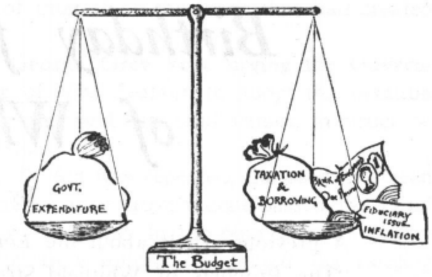
Machinations in the Money Market



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

CONFISCATION OF FOREIGN EXCHANGE

PERHAPS the first country during modern times to confiscate all the overseas exchange belonging to its nationals was Hitler's Germany. It may be argued that Lenin forestalled Hitler in this practice but, as Russians under Communism were never allowed to own overseas exchange, the issue is rather academic.

Hitler, with the assistance of the banker Schacht, allowed German businessmen to earn overseas exchange and then promptly seized it, paying them in German marks a compensation fixed by the state that was completely inadequate.

Germans, of course, attempted to avoid this plunder by smuggling foreign drafts and all forms of easily carried valuables, such as diamonds, out of the country. There is nothing more difficult for a government than to block all methods by which the exchange of currencies can be effected. There are a thousand ways of avoiding exchange regulations. An English visitor, for example, might have his expenses paid for in Germany in exchange for depositing pounds to a German's credit in London. Or a merchant wishing to flee Nazism might underprice goods he was sending to London and arrange for the balance to be placed to his credit in a London account.

Diamonds become particularly valuable to people endeavouring to get money out of a country, for they are easily smuggled across the border and then sold for the currency required. Even stamp collections rise in value, for rare stamps are even more easily smuggled than diamonds.

Before the war we were constantly reading of men and women being arrested by the German customs authorities for currency offences. Christian nuns, travelling out of Germany, were particularly noted victims. To be effective, currency laws must not only provide that people leaving a country be carefully searched, but that all overseas mail be censored. The penalty of death for certain currency offences was actually promulgated by Hitler, but even this did not prevent black market exchange transactions from taking place.

In the years before the war the whole world was shocked at the disregard of personal liberty inherent in Hitler's exchange regulations, but the currency laws in Great Britain under the post-war Labour Government, with the exception that there was no death penalty, were very nearly on all fours with those of Hitler. Even under the succeeding Conservative Government they were only partially mitigated.

Let us consider what the British politician now means when he speaks of controlling overseas exchange. The word 'control' in this context is certainly an example of the famous British weakness for understatement. In actual fact all foreign currencies, outside the sterling area, owned by Englishmen must be surrendered to the Government. There is here far more than control; there is, quite literally, confiscation. Every dollar, for example, earned by an Englishman for goods supplied to or services performed for Americans must be surrendered. Even a British journalist who earns a few dollars for an article published in an American magazine cannot spend them on American books, but must hand them to his bank, which acts as a government collecting agency.

It would be far more realistic to-day to speak, not of the control, but of the confiscation, or at least 'requisitioning' of foreign exchange. Of course, compensation is paid, but invariably it is insufficient. If this were not so there would be no need for punishment to enforce the surrender of currencies.

Since 1949, when Great Britain devalued the pound, the inadequacy of the compensation paid has not been very great, but before that date, and especially when the Treasury was ruled by Sir Stafford Cripps, the rate of compensation was so low that it robbed the owners of overseas exchange to the value of many millions of pounds. Under Sir Stafford Cripps the rate of exchange with the USA was fixed at 4.03 dollars to the pound. This meant that, when our motor car manufacturers earned dollars by the sale of their cars in the United States, they were promptly seized by the British Government, which paid the unhappy exporter £1 for every 4.03 of his dollars it appropriated.

Now this might have been fair enough just after the war, but as soon as the Labour Party came to power it commenced a great expenditure on welfare services and capital development, which it was not able to pay for out of the proceeds of taxation. The Government therefore compelled the Bank of England to meet demands by increasing the supply of money. In 1945, after the most expensive war in history, the deposits in our bank stood at £4,692,000,000. In 1949, when Great Britain was forced to devalue the pound, this figure had increased to £5,974,000,000. As the production of consumer goods had not similarly increased, there is evidence here of a very great inflation or deterioration in the value of the pound. It was steadily losing its purchasing power.

