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By George E. Roberts

When we speak of foreign exchange we mean the relation between our money and the money of other countries and the cost of converting a sum in our money or bank credit into foreign money or bank credit, or the reverse. If I have $1,000 in a New York bank, what can I get for it in terms of a bank deposit in London, Paris, Berlin, Madrid, Genoa, Bombay, Yokohama, Buenos Aires or wherever I may want to use it? Or, if somebody sends me a cheque or draft on a bank in one of those cities, what can I get for it in dollars here in New York, assuming, of course, that the bank on which it is drawn is good and will pay it on presentation.

There are two principal factors in it: first, the relation of the currencies to a common standard of value and, second, the state of trade between the countries. Before the outbreak of the great war, by a gradual process of evolution, nearly all the important nations had brought their currencies into fixed relations to the gold standard. The dollar of the United States meant the value of 23.22 grains of fine gold, the pound sterling of Great Britain meant the value of 113 grains of gold, and so the franc of France, the mark of Germany, the guilder of Holland, the crown of Austria- Hungary, the ruble of Russia, the yen of Japan—each meant the value of a certain number of grains of gold; and you could ship the coins of any of these countries to any other country having the gold standard and have them re-coined into the money of that country. By reason of their fixed relations to the grain of gold they were in fixed relation to each other, subject to the cost of transportation and recoinage, which was very small. The equivalent of the gold sovereign in United States

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money, based on the gold contents, was $4.8665, and before the war, whenever exchange charges either way would vary from that by more than two cents, gold would begin to move.

On the other hand, China has been a silver standard country, and the rates of exchange between China and the gold standard countries have fluctuated with the gold value of silver bullion. At the outbreak of the war silver was worth about 55 cents an ounce and silver is worth now about $1.30 an ounce. So if you have a payment to make in Chinese taels, which means a certain weight of silver, the exchange of dollars into taels takes more than twice as many dollars as before the war.

Of course, when the European countries, after the outbreak of the war, began to issue paper money in excess of their ability to redeem it in gold, their currencies lost their fixed relations to the gold standard and became depreciated; and the depreciation entered into exchange rates.

That relationship of currencies to each other through their relationship to a common standard is one factor in exchange rates.

Then there is the effect of the state of trade. Distance and trade relations may be a factor in exchange rates even within one country and under the same monetary system, but exchange charges under such conditions are usually small.

Before coming to a study of the foreign trade situation I think it may be well to illustrate it first by a situation within our own country, where no conversion from one currency into another is necessary.

Let us suppose that the state of Oklahoma, by reason of a prolonged drought, has a crop failure. It has very little to sell and with which to offset the purchases which it must make in the outside markets. It buys nearly all its merchandise from outside and usually pays largely by means of its crops. Oklahoma will have a state of unbalanced trade. The burden of making the settlements falls first on the bankers. The merchant will come to his banker and say: "I have to carry a great many of my customers over until they make another crop. I have sold them my goods, and I have to sell them more goods in the meantime, but I can't get any pay and you will have to help me pay my bills in the east, and help me carry this load." The banker will lend to the merchant, and draw down his balances with his correspondent banks outside as low as he dares. Then if he has any municipal or railroad bonds which are marketable in the eastern markets he will sell them, to replenish his balances. And then he will present the case to his correspondent banks and borrow to replenish his balances. And the merchant, having got as much from his banker as he can, will fall back on the jobbers or manufacturers of whom he buys, and obtain extensions from them, and the merchant and banker will go to their customers, and, if possible, get them to give mortgages which can be sold outside and thus create credits and help to correct the unbalanced state of trade.

Here you see is no question of currency nor an exchange of one currency into another. It is wholly a question of getting credit to balance an unbalanced state of trade, and the conditions are much the same as in the relations between the European countries and the United States at this time. In both cases there is a necessity for credit. In the case of Europe it shows itself in the exchange rates. The high rates of exchange are something more than a charge for transmission or collection. They amount to a bid or charge for credit. In the case of Oklahoma the demand for credit does not figure in the exchange rates. The money is the same, the relations are much more intimate and it is plain borrowing.

