

## Invisible earnings enquiries

The original Committee on Invisible Exports, in its study *Britain's invisible earnings* (1967), published new estimates for a number of the items in the invisible account; these were based mainly on direct enquiries of financial institutions and other companies. The Committee recommended that some of these surveys should be continued at regular intervals to help improve the balance of payments statistics and to throw more light on the contribution made by invisible earners.

A programme for improving the official statistics about invisibles was agreed by the authorities, and for their part the Bank are carrying out a series of direct enquiries into the overseas earnings of certain financial and allied institutions and of some of the professions. These enquiries will take place at intervals varying from three to five years; they will serve as bench-marks, and figures for intervening years will be estimated by the Bank. The institutions which have agreed to participate in this programme are the banks, the London Stock Exchange, the Baltic Exchange and Lloyd's Register of Shipping. The investment trusts also are now providing the Bank with annual statistics of their overseas income, and it is hoped soon to agree with firms trading in the London commodity markets ways of improving the present statistics relating to 'merchanting'. Some of the enquiries about the overseas earnings of the professions are being conducted by government departments, and the Bank are to collect figures from accountants, actuaries and solicitors; the bodies which represent these professions have agreed to co-operate in special surveys and have pressed their members to participate.

These enquiries will provide a better basis for certain of the estimates used in compiling the official balance of payments. It is important that such statistics should be as up to date and reliable as possible, because receipts for "financial and allied services" and earnings by the professions form a significant part of the United Kingdom's total invisible earnings: in 1970 they are estimated to have contributed some £345 million, or 7% of gross private invisible receipts, and they have been rising rapidly in recent years. The enquiries will also help to keep up to date the information about the contribution made to the balance of payments by the financial and allied institutions whose activities are associated with the City of London. These earnings include not only receipts for financial services rendered to customers abroad, but also investment income and interest on the banks' external claims (less interest paid on their external liabilities). A previous *Bulletin* article<sup>1</sup> attempted to assess City earnings and estimates are now published annually in an annex to the official balance of payments statistics.<sup>2</sup>

The remainder of this article describes the various surveys which have been, or are being, conducted by the

<sup>1</sup> "The overseas earnings of U.K. financial institutions", December 1968.

<sup>2</sup> See *United Kingdom Balance of Payments 1971*, Annex 5 (H.M.S.O., September 1971).

Bank. Where possible, the results are compared with those derived from the surveys published by the previous Committee on Invisible Exports in 1967. These comparisons usually show a substantial increase in earnings between the two sets of surveys, even after making some allowance for the increase in figures of foreign currency transactions expressed in sterling terms which automatically resulted from the devaluation of sterling in November 1967.

#### The banks

It has been agreed with the banks that a survey of their overseas earnings and payments shall be carried out by the Bank every three years, and the first survey, covering the year 1969, has now been completed. Some 220 banks (including the U.K. branches of foreign-owned banks) took part, of which all but a handful had overseas earnings to report. Between the Committee's enquiry into the banks' earnings in 1965 and the Bank's enquiry, net earnings of all types increased substantially, the strongest growth being in those from foreign currency business and from dealing in foreign exchange markets on behalf of overseas customers. Even more marked than the rise in net earnings, however, was the increase in the gross figures: for example, foreign currency business grew roughly tenfold. Earnings, under the headings which the banks were asked to report, are set out in Table A below, along with the figures derived from the Committee's 1965 survey. The two sets of results, although not precisely comparable, indicate the major changes which have occurred.

