

(2) *Bill on Madrid.*

19,600 Pesetas = 3,752 Dollars.

(approximately at 19.70 Pesetas
to £1)

£1,000 0. 0.

Gain to Merchant by remitting through

Madrid £5 17. 10.

Operations of this kind have the effect of averaging the rates almost immediately ; and great skill is essential to take advantage of difference in the rates under such circumstances as those given.

SYNOPSIS OF CHAPTER VII.

THE COURSE OF EXCHANGE.

- § 1. THE COURSE OF EXCHANGE.
 - 2. THE QUOTATIONS.
 - 3. FLUCTUATION OF RATES.
 - 4. MINT PARS OF THE EXCHANGES.
- H

CHAPTER VII.

THE COURSE OF EXCHANGE.

§ 1. THE COURSE OF EXCHANGE.

The centre of the business in Foreign Bills in the United Kingdom is the Royal Exchange, London, where those desirous of selling or buying Bills meet twice weekly (Tuesday and Thursday). After the close of Business the principal Bill Brokers issue a Price List of Bills known as the "Course of Exchange." The following is a copy of that for January 8th, 1920.

ON.	USANCE. (When payable.)	PRICES.		EXPLANATION.
Amsterdam and Rotterdam ..	Cable	10.03	10.08	Florins & cents for £1
Belgium	Cheque	41.65	41.65	Francs & centimes for £1
Paris	Cable	41.80	42.20	Ditto
Ditto	3 months	42.30	42.50	Ditto
Marseilles	3 months	42.30	42.50	Ditto
Switzerland	Cable	21.25	21.35	Ditto
Ditto	3 months	21.75	21.85	Ditto
Germany	Cable	188.00	192.00	Marks & pfennigs for £1
Italian Bank Places..	Cable	50.15	50.55	Lire & centesimi for £1
New York	Cable	3.73 $\frac{3}{4}$	3.75 $\frac{3}{4}$	Dollars & cents for £1
Ditto	Demand	3.75 $\frac{1}{2}$	3.78 $\frac{1}{2}$	Ditto
Lisbon and Oporto ..	Cable	17	18 nom.	Pence for milreis 1
Madrid and Spanish Bank Places ..	Cable	19.70	19.85	Pesetas for £1
Ditto	3 months	58	58 $\frac{1}{2}$	Pence for 1 peso
Copenhagen	Cable	20.65	20.95	Kroners & ore for £1
Christiania	Cable	18.90	19.00	Ditto
Stockholm	Cable	17.65	17.80	Ditto
Helsingfors	Cable	122.00	126.00	Finnish marks for £1
Buenos Ayres	Cable	62	63	Pence for 1 dollar
Rio de Janeiro	Cable	17 $\frac{1}{2}$	18 $\frac{1}{2}$ nom.	Pence for 1 milreis
Athens	Cable	25.6	26.1	Drachmæ for £1
Calcutta and Bombay	Demand	2/3 $\frac{1}{8}$	2/3 $\frac{3}{8}$	Shillings & pence for 1 rupee.
Ditto	30 days gt.		2/3 $\frac{5}{8}$	Ditto

The remarks outside the ruling are not part of the Course of Exchange as issued, but have been added to make the relationship plain. At first sight it would appear very unusual to quote most of the rates in Foreign Money when they are being bought and sold in this country for sterling payments. However confusing this may appear to the mind of one not

versed in the Exchanges, yet it has behind it an element of sound common sense. Bills on London are quoted on all the Bourses of the World, and are more in demand than those on any other financial centre, consequently to an operator in Bills of Exchange the habit of quoting in terms of the Foreign Currency enables him to see at a glance whether it may not be profitable for him to buy Bills and send them to his Agent in the Foreign country, who could buy Bills on London with the proceeds.

§ 2. THE QUOTATIONS.

It will be noticed from the "Course of Exchange" that two rates are quoted, except in the case of thirty-day Government Bills on India. One of these is for First Class Bills (such as those drawn on Good Banks), and the other for ordinary Trade Bills. When the quotation is in foreign money the first or lower rate is the rate for First Class Paper, the second or higher for Commercial Bills. When the price is quoted in pence to the foreign unit, the lower represents the price for Commercial Paper and the higher the price for First Class Bills.

It may appear that the two quotations embody different principles, but this is not so. It will be clear that one must expect to pay a higher price for a better article, and this is apparent when the quotation is in English Coinage. If we consider for a moment the quotation shown for Paris, *i.e.*, 41.80 — 42.20, we shall see that what really happens is that in the first case we receive 40 centimes less for £1 sterling than we do in the second case, hence the price must be higher in the first than in the second quotation. Clearness on this point will enable it to be understood why it is that when prices in foreign currency rise, we say the "Exchanges move in our favour," and are moving "against us" when the quotation falls. If the rate advances it means we are obtaining more units of the Foreign Currency for £1 sterling, while when the rate drops we get fewer of such units. High rates are favourable to us therefore, and low rates are unfavourable. The reverse of this rule applies when the unit of Foreign Currency is quoted in English money, and this fact needs no demonstration.

The reason why Commercial Bills are cheaper than First Class Paper is the element of risk which is inherent to them. If a long term bill (*i.e.*, three months) is purchased and sent abroad, the receiver when he discounts it will be charged more by the Discounter than if it were drawn on a well-known firm of Bankers. He charges for the risk. This fact of course only applies to "Long" bills; in the case of "Cheques" it is usual also to include Bills which have only a few days to run before maturity, and one payable immediately is consequently higher priced.

It will be noticed that under the heading of "Usance" we get various times for payment, e.g., "Cable," "Cheque," "Demand," "3 months" and "30 days." The difference between "Cable" and "Cheque" or "Demand" is that the former is payable when a cable is received, whereas in the other case, the payment can only be obtained after the arrival of the Bill. So that cable rate on New York means that the money can be obtained in that City within a few hours of the transaction being completed here; whereas in the case of the "Demand" draft, several days must elapse to allow for the bill to be sent by post to New York. Under these circumstances the number of dollars and cents obtained for £1 in the second place will be more than in the first, and this covers the loss of interest met with through paying a sum here immediately in return for an equivalent sum of money paid in New York after the expiry of some days. Similarly it will be seen that the "long" rate, such as the three months' rate on Switzerland, shows a larger return for £1 for much the same reason, though in this case provision has to be made for the element of risk and for additional stamps that enter into the transaction.

The long rate will obviously be based on the sight or "Cheque" rate, but will vary from time to time without any alteration in the sight quotation. This latter alteration will be due to the rate of interest ruling in the Country where the Bill is payable.

Illustration.