Now, turn from the case of Oklahoma, as I have supposed it, to the case of Canada. The United States sold to Canada last year about $700,000,000 worth of products, and Canada sold to this country about $400,000,000. There is another case of unbalanced trade, not due to crop failure, but there is the same kind of a situation to consider. The sales of Canadian products in this country created only about one-half enough credits to offset the Canadian purchases. The Canadian banks could draw drafts up to $400,000,000, and then their balances would be exhausted, unless they were replenished by some other means. If the Canadian banks had gold that they could spare they might ship it to New York and draw against it, but they have had no gold to spare. The total gold reserves of Canada are only about $200,-

000,000, and in the present state of the exchanges they might all be drained away, so the government has maintained an embargo on gold exports since the beginning of the war.

If it was known that this trade balance was only temporary, if it was of a seasonal character, running one way part of the year and the other way in the rest of the year, the Canadian bankers might borrow in this country to tide over the situation; but they don't know that. Exchange between this country and Canada is very closely involved with exchange between New York and London, so the Canadian banks dare not borrow heavily for settlement purposes. The situation is too unsettled and runs into too much money.

Here is a situation where our old friend the law of supply and demand comes into play. There is a demand in Canada for more credits in the United States than are normally supplied, competition results and exchange goes to a premium. In Montreal, Toronto and other Canadian cities exchange on New York is commanding a premium of 5 to 6 per cent. Now see what that does: it offers an inducement for the creation of New York exchange. It is an open offer to anybody to come forward and furnish credits in New York for Canadian use. Anyone who will borrow in New York can sell the credit in Canada at a premium of 5 per cent, or if a Canadian holds bonds or stocks that are salable in the American market he may sell them, take his pay in a cheque on a bank in one of our centers and sell the cheque to a Canadian bank at a premium. Again, Canadian merchants may obtain credit from jobbers and manufacturers in this country or may induce them to take their pay in Canada. One way and another, by transactions like these, that $400,000,000 trade balance has been settled or adjusted for the time being. American manufacturers have millions of dollars of deposits in Canadian banks received by their Canadian agencies in payment for goods, which they are leaving there hoping for a more favorable time to bring them home. The treasurer of a prominent firm of farm implement manufacturers told me recently that they had over $2,000,000 in Canadian banks, accumulated in that way.

I want to emphasize that these exchange charges are not made arbitrarily by bankers. They are not charges for the benefit of bankers and they are not under the control of bankers. A banker has to buy practically all the foreign exchange he sells and pay the market price for it, just as a merchant has to buy goods to meet the wants of his customers. Furthermore, it is only by offering a premium, or, in other words, by paying for the service, that people can be induced to come forward and create exchange under abnormal conditions and to meet special demands.

The exchange situation between this country and Europe is very much more acute than between this country and Canada. In the first place the trade is more unbalanced; the balances are larger in proportion to the volume of trade; and, again, the relations between this country and Canada, between the buyers and sellers who are dealing with each other, are closer, and it is easier to accomplish the various shifts by which settlements are made or postponed. Furthermore, the relations, business and financial, between the United States and England are closer than between the United States and the continent, and the relations between London and New York are not so bad as between New York and the cities of the continent, but they are well-nigh desperate in any case.

The European countries have need to buy more of us than in normal times, and they have neither gold nor goods to pay. Their industries are disorganized, and many of them are in need of raw materials which they can get nowhere except of us. And so we have seen the European exchanges sinking lower and lower from month to month; or, if you will turn the situation around and see it from the European standpoint, American exchange has been rising higher and higher, until it has become almost prohibitive.

It is no secret that the food administration of the British government is buying wheat and other foodstuffs in this country now and selling drafts on the British treasury at current rates to obtain the means of payment. There is no question about the payment of these pounds sterling in London—the discount is all because of the difficulty of finding someone who wants to use pounds sterling in London, and London is the most cosmopolitan market for commodities and investments in the world. The British people hold investments all around the world. You can buy securities representing nitrate companies in Chili, railroads in Argentina, railroads and public utilities in Brazil and investments all over South America, in Canada and elsewhere, and use a London credit for that purpose. You can buy any security on the London market at more than 25 per cent discount from the price which the seller gets for it, by making the purchase from the United States by the use of sterling exchange. This is an extraordinary situation. It is not because the credit of Great Britain is broken down; for, if desired, the credit can be converted immediately into investments in countries that have not been in the war. It is partly that our people are not accustomed to foreign investments, and largely because there seems to be so much use for money at home.