**Table A**

**Invisible earnings of banks in the United Kingdom<sup>a</sup>**

£000

|  | 1965      | 1969                   |
|--|-----------|------------------------|
| From sterling claims and liabilities:  |           |                        |
| (i) Earnings from interest or discount on sterling overdrafts, loans, bills, etc.              | 32,318    | 65,233                 |
| (ii) Payments of interest on sterling deposit and current accounts                             | — 47,957  | — 82,449               |
| Net  | — 15,639  | — 17,216               |
| From foreign currency claims and liabilities:  |           |                        |
| (i) (a) Earnings from interest or discount on loans and overdrafts, bills, etc.                | 71,270    | (767,359) <sup>b</sup> |
| (b) Other investment income from overseas (e.g. from Treasury bills and government securities) | 2,179     | (5,000) <sup>c</sup>   |
| (ii) Payments of interest on deposit and current accounts                                      | — 77,861  | — 752,937              |
| Net  | — 4,412   | 19,422                 |
| From credit and bill transactions (net)  | 6,719     | 8,360                  |
| From foreign exchange dealing (net)  | 5,366     | 17,106                 |
| From new issues of overseas securities (net)   | 647       | 3,694                  |
| Miscellaneous earnings (net)   | 4,872     | 11,762                 |
| Total earnings   | 123,371   | 878,514                |
| Total payments   | — 125,818 | — 835,386              |
| Net  | — 2,447   | 43,128                 |

<sup>a</sup> Including foreign-owned banks.

<sup>b</sup> Residual (after deduction of estimated investment income from total earnings from foreign currency claims).

<sup>c</sup> Estimated.

In the four years between the two surveys, the banks' gross receipts from their sterling business with non-resident customers doubled, while their payments to non-residents increased by 70%; in absolute terms, however, payments rose more than receipts. It seems likely that the faster proportionate rise in their receipts – notably from lending against bills and promissory notes – reflects in the main the provision of medium and long-term export credit. However, part of the sterling which the banks hold for their overseas customers is normally employed in their business within the United Kingdom, and so earns interest from residents; thus the banks continued to make net payments of interest abroad.

As already noted, it is the growth of foreign currency business which is the most striking feature of the comparison between the two sets of survey results. The figures illustrate the rapid growth of euro-dollar business in London; this development was particularly rapid in 1969, when U.S. banks in London borrowed substantial amounts of euro-dollars to relend to their head offices, which were facing tight domestic monetary conditions. Increases in interest rates also contributed to the steep rise in the banks' earnings and payments of interest between 1965 and 1969.

By comparison with the dramatic rise in the gross figures of interest on foreign currency business, the change in the net balance (from a payment of £4 million in 1965 to a receipt of £19 million in 1969) is comparatively modest. But none of the figures measure the banks' total earnings: when they convert foreign currency deposited with them into sterling to lend to their customers in the United Kingdom, or lend the currency direct to domestic customers (which is permitted, under certain conditions, to finance investment overseas or for use within the United Kingdom<sup>1</sup>), the earnings on this part of their business will not be reflected in the figures shown in Table A, for they do not come from overseas residents. Indeed, at times when the banks are switching foreign currency deposits into sterling (as they were doing on a substantial scale in 1965, though not in 1969) or are on-lending foreign currency deposits to their domestic customers, their gross earnings from abroad may be exceeded by their gross payments abroad.

Earnings from credit and bill transactions did not rise as rapidly as most of the other categories. These earnings are mainly commissions and fees from the arrangement of documentary credits and drawings under them, and from the collection of bills, the execution of clean credits and so on. The slower growth of these earnings may reflect the fact that much export business in recent years has been financed by the banks at fixed rates favourable to U.K. exporters.

By contrast, earnings from foreign exchange dealing seem to have more than trebled (though these particular statistics should be regarded with some reserve as they are probably subject to greater errors of estimation than most of the others). One reason for the increase, no doubt, is the growth in the number of foreign banks in London:

<sup>1</sup> On 12th January 1971 exchange control regulations were amended to restrict short-term foreign currency borrowing for use within the United Kingdom. See the March 1971 *Bulletin*, page 8.

between the two surveys the number of reporting banks increased by 10%. Also, the growth in euro-dollar business led to increased foreign exchange dealings by banks already established here. Finally, it seems clear that the banks in London have secured a substantial share of the rapid growth of foreign exchange business which in the last few years has accompanied the exceptional expansion of world trade and payments.

Earnings from new issues have also risen substantially, mainly, it seems, because of the growing number of foreign currency issues in which U.K. banks have played a leading part. The large rise in "miscellaneous earnings" seems likely to have come in the main from the management of portfolios and other security transactions on behalf of overseas customers; though this heading also covers such items as commitment fees, guarantees, penalties paid under break clauses, executor and trustee services, and charges for current account operations.

