will buy only 1 ounce of gold, the par of exchange between the two countries will follow the course of that depreciation.

The course of the exchanges of India has been much affected of late years by the depreciation of silver, and so also those of all silver-paying countries. The drawer of a bill sterling on London in Calcutta or Bombay is literally selling gold for silver, and, whatever the more ordinary par may have been, is bound to take into account the market value of silver. In 1876, owing to the large quantity of demonetized German silver thrown upon the market, less directly to a pre-existing cause, namely, the large extent to which silver had been cast out even of the fractional currency of countries largely committed to inconvertible paper, and also to exaggerated reports of abundant increase of production in the American mines, silver fell to 47d. an ounce—about the lowest point reached in its relation to gold, and a great reduction from what had long been its par value of 5s. 2d. an ounce. The consequence was that the Indian rate of exchange declined to 1s. 6½d. per rupee in six months' sight bills on London, or, in other words, that the rupee, having an accustomed par value of near 2s., was worth only 1s. 6½d. sterling, *minus* say seven months' interest accruing between the date and the maturity of the bill. It is difficult, or rather impossible, as foreign bills are negotiated, to distinguish the respective force of the various causes operating on the rate of exchange. In the case of India nearly all the constituents of exchange are adverse to the value of the rupee, save that of rate of interest, which is higher in Calcutta or Bombay than in London. The Indian drawer of a six months' bill on London would lose more by holding the bill till its maturity than the buyer of the bill who remits it to London for acceptance and discount; and some middle term must be struck between them, according as the rates of interest in India and England vary. But, on the other hand, India is a country where the imports always exceed the exports, where foreign capital in many forms has been largely invested and has to render its annual tribute, and where the financial relations of the Government of India and the Government of England are such that the latter has to draw periodically a considerable amount of bills on the Indian treasuries; so that, whatever the par of gold and silver might be, the supply of bills on London would always be less than the demand, or, in other words, the Indian creditors have some advantage over the Indian debtors of London in the rate of exchange. Were gold the money of India, the range of the premium thus established on the bill on London would be limited by the cost of remitting gold; but silver being the money of India, the action of the premium itself, or rather of the relative indebtedness of which it is the result, is to extend the range of the specie limit by lessening the demand for silver abroad. The rupee being less valuable than it formerly was, does less work in the Indian circulation and is all the more needed at home; to export it in payment of the adverse balance of trade would be to send it where it is less valuable still. It may thus be concluded that the depreciation of silver has been much the most potent and constant element in the adverse current of Indian exchange. The price of silver having since 1876 risen to 53½d., the rate of six months' bills in London has risen to 1s. 8¾d. The rate of Indian exchange rises in the export seasons when the supply of foreign bills is increased; and it rises with the price of silver at all seasons.

In the silver exchange between Hamburg and London the same rule prevailed. In Hamburg silver was money, but in England and other countries which have a gold standard it is only merchandise, and a rise or fall in the price of silver affected the value of a bill on Hamburg or a bill drawn on Hamburg in English sovereigns. Where a double standard exists, as in France, bills between that country and another are drawn in the standard which is common to both. Thus in the direct exchange between Paris and London, the bills are usually or almost wholly gold bills.

2. Were there a common international money, the supply and demand of bills would be the chief determining cause of a rise or fall in the rate of exchange. Hence, in distinction from the nominal par, the relation of supply and demand of bills has been called "real exchange." Mr Goschen speaks of it as "the primary element in the value of bills," which, from so practical an authority, may be regarded as indicating that, notwithstanding all the varieties of money, this continues to hold the chief place in the negotiation of bills of exchange, or that, the nominal par being once determined, or a common principle formed for its rectification when the money of a country has depreciated, it ceases to require the calculation which must always be given to the supply and demand of bills in the market. As the sum of the bills offered, and the sum ready to be bought, never express the whole of the claims upon, or the whole of the debts due to a country, but only such claims as have been drawn for, and debts the time of payment of which has come or is nearly approaching, there is always more or less change of the relation of supply and demand, as well as opportunity of judgment as to the probable course of the market, and means of applying correctives if the balance be swaying too much on the one side or the other. If the price of foreign bills be depressed for want of buyers, drawers may hold back a little; on the other hand, if the demand has raised the price of bills, all who have sums to draw for will be induced to take advantage of the market, and so increase the supply. The buyers are moved in the same way, quickening or delaying their purchase within the limits of their period of remittance, according to their judgment of the probable course of the exchange. But the buyer cannot delay beyond the day when his remittance is due in the foreign country; nor the drawer beyond the ultimate date of drawing, or his own need of realizing the value of his bill; so that, amidst this oscillation, it is always the peremptory business to be done that determines the effect of supply and demand on the rate of exchange. The debtors of a foreign country, finding the supply of bills on that country less than the demand, will be ready to give an addition of price for them, in proportion to the scarcity, within the cost or up to the cost of remitting specie; and the creditors or drawers on a foreign country will submit in the other extremity to discount on their bills within the cost of sending them to their correspondent or banker's correspondent abroad, with orders to take payment and remit the proceeds in specie. When the course of exchange, as thus pursued from week to week, reveals that the claims immediate and maturing upon any country are greater than the debts due to it, and cannot be discharged through the mechanism of direct and indirect bills of exchange, its balance of debt can only be paid by remittances of bullion or an increased export of goods and produce, or other exportable value.