The dollar was also deteriorating in value, but not to the same degree, and the result was that by 1948 it was quite evident to the men who wanted to buy overseas exchange that 4.03 dollars were worth very much more than £1 sterling. In other words, the rate of 4.03 dollars to the pound greatly undervalued dollars and overvalued sterling.

Now any shopkeeper will tell us that if he gets a very good line and puts it on show at a very low price there will be a rush to buy it. If, as a result of government price regulations, he is not allowed to raise its price, it will soon become scarce and he will probably put his stock under the counter to keep it for his friends.

This is precisely what happened to the dollar. During the post-war years the dollar could be used to purchase almost anything. It was a very valuable currency to hold. The pound, on the other hand, was a definitely inferior currency. If you were a foreigner you could not buy what you liked with it. To begin with you had to get the consent of the British Treasury if you wished to exchange it for currencies outside the sterling area. Even when you tried to spend it in Great Britain the Board of Trade gave you a list of the goods you were allowed to buy; coal, which you invariably wanted particularly, was conspicuous for its absence from that list. It was because of such facts as these that British officials, anxious to buy meat and other commodities abroad, met with so many difficulties.

The result of all this was that the one desire of most foreigners who owned pounds was to exchange them as quickly as they could for dollars. This undervaluation of the dollar also made the British importer as anxious as the foreigner to exchange his pounds for the American currency. He found that he could purchase more goods with 4.03 dollars in America than he could anywhere else with £1.

All this meant that there was a very great demand for dollars. But at the legal rate of exchange there were very few people anxious to sell them for British pounds. Dollars became a hard currency. Everyone spoke of the dollar shortage.

To most people this dollar shortage implied that there were less dollars with which to buy our food and raw materials than before the war. But this was not so. In actual fact the American £1,000,000,000 loan (paid originally in dollars), the Canadian dollar gift and later Marshall Aid, together with the dollars earned by our export trade, gave us more dollars than we had ever before possessed. But we had not enough to meet the excessive demand created by pricing them too cheaply. If someone were to offer us pound notes at 18s. each the demand would be unlimited. That was precisely the position of the dollar. The British Government was confiscating them from those who earned them, and selling them below their value. The result was that the demand for them was insatiable.

The economist Roy Harrod, knowing the interpretation the public placed upon the so-called dollar shortage, was one of the few writers who tried to enlighten them. In his book *Are These Hardships Necessary?* he wrote: 'This allegation of a world dollar shortage is surely one of the most brazen pieces of collective effrontery that has ever been uttered.'

It must be realised that anything can be made to appear in short supply by merely fixing the price below its market value. Any government with totalitarian leanings can always create high prices by inflating the currency. This in turn gives it the excuse for fixing prices and rationing supplies. It was the inflation of the pound that created the excessive demand for the dollar.

It is worthwhile mentioning here that the Americans, during the reign of Dr. Dalton at the Treasury, made one very generous attempt to free the pound. One of the conditions of their £1,000,000,000 loan was that we made the pound convertible. Dr. Dalton did so but he retained the fixed rate of 4.03 dollars per pound. To every foreigner who had pounds in Great Britain this meant a free gift from the British public. They rushed to obtain Dr. Dalton's cheap dollars. His whole loan of £1,000,000,000, paid in approximately 4,030,000,000 dollars, would have soon disappeared if he had not quickly gone back on his word and controlled foreign exchange again.

To free foreign exchange means to free the rates at which it is sold. If the Government merely allows the public to exchange their currencies at fixed rates, gluts and shortages will soon appear. If governments want free exchange rates to remain stable, the only way this can be effected is to make currency convertible, on demand, into some commodity with intrinsic value such as gold. When the world went off the gold standard it lost its one hope of retaining an international currency. This loss can, however, be repaired to a very great extent if exchange rates are free to reflect the changing values of currencies.

A rather obvious question now arises. Why did Great Britain fix the exchange rate so that it undervalued the dollar? We can be sure that although the idea of a planned economy was very popular during this period, this rate was not fixed by scientific planners working out in some secluded back room of the Treasury what was best for the country as a whole. Such decisions are not left to scientists or economists; they are always made by politicians.

At that time, it must be remembered, the Government policy of spending more than it could pay for from the proceeds of taxation was bringing about a very great inflation This tended to increase the sterling price of food. If, however, the exchange rate failed to reflect this inflation of the pound, then, for the time being at least, we would be able to buy our food from overseas at cheaper rates. Cheap dollars to some extent meant cheaper food for Great Britain. Thus this fixed rate of 4.03 dollars to the pound hid our inflation and saved us for a time from its consequences.

