

WHAT exactly is foreign exchange? Bankers are always buying and selling foreign exchange in the market but to most of us it is a very mysterious and abstract commodity indeed. Can an ordinary man buy foreign exchange if he wants to? Are there many kinds of overseas exchange? How do Britons acquire it? Should its sale be controlled by the Government or should it be sold freely?

Let us imagine a visit to a banker in the City of London and let us explain to him that we would like to understand a little concerning this strange commodity which he sells.

If he were a kindly and patient banker he might indulge our curiosity by producing a list of all the different kinds of foreign exchange he had available with their price attached. We would then discover that foreign exchange was nothing less than foreign money. That he had on his list for sale French, Swiss and Belgian francs, Norwegian and Danish kroner, U.S. and Canadian dollars, Dutch guilders, German marks and even Australian and New Zealand pounds.

We find that a banker deals in foreign currencies very like a Covent Garden merchant deals with vegetables. His price list could be compared with any price list of a vegetable merchant, except that the latter shows his prices in so much English money for the lb. or cwt. of the commodity he has to sell, while the exchange broker's list shows us how many dollars, francs, kroner, etc., he is prepared to sell us for every £1 sterling.

Is foreign exchange then simply foreign or Commonwealth money? Very nearly. To be exact it is that part of foreign or Commonwealth money which is available for sale for British sterling. The word 'foreign' being applied to both foreign and Commonwealth exchange.

For the greater quantity of foreign and Commonwealth money is not, of course, available for sale in this way. Its owners have no desire to exchange it for British sterling for which they have no use. They want to keep their money for buying goods and services in their own country.

However, there are always some people who have foreign money for sale, and these are usually Englishmen, or foreigners who want to do business with Englishmen. There are certain classes of Englishmen who are most expert at earning foreign money, and as they live in Great Britain and pay wages in this country they are always willing and anxious to sell these foreign earnings for British pounds.

In the City of London particularly, there are many people who earn foreign exchange. London's great insurance firms insure cargoes and property abroad, and, in whatever country they do business, they are paid in the currency of that country.

London banks frequently perform services for foreigners and are paid in foreign currency. Then there are those people who have invested money abroad, or who have

Freedom for t

This is the first of a series of articles condensed from the *Free Convertibility of Sterling* by **GEORGE WINDER**, by the Institute of Economic Affairs.

inherited foreign investments from their fathers; they receive payment in foreign money.

But by far the greatest earners of foreign currency are British exporters. The value of their exports runs into hundreds of millions of pounds a year, all of which is paid for in overseas currency. This means that our exporters earn millions of dollars, kroners, francs, etc., etc., which they require their customers to exchange into pounds so that their accounts may be settled.

The value of the goods exported can always be ascertained through the Customs authorities, but there is no certain record for the services rendered to overseas customers by insurance companies and banks, etc. As, however, these services earn foreign currency just as effectively as exported goods, they are called invisible exports.

Together these visible and invisible exports earn the British people nearly one quarter of their total income.

As those who earn these vast quantities of foreign currency live in Great Britain their foreign earnings can give them little satisfaction until they have been exchanged for British pounds. To enable this to be done there must be found people who are willing to buy foreign currency. By far the greatest class of people who are willing to consider such a transaction are British importers, who require it to pay for foreign goods. In addition, the British Government may need foreign currency to pay for the upkeep of troops abroad or to pay interest on loans, or people who intend to travel may require foreign currency for their requirements while abroad.

The exchange broker's business is to put the buyers and sellers of foreign currency in touch with one another. His chief customers are banks. Owing to the intervention of banks and middlemen the machinery set up to exchange British money for foreign money may appear, at first sight, to be very complex and mysterious, and we shall deal with this in a later chapter. Enough for us now to know that fundamentally the business of selling overseas exchange is no different from any other business in which commodities are bought and sold.

Sometimes money is spoken of as being convertible. This now merely means that it can be exchanged. Pounds are convertible into dollars but the rate of convertibility is fixed. The expression 'free convertibility' should be confined to those currencies which can be freely exchanged

e Pound



at the free market rate. Before 1914 a convertible currency meant one which could be exchanged for gold at a fixed rate.