The earnings shown in Table A do not, however, include the whole of the banks' overseas income, for the banking enquiry did not cover profits earned by the banks' branches and subsidiaries operating overseas. Nor, on the other hand, do the payments figures include the profits earned by branches and subsidiaries in the United Kingdom which accrue to head offices or parent banks abroad. Both these excluded categories are reported annually by the banks as part of the direct investment enquiry and they are included in the overall estimates of net banking earnings which are published as a supplement to the official balance of payments;<sup>1</sup> the latest figures in the supplementary series are shown in Table F of this article, with figures for 1965 and 1969 for comparison.

The official balance of payments estimates which were published at the beginning of this month allow for the results of the 1969 banking enquiry and for the fast growth of banking earnings between 1965 and 1969. A change of treatment of the banks' earnings on their foreign currency business is also incorporated.<sup>2</sup> Several adjustments to the results of the enquiry had to be made before they could be incorporated in the official estimates – notably to allow for the fact that part of the earnings reported by the banks as "other investment income" is already included (indistinguishably) in the official estimates of interest, profits and dividends.

The buoyancy of the banks' overseas earnings in these four years, during which there was a decline in the total of the sterling balances, should allay fears which are sometimes still expressed that any diminution in the role of sterling in financing world trade will reduce this country's invisible earnings. However, to the extent that these earnings are attributable to the London offices of U.S. and other overseas banks, the gain is partly offset by the profits which accrue to the parent banks abroad.

<sup>1</sup> See *United Kingdom balance of payments 1971*, Annex 5.

<sup>2</sup> Hitherto "Financial and allied services" has included the banks' net earnings (or payments) on their foreign-currency business, mainly on the grounds that this was a form of 'merchandising of money'. From now on this element will be incorporated in interest, profits and dividends along with the banks' interest payments and receipts on their sterling business for overseas customers.

### The Baltic Exchange

The Baltic Mercantile and Shipping Exchange is the world's largest shipping market; it is estimated that cargo space arranged by its members accounts for more than 65% of world tonnage which is freely available for international use. The greater part of this business is connected with tramp shipping – vessels which, broadly speaking, are available to trade at any time, in any direction, carrying the most profitable cargo available. A much smaller proportion of fixtures is made in the liner trade (cargo ships running on regular routes at regular intervals). On the floor of the Exchange, brokers and agents, representing ship-owners and charterers respectively, exchange information on ships to be filled and cargoes to be carried, and agree terms. Commissions are received for this service and, where foreign owners and charterers are involved, these commissions constitute U.K. invisible earnings. The Baltic's members also earn commissions and fees from abroad from the sale and purchase of secondhand ships and from arranging the charter of aircraft to carry goods and passengers; and some of them are commodity traders dealing mainly in grains, vegetable and other oils, and oilseeds.

The Baltic agreed to take part in surveys of their members' overseas earnings every four years. The results from the survey covering earnings during the year 1969 are set out in Table B below, along with those obtained by the Committee in a survey three years earlier.

**Table B**  
**Invisible earnings of the Baltic Exchange**

| £000  | 1966          |     | 1969             |
|---|---------------|-----|------------------|
| <b>Shipping</b> Gross commissions and/or fees in respect of freight on U.K. imports, exports and cross-trades, time chartering and purchases and sales of ships, etc. | 6,803         |     | 15,118           |
| <b>Commodity trading</b> Gross commissions and/or profits in respect of dealing in commodities such as grains and oilseeds  | 567           |     | 1,598            |
| <b>Air</b> Gross commissions and/or fees in respect of air freight and chartering and purchases and sales of aircraft   | 176           |     | 752              |
| <b>Other activities</b>   | 1,798         |     | 2,197            |
| Less adjustment to avoid double-counting  |               | —   | 500 <sup>a</sup> |
|   |               |     | 1,697            |
| Any payments to non-residents in respect of the above categories of expenditure and not netted out above  | —             | 668 | —                |
| Miscellaneous <sup>b</sup>  | 2,051         |     | —                |
|   | <b>10,726</b> |     | <b>19,631</b>    |

<sup>a</sup> An estimate of what is reckoned to be already covered in the official balance of payments estimates under certain activities not confined to the Baltic (for example, insurance, investment income and commissions on imports and exports).