It is unnecessary to dwell further on the law of supply and demand of bills, which differs little from that of other commodities, beyond remarking that an inadequate idea would be formed of the efficacy of bills of exchange in liquidating international debts without taking into account an immense banking organization, aided by bill-brokers and dealers in foreign exchange, who have all the main currents of indebtedness under their eyes, and know with the precision of practice how the debts of one centre can be met by its claims upon others, and a stupendous mass of conflicting operations, ordinary and extraordinary, be most economically effected. Fifty or a hundred millions sterling, as in the

case of the French indemnity to Germany, can be transferred from Paris to Berlin at a time without material disturbance of the more ordinary business of exchange. The British chancellor of the exchequer could transfer three millions and a quarter from London to Washington in payment of the Alabama indemnity before the operation was well known in the principal marts of the two countries. When England is lending ten millions to India, fifteen millions to the Australian colonies, or twenty millions to innumerable enterprises in the United States and Canada, or so many millions to Russia, Turkey, or the River Plate republics—or making several of such loans at nearly about the same time, as has sometimes happened—the effect on the foreign exchanges, though considerable, is seldom thought of. A foreign loan is usually taken out—a large part in goods, another part in bills, and the balance most probably in specie. But the effect of a foreign loan on the exchanges is exactly the same as if the borrowing country had exported produce to the lending country equivalent to the amount of the loan, placing it in debt to that amount. The lender has become bound by contract to pay so much to the borrower. The whole weight of a foreign loan, therefore, falls at once to what may be called the adverse exchange of the lending country or the favourable or less unfavourable exchange of the borrowing country. The reverse action comes in half-yearly or yearly rills, when the interest and redemptions of the loan, spread over a series of years, are payable. A foreign loan, if prudently and honourably conceived, may thus, as regards even the rate of exchange, be advantageous on both sides. The lending country gives a great advantage at once to the borrowing country in its exchange, which may be no evil in itself, and which the borrowing country, if the terms of the loan be fulfilled, repays in a period of years, during which its exporting and paying power may be reasonably expected to increase, which may be a common good. It may be added that foreign loans and investments of capital in foreign countries, badly as many may have been conducted, yet in their product of sound and marketable stocks and shares come to play a generally useful part in the rates of exchange. The value of commercial bills might not be so equable between such centres as London and Paris, or London and New York, without the intervention of stock-exchange securities.

Rate of interest.

3. It is obvious that the number of days or months a bill has to run before payable imports the question of interest as an element of valuation in the rate of exchange. The usance of foreign bills is extremely various, from short to long, from payable at sight to payable at six months after sight; and days of grace are allowed by the law or custom of some few countries considerable enough to be taken into count. Where a bill is payable so many days or months after sight the time that must elapse, in the ordinary course of communication, before it can be presented for acceptance, is a further prolongation of the currency of the bill. The buyer takes it with this weight of time upon it, and, whatever the period may be, is entitled to a concession equivalent to the interest of the money which he pays, the converse happening in the case of stocks and shares on which dividend or interest has accrued at the period of sale, and must be accounted for to the seller in the price. But the important question in foreign bills of exchange is what rate of interest is to rule in the transaction. Is it that of the country where the bill is drawn, or the country where it is payable, or a compromise between the two? The drawer, in offering to transfer his bill to a buyer, is wholly in the domain of the rate of interest in his own market. If he sells, he gets the value of the bill in money worth so much interest; and if he holds the bill till its maturity, or to some period nearer its maturity, he deprives himself of money for that period worth the same interest. The buyer who, in the event of an exchange, pays down the value of the bill in money would seem to be under the same condition; but in reality, when closely examined, the relations of the buyer and the seller of a bill of exchange to the rate of interest are different. The buyer has a debt to pay in the country on which the bill is drawn, which debt he is bound to pay *now;* and for his purpose the bill is all the more valuable the less weight of interest it bears, or, in other words, the less discount it is subject to. Supposing, therefore, the bill is drawn in a country where the rate of interest is 7 per cent. on a country where the rate of interest is 3½ per cent., possession of the bill will be more profitable, as regards rate of interest, to the buyer than to the seller. If the seller holds the bill, it bears 100 per cent. more weight of interest than it would bear in the hands of the buyer. If the rates of interest in the two countries be exactly reversed, the bill bears 100 per cent. more of this weight in the hands of the buyer than of the seller. Thus, after the par of the currencies has been established, which, as we have seen, is always practically established, even in the case of an inconvertible paper currency, by the bullion test, and must be regarded as the first condition of all foreign exchange, this question of interest is sufficiently important to modify the action of supply and demand, and of other circumstances operating either to raise the rate of exchange above or depress it below the par of the currencies. It is one of those innumerable commercial relations in which there is an advantage to buyer or seller, but which cannot be realized without mutuality, and which consequently helps them to a transaction. If the advantage of rate of interest be in favour of the buyer of a bill of exchange he will be inclined, other elements of valuation considered, to give a somewhat larger price for it than if this were not in the account; and if the advantage be in favour of the seller he will be less exacting. The whole advantage on either side may not be realized in the actual terms in either case; but it will have had some effect towards a mediation of the prices.