THE RATE OF EXCHANGE

THE first consideration of the British earner of foreign currency will naturally be how much can he sell it for, or to put this in another way, how many units of his foreign currency must he part with for every British pound sterling he receives in exchange.

It is upon the answer to this question that the rates of exchange which we see published in our commercial papers depend. Now we know that the supply and demand of every commodity that can be bought and sold tends to fluctuate. Perhaps a foreign country wants more British pounds than usual to buy railway equipment or to pay a debt, or perhaps a British firm wants an exceptional quantity of foreign currency to buy raw materials of some kind; perhaps a buyer of Danish goods may find it actually pays him to purchase Swedish kroner and use them to buy Danish kroner instead of making the purchase direct.

All such considerations and a thousand besides affect the price at which currencies are bought and sold. When the Government does not interfere with exchange transactions, fluctuations in exchange rates are inevitable. These fluctuations have the effect of balancing the supply and demand for foreign currencies, so that the phenomenon we know to-day as external disequilibrium was unknown in the days when exchange transactions were free from state control.

While it can readily be seen that the day-to-day supply and demand for currencies will cause fluctuations around a central price, what is the real value behind that central price and behind all demands for currencies? What is it that, subject to these fluctuations, decides that so many units of one currency shall exchange for so many of another?

We could readily see the answer to this question when most of the world's currencies were convertible into gold. The value of currencies was then fixed by the amount of gold for which they could be exchanged. A pound note or a pound deposit in a bank could always be exchanged for a gold coin weighing 113 grams of gold. In the USA one could obtain for 113 grams of gold just

4.866 dollars. This meant that one pound sterling was worth as much as 4.866 dollars, and that was the rate at which these currencies would be exchanged.

The exchange rate under the gold standard could still fluctuate most effectively but such fluctuations were limited to the cost, with insurance, of transporting gold from one country to another. If an American who required to pay a debt in Great Britain found that he had to pay a few cents more than 4.86 dollars for every pound he required, he could purchase gold, send it to England and there sell it for pounds.

But now that most of the world is no longer on the gold standard, what decides exchange rates? We have seen that under the gold standard it was the respective power of currencies to purchase gold. To-day, subject to considerations which we shall mention later, it is the respective power of currencies to purchase, not only gold, but all forms of goods and services.

If an Englishman finds that he can have a very good holiday in a seaside resort in the South of England for £100, and that he can have an equally good holiday in Sweden, with similar accommodation and food, for 2,000 kroner, then he would probably agree that £100 was roughly equal in value to 2,000 kroner and that an exchange rate of 20 kroner to the £1 was fair enough.

If a merchant finds that he can get as much iron in Sweden for 2,000 kroner as, allowing for costs of transport, he can get in Britain for £100, he too will consider that 20 kroner are a fair exchange for £1.

So we see that what decides businessmen to consider an exchange rate reasonable is the respective purchasing power of the two currencies concerned. Or, as the economists express it, 'The rate of exchange at which two currencies tend to exchange is the same as their respective purchasing power'. This is called the theory of 'Purchasing Power Parity'.

This is not an exact rule. It is subject to many other factors, such as the freedom of capital movement, tariffs, and the relative stability of the governments of the countries concerned.

The value of currencies, like the value of many other commodities, depends upon a thousand factors which cannot be measured. They depend upon the opinions of the thousands of businessmen who want to buy currencies and upon those who wish to buy and sell the goods those currencies can purchase.

No government has a yard-stick that can measure the value of the goods currencies can buy, and this means that no government has a standard for measuring the value of currencies and the rate at which they should exchange for one another. The only possible way to ascertain the value of a currency is to place it on the free market and see what people will pay for it. There is only one true and just price and that is the price arrived at by the consensus of opinion of all the buyers and sellers in the market.

To fix by law an exchange rate between two currencies which will represent the true value of both currencies

is impossible. When values depend upon so many factors which cannot be measured, then it is almost inevitable that a fixed rate must cheat one of the parties to every exchange transaction.

