STRICTLY CONFIDENTIAL (FR)

CAN CONTROLS BE SUCCESSFULLY USED TO PREVENT SPECULATIVE CAPITAL MOVEMENTS IN THE U.S. BALANCE OF PAYMENTS?

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SUMMARY

Very large amounts of funds have flowed through the foreign exchanges during recent international monetary crises. Such capital movements tend seriously to disrupt the domestic and international economic policies of many nations, and complicate the problems of establishing and maintaining appropriate exchange rates between currencies. What are the possibilities of the United States Government's using controls to prevent or substantially to moderate these disruptive flows in a time of exchange market crisis, without at the same time interfering to an unacceptable degree with normal trade and investment transactions?

The discussion here does not deal with questions of whether controls or other measures could be so used as to prevent the emergence of speculative crises, nor with the still broader questions of achieving and maintaining basic equilibrium in the balance of payments. Large flows of short-term capital in response to interest-rate differentials sometimes have disruptive effects in domestic financial markets, and sometimes are among the background causes of a speculative crisis in foreign exchange markets. The discussion here deals only with flows at times when market participants are already expecting or fearing an early change in currency values.

The observations and conclusions contained in the body of the paper can be summarized as follows:

1. Certain types of transactions in the U.S. balance of payments have been especially important at times when participants in exchange markets have expected a change in official policies (either abroad or in the United States) that would lead to a depreciation of the dollar against one or more major foreign currencies. Broadly defined, these are:

a. changes in the timing of international payments and receipts for current account transactions (e.g., acceleration of payments for imports and delaying of export receipts) commonly referred to as "changes in leads and lags";

b. direct placements of funds abroad by persons and businesses not covered by any of the existing control programs;

c. outflows of funds that in principle are covered by existing control programs but that in practice may nevertheless occur (the OFDI program covers major corporations and the VFCR program applies to banks and nonbank financial institutions);

d. other borrowings by foreigners from U.S. sources of credit (e.g., borrowings by foreign companies from their direct investment affiliates located in the United States, which in turn borrow from U.S. banks); and

e. actions by foreigners to reduce normal inflows to the United States -- equities as well as interest-bearing assets -- or to withdraw funds from the United States by selling assets.

The first type of flows -- changes in leads and lags -- has probably been the most important quantitatively.

2. The existing control programs (OFDI, VFCR, IET) might be tightened up so as to reduce the possibilities for outflows of type (c) and further extended to deal with outflows of type (d), but not without introducing further complications into normal business and banking operations. Changes in legislation might be required.

3. A tightening up and extension of existing control programs that was not combined with an effort to control flows of type (a) (leads and lags) and flows of type (b) would fail to meet the objective of stemming a major fraction of the disruptive flows. In fact the result might be a larger outflow through the uncontrolled channels.

4. The only possibilities for controlling leads and lags and flows of type (b) would involve surveillance of all payments from U.S. residents to nonresidents, and probably also receipts by U.S. residents from abroad.

5. It would be technically feasible to design such a system of exchange controls. Banks would of necessity play a major role in its administration. But the system would have to reach into the entire network of normal trade and investment transactions.

6. If capital outflows of type (e) above were to be controlled, exchange controls would have to be extended to nonresidents (e.g., preventing foreigners from reducing their deposits in U.S. banks or repatriating the proceeds from the sale of equities without prior authorization). Such controls would

discourage normal inflows, with serious long-run effects on the U.S. balance of payments. Furthermore, there would be no way to prevent the cessation of normal inflows at times of speculation against the dollar.

7. The experience of foreign countries has been that without willingness to inflict very severe penalties on violators it has been impossible to organize and administer water-tight exchange control regimes. Even in countries that had quite comprehensive exchange controls in the earlier post-war years, there were sharp spurts in outflows at times when market participants believed exchange rates were seriously out of line. Growth of the operations of multinational corporations has been a significant factor making reliance on banks as administrators of controls an inadequate strategy.

8. Because of the number and complexity of U.S. businesses and financial institutions, and a past history of relative freedom for foreign payments and receipts, the chances of instituting a U.S. program of exchange controls that could effectively prevent disruptive flows in an exchange crisis are even less than the chances of doing so in other countries.

9. Thus, on technical and administrative grounds alone, there is substantial doubt that the U.S. Government can effectively control disruptive capital flows in a time of exchange crisis -- whatever the nature of the control program. Even the attempt would require extending the control system to include all transactions, including normal trade and investment flows.

I. Types of Capital Flows to be Controlled

A first step in an analysis of measures to limit disruptive capital flows is to try to identify the types of flows to which attention should be directed. For the U.S. authorities, primary consideration falls on the activities of U.S. residents in moving funds from or toward the United States; there are also important flows resulting from movements of funds among foreign countries by corporations or others under U.S. jurisdiction, and from the movement of funds controlled by decisions of foreigners. This paper deals primarily with flows of funds to and from the United States at the initiative of U.S. residents and gives less attention to the other flows.

At times of exchange crisis attention is directed primarily to flows of funds motivated by a desire to obtain a capital gain (or avoid a loss) in the event of a large change in the exchange rate between the U.S. dollar and one or more foreign currencies. Such flows are the prime focus of this discussion, rather than flows of liquid capital in response to differences in interest rates. (Flows of the latter type have exchange market effects, and sometimes contribute to the building up of a crisis situation. This paper does not deal with that problem -- which is part of the general problem of achieving and maintaining balance of payments equilibrium -- but only with the problem of controlling flows in a crisis situation. The two motivations may coincide in times of crisis, however, adding to the difficulty of establishing an effective deterrent.)

The following paragraphs discuss the principal forms of capital flows, or channels for such flows, which can be important when the market expects, rightly or wrongly, that a substantial depreciation of the dollar against one or more foreign currencies is imminent (the same channels work in reverse if a depreciation of other currencies against the dollar is expected).

(1) Movements of U.S.-owned liquid funds from holdings of dollar assets in the United States to liquid assets denominated in foreign currencies. Such flows could be effected readily by any U.S. resident, but would in principle be subject to some restraint if carried out by direct investors subject to the OFDI regulations, or by banks subject to the Federal Reserve ceilings (VFCR). (See Appendices A and B).

An individual or company can make such a transfer at present simply by instructing a U.S. or foreign bank to purchase foreign currency for his account and deposit it in a foreign bank, or to purchase money market paper abroad. A direct investor corporation would find it especially easy to do this, either directly or through a foreign affiliate, since its normal business practices call for maintaining substantial accounts abroad.

(2) Purchases by U.S. residents of other types of assets denominated in foreign currencies. In the case of securities (or debt instruments with a maturity of one year or more) the purchase would be subject to the Interest Equalization Tax, as well as to the VFCR in the case of banks, and to the OFDI regulations if the securities were issued by a foreign affiliate and purchased by a U.S. head office. However, other less

marketable types of assets, such as real estate, would not be restricted if purchased by member of the general public not subject to the control programs.

(3) Changes in the timing of payments and receipts (commonly known as leads and lags.) Shifts in accounts receivable from or payable to foreigners enabling transactors to avoid potential losses, or speculate on capital gains (commonly known as leads and lags). This type of transaction is readily available to U.S. residents engaged in foreign trade or other activities which normally lead to a maintenance of open accounts. For example, a U.S. importer may come to believe that the dollar may be devalued against one or more currencies, so that his imports will cost more in the future. To reduce this extra cost he may order well in advance and pay the foreign exporter immediately for goods that would ordinarily be paid for on or after delivery. Alternatively, the U.S. importer may purchase foreign exchange immediately and invest it abroad for an interim period, or he may accelerate his actual imports as much as possible. Similarly, the exporter may allow his foreign customer to delay dollar payment until after an expected appreciation of the foreign importer's local currency in return for acceptance of an increase in the dollar price.

It should be noted that multinational corporations account for a major share of U.S. trade -- including trade with their own affiliates and trade with independent foreigners. Dealings with affiliates would be affected by the OFDI regulations, but there are no restraints on credit arrangements with other foreigners.

(4) Transfers of funds by U.S. residents into dollar-denominated assets abroad. U.S. residents may increase their holdings of dollar-denominated liquid assets abroad -- principally in the Euro-dollar market -- at times of speculation, because at such times Euro-dollar interest rates are pushed up by speculators wishing to borrow dollars in order to buy foreign currencies. While the U.S. investor is not speculating directly, he is supporting speculation in a strong currency by reducing the cost of the financing to speculators. This type of outflow may often be easier to accomplish than type (1) since it does not involve a foreign exchange transaction. Again, financial institutions and direct investors (U.S. companies owning and operating affiliated firms in foreign countries) covered by the VFCR and OFDI control programs are inhibited in making such dollar transfers. The general public, being subject to no restrictions -- except the IET on purchases of foreign equities and long-term debt instruments -- is free to make these transfers.

(5) Increased borrowing by foreigners from U.S. sources. Foreigners expecting upward revaluations of their currencies may borrow dollars from U.S. sources in greatly increased amounts. This may take the form of drawdowns on existing credit lines with U.S. banks (which would be subject to the VFCR) or it may be possible for those with direct investment affiliates in the U.S. to have those affiliates borrow here and remit to the foreign parent through the inter-company account (which is not covered by any U.S. Government specific restriction).

(6) Liquidation by foreigners of assets in the United States. Foreigners normally holding liquid assets in the United States, such as working balances in banks, can reduce them to a minimum; they can also either liquidate, or hold back from normal purchases, of such marketable assets as U.S. corporate stocks. There is no restriction on such activities by foreigners.

II. Which Types are Most Important?

One of the most frustrating aspects of speculative episodes, such as those experienced in May and August 1971 and mid-June to mid-July 1972, is that normal statistical reporting programs fail to pick up specific information about the large flows that are occurring. This is so even though many of the types of flows that are the most likely vehicles are covered in part by the reporting programs. This difficulty in identifying the flows that are occurring is found in all countries; typically, much if not most of the flow of capital at times of crisis appears under "errors and omissions" in the balance of payments accounts.

In the U.S. statistics it is believed the data are quite accurate for assets and liabilities of banks and nonbank financial institutions. U.S. direct investors supply much more information on their foreign activities than do their counterparts in other countries, but it is quite possible that short-term flows in crisis periods escape the normal monthly or quarterly reports. Information on short-term capital flows of corporations that are not direct investors is probably poor, as is information on trade credits;

information on transactions by the general public, apart from transactions in foreign securities or certain other items that can be reported by U.S. banks or securities dealers, is very scanty.

Most of the information available is based on data giving outstanding asset or liability positions at the ends of months or quarters. Consequently, there is virtually no information available on gross credit flows, or on the terms on which credit is extended; at best, the net capital flows between reporting dates can be computed.

In the attached Table 1 the flows of capital reported in the U.S. balance of payments are shown in some detail for a number of periods, including the quarters in 1971 when speculation was strong, and the first quarter of 1972. The table also shows the quarterly errors and omissions in the accounts (line D). Table 2 gives an indication of the magnitude of speculative pressure in crisis weeks and months. Table 3 provides information on the amounts of outstanding assets and liabilities of various types to the extent they can be measured or estimated.

The following are some of the main features of the capital outflows in 1971; other crisis periods are likely to center on similar problem areas.

a) Outflows covered by the various control programs showed some sizable increases, but did not account for a major share of the total outflow. Direct investment outflows (covered by the OFDI except for Canada) rose by $0.6 billion; purchases of foreign securities (covered by the IET, though Canada and certain other borrowers are exempt) did not rise; foreign claims reported by U.S. banks rose by nearly $3 billion, including an increase of $1.5 billion in the crisis period in the third quarter when banks temporarily exceeded their VFCR ceilings. Some of the outflow reported by banks is exempt because it is on behalf of their customers, another large part involving their own funds is also exempt (including export credits after October 1971, claims on Canada, participations in Export-Import Bank loans, etc.), and some part of the reported outflow is accounted for by U.S. agencies and branches of foreign banks.

b) Outflows of U.S. capital of types not covered by restrictions are reflected partly in claims on foreigners reported by nonbanks. The reported increase in such claims was about $1.1 billion in 1971 -- fairly large but not greatly above the $650 million annual outflow in 1968-70. Nearly all of this outflow in 1971 was in liquid or other short-term forms including permitted changes in liquid foreign assets of direct investors subject to the OFDI. It is important to note that the increase was primarily in foreign assets denominated in U.S. dollars -- there was very little recorded outflow directly into foreign currency assets abroad.

c) A significant part of the adverse shift in the U.S. capital accounts in 1971 reflected the behavior of foreign holders of U.S. assets. These investors withdrew large amounts of funds from the United States via their affiliates here (who were probably borrowing from U.S. banks) and by reducing their working balances in U.S. banks.

In addition, foreign investors sharply cut back their lending to U.S. direct investor corporations. At such times the U.S. corporations, who use most of the proceeds of such loans to finance their direct investments abroad, tend to substitute U.S. funds, at least for an interim period. Finally, there was a significant decrease in the net volume of foreign purchases of U.S. equity securities until the last days of the year, following the Smithsonian meetings. However, there was little sign of any eagerness to unload foreign holdings of U.S. corporate stocks, which have a market value of about $20 billion.

d) Most striking in the 1971 experience was the jump in the negative errors and omisstions from the $1.3 billion average of 1968-70 to a total of $10.9 billion. Such an increase is generally attributed to a shift in volatile capital flows. As far as can be judged from an examination of the statistical evedence at hand, these unrecorded outflows were primarily either by persons -- domestic or foreign -- not covered by the existing programs or by direct investors through their transactions with non-affiliated foreigners. Within the year, however, there may have been sizable outflows at crisis periods by direct investors of types covered by the restraints.

Any attempt to break down the components of the errors and omissions item is obviously highly conjectural. The most difficult kinds of capital flows to capture in the normal statistical apparatus are the changes in accounts of U.S. traders with their foreign counterparts, (although there exists a quarterly Treasury reporting form on which certain important types of trade credit are in principle reportable) and the flow of liquid funds and even longer-term investment capital on the part of individuals or the many thousands of businesses that are not direct investors and therefore escape also the reporting of their activities to regulatory agencies. It is believed, though it cannot be proven, that a large if not dominant part of the outflow from the United States in crisis periods is by transactors not covered by present controls, and another substantial part may result from transactions of direct investors other than transactions reportable to the OFDI.

III. Effectiveness of Existing Control Programs

The prime consideration in this paper is whether the existing control programs could be made more effective in dealing with outflows in crisis periods, rather than the question of their effectiveness over longer periods or in more normal times.

The VFCR appears to keep banks' foreign lending (and position in foreign liquid assets) under reasonable control over-all, but there are exemptions and the banks do go over their voluntary ceilings when, in crisis periods, they find their large credit lines to foreigners drawn upon. It might be possible to avoid these surges in lending by computing ceilings on a daily average basis (see Appendix B). Such a stricter rule would imply large penalties when banks' outstanding credits to foreigners bulged within a monthly reporting period, and would force banks to be more restrained in entering into commitments to lend to foreigners. Weaknesses in the VFCR controls did not seem to be a major factor in last year's crises. In the future, however, the export exemption could be an important weakness if pressure is exerted on capital flows through other channels.

The IET appears to be an effective barrier to purchases by Americans of foreign securities in this market, apart from those that are specifically exempt, such as Canadian issues and those of international institutions. However, it is not known to what extent Americans may evade the tax by purchasing securities directly in foreign markets. Even a strict exchange control regime would have difficulty stopping that kind of illegal activity.

It is much more difficult to appraise the effectiveness of the OFDI controls on multinational corporations (see Appendix A). The fact that there is some overall restraint on the use of U.S. funds for direct investment abroad is clear enough from the fact that the companies do borrow large amounts abroad when U.S.-source funds would be cheaper and readily available in large quantities. For present purposes the question is whether the OFDI controls can prevent, or even detect, large flows that occur between reporting periods, but which are off the books on month-end or quarter-end reporting dates. A method of daily-average balancing of inter-company accounts is probably not feasible because of the seasonal and other irregularities that arise in the normal course of business in the accounts between a U.S. parent company and its many foreign affiliates. As noted in Appendix A, however, it might be possible to prevent direct placement of liquid funds abroad by U.S. parent companies. There is some suspicion that such placements are important, but there is little direct evidence to substantiate this belief.

On the whole, while some tightening of existing programs to avoid large disturbing outflows is possible, the necessary measures would add considerably to the reporting and management burdens of banks and corporations, not only in crisis periods but in the conduct of normal operations. An important gap would remain unless there were changes in the legislation exempting export credit from the VFCR. What is more important, it is likely that the major disturbing flows originate with transactions not now subject to any controls, such as shifting payment terms on international trade in goods or services, or placing of liquid assets abroad by individuals. Moreover, existing programs do not restrict foreigners in their decisions to move funds to or from the United States.

In sum, modification of existing control mechanisms is a difficult step and it would affect only part of the flows that occur in periods like May and August 1971, or mid-June to mid-July 1972, or that might develop in the future. To attempt to tighten these controls while leaving other channels uncontrolled might only have the effect of inducing larger outflows through uncontrolled channels.

It might be useful to add a few words on probably the most important form of uncontrolled capital flow -- the shifts in leads and lags already mentioned above. This avenue for flows might be used by any business engaged in foreign trade. This would include the multinational corporations, since they are dealing with non-affiliated foreign customers as well as with their own affiliates, where the OFDI regulations would have some effect.

The potential size of the flows involved is greatest when it involves U.S. imports. At present U.S. imports amount to over

$4 billion per month, and are mainly invoiced in dollars. When traders become convinced that there is a sizable risk of a revaluation of other currencies against the dollar there is a mutual interest on the part of the U.S. importer and the foreign exporter in effecting payment as soon as possible. The foreign exporter will wish to receive advance payment to avoid any loss on future dollar receipts, while the U.S. importer may wish to protect himself against an increase in the dollar prices of imports, or to accommodate the exporter. Consequently, in a few days or weeks U.S. importers may order ahead and pay for imports they are expecting over several following months. This shift in the timing of payments could by itself potentially produce a flow involving some multiple of $4 billion. For that part of U.S. imports paid for in foreign currencies, foreign exporters would be indifferent as to advance payment, but U.S. importers would wish to pay in advance. Typically, in times of exchange market crisis, covering of potential exchange risk in forward currency markets is likely to be expensive and difficult to obtain.

On the side of U.S. exports, there is less scope for sudden outflows of funds from the United States at times when a devaluation of the dollar is feared. For exports denominated in dollars -- the usual case -- foreign importers will wish to delay payment, while the U.S. exporter will have no special incentive to delay receipts. However, if U.S. exporters accommodate their foreign customers by agreeing to delay receipts, the immediate effect is only the amount of export proceeds that would otherwise have been received. In a week, at current levels of exports, such a delay could amount to $1 billion, if applied to nearly all exports.

