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BANK OF ENGLAND
Threadneedle Street
London
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11th May 1979.

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My dear Chancellor,

I enclose, as promised, a note on policy towards exchange control. This argues that, in the light of the major changes in the United Kingdom's external liquidity and balance of payments position in recent years, it would be right to make an early and substantial move towards relaxation. A proposed package of measures is enclosed; but this should I think be regarded very much as a first shot. As the weakness of the exchange and domestic markets in recent days has demonstrated, we may be in for quite a difficult period, for some time. I believe that it will be right to decide precisely how far it is appropriate to go on exchange control relaxation at this stage only in the light of the general thrust of all of the Government's financial and economic policies as they emerge, especially in your forthcoming budget.

Perhaps I may comment here, however, on certain features of our proposals. I believe it is important to lay as much emphasis as possible on relaxations which are likely to help business; which are least likely to lead to volatile flows; which are likely most to reduce the burden of administration; and which are most urgently required to meet our EEC obligations. At the same time I believe we should be extremely cautious in relaxing at this stage controls over potentially volatile flows.

These considerations mean moving fairly far towards full freedom for outward direct capital and personal transactions while for the time being making only minimal adjustments to our regime for portfolio investment. Unfortunately this implies that while

in practice most reasonable non-portfolio transactions by business and persons are allowed ceilings will have to be maintained to enable monitoring to continue to avoid circumventions of the restrictions on portfolio investment.

The question of relaxing our restrictions on sterling finance of third country trade is a difficult one. On the one hand, this is pre-eminently an area of potentially volatile flows: it greatly added to our difficulties in 1976. On the other hand, there is persistent pressure from the merchants and banks for liberalisation; and certainly, in the case of the merchants, inability to use their own currency is proving a burden. Our suggestion is that we attempt to meet the conflicting considerations involved by allowing both merchants and banks to use sterling for financing third country trade, but under supervision and not to an unlimited extent. We are reasonably confident that a regime of this kind which would go a long way to satisfying their demands could be devised and operated for merchants who, as I have said, have been particularly hard hit. For banks, however, the position is more difficult and, I am bound to say, less urgent in the sense that we believe the hardship involved here is less. We are exploring ways in which we could implement and monitor individual ceilings for banks which would be sensible and equitable but I should warn you that we do not yet feel completely confident that it would be possible to propose a fully satisfactory scheme. We shall need to talk to the banks to be certain.

Since our paper was drafted we have received a note by Mr.Hague to the Prime Minister of 4th May in which he puts forward the idea of "feeding" the premium market from official reserves. I would like, if I may, to give you a considered response to this suggestion on its merits in due course. I would only say now that this does not seem to me a likely candidate for immediate action if only because our firm understanding (arising out of an earlier consideration) is that it would need legislation to allow the reserves to be used in this way.

Yours sincerely

Gordon Richardson

The Rt.Hon.Sir Geoffrey Howe, QC, MP.

Exchange Control
Conf. section

Policy towards Exchange Control

1. Exchange control has now been in continuous operation - though the severity of the regime has varied from time to time - for forty years. A brief description of the present regime is attached as Appendix I to this paper.

2. Throughout almost all of the past forty years, sterling has been weak or potentially weak. The current account has never been strong - and, for the years after the OPEC price rise, was in large deficit. But more important than the weakness of the current account has been - for most of the period - the weakness of the UK's external liquidity position. The reserves have been exiguous on almost any criterion, while there have been large external liabilities - both publicly and privately held - which were short-term in form and potentially volatile.

3. These underlying conditions help to explain why UK exchange control has been more severe than that in any other industrialised country (except perhaps Sweden). (A short account of the exchange control regimes operated in other Group of Ten countries is attached as Appendix 2 in case it is useful: but it is not suggested that the Chancellor read it.) The underlying conditions also explain the form which the UK's exchange control has taken.

4. In recent years there have been no restrictions on current transactions. Thus exchange control has not been used to influence the current balance directly - though over the longer term there must have been many indirect effects on the current account, especially on net interest, profits and dividends, which have probably been on balance adverse.

