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Alfred D. Fairweather

Manufacturing Optician

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NEED OF IMMEDIATE REFORM IN AMERICAN BANKING SYSTEM

By ANDREW CARNEGIE.

We are spending \$400,000,000 to open a great new trade route to the markets of the far east, and many good Americans seem to feel that the moment the Panama canal is opened to commerce we will at once be in a position to command a great share of the trade of the Pacific. But unless we speedily reform our banking system so that we may be in a position to finance the Panama canal trade a good part of this four hundred millions will be wasted.

If we are to have the advantages in finance enjoyed by our European competitors a sweeping revision of our present banking laws is absolutely necessary. Foreign banks, especially those of London, now finance our foreign trade, and we pay them rich tribute for the service. To show how London finances our foreign trade for us let me quote from the foreign trade expert of one of the greatest banks:

"An importer of coffee (A) in New York purchases a certain number of bags of coffee from an exporter (B) in Brazil. A agrees to furnish B with a commercial letter of credit. 'B' is not in a position, we will say, to await the arrival of the coffee in New York and the return of a remittance before receiving his pay. A on the other hand is unable to remit B for the coffee before its receipt and sale to his customers. A goes to his banker in New York and requests him to authorize B to draw upon the New York banker's London correspondent at ninety days' sight with bills of lading for coffee to the amount of the purchase attached to the draft, consular invoice and insurance certificate; if B is to furnish the insurance.

Financed in London. "If A's banker is willing to extend the credit, he writes a letter (or uses a printed form), requesting his London banker to accept B's drafts upon presentation under the conditions already mentioned and others of minor importance. This letter is issued in duplicate, one copy going to the London banker, the other being delivered to A. A then mails the copy received by him to B. B thereupon arranges to ship the coffee, obtains the bill of lading, invoice, etc., and takes them with the copy of the credit to his banker in Brazil. A draft is then drawn on the London bank under the terms of the credit at ninety days' sight and is discounted by the Brazilian banker, the proceeds being placed to the credit of B's account or given to him in the form of a check of cash.

The Brazilian banker then forwards the draft and documents, except such documents as the instructions may require to be forwarded direct to New York, to his London banker. He may secure discount of the bill at once by cable or await its arrival in London before doing so, or he may request his London banker to have the bill accepted and hold it for maturity. If the bill is discounted, the Brazilian banker may draw against it immediately and thus put himself in funds to purchase other coffee bills. Upon receipt of the bill by the London correspondent, it is presented to the London banker on whom it is drawn for acceptance. The acceptor bank examines the documents, and if they are drawn according to the terms of the credit, accepts the draft and returns it to the correspondent of the Brazilian bank, retaining the documents, which it then forwards to the New York bank which opened the credit.

System of Extending Credit. "The London bank has in effect agreed to pay it at the end of ninety days. Upon maturity payment is made and the amount is charged to the account of the issuing New York bank. Upon receipt of the documents, the New York bank delivers them to its customer under a trust receipt or against collateral and the latter is then in position to obtain the goods. Ten days before the bill of exchange is due in London the New York bank col-

lects the amount from A, together with the commission agreed upon when the credit was opened, and remits the amount to its London banker to meet the draft. On all such transactions the London banker, while not himself advancing any money, is extending a credit for which he charges the New York banker a commission. The result is that we are paying tribute to European bankers amounting to an immense sum annually for the purpose of financing our imports.

"The fact that London exchange is more marketable generally throughout the world than New York exchange is one of the principal reasons why it is necessary for us to issue credit upon London instead of upon New York."

That our defective banking laws have been in existence for half a century, that they still continue to exist, are matters of wonderment throughout the civilized world. Perhaps the simplest explanation is that our country is comparatively so new. With tremendous natural resources back of us, and with unequalled enterprise, we have gone ahead sweepingly and regardlessly. But with all our wastefulness, it is doubtful if any one extravagance equals in dire results the successive losses this country has sustained from our periodical money panics, brought on directly by our panic-breeding banking system.

American Methods Antiquated. Our present system was founded on a war debt. It dates back to 1863, when the country faced a great crisis. The federal treasury was empty; government credit was gone. The temptation to use banking for this purpose was too great to be resisted. Perhaps it was excusable then; but in neglecting a revision of this system to meet modern requirements, what a terrific price has been paid!

In framing these banking laws no thought was had for the country's great development in agriculture, commerce and industry. No provision whatsoever was made for foreign trade. In fact, the laws forbade the establishment of American banks abroad. Today, as an instance, European banks are firmly established in South America, and are actively furthering there the interests of European trade. Practically all the ports of Latin America, large or small, have them. Yet in our own sister continent you will not find a single banking institution bearing a North American name.

American banks in foreign markets would be powerful aids to the upbuilding of our commerce; manifestly and for the subjoined reasons are they indispensable. First. They would furnish a direct financial exchange.

Second. They would provide a safe and efficient means of obtaining credit information, independent as to foreign merchants and impartial as to American exporters.

Third. They would correctly present to foreign customers the standing of our own export houses.

Fourth. They would furnish capital or credit at the foreign market.

Fifth. They would bring American financial interests in touch with foreign enterprises, which, if exploited, would create business for the American exporter.

Volume of Foreign Trade. Our foreign trade today amounts yearly to four billion dollars. American goods now traverse the world. In some staples we control the foreign supply. There are no geographical barriers to our world markets.