It is important to recognize that the shifts in leads and lags described above do not represent outright speculation against the dollar (such as switching into foreign currencies by an American not normally doing any foreign business) but would be characterized by the transactors as a form of risk aversion. Of course, the disruptive effect is the same.

IV. Alternative Regulatory or Restraint Programs

From time to time there have been a number of suggestions for replacing the present set of controls with a more uniform or market-oriented system. Some of these suggestions are reviewed here, primarily with regard to their ability during a crisis to cover transactions not now subject to the existing programs and thereby help prevent massive speculative outflows. The principal possibilities (apart from actual exchange control) seem to be:

a. Application of a tax of the IET type to a much broader range of transactions.

b. Application of a reserve requirement to a broad spectrum of foreign assets.

c. Shifting the VFCR program to a control over the net foreign position of banks (rather than the present ceiling on the gross amount of foreign assets outstanding).

d. Devising an auction system under which certain foreign payments could be made only through the purchase of shares of an over-all total of permissible payments.

e. With respect to foreign assets in the United States, variable incentives through reserve requirements or allowable interest rates.

The most plausible of these measures for general application would be a form of tax extended over a wide range of capital flows, and perhaps over all of them. Such a plan has been intensively studied with respect to direct investments, but for many technical and other reasons (see Appendix A) an effective and administratively feasible tax seems out of reach. There are also a number of more general problems with a tax on capital outflows that raise serious, if not fatal, doubts about its utility against speculative flows:

(i) To be a deterrent when a sizable capital gain was expected in a short time a tax rate would have to be very high; but such a rate, unless it could be varied with blinding speed and foresight, would clearly interfere with normal transactions. Moreover, it would be extremely difficult to tax only certain types of transactions; e.g., if export credit were exempt but holdings of Euro-DM deposits were not, the tax would be helpless to prevent evasion unless there were also a strict system of exchange control.

(ii) If a tax were applied to extensions of export credit it would clearly damage the interests of U.S. exporters, and would be inconsistent with the legislative action exempting such credits from the VFCR.

(iii) If a tax were applied to each transfer from direct investors to foreign affiliates, so as to cover shipments of machinery and parts on credit as well as cash transfers, it would be extremely severe and might only cause the affiliates to turn to offshore sources of machinery and supplies. If applied only to cash transfers to affiliates it would be ineffective, since non-cash transfers could easily be substituted. Moreover, a tax would have to be designed so as to apply also to undistributed profits of the foreign affiliates.

(iv) A tax on capital outflows, collected at the time the transaction takes place, assumes that a capital outflow can be clearly identified. This would not be the case in crisis situations, when the person remitting funds abroad may be willing to tell a bank or other withholding agent that the payment was for goods or services received. It would probably take a tight exchange control rather than a tax to deter this kind of evasion.

(v) A tax on capital outflows other than types covered by the IET would require new legislative action.

The use of reserve requirements against increases in foreign assets involves many of the same difficulties as the tax proposal. As applied to corporations, it would be necessary to have a rate high enough to deter speculation at times of crisis -- which would then cut across the legitimate business needs of direct investors and exporters. Moreover, the vast size and number of U.S. business enterprises -- very much larger than in Germany, for instance -- would require an extensive reporting and surveillance system. It is clearly a great deal easier and more politically acceptable to apply such a reserve requirement to funds borrowed abroad, as is done in Germany, or by the Federal Reserve respecting Euro-dollar borrowing by U.S. banks, than to apply the reserve requirement against foreign assets. Even in the German case there is an exemption for credits related to foreign trade, and a variety of evasive techniques soon developed.

Apart from the possible application of reserve requirements against banks' foreign assets, it would be difficult to stretch any existing authority, such as the Trading with the Enemy Act, to cover such a device as applied to persons or corporations.

Although auction systems have been proposed, they are usually intended either to limit direct investment outflows (would-be investors would be allowed to export capital only on the basis of chits they had purchased from either the Government or, perhaps, exporters, in an auction market) or to restrain imports (importers could only import if they had purchased chits derived from export proceeds). Apart from the rather obvious deficiencies of these devices for these specific purposes, they imply an exchange control environment, since it would still be open to a trader or speculator to shift funds through banking channels unless presentation of a chit was required for all transfers to foreign accounts.

Remodeling the VFCR by substituting the use of reserve requirements, or the balancing of net foreign positions, deserves consideration as a more permanent form of restraint to help establish and maintain balance of payments equilibrium, but it is doubtful that such a change would help in a crisis situation to deal with the kinds of capital outflow that cause the greatest disturbance.

Finally, while measures providing market incentives or deterrents for the placement of foreign funds in various types of U.S. assets might have a useful role in overall management of the balance of payments during "normal" periods, there is no feasible way to block foreigners from withdrawing assets they hold in the United States when they wish to do so. The United Kingdom is a striking example of a reserve currency center that had its most acute problems at times of crisis because of withdrawals of funds by nonresidents.

None of these alternative forms of regulation of capital outflows seems to have much of a chance of shutting off the kinds of outflow that develops in crisis periods, since they do not effectively prevent placement of liquid funds abroad by individuals or the stretching of payment terms on foreign transactions by those regularly engaged in foreign transactions. There seems to be no remedy capable of reaching such transactions other than an extensive exchange control system under which permits would be required for virtually all foreign payments.

V. Consideration of Exchange Controls

The distinctive feature of an exchange control system is that all private payments to foreigners, whether for goods or services or capital outflows would be subject to Government permit. Further, receipts for exports of goods or services, or from investment income, would be registered to ensure prompt repatriation. This system is not to be confused with the types of controls now enforced by the OFDI and the Federal Reserve (VFCR). In both these programs there is no surveillance over individual transactions -- instead there are over-all ceilings within which the direct investor, or the bank, can operate as its business judgment dictates. (In practice, this has tended to mean continuing to expand abroad, but substituting offshore financing for U.S. funds).

An exchange control system, however, is designed to insure, for instance, that exporters could not speculate against the currency by leaving their export proceeds abroad, or importers speculate by making advance payments for imports. In its more comprehensive forms, there would also be limitations on the amount of currency a traveler could take abroad, and specific permits required for, e.g., payment of royalties to foreigners or for personal remittances.

To illustrate the elements of an exchange control system as it might operate in the United States, the following steps could be involved:

(i) All payments to foreigners by U.S. residents, perhaps above some minimum, would be required to be effected through an authorized bank. (Certain banks would be "authorized" so as to avoid involving too large a number of banks in the paperwork required). The purpose of the payment would be given, and the recipient identified. Banks would maintain the necessary record keeping in automated form so that information from all banks on each transactor could be collated (see also Appendix B).

(ii) Designated banks would be generally authorized to effect payments for goods and services, except that such payments must stipulate that the goods or services would be delivered to the transactor within, say, 30 days of payment, and documentary evidence to that effect presented to the bank when delivery is received.

Exceptions would have to be referred to a special Government office (SGO), presumably established by the Treasury.

(iii) Payments to purchase foreign securities would be authorized if the IET applies, or if the security is specifically exempt from the IET; otherwise permission would be referred to the SGO.

(iv) Payments to foreign affiliates would be authorized, in addition to those covering imports, if the direct investor stipulates that the payment is included in his reports to the OFDI and is covered by his ceiling. (Copies of such documents would be forwarded to the OFDI).

(v) All other payments to foreigners, above a minimum amount, would not be authorized without clearance by the SGO.

Even in skeleton outline it is obvious that such controls over outpayments would require a good deal of extra work by the banks, and a large Government and private bureaucracy. One indication of the paper work involved in checking on whether the rules on import payments are being observed is the following data on import clearances:

Total import documents processed each month	250,000+
Valued at over \$1 million each:	
Number	200
Value	\$675 million
Percent of monthly import value	15%
Valued at over \$50,000 each:	
Number	8,000
Value	\$2.5 billion
Percent of monthly import value	55%

In addition to the import documents actually processed each month there are about 300,000 that cover shipments of $250 or less which are merely sampled to derive an estimated overall value. Under such a system banks would be required to match individual transfers of funds against the proof of an import document, or a comparable evidence of payment for services or income.

Ensuring that Americans who are receiving funds from foreigners (from exports, interest and dividends, fees, etc.) actually return those funds to the United States rather than holding them abroad, is an even more difficult task. In this case, the transactor does not need to take any positive action with any U.S. financial institution to achieve his objective -- though he must take the chance that he will have difficulty when he ultimately remits his foreign-source earnings.

One obvious possibility would be a requirement that each exporter file each export document with an authorized bank, and present that bank with proof that he received payment not more than, say, 30 days from date of shipment. Again, some idea of the volume of transactions may be useful:

Total export documents processed each month		350,000+
Valued at over $100,000 per document		
Number	3,500	
Value	$1.5 billion	
Percent of monthly export value	40%	
Valued at over $20,000 per document		
Number	25,000	
Value	$2.5 billion	
Percent of monthly export value	60%	

In addition to the export documents actually processed there are about 200,000 per month covering small value shipments that are only sampled to established an estimated overall value.

The volume of paperwork would be evidently very large unless only shipments over a minimum size were covered. A simple form of evasion would involve splitting shipments to get below the minimum. The special difficulty with exports is that any such exchange control program cannot help but be an additional deterrent to potential American exports. Exporters would have to take the extra steps of validating each transaction with a bank, and adjusting their payment terms. Many firms for whom export business is marginal would probably give it up.

Even greater difficulties of enforcement would be encountered it if were desired to force prompt repatriation of income from foreign investments (apart from direct investments, where the OFDI might be made more effective). In fact, the most likely procedure would be in connection with the tax collection apparatus, but that would be totally ineffective against delays of a few weeks or months in effecting remittances.

While it is possible for those due to receive payments from abroad to delay receipts, and thus speculate on a capital gain, the amount of such potential remittances that would accrue in a short time is less than would be involved in advance payments for imports. The total of exports (other than Government shipments) and income receipts (apart from direct investment and U.S. Government receipts) in a month is roughly $4 billion, so that while cumulative delays in making remittances could have a very substantial effect, the effect in a week or two of even total failure to remit might not by itself exert decisive pressure at that time. This might appear to be an argument in favor of stricter surveillance over outpayments than on receipts from abroad. However, such an unbalanced system would soon lead to a situation where importers avoided controls by obtaining the foreign exchange they needed, at a premium rate, from those with uncontrolled foreign-currency earnings.

It is not difficult to envision the myriad forms of evasion of exchange controls that would quickly emerge. Obvious problems arise from exports of currency; this is the principal form of evasion of the Italian exchange controls, amounting to over $2 billion in 1969. Controls on receipts and payments connected with merchandise transactions would lead to the use of false values -- exports underinvoiced so as to accumulate uncontrolled funds abroad, and imports overinvoiced for the same purpose. Just as with the existing control programs there would be pressures to exempt certain countries or types of transactions, but this would open even greater opportunities for evasion if it were done in an exchange control environment. For instance, if Canada were exempt there would be enormous pressure for funds to move through Canada, and it is highly unlikely that the Canadians would be willing to erect an exchange control barrier to prevent it -- especially when their exchange rate is floating.

In some cases of very severe exchange controls countries have limited the freedom of nonresidents as well as residents to move funds out of the country, or to acquire new assets. Even the United States blocked certain foreign assets here in World War II, and still blocks foreign assets of some Communist countries. This point is raised because the potential for large disturbing flows of funds rests in considerable part with decisions of foreigners about their holdings of assets in the United States. As shown in Table 3, private foreigners had investments in the United States valued at $69 billion at the end of 1971.

Even this summary consideration of exchange controls exposes a formidable problem in terms of administrative difficulty. It would also be necessary to explore much more carefully whether authority to take these steps can be found in the Trading with the Enemy Act, the Recordkeeping Act of 1970, or in some other statute. Some measures would clearly require new legislation if they involved new types of taxes. To adopt a control mechanism of this type overnight without leaks being made to the public would be extremely difficult.

One of the problems with an exchange control system is that to be operative in times of crisis it must also be operative to some degree at other times. For reasons already presented, this could not fail to result in inequities and differential impacts on various types of normal commercial and financial transactions. Damage to exporting interests probably could not be avoided. Importers would certainly encounter difficulties, which would probably lead to political problems with foreign countries, especially if there were discriminatory aspects to the controls.

Even if it were possible to follow other countries in designing controls that met the IMF rule that current account payments should not be affected, such an action by the United States would go a long way toward encouraging resort to exchange controls as an acceptable way of dealing with "temporary" balance of payments pressures.

VI. Notes on Foreign Experience with Control Programs

In recent years the amplitude of the back-and forth movement of liquid capital among industrial countries has increased considerably and has at times threatened the stability of exchange rates and the management of monetary policy. The growth in these flows was permitted by a progressive liberalization of restrictions on capital movements, which began in the late 1950's. The relaxation of these restrictions helped to accommodate the financing requirements of rapidly expanding international trade and investment. Contributing to the expansion of international capital movements were innovations in the techniques of international banking, which resulted in a closer linkage of national financial markets as financial transfers across borders were handled with increasing efficiency, and growth of multinational corporations.

The beneficial aspects of these developments are clear, but with these benefits came also an increasing disequilibrating potential. In recent years the disturbing elements of these flows halted the trend towards liberalization of capital controls and led governments to adopt a host of measures aimed at influencing the volume and direction of international capital movements. Experience with these measures shows that they can aid in the achievement of various policy goals, particularly in the case of domestic investment targets, and also in assisting controlling domestic liquidity or in smoothing temporary balance of payments difficulties. However, at times when the underlying situation was itself unstable, controls have not been effective. An evaluation of the efficiency of countries' experience with various instruments aimed at "controlling" -- in the sense of "guiding" -- capital flows depends entirely on what the controls were intended to achieve. If the aim was to smooth temporary fluctuations in situations which in themselves were not volatile, they probably can be said to have had a fair modicum of success. If they were intended to prevent speculation when the market was convinced of a more basic disequilibrium they were clearly not adequate, as indicated by the discussion of the experience of France and the United Kingdom given in Appendix C.

In the Swedish case, for example, capital controls are used as an auxiliary instrument to fiscal and monetary policy, primarily in order to achieve certain domestic investment objectives. As such, they have worked very well, but in times of instability in the international payments situation they have not been able to protect the international reserve position of the Bank of Sweden -- nor were they designed to do so.

Methods of control

A large variety of types of controls have been employed at various times (for a listing of those applied by selected individual countries as of June 1, 1971, see Appendix C). They can subdivided into the following general categories:

Direct measures

a) exchange controls
b) quantitative limitations on banks' foreign assets and liabilities
c) controls on purchases and sales of domestic financial and fixed assets by non-residents

Indirect measures

a) dual exchange markets instituting a special rate of exchange for capital transactions
b) selective restrictions on interest payments or rates at which interest is paid on non-resident financial assets
c) special reserve requirements against banks' or non-banks' foreign assets or liabilities
d) intervention in forward exchange markets or limitations on use of forward cover
e) selective tax measures applying to treatment of foreign-earned income or income accruing to non-residents.

Controls designed to achieve balance of payments or domestic liquidity objectives have in one way or other led to increasingly comprehensive exchange control mechanisms -- if only for administrative purposes in order to gain information needed for the enforcement. This stems in part from the fact that, at times of stress, so-called volatile capital movements spill over into transactions which are normally considered to be of a more stable nature, i.e. commercial transactions and transactions legally considered to be of a long-term nature.

With respect to the substitutability of transactions in bonds or stocks for those in short-term assets, it is clear that countries which have maintained a special foreign exchange market for all capital transactions, such as Belgium and France, have generally been more successful in moderating disturbing capital movements than have countries using mainly monetary instruments. However, when exchange rate differentials between the market for capital and that for current account transactions widen appreciably, this type of control also can be counterproductive in raising questions about the feasibility of maintaining these differentials. The administrative machinery necessary to achieve the separation of foreign exchange markets for different types of transactions is illustrated in the quotation below.1/

"In order to implement the separation of markets, authorized banks keep separate accounts in free and official foreign exchange for their customers, and maintain separate positions (both spot and forward) in foreign currencies in the two markets. Under the regulations, they are responsible for ascertaining the nature of any receipt or payment, and this in turn determines whether they have to buy for or sell from their own "official' or 'free' foreign exchange holdings, or, as the case may be, debit or credit an 'official' or 'free' account for the transferor or transferee. For nonresidents the banks keep so-called 'financial' accounts in Belgian francs which can be used only for transactions that may or must be made through the free market. Every day the main banks submit to the exchange control authority (the Belgium-Luxembourg Foreign Exchange Institute -- IBLC) information on their transactions with foreign countries, and every month all banks submit statements of their assets and liabilities by market, of the accounts which they keep in official and free exchange for residents, and of the 'financial accounts' and other accounts in Belgian francs which they keep for nonresidents, as well as of their transactions in each market, classified by type of operation. This information enables the IBLC to reconcile their transactions with changes in the accounts of banks and thus helps to detect irregularities. In addition, IBLC controllers periodically visit banks to supervise their procedures; these controls are undertaken with increasing frequency in periods

1/ Ralph Wood, "Dual Exchange Markets, Key Facts and Questions" internal Federal Reserve Board paper dated April 14, 1971. Mr. Wood quotes an internal IMF paper on the Belgian dual exchange market system, DM/70/45 dated June 11, 1970.

when the discount on the Belgian franc in the free market tends to widen. Finally, a direct check on import payments and on the surrender of export receipts is possible through the customs declaration of which a copy is remitted to the IBLC."

This type of machinery, in principle, could also provide the framework for controlling swings in financing arrangements for commercial transactions. In times of doubt about exchange rate stability, foreign transactors have hedged their foreign exchange risks by either speeding up, or delaying, payments on export and import transactions. Shifts in these "leads and lags" associated with the financing of commercial transactions have at times contributed importantly to increases in the amplitude of the ebb and flow of international capital movements. Table 4 illustrates, in the case of France in the 1968 crisis, how important these shifts can be (captured mainly in the errors and omissions and the non-bank short-term items). These flows occurred despite long experience with and the tightening of that system when difficulties started. The British experience in 1966-1967 before the devaluation of the £ sterling also illustrates this point.[1/]

Table 4
France: Private Capital Flows (non-Franc area)
(In millions of U.S. dollars)

	1965	1966	1967	1968	1969	1970
Private long-term	361	156	168	-681	394	423
Non-bank short-term	-352	-223	-251	-1,384	-284	957
Bank short-term	-253	80	369	-501	565	450
Errors & omissions	171	93	-205	-260	172	341
Total	-73	106	81	-2,826	847	2,171

Source: OECD

1/ For a description of the French and British control systems see Appendix C.

In recognition of how changes in payment methods for commercial transactions can substantially affect financial flows, the Dutch government has moved recently to curb this influence: financing arrangements for periods longer than usual, as well as prepayments for exports, now require Central bank approval.

Almost all the administrative burden required for the controls discussed above devolves upon the banking system. Consequently, efficacy of such measures is undermined when a substantial amount of business is transacted outside the banking system, e.g., through inter-company transfers.

