

EASTERN EXCHANGE

Expert Opinion On How Europe Depends On Asia— The Need For Stable Rates

DETERMINING FACTORS EXPLAINED

(By L. W. CROSS IN "BUSINESS ORGANIZATION AND MANAGEMENT.")

"The East is East and the West is West, and never the twain shall meet," is an expression freely quoted. The idea this prophecy was intended to convey is not exactly clear. It was probably meant to show the incompatibility of Eastern and Western civilization, and that as old and water could not combine, so the Eastern and the Western minds could never operate in harmony. Whether this view be right or whether it be wrong, it is quite clear that the Western civilization could not maintain its full development without the agricultural resources of the East. India and China are at different stages of economic development, but China alone can provide every kind of raw material of which the world stands in need. Wheat, cotton, coal, iron, seeds of every kind, etc., are even in her present economic position produced in large quantities. It is only recently that a cargo of coal from China was discharged at Newcastle at a price below that at which it could be sold locally.

The Determining Factors In Production Cost

The West is dependent upon the East not only for the simple reason that it produces many of the necessities of life which we import, but as a large consumer of our manufactured articles. The East, particularly India and China, is a large buyer from the British Isles, and it is in this dual dependence that the Eastern exchanges play such an important part.

The two determining factors in the cost of production are:

1. The cost of the raw materials used.

2. Wages.

It will be readily appreciated how important an influence the Eastern exchange have on these two factors. The raw materials that come from the East form the basis of a large proportion of the manufacturing activities of this country. The food of our people, to a considerable extent, also comes from the East. The relation of the price of raw materials to the cost of manufacture is quite obvious, but the influence of the exchange on the other factor of production—wages—is not quite so apparent. Wages must inevitably rise with the cost of living, and the cost of living cannot fall while the cost of the necessities of life are so heavy, and an unduly high exchange is a determining factor of the price of necessities. A high rate of exchange with the East has the obvious effect of increasing the cost of the commodities coming from the East, and as these are so essential to the life of the community, it is clear that they must exercise an influence on one or other of the factors of production. If they be raw materials the cost of manufacturing is increased, and if food, wages must rise, and unless the buying public, whether at home or abroad, is able to absorb goods produced under these conditions, the inevitable result must be unemployment.

Necessity Of Stable Exchanges

There is another side of this problem and that is, if the exchanges fall away unduly there is an automatic check to the flow of manufactured goods to the East. The Manchester trade is linked very intimately with the East. A 25 per cent. reduction in the value of the Shanghai tael or the rupee in effect means a 25 per cent. import duty on goods from Europe, as the native merchant has to provide 25 per cent. more local currency to buy the sterling equivalent. Unless other circumstances intervene, this movement would show itself in a reduced demand from the East for our goods. It is clear how very important the Eastern exchanges are to the community, and that we cannot be indifferent to the significance of their movements. If they be too high their influence is reflected in higher wages due to increased cost of living. If they be too low the effect is to curtail demand for our goods. Extremes in foreign exchanges (as in all other affairs of life) are always unfavourable, and the important point to remember is, that if we are to have a stabilized trade—both domestic and international—it is imperative that the Eastern exchanges should not be subject to wide variations.

It is essential to an exporter to have a reasonable exchange, and if it be desirable that a reduction in any given exchange should take place, this ought to be brought about slowly and not in violent spasms. Unfortunately, the Shanghai exchange is the happy hunting ground of the speculator. These speculative operations are most undesirable for the trader and the banker. Under such circumstances the trader does not know exactly

how his shipments are likely to turn out, and the steps he takes to protect his position by a suitable provision in his price may sometimes turn the business in other directions, and the banker may be led to take more caution than is justified by the actual position.

The stabilizing of the Eastern exchanges is a matter of grave import, and has received and is receiving much attention from the British Government in regard to India. The Consortium Governments are also thoroughly investigating the currency and general financial position of China.

The Case Of India

In previous articles we have seen that Japanese currency is constructed on a gold standard, and therefore its parity must always move relative to gold as expressed by the London-New York quotation. Indian currency and exchange is now passing through an experimental period due to the India Government's decision early in the year to stabilize exchange on the laying-down price of gold either in Bombay or in London, and to alter the relative value of the rupee from 15 to £1 sterling to 10 to £1 sterling for internal circulation. This alteration was made legal by the Indian Government in the middle of September of this year. The new policy inaugurated by the Indian Government has apparently failed immediately to accomplish its purpose, but what the ultimate result may be time alone will show.