But what of our banking system? It is still circumscribed by the boundaries of the United States. We, the wealthiest country in the world, have no world credit. We cannot control our gold supply. We alone of all civilized countries collapse periodically under money panics.

pendent banks. They have no way of cooperation. But complete banking cooperation is absolutely necessary to control arising panics. Other countries have proved this. Our banks have demonstrated it by being compelled in times of stress to fall back upon their local clearing house associations, the only means—but a crude means—of co-operation that we have. The necessity of co-operation is a fundamental banking principle. It is not to be argued against. But aside from this theoretical truth, we have the obvious to guide us. They do not have panics abroad; we do.

Again, it is only by co-operation, and the consequent fixing of a uniform rate of discount, to be raised or lowered as circumstances demand, that we can control the flow of gold to and from this country. This is fundamental to international credit. It is also a banking principle.

No B and D Discount Market. A second striking peculiarity of our banking system is that we have no broad discount market such as they have in Europe. Our banks are forbidden by law to accept business bills for discount. Instead they take, for instance, the business man's promissory note. In other words, a merchant in this country who has sold a bill of goods and wishes to realize at once on the sale cannot change this prime evidence of exchange into a credit instrument. He gets credit at his bank on his "promise to pay." But this latter instrument, showing no transaction to goods, is confined to the one bank that takes it. The maker's ability to pay is unknown to other banks. So this kind of a credit instrument has no circulation powers whatever.

In Europe, on the contrary, the business bill becomes in itself a credit instrument. The bank accepting it stamps it as a banking instrument. It is good at any other bank in that country. It may be rediscounted at the central bank of all these banks, or it may travel to other European countries.

Now, aside from the ready elasticity of credit that such a discount and rediscount market gives to business at home, it must be apparent that it has also a direct effect upon foreign trade. Today our local credit instruments do not pass current in the world's markets. As a consequence the American shipper is forced to buy foreign exchange. Aside from the fact that for this unnecessary accommodation we pay annual tribute to Europe of millions of dollars, it must be apparent that the whole period of our foreign trade expansion has been seriously hampered by banking accommodations which are necessarily worked upon a limited scale and which assuredly have no reference to the broader needs of this country.

The general and further result of the workings of our discredited monetary system is the isolation in a measure of the whole American market.

International enterprises prefer to establish their headquarters in countries whose banking systems are upon a more stable basis. They cannot afford the risks of such occurrences as our disgraceful panic of 1907, with its suspensions of payment, shortages of accommodation and general financial disturbance. Again, because we have no uniform system or standard for financial transactions, such as exists abroad, American securities are naturally looked upon with doubt by foreign investors and are listed only with hesitation by foreign exchanges.

Our national monetary commission recently presented a plan of reform. The object is not only to preserve the independence and usefulness of our excellent banks, but also to give them a system based upon economic laws and the needs of the nation. The plan proposes the formation of a reserve agency, not in any way a European central bank, but co-operative association of all our banks. The banks individually shall be permitted to discount bills drawn for agricultural, commercial and industrial purposes—in other words, prime, day-to-day business bills—just as is now done in Europe. The reserve agency will hold the bank reserves of all the banks and use them for the rediscount for the individual banks of this commercial paper. This instead of holding this reserve money idle or sending it to New York for speculative loans, as at present.

Here, then, we have what we now lack—namely, (1) perfect elasticity of credit, (2) standard banking instruments which will pass current throughout the world, and (3) a great united banking resource held ready and sufficient to control and regulate any threatened financial crisis.

Benefits of Suggested Reform. The benefits of this reform to the American shipper must be apparent. In the first place he would be spared the losses of our recurrent money panics. I do not know what percentage of the hundreds of millions lost by American business houses in the panic of 1907 fell upon the export and import trade, but in the aggregate they must have been very great. Every shipper will recall clearly enough his individual losses, and he is cognizant, too, of the dull market that followed for several years this financial upheaval.

Secondly a standardized business paper would give to the American merchant the very same banking accommodations he now seeks abroad. In selling goods, for instance, to a buyer in Buenos Aires, he would draw at a specified number of days upon his correspondent in that city. He could have his draft discounted at his home bank, assuming obligation for the amount of the loan only in case of default by the buyer in Buenos Aires.

This loan being necessarily of longer period than ordinary commercial loans, the merchant's bank need not bear the burden of protracted credit, but can have the paper rediscounted at the reserve association of which it is a member. Thus the bank may keep its credit resources open to other merchants at all times.

New Class of Banks. In addition the plan permits a new class of banks, which will in effect be highly specialized institutions to finance foreign trade. Their functions will be similar to those of the chartered banks of Great Britain which are intended to carry on banking op-



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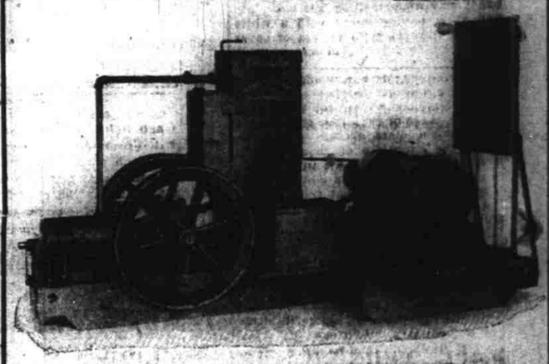
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