The same problem arises in connection with attempts to control capital movements by regulating foreign asset and liability positions of the banking system. This type of regulation has proved to be more palatable to many authorities than have more stringent direct controls. However, possibilities for avoiding these controls, for example by carrying out transactions without the use of domestic banking facilities, are relatively ample, so that the incentive does not have to be very great for loopholes to be utilized. Consequently, these measures have generally led to more direct and comprehensive types of controls. The German experience is a recent and telling example.

In moving to more comprehensive systems of controls, countries generally have not made extensive use of selective tax measures. The IET in the United States and the German withholding tax on interest on bonds held by non-residents are examples of this type of measure. But there are no examples, to our knowledge, of a wider application of variable ad valorem taxes on foreign lending or borrowing.

July 23, 1972.

Table 1

PRIVATE CAPITAL FLOWS: U.S. and FOREIGN
(millions of dollars, seasonally adjusted, outflow (-))

	1968	1969	1970	1968-70 Average	1971	1971 Qtr.1	1971 Qtr.2	1971 Qtr.3	1971 Qtr.4	1972 Qtr.1	1972 Qtr.2
A. TOTAL PRIVATE CAPITAL: U.S. and FOREIGN	+4,679	+8,134	-7,868	+1,648	-14,332	-4,304	-2,665	-5,317	-2,047	-1,456	
B. U.S. PRIVATE CAPITAL	-5,383	-5,424	-6,886	-5,898	-9,781	-2,203	-1,954	-3,521	-2,104	-2,879	
NONLIQUID	-4,826	-5,586	-7,137	-5,850	-8,710	-1,931	-2,049	-2,966	-1,764	-2,186	
LONG-TERM	-4,297	-4,855	-5,753	-4,968	-6,348	-1,659	-1,813	-1,927	-949	-1,654	
U.S. direct investments abroad	-3,209	-3,254	-4,400	-3,621	-4,765	-1,290	-1,277	-1,410	-788	-994	
U.S. purchases of foreign securities	-1,226	-1,494	-942	-1,221	-909	-361	-372	-249	+73	-388	
Changes in U.S. claims on foreigners											
reported by U.S. banks	+358	+317	+175	+283	-565	+25	-153	-237	-200	-198	
reported by U.S. nonbanks	-220	-424	-586	-410	-109	-33	-11	-31	-34	-74	
SHORT-TERM	-529	-731	-1,384	-881	-2,362	-272	-236	-1,039	-815	-532	
Changes in U.S. claims on foreigners											
reported by U.S. banks	-44	-658	-1,023	-575	-1,807	-139	-91	-892	-685	-566	
reported by U.S. nonbanks	-485	-73	-361	-306	-555	-133	-145	-147	-130	+34	
LIQUID	-558	+162	+252	-48	-1,072	-272	+95	-555	-340	-693	
Changes in U.S. claims on foreigners											
reported by U.S. banks	-61	-209	-99	-123	-566	-94	+32	-392	-112	-518	
reported by U.S. nonbanks	-497	+371	+351	+75	-506	-178	+63	-163	-228	-175	
C. FOREIGN PRIVATE CAPITAL	+10,063	+13,558	-983	+7,546	-4,550	-2,101	-711	-1,796	+57	+1,423	
NONLIQUID	+6,254	+4,896	+5,257	+5,469	+2,141	+475	+129	+200	+1,336	+895	
LONG-TERM	+5,495	+4,805	+4,355	+4,885	+2,199	+737	+208	+44	+1,209	+892	
Foreign direct investment in U.S.	+319	+832	+1,030	+727	-67	+124	+1	-374	+181	-335	
Foreign purchases of U.S. securities	+4,389	+3,112	+2,190	+3,230	+2,282	+559	+196	+606	+921	+1,066	
Corporate stocks	(+2,096)	(+1,565)	(+697)	(+1,452)	(+849)	(+78)	(-3)	(+230)	(+544)	(+679)	
New foreign issues by corporations	(+2,129)	(+1,029)	(+822)	(+1,326)	(+1,161)	(+317)	(+263)	(+225)	(+356)	(+309)	
Other	(+163)	(+518)	(+671)	(+451)	(+272)	(+164)	(-63)	(+151)	(+20)	(+78)	
Changes in U.S. liabilities to foreigners											
reported by U.S. banks	+72	+160	+23	+85	-249	-152	-61	-71	+35	+204	
reported by U.S. nonbanks	+715	+701	+1,112	+843	+233	+206	+72	-117	+72	-43	
SHORT-TERM											
Changes in U.S. liabilities to foreigners											
reported by U.S. nonbanks	+759	+91	+902	+584	-58	-262	-79	+156	+127	+3	
LIQUID	+3,809	+8,662	-6,240	+2,077	-6,691	-2,576	-840	-1,996	-1,279	+528	
Changes in U.S. liabilities to:											
Commercial banks abroad	+3,387	+9,166	-6,508	+2,015	-6,908	-2,928	-892	-1,775	-1,313	+438	
International and regional institutions	+48	-63	+181	+55	+682	+280	+198	+149	+55	+29	
Other private foreigners	+375	-441	+87	+7	-465	+72	-146	-370	-21	+61	
D. ERRORS AND OMISSIONS	-399	-2,470	-1,174	-1,347	-10,927	-944	-2,586	-5,380	-2,018	+480	

Source: U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business, June 1972.

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Table 2

U.S. Official Settlements Balance, Total and
Distributed by Major Countries, Selected Periods 1971 and 1972
(In millions of dollars)

Month	Official settlements balance (deficit -)	Total of countries shown (inc.+)	Major Countries 1/								
			Germany	Japan	United Kingdom	France	Netherlands	Switzerland	Canada	Belgium	Italy
1971 - Jan.	-874	1,270	210	14	279	216	66	-4	16	204	269
Feb.	-1,931	2,098	750	190	601	52	125	181	49	78	72
Mar.	-2,632	2,843	1,059	823	474	86	151	8	74	34	134
Apr.	-2,349	2,229	790	266	683	69	-92	349	17	56	91
May	-5,320	4,857	2,224	1,185	310	344	203	294	47	307	-57
June	1,204	-1,581	-2,367	475	635	59	8	-257	-22	-25	-87
July	-2,480	1,748	277	324	354	694	-8	-34	78	58	5
Aug.	-8,759	8,498	-310	4,373	252	741	280	2,045	264	577	276
Sept.	-1,465	1,759	247	1,180	463	-399	4	25	-12	-3	254
Oct.	-1,228	1,172	251	576	589	-183	-7	8	68	-64	-66
Nov.	-1,780	1,812	139	616	919	195	--	-7	280	-37	-293
Dec.	-2,874	2,616	762	547	869	309	-15	-28	270	-65	-33
1972 - Jan.	-868	694	396	536	16	-18	8	-80	-6	-1	-157
Feb.	-1,321	1,258	766	411	-21	-4	95	-17	7	52	-31
Mar.	-1,071	909	78	430	97	-31	419	-96	71	66	-125
Apr.	-267	-64	255	88	-590	33	59	-45	129	--	7
May	554	-731	2	-457	4	-3	-24	-253	135	-78	-57
June 2/	e/ -1,200	552	1,096	-463	-225	446	-34	-200	173	-4	-237
Week ending 2/											
1971 - May 12	-4,270	4,579	2,207	842	113	242	312	674	37	150	2
Aug. 11	-2,018	1,006	-178	455	-539	189	296	212	213	355	3
18	-3,853	3,989	51	1,054	754	281	3	1,616	47	185	-2
25	-1,486	1,883	3	1,748	-6	27	-1	97	15	1	-1
Sept. 1	-1,184	1,224	--	1,175	22	29	--	3	-2	-2	-1
1972 - June 28	-1,258	1,036	1,013	-24	-163	118	1	--	92	--	-1
July 5	-340	-219	332	-36	-130	-9	-10	1	-45	--	-322
12	-1,173	1,251	569	146	-10	231	193	105	6	21	-10
19	-3,188	3,038	1,338	62	86	232	300	993	5	19	3

e/ Estimate.

1/ Includes increase or decrease (-) in foreign official holdings in the United States and increase (-) or decrease in U.S. reserve assets. Data on official holdings for Jan. 1971 - May 1972 are total holdings and for June 1972 and weekly periods are holdings at F.R. Bank of N.Y. only.

2/ Difference between official settlements balance and total of countries shown reflects mainly changes in official holdings at commercial banks, for which country breakdown is not yet available for June 1972 and not available for weekly periods, and changes in countries not listed.

Table 3

INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES

In billions of dollars

Item	1950	1960	1969	1970	1971[e]
U.S. assets and investments abroad	54.4	85.6	158.1	166.6	181.0
U.S. private investments	19.0	49.3	110.4	119.9	134.9
Long-term, total	*17.5*	*44.5*	*96.3*	*104.7*	*116.0*
Direct investments	11.8	31.9	71.0	78.1	86.0
Foreign securities	4.3	9.6	18.7	19.6	22.3
Banking claims and other	1.4	3.1	6.6	7.0	7.6
Short-term, total	*1.5*	*4.8*	*14.1*	*15.2*	*18.9*
Reported by banks	.9	3.6	9.7	10.8	13.4
Other	.6	1.2	4.4	4.4	5.5
U.S. Govt. credits and claims [1]	11.1	16.9	30.7	32.2	34.0
U.S. monetary reserve assets	24.3	19.4	17.0	14.5	12.1
Monetary gold	22.8	17.8	11.9	11.1	10.2
Other	1.4	1.6	5.1	3.4	1.9
Foreign assets and investments in U.S.	17.6	40.9	90.8	97.5	122.5
U.S. liabilities to private foreigners	12.9	28.2	71.4	71.1	69.2
Nonliquid	*8.7*	*19.0*	*42.5*	*48.5*	*53.3*
Direct investments in U.S.	3.4	6.9	11.8	13.2	13.4
U.S. corporate securities	3.1	10.0	22.9	25.6	30.4
Corporate and other bonds	.2	.6	4.8	6.9	8.6
Corporate stocks	2.9	9.3	18.1	18.7	21.8
Other long-term liabilities	1.5	1.6	4.8	6.0	5.9
Short-term reported by nonbanks	.7	.6	2.9	3.7	3.6
Liquid	*4.2*	*9.1*	*28.9*	*22.6*	*15.9*
To foreign banks (incl. U.S. bank branches)	2.1	4.8	23.6	17.1	10.3
To others	2.1	4.3	5.3	5.5	5.6
U.S. liabilities to foreign official accounts	4.7	12.7	19.5	26.4	53.2
Reserve liabilities	*4.6*	*11.9*	*17.1*	*24.4*	*51.8*
Of U.S. banks	2.4	4.0	8.5	6.5	7.4
Of U.S. Govt.	2.2	7.9	8.5	17.9	44.4
Nonreserve liabilities of U.S. Govt. [2]	*.1*	*.8*	*2.4*	*2.0*	*1.4*

[1] Other than U.S. monetary reserve assets.
[2] Includes small amounts of liabilities to private foreigners.
[e] Estimated.

NOTE.—Data for 1950, 1960, 1969, and 1970 are as published by the Bureau of Economic Analysis, U.S. Dept. of Commerce; data for 1971 are estimates based on capital flows as reported by the BEA plus rough allowances for reinvested earnings, and changes in market valuations. The basis of valuation is as follows: direct investments at book values as appearing, in principle, on the books of the affiliates rather than the head offices; securities at market values; other assets and liabilities at stated values in the accounts of banks and other debtors or creditors. For more detailed data see *Survey of Current Business*, U.S. Dept. of Commerce, Oct. 1971. Details may not add to totals because of rounding.

This table only reflects assets or liabilities for which some record or estimate is available; it does not reflect assets or liabilities arising from unrecorded capital flows.

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APPENDIX A

Activities of Multinational Corporations

At times of international financial turmoil attention tends to focus on the role of the large corporations which operate various types of businesses in more than one country -- multinational corporations. At such times it is generally believed that the multinationals are either initiators or at least major participants because of their ample financial resources (including their ability to borrow), their current and expected need for various foreign currencies, their financial sophistication which leads them to minimize any possible exchange losses, and to occasionally seek a profit, and their complexity, which defies the ingenuity of would-be controllers. Apart from their possible role in times of crisis, multinationals are commonly subject to some degree of control either because their capital outflows put a strain on the balance of payments even in normal times (the basis for the U.S. controls), or because they are regarded as threats to domestic control over basic industries (as is the case in a great many countries, both developed and less developed). In the context of sudden shifts of mobile funds, therefore, it seems useful to indicate briefly the specific problems of applying restraints to these enterprises.

1) Scope of U.S. multinationals

The magnitude of the operations of U.S. multinationals can be indicated with a few key statistics:

a) Their present book value is on the order of $85 billion -- market value would be larger.

b) Total assets of the foreign affiliates are probably twice as large as the parent company investment -- the difference representing some minority foreign equity interest but mainly derived from long and short-term borrowing abroad.

c) Shipments to the foreign affiliates of these corporations account for about one quarter of U.S. exports, and they supply a substantial part of U.S. imports of materials, plus a lesser share of U.S. imports of manufactures.

d) The U.S. share in the earnings of these controlled foreign affiliates is now well over $9 billion; receipts entering the U.S. balance of payments in 1971 as dividends, interest, branch profits, royalties, and fees totaled $9.4 billion -- by far the largest current receipt other than merchandise exports.

e) Capital outflows from the U.S. to the foreign affiliates, after deducting the use of funds borrowed abroad, reached $3.4 billion in 1971, about $1.0 billion more than in 1970.

2) Operation of present controls

The present control system operated by OFDI is based on a recognition that there is a constant enormous flow of receipts and payments between U.S. head offices and their foreign affiliates, which are not readily or even meaningfully divisible into capital flows and payments and receipts connected with the flow of goods, services, and income within the corporate structure. In practice this flow of payments is largely reflected in a set of intercompany and branch account balances, supplemented of course by much less frequent changes in the ownership accounts carried as stock ownership or long-term creditor interests. Moreover, a large part of the increase in U.S. parent company investment each year derives from retained foreign profits which do not appear as capital flows in the U.S. balance of payments. Consequently, control over these investments is maintained not by detailed records of individual transactions but instead by limitations on the aggregate annual amount by which the sum of net balances in intercompany accounts, capital transfers in the form of purchases of stock or bonds of the foreign affiliates, and retained earnings of foreign affiliates are permitted to increase. In addition, direct investors are subject to a limit on the amount of liquid funds they can hold directly abroad, tied to their historical experience.

As is well known, the main effect of this system of controls is to cause companies that wish to expand abroad at a rate faster than their OFDI ceilings would allow to do so by borrowing abroad. The amount of the ceilings is computed either on a historical base, or in relation to earnings of the foreign affiliates, and complex provisions have emerged in an effort to differentiate among groups of foreign countries and to provide exemptions or special allowances for certain problem situations -- for instance, the provision of credit coveringexports from the U.S. parent to the foreign affiliates.

Although the OFDI and others have given the most serious consideration to replacing the present quota system with a system based on a tax, or some other market-oriented device, the very multiplicity of the relations between the head offices and their foreign affiliates, plus the need to cover foreign earnings (which introduces great legislative problems) has frustrated such efforts.

It is not the purpose of this discussion to evaluate the general effectiveness of this system of controls, but rather to consider its effectiveness at times when the companies would have a strong reason to move mobile funds from weaker into stronger currencies. On the whole, the OFDI program is not likely to detect or prevent such flows -- if in fact they are occurring.

Under the present system, reports to OFDI covering transactions with foreign affiliates (which could include large cash flows) are rendered quarterly, but they are at least 3 months after the event, and they reflect only end-of-quarter positions. It is only considerably later that the reports are analyzed, and it is notoriously easy in any case to reduce end-of-month positions by short-term borrowing abroad. While this sounds like loose practice, the only effective way to prevent large bulges in these intercompany accounts between reporting dates would be to introduce some form of daily average balance reporting. Because these intercompany accounts are the locus for all types of flows not only between the parent companies and the foreign affiliates, but also in many cases among the foreign affiliates, they are subject to a great many seasonal and other irregularities beyond the control of the parent. Consequently, daily average balancing would impose a most significant additional reporting and management burden on the companies. Since this is only one of a multiplicity of channels for moving funds, it would seem to be unwise to exact such a cost for a highly dubious benefit.

Apart from movements of funds through their affiliates, multinationals hold liquid assets abroad in their own accounts -- and, as noted above, they are limited in what they can hold at the end of any month by the amount held on a monthly average basis in 1965-66. Reports on these end-of-month amounts are sent to OFDI on a quarterly basis, about six weeks after the end of a quarter. Clearly this leaves room for sizable outflows between month ends, and it would probably be possible to institute daily-average reporting for these assets. Here again, however, the question arises whether this is worth doing if there remain other channels readily available -- either to multinationals or persons not covered by any controls. For instance, to require daily-average balancing for directly-held liquid funds, but not to go to a similar system for intercompany accounts (which would be infinitely more difficult)

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would not be effective, since cash funds could be invested abroad via the foreign affiliates and the intercompany accounts.

As noted in the main body of this paper, the multinational corporations are also probably responsible for a large part of the flow that takes the form of shifts in leads and lags vis-a-vis nonaffiliated foreigners -- which is not covered by OFDI regulations. In the absence of a reporting procedure that would detect short-term speculation, the OFDI has conducted telephone surveys and does some regular spot-checking with major reporters. It is estimated that there are now about 3,500-4,000 direct investors with about 25,000 foreign affiliates. About 400-500 of these direct investors are large enough to be required to file quarterly reports with OFDI. Present plans are to make further reductions in reporting requirements for the smallest firms. Whether these arrangements could succeed in detecting short-term positioning by the companies is very doubtful. Indeed, it is extremely difficult to verify the accuracy of reports received from the companies in any case.

3) Flows among foreign affiliates

Apart from their potential for moving funds from the U.S. at times of crisis, the multinationals can also exert pressure on foreign currencies by arranging their foreign affiliates' asset composition. For instance, a firm with an affiliate in the U.K. and an affiliate in Germany could arrange advances of cash from the former to the latter, or, if the affiliates have a sizable volume of bilateral dealings, the parent can shift funds through changes in their current account payables and receivables. Moreover, the multinationals can readily borrow Euro-dollars and switch them into foreign currencies, perhaps more easily than can be done by other market participants.

There has been no suggestion that the U.S. Government should intervene in these offshore movements of funds -- other countries have attempted to control them with varying success. It would seem that any effort to dampen these flows, whether by multinationals or others, would require a concerted effort on the part of many countries, since discrepancies in control arrangements would merely shift the pressure from one country to another.