The price of a bill, apart from other elements, is the sum of the bill *minus* the interest it bears at the rate of discount in the country where it is payable. Yet in the practical negotiation this does not hold exact, because the value of the bill to the seller or the buyer is always modified by the relation of the rate of interest where it is payable to the rate of interest where it is drawn.

Rate of interest, though in the aspect it presents to the seller and buyer of a bill thus plain enough, yet comes to play so great a part in the general course of exchange that it is worth while to pursue the subject a little further. Rate of interest regulates the supply and demand of bills, and affects the rate of exchange through that element; where the balance of indebtedness is against a country an advance of the rate of interest tends to restrain imports and to stimulate exports, by which effects the balance of debt is reduced; and where the action of trade is not sufficient to overcome the evil, further rises of the rate of interest may be employed to attract imports of foreign capital and specie. In the case we have supposed of two countries, where the rate of interest is 100 per cent. more in the one than the other, this relation of their rates of interest may be the normal relation from the greater abundance or the greater profits of capital in the one than the other, and their exchange may be supposed to be in equilibrium, so that this normal relation is not disturbed by any changes of rate of interest to correct the supply and demand of bills, or the balance of trade. The effect, as we have seen, of difference of interest was in favour of the price of the bill drawn by the country of high interest on the country of low interest, from the fact that the buyer was moving the bill

out of a market where it bore a weight of 7 per cent. to one where it bore a weight of only 3½ per cent. interest. But suppose the balance of indebtedness has become so adverse to the country of low interest that the rate has been increased to 7 per cent. in order to improve the course of exchange, and that the effect has been, as must more or less follow, to render the foreign drawer less eager to sell, and the foreign remitter more eager to buy. The remitter or buyer will find the new influence thus introduced operating in the same direction—viz., in favour of the price of the bill; but, on the other hand, the difference of interest has disappeared. Two effects have thus proceeded from the same cause, which neutralize each other so far as they go; and the remitter, instead of buying a bill, may as well, as regards the rate of interest in the two countries, be drawn upon by his foreign creditor. If the rate of interest be further increased to 10 per cent., the drawer may be induced to hold the bill in order to save the 3 per cent. of discount above the rate of interest in his own market, or an investing buyer may intervene, and give such a price for the bill as will allow the seller 1½ or 1 per cent. of the profit, and leave 1½ or 2 per cent. to himself. In either case the bill would be held till it matured, and relief to that extent be afforded to the exchange of the country raising its rate of interest. But it is clear that not until the rate were raised 3, 4, or 5 per cent. above the rates of the countries drawing upon it could any effect of this kind be produced. It thus appears that the function of rate of interest in controlling the supply and demand of bills is a strictly limited function; and this limitation will probably be found in all the effects expected from it on the state of exchange. It may hasten the course of payments due to a country, but it does not lessen the adverse balance of indebtedness, nor can it much retard the pressure of the foreign claims. It may restrain importation of foreign goods, but it may not at the same time increase exportation of domestic goods; or, if increasing export, it may not diminish import. These are results which will depend on many other causes. It may tend to lower prices, and thus seem to check import, while facilitating export; but, forming in itself an addition to the cost of production and exchange, it may render much outward as well as inward trade less possible. If the rate of interest be carried high enough it may attract much capital from neighbouring countries. Foreign bankers and lenders will buy up bills on the country as the best mode of importing their capital, or may import specie; and admirable as this service may often be, yet it does not lessen the foreign indebtedness of the country. It only transmutes one form of the adverse balance into another more convenient for the time being; and in the meanwhile, if the high rate of interest has crippled the productive and exporting resources of the country, little good or a reverse balance of evil may have been done. Hence bullion reserves are either inadequate in the plan of their formation, or they miss their use and efficacy if, when a heavy balance of indebtedness appears in the exchanges, they cannot be trenched upon without large and excited advances of the rate of interest.