<sup>b</sup> Total net earnings where returns gave insufficient information to permit analysis under the above headings.

These are not the whole of the Baltic's invisible earnings, for the response to the 1969 enquiry was incomplete: fewer than 310 firms, representing what is probably just over 50% of the Baltic's active trading membership, completed returns. The relative importance of the business of those who did not

respond is difficult to judge, so that it is virtually impossible to gross up the results satisfactorily. The indications are that total earnings for ship chartering are probably more than twice as large as those actually reported, and earnings from purchases and sales of ships may have been three times as large.

A precise comparison with the previous survey results is misleading for the response was even less complete in 1966, but there is little doubt that the Baltic's earnings have been growing rapidly. Indeed, between 1966 and 1969 commissions and fees earned in the shipping and air markets probably expanded at an average annual rate of some 14%. Quite apart from the effects of devaluation already referred to, this rapid growth reflects, to some extent, the sharp rise in freight and charter rates which accompanied the strong world-wide demand for tonnage. Nevertheless, turnover has also risen substantially.

The size of some categories of reported earnings depends crucially on the response of a few firms. Even so, other evidence confirms that air charter business has been growing very fast and that the ship resale market has been booming; indeed, these two categories may have been growing faster than earnings from the more traditional business of ship chartering.

In the balance of payments accounts the Baltic's earnings from the shipping and air markets form the larger part of the "brokerage" item which is included under "financial and allied services". The rapid growth in the Baltic's earnings revealed by the surveys has made it necessary in this case too to raise official estimates. In the published accounts the Baltic's commodity earnings are treated as part of the considerably larger overseas earnings of U.K. commodity traders generally.

#### **Protection and indemnity clubs**

Excluded from Table B are the invisible earnings of protection and indemnity associations and other mutual insurance clubs. Most of these clubs, which exist as mutual, non-profit-making associations of shipowners, are managed in London or the North of England.<sup>1</sup> The risks they cover are, generally speaking, shipowners' liability to third parties, such as sickness of and injury to crew members and, for tankers and the oil companies in particular, accidental pollution. These are the risks and liabilities which fall outside the normal maritime insurance policies. Some clubs also cover liabilities arising from strikes and, in certain circumstances, war damage. There are a score or so of major British clubs, about half of which are members of the Baltic Exchange. A separate enquiry has been carried out to measure the impact of their transactions on the balance of payments. The response to this enquiry has been good.

So far as the larger U.K. clubs are concerned, probably well over half the total tonnage insured belongs to foreign shipowners. In any one period the clubs will normally have a surplus of calls (premiums) from overseas sources over claims paid overseas, or vice versa, which will cause net

<sup>1</sup> Other clubs, consisting mainly of foreign shipowners, are managed outside the United Kingdom, but the managers employ London agents to carry out part of their activities.

inflows or outflows of funds. Moreover, the gross movements of funds across the exchanges, like those of insurance companies, may be fairly substantial and, as these movements may have a significant effect on the balance of payments, the clubs were asked to report them as part of the enquiry. (The figures, however, are still incomplete and are not reproduced in this article.) By contrast, the invisible earnings of the clubs' managing bodies or their agents in this country are relatively modest; these earnings are probably between £1 million and £2 million a year at present but are thought to be increasing.

#### **The investment trusts**

In conjunction with the Association of Investment Trust Companies, the Bank began last year to collect statistics of the overseas income of such companies, the first year covered being 1969. Figures of income earned by investment trust companies on their holdings of overseas securities are not required for the compilation of the balance of payments accounts; these rely on comprehensive estimates of investment income derived from the Board of Inland Revenue's records. Nevertheless, it was felt desirable that firm figures, rather than rough estimates, of the overseas income of investment trust companies should be available, both for official use in assessing the contribution of financial and allied institutions to U.K. invisible earnings and in the interests of the companies themselves. (Rough estimates for years before 1969 had been compiled by applying what was thought to be an appropriate interest or dividend yield, net of certain taxes, to holdings of overseas securities at the end of each year.) The total obtained from the new enquiry for income in 1969 was nearly £34 million:

**Table C**

£000

Investment income received, net of foreign tax, from:

|                 |               |
|-----------------|---------------|
| United States   | 21,791        |
| Canada          | 2,795         |
| Sterling area   | 6,381         |
| Other countries | 2,693         |
| <b>Total</b>    | <b>33,660</b> |

To arrive at a figure of the net contribution made by the investment trust companies to the invisible account it is necessary to deduct from this total some £2.7 million paid abroad by the companies on foreign currency loans raised to finance the purchase of overseas securities. Distributions to non-resident shareholders have also to be deducted, but these are very small in total.