4) Summary of considerations

It would be a major task to attempt to exercise control over flows of mobile funds originating with multinational corporations, and it would be extremely difficult to do so without adding substantial complications to their normal business procedures. The least difficult part of such a tightening of surveillance would be a requirement for more effective reporting on liquid assets held abroad, but this would be only a gesture if other channels for short-term flows are available either to these companies or the general public.

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Appendix B

Activities and Role of Commercial Banks

1) Summary. The present control system probably operates fairly well to restrain outflows of banking funds in periods of stress, and could be made somewhat more effective if desired. However, the exemption of export credit required by law leaves a sizable potential avenue for such flows, and tightening up on banks alone would not prevent speculation through other channels. To close all potentially important channels would require some form of exchange control.

In an exchange control regime, banks would probably be called on for a major share of the surveillance burden. This might very well impair their ability to conduct their regular domestic and foreign business.

2) Restraints on Capital Outflows by Banks and Financial Institutions. The VFCR program in effect since 1965 has been broadly effective in restraining capital outflows by banks and other financial institutions. It is a voluntary system, which could be made mandatory if desired. However, the program has not prevented abnormal and largely temporary outflows at times of great speculative pressure (a) because these outflows in large part result from foreign banks drawing against unused credit lines with U.S. banks, and the U.S. banks cannot immediately adjust their positions by reducing other

foreign assets, and (b) because compliance is only measured at month-ends, although banks are requested to remain in compliance throughout the month. Although since November 1971, the program has not been applied to export financing, outflows under this heading have not risen sharply. By and large, outflows from nonbank financial institutions have not been substantial.

According to the VFCR reports, the largest increases in foreign assets subject to VFCR restraint amounted to $600 million in May1971 and $1.2 billion in August 1971. In both cases the bulge was eliminated in a month or two. Investigation into the August increase showed that at least $0.5 billion represented drawdowns on credit lines by Japanese banks. It is interesting to note that banks did not report significant increases in short-term foreign assets held by their customers in these crisis periods, suggesting that if U.S. persons were adding to their liquid assets abroad they were not holding them in custody at U.S. banks where they could readily be identified if they were subject to control.

If it were considered desirable to institute a control program that would minimize the possibility that large capital outflows by U.S. banks would occur at any time during the month, it would be necessary to establish the bank control program on a daily (or daily average) basis -- as was done in the case of the Board's Euro-dollar reserve requirements. In principle, that could be done with the present technique of the VFCR but some banks maintain that it would be very difficult, if not impossible.

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If this were done, and if the banks were required to avoid overages or were subject to a sizable financial cost on any overages, it is likely that the costs charged by U.S. banks on foreign credit lines would be set at levels that would prevent surges of foreign drawings on these credit lines at times of speculation. (The rates set by U.S. banks would have to be high enough to induce foreign banks and other foreign customers to obtain credits elsewhere -- e.g., in the Euro-dollar market. While overnight rates in the Euro-dollar market have soared to astronomical levels in periods of peak speculative activity they have not remained at those levels for more than a day or to. Consequently, it would probably be feasible for U.S. banks to prevent very short-term use by foreigners of credit lines by specifying that drawings be outstanding for a somewhat longer period.)

A major difficulty would arise if it were considered necessary to prescribe the terms on which banks could make export credits. For instance, if an effort were made to restrict extensions of credit directly by U.S. exporters, or delays in normal collections for exports, exporters might shift to the use of commercial bank credit. To avoid enterference with normal business practice, while at the same time limiting outflows, the controls would involve banks in determing whether the terms they were asked to provide were consistent with normal practice in the trade.

However, the Federal Reserve is prevented by statute from taking steps to limit banks' financing of U.S. exports, and inauguration of such a control program would require substantial amendment of the Export Expansion Financing Act of 1971. In the absence of such action, one would expect that restrictions on the ability of U.S. exporters to extend credits would merely result in a shift of the financing to U.S. banks. Thus, barring legislative action, potential credit outflows related to U.S. exports would be likely to occur. At current levels of U.S. exports a potential incremental outflow of $4-6 billion could take place over 2-3 months as a result of a one-time shift in terms of payment. It should be noted that up to now banks have not reported major increases in exempt export credits.

On the whole, speculation or hedging operations by U.S. banks would not appear to involve a substantial threat of outflows, although banks may contribute to destabilizing developments by engaging in forward exchange transactions that shift market rates and thereby create profitable arbitrage opportunities for transactions by others. So far as is known, U.S. banks maintain relatively close controls over the foreign exchange transactions of their head offices and have stated limits on the extent of positions in particular currencies. A requirement that banks report daily on their home office foreign exchange ledgers -- corresponding to the daily data required on their foreign credits -- coupled with substantial penalties for overages on these accounts, would probably be adequate to ensure that banks did not generate large outflows.

Although legally the Board could probably apply similar restraints on foreign branches of U.S. banks under the authority of Regulation M, the extension of a control program extraterritorially could involve extensive negotiations with foreign authorities. Such a restraint on the foreign branches of U.S. banks could only be effective, if at all, as part of a general program (undertaken by all countries) to regulate Euro-dollar market activity of all banks. Pending a general agreement on the need for such a concerted effort, and also on the techniques to be employed to make it effective, it would be advisable to limit any U.S. program to the domestic offices of U.S. banks, and to recognize explicitly that all major international banks in the world conduct transactions in dollars that can affect reserve inflows by foreign central banks. (It might be noted that the activities of foreign branches of U.S. banks for their own accounts do not appear to have been a principal factor in exchange rate speculation during the past 2-1/2 years. Balance sheet data show that for all foreign branches of U.S. banks, month-to-month swings in the net foreign currency positions were $400 million or less, except in October 1971, when the swing was about $600 million -- this single shift represented about 1-1/2 percent of the total dollar assets and about 3 percent of the total foreign currency assets of the branches. How much of the shift resulted from initiatives by the branches and how much from customer initiative cannot be determined.)

In sum, it would be possible, but difficult, to prevent large outflows through non-export bank credit and/or short-term placements of funds by institution of a control program covering the daily position of each U.S. bank. It would require legislative changes to develop a program covering bank export credits. Any program would have to be extended to U.S. agencies and branches of foreign banks to the extent that they establish net foreign asset positions (a concept that might have to be defined differently for different groups to take account to their different modes of operation). In principle, such a program would permit banks to continue to finance trade and some customary non-trade transactions. In practice there would doubtless be frequent administrative decisions to be made concerning the appropriate terms for financing of export transactions that did not fit neatly into the rules, there would be a significant increase in documentation required, and some adverse effect on exports seems almost inevitable. Further, unless the Canadian exemptions were removed the efficiency of U.S. controls would depend to a considerable extent on continued cooperation by the Canadian authorities.

It is important to note that limiting banks' financing of exports or other transactions would be ineffective in crisis periods if comparable financing by nonbanks continued unrestrained.

3) Use of Banks in Administration of Programs for Nonbanks.

Any comprehensive U.S. exchange control program applied to nonbank businesses and individuals could probably be successfully administered only if part of the burden of administration were placed on the banking system. Most countries that have employed extensive control systems rely heavily on banks, and in the case of the United States the enormous volume of transactions and numbers of transactors that would be covered would make it essential to make use of the recordkeeping facilities of the U.S. banking system. Whether it would also be advisable to assign to banks some responsibilities for ensuring compliance by nonbanks is less certain.

Under the Financial Recordkeeping and Currency and Foreign Transactions Reporting Act of 1970 (which came into effect on July 1, 1972) U.S. banks and other specified types of financial institutions are required, inter alia, (a) to keep for five years records of all transfers into or out of the United States involving more than $10,000, and (b) to make reports to the U.S. Treasury of unusual currency transactions involving amounts of more than $10,000. (The issue of whether banks can make available the information to Government agencies is currently being tested in the courts.)

Such information on financial transfers would be required for effective administration of a comprehensive control program. But, in addition, it would be necessary to identify the financial transfer with the other elements of the transaction -- e.g., the payment for imports, an "authorized" remittance, etc. -- which would have to be represented by pieces of paper authenticating the purpose of the transfer. Of course, alternatives could be suggested, such as a direct filing with a U.S. Government agency which would then sample financial data reported by banks to see whether there were records of financial transfers for which there were no authorizations. This alternative might have the merit of reducing the amount of paper work required of the banks, and thereby helping avoid an overloading of the financial system that could cause disruptions in domestic payments as well. However, it would almost certainly be ineffective in catching speculative flows as they occur.

It should be noted that shipments of currency would escape such a control system. The Recordkeeping Act of 1970 does require all persons to report shipments of currency in amounts in excess of $5,000 and as well as requiring financial institutions to report all unusual transactions of more than $10,000; but individuals or businesses desiring to ship currency abroad could doubtless accumulate substantial amounts in relatively small individual transactions. If the export of currency became a significant problem, restrictions could be placed upon the repatriation of currency from abroad, and this would doubtless result in the development of a separate market abroad for U.S. currency at a more depreciated rate than applied to other transactions.

The use of "counterpart" bank accounts could develop into a significant avenue for evasion if controls here and abroad proliferate.

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Essentially a French business, for example, could set up a franc account in its name, but to be used only to make payments on behalf of a U.S. firm, and correspondingly the U.S. company would set up a dollar account in a U.S. bank from which it would draw on order of the French company. Such practices were characteristic of the control period of the late 1940's in foreign countries; given the enormous growth in number of companies with international experience and the growth in their financial resources, the practice could become much more extensive today. Whether that would occur would depend upon whether U.S. and foreign companies believed that they might be sufficiently disadvantaged by U.S. and foreign control programs to warrant setting up such accounts.

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APPENDIX C

Selected Material on Foreign Experience with Controls

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APPENDIX C

Main Forms of Capital Control Applied in Selected Industrial Countries as of June 1, 1971 [1][2]

	BLEU	Canada	France	Germany	Italy	Japan	Nether-lands	Norway	Sweden	United Kingdom	United States
Exchange control[3]	X	-	X	-	X	X	X	X	X	X	-
Direct controls (not exchange controls)[3]	X	-	X	-	X	X	X	X	X	X	X
Voluntary programs, guidelines, gentlemen's agreements	-	X	-	-	X	X	X	X	-	X	X
Special foreign exchange market for some or all capital transfers	X	-	X	-	-	-	-	-	-	X	-
Taxes on capital outflows	-	-	-	-	-	-	-	-	-	-	X
Taxes on capital inflows	-	-	-	-	-	-	-	-	-	-	-
Special taxes on income only from nonresident-owned capital	-	-	-	X	-	-	-	-	-	-	-
Certain outward direct investment subject to special exchange rate	(X)	-	-	-	-	-	-	-	-	X	-
Outward direct investment restricted	-	-	X	-	X	X	-	X	X	X	X
Restrictions relaxed or intensified	-	-	R	-	-	R	-	-	I	R	R
Certain inward direct investment subject to special exchange rate	(X)	-	-	-	-	-	-	-	-	-	-
Inward direct investment restricted[4]	-	-	X	-	-	X	-	X	-	-	-
Restrictions relaxed or intensified	-	-	R	-	-	R	-	-	-	-	-
Outward portfolio investment subject to special exchange rate	X	-	X	-	-	-	-	-	-	X	-
Outward portfolio investment restricted	-	-	X	-	-	X	-	X	X	X	-
Restrictions relaxed or intensified	-	-	-	-	-	R	-	-	-	R	-
Inward portfolio investment subject to special exchange rate	X	-	-	-	-	-	-	-	-	-	-
Inward portfolio investment restricted	-	-	-	-	-	X	-	X	X	-	-
Restrictions relaxed or intensified	-	-	-	-	-	R	-	-	-	-	-
Residents free to issue securities abroad	X	X	-	X	-	-	-	-	-	-	X
Restrictions relaxed or intensified	-	-	R	-	R	I	-	-	-	R	-
Free access for nonresidents to domestic capital market[5]	-	X	-	X	-	-	-	-	-	-	X
Such access tightly restricted	X	-	X	-	X	X	X	X	X	X	-
Restrictions relaxed or intensified	-	-	R	-	I	R	R	-	-	-	-
Long-term borrowing from nonresidents restricted	-	-	X	-	X	X	X	X	X	X	-
Restrictions relaxed or intensified	-	-	R	-	R	I	-	R	R	R	-
Long-term lending to nonresidents restricted	-	-	X	-	X	X	X	X	X	X	X
Restrictions relaxed or intensified	-	-	R	-	-	-	R	-	-	-	R
Preferential capital controls for associated monetary area[6]	-	X	X	-	-	-	-	-	-	X	X
Preferential capital controls for EFTA countries	-	-	-	-	-	-	-	-	-	X	-
Preferential capital controls for EEC countries	X	-	X	-	X	-	X	-	-	-	-
Personal investment in real estate abroad subject to special exchange rate	X	-	-	-	-	-	-	-	-	X	-
Personal investment in real estate abroad restricted	-	-	X	-	X	X	-	X	X	X	-
Restrictions relaxed or intensified	-	-	-	-	-	-	-	-	I	-	-
Emigrants' transfers restricted	-	-	X	-	X	X	-	X	X	X	-
Restrictions relaxed or intensified	-	-	-	-	-	R	-	-	R	-	-
Export of domestic banknotes by travelers restricted	-	-	X	-	X	X	-	X	X	X	-
Restrictions relaxed or intensified	-	-	R	-	I	-	-	-	-	R	-
Import of domestic banknotes by travelers restricted	-	-	-	-	-	-	-	X	X	-	-
Restrictions relaxed or intensified	-	-	-	-	-	-	-	-	-	-	-
Restrictions on acceptance from foreign banks relaxed or intensified	-	-	R	-	I	-	-	-	I	-	-

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APPENDIX C

Main Forms of Capital Control Applied in Selected Industrial Countries as of June 1, 1971 1/2/ (concluded) a/

	BLEU	Canada	France	Germany	Italy	Japan	Nether-lands	Norway	Sweden	United Kingdom	United States
Export of gold by travelers restricted	-	-	X	-	X	X	-	X	X	X	X
Import of gold by travelers restricted	-	-	X	-	X	X	-	X	X	-	X
Import and export of gold at special exchange rate only (specified transactions)	(X)	-	-	-	-	-	-	-	-	-	-
Private persons free to hold domestically any amount of gold coins	X	X	X	X	X	-	X	X	X	X	X
Collection of export proceeds required	X	-	X	-	X	X	X	X	X	X	-
Surrender of export proceeds required	-	-	X	-	-	X	-	X	-	X	-
Maximum period for collection and/or surrender prescribed	X	-	X	-	X	X	-	X	-	X	-
Collection/surrender requirements relaxed or intensified	-	-	R	-	-	-	-	-	-	R	-
Nonbank residents' forward cover restricted to permitted underlying transactions	X	-	X	-	X	X	-	X	X	X	-
Nonbank residents entirely free to engage in forward transactions with nonresidents	-	X	-	X	-	-	X	-	-	-	X
All borrowing and lending between residents and nonresidents subject to special or general permission	X	-	X	-	X	X	X	X	X	X	-
Some such borrowing and lending restricted or subject to guidelines	X	X	X	X	X	X	X	X	X	X	X
All individual borrowing and lending between residents and nonresidents uncontrolled	-	X	-	X	-	-	-	-	-	-	X
Some borrowing and lending between residents and nonresidents uncontrolled only through special exchange market	X	-	-	-	-	-	-	-	-	-	-
Nonresidents' access to domestic bank credit restricted 7/	X	X	X	-	X	X	X	X	X	X	X
Residents' access to foreign bank credit restricted	X	-	X	X	X	X	X	X	X	X	-
Nonresidents (including banks) free to establish nonresident accounts in domestic currency and withdraw balances in foreign currency 8/	X	X	X	X	X	X	X	X	-	X	X
Banks free to borrow foreign currency from nonresidents	X	X	-	X	X	-	X	X	X	X	X
Banks free to lend to nonresidents foreign currency borrowed from nonresidents	X	X	X	X	X	X	X	X	X	X	X
Banks free to switch borrowed foreign currency into domestic currency	(X)	X	-	X	X	-	X	X	-	-	X
Controls over banks' short-term foreign assets or liabilities (specified below)	X	X	X	-	X	X	X	X	X	X	X
Guidelines or voluntary program for banks' borrowing from or lending to nonresidents	-	X	-	-	X	X	-	X	-	-	X
Controls over foreign position of banks	X	-	X	-	X	X	X	X	X	X	X
Controls relaxed or intensified	R	R	R	-	R	-	R	I	-	R	-
Reserve requirements against banks' foreign liabilities	-	-	X	X	-	X	-	-	X	-	X
Ceilings or other limitations on banks foreign asset position	X	-	X	-	X	X	X	X	X	X	X
Banks' foreign assets included in de facto or de jure ceiling on bank credit	X	-	-	-	-	-	-	X	-	X	-
Ceilings or other limitations on banks' foreign liabilities	X	-	-	-	X	X	X	X	X	-	-
Interest ceilings (or prohibition) on banks' liabilities to nonresidents	(X)	-	(X)	(X)	-	X	(X)	-	-	-	X

1/ Parentheses indicate that substantive changes occurred in the period April 1-June 1, 1971.
2/ Where a relaxation (R) or intensification (I) of any specific type of control is shown, the modification relates to the period January 1, 1970 through April 1, 1971.
3/ Other than controls or restrictions imposed for security reasons.
4/ Excludes restrictions on nonresidents' access to physical resources or strategic industries and those on foreign participation in financial institutions.
5/ No allowance made for nonofficial queue systems.
6/ Also covers in Canada preferential access for United States, and in United States preferential access for Canada.
7/ Including access by nonresident-owned or nonresident-controlled companies established in the country concerned.
8/ Accounts that may be freely credited with domestic currency proceeds from the sale of convertible currencies transferred to the country concerned and that may be freely debited for outward transfers in convertible currencies.

a/ Source: International Monetary Fund internal document SM/71/181 dated July 14, 1971.

Control of Capital Transactions in France[1/] [a/]

I. Trends in Capital Controls

France presently maintains a system of exchange and other controls over inward and outward capital transactions with all countries other than Monaco and the operations account countries.

The evolution of the French system of controls on capital over the last decade displayed the following general tendencies.

Regarding the degree of restrictiveness of the system, the period 1960-67 was characterized by a virtually uninterrupted move toward liberalization which culminated in the abolition of exchange control in the beginning of 1967. The major exceptions in this respect were certain measures taken in 1963 to discourage the inflow of short-term capital and the more careful scrutiny applied in the mid-1960s to foreign applications for direct investment in France. Following the abolition of exchange control in 1967 special controls were introduced, without prejudice to the convertibility of the franc, over borrowing abroad by residents and over inward and outward direct investment. Following the May 1968 crisis and the massive outflow of capital, exchange control was reimposed in addition to the special control measures. There were several changes in the course of 1968 but the system that eventually emerged in November of that year was more restrictive than the one prevailing in the early 1960s, especially with regard to outward capital transfers by residents. Controls over investments and borrowings were further tightened in 1969. After the devaluation of the franc in August 1969 the "security currency" (devises-titres) market, which was eliminated in 1962, was re-established. In 1970 and early 1971, there was a degree of relaxation especially with respect to direct investment and the obligations related to the net foreign currency position of authorized banks. In May 1971, however, the French authorities increased reserve requirements for nonresident franc accounts and announced that it might be necessary in the future to take other measures aiming to stem an inflow of foreign capital.