I wish to remit to my agent in Paris the sum of £1,000. I can do so by purchasing a Cable remittance at 41.80, and thus my correspondent will obtain an immediate payment of 41,800 francs. If I buy a three month Bill I pay £1,000 immediately for a payment in the future, and must calculate that a certain amount of interest will accrue at the French rate of interest; for my correspondent will either credit me with the amount of the Bill in three months' time when he receives the money, and in the interim charge me interest at the French rate, or he will discount the Bill immediately and credit me with the proceeds. Assume the Bank Rate in France to be 6 per cent., then the charge on a three-months Bill will be $1\frac{1}{2}$ per cent., and I shall expect therefore to buy the Bill $1\frac{1}{2}$ per cent. cheaper, or obtain 42.42 francs for £1. I must also pay the Foreign Bill stamps ($\frac{1}{2}$ per mille), say $2\frac{1}{4}$ centimes, making the rate 42.44 $\frac{1}{4}$. As I shall remain liable on the Bill as an Endorser for three months I shall expect to be recompensed for my trouble, and this will cause the rate to be still higher. If I calculate my chance of loss to be

$\frac{1}{2}$ per mille I shall get a rate of 42.46 $\frac{1}{2}$, and £1,000 will now purchase a Bill payable in three months time for 42,625 francs. If this Bill be discounted at the Bank Rate of 6 per cent. the net proceeds are 42,085 francs. which is approximately the amount received for the cheque, plus 285 francs for the expenditure on stamps, and the risk run. It will be seen therefore that the long rate is based in the first place on the sight rate, fluctuating with it, but the amount by which it differs from the sight rate will depend upon two factors: (1) the Bank Rate ruling in the country of payment and (2) the general state of credit.

It must be noted that the Bank Rate has been utilised in making these calculations, but, as in London, the market rate is usually below the Bank Rate, and this being the case it follows that the calculations necessary would be made at the Market Rate.

Occasionally Bills are quoted which have odd periods such as thirty days to run before maturity. In such cases a calculation based on the "Long" rate and called the "tel quel" or "t.q." is made.

Prior to the war it was usual to quote the American dollar in pence in London, whereas New York quoted dollars and cents to the £; and this was also the case with Spain, where we quoted pence to the peso, and they quoted pesetas to the £ (5 pesetas = 1 peso). There has been a tendency to bring our Course of Exchange into line with the foreign procedure, and New York is quoted in dollars and cents; but it will be noticed that Madrid is still quoted in the old manner for the three months' rate, but in the same way as Madrid for the Cable Rate.

§ 3. FLUCTUATION ~~OF~~ RATES.

Fluctuations in the rates depend upon two sets of causes: (1) the Demand and Supply of Bills and (2) the condition of the Currency in the countries.

Fluctuations in the rate do not depend entirely upon the amount by which one country is indebted to another, since these debts may be "standing" ones, consequently they have no effect till they are being settled; though where Capital has been invested abroad interest has to be paid to the lenders, and when this is being remitted the exchanges may be affected.

Trade between countries in the normal way is the main ruling factor which regulates demand and supply, but it does not of necessity confine

the fluctuations to the exchanges of the Countries directly concerned. London may be called upon, as she is at the present time, to make heavy payments to New York. It may be found more convenient and cheaper to buy Bills on some other centre, realise them there and with the proceeds purchase Bills on New York.

To illustrate this from the above Course of Exchange :—The rate on New York for First Class Paper on Jan. 8th, 1920, was $3.73\frac{3}{4}$, and on Germany 188.00. On the same day 1 mark would purchase 2 cents. Therefore, by buying marks in London at 188, selling them in Germany and buying Bills on New York, we should obtain 3.76 dollars for £1, a gain of $2\frac{1}{4}$ cents, or, to put it the other way, a remittance for $\$3.73\frac{3}{4}$ would cost less than £1. This does not seem much, but on a remittance of a large amount the total saved would be considerable.

The demand being great and supply short it often happens that Stocks and Shares which have an international market are purchased in one country for sale in another, and by such means a considerable saving may be effected. This will affect the demand for Bills and prices will fall.

The second group of influences which affect exchanges are those connected with the Currency. A depreciated or debased currency will cause exchanges to move against the country of circulation, since it must be remembered that it is the weight of gold which is the basis of Exchange, and not the face value of the coins, though the rate of Exchange is quoted in the currency which is legal tender for the time being. If paper currency has been over-issued in any country, gold will not be found in the ordinary channels of circulation, and is unobtainable on demand in exchange for the Notes, and consequently to obtain it a premium will have to be paid. The amount of such premium will cause the Exchanges of that country to move against it to a similar extent.

Where countries are using different standards as a basis for their currency, such as gold in one and silver in another, the rate of Exchange will fluctuate by the variations of the silver price of gold or *vice versa*, and consequently the rates of Exchange between London and those countries using a silver standard will fluctuate, not only owing to the supply and demand, but also by the market price of silver in London. This has been amply illustrated by the case of India. Normally the rate of Exchange between this country and Calcutta was round about 16d. to the rupee, but with the great increase in the gold price of silver the rate has increased, and by the above "Course" will be seen to stand at $2\frac{3}{4}$ d. per rupee payable on demand.

§ 4. MINT PAR OF THE EXCHANGES.

The following are the Mint Pars of Exchange between London and the principal Financial centres of the world :—

Amsterdam	..	12.10 Florins and cents to £1 sterling.
Berlin	.. ..	20.43 Marks and pfennigs to £1 sterling.
Bombay	.. ..	16d. Pence to one rupee.*
Brussels	.. ..	25.22 Francs and centimes to £1 sterling.
Buenos Ayres	..	47½d. Pence to one dollar.
Copenhagen	..	18.15 Kroners and ore to £1 sterling.
Italy	.. ..	25.22 Lira and centesimi to £1 sterling.
Lisbon	.. ..	53.28 Pence to one milreis
Madrid	.. ..	25.22 Pesetas to £1 sterling.
New York	.. ..	4.86 Dollars and cents to £1 sterling.
Paris	.. ..	25.22 Francs and centimes to £1 sterling.
Rio de Janeiro	..	16d. Pence to one milreis.
Singapore	.. ..	2¼d. Shillings and pence to 1 dollar.
Stockholm	.. ..	18.15 Kroner and ore to £1 sterling.
Switzerland	..	25.22 Francs and centimes to £1 sterling.
Vienna	.. ..	24.02 Kroner and heller to £1 sterling.
Yokohama	.. ..	2/0½d. Shillings and pence to 100 yen.

* From 2nd February, 1920, the Exchange between India and this country will be at the basic rate of one rupee for 11.30016 grams of fine gold—which is equivalent to a value of 2/- per rupee.