5. The primary aim of exchange control has in fact been to affect the structure of the UK's external asset/liability position in various ways. There have been continuous attempts to improve the liquidity of the UK's external balance sheet or prevent its deterioration. In particular, there has been a consistent aim to increase the holdings of official reserves rather than the holdings of net external assets by the private sector. There has also been a continuing concern to minimise the exposure of the UK overall balance of payments to volatile capital movements (though there has not, in recent times, been any attempt to constrain the ability of non-residents to withdraw funds from this country).

6. This does not fully describe the purposes to which exchange control has been put. For a few months at the end of 1971, before the Smithsonian agreement, exchange controls were used to deter inflows in order to relieve the upward pressure on the exchange rate; but this was exceptional and increasingly unsuccessful. Exchange controls also serve other purposes. For example, the control over banks' foreign exchange dealing positions which is necessary for external policy reasons, is also necessary for prudential reasons. Similarly, the exchange control regime devised for the commodity markets also facilitates supervision of these markets by the Bank. While in principle such matters could be handled in other ways, the Exchange Control Act has in practice been a convenient way of doing so.

7. These special considerations apart, one may say that the underlying thrust of exchange control has been to enable the authorities to have more control over the exchange rate against downward pressure and more ability to withstand short-term volatile pressures. The fact that non-resident movements have not been controlled has, however, strictly limited the extent to which the authorities have in practice been able to withstand or moderate the pressures from volatile flows. It is also perhaps fair to say that exchange control has necessarily concentrated on the short-term at the expense of longer-term considerations.

8. Over the past couple of years there have been some major changes in the UK's external position. The reserves have risen from around $5 billion at the end of 1976 to over $21½ billion at present (though part of this improvement represents a revaluation of gold and non-dollar components). On the liabilities side, there is $23½ billion of official debt outstanding; but this is contractual and with repayment dates reasonably spread over time. The official sterling balances have, on the other hand, been run down to, effectively, working levels; and the UK is committed to keeping them there. Private sterling holdings have continued to rise year by year to stand now at £5½ billion; but these have in the past not proved very volatile: for example, they did not fall even in 1976. Thus the structure and liquidity of the capital account has notably improved.

Despite this, the UK economy remains vulnerable to short-term capital flows in both directions. Sterling's role as a reserve currency has been virtually abolished, but the facilities of the City of London mean that it is still widely held and traded in, so that there is more scope for substantial volatile movements in sterling than for the currency of any other industrial country except the US and perhaps Germany and Switzerland.

9. The current account has also greatly strengthened: after a number of years of deficits on a substantial scale (the UK ran a cumulative deficit of £7½ billion from 1973 to 1976) we are now roughly in balance or perhaps small surplus. Two special factors, working in opposite directions, have been of great importance here. On the one hand, North Sea oil is now contributing £4½ billion per annum to the current account - and the contribution is likely to rise steadily to reach £8½ billion (at 1977 prices) in 1985. On the other hand, our net contribution to the EEC Budget is likely to amount to £780 million this year. Over time, the net effect of these two factors seems certain to be strongly and increasingly positive, both on the current balance and, more pervasively, on market sentiment. The result is likely to be a tendency to hold the exchange rate higher than the general condition of the non-oil economy and the non-oil balance of payments would otherwise imply.

10. This does not mean that we can necessarily expect the exchange rate to remain strong, as it has been in recent weeks. The non-oil balance of payments is in serious deficit and may well deteriorate further, so that there is no guarantee that the current account as a whole will remain in surplus. But even if the exchange rate should show a tendency to weakness, it is a reasonable guess that, over the next few years, market forces, together with appropriate domestic policies, will result in an exchange rate judged to be too high rather than one which is judged too low. (Our separate brief on exchange rate policy dated 4th May argued this point in greater depth.)

11. The foregoing suggests two broad conclusions for exchange control policy. First, that the UK's external balance sheet and the

forces acting on the sterling exchange rate have altered radically from those which have broadly pertained since the war and which have provided a principal justification for the present exchange control regime. But, secondly, that the rate is nevertheless likely to remain fragile and its prospects uncertain, so that one must be cautious in removing too completely or too rapidly the whole array of measures which have hitherto helped to provide some stability for the rate. Such arguments for caution are reinforced by the fact that after forty years of continuous control it is impossible to say in advance how big any reaction to their total abolition might be; and by the thought that it would be embarrassing and might indeed be difficult to re-impose the previous degree of control after it had been relaxed.