With respect to methods of control employed in the last decade, the French authorities relied heavily on direct exchange control. In the short interval 1967-68, during which exchange control was abolished, special controls outside the exchange system were introduced and since 1968 maintained in addition to the exchange control measures, which have again been restored

1/ A summary of the exchange controls of France including those affecting banknotes and gold, is to be found in the Annual Report on Exchange Restrictions.

a/ Source: International Monetary Fund internal document SM/71/181 dated to their position in the over-all regulatory system. A noteworthy development in the last three years has been the increased reliance placed on direct and indirect regulation of banking operations. Although such controls had been relaxed in 1970, it is only in recent months that more emphasis has been placed on them in order to curb undesirable effects of inward capital movements.

As regards the scope of the regulatory system, the emphasis, on balance, was on outward capital movements especially in the early and late 1960s, reflecting over-all French economic conditions in those years. With respect to inward transfers, foreign direct investment was made subject to closer scrutiny during the mid-1960s in accordance with domestic planning targets. Following the growth and developments in the Euro-currency market, emphasis has been placed in more recent years on the control of short-term capital inflow.

II. Methods of Control

As mentioned above capital movements between France and all countries other than Monaco and the operations account countries are subject to exchange control. Certain controls that are independent of the exchange control regulations are maintained over inward and outward direct investment and over borrowing abroad; these do not apply to relations with the operations account countries or Monaco, and since February 1971 to direct investments in and from EEC countries.

Outward transfers of resident-owned capital generally are restricted; the transfer abroad of nonresident-owned funds in France, including the sales proceeds of capital assets is not restricted. However, the sale of foreign securities in France by nonresidents is prohibited. Capital receipts from foreign countries are permitted, provided that the foreign exchange proceeds are surrendered. Capital assets abroad of residents are not subject to repatriation, but income from such assets is subject to repatriation.

The current French system of controls over various forms of capital transactions is summarized below.

1. Direct investment

Both inward and outward direct investments are subject to exchange control which is more restrictively applied in the former case. French direct investment abroad may be financed, within certain limits, by purchases on the exchange market, and foreign direct investment in France must generally be financed with an inflow of foreign exchange. In addition foreign direct investments in France and French direct investment abroad, implying control of a company require prior authorization by the Minister of Economy and Finance, who in practice gives an answer within two months from receipt of the declaration. Analogous provisions apply to the liquidation of direct French investments abroad, but liquidation of foreign investments in France is subject only to a declaration made *a posteriori*.

Throughout the period under review both inward and outward direct investments have been subject either to exchange control or special controls and since 1968 to both.

2. Borrowing and lending abroad

Borrowing abroad by residents, with certain exceptions, is subject to exchange control and requires, in addition, prior authorization by the Minister of Economy and Finance. In July 1970 the scope of exemptions from prior approval for borrowing abroad was reduced. Lending abroad is subject to exchange control authorization and is restricted.

Borrowing and lending abroad by nonbanks was subject to exchange control of varying intensity in the years 1960-67. During the 1967-68 interval when exchange control was abolished only borrowing abroad required prior authorization by the authorities.

3. Portfolio investment

French and foreign securities held in France by nonresidents can be exported under certain conditions. The exportation for the account of residents of French securities held in France is prohibited. Purchases of French or foreign securities abroad by residents cannot be financed with foreign currency acquired on the French exchange market, but are freely permitted through the "security currency" (devises-titres) market (see below). In addition to exchange control, foreign issues on the French capital market are subject, with certain exceptions, to prior authorization by the Minister of Economy and Finance, which has not been granted frequently up to now.

4. The "security currency" market

French and foreign securities deposited by residents with an authorized bank abroad may be sold abroad, the proceeds from the sale being sold on the Security Currency Market ("Marché de la devise titre"). This market was re-established in August 1969 and gives rise to a special rate. Funds in the Security Currency Market are available for the purchase abroad of French and foreign securities.

A similar market existed until 1962, when it was terminated following the permission for residents to buy on the exchange market in France the foreign exchange required to purchase French and foreign securities on stock exchanges abroad.

5. The forward exchange market

Forward exchange transactions take place at freely negotiated rates, i.e., without any official intervention in the market. Residents other than banks may conclude forward exchange contracts for a maximum period of three months in respect of imports of specified commodities, but forward sales of foreign currency are free. For most imported products the term of the contract is generally one month. Authorized banks, which may also act on behalf of banks established abroad, are permitted to deal spot or forward in the exchange market in France and, also, to deal with their correspondents in foreign markets in all currencies subject to certain limitations on their foreign exchange positions and on credits in francs to nonresidents (see below).

In the early 1960s, the Paris forward market was limited to transactions related to trade; financial forward transactions were not permitted. Authorized banks, up to 1967, were not allowed to take an open position either spot or forward; they acted only as intermediaries, and the total spot or forward sales of exchange by customers had to be covered by total spot or forward purchases, respectively. These regulations were gradually relaxed for nonbank residents, and by 1966 they could freely conclude forward exchange contracts not exceeding one year in respect of receipts and payments for any permitted current or capital transaction.

6. Regulations pertaining to authorized banks

The Bank of France has since 1968 imposed limits on the foreign exchange positions (positions de change)[1/] of the authorized banks and on their claims in francs on foreign countries. Banks are prohibited from making, extending, or renewing loans in French francs: with the exception of some particular types of loans ("crédit de courrier," documentary credit in favor of French exporters). In May 1971 it was announced that franc accounts of foreign banks were reclassified and would be treated as sight deposits subject to the 9.25 per cent reserve requirement. For these deposits, which were previously classified as time deposits, there is a 6 percentage point increase in reserve requirements. At the same time, the Bank of France was accorded the power to raise the obligatory reserve requirement on nonresident deposits to 100 per cent and to restrict or to abolish the remuneration on such deposits. These developments indicate a tendency to return to the more restrictive practices on inward capital movements of earlier years. For example, from 1963 to 1966, French banks were not permitted to pay interest on franc balances held by nonresidents. Also between January 1969 and July 1970 the net foreign currency positions (positions en devises)[2/] were under control, with banks maintaining positions above certain limits required to make U.S. dollar deposits with the Bank of France. However, this set of controls is designed as a safety device which does not hinder current transactions and allows nonspeculative capital flows to be effected under administration control.

1/ Total of each bank's own spot and forward positions in foreign currency vis-à-vis residents and nonresidents combined, excluding positions of customers.

2/ Spot assets and liabilities vis-à-vis nonresidents only.

NOTE ON FRENCH DUAL EXCHANGE MARKET

The official market now includes merchandise export and import transactions and all other current account transactions except for tourism. Capital and tourism transactions are carried out in the financial market, where the franc value is currently about 5 per cent above the franc value in the official market.

Originally, the official market included only merchandise exports and imports and related expenses and "current payments to and from governments and specified public authorities." (Quote is from IMF, SM/72/76 April 11, 1972, p. 15.) All invisibles except for those just noted were transacted in the financial market.

The French justification for initially including practically all invisibles in the financial market was twofold: First, it was maintained that the authenticity of merchandise trade transactions could be reasonably easily verified, but that "there might be a tendency for capital transactions to be disguised as current invisibles" if invisibles were included in the official market. (Ibid., p. 16.) Second, it was noted that the deficit on invisibles just about offset the surplus on capital account, thereby keeping the premium on the franc in the financial market relatively small. It was held that if the premium got too high -- i.e., as high as 10 per cent -- "the separation of markets would be difficult to maintain for long..." (Ibid., p. 16.)

The IMF, naturally, objected to invisibles being excluded from the official market, as did French businessmen and financiers who stood to gain from a lower priced franc. Thus, apparently bowing to these pressures, the French authorities this spring transferred transactions in all invisibles but tourism to the official market. The French authorities are believed not to have intervened in the financial market. French officials, according to the IMF, found the dual market "most useful in staving off unwanted capital inflows and in providing some insulation for the domestic monetary system." (Ibid., p. 16.)

EXCHANGE CONTROLS IN THE UNITED KINGDOM

U.K. exchange controls in the post-war period derive their authority from the Exchange Control Act of 1947. The powers contained in that Act are vested in the Treasury, but controls have generally been administered by the Bank of England, acting as agent for the Treasury.

The controls were quite restrictive in the immediate post-war years, but were gradually eased in subsequent years. In 1958, nonresident holdings of sterling became freely convertible, and the United Kingdom formally accepted the obligations of Article VIII of the IMF Agreement in February, 1961. Beginning in 1961, the controls were again intensified.

The discussion that follows deals with some of the controls in force after 1961, and tries to give some crude assessment of their effectiveness.

Controls on outflows of long-term capital[1/]

In July 1961 restrictions were imposed on direct investment in countries outside the sterling area.[2/] New investment qualified for official exchange only if it could be shown that it

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1/ Much of the description of these controls is taken from the Bank of England Quarterly Bulletin, September 1967.

2/ For purposes of U.K. exchange control, people (and their assets) are classified according to the country in which they reside: a distinction is made between countries in the overseas sterling areas (OSA)and the rest of the world "non-sterling area" or (NSA). Until recently, there was no U.K. control over payments from the United Kingdom to OSA residents.

would produce sufficient benefits to U.K. export earnings, and thus to the balance of payments, within two or three years. Companies which could not meet this criterion, and could not borrow abroad in foreign currency, were thereby precluded from investing. This caused difficulties for some companies, especially those which needed additiona financing for existing investments. From May 1962, therefore, companies whose investment could not qualify for foreign currency at the official exchange rate were allowed to buy the currency in the investment currency market (at a premium then of about 3 per cent).[3/] This was the first time that the investment currency market was allowed to be used for other than portfolio investment.

In 1965 further restrictions were imposed on direct investment outside the sterling area. In April the criteria for obtaining official exchange were made more stringent, in that a commensurate return was not only required in the short run but must continue thereafter. As of July foreign currency could no longer be acquired at the official rate even if the investment met the new criteria -- all direct investment had to be financed either with investment currency or by borrowing foreign currency abroad. In May 1966 the rules were tightened still further: the use of investment currency for direct investment was reserved for projects which met the

3/ Prior to May 1962, a distinction was made between dollar securities (both U.S. and Canadian), on the one hand, the proceeds from the sale of which could be used to purchase any non-sterling security, and non-dollar foreign securities, on the other, which could be switched only into other non-dollar securities. When switching from non-dollar into dollar securities was generally permitted, in May 1962, the two currency pools merged into the one "investment currency market." Residents could then switch freely from one currency security to another, provided it was quoted.

criteria, so all other investment had to be financed from foreign currency borrowing.

In April and July 1965, the right of U.K. residents to sell the proceeds of certain capital items, such as legacies and gifts, in the investment currency market -- and to obtain the premium in that market -- was withdrawn. The proceeds had to be sold instead at the official rate of exchange, thus increasing official reserves rather than the pool of investment currency. For a similar reason, also from April 1965, 25 per cent of the proceeds from all sales of foreign currency securities including sales abroad for the purpose of switching investments, had to be sold in the official exchange market. At the same time, U.K. residents were no longer allowed to buy property outside the sterling area for private use with investment currency (which had been permissible since April 1964). Instead, they were required either to buy the property for sterling from another resident or to purchase foreign currency in the "property currency" market at the current premium.4/

There was, finally, a voluntary program introduced in May 1966. U.K. companies with plans to invest in any of the four main developed countries of the sterling area5/ were asked to postpone investment which did not satisfy the criteria for investment outside the sterling area. If that was not practicable, they were asked to

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4/ The property currency market was merged with the investment currency market in August 1970.

5/ Australia, New Zealand, South Africa, and the Irish Republic.

finance such projects from local sources. Similarly, institutional investors were asked to insure that there be no significant increase in their holdings of securities denominated in the currencies of these four countries. This request was extended to holdings of securities denominated in NSA currencies.

Most of these controls have been modified further in subsequent years. One notable modification, in June 1972, was the extension of some of the controls to OSA countries.

Controls on outflows of short-term funds[6/]

Virtually all transactions of residents with nonresidents -- whether in sterling or any other currency -- are subject to control. Notably, a resident may not buy or sell (other than from or to an Authorized Bank[7/]) or hold any foreign currency. Thus, for example, exporters may not hold foreign currency receipts abroad but must sell the proceeds immediately to an Authorized Bank, and importers may not buy spot foreign currency in order to hold it until payment is due.

Banks in the United Kingdom are restricted as concerns the amount of any net assets in foreign currencies they may hold. The Bank of England assigns one limit on each bank's net spot assets

6/ Cf. Rodney Mills, "Regulations on Short-Term Capital Movements: Current and Recent Techniques in Selected Industrial Countries," July 24, 1972.

7/ An Authorized Bank is any bank authorized by the Treasury to deal in gold and foreign currencies and to implement certain types of Exchange Control transactions.

in foreign currencies that are covered forward, and a second limit on the bank's total net assets in foreign currencies -- both spot and forward combined. These limits were reduced in the mid-1960's when balance of payments deficits were putting pressure on the official reserves, and since then they have been very small. However, the limits on net spot assets covered forward were doubled in September 1971.

Effectiveness of controls

In trying to assess the effectiveness of these controls, it is not sufficient to ask if they enabled the authorities to defend the exchange rate parity -- for they clearly did not. Nor can much be gained by asking if the controls lived up to expectations.[8/] Instead, one must try to determine what the impact of the controls actually was.

In Table 1, data on long-term flows between the United Kingdom and the NSA countries are presented. It is these flows -- not flows to OSA countries -- that have been subject to control.

8/ It is difficult to know what the controls were expected to achieve. One indication of official expectations is provided in the IMF Article VIII U.K. Consultation report for 1966: "The exchange control measures taken in 1965 will have their full year effect on private long-term capital account in 1966. The effects of these measures will be reinforced by the voluntary program....The U.K. representatives expected that there would be some net inflow of private long-term capital in 1966. As for 1967, a marked net inflow was expected...." (SM/66/78, Part I, p. 17) The actual data for 1966 and 1967 show net outflows of private long-term capital of £26 and £82 million, respectively.

Table 1. United Kingdom: Private Capital Flows With Non-Sterling Area Countries
(in £ millions)

	1964	1965	1966	1967	1968	1969	1970	1971
Long-term capital (net)	-53	+75	+121	+131	+156	+279	+231	+415
of which: U.K. investment overseas	-212	-169	-162	-230	-373	-290	-491	-514
Overseas investment in U.K.	+159	+244	+283	+361	+529	+569	+722	+929
Short-term capital (net)	+95	-50	-437	-182	-524	-371	+643	+1,742
of which: Banking and Money Market Liabilities in Sterling	-15	-2	-117	-68	-111	-5	+79	+352
other	+110	-48	-320	-114	-413	-364	+564	+1,390
Errors and Omissions	-111	+145	-61	+136	-301	+735	+547	+881
Total	-69	+170	-377	+85	-669	+643	+1,421	+3,038

Source: H. M. Central Statistical Office.

On the basis of the above description of the tightening of the controls, we would expect to see some impact, beginning in 1965, or certainly in 1966, on both direct and portfolio investment abroad by U.K. residents.

Total U.K. investment abroad (net; NSA countries) was in fact lower in the years 1965-1967 than in 1964. Looking back several years earlier, however, it seems that 1964 was an exceptional year; the large outflow in that year seems related primarily to the purchase by the Royal Dutch/Shell Group, for about £60 million, of a half interest in Montecatini's petrochemical business, although portfolio investment abroad was also unusually high.

The turnaround in portfolio investment in 1965 and 1966 was quite sharp, but it was not sustained in 1967 and 1968, nor was the rate of inflow in 1965 and 1966 significantly different from rates experienced in the early 1960's.

It is difficult, in short, to find strong evidence in the data that the investment controls resulted in lower net outflows to NSA countries. Nevertheless, it is quite likely that, in the absence of controls, the outflows would have been even greater. Moreover, it is likely that a larger proportion of the direct investment abroad that did take place was financed from local sources, thereby mitigating the drain on U.K. reserves.

It is even harder to determine the extent to which controls an short-term flows have reduced the size and volatility of outflows of resident funds. However, in terms of the overall usefulness of the controls, two points in particular deserve mention:

(1) The controls do not apply to nonresidents. Thus, for example, the existence of a large volume of liquid sterling liabilities to nonresidents means that very sizable short-term outflows can take place -- not subject to the controls.

(2) The financial community in London derives a large part of its international business from transactions in currencies other than sterling -- notably in dollars. So long as banks switch only from one foreign currency to another, rather than into or out of sterling, the controls do not interfere with this portion of their international business. If this business were conducted more largely in sterling, resistance to the controls would presumably be greater.

Appendix D

REGULATIONS ON SHORT-TERM CAPITAL MOVEMENTS:
RECENT TECHNIQUES IN SELECTED INDUSTRIAL COUNTRIES

by

Rodney H. Mills, Jr.

July 24, 1972

CONTENTS

REGULATIONS ON SHORT-TERM CAPITAL MOVEMENTS: RECENT TECHNIQUES IN SELECTED INDUSTRIAL COUNTRIES[1/]

I. INTRODUCTION

By the end of the 1950's the external positions of most of the principal industrial countries were strong enough to allow them to make considerable progress towards shedding the controls on capital movements that they had introduced in the 1930's and 1940's to protect their official reserves. But in the past 15 years almost every major industrial country has felt it necessary to impose new regulations on capital movements, in the great majority of cases to limit net capital inflows rather than outflows. The new measures (here understood to include modifications of existing regulations as well) were adopted mainly to facilitate domestic monetary management, but sometimes for other reasons as well, notably to promote international monetary cooperation by limiting official reserve accruals. A characteristic of the new measures is that they have been applied almost exclusively to short-term capital flows rather than long-term, and this paper deals systematically only with regulations on short-term flows.

The new regulations instituted to prevent or moderate short-term net <u>inflows</u> (a category that encompasses measures to encourage outflows as well) by and large have been imposed on banks rather than

1/ This paper covers developments since the late 1950's in Belgium, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, and the United Kingdom.

nonbanks. Capital movements that take place through operations of banks are less complex than those occurring at the direct instigation of corporations and other nonbanks, and they involve a far smaller number of individual participants. Consequently, it is easier in the case of banks to design regulations that are relatively simple and that can be put in place quickly, while at the same time being readily enforceable and fairly equitable to all those directly involved. It appears that the regulations on banks have been quite effective in achieving their purpose. But they have not, of course, eliminated speculative capital inflows. For one thing, regulations on banks do nothing about speculative flows outside the banking system, such as shifts in leads and lags in payments for trade and services. Moreover, monetary authorities have not wanted to keep banks under permanent tight control, and so have generally taken action on speculative inflows only after these have already been set in motion.