SYNOPSIS OF CHAPTER VIII.

THE EXPORTATION OF CAPITAL.

- § 1. SENDING CAPITAL ABROAD.
- 2. WHAT AN EXPORT OF CAPITAL REALLY IS.
- 3. HOW AN EXPORT OF CAPITAL IS EFFECTED.

CHAPTER VIII.

THE EXPORTATION OF CAPITAL.**§ 1. SENDING CAPITAL ABROAD.**

In sending Capital abroad to foreign Countries the aid of the Money Market is always required, but the fundamental operation is carried out by the Merchants and others by whom our commerce is conducted. It is desirable, therefore, to consider in what form Capital can be transferred to other countries, and the various operations by which such a result is obtained.

§ 2. WHAT AN EXPORT OF CAPITAL REALLY IS.

It is a clear proposition that fixed capital cannot be exported. Land, buildings, railways, canals, docks, fixed plant and machinery are not capable of transshipment for the use of other countries, so that a person who holds an interest in assets representing fixed capital is not able by a single transaction to invest his capital abroad. To do so, he must first find a purchaser for his fixed assets, and by means of a sale turn his fixed capital into circulating capital. Thus it becomes evident that any capital which is exported must necessarily be circulating capital.

When the demand for capital abroad is satisfied in whole or part by means of a loan raised in this country, it is perhaps thought that the result is to create a deficiency in the circulating capital of the country, to starve home industry and enterprise, and to restrict the employment of labour.

As a matter of fact a deficiency in the circulating capital of the country is not likely to be created. It must be remembered that there is always a floating margin of capital seeking remunerative investment, and it is upon this margin that any deficit must first be demonstrated.

To illustrate this it is obvious that if A, a tradesman, has £3,000 locked up in book debts and stock, he is not going to realise these by a forced sale for the purpose of investing in foreign stocks. Even if he is making a loss in his business a forced sale of assets would be disastrous to him, and if he is making a profit the return is probably greater than the yield of the foreign investments.

Industry and enterprise, as is explained later, are not starved by foreign investments; for if a diversion of capital is temporarily effective on the floating margin, legitimate enterprise will obtain its capital

from the realisation of investments, or by raising money on loan. If money is raised on loan in such circumstances the rate of interest will be higher than if there had not been a depletion of floating capital ; and if there is great stringency in the money rates a high bank rate will result, which, being effective as the market rate of interest, will tend to attract capital to this country, and so remedy the deficiency originally created.

This extreme position is, however, only created when the exportation of capital involves an export of gold, which is not necessarily brought about by over-investment in foreign securities, but by the general relation between this and other countries on the point of the balance of indebtedness.

It may be taken for granted that when capital is exported it is either because there is an actual available surplus of capital here, or because the earning power of that capital (so far as it is a reduction of the margin of floating capital) is greater at the point to which it is attracted than it is here.

It is clear that, although the visible imports of Great Britain largely exceed the visible exports, nevertheless, the total imports, including the invisible imports, must balance the total exports, including the invisible exports. No nation gives anything away, and, conversely, no nation receives anything for nothing ; and therefore imports must necessarily be paid for by exports. An export of capital, as will be seen later, is not an export of money or gold, since usually the imports of bullion exceed the exports ; but rather an export of goods which are not paid for by imports, but allowed to remain as a loan either to the nation receiving the goods or to some other nation.

In saying this it must not be supposed that the exported goods go necessarily directly and immediately to the country to which the loan is made, or, in other words, to which the capital is exported ; but the actual result is that goods and services exported exceed the imports of goods and services, and the excess is not paid for, but a debt created, which is ultimately transferred over to permanent loan creditors.

Consequently to balance the International Trade Accounts of Great Britain of any year, capital invested abroad during the period under review can be conveniently dealt with under the heading of invisible imports. It is represented by the excess of debts due to us over liabilities incurred, and which our wealth as a nation enables us to leave where it is most remunerative.

To illustrate this the following statement of the international transactions of Great Britain for the year 1913 is submitted. This statement is not of course accurate, but is an estimate on the data available :

STATEMENT OF TOTAL IMPORTS AND EXPORTS FOR 1913.

IMPORTS.

Amounts due by us for—

VISIBLE IMPORTS:

Goods Imported	£769,034,000	
Less Re-Exported	109,656,000	
	<hr/>	659,378,000
Bullion Imported	74,029,000	
Less Exported	62,132,000	
	<hr/>	11,897,000

671,275,000

INVISIBLE IMPORTS:

Interest due for Foreign holdings of British Securities, and Earnings of Foreign businesses in this country	18,000,000
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CAPITAL INVESTED ABROAD

during year 1913	171,186,000
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£860,461,000

EXPORTS.

Amount due to us for—

VISIBLE EXPORTS:

Goods Exported	525,461,000
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INVISIBLE EXPORTS:

Shipping, Freight, &c. ..	100,000,000
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Interest receivable on Capital invested abroad and earnings of British Businesses abroad	235,000,000
	<hr/>
	335,000,000

£860,461,000

The fact that this country puts a large amount of money into a foreign or colonial Government loan, or subscribes to a new issue of a foreign or colonial railway, does not mean that the amount of money subscribed or agreed to be subscribed by the various allottees of the loan or issue will go out of this country in specie. An outflow of gold may follow the flotation of a foreign or colonial issue, but this is attributable to the working of the foreign exchanges; and although the state of the exchanges is bound to be affected by the exportation of capital, this will not as a rule have the effect of causing a gold movement.

The reason for this is not far to seek. London has been for many years the world's most important centre of money and capital, and, in spite of the facilities of commerce which modern science has brought into being, the importance of a Bill on London for the settlement of international transactions is still paramount.

While this is the case, London, by means of the control of the bank rate by the Bank of England, can send its surplus capital out of the country without depleting its store of gold. But if the exportation of capital does not involve an export of gold, what result follows from the subscription to a foreign or colonial issue? This is difficult to demonstrate with cast-iron accuracy, for the effect that follows as a result of the contribution alone may be lost in the complex maze of intricacies which collectively determine the foreign exchange rates; but it may be said that where the borrowing country is so indebted to this country that the balance of indebtedness is in favour of this country, the result of lending money in its international effect is merely a definite extension of credit in respect of a sum equal to the loan, and a correction of the exchanges in favour of the borrowing country.

§ 3. HOW AN EXPORT OF CAPITAL IS EFFECTED.

It will be understood that the raising of a foreign or colonial loan in this country is principally carried out by a transfer of credit. A certain amount of money may be paid to the bankers for the purpose of applications, but as a rule these applications will be covered by cheques. The various applicants will draw cheques on their own bankers, and these bankers will honour the cheques through the Clearing House when they are presented by the collecting banker; and the net result is a shifting of credit in the books of the Bank of England from the various banks on which the cheques were drawn to the bank to which the cheques were paid.