4. Nothing is more definite in the system of exchange than what has been more than once stated in the course of these remarks, namely, that the cost of remitting specie forms the limit of variation in the rates of bills. That the buyer of a foreign bill will not give more for it than the cost of remitting specie equal in amount to his foreign debt is an axiom which holds good under all the ordinary conditions. But there are exceptions to the rule where the conditions vary from the ordinary. From the countries of productive gold and silver mines bullion flows abroad as naturally as the corn, cotton, wine, or oil which forms the special merchandise of a country, and it will so flow irrespective of supply and demand of bills, rate of interest, and other causes which have so much sway in rates of exchange. San Francisco will export gold and silver to London in all states of supply and demand of bills, and when its rate of interest may be double that of the Bank of England, and in the common parlance money is there dearer than in London, though it may be only that the average profits of capital are larger in the one place than in the other. If bullion is needed at New York, and commanding a higher premium on the Federal currency, it will be matter of calculation to the bullion exporter at San Francisco whether to send a consignment to New York or to London. If, since the discovery of the Californian mines, a metallic currency had been established throughout the Federal Union, the United States would no doubt have absorbed a proportion of the gold and silver shipped to Europe; but this object accomplished, the export to Europe would have proceeded much as it has been proceeding. In short, from gold and silver producing countries the export of bullion is not a remittance of money, but a transmission of the exportable produce of labour, which but for export would not have been produced. Then, there is the case of exchange between countries of silver standard and countries of gold standard, from either of which remittances of specie cannot be made without exact reference to the market value of the two metals. This will have been already marked in the par of exchange between the gold and the silver country, but it will have introduced a new element into the cost of remittance, since the specie remitted will have to be sold into the specie standard of the country to which it is remitted. Silver from India and China, for example, in the circumstances of recent years, cannot be remitted in payment of an adverse balance of exchange without taking into account a subsequent act of merchandise—namely, what the silver will bring in the gold of England; and this, with silver under a course of depreciation, may be so doubtful that the buyer of a bill on London will rather yield in the rate of exchange, and give some fraction more of a rupee for the pound sterling than run the risk of it. Neither in payment of an adverse balance of debt, nor in transferring capital from one country to another with the view of taking advantage of a higher rate of interest, can specie be remitted between gold and silver standard countries free from this contingency. A Hamburg capitalist wishes to profit by a rate of interest two or three per cent. higher in England than at home. He will therefore buy bills on London up to a certain limit of price; if he has any gold, he will then remit gold rather than exceed this limit for bills; or he will remit the silver specie of Hamburg subject to its market value in London. In this case, indeed, the foreign capitalist has more than one act of merchandise to contemplate, for he has to look to the reverse action when the rate of interest may be higher at home than in England, and when it will be his motive to re-convert his English sovereigns into silver, which in the relative condition of the two metals may be either favourable or unfavourable. If unfavourable, he will buy bills of England on Hamburg, or some other centre with which the exchange is favourable to Hamburg, rather than re-transmit silver at a higher cost than the rate of the bills. It is obvious that all this does not alter the principle that the cost of specie remittance is the limit of rate of exchange on bills, but only that it gives a larger range to the variation of rate, and to the specie limit, between two countries whose money and standard of value are of different metals than would exist between two countries where they were of the same metal.

In exchange between a gold-paying and a silver-paying country, one of which, say the silver country, has gone largely into an inconvertible paper currency, the case becomes more complicated and the specie limit to adverse

rate on bills recedes, till, if the inconvertibility be so great as to be incapable of valuation, or the Government in its ignorance or alarm has prohibited the export of specie, the limit is wholly lost. A Russian merchant, who has ample silver and paper roubles at command for his purposes, but has a debt to discharge in America, or needs to lift a cargo of cotton at Liverpool or of sugar at Glasgow, and finds that the remittance even of such specie as he may be able to produce is illegal, must buy a foreign bill or a banker's draft on London at any price. At this stage the rate of exchange passes out of the domain of principle, or natural action of principle, into that of purely arbitrary considerations. When, from much less sufficient causes, general discredit passes upon a country, the rate at which its bills or acceptances may be valued is scarcely more reducible to rule. It might even be difficult to define why in the same general circumstances there should be collaterally a higher and lower course of exchange, and the bills drawn or payable by one firm should differ in their rate from those drawn or payable by another firm. It is only by removing abnormal conditions that one arrives at the underlying principle which governs exchange, and determines the success with which it is conducted.

Accordingly it is in countries where bullion, separated from its necessary export from the mines, has become money, and forms the common standard of value in their international trade, that the limitation of the rate of exchange by the cost of specie remittance is most clearly visible. Between all nations trading on a gold basis there is a well-known and definite point above and below the par of exchange where it becomes profitable to move gold from one to the other, and which marks the extreme range of variation in the price of bills. Thus in the exchange of London with Paris, New York, and Berlin respectively, 25·10, 4·81, and 20·30 mark a point in the price of bills below par when it pays to send gold from London to these centres; and, on the other hand, 25·30, 4·87, 20·50, a point above par when it becomes profitable to move gold from Paris, New York, or Berlin to London.