This paper discusses, inter alia, eleven types of measures that have been imposed on banks to prevent or moderate short-term inflows. Four of these types involve the use of incentives and disincentives to influence bank behavior. They concern themselves with reserve requirements and access to central bank credit -- two rather traditional tools of credit control -- as well as with swaps of foreign currency between commercial banks and the central bank, and with special measures used in Japan to finance imports. The remaining seven types of regulations on banks are more "authoritarian," being directives that limit, prohibit or order certain activities. Of these seven types, it is analytically useful to distinguish the first three from the second four. The first three have to do with limits imposed on banks' net or gross foreign assets and liabilities, or with their net positions in foreign currencies, and are clearly designed to affect the operations of the banks themselves. The latter four types prohibit or order certain banking activities, but their purpose is really to influence foreign depositors -- specifically, to discourage their placing funds in the country. These regulations consist of prohibitions on interest payments to foreigners, prohibitions on the opening of new deposits by foreigners, application of negative interest on foreign deposits, and the blocking of funds in foreign-owned accounts.

Still in the context of measures to limit capital inflows, the measures imposed on nonbanks have been, as noted, far less numerous than those imposed on banks. With one exception, the measures on nonbanks have been an integral part of the country's exchange controls. Two countries have used exchange controls to limit certain types of inflows on a continuing basis; two others have changed controls on the timing of receipts and payments in order to forestall undesirable shifts in leads and lags. The one measure taken outside the exchange controls area has been Germany's recently-instituted reserve requirement on foreign liabilities of nonbanks.

Some countries have prohibited sales of certain assets to foreigners, a type of measure that applies to both banks and nonbanks.

With regard to techniques to limit short-term net capital outflows, some measures of this kind have been placed on banks. All of these regulations have dealt either with limits on banks' net foreign assets (used in five countries) or limits on banks' net foreign-currency position. Exchange controls on nonbanks were abolished prior to the 1960's in some of the major industrial countries, and in some others have not been effectively used to protect the balance of payments because there has been no need. The United Kingdom, France (since 1968), Italy and Sweden have used exchange controls on nonbanks to limit short-term outflows for balance of payments reasons.

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A few words may be appropriate concerning the historical sequence of these various regulations. Measures to limit inflows were adopted on an increasingly widespread scale in the period from 1958 to mid-1966. That period was, generally speaking, one of strong economic expansion in the industrial countries as a whole, and most of the time monetary authorities were concerned about actual or potential inflation. To reinforce policies of monetary restraint, Germany, Italy, France, Switzerland, the Netherlands, Sweden and Japan instituted new regulations on banks, and the Netherlands and Sweden also used exchange controls on nonbanks, to limit net capital inflows or to encourage funds to flow out. In Germany and Italy, the objective of contributing to international monetary cooperation by reducing official dollar holdings provided an additional stimulus for the encouragement of capital outflows.

After mid-1966 the temporary abatement of inflationary pressures in Europe led to the abolition or deactivation of many of these regulations, and when inflationary pressures were renewed about the end of 1968 there was less extensive use than before of regulations on capital inflows as a tool of anti-inflationary policy. One reason for this was the very restrictive monetary policy in the United States that pulled funds from Europe, via the Euro-dollar market, in 1968-69. However, Germany retained or revived (sometimes with modifications) all the regulations employed earlier, partly to discourage speculative inflows generated by expectations of the revaluation of the mark that eventually materialized in the autumn of 1969. In Japan, several measures were used in 1969-71 to temper the size of reserve gains, as much or more because they attracted international attention to Japan's strong balance of payments position as because they interfered with domestic credit policy.

There was a spate of new measures to limit short-term capital inflows in 1971 in connection with the upheaval in exchange markets. The floating of the German mark and the Dutch guilder in May 1971 led to some measures to limit short-term inflows in those countries and to steps in Belgium and France to head off or terminate speculative inflows into their currencies. The suspension of the convertibility of the U.S. dollar into gold or other reserve assets on August 15, by generating massive flows out of the dollar into a number of European currencies and the Japanese yen, caused the authorities in the United Kingdom, Switzerland and Japan to act to prevent speculative inflows, and prompted additional moves in France and the Netherlands to the same end.

The measures instituted in the wake of the U.S. action were motivated by two related and mutually inconsistent considerations. On the one hand, it was feared that enormous reserve increases would greatly complicate the task of domestic monetary management. Reserve increases and their domestic monetary impacts could be avoided by letting the exchange rate float freely. On the other hand, there was also a reluctance to let exchange rates appreciate "too much" because of uncertainties about the general exchange rate realignment that by then was seen to be inevitable. The central banks of the United Kingdom, Switzerland, and Japan intervened in the exchange market to hold down the rise in the rate; the French chose to allow no rise whatever in the franc relative to the dollar for trade and government transactions, while allowing the franc to float in a second exchange market for other transactions. (In May 1971, Belgium had modified its already-existing dual exchange market system so as to channel all capital flows through a "free" market with a floating rate.)

Most of the post-August 15 measures were rescinded shortly after the December 18 Smithsonian meeting which produced a general exchange rate realignment. But in February and March of 1972, Belgium, the Netherlands and Japan experienced undesirably large reserve increases and instituted new regulations to limit short-term inflows. In late June of 1972, following the floating of the pound sterling, Germany, Japan and Switzerland acted to limit inflows of speculative funds.

New regulations since the 1950's to prevent short-term capital outflows, or intensifications of existing controls on outflows, have made their appearance in three situations. First, the events of May-June 1968 in France led to extraordinarily large wage increases, seriously impaired France's international competitiveness, and caused the reimposition of exchange controls on all outflows of resident nonbank funds as well as new regulations affecting French banks. The exchange controls remain (but not the bank regulations) despite the return to health of France's external position. The second situation was in 1969 when U.S. banks were borrowing heavily in the Euro-dollar market and European banks and nonbanks stepped up their lending in that market to meet part of the increased demand. At various times in 1969 Italy, Belgium, the Netherlands and Sweden moved to prevent further net lending abroad by their commercial banks, or to force a reflow of funds, in order to protect their official reserves. In the Italian case, an additional objective was to prevent net foreign lending by banks from tightening domestic monetary conditions. Finally, the Italian authorities acted in February 1970 and again in June 1972 to discourage capital outflows financed by exports of Italian banknotes.

II. TECHNIQUES TO LIMIT INFLOWS OR ENCOURAGE OUTFLOWS

A. Measures Affecting Banks

1. Reserve requirements on foreign liabilities

a. Germany. Banks in Germany have been subject to reserve requirements on their liabilities to foreigners as well as to domestic residents. The requirements have been used in two ways in order to influence flows of funds between Germany and other countries. One way has been to set reserve ratios on foreign liabilities higher than those on comparable domestic liabilities, to discourage banks from borrowing abroad. At most times since 1957 German banks have had to maintain higher average reserve ratios on foreign liabilities than on domestic liabilities, or else have been subject to an additional marginal reserve requirement on foreign liabilities but not on domestic liabilities, or both. The other way in which reserve requirements have been manipulated so as to influence capital flows has been to allow banks what is known as an "offset right." Since 1961, foreign liabilities have usually been exempted from reserve requirements to the extent those liabilities were offset by certain types of foreign assets. The offset right has thus encouraged banks to place funds abroad.

Average reserve ratios on foreign liabilities were at discriminatory levels (i.e., higher than on comparable domestic liabilities) from May 1957 through March 1959; from January 1960 through January 1962; and from April 1964 through January 1967.

When the economic downturn in Germany after the summer of 1966 eliminated the need for barriers to capital imports, the ratios on foreign liabilities were lowered to the same levels as on domestic liabilities as of February 1, 1967. From June 1, 1971 to the date of this writing, discriminatory average ratios on foreign liabilities have again been in effect. The differentials with respect to the ratios on domestic liabilities were widened on July 1, 1972.

Whenever the average reserve ratios have been higher on foreign than on domestic liabilities, the differentials have been greatest as regards sight liabilities; but it has been the gap with respect to time liabilities that has been crucial to the effectiveness of the regulation as a deterrent to foreign borrowing. German banks have been prohibited from paying interest on foreign-owned deposits most of the time since 1960, but they have not been subject to restrictions on rates payable on short-term loans from banks abroad, which are treated as time liabilities for reserve requirement purposes. Time liabilities are those for which the banks have been able actively to bid, and are thus those with respect to which differential reserve requirements influence banks' behavior.[1/] When discriminatory ratios have been in effect, the ratios on foreign time liabilities (including borrowings from foreign banks) have usually been 10 or 11 percentage points higher than on domestic time liabilities for the large banks. (In Germany, average reserve ratios rise with bank size.)

1/ Although foreign-owned demand deposits have been of large size, they have been kept solely on the initiative of the depositors.

Marginal reserve requirements on foreign liabilities were imposed briefly in 1961, and have been applied almost continuously since December 1968, when a new boom was getting under way in Germany. By contrast, domestic liabilities have been subject to a marginal reserve requirement only during July-August 1970. The marginal requirements have been additional to, not a substitute for, the average reserve requirements. The marginal reserve ratio on foreign liabilities was 100 per cent, on all classes of liabilities and banks, from December 1968 through October 1969, in which period the base level from which increases were measured was moved up twice. After a 6-month hiatus when no marginal requirement was in force, the ratio was set at the lower level of 30 per cent, and except during July-August 1970 was maintained at 30 per cent until March 1972, when the ratio was raised to 40 per cent. A further rise to 50 per cent occurred July 1, 1972. The base level has been advanced several times further. At the present time, foreign time liabilities of large banks carry an average reserve ratio of 35 per cent and a marginal reserve ratio of 50 per cent, while comparable domestic liabilities are subject only to a 10.7 per cent average reserve ratio.

German reserve requirements do not distinguish between liabilities in marks and liabilities in foreign currencies; thus, German banks' borrowing abroad of Euro-dollars or other Euro-currencies have not been exempted from discriminatory treatment under the reserve requirement regulations. To have exempted foreign borrowings denominated in foreign currencies from the reserve requirements would, of course, have totally undermined efforts to impede capital inflows by the reserve requirement technique.

The provisions of the offset right were unchanged between May 1961, when it was first introduced, and the end of December 1966. In that period, banks were subject to average reserve requirements on foreign liabilities only to the extent that the latter exceeded banks' holdings of sight and time deposits in foreign banks and holdings of foreign money market paper. While the main purpose of the provision was to encourage "money exports," a question of equity may also have been involved. The offset right allowed German banks to borrow funds abroad and relend them abroad without incurring a penalty. Clearly, this kind of offshore intermediation -- an important function of most banks that borrow or lend in the Euro-currency markets -- is penalized if a bank must maintain reserves against liabilities representing funds that, in effect, do not enter the country to begin with.

The incentive given by the offset right to shift funds abroad decreased as more funds were shifted in that way. This resulted from the fact that average reserve ratios were lower on time liabilities than on sight liabilities, and still lower on savings deposits. Banks naturally offset eligible foreign assets against those liabilities incurring the highest reserve ratios, and the additional reserve-reducing benefit of the offset right declined as assets were offset against liabilities bearing progressively lower reserve ratios.

The offset right was abolished -- temporarily, it turned out -- on January 1, 1967. It was reintroduced effective January 1, 1969, altered in form to fit with the marginal reserve requirement that had been imposed the previous month. Foreign liabilities were exempted from marginal reserve requirements (but not from average reserve requirements) if the funds were immediately relent abroad. There have been three subsequent modifications. From August to December, use of the offset right was restricted to foreign liabilities denominated in foreign currencies only; this restriction was an attempt to discourage the formation of speculative foreign-owned mark deposits. Since August 1969 the provision has not been applicable to interest arbitrage transactions associated with commercial bank swaps with the Bundesbank; this restriction was designed to prevent abuse of the swap facility (discussed on pp. 17-20). And since October 1970 the use of the offset right has been limited to interest arbitrage transactions involving only one foreign currency and where the resident bank and the foreign customer are not affiliated.

b. Japan. Reserve requirements on foreign liabilities of the Japanese foreign exchange banks were first introduced in June 1962. One requirement has related to banks' total foreign liabilities. From June 1962 until very recently, banks had to hold a specified percentage of their total outstanding foreign liabilities in the form of relatively liquid foreign exchange assets. This requirement was abolished on June 1, 1972. Effective May 16, 1972, a new requirement was imposed. Under the new requirement, banks are subject to a marginal reserve ratio only on their free yen liabilities to foreigners, and this reserve has to be held in yen at the Bank of Japan.

One purpose of the requirements has been to limit capital inflows that, if not so limited, might impede the attainment of domestic monetary objectives. A second purpose of the reserve against total liabilities was to promote sound bank management, by ensuring that banks could meet sudden withdrawals of Euro-dollar deposits for foreign banks better than if no foreign exchange reserve requirement existed.

The foreign currency assets eligible for satisfying the reserve requirements against total foreign liabilities included foreign banknotes, other cash items due from foreigners, sight and time deposits with foreign commercial banks, call loans to foreigners, and short-term bills of foreign governments. The required reserve ratio was initially 20 per cent. Between January 1963 and June 1965 the requirement was a mixture: it consisted of an average reserve requirement against deposits outstanding on a certain base date (20 per cent as of December 1962 and 25 per cent as of July 1964), together with a marginal reserve requirement (30 per cent) against increases over base-date levels. The requirement reverted to a straight 25 per cent average requirement in June 1965, the ratio dropping to 15 per cent in April 1966. The Japanese authorities did not increase the ratio in the period May-December 1971, believing that increases in the reserve ratio would be ineffective in stemming the massive short-term capital inflows of that period.

The marginal reserve requirement against increases in nonresident free yen liabilities, which is met by yen deposits at the Bank of Japan, was instituted with an initial ratio of 25 per cent. On July 1, 1972, after the floating of the pound, the ratio was doubled to 50 per cent, and the base period was moved up to May 21-June 20.

c. Switzerland. When efforts to combat inflationary pressures in Switzerland were intensified in March 1964, one of several measures adopted was to require banks to choose between two alternative courses of action with respect to any increases after January 1, 1964 in their Swiss franc liabilities to nonresidents. Banks could either convert these francs into foreign currencies and place them abroad, or see them sterilized in a non-interest-bearing account at the Swiss National Banks, i.e., subjected to a 100 per cent marginal reserve requirement. The banks of course chose the former alternative. Since the banks had been prohibited since 1960 from paying interest on nonresident franc deposits, they were not in any case bidding for funds in external markets for the purpose of domestic employment. But the reserve requirement did keep out of the banks' reserve base inflows of funds that were at the initiative of foreign depositors, who desired Swiss franc balances, even though no interest was paid on them, as a refuge or as a speculation on a revaluation. The marginal reserve requirement was removed in October 1966 when the threat of domestic inflation was receding. It was used again in 1971, in very different circumstances.

A new gentlemen's agreement between the Swiss banks and the Swiss National Bank was made in August 1971 after the suspension of the convertibility of the dollar. It provided for, inter alia, a 100 percent marginal reserve requirement on increases in liabilities to nonresidents (in foreign currencies or Swiss francs) above the July 31 level. But the reserve requirement did not apply to the extent that an increase in liabilities was offset by a rise in a bank's foreign assets in foreign currency (or in Swiss francs if the funds were to be spent abroad). The banks of course availed themselves of this privilege, and most of the large volume of foreign funds that entered Switzerland in the first half of August 1971 was thus re-exported. (However, Swiss banks' liquid balances in Swiss francs still remained very large because the better part of the total early-August inflow of funds from abroad was repatriation of Swiss-owned funds.) The marginal reserve requirement was tightened in early April 1972 by being given a more restrictive interpretation, namely, that foreign currency assets abroad that were covered forward were no longer eligible to meet the requirement. The new interpretation was designed to soak up excess bank liquidity (and was accompanied by the imposition of a marginal reserve requirement on increases in domestic liabilities over the July 31, 1971 level).

2. Special provisions on central bank credit

a. Germany. When the restrictive posture of German monetary policy was accentuated in 1964, the Bundesbank announced that, effective August 1 of that year, it would reduce a bank's rediscount quota by the amount that its gross nonresident liabilities exceeded the average of the first half of 1964. Banks had to make increasing use of their rediscount quotas over the next two years, but the effectiveness of this penalty provision was greatly blunted by the fact that those banks most inclined to borrow abroad tended to have the least recourse to rediscounting. The regulation was dropped in June 1967 but was revived in 1969 with narrow applicability. The new version related reductions in rediscount quotas to increases (over March 1969 levels) in banks' foreign "borrowing" only in the form of en pension transactions, i.e., sales of assets under repurchase agreement (which was escaping reserve requirements).

b. Japan. To discourage the foreign exchange banks from importing funds, since June 1970 the Bank of Japan has been granting these banks special 4-month yen credits, which are outside their rediscount and loan ceilings, for the purpose of financing imports. These special credits are extended at the basic discount rate, up to a maximum percentage of each bank's total financing of imports. The percentage was initially 15 per cent, but is now 50 per cent. This arrangement has formed one part of an extensive program known as "yen shift." To hold down official reserve accruals, since the spring of

1969 the Bank of Japan has used this and a variety of other devices as well to shift a large part of the financing of Japanese imports from foreign banks and suppliers to Japanese banks, as is discussed immediately below.

3. Special measures for financing imports (Japan)

The first measure taken to implement the "yen shift" program concerned Bank of Japan "guidance" to the foreign exchange banks regarding their domestic liquidity positions. Since April 1969 the Bank of Japan has allowed banks to reduce their net short-term domestic assets to levels lower than the Bank would normally permit, if the difference results from the financing of imports by yen call loans contracted to repay banks' Euro-dollar or other foreign borrowings, or by yen loans extended to customers to prepay the latter's import loans from abroad. The second measure to promote the "yen shift" was a 3-month operation during October-December 1969. The Bank of Japan supplied yen funds to the foreign exchange banks at call-money rates by purchasing government, government-guaranteed, and certain other bonds under a renewable 3-month repurchase agreement. The proceeds of these operations, amounting to some $280 million equivalent (at the exchange rate of the time), had to be used to finance imports, or lent in the Euro-dollar market <u>via</u> renewable 3-month yen/dollar swaps with the Foreign Exchange Special Account administered by the Bank of Japan.

The third measure was the special loan facility initiated in June 1970 and described earlier. At the present time these special loans approximate $2 billion equivalent (at June 1972 exchange rates). Finally, since March 1971, the Ministry of Finance has made dollar deposits with the foreign exchange banks for use by the latter, first for financing imports (in the months March-May 1971), then for reducing banks' gross foreign liabilities. Currently these deposits also total about $2 billion equivalent. The Ministry of Finance earns an interest rate on these deposits that varies with the U.S. prime rate and the Euro-dollar deposit rates.