The cotton mills of Lancashire are running upon cotton which is going forward from this country, bought with sterling exchange yesterday at about $3.75. And when you turn the situation around and consider the discount on sterling as a premium on the dollar it amounts to about 33⅓ per cent.

And if the situation with England is bad, that with France is worse. The premium on New York exchange in Paris is about 130 per cent. We think prices are high in this country; but how can the French people pay these prices, and in addition a premium of 100 per cent upon New York exchange, and then pay the abnormal ocean transportation charges besides?

And in the case of Italy the situation is still worse. Italy is without coal, iron, copper, cotton or oil. She produces none of these common necessaries, and this is almost the only country where she can get them. How can she do without them? And how can she afford to buy them at such cost? Before the war both Italy and France imported coal from England, but under labor troubles there production has fallen off until England has almost none to spare. We had word the other day that 3,500 factories using electric power in Paris and vicinity were shut down for want of coal. The coal strike in this country probably has put an end to coal exports even if credits were arranged.

Cotton mills are idle to-day in Italy, France, Belgium, Germany, Poland, Bohemia and Austria, and the skilled operatives are idle and supported by unemployment doles, because they cannot finance the purchase of cotton—and our supply of cotton is the largest in years and far beyond the capacity of our mills to work up. Our own consumption of cotton this year is behind that of last year.

A financial committee has been in this country for months from Czecho-Slovakia, trying to get a loan of $25,000,000 or $30,000,000 to be expended here for cotton and other raw materials. They have been able to get about $5,000,000. There are commissions or representatives here from nearly every country on the continent upon the same mission, and I don't believe any American can hear their pathetic pleas without wishing every citizen of rich and prosperous America might hear them.

The dislocation of exchange is approaching an actual breakdown of international trade relations. The lower these exchanges go the greater the offerings have to be to make the same purchases. They are giving up what is real wealth, and the point is being approached when it is scarcely conceivable that purchases can go on.

The situation gives one a painful feeling of the incapacity or ineffectiveness of the social organization. It is due to a want of co-ordination and unity in the world society, as most of our troubles are. Modern, highly organized society has never known such a state of helplessness. Europe is thrown back into primitive conditions with a population which cannot be supported under primitive conditions. They must have supplies of food and raw materials for their industries from outside themselves or all European society is in danger of going into chaos. Mr. Hoover has estimated that 100,000,000 people in Europe west of Russia must be fed from outside that territory or they will die. That is not so extraordinary a statement when you understand that even in normal times before the war 70,000,000 people west of Russia had to obtain their food from Russia and outside of Europe, but in normal times they paid for this food by means of the exports which were normally flowing out. Now the food imports must be larger and there are fewer exports to meet them.

This is one of the great crises of the world's history, and the hopes of Europe naturally center in the United States. The war touched the United States but lightly as compared with Europe.

We prospered through it, in spite of it, and to some extent by means of it. We are richer as a people than when the war bgan, with greater productive capacity. The wealth-producing capacity of the United States is from one-third to one-half that of all the world. In capacity to produce steel and iron, labor-saving machinery and all kinds of industrial equipment, this country is practically equal to all the rest of the world put together. And so it is of supplies of some important raw materials. We have the resources and the ability to increase the production of those things as no other country can.

We have what Europe needs, and what she can get practically nowhere else. At any rate she can get relief promptly nowhere else, and she needs it promptly. Furthermore, we have the financial resources for providing the relief. We went into the war a debtor country and came out a creditor country. We have bought back in large part the American securities formerly owned in Europe, and bought them at very low prices by selling war supplies and foodstuffs at very high prices. And the fact that they have sold their American securities makes them more helpless in their present situation for they have denuded themselves of their liquid assets.

Now that is the situation and the relation in which Europe and America stand to each other to-day. But desperate as the situation may appear on the surface, Europe is by no means unworthy of credit. The chief risk, and I would say the only risk, in extending credit to Europe is that of social disorder, that all governments may be submerged, all obligations dishonored, and society thus lapse into utter and final ruin. But I have too much faith in mankind to believe that that will happen, especially if they have help to get on their feet and reorganize their industries and give employment to their people.