When the rate of exchange, touching, under the supply and demand of bills and other elements of valuation, these extreme points on one side or the other, and tending to exceed them, is the result of an actual over-indebtedness, a transmission of bullion is the best and most satisfactory mode of settlement. It directly reduces the balance of debt, and renders the price of bills again more equitable to the traders. All other modes of fencing it off, save an increased export of goods and produce, are more or less illusory. If, in such a juncture, an amount of foreign capital has been invested in bills on the country with the view of holding them to maturity for sake of profit in rate of interest, and now with the view of realizing the value of the bills in gold they should be pressed on the market before maturity for discount, an advance of one per cent. in the rate of discount may be sufficient to induce the foreign capitalists to hold the bills till they mature. And another advance of one per cent. in the rate of discount may induce them to reinvest in other bills on the country. But the root of the adverse exchange will not have been removed. It will always appear when the foreign capital thus invested in bills on the country is from any cause withdrawn, and until the over-indebtedness is liquidated by remittances of specie, increased export of produce, or transfers of saleable shares and securities.

If, on the other hand, the rate of exchange has been brought to the specie limit by bills, representing no actual debt, but drawn and accepted solely for the purpose of moving bullion, as may probably happen, there is no remedy for what may prove an inordinate demand for specie by irregular means but the detection of the bills, and either refusing them discount or discounting them under exceptionally high rates of interest.

5. An exposition, however brief, of the causes operating on the rate of exchange would scarce be complete without including the effect of opinion or estimate, correct or erroneous, of the probable course of the market; and therefore it may be observed that a judgment has to be formed in every new phase of the numerous fluctuations. The seller of bills finds that within a few days the market has taken an unfavourable turn. If he judges that this has arisen from merely accidental or temporary causes he will be inclined to hold his bills for what he deems their true value; or if, on the contrary, he judges that the causes operating are more deeply seated, and likely to become stronger for a time, he will sell with the least possible delay. Should his judgment be justified by the event he will have done what is right for him, if otherwise he will have done what is wrong; but in either case, his abstention or action will have affected the supply and demand of bills in the meanwhile. In all the great marts of exchange, and in London probably more than in others, there are frequent wave-currents so to speak, which cannot be rightly interpreted either as the sign of a protracted state of exchange between the points of the compass in which they flow, or of the general foreign indebtedness of the centre upon which they are directed. When New York balances its debts to China and India by bills on London, the bills affect the course of Eastern exchange; but they lose much of the significance they might otherwise bear when it is considered that New York is in course of compensating London in other directions. These operations come to be understood and systematized by dealers and agents in bills with much accuracy; but in addition to the judgment that may be formed by a thorough analysis of the substance of the various currents of exchange, there is the effect of opinion on external events, which, though of almost daily occurrence in one quarter or another, are wholly of future account, and which impress, not only the connoisseurs of exchange, but the whole body of drawers and remitters, from whom the original impulse on the action of exchange in all cases comes. The examples that might be adduced of the great effect of passing events on exchange are innumerable. In the beginning of 1861, when the disastrous rupture between North and South had occurred, and war was imminent, the United States had a most favourable balance of trade with England and Europe. Their exports of wheat and flour and cotton in the previous year had at once reached a maximum in quantity and a rise in value. The drawer of a bill on London was in so good a position that he had only to wait for the buyer to get the value of his bill up to the specie point. But so eager were the drawers, in view of the pending outbreak of civil war, to realize what was owing to them abroad, that they threw their bills on the market in an abundance which reduced their price to the other end of the scale. This, of course, had its converse effect at London, and bills on New York were there selling at such a premium that it seemed as if the United States would have to remit bullion to Europe. The volume of bills, however, told its own tale after a while. England had to remit bullion in large quantity to the United States, and then people began to awake to the perception that, in the exchange transactions, the one element most important of all had been left out—namely, the relative indebtedness. It must have been a time of much profit to those on both sides of the Atlantic who knew the actual state of affairs, and of much loss to those who did not know, of whom there can be little doubt that the latter were much the greater number. but the balance of value between the two countries, as expressed on the face of the bills, had to be rendered all the same.

To take a more recent case. The exchange value of the Russian rouble during the last twelve months of war between Russia and Turkey will amply illustrate what is meant by the prevailing judgment on events in their future aspect, which, while proceeding on a certain amount of reason, yet borders on panic, and may be of the nature of panic. The issue of paper roubles had gone the length of 730 millions before the war, and there was a constantly increased remission during the year, counteracted in some measure by conversions into loans bearing interest. On the mobilization of the troops the value of the rouble was 29d. to 30d.; on war being declared it fell to 27d.; when it seemed as if Plevna could not be taken it sank to $22\frac{1}{2}$d.; when Plevna fell it rose to $26\frac{7}{8}$d.; and when it followed that the conquest of Turkey and an armistice did not end the difficulties, it fell to the lowest point it had touched, $22\frac{1}{8}$d.