4. Swaps between the central bank and commercial banks

a. Germany. Swaps of dollars against marks between the Bundesbank and German commercial banks were at many times an important means by which the Bundesbank has encouraged banks to place funds abroad. In making a swap facility available to the banks, a primary objective has been to promote domestic monetary stability by syphoning off excess liquidity in the banking system. However, Germany has had large balance of payments surpluses much of the time in the past 15 years, and an additional consideration in offering swaps to the banks has sometimes been to promote international monetary cooperation through shifts of U.S. dollar balances from the Bundesbank to the banks.

The Bundesbank began to offer dollar/mark swaps to the banks as early as October 1958, doing so on a preferential basis, i.e., charging a premium on forward marks lower than the market premium. Over the years the maturities of swaps have ranged from two weeks to six months, the banks usually being offered a wide choice; the forward mark premium has of course been varied in the light of market conditions, but has always had to be lower than the market premium to make the swaps attractive. However, there have been lengthy periods when the Bundesbank has not made swaps available. Swaps have not been offered since September 1969 except on one day, April 1, 1971.

German banks were offered, and took up, a considerable amount of swaps between October 1958 and late 1962, in which period outstanding swaps were the equivalent of about one-third of the banks' short-term foreign assets. After the early months of 1962 swaps were de-emphasized by the Bundesbank, and their outstanding volume fell to zero by early 1963. Even though German monetary policy became progressively tighter in 1964-66 swaps were not offered except between March 1964 and September 1965, and the dollars could be used only to purchase U.S. Treasury bills.

The Bundesbank resumed offering swaps in November-December 1967, during and just after the sterling crisis that forced a devaluation of the pound and which witnessed an inflow of speculative funds into marks. It did so again in March 1968 during the gold crisis that gave birth to the two-tier gold market, again to encourage the exodus of speculative funds. Finally, swaps were offered continuously from late August 1968 to September 24, 1969, on terms that the banks found attractive and which led them to utilize the facility heavily. This 11-month period saw massive speculative movements into the mark in November 1968, May 1969, and September 1969, the latter culminating in the interim floating of the mark and its subsequent revaluation in October. These inflows complicated the task of monetary management particularly since credit demand was rising strongly, and the purpose of the swaps was to skim funds from the banking system's reserve base.

It is generally believed, however, that during the periods of massive speculation on the mark beginning with November 1968 the swap arrangement led to much smaller net export of funds than their amount implied. German banks reputedly resold on the exchange market -- in effect, resold to the Bundesbank -- the dollars received from swaps, and used the related forward sales of dollars to the Bundesbank as cover against forward purchases of dollars from resident customers, since they could buy forward dollars in the market for less than the sale price stipulated by the contract with the Bundesbank. Or, what comes to the same thing in terms of the banks' net foreign position, while placing abroad the dollars acquired by swaps they could borrow abroad, sell the borrowed dollars spot, and repurchase them forward at a large enough discount to earn them a profit. Such abuses of the swap facility may, at least in part, explain why the Bundesbank did not offer swaps during the May 1971 speculative rush into marks that precipitated the seven-month floating of the currency felt necessary to preserve domestic monetary autonomy.

b. Italy. Preferential swaps have been used extensively in Italy where, in November 1959, facilities were set up by which banks could use lire to purchase U.S. dollars spot, at the market rate of exchange, from the UIC (Italian Exchange Office, managed by the Bank of Italy), and simultaneously resell the dollars forward to the UIC at the same rate of exchange, i.e., without paying a premium for forward lire. (Swaps with equivalent spot and forward rates are called "flat" swaps.) The maturity of the swaps has been kept at two or three months but the banks have had the privilege of advance repayment. From 1959 until the end of 1964 swaps were continuously available, and while the Bank of Italy assigned each bank a limit it appears that banks obtained all the swaps desired.

The main purpose of the swap facility was not to promote exports of funds but to provide Italian banks with dollars for internal lending. The banks competed with each other on rates on loans to customers more vigorously as regards loans in foreign currency than on loans in lire. To encourage lower interest rates on bank loans, the Bank of Italy wanted the banks to have all the foreign currency they wished (consistent with the general tenor of monetary policy). At the same time the authorities did not want the banks to build up too much foreign debt in the process; hence the decision to provide the foreign currency through swaps. However, the dollars that banks acquired by swaps with the UIC could be placed abroad, and to the extent they were so placed the swap facility, by requiring no premium on forward lire, encouraged such placements and a consequent shift of dollar funds from the Bank of Italy to the banks. Indeed, an additional objective of the swaps in the early

1960's was to reduce Bank of Italy dollar holdings through such shifts.

Banks' use of the swap facility in part to obtain funds for external lending (reducing net liabilities by increasing foreign assets rather than reducing gross liabilities) led the Bank of Italy to restrict and then terminate the making of swaps (other than roll-overs of existing swaps). At the end of 1965 economic activity was still sluggish. Monetary policy was easy, and banks were building up net foreign assets. To keep funds at home and further ease monetary conditions, the Bank of Italy restricted the use of "flat" swaps to those banks that still had net foreign liabilities in foreign currency; other banks were made to pay a premium on forward lire aligned with the market premium, except on renewals of old swaps.

New swaps were made prohibitively expensive in February 1969, when rising rates in the Euro-dollar market were inducing Italian banks to export funds. For a number of months prior to that time, the banks did not renew some dollar loans to domestic customers, and also increased their use of the swap facility, to acquire dollars for placement in the Euro-dollar market. In February the taking up of additional swaps was effectively discouraged by raising the forward lira premium to 5 per cent (except on renewals). The volume of outstanding swaps, which reached a record high in February 1969, fell sharply in the next few months when new regulations forced Italian banks to repatriate funds. There has been little change in the outstanding volume since mid-1969. The abrupt shift in the swap policy and the forced repatriation of banks' foreign assets (a measure described later on) were prompted by a desire to protect the official reserves as well as by domestic considerations.

c. Switzerland. Switzerland has long been a magnet for funds seeking safety, and on various occasions in the past 11 years there has been strong speculation on a revaluation of the Swiss franc. Political and financial disturbances around the world have often sent waves of funds to Switzerland, obliging the Swiss National Bank (BNS) to "mop up" excess bank liquidity in one way or another.

On numerous occasions in 1961-67, and more recently in May 1971, the BNS engaged in what amounted to swaps of foreign currency for Swiss francs with Swiss commercial banks. However, this could be done only sporadically, since these transactions had to be linked to swaps between the BNS and other central banks by which the other central bank had repurchased foreign currency forward. Until very recently the statutes of the BNS prohibited it from making net forward purchases of foreign currencies. Thus, when it wished to induce Swiss commercial banks to employ excess liquidity abroad instead of at home, the BNS could repurchase forward foreign currency sold spot to the banks under a swap arrangement only if it simultaneously sold the foreign currency forward. Consequently, the BNS could swap out to Swiss banks only foreign exchange that it in turn had acquired under swaps with central banks and that it had therefore sold forward to these central banks. Over the period 1961-67 (and in May 1971) the BNS frequently swapped to Swiss commercial banks dollars that it acquired when the Federal Reserve drew on its swap line with the BNS; it also swapped out sterling acquired by swaps with the Bank of England in March 1961 and November 1964, and lire acquired by swaps with the Bank of Italy in March 1964. Now that it is authorized to make net forward purchases of foreign currency, the BNS could make more regular use of swaps with Swiss commercial banks in the future.

5. Limits on banks' net foreign position

a. Italy. Controls on net foreign borrowing by banks in Italy were employed forcefully in the first half of the 1960's to limit inflows of funds through the banking system, and they had important effects on domestic credit conditions.

In the summer of 1960 the Bank of Italy moved to limit the expansion of bank liquidity then occurring because of a balance of payments surplus. Italian banks (as a whole) had built up sizeable net foreign liabilities, and to reduce their liquidity the Bank of Italy directed them to eliminate net foreign liabilities denominated in foreign currencies by the end of the year. This relatively modest use of this type of control was followed by more dramatic employment three years later. The prohibition on net foreign liabilities was lifted in November 1962. Between then and the end of August 1963, Italian banks increased their total net foreign liabilities very rapidly to help meet soaring loan demand that was accompanying an inflationary domestic boom. When it became imperative, in the summer of 1963, to bring demand expansion in Italy under control, the tool employed was to slow bank credit expansion by prohibiting banks from increasing their net foreign liabilities in foreign currencies above the August 31 levels. The banks were also asked to reduce these net liabilities if they could; but no actual reduction was needed to achieve a slowdown in credit extension since a large balance of payments deficit was already putting heavy pressure on bank liquidity.

Italian monetary policy turned easy after the economy slipped into recession in 1964. Banks generally found it profitable to pay off net foreign liabilities in foreign currency, and (as a group) did so by September 1965. At the end of that year the Bank of Italy directed that any bank with net foreign assets in foreign currency, either then or on any future date, would not be allowed to shift back into a net liability position. This directive, issued to strengthen the authorities' control over bank liquidity, prevented banks (as a group) from pulling in more than a small amount of funds from abroad in 1967 in response to renewed economic expansion in Italy. Since then, however, regulation of banks' net foreign position has not played much of a role as a tool of domestic credit control, essentially because economic conditions in Italy have not called for policies of credit restraint; indeed, since mid-1969, Italy has been plagued by serious underutilization of resources.

The end-1965 directive was superseded by another in late August 1971, following the U.S. measures of August 15. To prevent speculative flows of funds through banks, the Italian authorities instructed the banks to balance their net foreign position by September 15 and to maintain a balanced position thereafter.

b. Netherlands. As part of a policy of monetary restraint, Dutch banks were prohibited, effective August 1, 1964, from incurring net foreign liabilities in excess of a small margin of 5 million guilders. However, this prohibition -- still in force at the present time -- has been of little practical significance. In August 1964 Dutch banks (as a group) had a large volume of net foreign assets, which the prohibition on liabilities could not prevent being drawn down sharply from then until the end of 1967. Subsequently, Dutch banks built up their net foreign assets again in response to Euro-dollar market developments, and such assets are still large.

c. Sweden. Banks in Sweden have long been prohibited from having net foreign liabilities. But the prohibition has been largely irrelevant to Swedish banking practices at almost all times since (at least) the early 1960's because Swedish banks (collectively) have usually had substantial net foreign assets.

d. Belgium. In the spring of 1971, Belgium was experiencing strong wage-push pressures on prices and it was not clear yet that excess demand pressures would (as it happened) diminish fairly fast. Monetary policy remained quite tight, and Belgian banks found it advantageous to pull in funds from abroad. At the same time, the current account and nonbank capital movements were already causing a balance of payments surplus. To prevent undue additions to bank liquidity, in March Belgian banks were requested not to allow their net foreign position, adjusted by certain additions and exemptions, to decrease by more than a small amount relative to the position at the time; "decrease" here means either an increase in net foreign liabilities or a decrease in net foreign assets. Banks failing to comply would have their rediscount quotas reduced. In early May, speculation on a floating or revaluation of the Belgian franc (associated with that relative to the mark and the guilder) caused a big increase in banks' franc liabilities to nonresidents that was not offset by an equivalent rise in banks' foreign assets. Since this occurred on the initiative of the nonresident depositors rather than of the Belgian banks, the National Bank of Belgium chose not to reduce rediscount quotas but to convert the provision into a 100 per cent marginal reserve requirement, i.e., to require the banks to deposit with the National Bank the franc equivalent of the excessive deterioration in the net foreign position. This regulation was in turn abolished in September 1971, having been made pointless by the floating of the franc the month before.

Belgium used the same type of control in March 1972 when speculation against the dollar was causing large reserve gains in several countries and not insignificant ones in Belgium. The banks were asked not to allow their net foreign position (excluding nonresidents' holdings of francs acquired in the financial franc exchange market) to decrease beyond the March 9 level. This provision is in force at this time.

e. France. In countries where expectations of currency appreciation became strong in the summer of 1971, and where the central bank had not ceased to intervene on the exchange market, the danger existed that commercial banks might borrow heavily abroad, or liquidate foreign assets, and offer the proceeds on the exchange market. The French authorities acted in early August to prevent such an eventuality, by prohibiting banks in France from decreasing their net foreign position relative to its August 4 level. This meant that banks with net foreign liabilities on that date could not increase them and that banks with net foreign assets were not allowed to run them down. This measure was rescinded a few days after the December 18, 1971 currency realignment.

f. Japan. The Bank of Japan has created a rather complicated system of controls with reference to both the gross and net foreign liabilities of the foreign-exchange banks, to their foreign-currency position, and to parts and combinations thereof.[1/] One of the controls on banks' net foreign liabilities is commonly known as the "yen conversion" control, since it applies to that part of banks' net foreign liabilities that is denominated in foreign currencies, i.e., to banks' foreign borrowings of foreign currencies

1/ For any bank the foreign position is given by all assets and liabilities vis-à-vis nonresidents, including those denominated in domestic currency. The foreign-currency position is given by all assets and liabilities in foreign currencies, including those vis-à-vis domestic residents.

converted into yen on the exchange market. This control, first instituted in February 1968, places a ceiling on each bank's cumulative yen conversions as of specified dates. Usually the ceilings have had to be met twice a month. However, between September 1, 1971 and December 21, 1971, they were tightened and had to be met each day. Another control has related to the sum of banks' net Euro-dollar liabilities and gross free yen liabilities, i.e., yen liabilities to foreigners. Each bank was assigned limits on this sum beginning in July 1964. This control was removed January 6, 1972.

6. Limits on banks' gross foreign liabilities (Japan)

Japan is the only major industrial country known to have imposed quantitative limits on banks' gross foreign liabilities. This was done on August 18, 1971, when the Bank of Japan prohibited the banks from increasing the sum of their gross foreign liabilities denominated in both foreign currencies and free yen above the level of that date. On August 27 separate ceilings were set relating to the free yen liabilities alone that barred further increases. These controls were lifted soon after the December 1971 exchange rate realignment.

7. Limits on banks' net foreign-currency position

a. France. Until the end of 1966, banks in France were in principle required to keep a balanced spot position and a balanced forward position in every foreign currency, the positions being defined to include positions with domestic as well as foreign residents. The purpose of the regulation was to prevent banks from borrowing abroad for internal lending, or lending abroad funds raised internally, operations the French authorities looked on as troublesome for monetary management. However, banks were allowed to take an open spot position (provided they covered forward, which they would normally do anyway) at the initiative of a foreign correspondent bank wishing to borrow or lend in France. Because of the difficulty in identifying initiative, the regulation often proved unenforceable and thus did not always prevent French banks from moving funds. This could be accomplished by swap transactions. If a French bank wished to borrow abroad it could sell dollars spot to its foreign correspondent for francs, which the correspondent acquired by selling the dollars on the Paris exchange market, and repurchase the dollars forward at a rate attractive to the correspondent. When such operations were extensive they drove the spot dollar exchange rate to its lower limit and the Bank of France became the supplier of the needed francs. The regulation was abolished at the end of 1966, a month before exchange controls on nonbanks were largely done away with.

b. Sweden. Banks in Sweden have not been allowed to let spot assets in any foreign currency fall short of spot liabilities in that currency, except to a small extent where a spot liability is covered by a forward purchase.

c. Japan. The Japanese foreign-exchange banks have been subject to a control known as "position guidance" that sets maximum limits for each bank on its overall net position in foreign currency. The overall net position is the sum of the spot position and the forward position, and in Japan is often called the "net overbought" or "net oversold" position depending on whether the position is positive or negative. It is clear that position guidance cannot prevent banks from being net borrowers or net lenders of a foreign currency if the banks cover forward their net spot position in that currency, since the spot and forward positions together give an overall net position of zero. Position guidance can limit net borrowing or lending of a foreign currency where the spot position is not covered forward. But the primary purpose of "position guidance" has been to promote sound banking practices.

d. United Kingdom. Soon after the U.S. measures of August 15, 1971, the British authorities took several actions to prevent capital inflows, and one of these concerned the foreign-currency position of banks. Effective August 31, banks in the United Kingdom were prohibited from switching into sterling from foreign currencies on a covered basis, and since they were already enjoined from doing so on an uncovered basis this meant that switching was no longer possible. Moreover, existing net liabilities in foreign currencies could be continued only until maturity.

There was an interesting difference between these controls and the new controls imposed earlier in August in France, which prohibited any decrease in the banks' net foreign position. Since the French measure related to the foreign position, it took account of the banks' position in francs (as well as in foreign currencies) vis-à-vis nonresidents. The British regulation, which related to the banks' foreign-currency position, ignored their external assets and liabilities in sterling. Consequently, if expectations of a rise in the exchange value of the franc motivated nonresidents to increase their franc deposits with French banks, or to pay off loans from them, the banks had to offset the resulting rise in their liquidity by acquiring foreign-currency assets abroad. The British regulation, by contrast, made no effort to prevent upward pressure on the exchange rate or a rise in bank liquidity stemming from analogous actions by nonresidents with respect to sterling deposits and loans.

8. Prohibition or reduction of interest payments to foreigners

a. Germany. Although banks may be prevented or discouraged from borrowing abroad, short-term funds may still flow into a country's banking system at the initiative of foreign depositors. To discourage such inflows, in June 1960 the Bundesbank prohibited German banks from paying interest on sight or time deposits of nonresidents except for savings deposits of individuals. The prohibition extended to foreign currency deposits as well as mark deposits. (German banks could still pay interest on foreign currency funds in the form of "borrowings" from foreign banks as opposed to "deposits.") To reinforce this regulation, banks were also prohibited from selling domestic securities to non-residents under repurchase agreements and from selling money market paper to nonresidents. The interest ban was partially revoked between May 1962 and March 1964 (when interest could be paid on some time deposits of not less than 30 days), but it was resumed with its former intensity in March 1964 when monetary policy was tightened. The exemption for savings deposits was ended in November 1968. At the end of 1969, following the October 1969 revaluation of the mark and a massive exodus of speculative funds, the interest ban was taken off. Subsequently, however, the authorities saw fit to reimpose it on May 9, 1971, when the mark was floated; savings accounts up to DM 50,000 were exempted. The prohibition remains in effect at this writing.

b. Switzerland. In August 1960, after the Congo crisis caused a heavy flow of funds to Switzerland, the Swiss National Bank entered into a gentlemen's agreement with Swiss commercial banks, the main provision of which was an undertaking by the banks party to the agreement not to pay interest on Swiss francs deposited by foreigners since the previous June 30. In addition, banks agreed not to accept foreign Swiss franc deposits with a maturity of less than 30 days, agreed to apply a service charge each quarter, at an annual rate of 1 per cent, on deposits with a maturity of under 60 days, and pledged themselves to do what they could to keep foreign funds from being invested in Swiss securities or real estate. The interest ban did not apply to foreign-currency deposits, which Swiss banks could thus continue to attract.