All the various applicants have reduced their own credit at their bankers, and those bankers have reduced their credit at the Bank of England; while the collecting bank acting for the foreign or colonial

Government concerned has had its credit increased by the Bank of England, and has correspondingly increased the sum standing to the credit of its foreign or colonial customer for which the loan was issued. Yet it may be said that the whole transaction *per se* has hardly involved the movement of a single coin; it is a mere shifting of credit, resting for its effectiveness on the law of contract, which has been finally carried through at the Bank of England by means of our cheque system.

Having raised the loan, it becomes necessary for the collecting banker or financier to settle with the Government, Authority, or Company for which he has acted as agent. It might be said: Why not draw the money in gold out of the Bank of England and ship it out? The answer to this is, that there are readier means of effecting the settlement than by sending gold—methods which are more effective and infinitely cheaper; and a Government or other authority that has raised a loan at a competitive rate of interest, or at a discount, or possibly at a large expenditure on underwriting, does not wish to add unnecessarily to the expense attached to the borrowing transaction.

The result of sending gold when the operation is not justified by the exchanges—which in this country of free gold would normally be quite possible—would be so peculiar that it is worth consideration.

Firstly, when the gold has left this country, gold being scarce, the Bank of England would raise the bank rate. Market money being scarce, the bank rate would become effective as the market rate, and would continue high—being raised whenever necessary—until an equal quantity of gold has been attracted back.

In the meantime, if the balance of indebtedness was against the country which had so calmly walked off with the gold, bills on London in that country would be at a premium. If the rate rose above the specie point gold would at once be exported to us by that country in settlement of the trade differences.

Such a proposition is practically an absurdity, for our bankers would lend no countenance to the subsequent financing of a country that so unnecessarily disturbed our money market.

The question is still to be answered, however, if gold is not sent out of the country, how is the settlement effected?

To clearly show what is done, the multifarious and ever-changing factors which go to make up the balance of indebtedness will be eliminated and simple cases quoted; and although the issues cannot in practice be narrowed down to the extent demonstrated the cases taken will serve to illustrate the theory on which the transactions are actually conducted.

(a) *Where the people of the Borrowing Country are largely Indebted to the people of the Lending Country.*

Assume that the balance of indebtedness between England and Japan is represented by the following facts. T. Nogi, of Japan, owes J. Bull, of England, £100,000; N. Togo, of Japan, owes R. Davidson, of England, £100,000; and M. Komura, of Japan, owes A. Thomas, of England, £100,000. If these are the only outstanding transactions at the moment there is a balance of indebtedness against Japan and in favour of England of £300,000.

The Japanese Government issues a loan of £300,000 in England, which is fully taken up, the Yokohama Specie Bank thereby obtaining an additional credit of £300,000 at the Bank of England.

J. Bull, R. Davidson, and A. Thomas each draw on their Japanese debtors for £100,000; the Yokohama Specie Bank buys up the bills, and the English creditors are settled with by the purchase. The bills are forwarded to the Japanese head office of the Yokohama Specie Bank which collects the money from the Japanese debtors.

From this it is evident that the individual contributors to the loan issue have taken the place of the English creditors, and the Japanese Government has taken the place of the Japanese debtors, and yet no money has passed. But there is this difference in the position, England has invested a portion of her surplus capital, and will get a good return upon it, in addition to the trade advantages which invariably fall to the lot of the big creditor; while Japan has prevented the depletion of its own gold resources, and by the extension of credit to the term of the loan provided the country with an increase of capital, thus preventing the capital invested in its own trade from becoming restricted.

(b) *Where the people of the Borrowing Country are largely Indebted to the people of various other Nations.*

Assume that T. Nogi, of Japan, owes H. Muller, of Germany, £100,000; N. Togo, of Japan, owes C. Rubenstein, of Germany, £100,000; and M. Komura, of Japan, owes H. Andre, of France, £100,000. If these are the only outstanding transactions at the moment, there is a balance of indebtedness against Japan of £300,000, and in favour of Germany and France to the extent of £200,000 and £100,000 respectively.

Now if a loan of £300,000 is raised here, the head office of the Yokohama Specie Bank in Japan can sell to the Japanese traders bills drawn on their London branch, and these bills on London can be forwarded to the German and French creditors, The German and French

creditors can sell the bills to purchasers in Germany and France who are desirous of settling their own debts in London, and these purchasers will forward the bills to their London creditors, who will then ultimately collect the money.

Thus the result is a mere shifting and extension of credit, with the same consequences.

SYNOPSIS OF CHAPTER IX.

**THE EFFECT OF THE WAR ON THE MONEY
MARKET.**

- § 1. THE CRISIS AND ITS EFFECT.
- 2. CURRENCY NOTES.
- 3. THE GOLD COINAGE.
- 4. INFLATED CURRENCY AND PRICES.
- 5. THE DOLLAR SECURITIES COMMITTEE.

CHAPTER IX.

THE MONEY MARKET AND THE EUROPEAN WAR,

1. THE CRISIS AND ITS EFFECT.

The Political Crisis which preceded the outbreak of the War, and which culminated in the Ultimatum from Austria to Serbia on the 24th July, 1914, was accompanied by a monetary crisis in the chief Cities of Europe and also in America. The rapid depreciation of Securities, brought about largely by the possibility of war, was particularly felt on the London Stock Exchange, since in respect of loans from Account to Account by Bankers to Stockbrokers the margin of Security was constantly diminishing so that Bankers were calling for further Security and in fact were doing their utmost to reduce credits in this direction. Such a large number of Stockbrokers found themselves unable to meet the situation that eventually the Stock Exchange had to be closed.

On Thursday, 30th July, 1914, the Bank rate was raised from 3 per cent. to 4 per cent., and on the following day it was again raised to 8 per cent., while on Saturday, 1st August, 1914, it was further increased to 10 per cent. This heavy rate was not maintained for a very long period, but within a very short time, when the Government took the situation in hand, was reduced to 5 per cent.

The period at which the monetary crisis arose was very unfortunate, being just before the August Bank Holiday, when at normal times a large number of people are going away holiday-making, and it was therefore natural that large holiday withdrawals should be made; and a number of the Joint Stock Banks, having regard to the position they were in, paid out, as they were entitled to do, in Bank of England Notes. Many of the persons receiving these Notes either did not realise that these were Legal Tender anywhere in England, or else assumed that they would have difficulty in negotiating them in the country and at the seaside, with the result that they at once took them round to the Bank of England to turn them into gold, thus giving London the unusual sight on Friday, 31st July, and Saturday, 1st of August, of a large queue lined up in Threadneedle Street patiently waiting to get into the Bank of England to change their Notes. This had a bad effect on the public mind, and possibly caused excessive demand on all the Banks.

