Lesson of New Zealand

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

MECHANISM OF EXCHANGE

WE have seen that the chief earners of overseas exchange are our exporters of both goods and services, who usually leave it to their customers to worry about the actual job of exchanging, or, as it is sometimes called, converting, this overseas currency into British pounds. They in turn usually hand this job over to their bank.

Let us take a simple example of the exchange of currencies which takes place when British goods are sent abroad. Let us imagine that a British firm, which we shall call Vulcan Cars Ltd., has sold £100,000 worth of motor cars to the American firm of Car Sales Inc., New York. Having arranged for the motor cars to be shipped, Vulcan Cars will draw a Bill of Exchange upon the New York firm requiring it to pay £100,000 within a period of, say, ninety days to Vulcan Cars or to whomever owns the bill when it falls due.

This bill will be sent to Vulcan Cars' agent in New York together with the Bill of Lading—which is the document which entitles the importer to receive the cars from the shipping company. The agent will present the Bill of Exchange to Car Sales Inc., for acceptance. Upon its being accepted and signed the agent will hand over the Bill of Lading.

The Bill of Exchange will then be sent back to Vulcan Cars Ltd. As they probably do not wish to wait ninety days for their money they will take this bill to their bank which will credit them at once with £100,000, less a small discount for thus accommodating them.

The bank, which we will call County Bank Ltd., will then send this bill back to its New York agent, and when the ninety days are up it will collect the equivalent of £100,000 in dollars, at the prevailing rate of exchange, from Car Sales Inc.

In actual practice, this transaction will be simplified by the fact that County Bank Ltd. will probably handle, on behalf of Vulcan Cars, all the business connected with this bill from the moment the cars are shipped and will arrange for its acceptance by Car Sales Inc.

County Bank Ltd. is constantly doing this service for British exporters so that in the course of a year it pays out many millions of pounds for Bills of Exchange which will eventually be paid in America in dollars. Constantly to pay out pounds and receive dollars in return would be embarrassing for any bank if there were not a reverse process to relieve it of such dollars and restore its supply of pounds. Fortunately American firms are regularly exporting goods to Great Britain and drawing up bills requiring British importers to pay dollars within a stated time in the USA. The New York agents of County Bank Ltd. are constantly using their dollars to buy these bills which are sent to England and in due course presented to the British importer, for payment of the equivalent number of pounds. New York banks, too, are of course doing similar work for their own importers and exporters, and County Bank Ltd. is therefore receiving from the London agent of these New York banks sterling payments for bills drawn in sterling.

This is a simplified description of those exchange transactions by which payment is made for goods passing between countries. In practice many refinements take place. For example, Car Sales Inc., with the object of placing its credit on a firm foundation, may arrange with its bank to accept such bills on its behalf and will request Vulcan Cars Ltd. to draw upon its bank instead of upon themselves. The signature of a well-known bank upon a bill in place of the unknown firm of Car Sales Inc. will make it far more easy to discount or sell such a bill.

Or Car Sales Inc. may arrange for an English bank to accept bills on its behalf, thus saving the delay of sending a bill for acceptance to New York. In fact, most bills drawn in England upon foreign importers are to-day, by arrangement, usually accepted in London. This is known as the Documentary Credit system.

By buying bills which must eventually be met by foreigners in payment for the delivery of British goods, banks have built up a great trade in foreign currency so that if necessary they can always accept a customer's sterling in Great Britain and pay out the corresponding value in foreign money, wherever required, by merely cabling instructions to their branch or agent.

A British bank may buy millions of pounds worth of Bills of Exchange within a few weeks. Sometimes it runs out of cash to finance this vast purchase. It can however always re-discount its bills on the market. The rate at which the Bank of England takes bills from the market is the famous Bank Rate of which we hear so much.

It used sometimes to be said that paying for imports runs the country short of money and that therefore tariff barriers should be erected to 'keep the money in the country'. This is entirely fallacious, for except when gold is used to correct small balances, money never leaves a country to pay for goods or services. Even when one 'sends' money abroad to a friend no money actually leaves the country. If, for example, one decides to send £20 to a daughter holidaying in Switzerland one simply pays £20 into a London bank. The bank will telegraph instructions to its branch in Switzerland to hand the fortunate child the equivalent in Swiss francs, charging for its trouble a few shillings commission. What has really happened is that £20 has been exchanged for Swiss francs at the prevailing rate of exchange and no money has left the country.