The effect of this policy is to make Indian exchange move relative to the two precious metals—gold and silver. So far as gold is concerned, its movement to and from India is entirely free, and its influence on exchange is determined chiefly by the demand for it in the Indian bazaars, which is sometimes as high as 7½ per cent. over the London price. On the other hand, if necessary, exchange can be provided by reselling gold on the London market. With regard to bar silver, the influence this exerts on the outward rate is based chiefly on the price at which it can be bought in London and sold in Bombay.

Owing to the closing of the Indian Mints to the free coinage of silver since 1893, the price of standard silver in London is the only absolute silver factor determining the course of the Indian exchange. If the price of silver in London is higher than the exchange rate of the rupee plus the laying down price of the silver contents of the rupee coin here, either one of two things will happen; the price of silver will fall or exchange will rise—the determining factor being whether the silver contents of the rupee will yield a greater sterling value than a purchase of exchange. The rupee cannot be automatically provided in the other direction, i.e., in Indian exchange the influence of both the precious metals must be taken into account. The previous article demonstrated clearly that the exchange of China is a white metal exchange pure and simple, and though gold is sent there the operation is chiefly of a commercial character.

The Consortium Banks, in the efforts that they will undoubtedly make to reform the currency of China and to give some stability to her exchange, will of necessity take fully into account the silver problem. The exchanges of China, and India to a lesser extent, will for many a day to come be linked with silver.

The Silver Position

No review, however brief, of the Eastern exchanges, would be complete without some reference to silver. The War is responsible for the great change in the silver market, its wide fluctuations and the serious disturbance in the Eastern exchanges. Before the War silver moved between 25d. to 30d. In February, 1920, the price of standard silver had risen to its peak of 89½d. By the middle of June it had fallen to 44d., and on August 21—about two months later—it had risen to 63½d. To-day (October 25) it is 52½d.

These wide variations in the price of silver this year alone will show how disturbing a factor the movements in the price of silver are in the Eastern exchange. In view of its influence on the Eastern exchanges, the course of the silver market is always of considerable importance to the banking and commercial community. One of the most remarkable results of the War is that, whereas, before, and to a considerable extent during the War, Europe was a regular buyer of silver for coinage, since the armistice Europe and the Near East have been consistent sellers of silver. Many factors have contributed to this, but the chief are the high price

of silver and the depreciated exchanges of the continent and the Near East. The result has been to throw to the London silver market large quantities of melted silver currencies, and it is this flow of silver to London that has contributed in no small degree to the weakness that has taken place, and unless the export trade of the East takes a more favourable turn, this factor will continue to cause wide fluctuations in the price of silver and consequently of the Eastern exchanges.

Perils Of Violent Fluctuations In exchanges

Commerce and banking require steadiness in exchange for their fullest development, and in the grave uncertainties of the present situation, violently moving exchanges with the East are a source of danger to commerce and finance. Every step should be taken by those who have the power, to do everything possible to eliminate the wide movements in the Eastern exchanges which mean so much to the cost of food and of the raw materials of industry and the absorption by the East of our manufactured goods.

Silver, the complement to the Eastern exchanges, is, though unknown to the majority of people, one of the largest factors in the adjustment of many of the international post-war problems, and through the London market is assuming a growing importance.

The Comptroller

We cannot close this series of articles without a reference to the very important factor in Eastern trade and banking—the comptroller. The internal arrangement of the Chinese banks and large commercial houses comprise a dual organization. There is the European staff which is usually entirely ignorant of the language, customs, and standing of the natives. To correct this want, a comptroller is appointed, who has a separate office and a native staff on the premises. Practically all dealings with the natives take place through this gentleman, and he keeps his own set of books of the dealings. These books are balanced daily, and the respective accounts are compared with the accounts kept by the European staff to ascertain whether they agree. The need for such an appointment arose in the first place owing to the want of knowledge by the bank staff of the language of the country, and to the fact that the status and means of the native merchant is often unknown to the bank manager, who tries to protect his interests by the guarantee that the appointment of the comptroller provides—the latter's transactions are also sometimes guaranteed in other ways, so as to provide a tightening up of the security of the bank. This arrangement, though valuable, is a bar to progress as it does not induce the European to get to know the language or the tastes of the natives, and it is, of course, to the interests of the comptroller to see that this situation remains, and it gives him added security in his position.

In conclusion, it cannot be too strongly urged on our manufacturers and merchants to make every effort to maintain and develop the vast potential trade of China and India. We have assets in our prestige, knowledge, and commercial and banking experience which the United States of America and Japan have not. Some English companies are setting aside a fixed proportion of their output for the Eastern market and in view of its importance it might be a good policy for the whole of those who trade with the East to follow a similar course.

The statement may seem to be a little exaggerated, but a proper development of the East may mean the salvation of Europe.