The term "favourable exchange," as commonly used, not only means a state of the exchanges when the debts due to a country abroad are so much greater than what it owes abroad as to affect potentially the demand and supply of bills, and when the money of the country so situated, as expressed in the price of bills, is equal to more of the money of a foreign country than the nominal par—when its bills on abroad, in short, are dull of sale, while the foreign bills on itself are in much demand; it is also applied to all stages, moderate or extreme, of this relation of the foreign exchanges. And so the term "unfavourable," of course, applies to the opposite conditions. If these phrases had ever any reference to the prosperity of the foreign trade of a country, they must have arisen under the sway of "the mercantile system" of the last century, the principle of which was that a balance payable in specie is the cardinal condition of prosperous trade with any foreign country; or, if introduced under that erroneous theory, they have been prolonged by the usage of bankers and other dealers in foreign exchange, who, having large liabilities entailing bullion payment, naturally consider a state of exchange which is on the eve of bringing specie more favourable than one on the eve of taking it away. This is quite true in the monetary view of the question, and it is true also as to the relative indebtedness for the time being. But it is not true to extremes even in a monetary sense. The condition of a country to which specie was always flowing in and never going out would be a realization of the fate of Midas. The most favourable exchange, therefore, is that where there are only moderate oscillations up or down from the par of exchange.

While the terms "favourable" and "unfavourable" are thus somewhat misleading as regards substantial interests, they are involved in a minor technical complexity, which, though well understood by those in the business, may here be stated. The terms would be strictly applicable in the sense they are used, were the rate of exchange always quoted in the home money. The *certain* properly in exchange transactions is the number of pounds, dollars, francs, or florins a remitter has to pay abroad; the *uncertain* is what amount of his own money is equal to this amount of the foreign money. Were the quotation on both sides respectively always made in the home money, the fall or rise of the quotation would always be identifiable with such terms as "favourable" or "unfavourable." Both drawers and remitters would be so familiar with their significance as to know what they meant. But this is not the practice, and, with so much variety of currency, could hardly have been the developed practice of exchange. The pound sterling of England is the largest monetary unit, and there is always facility of expressing minute shades of difference in the smaller units, more especially when, as in the case of Paris or New York, they have a decimal character. In London, consequently, the public only hear quotations of rate of exchange with such countries as France and the United States in the foreign money—London thus giving what is called the *certain*, and the smaller moneys the *variable*. On the other hand, not only in the Australian and other British colonies, where the standard of value is the same as in the parent country, but in such large commercial regions as China and India the quotation of rate of exchange on both sides is always expressed in sterling. The Chinese tael of silver is worth so many English pence sterling at Canton; and the rupee is worth so many English pence at Bombay or Calcutta; and in the same terms run the quotations in London. The practice may not alter in any iota the true rate of exchange, but it has the result that when the rate is quoted in sterling money, as in the Indian, Chinese, and Australian exchanges, every drop in the quotation is "more favourable" to England, every rise "less favourable," and this will hold good whether the quotations are made in England or in India, China, or Australia; whereas, on the other hand, when exchanges are quoted in foreign money—French, German, or American, &c.—every drop in the rate by the same rule is "less favourable," every rise in the rate "more favourable" to England, whether the quotation be made in England or in the foreign countries.

The states of exchange to which the terms "favourable" and "unfavourable" are thus applied refer wholly to the effect of the demand and supply of bills; so that, since the fluctuations of exchange are due to various causes, it would be an improvement were the quotation always to include the par of exchange, whether between the gold money of one country and the silver money of another, or between either and inconvertible paper, the depreciation of which has to be determined by the gold or silver premium in the country of its currency. The actual rate above or below par would show the effect due to the supply and demand of bills. When a sudden alteration takes place in foreign exchange, nothing is more difficult than to discover the relative force of the cause or causes to which it is to be ascribed, and yet nothing is more necessary to know than this, whether in the correctives that may be applied or in the lessons to be conveyed to importers and exporters.

The limited meaning to be given to such terms as "favourable" and "unfavourable" exchange probably applies to other statements that may arise legitimately in connexion with this subject. The principle, for instance, that the profit and loss of exchange transactions fall, not between the two countries concerned, but between the foreign creditors and debtors in one or other, is exact within its own range; but it leaves as an open question whether in a country where from a depreciated and depreciating currency the rate of foreign exchange is always rising, the general result may not be adverse to its interests in export and import trade. In like manner it would be more than questionable, because "the mercantile theory" was wrong in supposing that a balance of foreign trade in specie, or an excess of export value over import value, was the necessary condition of national prosperity, to posit the opposite doctrine that an excess of imports over exports is the only prosperous condition. The solution of this question must depend on what may be called the permanent indebtedness of some countries to others. A country which is under large tribute to foreign capital is assuredly in the right way for itself and for other countries when the value of its exported exceeds that of its imported produce. And so also it may be observed that "rate of interest," if we are correct in our reasoning on that head, may not have the absolute control over the exchanges which was so strongly emphasized for some years after the passing of the Bank Charter Act of 1844, and has since only been modified in practice without any express recognition of the principles involved.