Even capital does not leave the country in the form of money. If an investor wants to send £50,000 to Canada he would pay that amount to his bank in England, and its branch in Canada would place the equivalent amount in dollars at his disposal in Canada.

What in fact would probably occur is that £50,000 worth of dollars that had been earned by some British exporter would be transferred to the Canadian account of the British capitalist. Instead of being used to buy Canadian goods for export to Great Britain they would be used for investment in Canadian industry. This would eventually mean the earning of interest or dividends which would be used to produce a yearly flow of goods to Great Britain.

When a Dominion borrows money on the London market, let us say, £10,000,000, this money never leaves London. It is simply placed to the credit of that Dominion in a British bank. The Dominion's government then uses that money to buy the railways and harbour installations, etc., for which the money was lent. In years to come the people who contributed to that loan will receive, in the form of interest on their stock, some of the wealth these railways and harbour installations have helped to create. That interest will reach this country in the form of Dominion products.

British banks, by discounting or buying the bills of British exporters, are constantly acquiring overseas currency, and by discounting or buying the bills of foreign exporters they are constantly repossessing British currency. Currencies are not sent from one country to another but goods are. The exchange of currency is only a means of bringing into effect this exchange of goods. As money in its own country is a means of exchange, so the exchange of currencies is a means of exchanging goods and services between nations.

But let us now suppose that some foreign country, say, America, kept sending us large quantities of goods and for reasons such as the American tariff barrier we exported few goods in return; what would happen then? The American exporters would be drawing up large numbers of bills upon Englishmen requiring payment in dollars and offering them for sale in the New York market. But as British banks would be discounting few bills drawn upon Americans they would find the dollar exchange moving against sterling. Dollars in the possession of those anxious to buy American bills would become scarce. The dollar would become a hard currency.

In consequence those who were short of dollars but who had plenty of bills entitling them to payment in pounds would be willing to pay a few more pounds for the dollars they required. A pound would exchange for fewer dollars than formerly. With many pounds chasing few dollars the inexorable laws of supply and demand would operate and the price of dollars would go up in terms of pounds.

This would mean that it would cost a British importer a little more in pounds for every 100 dollars worth of goods he wishes to buy. Imports are consequently discouraged. At the same time the American importer finds that he can buy more British pounds for his dollars than formerly. This cheapens the price of British goods to the American importer and in consequence exports are encouraged. This tends to balance the supply of dollar and pound bills in the market again.

It is impossible for a country to continue importing more goods and services than it pays for by the export of goods and services unless it runs into debt, which it

Cat among the Pigeons

RIGHT in the middle of general nervousness in the gold and exchange markets, the case for flexible exchange rates has again been brought under discussion in Germany — this time not by an isolated statement from a private theorist, but instead by a considered suggestion from an official advisory committee.

The bombshell came from the council of experts, three professors and two businessmen, set up by the government some months ago to examine the economy and to recommend any practical steps required to smooth its future development. In the committee's first report, now out, the "five wise men" chose to expound in great detail the advantages of flexible rates of exchange, particularly for stabilising domestic prices. They dismiss as preponderantly political the question of whether fixed exchange rates are essential to international financial cooperation and integration. The experts could hardly have demonstrated their independence more flagrantly. For this stand flies in the face of all past government and central bank statements on exchange rate policy.

An embarrassed government has tried to scotch this awkward suggestion by publishing alongside the committee's report an official communiqué once again clearly abjurring any transition to flexible rates. It not only points to Germany's legal ties but also states categorically that even without these commitments the government would not desert its defence of a fixed rate of exchange.

— *The Economist*, January 16.

eventually repudiates, or it finds a kindly neighbour like the USA which, without any thought of reward, will put dollars at its disposal with which to purchase American goods.

Unless a country is willing to make free gifts to the world, it will soon find that, if it reduces its imports by such means as customs tariffs, its exports will be reduced to an equal amount.