The Joint Stock Banks also found it necessary to restrict the granting of Credits, and to call in money from any source which was available; and they were largely compelled to this course by reason of the fact that where in normal times they could sell their own Investments, or if Borrowers did not meet their obligations could sell Collateral Securities, the closing of the Stock Exchange made practically all Investments and Collateral Security unsaleable.

In common with the Accepting Houses the Joint Stock Banks were committed to heavy liabilities on Bills which they had accepted for customers, and for the sake of their own Credit they were bound to meet these Bills; but the restriction on Credit which all the Banks adopted, and the difficulty that Foreign Debtors had to make remittances, caused many persons for whose accounts such Bills were accepted to fail on their part to provide the necessary Funds, so that the closing of the Stock Exchange had undoubtedly put the Joint Stock Banks into a very difficult position.

The Foreign Exchanges generally were in favour of London, so much so that Bills on London were at a high premium, or were not to be had at all. The only exception was Paris, where the rate of Exchange fell to 24.50 in consequence of the French Bankers throwing on the Market large quantities of Bills on London in order to draw Gold into France.

In spite of the Exchanges being generally favourable to this country, however, it was realised that Foreign Debtors would very largely fail in making remittances, and that the stability of the Banks would be in danger unless special measures were taken. The result was that the Government extended the Bank Holiday to four days.

Had a paper currency been available of lower denomination than £5 the crisis could probably have been met by the suspension of the Bank Act, but there can be no doubt that for ordinary purposes the smallest Bank of England Note is too high in value to make it an effective medium of exchange for all purposes.

§ 2. CURRENCY NOTES.

During the Extended Bank Holidays, Parliament, by passing the Currency and Bank Notes Act, 1914, gave power :—

- (1) To the Treasury to create an Emergency Currency by the issue of £1 and 10/- notes.
- (2) To the Bank of England to Suspend the Bank Act, 1844, but as the need of additional Currency was met by the new Treasury Notes, there proved no need to take advantage of the suspension.

At the same time Postal Orders were declared Legal Tender to any amount, and met an urgent need for small change. This provision was withdrawn when the Treasury Notes had passed into circulation.

These Notes were mainly designed to relieve Bankers from any shortage of cash and to maintain the gold reserve of the Country from depletion, which might ensue as a consequence of the demand for money on that part of the population alarmed at the prospect of war. They were made legal tender in the United Kingdom for the payment of any amount, and it was provided by the Act that the holder of any note should be entitled to gold coin to its face value in exchange for it on demand at the Bank of England during Office hours.

Arrangements were made by the Act for these Notes to be issued to Bankers up to an amount not exceeding 20 per cent. of their liabilities to customers on deposit and current accounts. To safeguard the Treasury from loss it was provided any issue so made was to be regarded as a floating charge on the assets of the Bank to whom they were issued,

such charge to be in priority to any other charge of any kind whatsoever. No registration of the charge was necessary as the Act gave the necessary power. The amount of the notes issued to any Bank was treated as an advance and bore interest from day to day at the current bank rate. Banks were entitled to repay the whole or part of such advance at any time, with a right to re-issue if necessary, provided that the limit specified was not exceeded. It will thus be seen that the first issue of notes was really an addition to the cash resources of the Banks, to enable them to avoid the necessity of realising securities to meet an abnormal demand for money, or of drawing on their deposits with the Bank of England, which would affect the Reserve of the Banking Department of that institution.

Any repayments of advances received by the Bank of England on behalf of the Treasury were to be applied at once to cancelling any currency notes which had been returned from circulation, and were in the hands of the Bank of England—or if the amount so received exceeded the notes then held for cancellation, the surplus was to be placed to the credit of a separate account in the Books of the Bank of England and applied to cancel notes as they came into their possession.

The Treasury was given the power to call in any issue in exchange for gold, but owing to their crudeness and the ease with which they might be forged, the first issue was regarded with suspicion, and it became necessary to withdraw them for others of a better type, and before this could be done power had to be given to the Treasury to effect a change, since the original Act only gave the right to exchange for gold. This power was conferred by the Currency and Bank Notes (Amendment) Act, 1914. By the same Act the Treasury were empowered to issue Certificates to Bankers entitling them to Currency Notes on demand to the amount enumerated in the Certificate. These Certificates were thus really Certificates of Credit, so that the Bank could operate on the basis of these notes, without actually using them, unless emergency arose.

In Scotland and Ireland the notes were not issued to the General Public, though some are naturally in active circulation, but were used in conjunction with the Certificates as cover for their own Notes by the Banks of Issue in those Countries, thus enabling them to put into circulation additional Notes to the amount of Currency Notes issued to them.

A return of Currency Notes is published in the "London Gazette," as well as those of Edinburgh and Dublin on Friday of each week.

The following is a copy of the return published on 2nd January, 1920 :

CURRENCY NOTES.

(4 and 5 Geo. V. cc. 14 and 72.)

1. ISSUE ACCOUNT.

	£	s.	d.
Totals issued up to 24th Dec., 1919..			
£1 Notes	1,073,247,978	0	0
10/- Notes	326,974,999	10	0
Currency Notes Certificates ..	102,390,000	0	0
Issued during the week ended 31st Dec.			
1919. £1 Notes	3,184,842	0	0
10/- Notes	718,353	10	0
Currency Notes Certificates ..	2,500,000	0	0
	£1,509,016,173	0	0

	£	s.	d.
Total cancelled up to 24th Dec., 1919			
£1 Notes	795,622,666	0	0
10/- Notes	280,389,654	0	0
Currency Notes Certificates ..	68,370,000	0	0
Cancelled during the week ended 31st			
Dec., 1919. £1 Notes	5,681,613	0	0
10/- Notes	1,100,218	0	0
Currency Notes Certificates ..	1,700,000	0	0
	1,152,864,151	0	0
Outstanding—			
£1 Notes ..	275,128,541	0	0
10/- Notes ..	46,203,481	0	0
Currency Notes			
Certificates..	34,820,000	0	0
	356,152,022	0	0
	£1,509,016,173	0	0

2. BALANCE SHEET.

	£	s.	d.
Notes Outstanding	321,332,022	0	0
Certificates Outstanding	34,820,000	0	0
Investments Reserve A/c.	17,182,526	0	0
	<hr/>		
	£373,334,548	0	0
	<hr/>		

ADVANCES—

	£	s.	d.
Scottish and Irish Banks of Issue ..	<hr/>		
Other Banks	250,000	0	0
Post Office Savings Bank	<hr/>		
Trustee Savings Banks	245,000	0	0
CURRENCY NOTE REDEMPTION A/c.—			
Gold Coin and Bullion	28,500,000	0	0
Bank of England Notes	4,000,000	0	0
Government Securities	337,536,760	0	0
Balance at the Bank of England ..	2,802,788	0	0
	<hr/>		
	£373,334,548	0	0
	<hr/>		

Treasury Chambers, 2nd Jan., 1920.