#### **Other institutions**

As already noted, the earnings of the Baltic Exchange form the larger part of "brokerage" included within the official balance of payments estimates. Nearly all the rest of the brokerage item comprises the earnings of the London Stock Exchange and Lloyd's Register of Shipping.

Overseas earnings of the *Stock Exchange* have been collected by the Committee on Invisible Exports and made available to the Bank since 1966. The largest part of these earnings is from brokers' commissions on dealings on behalf of overseas clients. In 1966 the Committee reported that about one fifth of broking firms (about 40 in number) were continuously engaged in foreign business, though most of it was transacted by no more than a dozen of them. There are also significant overseas earnings from operations carried on by brokers who have joint accounts with firms abroad. New issues of overseas securities are another source of foreign earnings, though it is not as important as the first two. As new issues of overseas securities are usually handled by brokers in conjunction with the banks, the brokers are asked to differentiate between their earnings received from a U.K. bank and those received from other sources, so that duplication with banking earnings may be avoided in the balance of payments accounts.

In recent years, overseas earnings of the *Stock Exchange* have been as follows:

**Table D**

**London stock exchange**

| £000  | 1966         | 1967         | 1968         | 1969         | 1970         |
|---|--------------|--------------|--------------|--------------|--------------|
| Brokers' commissions on dealings on behalf of overseas clients        | 1,430        | 2,100        | 4,425        | 4,828        | 5,360        |
| Arbitrage and share of joint account profits and losses – net profits | 914          | 1,447        | 3,582        | 3,173        | 3,136        |
| Fees in respect of new issues of overseas securities:                 |              |              |              |              |              |
| Received from a U.K. banker   | 115          | 166          | 73           | 87           | 34           |
| Other fees  | 83           | 199          | 379          | 453          | 252          |
| Other revenue from services rendered to overseas residents            | 38           | 44           | 73           | 119          | 93           |
|   | <b>2,580</b> | <b>3,956</b> | <b>8,532</b> | <b>8,660</b> | <b>8,875</b> |

All figures exclude jobbers' earnings: it would be almost impossible to collect estimates of these, because jobbers, dealing as they do direct with brokers, have no sure way of knowing whether or not a purchase or sale originates from overseas. Moreover, their profits cannot readily be allocated to particular deals.

The overseas earnings attributable to *Lloyd's Register of Shipping* arise from the Society's many activities – notably the inspection of new ships and machinery and of large industrial complexes ashore, and the periodic survey of vessels already in commission – on behalf of clients abroad.

**Table E**

**Lloyd's Register of Shipping**

| £000                 | 1968                  | 1969  | 1970  |
|----------------------|-----------------------|-------|-------|
|                      | (years ended 30 June) |       |       |
| Net foreign earnings | 3,030                 | 4,050 | 5,000 |

The figures relate to the earnings of the Society's offices overseas and are not necessarily all received from overseas clients, though it seems fair to assume that the bulk is non-resident.



### **The overseas earnings of the professions**

An allowance for the invisible earnings of accountants, solicitors and other professions is included in the official balance of payments accounts under the heading of "other services". It is largely based on estimates for 1965 collected by the original Committee. Following their investigations, the Committee concluded that professional earnings were a significant element in the invisible account, and their general recommendations provided for the continuation of the statistical enquiries which they had instituted. The proposal that such enquiries should be regular was accepted by the authorities, and the Bank undertook to approach the accountants, the solicitors and the actuaries. They are carrying out this programme with the assistance of the professional associations concerned. It has been arranged that enquiries shall take place every five years and that figures shall be estimated for intervening years. On the first occasion a full survey of each profession is being carried out; subsequent enquiries may be confined to smaller samples.