We say that Europe ought to get to work, but it is slow getting to work without tools or materials or credits.

The people of Europe have something to offer as a basis of credit. The soil of Europe, the natural resources, the industrial works and accumulated wealth of all kinds and, finally and most important of all, the population of Europe are abundant assets.

Industry and Skill Abroad

The people of Europe are industrious and skillful. They are a wealth-producing, thrifty people. Those countries are not bankrupt. It is true their indebtedness is large, but most of it is held by themselves and counts as assets as well as liabilities. No people ever went broke making payments to themselves. National indebtedness involves some problems of taxation, but where the payments of interest and principal are back to the residents and taxpayers of the same country, the problem is comparatively simple. The payment of indebtedness does not extinguish the capital transferred.

These people are not bankrupt simply because they cannot pay down on the nail. They are in the same position as farmers who have lost their crops, but still have their farms. The farmers have nothing to sell, and they have to buy seed and live somehow until they can raise another crop. Every country banker knows that there is an obligation upon him to be liberal with credits at such a time. There isn't a country merchant who doesn't know that he is interested in carrying his customers through and in supplying them with what they need to make the next crop.

The European situation is that of not having transportable wealth. They cannot ship their houses or lands or industrial works, their coal mines or forests or railways across the ocean, but they can send us securities based on these properties and pledging the income from them.

Now we have an interest in this situation on the business side. The industrial activity which has prevailed over this country this year has been largely due to the foreign demand for our products. Since the United States entered the war in 1917 the United States government has lent nearly $10,000,000,000 to foreign governments, nearly all of which has been expended in this country for the products of the soil and shops. It has made $2,000,000,000 of such loans since the armistice was signed. Our productive capacity has been expanded under this demand. In farm products the best authorities say that we have a surplus which, together with that of other exporting countries, is sufficient to meet the needs of Europe.

I know that some people argue that it would be better to have our exports fall off, for then prices would fall, but there is another side to that. If we lose rapidly not only our export business but one-fourth or one-half the buying power of the farming districts of this country, what will be the effect upon our industries generally.

I want to see prices come down, but I think the best way of accomplishing it is by getting people back to work all over the world and increasing production. That will be a gradual process, and industry will adjust itself to it in all branches together and it will be a return to normal conditions. It isn't going to reduce the price of cotton cloth anywhere to keep the cotton mills of Europe idle. The price of sugar is not going to come down until the sugar-producing industry of Europe is revived. We want to see the cost of living lowered by reason of an abundance of the necessaries of life for all people, rather than by a glut of products in this country while people are starving elsewhere. We can never get back to normal conditions in the market until normal production is restored.

There are two views to take of this situation. First, with consideration for our obligation as the richest and most powerful nation in the world, to come forward in this emergency and do our part to re-establish industry and order in Europe. And then there is the consideration from a business standpoint, having regard for our position as a creditor nation. It is a new position for us, but it involves certain obligations and responsibilities. A nation can no more hold a creditor position and not recognize those obligations than a bank can hold its deposits and recognize no obligation to make loans. What would you say of a rich man who in time of public calamity refused to use his wealth in any way, even for business purposes, for the relief of the situation? If we aspire to high position in international affairs, to leadership in world finance, we must have the vision and courage and public spirit to play the part.

We have come into this situation suddenly, as the result of the war. Great Britain and Germany grew into their great foreign trade gradually as the result of their foreign investments. We are confronted now with the questions: "Can we rise promptly to an appreciation of the situation? Can we develop a body of foreign investors? Are we willing to lend and lend and lend continually to support and develop our foreign trade? Will our investment market take up the offerings that will have to be made here in order to hold the exchange situation level?

The fact is that we have brought our industries to such a stage of development, and developed our wealth so far beyond that of other countries, that in the very nature of things it is now to our interest to be a lending nation to help to bring forward the backward nations.

There is a morality in the economic law, or, to put it differently, the economic law and the moral law are one. The fundamentals of universal law are never in conflict with each other. What is our duty to do it is also our interest to do.

There is an obligation upon us to assist in restoring industrial order in the devastated countries of Europe, to put these people back into their homes and workshops, to supply them with the means of becoming self-supporting and prosperous again; and it is to our interest to do so, because it will furnish employment to our industries.