N. F. WARREN FISHER, *Secretary for the Treasury.*

The first part of this return needs no comment, for it is a simple statement showing the total notes issued, those cancelled and those still in circulation, while the second part shows how the note issue is accounted for. It will be observed that the total advances to Banks of all kinds outstanding is £495,000, a satisfactorily small amount when the size of the issue is considered. The Currency Note Redemption Account is interesting in so far that it shows that there is only some £35,302,788 (*i.e.*, Gold Coin and Bullion, Bank of England Notes and Balance at Bank of England) to meet a total issue of £356,152,022, the Balance being made up of Government Securities, against which an investment Reserve of £17,182,526 has been created. This amount of notes issued against Government Securities represents a fiduciary issue and corresponds roughly to the inflation of our currency at the present time as the following comparison shows. The amounts at 30th June, 1914, have been estimated by Lord Cunliffe's Committee as follows :—

Fiduciary Issue of the Bank of England	18,450,000
Bank of England notes issued against Gold coin and Bullion	38,476,000
Estimated amount of Gold coin held by Banks (excluding gold coin held in the Issue Department of the Bank of England) and in public circulation ..	123,000,000
Grand Total ..	<u>£179,926,000</u>

On the 31st Dec., 1919, they were as follows :—

Fiduciary Issue of Bank of England	18,450,000
Currency Notes not covered by Gold	323,652,022
Total Fiduciary issue ..	<u>£342,102,022</u>

Bank of England Notes issued against Gold coin and Bullion	90,298,260
Currency Notes covered by Gold	28,500,000
Amount of Gold coin held by Banks (excluding the Issue Dept. of the Bank of England) estimated by Lord Cunliffe's Committee at	40,000,000
Grand Total ..	<u>£500,900,282</u>

An increase of £320,974,282.

The increase in the circulation in the Currency Notes is shown clearly in the following statement extracted from the latest official return :—

1914	1915	1916	1917	1918
£38,478,000	£103,125,000	£150,144,000	£212,782,000	£323,241,000

By notes in circulation is meant that this amount has been issued by the Treasury and is still outstanding; but those in the hands of the General Public would amount to a much lower sum, since the Banks would hold large amounts as part of their Cash Reserve.

It is interesting to note that Lord Cunliffe's Committee have reported as follows :—

“The issue of fiduciary notes should, as soon as practicable, once more be limited by law, and the present arrangements under which deposits at the Bank of England may be exchanged for Legal Tender Currency without affecting the reserve of the Banking Department should be terminated at the earliest possible moment.”

§ 3. THE GOLD COINAGE.

As is mentioned previously, Treasury Notes are exchangeable for gold on presentation during Office hours at the Bank of England, but they have been everywhere accepted in place of gold, and demand for the gold metallic currency seems to have disappeared, there being none in active circulation.

Lord Cunliffe's Committee reported that “While the obligation to pay gold on demand should be maintained, it is not necessary or desirable that there should be any early resumption of the internal circulation of Gold coin.”

This conclusion is very important in view of the fact that gold to-day stands at a premium—being quoted 116/- per oz. fine on January 26th, 1920. Before the war the price of gold was £3 17s. 10½d. per oz. Standard (equivalent to £4 5s. per oz. fine), and our gold coins have been minted on this basis. If, therefore, sovereigns were released for general internal circulation at the present time, we should find two prices ruling, a “paper price” and a “gold price,” as otherwise the sovereign would entirely disappear, being either melted down and the gold sold for the paper price, or else being hoarded, since it is more valuable than the £1 note.

The underlying principle is that first enunciated by Sir Thomas Gresham in the reign of Queen Elizabeth, and since known as “Gresham's Law.” This stipulates that when two mediums of currency are in circulation together at a fixed ratio of exchange with one another, then if one be undervalued in the terms of the other, this undervalued medium

will tend to disappear from circulation. If the £1 Treasury Note and the sovereign were circulated as equal in value while gold was at a premium then the sovereign is undervalued in the terms of Treasury Notes, and people will pay in the currency which has the lesser value.

When we say that gold stands at a premium it must be remembered that it means we have to pay more £1 notes for an ounce of it; and though gold has increased in price by the operation of the law of supply and demand owing to a decrease in production, yet the increase is largely an increase in the "paper price." Some economists therefore state that the "paper currency" has depreciated, in preference to saying that gold has moved to a premium.

§ 4. INFLATED CURRENCY AND PRICES.

It is interesting to note the connection between an inflated currency and the prices of commodities.

In 1914 the total amount of currency in circulation was	128,000,000
---	-------------

In addition to which the Bank Deposits (excluding the Bank of England) amounted to ..	1,070,000,000
---	---------------

Estimated spending power of the Public in 1914	<u>£1,198,000,000</u>
--	-----------------------

At the beginning of 1920 the money in circulation was estimated at	393,000,000
--	-------------

And the Bank Deposits (excluding the Bank of England) at	2,300,000,000
--	---------------

Estimated spending power of the Public in 1920	<u>£2,693,000,000</u>
--	-----------------------

It will be seen that there is a very large increase in the spending power possessed by the public in the early part of 1920 as compared with the year 1914, and this expansion is very largely due to the creation of Bank Credits which became necessary in order to finance the operations of the war. Subscriptions to War Loan by the Banks, advances against War Loans by the Banks, and Government borrowing have all tended to inflate Bank Deposits. The bulk of the expenditure was not incurred in the creation of wealth, but was very largely expenditure on Munitions and in payment of services diverted from production to the War.

The period of the War having diverted the energies of the country from the production of wealth meant that when the War came to an

and the stock of commodities necessary to supply the wants of mankind were very considerably depleted ; so that quite apart from any question of payment the supply of these commodities was seriously reduced, and this state of affairs prevailed not only in England but practically in all countries.

The high prices ruling for commodities at the beginning of 1920 is, therefore, largely attributable to two things ; firstly, the depleted stocks of commodities creating a deficient supply, and secondly, the increased spending power in the hands of the public creating an abnormal demand. Although to a certain extent prices have been, and are controlled by Governments, yet in the main they are controlled by the law of demand and supply.

Prices therefore tend to rise by reason of an inflated currency, in consequence of the increased spending power which it supplies without any corresponding increase in production.