*The accountants* The Bank's first enquiry relates to invisible earnings in 1970 and covers members of the Institute of Chartered Accountants of Scotland, the Institute of Chartered Accountants in England and Wales and the Association of Certified Accountants. Early in 1970 each body notified its members of the intention to hold a survey and asked them to maintain records of overseas receipts and payments during the ensuing year. Towards the end of the year these firms were asked to complete a short questionnaire – limited to total receipts and total payments – and to return it direct to the Bank as soon as possible after the year's end.

Although the response to this survey is as yet by no means complete, it is clear that there has been an increase in the invisible earnings of accountants since the survey in 1965. The replies so far received show total reported earnings of about £1½ million, divided as between £0.12 million for the Chartered Accountants of Scotland, £1.39 million for the Chartered Accountants in England and Wales, and £0.02 million for the Certified Accountants. Allowing for replies still to come in, it is estimated that total overseas earnings of the accountants might be some £2½ million a year at present.

*The solicitors* Solicitors in the United Kingdom are being canvassed about their invisible earnings in 1971. The Law Society and the Law Society of Scotland have undertaken to collaborate with the Bank in these enquiries and have sent out circular letters notifying solicitors that they will be sent questionnaires at the end of this year. As in the case of the accountants, only two total figures will be called for.

*The actuaries* The majority of actuaries are employed in full-time service with insurance companies and other institutions. Consequently, any overseas earnings which may be generated by their activities form an indistinguishable part of the earnings of such institutions. However, with the help of the Institute of Actuaries and the Faculty of Actuaries in Scotland, the Bank hope to make an up-to-date

estimate of the invisible earnings of actuaries engaged in whole-time or part-time professional practice. The Institute and the Faculty have agreed to carry out an informal survey of such earnings in 1971.

The enquiries into the invisible earnings of the professions are expected to lead to upward revisions of official estimates at present in use. No attempt is being made to quantify "indirect" professional earnings – that is, earnings which accrue directly to other sections of the economy as a result of the work of the professions; this omission is not from choice but because in most cases it would be impossible to identify, let alone quantify, any indirect earnings to which professional services may give rise. Though there still remain some types of earnings – by the medical profession, the independent schools and so on – which are not at present satisfactorily measured, the present series of enquiries is a notable step forward in assessing the contribution which the professions as a whole make to the balance of payments.

### Conclusion

The chief discovery from these surveys is that almost all the forms of invisible earnings which have been canvassed have been rising faster than had been expected. As noted earlier, this has made it necessary in the case of the banks and the Baltic Exchange to revise the official balance of payments estimates upwards. For 'City-type' earnings as a whole, it is now estimated that the net total in 1970 – some £540 million – is about 3% larger than previous calculations had suggested. The following table drawn from Annex 5 of the *United Kingdom Balance of Payments 1971* shows how the £540 million is made up.

**Table F**  
**Net overseas earnings of U.K. financial and allied institutions**

| £ millions                        | 1965    | 1969    | 1970    |
|-----------------------------------|---------|---------|---------|
| Insurance                         | 81      | 257     | 281     |
| Banking <sup>a</sup>              | 36      | 110     | 96      |
| Merchanting                       | 30–35   | 40–45   | 40–45   |
| Other:                            |         |         |         |
| Investment trusts etc.            | 35      | 42      | 45      |
| Baltic Exchange                   | 19      | 33      | 47      |
| Other brokerage etc. <sup>b</sup> | 7       | 27      | 27      |
|                                   | 208–213 | 509–514 | 535–540 |

<sup>a</sup> Includes the profits of the banks' branches and subsidiaries overseas; the profits earned by branches and subsidiaries in the United Kingdom which accrue to head offices or parent banks abroad are netted out against the banks' overseas earnings.

<sup>b</sup> Mainly the earnings of the London stock exchange and Lloyd's Register of Shipping.

It seems likely that an upward revision of professional earnings will also be necessary when the various surveys are completed.

The Bank are keenly aware of the considerable work and expense to which these enquiries put those who take part, and they do not underrate the difficulties in providing the information which is asked for; for this reason, they do their

best to keep requirements to a minimum. They wish to thank all those who have taken part, and are taking part, in such enquiries; and they hope that understanding of the need for them, and of the importance of a full response, will be increased by the publication of these results.