Not only is there a day-to-day change in the value of currencies, but since the days of the gold standard there is constantly proceeding a more fundamental change in their values which we shall consider later. The exchange values fixed by governments since the war have only recognised these fundamental changes long after they have progressed to a considerable extent. For example, the change in the dollar-pound exchange rate effected by Sir Stafford Cripps in September, 1949, recognised a real change in values which had taken place long before, and this tardy recognition of the fact of change did immense harm to Britain's export trade.

The only way to arrive at a true and just rate of exchange, and such a rate is also the expedient one, is to allow currencies to be freely converted into some real value such as gold; failing that the only way to arrive at a realistic rate of exchange between currencies is to allow them to be freely exchanged in the market.

Only in the free market can the true values of currencies be decided. The free rate is therefore the only just rate.

SITE-VALUE RATING IN KENYA

(Continued from page 7)

course, and the only apportionment of a year's rates that can arise is on a change of ownership. This division of liability is a matter for adjustment between the purchaser and the vendor and is of no concern to the local authority.

The local authority is required by statute to publish notices informing the public of the amount of the rate (which is expressed as a percentage of the unimproved site value), due date, etc., before the commencement of the financial year, and rates remaining unpaid after the due date attract interest until payment is made, the statutory maximum interest rate of one per cent per month being applied in Nairobi. The Rating Ordinance states categorically that the responsibility for making payment by the due date rests with the ratepayer and there is no requirement on the local authority to issue a demand note. Nevertheless demands are issued, but proof of posting is not necessary, nor is non-receipt an acceptable excuse to the courts. Recovery procedure is by summons to a magistrates court, and further action on non-payment may be by application for committal to prison (rarely used) or by application for court permission to sell the plot by public auction and recover from the proceeds. Of substantial assistance to local authorities in the recovery of rates and many other charges is a statutory provision whereby a transfer of ownership is not registered by the Lands Department without the production of a clearance certificate from the local authority stating that all accounts are clear. A further aid to rate collection is a procedure whereby a local authority may by notice require the tenant(s) of

property constructed on the land to pay rent to them in settlement of outstanding rates.

From the preceding paragraph it will be seen that the recovery of rates is far less arduous a task administratively than is the case in this country. The absence of void periods, of the need for apportionment, the penal rate of interest and the other avenues that may be taken to obtain payment result in few bad debts. These do arise, of course, in occasional cases, such as where a plot is heavily indebted to the Crown with a claim preferential to rates, or where the owner is deceased and his estate is not worth the task of administration, etc., but these are few in number.

Lest the reader at this juncture should conclude that a system such as that outlined above could be the panacea for the shortcomings of the British rating system, it is as well to make several points on local government finance generally in Kenya in order to put the position into perspective. First, until this year education was administered nationally and no cost fell on local authorities. Secondly, residents have been charged for specific services (at least in Nairobi and probably elsewhere) to a far greater extent than in this country, thereby reducing rate-borne expenditure considerably. Examples include a monthly sewerage charge based on water consumption (all water supply is by meter — there is no water rate), similar charges for non-sewered property, refuse removal charges wherever more than one dustbin is emptied, parking meter fees, fees for the service of the fire brigade at fires, fees from persons attending clinics, medical dispensaries, etc., charges for anti-malarial measures at private premises, vaccination, inoculation, and many others.

Although these charges are individually small, in total they are quite substantial, and many of them indicate that the policy of the first administrators of a new town in a new country was to require the inhabitants to pay according to the individual services they enjoyed, particularly as many of these services in the early days were not available to everyone. In fact, it could be said that the bulk of the rate charge represents permanent services provided by the local authority, for which the owners of vacant land must pay their fair share. Thus all owners pay for the construction of major roads, the maintenance of public roads, the construction and maintenance of main sewers, street lighting and cleaning, etc., while as far as other rate-borne services are concerned at least some contribution is gathered from residents in proportion to the use they make of them. Whether this policy is pertinent to a more sophisticated society living in far more established conditions is possibly open to question. It may be that a more suitable solution in urban areas of a country where land is scarce rather than undeveloped is a site-value rate to recover the costs of services provided so as to make the development of the land possible, plus an improvement rate to meet expenditure on services arising out of the construction of buildings and their occupation.