§ 5. THE DOLLAR SECURITIES COMMITTEE.

At the outbreak of the war the Exchanges showed abnormal fluctuations, and this was particularly true of those on New York, for at the time the indebtedness of America to Europe was estimated at about \$250,000,000, an indebtedness which would have been largely adjusted by the shipment of the harvest produce. Owing to the uncertainty of events shipping was disorganised, and the cable rate on London quoted in New York rose from a normal of \$4.86 to \$5.00, and ultimately to \$7.00 to the £ sterling, the specie points being inoperative owing to the enormous risk attending the shipment of gold.

Arrangements were promptly made by the American Government to adjust the Exchanges, and a special loan of \$182,000,000 was raised. Of this amount \$82,000,000 was applied to meeting New York's indebtedness to Europe, and \$100,000,000 to steady the exchanges. The gold was by arrangement with the Bank of England sent to Ottawa at an exchange rate of \$4.90 to the £ ; and this was equivalent to a large credit in London. The effect was marked, for the rate on London steadily fell till the end of 1914, when the official quotation was \$4.86½. The "Mint Par of Exchange" between London and New York is \$4.86½. As a consequence of the purchases of War material, etc., from the United States the rate moved against England during the first half of the year 1915. In March the Cable rate on New York was quoted in London round \$4.80, and by July had receded to \$4.77, and was still falling, the lowest point reached during this year being \$4.51. In July, 1915, the Treasury first took steps to rehabilitate the exchanges on New York

by instructing the Bank of England to purchase American Dollar Securities in this country for sale in New York, and by the end of 1915 such securities to the nominal amount of \$233,000,000 had been dealt with, and exchanges had shown an upward tendency from the end of October.

In December of the same year steps were taken to extend this procedure; and first Insurance and Trust Companies, and subsequently the General Public, were invited by the Treasury to submit lists of American Dollar Securities they were willing to sell or loan to the Government.

The following were the main terms of the scheme adopted (afterwards known as Scheme "A") :—

1. *Purchase.* The Treasury undertook to purchase suitable securities at prices based on the current New York quotations, the sterling price to be paid at the exchange rate of the day. Where no reliable quotation was obtainable the price was to be fixed by agreement. (An option was given to the vendor to take 5 per cent. Exchequer Bonds maturing in 1920, instead of Cash.)

2. *Deposit on Loan.* These were to be accepted by the Treasury for two years from the date of deposit. The interest on the holding would be paid to the Depositor, together with an additional payment of $\frac{1}{2}$ per cent. per annum on the nominal amount of the security. The securities were to be inscribed in a Special Treasury Register and transferable by Deed. The Treasury were to pay all the expenses incidental to the transfer of the securities into their name, while Treasury Certificates were to be issued to the Depositor and arrangements made for those certificates to be negotiable on the London Stock Exchange. Power was given to the Treasury to sell on behalf of depositors, and there was an option given to the Depositor of releasing the security deposited by payment of the dollar value in New York. In each case the understanding was that the equivalent value in sterling at the rate of Exchange of the day should be paid to the Depositor in London.

If the Treasury found it necessary they might sell the securities deposited on notifying the Depositor that they were taking over the security at a price calculated on the closing quotation in New York on that day, plus $2\frac{1}{2}$ per cent. on the amount so calculated. Payment was to be made in London in sterling at the exchange of the day but free of Brokerage and Commission.

A Committee was also appointed by the Chancellor of the Exchequer, under the Chairmanship of Sir Robert Chalmers, K.C.B., and consisting of the Deputy Governor of the Bank of England and two members

nominated by the Bankers' Clearing House and two nominated by the Committee of the London Stock Exchange, to administer the scheme.

The first portion of the scheme was put into operation in January, 1916, when a list of 54 selected securities was issued, the respective quotations at which they would be purchased by the Committee being based on the current New York price specially sent by cable the previous evening. Additional securities were listed from time to time, and by the 17th of March, 1916, the Committee was dealing in 256 different securities, and purchases to the value of £40,500,000 had been made, and it had been found advisable to use special Contract Notes for the dealings.

The deposit portion of the scheme came into operation on 24th March, 1916, when the Committee intimated their readiness to receive no fewer than 778 securities on deposit. The minimum amount of any one security acceptable for deposit was fixed at \$5,000.

Though a huge volume of business was transacted it was found by the Treasury in May, 1916, that the amounts purchased and loaned were insufficient, and steps were then taken to bring pressure on those unwilling to assist the Government. This was done by the passing of a resolution by the House of Commons which was embodied in Sec. 27 of the Finance Act, 1916, providing for a penal Income Tax of 2/- in the £ on such securities as the Treasury specified its willingness to purchase, and which were not placed at its disposal either by sale or deposit. Provision was, of course, made for relief from this Special taxation where failure to place the securities at the disposal of the Treasury was unavoidable, or in which the holders were not domiciled in the United Kingdom. This special tax remained operative until 6th April, 1919, and its effect was very marked; for by 12th August, 1916, the aggregate purchases of the Committee were £109,228,000, while securities valued by the Committee at £83,614,000 had been deposited.

On 16th June, 1916, the Deposit Scheme was extended to holders of smaller denominations than £5,000, the previous minimum. These small holdings were to be deposited through approved agents, such as Bankers and Stockbrokers (of whom 283 were appointed). The agents were to aggregate the deposits and deposit them with the Treasury in their own name—but were to keep a sub-register and undertake the distribution of the interest and additional remuneration.

In August of the same year a new deposit scheme was instituted. This was known as Scheme "B," and followed the same lines as the previous scheme, with two important exceptions:—

- (1) The duration of the deposit was to be five years from 31st March, 1917, but the Treasury reserved the right to return the securities at any time after 31st March, 1919, on giving three months' notice to the depositor.
- (2) The Treasury might sell the securities, but would continue the payment of the interest and additional allowance until the end of the period of deposit, when similar securities were to be returned, failing which the depositor was entitled to payment of the "Deposit value" (calculated according to rules laid down in the Scheme) plus 5 per cent. on that value; or the price actually realised, whichever was the greater.

Depositors under the original Scheme were given the option of transferring to the new Scheme, and a large number did so. The new Scheme applied to the same securities as before as well as to additional ones then specified.

The securities deposited with the Treasury were used as security for credit opened in New York, and in October, 1916, the Treasury were notified that it was desirable that a certain amount of British Railways Debenture Stock should be lodged as part of the Security for a new loan then about to be floated in the United States. As the amount required was limited, a private invitation to deposit their holdings was issued by the Committee to a few large holders of such Stocks, mainly Insurance Companies. The terms of deposit under Scheme "B" were varied by the fact that the additional interest allowed was 10 per cent. of the annual rate paid on such securities instead of half per cent. per annum on the nominal value. Stocks to the nominal value of £17,500,000 were deposited under this scheme.

