

Chapter 14

On Currency Arbitrage

Hundreds of millions of dollars worth of foreign exchange transactions take place all over the world daily.

A transaction in foreign exchange is essential whenever the parties involved are doing business in two different countries and have to use two different currencies to consummate it. Arbitrage makes it possible to provide the foreign exchange needed for such transactions with minimal risk. Since the bank-of-issue I am attempting to describe would be doing business all over the world, it would have to engage in foreign exchange transactions on an enormous scale. Its own currency would be a foreign one even in the country in which the institution was located. In the Exeter experiment, the constant was a foreign currency even in Exeter; every conversion of constants into dollars and dollars into constants was in fact a foreign exchange transaction.

To make it possible to discuss this concretely rather than abstractly, I am going to call the bank-of-issue the BISC—the Bank for the Issue of a Stable Currency, and the currency it issues a constant.

There are many reasons why such a bank would have to equip itself for currency arbitrage of which these four are typical: (a) it would be accepting foreign currencies for

conversion into constants from its depositors. In the Exeter experiment the first problem we had to solve was that of the conversion of dollars into constants. Since the depositors in BISC would be located all over the world and the deposits would include their own national currencies, it would need to deal in foreign exchange to dispose of them (b) it would need foreign currencies for the withdrawal of funds by its depositors who had to use their own currency for local transactions (c) it would need them to provide for the needs of depositors when they engage in international transactions. Supplying this need would provide it with an enormous volume of business since it could provide it far less expensively than is the case today (d) the constant, being a stable international monetary unit, would make it possible for BISC to develop a source of income from the sale of the traveler's check and similar instruments, since they would be inflation proof. It would, of course, have to accept foreign currencies for them and have to have foreign currencies on hand to redeem them.

What makes the existing methods by which foreign exchange is provided so risky and so expensive are two facts, the fact that the fluctuations in value and changes in purchasing power of existing national currencies are in each instance independent variables, and the fact that the only method available now for measuring the value of foreign currencies is measuring them in a currency which is itself constantly fluctuating in value.

For BISC or any similar institution to provide the foreign exchange needed for legitimate international business transactions, it would have to use two instruments, the International Standard of Value already described and the International Currency Price Index described in the appendix. Computation of such a price index monthly proved adequate for experimental purposes but once such an institution as BISC began to really operate on a large scale, computation on a daily basis would become necessary. Once computation

of such an index was computerized, it could not only be issued daily, it could be issued hourly if any need for doing so developed.

Two enormously important steps toward international monetary decency and sanity would be made possible by BISC's operations in foreign exchange:

1. Costs of making foreign exchange transactions no matter how large would be trifling since a mere check in constants would make it possible to transfer funds from one country to another. The monetary barriers between nations would be eliminated. An American, for instance, could pay with dollars for a purchase in England in pounds for no more cost than the charge his bank now makes for writing a banker's check. If BISC's operations become wide enough and both parties to such a transaction had checking accounts with their banks in constants, the American could pay for his purchase in England in exactly the same way he now pays for purchases in the United States, by simply writing out a check for it. When the Exeter experiments were extended to England by opening accounts there, this was made possible.

2. Speculation in foreign currencies would be rendered virtually profitless. This now often generates horrendous mass-movements of currencies from one country to another. In foreign exchange, as in any kind of trading, speculation would no longer intensify natural disparities in exchange rates. These are bad enough now that each currency is being inflated and inflated at different rates by each country. The existence of the constant and the operations of BISC would provide everybody everywhere an alternative to the use of their inflated currencies and at the same time deprive speculators of the opportunity to exploit existing disparities.

The whole situation so far as foreign exchange transactions are concerned would be transformed the moment a stable international monetary unit was made internationally available.