This does not mean, of course, that a people's imports from a given country must balance with its exports to that country. British imports from America, for example, could quite easily be paid for by the export of rubber from Malaya which Great Britain would pay for by sending goods to Singapore. Bills drawn in England upon Malayan merchants could be purchased by Americans and used to pay for the rubber they require. These three-cornered transactions are done through reciprocal accounts known amongst bankers as Nostro and Vostro accounts.

Before the first world war international payments had ceased to be a problem; currency shortages and unbalanced international payments were unknown. So was the existence of economists in government departments.

STATE CONTROL

WE have now seen something of the machinery whereby foreign currencies are bought and sold, and we have seen that the price of such currencies measured in pounds sterling depends upon the opinions of buyers and sellers as to their power to purchase goods and services.

In a free community the consensus of such opinion creates the market value of a currency and this is the only value that can be described as a true one. It follows, therefore, that except in rare instances (where an arbitrary value happens to coincide with the market value) any value placed upon a currency by the state must necessarily be a false one. It also follows that, except in the rare instances mentioned, where currencies are sold at controlled rates, one of the parties to every transaction will inevitably receive less than he is entitled to. Someone, in fact, is robbed.

Businessmen, if left free to buy and sell currencies, are not powerful enough to overcharge each other. There are always too many sellers in the market. If currencies are to be sold at false values a power of monopoly, which only a government can wield, is necessary. It is almost certain that there is no history of rings or monopolies in exchange transaction except where governments have interfered to create them. For a period which begins sometime after the Napoleonic wars and ends with the outbreak of war in 1914, most of the world's governments left the buying and selling of currencies entirely to businessmen.

War certainly gives the Government an excuse for action in the currency market. It has as much right, during times of war, to requisition the foreign currency owned by its nationals as it has to take possession of any other form of property. But when peace returns this right to requisition foreign currency should end just as soon as the general right of the Government to requisition comes to an end.

If, during times of peace, a government retains its war time power to control currencies, then the rates of exchange it authorises are almost certain not to coincide with the free market rate, which means that the government favours one party to every exchange transaction.

We have become accustomed to the Government interfering in the economy with the purpose, often misdirected, of helping the poorer members of society; it is difficult, however, to see how the control of exchange rates can benefit the poor. In fact, such examples of exchange control as are so far forthcoming indicate that the poor are far more likely to suffer than to benefit by such state activity. It must be remembered, too, that there are always two parties to every exchange transaction and that any rate which benefits one party must injure the other by exactly the same amount.

A typical example of peace time exchange controls is afforded by the arbitrary fixing of the New Zealand and sterling rate by the New Zealand Government.

When in 1931 Great Britain, as a result of her failure to keep to the rules of the Gold Standard, was forced off gold, it became evident that both the New Zealand and Australian pounds were less valuable than the pound sterling. Australia, which had passed through a period of inflation, found that it required 125 Australian pounds to purchase £100 sterling. New Zealand, on the other hand, found that she could obtain £100 sterling for 110 New Zealand pounds. Subject to the many factors influencing exchange rates, both these rates represented approximately the purchasing power parity of the two currencies.

It was soon pointed out to the New Zealand farmer that when he sold £100 worth of produce on the London market he received £110 in New Zealand currency, but when the Australian sold £100 worth of produce to London he received 125 Australian pounds.

Quite overlooking the fact that his own New Zealand pound had a greater purchasing power than the Australian pound, the New Zealand farmer saw, in this apparent difference in returns, nothing but injustice. He demanded that his government fix the rate of exchange so that he, like the Australians, should receive £125 in the currency of his country for every £100 worth of produce sold in Great Britain. The New Zealand Government succumbed to the pressure of the powerful farming interests, and fixed the rate at 124 New Zealand pounds for £100 British. Near enough to the Australian rate to satisfy the New Zealand farmer.

The fundamental difference between the Australian and New Zealand rate now, on the face of it so similar, was that the Australian rate had been arrived at in the free market whereas the New Zealand rate was £14 more than the free rate.

Several consequences followed. Those who had New

Zealand money to sell did not wish to part with it at £124 New Zealand to £100 British. Such a rate meant that for each New Zealand pound the seller received the equivalent of 16s. in British money, whereas in real purchasing power, as indicated by the abandoned free market, it was worth about 18s.