NEGOTIATION OF BILLS OF EXCHANGE.

Rates of exchange have undergone much variation of late years from changes of standard—in some cases from gold to silver, and in others from silver to gold—and from the circulation of forced paper currency. The tendency, however, is to greater uniformity. The gold standard of value adopted at Berlin extends to the whole German empire, and the rates of exchange are now calculated in imperial marks and pfennige at Hamburg, Frankfort-on-the-Maine, Altona, and other German places, where different moneys formerly were used. The money under the new system is 100 pfennige = 1 mark, 20 marks = 1 twenty-mark gold piece (imperial mark) = 19s. 6·954 sterling mint par. The mark, which is the unit or integer of the system, is a silver coin based on the ratio of 1 to $15\frac{1}{2}$ as the relative value of silver and gold. In like manner the kingdom of Italy has extended a uniform exchange; and the rates at Naples, Palermo, Messina, Milan, Turin, Florence, Leghorn, and other Italian towns are similar to the rates at Genoa.

Bills of exchange may be made payable on demand (as the invariable rule is in the case of cheques), at sight, at a certain specified time *after sight* or *after date*, or at *usance*, which means the customary or usual time for which bills are drawn from a given place, and when the time is doubled it is called *double usance*. No bills are now drawn in London at *usance*, and the practice is being gradually dropped in other countries. The usance of bills drawn from France, Holland, and Germany is 30 days' date; from Spain and Portugal 60 days'; and from Italy 3 months' date; but the currency of bills is regulated more by the classes of business to which they relate than to the usage of any country. The allowance of *days of grace* is also going out of fashion. *Three days* are still given on bills drawn upon or payable in the United Kingdom otherwise than at sight, and a similar practice holds in the United States. St Petersburg gives 3 days on sight bills and 10 days on date bills, Copenhagen 8 days, Christiania 8 days; but in these and other cases the allowance may not mark so distinctly the day when a bill is legally due as an interval within which certain legal proceedings of the respective countries cannot be instituted. The practice, which was at one period extremely various, has now been reduced within such narrow limits that in exchange transactions in London no account is taken of days of grace.

Bills of exchange in London are bought and sold through brokers, who go round the mercantile and banking houses, and discover whether they are buyers or sellers of bills. The negotiations are determined on Tuesdays and Fridays, which correspond with the principal post days in foreign exchange business. In London, as in other great commercial cities, bankers deal largely on the rise and fall of exchanges,—buying bills when they expect a rise, and selling bills when they expect a fall.

Foreign bills are generally drawn in duplicate or triplicate, lest the first should miscarry. When thus drawn in sets, the first is payable only "second and third unpaid," the second "first and third unpaid," and the third "first and second unpaid." Where there is a doubt as to the acceptance, the first may be sent unindorsed to a correspondent of the drawer in the place of payment to have it accepted, and the second sold and put in circulation, bearing the name and address of the party holding the first or accepted bill "in case of need," that is, in case he may not have obtained acceptance, and will protect the drawer from having the bill returned through the indorsers. The indorsed second, and the accepted first of exchange, when wafered together, become one bill and are valid.

Exchange, as regards the abundant arithmetic to which it gives rise in its negotiation, may be divided into—(1) Direct, or exchange between two countries wholly based on their rates of exchange, which is so simple as to need no remark; (2) Cross, or exchange between two countries in which a third country has an interest, as when London, say, has 10,000 francs in Paris which he wishes to move to Hamburg, and has to take account of his own course of exchange to Hamburg as well as the direct between Paris and Hamburg, which is only less simple than direct exchange, inasmuch as it requires two formulæ instead of one; and (3) Indirect or arbitrated, where exchange between two countries is conducted through the medium of a third, or more than one other country, and thus becomes more compound as the sphere of the operation is extended. It is an arbitrated rate because it has no actual form, and is found only in figures out of the current rates of exchange between more than two countries. The object being to discover how a debt in one place may be most economically paid from another, the question carries along with it not only the difference between remitting and drawing which exists in the simplest direct exchange—the debtor in the one country and the creditor in the other having always the option of the one remitting or the other drawing—but such *minutiæ* as whether the rate of exchange given be in the foreign money or in sterling, till it results in the following rules:—

"*For Remittances*:—

"With a foreign rate, any arbitrated rate is better than the direct rate if it is *greater* than the latter;

"With a sterling rate, any arbitrated rate is better than the direct rate, if it is *less* than the latter:

"Because, in either case, a given sum in sterling will produce a greater sum in foreign money, or a given sum in foreign money will cost a less sum in sterling.