In January, 1917, the Defence of the Realm (Securities) Regulations, Nos. 7c, 7d and 7e, came into force, and these gave the Treasury power to acquire securities, and placed restrictions on the disposal of such securities. While securities might still be deposited, they were subject to any orders that the Treasury might issue. The first notice under these Regulations was issued on the 30th January, and specified the conditions on which securities could be sold abroad, and gave the Dollar Securities Committee the duty of issuing the permits necessary.

On 17th February, 1917, the Treasury exercised their power under Regulation 7c, and required all persons owning or having the custody of certain specified securities to deliver them to the Dollar Securities Committee on or before 17th March, 1917, at prices specified in the order, thus, in effect, making such securities, with all rights, the property of the Treasury as on the date of the order. Certain exceptions were allowed, among them being one in respect of securities tendered for deposit prior to 26th January, 1917.

In May, 1917, the acceptance of securities on deposit was discontinued, except in the case of those securities specified as subject to the additional Income Tax of 2/- in the £. The purchase of securities, however, continued.

During 1917 the activities of the Committee was somewhat extended by the necessity for maintaining the Dutch and Scandinavian exchanges, but the operations were comparatively small.

Scheme "B" was closed on the 1st March, 1918—but securities which were subject to the additional Income Tax, *and which had not been requisitioned* by the Treasury, were still accepted for a period to expire on the 31st March, 1922, on the terms of Scheme "A," but the Treasury reserved the right to return them at any time by giving three months' notice.

In March, 1918, the term of deposit of securities loaned to the Treasury under Scheme "A" began to end, and it was deemed desirable to offer to extend the time to that which applied under Scheme "B," and most depositors were agreeable, it being only necessary to return securities to the nominal value of \$476,270.

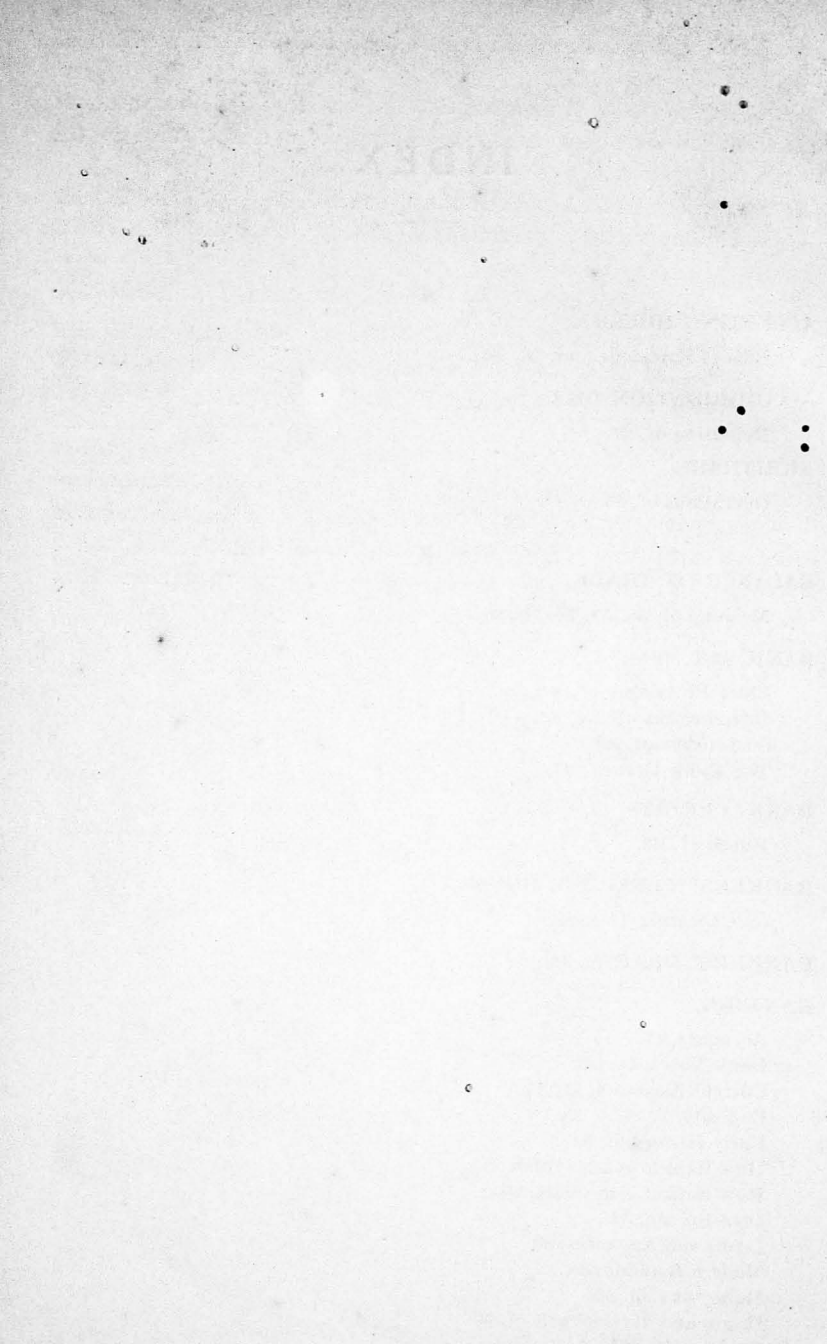
On 2nd January, 1919, the prohibition on the sale of securities abroad was removed, and at the same time the purchase of securities ceased, except in respect of those securities for which requisition orders had been made or those which were already on deposit, and purchases of these finally ceased on 28th April, 1919.

The Treasury having given the requisite notice commenced to return the securities loaned to them on the 1st April, 1919.

During the period of their activity the Committee dealt with no fewer than 2,027 different securities, and their values were calculated by the Committee to be as follows :—

Securities purchased by Bank of England in 1915	..	£46,600,396
Securities purchased by Committee	.. ..	170,044,000
		<hr/>
Total purchased	..	216,644,396
Securities on deposit 31st March, 1919..	.. ..	405,951,189
Securities on deposit sold to Treasury	.. ..	24,360,000
Special deposit of the Canadian Pacific Railway Co.	..	8,000,000
		<hr/>
Grand Total	..	<u>£654,955,585</u>

So successful were the operations of the Committee that the exchange with New York was subject to comparatively little fluctuation, and a practically uniform rate of $\$4.76\frac{7}{8}$ to the £ was maintained until 31st March, 1919, when the control was removed.



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