Nobody wants to sell a thing at below the market rate and this applies to currencies just as much as to any other commodity. New Zealand importers became reluctant to part with New Zealand money at this fixed price. It added to the cost of the goods they imported and this reduced their sales. On the other hand, owners of British sterling became very anxious to exchange it for this underpriced New Zealand money. The result was the demand for New Zealand money became so great that it could not be met.

There was nothing the Government could do but set up a department to ration the available supply. As it was the custom for New Zealanders to pass all their exchange transactions through a very few banks, this was not difficult.

The Government found that at this fixed rate of exchange there was only enough New Zealand currency, which could be exchanged into pounds, to meet the ordinary trade demands of British importers. Others had to go without.

The result was that many British people who wanted to send money to New Zealand to pay a debt, or to meet an insurance claim, or for the purposes of investment, etc., could not do so. For generations an Englishman has been able to send money all over the world by merely getting in touch with his bank; the fact that he could not now send money to a Dominion was, quite simply, beyond his comprehension.

In indignation he went to the New Zealand Government offices in the Strand. Here he was told that it was quite impossible for him to send money to New Zealand at the official rate, but that the New Zealand Government, as a special favour, would allow him to send it, provided he accepted £100 New Zealand to every £100 British sterling.

The result was that one man, usually an importer, could send £100 to New Zealand and receive £124NZ and another could send the same amount and receive only £100NZ. (In fact, of course, no money was sent to New Zealand. In one case £100 sterling was exchanged for £124NZ and in the other it was exchanged for £100NZ).

But owing to human ingenuity the New Zealand Government was not to be left to have it all its own way.

If a commodity is being bought for £124 and sold for £100 it obviously offers an opportunity for an honest broker to make a few pounds by bringing buyer and seller together. Why should an owner of British pounds not hand in his £100 to the London office of a New Zealand importer and that importer hand out say £112 to his order in New Zealand. Both parties to such a transaction would then be better off by £12 and be able to give a suitable reward to the broker.

This division of the difference between the two rates actually occurred. For the first time since the days of the pioneers some New Zealand exchange transactions were arranged quite outside normal banking channels.

Such exchanges of currencies were called Black Market transactions, but the New Zealand Government had neglected to make them illegal. They continued to grow in number and volume until the New Zealand Government decided to pay out £124 to everyone who wanted to send £100 sterling to New Zealand. This meant that the New Zealand tax-payer had to provide the money to meet the cost of this under-pricing of New Zealand currency.

But let us go back to the reason which caused the New Zealand Government to make this extraordinary incursion into economic affairs. Was it done to help the poor? If anything, the poor of New Zealand live in the cities, and to a great measure paid the cost of this experiment. When the New Zealand farmer sold £100 worth of goods in the British market he received £124NZ instead of the free rate of £110NZ. But when the New Zealand importer wanted to purchase £100 worth of British goods he had to pay £124NZ instead of £110NZ.

This meant that the state action of controlling the exchange rate took £14 in approximately every hundred out of the pockets of the importers to place it in the pockets of the exporters. As the farmer, as well as being a large exporter, is also a large consumer of imported goods, it may be claimed that this government action only took money out of one of his pockets to place it in another, but not everyone in New Zealand is a farmer.

Exchange control meant that the city dweller had to pay more for his clothing, books, furnishings, hardware, tools and machinery, etc. In fact, in some cases even his food increased in price, for New Zealand imports a large percentage of the wheat she consumes.

In fact, this extraordinary action of the New Zealand Government in fixing the exchange rates, as well as giving work in government offices, controlling exchange transactions and giving importers a great deal of trouble, extracted large sums of money out the pockets of one class of the community and placed it in the pockets of another class, probably the richer of the two classes affected.

In fact the sole object of this New Zealand exchange control between the two wars was a redistribution of wealth. This redistribution was not done with the object of alleviating the hardships of the poor or from any beneficient purpose whatever. It was simply an assertion of political power by a sectional interest for its own economic advantage. If we examine all state actions in controlling the exchange of currencies, it will be found that, except in the case of war, such sectional advantage is invariably the motivating reason behind them.