This agreement, made initially for one year only, was renewed each year until 1964 except for the elimination of the service charge feature in 1963. A new agreement was made, effective May 1, 1964, that was more efficacious than the old one because it was binding on all banks. The new agreement prevented banks from paying interest on foreign-owned Swiss francs deposited with them after December 31, 1963. It did allow interest to be paid on funds that had come in up to that time; but this relaxation could not have much effect in keeping funds in Switzerland since their presence there showed them to be interest-insensitive to begin with.

The 1964 agreement remained in force until March 1967, when it was allowed to lapse because Swiss economic conditions no longer called for credit restraint.

A speculative rush into Swiss francs in the first half of August, 1971 led to a new gentlemen's agreement between the Swiss National Bank and Swiss commercial banks which, inter alia, prohibited payment of interest on all new Swiss franc balances, or additions to old balances, received from nonresidents since the previous July 31. The agreement became effective August 16, earlier than originally planned, in view of the U.S. action on gold on August 15. It remains in effect at this writing.

c. France. Beginning in April 1963, the French authorities prohibited banks from paying interest on nonresident franc balances in order to reinforce the stabilization program launched a few weeks earlier. This prohibition continued until November 1966.

Speculation on a possible rise in the exchange value of the French franc broke out in July, 1971. One of the measures taken to offset or discourage capital inflows was a voluntary agreement by French banks, early in August, to forego paying interest on nonresident franc balances of up to three months maturity, effective August 17. This agreement was superseded on August 13 by an instruction from the authorities to the banks containing the same provisions. This directive was abolished in late December, after the currency realignment.

d. Netherlands. After the floating of the Dutch guilder in May 1971, two measures were adopted to limit short-term capital inflows and hold back the rise in the exchange rate. One of these was a prohibition on interest payments on foreign-owned guilder sight deposits. This ban was lifted after the Smithsonian meeting in December, but was reimposed on March 9, 1972 when speculation against the dollar was leading to very large reserve gains in the Netherlands.

e. United Kingdom. Effective August 31, 1971, banks in the United Kingdom were prohibited from paying interest on sterling deposits of nonresidents of the sterling area (existing time deposits of course being exempted from this.) This prohibition was removed immediately after the December 18 exchange rate alignment.

f. Japan. In March 1971 the Japanese authorities agreed to a reduction in the interest rates paid on foreigners' free yen deposits, in an effort to hold down reserve gains.

9. Negative interest on foreign deposits (Switzerland)

As noted above, from 1961 to 1964 Swiss banks applied a negative interest rate on foreign deposits in Swiss francs. This type of discouragement of foreign deposits was used again in 1972. On July 4, 1972 the Swiss Federal Council, under a law enacted in October 1971, ordered Swiss banks to apply a negative interest rate of 2 per cent per quarter on increments to foreign Swiss franc balances above the levels of June 30. This action was taken in the wake of the floating of the pound sterling, to head off inflows of speculative funds.

10. Prohibition on new foreign bank deposits

a. Germany. During the November 1968 exchange crisis, efforts of the German authorities to stem speculative inflows into marks included prohibiting German banks in principle from accepting additional deposits from foreigners (as of November 25) and from obtaining new foreign loans. The prohibition was ended in February 1969 after the speculative inflow had been reversed.

b. Netherlands. The heavy reserve gains in March 1972 that prompted the Dutch authorities to reimpose the ban on interest payments on foreign sight deposits in guilders was accompanied by more drastic action concerning time deposits. As of March 9, banks were forbidden from opening new guilder time deposits for foreigners and from renewing existing deposits at maturity. This measure is still in effect.

11. Blocking of foreign funds

a. Switzerland. Stronger disincentives than nonpayment of interest were applied to inflows of nonresident funds during the long international monetary crisis of 1971, but they were rare. In late August, the three largest commercial banks in Switzerland -- which do almost the entirety of the exchange market business -- agreed with the Swiss National Bank to place new or additional

Swiss franc deposits from nonresidents into accounts that would be blocked for three months, if the funds were deemed to be speculative and if the francs were acquired when the Swiss franc exchange rate for the dollar was approximately 3.1 per cent or more above parity. A new parity had been set when the franc was revalued by 7.1 per cent the previous May 9, but the franc was then a floating currency for practical purposes. Some incoming funds were automatically exempted: $2 million equivalent per depositor per day, the exemption dropping to $1 million if the franc appreciated to about 3.4 per cent or more above parity.

Early in December this agreement was terminated, but was almost immediately replaced by a modified version of the old one. There were two changes: the blocking would occur irrespective of the exchange rate, and the automatic exemption was made uniform at $1 million equivalent per customer per day. [These agreements indicate quite clearly that the Swiss National Bank would, in the absence of the agreements, have intervened in the exchange market, or taken some other measure, to keep the franc from appreciating above a certain level. After the December 18 Smithsonian meeting the second agreement was terminated.

b. France. Towards the close of the 1971 international monetary crisis, France acted to initiate an actual outflow of nonresident deposits. It was announced December 3 that, beginning

December 10, nonresident balances in French banks would (with certain exceptions) be usable only to make payments within the franc area, and that such balances in excess of November 30 levels would be subject to possible blocking and penalties. Reports suggest that the announcement had little effect in inducing an outflow. The measure was abolished after December 18.

B. Measures Affecting Nonbanks

1. Reserve requirements on foreign liabilities (Germany)

Although a number of industrial countries have used various techniques to limit foreign borrowing by nonbank institutions, only Germany has used reserve requirements for that purpose. In December 1971 the German Parliament passed the so-called Bardepot Law giving the Government authority to have the Bundesbank impose minimum reserve requirements, up to 50 per cent, against foreign loans contracted by German companies. The maintenance of relatively tight monetary conditions in Germany in 1969-71 induced German forms to borrow heavily in the Euro-currency loan market and contributed importantly to German balance of payments surpluses, which both hampered the conduct of monetary policy in Germany and made for greater imbalances in world payments. Even though economic activity had leveled off a long time before, German monetary policy still remained quite restrictive at the start of 1972. To curb enterprises' foreign borrowing, effective March 1 the Bardepot Law was invoked, with a reserve ratio of 40 per cent against foreign loans not already outstanding on January 1. The ratio was raised June 30, 1972 to 50 per cent, the maximum allowed under the Law.

2. Exchange controls

a. Netherlands. Inflows of short-term nonbank funds have been subject to exchange controls imposed to protect domestic monetary autonomy. Nonbank residents generally have not been allowed to obtain loans from foreign banks. While suppliers' credit from foreign exporters have not been subject to control, credits from other foreign nonbanks in excess of certain limits have been allowed only when consistent with monetary policy objectives.

b. Sweden. Sweden is the other major industrial country that for a long time has controlled short-term nonbank funds for monetary policy reasons. In general, short-term foreign borrowing by Swedish nonbanks has been prohibited except for commercial credits received by importers, advance payments received by exporters, and loans to foreign-owned companies in Sweden from parent companies abroad.

c. France. Most countries made no effort to control inflows of nonbank funds in 1971. France, however, took such a step on August 21 when delays in payments for imports other than equipment goods were limited to 90 days from customs clearance, there having been no limit previously. Affected imports that had cleared customs at any time prior to June 21, and which had not yet been paid for, had to be settled by September 21. This enforced a sizeable one-time outflow of short-term capital in September.

d. Japan. During the 1971 international monetary crisis, the Japanese took action concerning export receipts. To head off a capital inflow in the form of a lengthening of leads in the collection and repatriation of export receipts, effective September 1 Japanese banks were prohibited from purchasing bills related to export prepayment without specific approval. After the revaluation of the yen on December 18 this prohibition was removed. It was reimposed on February 25, 1972, when the Bank of Japan was again gaining reserves.

e. Italy. In early December 1971, Italy instituted a sweeping measure to limit speculative capital flows. Conversions of foreign currency into lire (and vice versa) were limited to those necessary for "normal" settlements of trade, services, and capital movements. Italian banks were authorized to refuse to make conversions not meeting those standards. The measure was withdrawn after December 18.

f. United Kingdom. On January 12, 1971, residents were barred from borrowing foreign currency abroad for conversion into sterling for use in the United Kingdom or to finance current payments to foreigners, unless the loans were for more than five years.

Residents were also prohibited in principle from borrowing sterling from residents of countries not in the sterling area. These actions were taken to reinforce domestic credit restraint and to prevent official reserves from being increased by volatile short-term funds.

C. Measures Affecting Banks and Nonbanks

a. Netherlands. On June 1, 1971 -- three weeks after the guilder was floated -- the Dutch authorities took additional action to hold down the appreciation of the exchange rate. Residents were barred from selling Dutch Treasury bills and guilder-denominated bankers acceptances to foreigners. This measure was probably rescinded after the December Smithsonian meeting.

b. United Kingdom. After the U.S. measures of August 15, 1971, the United Kingdom prohibited residents from selling to non-residents of the sterling area almost any type of short-term financial asset denominated in sterling, the main exception being bank deposits (on which, however, no interest could be paid). An initial list of proscribed assets issued on August 31 was lengthened on October 7; these assets included deposits with trustee savings banks, building societies, local authorities and hire purchase firms, certificates of deposit, Treasury bills, acceptances, commercial bills, and promissory notes. Government and Government-guaranteed bonds and bonds of local authorities were also included. The measure was rescinded immediately after December 18.

c. Germany and Switzerland. While formally outside the scope of this paper, mention may be made of measures taken in Germany and Switzerland in 1972, after the floating of the pound sterling, to prevent inflows of long-term capital. In Germany, effective June 29 residents were prohibited from selling fixed-income securities to foreigners without Bundesbank approval. In Switzerland, effective June 26 residents were barred from selling Swiss securities (including equities), and foreign securities denominated in Swiss francs, to foreigners, and were also prohibited from selling real estate to foreigners not already residing in Switzerland.

III. TECHNIQUES TO LIMIT OUTFLOWS

A. Measures Affecting Banks

1. Limits on banks' net foreign position

a. France. On January 31, 1967 France abolished almost all exchange controls, including all controls on short-term capital flows. The grave social disturbances in France in May-June 1968 caused the reimposition of exchange controls on all outflows of resident capital, both long-term and short-term (as well as on French travel expenditures abroad).

In May 1968, banks in France were instructed not to increase their net assets in foreign currencies, including the position with residents, as a means of protecting the reserves. After this control was ended in September there was a build-up of such net assets, and in the wake of the November exchange market crisis the banks were told to reduce their net assets in foreign currencies back to the September 3 level by the end of the year. Furthermore, they were instructed to reduce their franc claims on nonresidents to the September 3 level by January 31, 1969; these had grown as nonresidents borrowed francs and converted them to other currencies in expectation of a possible profit from devaluation. More drastic action followed in January when banks with net liabilities in foreign currencies vis-à-vis nonresidents were told not to reduce them, while banks with net assets in foreign currencies vis-à-vis nonresidents were told in principle to liquidate them by the end of the month and to deposit any remainder with the Bank of France in installments over a 3-month period.

The devaluation of the franc in August 1969 helped to usher in renewed French payments surpluses. Consequently, the banks' foreign-currency deposit requirement was reduced by half in April 1970 and abolished in July of that year.

b. Italy. The acceleration of U.S. banks' borrowing of Euro-dollars in the first quarter of 1969 accentuated outflows of bank and nonbank funds from Italy that had already become quite large in the preceding year. At the same time, changes in the taxation of dividends in Italy also served to swell the volume of capital outflows. Substantial reserve losses in the first quarter prompted the Bank of Italy to instruct the banks, late in March, to eliminate all net foreign asset positions by June 30. The position referred to here was the overall net foreign asset position, i.e., inclusive of the position vis-à-vis nonresidents in lire, not just in foreign currencies (as was the case concerning the earlier directives on net foreign liabilities). The inclusion of the lira position somewhat softened the measure's impact, since the banks had net foreign liabilities in lire. Even so, a large amount of funds was involved: the banks' net foreign assets at the end of March totaled about $750 million. Banks eliminated net asset positions partly by increasing their gross foreign liabilities and partly by repatriating gross assets and using the foreign currencies to pay off swaps with the UIC, the official reserves being bolstered either way. As earlier remarked, it was also the desire of the Italian authorities that tightening conditions in the Euro-dollar and foreign money markets not hamper their efforts to promote fuller utilization of resources in Italy, and this consideration was an additional -- perhaps even co-equal -- motivation for the action taken. The general prohibition on net foreign assets remains in force -- with certain assets being exempt from the requirement -- despite Italy's renewed balance of payments surpluses since 1970.

c. Belgium. Movements of bank and nonbank funds from Belgium into the Euro-dollar market resulted in substantial declines in reserves of the National Bank of Belgium in the second half of 1968 and the first quarter of 1969. Although the size of the reserves was large in relation to the rate of deficit in the balance of payments, the uncertainty as to how much further rise would occur in Euro-dollar rates led to action to protect the reserves. During 1968 and the first quarter of 1969 banks in Belgium had placed a large amount of funds in the Euro-dollar market that they had purchased in the Belgian official exchange market, whereas in principle their foreign currency assets acquired through that market were not supposed to exceed the level of working balances needed to implement the transactions of their customers. Accordingly, in early April the banks were instructed to reduce the sum of their foreign currency assets acquired through the official exchange market and their Belgian franc loans to nonresidents to specified maximum levels by June 30, the ceilings varying from bank to bank in relation to the volume of each bank's exchange market activity. The allowed ceilings totaled about $180 million less than the outstanding levels of the affected assets at the time. But as it turned out, the benefit of this measure to the official reserves was almost entirely offset by banks' increased holdings of foreign currency acquired through the free exchange market.

When the devaluation of the French franc on August 11, 1969 caused speculation against the Belgian franc, new ceilings were set on the sum of banks' holdings of foreign currency acquired in the official market and on their Belgian franc loans to nonresidents, equal to the actual August 14 levels. Later, on October 1, these ceilings were lowered further, and separate ceilings set for the foreign currency assets and the loans. The ceilings remained in force until November 1971, although there was no evident need for them; after early 1970 market forces in fact induced the banks continuously to build up net foreign liabilities rather than assets.

d. Netherlands. The Netherlands Bank incurred a considerable decline in reserves in the first half of 1969. Although the loss was almost entirely the result of a build-up of net Euro-dollar assets by Dutch banks rather than of a balance of payments deficit, some action to protect the reserves was felt necessary. In early July the banks were instructed to ensure that the average level of their net foreign assets in July-December be 10 per cent below the May 31 level or -- at bank option -- 10 per cent below the average of the March 31 and April 30 levels. Unlike the Italian and Belgian actions, this directive was, for the most part, meant only to prevent further reserve losses, rather than recoup earlier ones as well. An improvement in the Netherlands' official reserve position after the October 1969 revaluation of the German mark led the authorities to liberalize the regulation in November, by permitting net foreign assets to rise to 125 per cent of the base level. It would appear that the regulation has since been rescinded, because banks' net foreign assets have increased several fold since 1969.

e. Sweden. Informal limits were placed on the foreign currency balances of the larger commercial banks at the end of 1968. Because of a deterioration of the Swedish balance of payments, formal limits on their net foreign assets were imposed in August and September 1969. These limits have been maintained since.

2. Limits on banks' net foreign-currency position (United Kingdom)

Banks in the United Kingdom are restricted as concerns the amount of any net assets in foreign currencies they may hold.

The Bank of England assigns one limit on each bank's net spot assets in foreign currencies that are covered forward, and a second limit on the bank's total net assets in foreign currencies, spot and forward combined. These limits were reduced in the mid-1960's when balance of payments deficits were putting pressure on the official reserves, and since then they have been very small. However, the limits on net spot assets covered forward were doubled in September 1971.

B. Exchange Controls on Nonbanks

For many years Germany and Switzerland have imposed no exchange controls on their nonbank residents, while in Belgium the only significant control on outflows of short-term nonbank funds has been a limitation on advance payments for imports. The maximum allowed period by which payments could precede imports in Belgium was reduced from the usual three months to one month in August 1969, when the franc was under speculative attack, and then lengthened to three months again in June 1970.

At the other extreme, the United Kingdom, Italy, Sweden, and Japan continue to require approval for all or nearly all exports of short-term nonbank funds. The general practice in those countries is to allow freely only those outflows that are necessary for normal business operations, such as loans to foreign subsidiaries of domestic companies, suppliers' credits to finance exports, and advance payments for imports, the latter two of which must accord with standard practices in the particular trade, or fall within fixed limits, as concerns the time period involved. Regulations in the United Kingdom specifically prohibit switching out of sterling for interest arbitrage purposes. For Britain the retention of controls reflects the belief that the balance of payments is not strong enough to allow their removal, while for Sweden the prevalence of exchange controls manifests a basic predilection for controls as an economic way of life. The Japanese controls contrast with the recent inordinate strength of Japan's external position. But they have been applied with increasing liberality in the past year, and at present do not prevent any significant amount of capital outflow.

In Italy, the retention of controls on capital outflows appears to be motivated in good part by political considerations. In any case, the controls have been widely evaded in the past decade by capital outflows financed by illegal exports of Italian banknotes (almost entirely to Switzerland). The authorities have usually tolerated this illegal capital export, but on two occasions have taken steps to reduce it. In February 1970, when tax and political developments motivated increased outflows of Italian capital, the procedures for crediting foreign banks for remittances of Italian banknotes were changed in such a way as to increase the risks involved in this form of capital export, and to reduce sharply the magnitude of these operations. New action was taken in late June 1972, after the floating of the pound brought pressure on the lira. On June 28 the Italian Exchange Office directed that foreign banks could no longer convert into foreign currency the lire credited to their accounts for remittances of banknotes. This measure was expected to result in a depreciation of Italian banknotes in foreign markets, and discouragement of their export.

Although the Netherlands imposes exchange controls on some forms of short-term capital outflows, it does so for monetary policy reasons rather then to protect the balance of payments, ostensibly in the belief that return flows of funds that left the country earlier might turn out to be monetarily troublesome. These are no restrictions on suppliers' credits or advance payments for imports, export proceeds need not be surrendered, and since October 1967 all residents have been free to keep accounts with foreign banks. But nonbank residents are not free to hold foreign Treasury bills or other short-term money market instruments.

In France, all types of outflows of short-term nonbank capital were resubjected to exchange controls in May 1968. Limitations on advance payments for imports were an important control on short-term outflows, as were also limitations on delays in the collection and repatriation of export receipts. All the exchange controls imposed in May were lifted on September 4 but had to be reimposed on November 25 when the franc came under intense speculative pressure. Despite the elimination of balance of payments deficits after the devaluation of the franc in 1969 there has been very little liberalization of the controls on outflows of short-term nonbank funds. In particular, the continuation of severe limitations on advance payments of imports, along with unchanged regulations limiting both the maturity of supplier credits on exports and delays in the repatriation and surrender of export proceeds, reduce the scope for potential capital outflows in the form of adverse shifts in leads and lags.