"*For Drafts or Returns*:—

"With a foreign rate, any arbitrated rate is better which is *less* than the direct rate;

"With a sterling rate, any arbitrated rate is better which is *greater* than the direct rate:

"Because, in either case, a greater sum in sterling will be obtained from a given sum drawn for in foreign money."[1]

Nor is this all. Arbitrated rates are calculated for present money; the actual rates of exchange on which they are calculated have been affected by time and rate of interest. In the rate of direct exchange particularly, with which the arbitrated rate has to be compared, this effect has to be estimated, long bills reduced to short and the difference of interest on them discounted from the basis of calculation *prima facie*. This, in a superficial view, may be counterpoised by drawing speculative bills of long date on a foreign centre, but there are limits to drawing on a place for purposes external to its ordinary course of exchange, and a large amount of bills thus directed without corresponding remittances might produce an effect on the exchanges which would go far to upset the calculation.

It is obvious that arbitration of exchange, thus burdened at every additional length of the chain by difficulties of estimate, cannot be much extended or become too artificial without the risk of miscarriage. But the mediation of direct exchange through a third place is of such common and useful practice that it may be desirable to give an example broad enough to illustrate the general method of equation.

Take London on Paris at 3 months, quoted f.25·55; Paris on London at 3 months, quoted f.25·10.

The discount for 3 months, in the example to be given, is taken at 1 per cent., or 25 cents., which is deducted from the London rate and added to the Paris rate, to make the two short or cash rates; thus reducing the former to f.25·30, and raising the latter to f.25·35.

If this variable price were in sterling, as for instance with Madrid, the allowance for interest would have to be reversed, that is, added to the London price, and subtracted from the price abroad.

EXAMPLE.

From the following rates of bills in London and Paris it is required to find—

1st.—Whether, having money to transmit from London to Paris, it will be better for me to remit direct bills on Paris, or to order bills in Paris to be drawn upon me in London, at the rate of 4 per cent. per annum.

2d.—Whether, having money to draw from Paris, it will be better for my correspondents there to make me remittances, or for me to draw upon them.

3d.—If I have to make remittances to Paris, whether any indirect rate will answer better than the rates of direct bills.

4th.—If I have to obtain returns from Paris, whether any indirect rate will answer better than either of the direct rates.

RATES OF EXCHANGE.

London, June 17.		Paris, June 14.
25·55	Paris at 3 months.	
$12''1\frac{1}{4}$	Amsterdam	$209\frac{1}{4}$
$13''10\frac{1}{4}$	Hamburg	184
121	Frankfort	$210\frac{1}{8}$
$29·47\frac{1}{2}$	Leghorn[2]	15 loss = 100 lire for 85 francs

METHODS OF WORKING THE EQUATIONS.

Amsterdam.

£1?
1 — * $12''1\frac{1}{4}$ Florins and Stivers.
100 — * $2·09\frac{1}{4}$ Francs.
Francs $2·09\frac{1}{4} \times 12·06\frac{1}{4}$ = 25·24 Francs.

Hamburg.

£1?
1 — * $13''10\frac{1}{4}$ Mk. and Sc. = $218\frac{1}{4}$ Sc.
Sc. 1600 = Mk. 100 — * 184 Francs.
Francs 184 × $218\frac{1}{4}$ ÷ 1600 = 25·10 Francs.

Frankfort.

£1?
10 — * 121 Florins.
100 — * $210\frac{1}{8}$ Francs.
Francs $210\frac{1}{8}$ × 121 ÷ 1000 = 25·42 Francs

Leghorn.

£1?
1 — * $29·47\frac{1}{2}$ Lire Italiane.
100 — * 85 Francs.
Francs 85 × $29·47\frac{1}{2}$ ÷ 100 = 25·06 Francs

COMPARISON OF THE ARBITRATED RATES.

	Prices.		Pars.
	London	Paris.	
London, 3 months	25·55	...	25·30 short
Amsterdam	$12''1\frac{1}{4}$	$209\frac{1}{4}$	25·24
Hamburg	$13''10\frac{1}{4}$	184	25·10
Frankfort	121	$210\frac{1}{8}$	25·42
Leghorn	$29·47\frac{1}{2}$	85	25·06
Paris, 3 months	...	25·10	25·35 short.

[1] These rules of arbitrated exchange, accurately given in Tate's *Modern Cambist*, and the verbal puzzle of which turns chiefly on whether the rate forming the basis of calculation be foreign or sterling, lend force to the observation above that the one rate should never be lost in the other one-sidedly. If distinguished in the practical quotation of exchanges, there seems no reason to take other than one in arbitrated exchange.

[2] The loss at Leghorn is owing to cash premium on forced paper currency, but as it affects London and Paris equally, does not disturb the calculation.