In conclusion it should be stressed that the bulk of the foregoing notes have been compiled from memory

of experience gained some years ago and take no account of constitutional changes in Kenya during the last year or so which may well have altered some of the statutory provisions mentioned.

Currency Comments

Alan Day, Professor of Economics at London University, in *The Observer*, November 29.

The question that should now be discussed calmly is what these measures should be. After careful and restrained argument, the official and authoritative Radcliffe Committee concluded in 1959 that while we should not be "easily moved to devalue sterling," nevertheless "experience has revealed no other instrument as powerful as devaluation that can be used to restore competitive power . . .

It is now perfectly clear to me that the Government made a first-rate error of judgment when it decided not to devalue the pound during its first two or three weeks in power, before the crisis of confidence blew up and when it could still act of its own free will. Now the Government has got itself into a position where it has pathetically little freedom of action.

Karel Norsky in *The Daily Telegraph*, December 3.

In spite of the inter-governmental rescue operations, private holders of sterling in Europe are refusing to show confidence in the pound as long as the surcharge on imports is retained.

Surcharge is regarded as a camouflaged form of devaluation and it is pointed out that the introduction of an import levy by France in 1956 was followed by the devaluation of the franc two years later. There are fears that this pattern might be repeated in Britain.

Richard Fry, Financial Editor of *The Daily Telegraph*, December 3.

One would probably not go far wrong in estimating that the amount of foreign currency spent last month to support the pound was in excess of £100 millions: but we are left to guess. "No comment" is the word from Whitehall.

William Davis, City Editor of *the Evening Standard*, December 2.

Why, against this background, should investors stand so remarkably firm? Why don't they sell and buy back later? Why don't they switch to safer things like building societies, or finance houses? . . . Laziness, experienced brokers will tell you, has a lot to do with it. People simply cannot be bothered to hop from one thing to another.

Fervent dislike of taking any sort of loss is another big factor. Most investors simply hate the idea of selling anything if the price is less than they paid . . . But the main reason, without doubt, is still summed up in one

simple word: "Inflation."

Over the years it has become the talisman of the investment world — trotted out by many people with the blind faith of a man going over Niagara in a barrel. You can hardly blame them. Look what's been happening to the purchasing power of the £. Taking 1946 as a base, the picture looks like this:

1949	17s. 0d.
1954	13s. 10d.
1959	12s. 1d.
1963	11s. 0½d.
1964	10s. 7d.

Now look how a pound invested in 1946 has performed since then:

1949	15s. 9d.
1954	27s. 3d.
1959	50s. 0d.
1963	51s. 6d.
1964	56s. 0d.

Kept in a cardboard box under the bed, as you can see, that pound now buys only half as much. Put into shares it is worth considerably more than twice as much. Convincing evidence!

NEW CENTRE

THE Centre For Economic Inquiry is the name of a new school of social science established in Nairobi, Kenya. The founder and first Director is Mr. Kul Bhushan Sharma, an enthusiastic and energetic delegate to the recent International Conference. There he was able to learn much from School Extension Directors and on his way home visited the Henry George School in London.

Mr. Sharma has been fortunate enough to engage the co-operation of New Era College, at which he teaches, to provide premises for the offices and classrooms of the Centre, and to provide secretarial services. He intends to start running courses in Basic Economics as soon as possible.

And the Price Today?

"THE United States Government placed special trains at the Prince's disposal, and he travelled everywhere in a luxuriously appointed director's car. He had an excellent reception in Chicago, and went afterwards to shoot prairie fowl, quail, plover and a few cranes on the soft, rich, breezy meadows round the village of Dwight. He liked always to elicit factual information, and was interested to learn that the price of land in Dwight had risen during the past five years from ninety cents to one hundred dollars an acre."

—From the chapter on the visit by the Prince of Wales to the U.S.A. in 1860 from *King Edward the Seventh*, official biography by Philip Magnus. (John Murray, London, 1964.)