The effect upon our exporters and other earners of overseas exchange was that they received less for their earnings than they were entitled to, and, in fact, were robbed of millions of pounds to keep the price of food down. It may have been desirable to cheapen the price of food, but the costs of doing so should have been borne by the whole community, not by our exporters.

To fix an exchange rate is inevitably to rob one of the two parties to every exchange transaction, and like every other form of robbery, it brings unpleasant consequences. It is one thing for a government to fix the price of commodities at below their market value, but unless it can coerce suppliers, shortages become inevitable.

The effect of fixing the price of the dollar below its true value resulted in the American importer finding that he had to pay too many dollars to buy the pounds necessary to purchase British manufactured goods. The result was that British exports grew less and dollars became not only relatively, but actually, scarce. The false rate of exchange meant that the British manufacturer received roughly 5s. for every dollar he earned, whereas it was worth much more than that. With rising prices at home he soon found he could not compete on the American market.

During 1948 it became apparent to every businessman that this undervaluation of the dollar could not last. The one man who was not convinced of this was Sir Stafford Cripps, and he was master of the situation. During the following year he announced again and again that Great

Britain would never devalue the pound. By September it became evident, even to Sir Stafford Cripps himself, that if the pound were not devalued British trade would be reduced to a disastrous degree and serious unemployment in British industry would follow. He at last succumbed to the pressure of economic forces and devalued the pound, registering, in the new exchange rate, the fall in its value that had been taking place during his whole period of office. The result of this reversion to comparative honesty was the recovery of Great Britain's export trade.

Sir Stafford Cripps, during the whole of his period at the Treasury, by confiscating all the foreign exchange earned by Britons, was robbing our exporting industries of a large part of their earnings. The extent of this robbery increased as the value of sterling depreciated. As the devaluation of the pound in September 1949 is considered to have reduced its price, when expressed in dollars, to roughly its true value, and as this devaluation was long overdue, it is quite evident that Sir Stafford, over a long period, was paying our exporters 5s. for their dollars when in fact they were worth 7s. All the time that he was robbing our exporters he was pleading in speech after speech that Great Britain must 'Export or Die.'

For a year or two, by this form of robbery, we were able to force the export industries to bear on their backs the cost of providing food for the people at below its real cost, but at the same time we lost a wonderful opportunity to expand our export trade, the consequences of which we are feeling to this day.

During this post-war period Japan and Germany as export rivals were out of the market and the whole world was demanding our goods. Had our export industries been able to receive the full rewards of their endeavours, they would have been able to pay wages above the national average and thus obtain the labour they required. They would also have been able to modernise their plants, and by fully re-establishing their overseas markets they would have been able to consolidate their position for the future. The great improvement in Britain's export trade that resulted when the pound was allowed to be sold at 2.80 dollars gives us a glimpse of the trade we missed during those vital years, when, in the markets of the world, opposition was negligible.

The confiscation of foreign exchange that took place during the years that immediately preceded devaluation in 1949 has done the British economy harm that can never be fully estimated. The basic cause of this harm was the complete disregard of the individual's right to freely dispose of his overseas earnings. A government has no more right to confiscate foreign exchange than it has to seize profits or wages earned at home, except of course for necessary taxation in which all are treated alike and no section of industry is favoured or victimised. Behind every action of exchange control there is this denial of the individual's right to the property he earns.

Two thousand years ago the founder of the Christian religion told us that robbery was unlawful. Would it not be wise to accept this, or at least to consider whether it does not apply to governments as well as to individuals, before we follow the precedent for exchange control set us by Hitler and Lenin?

At The Expense of Producers

The real unearned income is that which accrues to an individual without his having done anything that contributes to production. Of the several types of such income the most important is that which issues from the site value of land. The recipient of such an income does nothing to earn it; he merely sits tight while the growth of the community about the land to which he holds title brings him an unmerited gain. This gain is at the expense of all true producers, whether they be labourers, enterprisers or investors in industrial equipment. The taxation of this gain can do nothing to deprive the community of any service since the donee is rendering none. The land will be there for the use of society whether the return from it is taxed or free. Society creates the value and should secure it by taxation.

—Frank D. Graham, Professor of Economics, Princeton University.