There is, however, one form of exchange control which is an exception to this rule. That is the control exercised by the Exchange Equalisation Account established in

Great Britain before the war. The object of this account was to iron out currency fluctuations. It was not intended to prevent long term changes in the prices of currencies. It acted merely as an exchange dealer.

One of the troubles of such an account is that those who control it may not discover a real deterioration in the value of a currency until they have spent many millions in overstocking it.

It is safer for the public to allow speculators in the buying and selling of exchange to take the risks involved. Their activities iron out exchange fluctuations without injury to the taxpayer. Exporters and importers, too, can always obtain from them fixed terms for supplies of currencies to be delivered at a future date.

However, the influence asserted over exchange rates by Equalisation Accounts, although bad, is certainly far less dangerous than the deliberate control of those rates for political purposes. They are certainly innocuous compared with that confiscation of overseas exchange in which it has been the practice of governments to indulge since the war, and which I will deal with in the next chapter.

A Discerning Economist

"A DEFECT of our property tax system that is seldom mentioned is that it puts a premium on obsolescence and penalises new housing. This is so because property taxes are *ad valorem* taxes. Every piece of real estate except land is subject to depreciation... Economists agree that taxes on land cannot be shifted but are capitalised... Homeowners who bought their homes some time in the past can reap large profits when selling them. Old homes should sell at a lower price because of the depreciation of the building, but in most cases the depreciation of the building is more than offset by the increased value of the lot... Increases in land values can be prevented by taxing land at an appropriate rate.

"We have found that a high and burdensome tax rate on improvements will discourage residential construction, penalise home ownership, aggravate the housing shortage and force up rents. A low rate of tax on land will have similar if not identical effects: it will lead to a rise in urban land values, which in turn will discourage residential construction, create unemployment, penalise home ownership, aggravate the housing shortage and force up rents. The paradox of property taxation consists in the fact that lower rates on improvements produce the same results as higher rates on land, and conversely higher rates on improvements produce the same results as lower rates on land.

"Expenditures of local governments increased from $9.1 billions in 1946 to $30.6 billions in 1957. A considerable part of this increase — maybe one-third or more — could have been avoided by a tax system that would ensure, not only a more rational use of land, but also a sound economy in our urban affairs."

Extracts from a paper advocating revision of U.S. property taxes to an emphasis on land values rather than on improvement values given by Dr. Herbert J. G. Bab, Ph.D. in Political Economy, and former J. M. Keynes research fellowship holder at King's College, Cambridge.

IN MEMORIAM

A. G. Huie

ALEXANDER GORDON HUIE, although he will be remembered chiefly by his friends in the Georgeist movement, will also be remembered by others among whom he exerted a considerable influence.

Mr. Huie was twenty-one when, in 1890, Henry George made a lecture tour of Australia, but he was not able to see George in person. He was a committed supporter and campaigned in fourteen elections from 1894 onwards on a programme of free enterprise, free trade, land-value taxation and proportional representation.

In 1901 he attended a meeting in Sydney at which the Sydney Single Tax League was formed. There, Mr. Huie was elected as Secretary of the League and remained in that post for fifty-two years. During this time he was responsible for much of the agitation that secured the introduction of site-value rating in New South Wales and the adoption of proportional representation for elections to the Australian Senate.

He founded *The Standard,* a monthly journal of the N.S.W. League, and remained as editor until his retirement from the secretaryship of the League in 1953.

At the 1964 Conference of the International Union Mr. Huie was elected a vice-president representing Australia.

Mr. Huie was a prolific writer of letters to the Press. In the first five years of his retirement he had over five hundred letters published in a great variety of newspapers. The *Sydney Morning Herald* alone published some two hundred and twenty letters from him over a period of more than forty years, and once published an article about him, acknowledging his widespread influence for more than sixty years.

Mr. Huie died on November 7, 1964, at the age of ninety-five. The organisation he built up in New South Wales owes a great deal to his drive and enthusiasm and continues to press for the reforms for which he so persistently and ably fought.

(A Personally Speaking article "Seventy Years A Georgeist," appeared in LAND & LIBERTY, December,1958)