Some people speak hopelessly about our ever recovering the amount of our loans to Europe. I do not feel so at all, but I think it is to our interest not to attempt to collect either principal or interest for some years to come. If the foreign governments were to attempt, under any such conditions as exist at present, to gather up exchange to pay the interest, it would send American exchange to a still higher premium and cut off our exports.

On the other hand, there are a few people who say that we ought to forgive and cancel the obligations which the United States government holds; but I do not think there is any occasion to do that. What we ought to do is to add the interest to the principal until these countries have recovered from the war, and lend them what further help we can to restore and increase their productive capacity. If we do that these debts will be of constantly diminishing importance. If development in industry is as great in the next thirty years as it was in the last thirty, these debts will be of relatively small importance.

The indebtedness of England at the close of the war with Napoleon was greater in proportion to the wealth of the country than her indebtedness of to-day, and she never did pay off that old debt, but by the development of steam power, by the improvements of her industries, she so increased her productive capacity that she was able to supply capital in the form of equipment for the building of railroads in America and for opening up other parts of the world, with the result that she opened up great markets and at the same time secured cheaper food for her people, and created the greatest era of prosperity ever known to England.

And so I expect these debts to be paid, not by grinding the people, not by taxation that will lower their productive powers, but by increasing the productive capacities of the people. They will be paid by the same kind of development that has been characteristic of industry in the last forty years.

I believe that before many years it will be possible to refund all these foreign debts in the open American market, so that they will be held by individual investors of all nations, and no longer be a matter of public concern.

I have made these remarks without reference to any movement now pending to provide credits. I am sorry to say that at the moment no organized movement is under way. Early in the summer a movement was started by New York and Chicago bankers to form a nation-wide organization for this purpose, but it soon developed that the reasons for the movement were not understood and that the motives behind it were questioned. It could not possibly be a success under such conditions, and so it has been held up. The feeling among bankers has been that the administration at Washington should take the lead, at least in impressing upon the country the fact that it is a matter of national concern. There is no doubt that the officers of the government recognize the importance of providing credits for Europe, but the situation at Washington has been complex and not favorable for action.

It is not desirable that the government should continue to make foreign loans. It would have to offer its own obligations on the market to provide the means, and it would not want to sell its bonds at rates above those carried by the issues outstanding. The public cannot be expected to lend to Europe upon that basis. The rate should not be excessive, but it should be fair to lenders in view of present conditions. The important thing to Europe is to have the credits provided.

The Edge Bill

The Edge bill, which is now pending, will authorize the establishment of banking corporations with a capital of $2,000,000 or more, which may issue debentures against foreign obligations in their hands. If the bill becomes a law such corporations may be organized in numerous localities to raise capital to finance the trade of those localities, or they may be organized by different lines of industry to finance their exports. The measure undoubtedly provides the means by which much foreign financing may be done. The only question about it is whether such division of efforts will accomplish as large results as a concentration of effort upon the sale of one security in all parts of the country.

All who understand the conditions upon which credits must be granted realize that they must run longer than the term of ordinary commercial credits, and that therefore they cannot be carried by the commercial banks or the federal reserve banks. The commercial banks are under obligations to keep themselves liquid to meet the current commercial demands upon them. The federal reserve banks have no authority under the law to extend such credits, which confessedly are not self-liquidating. They must be placed in the hands of investors who will take them and pay for them out of savings.

The most serious feature of the situation is in the condition of the investment market in this country. It is overloaded with offerings; our own government bonds are lower than during the war; and the entire security list is at a level which shows a want of buying power. The foreign government issues that have been brought out here since the armistice are all selling below the level at which they were issued. The taxation upon business profits is so heavy that purchasing power in that quarter is impaired, while the hopes of a new army of bond-buyers, which were raised during the war, seem to have vanished in the wild carnival of spending which has been raging since the armistice was signed. In the face of a world situation which calls for the most strenuous efforts to increase production and the most resolute personal economy to help make good the inevitable shortage, we have a general relaxation of effort either to produce or to save, due, we must believe, to failure to appreciate the gravity of the situation. Our people say that they have no money to put into foreign securities, but if our foreign trades cease abruptly the people may then discover that they might have bought the foreign securities and by sustaining our export trade have had more money for other uses and have preserved better social conditions at home while rendering help that was vital to Europe.