12. The situation therefore would seem to call for a substantial initial package of relaxations, but stopping well short of complete abolition and concentrating on those measures which are likely to produce the most long-term benefit to the UK or to get rid of those features of the present regime which are particularly widely disliked or particularly burdensome to administer. At the same time it would seem wise to proceed more cautiously towards those controls aimed particularly at limiting volatile flows.

13. A package aimed at meeting these various criteria is set out at the end of this note. Broadly it recommends major relaxations in the fields of outward direct investment and personal transactions; some movement towards the restoration of the use of sterling by both merchants and banks for third country trade; and only minor relaxations in control over outward portfolio investment. The intention of the package would essentially be to allow all reasonably-sized non-portfolio capital transactions by companies and persons. However, while a regime of control over portfolio investment is maintained, it will be necessary to keep ceilings on all non-portfolio transactions and to continue to monitor them, to prevent a complete circumvention of the rules for portfolio. This necessity will unfortunately limit the degree to which savings in administration can be made in both the Bank of England and in the commercial banks at this first stage.

14. In the light of the reactions to this package of measures and developments in the UK economy and balance of payments it is to be hoped that it will be possible to proceed steadily by further stages towards effectively getting rid of exchange control altogether. In any event we would hope to follow the proposed package with a series of second-order changes aimed at simplifying the regime and its administration.

15. The proposals recommended for the initial package are listed in broad terms with, in each case, some comments on their nature and significance and estimate of their maximum potential outflow effect. It should be emphasised that these estimates can be little more than guesses. In particular, if sterling were to be very strong there might be little outflow at all. Moreover, of course, if it were decided to let the relaxations fully affect the exchange rate directly, there would be no official intervention to meet the demands for foreign currency and hence no outflows, simply a downward pressure on the rate. Subject to these caveats, the maximum potential outflow in the first full year (if it were met with official exchange) might be, say, £1½ billion, of which about half would be once and for all.

16. These relaxations should be welcome to our partners in the EEC. We have of course a Treaty obligation to liberalise many specific forms of capital movements within the EEC although the more obvious types of potentially volatile movements are excluded. Under the terms of our Accession, we should long since have freed from restriction outward direct and portfolio investment, emigration, gifts and holiday homes. We have in fact been authorised by the Commission to maintain restrictions in these areas on grounds of our balance of payments difficulties. This case increasingly lacks conviction and is in any event due to be reviewed by the Commission before end-September. It seems likely that if something like the package of relaxations proposed in this note had by then been implemented we would receive authority to maintain our remaining restrictions for a further period. We might, however, meet some pressure from the Commission to make specific relaxations for intra EEC transactions. We should resist this. Our proposals are for worldwide relaxation. This is not only justifiable on its own merits, but it will also improve our standing under the

OECD code and, in particular, avert US protests about UK discrimination against them in matters of exchange control - on which subject they have already shown themselves to be sensitive.

17. Finally, it is obvious that relaxations cannot be decided on and introduced overnight. Detailed policies have to be agreed and Notices drafted and printed: ill-prepared relaxations could be damaging to the Government and to the Bank. The time necessary to implement a decision to alter an existing control obviously depends on the complexity of what is proposed. In particular, the proposal to reintroduce sterling finance for third country trade will need to be discussed with the banks and with the various representative bodies of the merchants before it can be fully articulated and implemented. In the case of other changes, it would be our objective to implement immediately after announcement if at all possible.

11th May 1979.

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SCHEDULE OF PROPOSED EXCHANGE CONTROL RELAXATIONS

Area of relaxation	Proposed measure	Comments
1. Outward direct investment Estimated maximum potential outflow: £700 mn. annually.	(a) A generous ration of official exchange (say, £5 mn. per project per annum) for new outward direct investment as currently defined (i.e., expertise by the investor and participation in management).	Authorisation by Bank of England is still necessary to rule ou[t] disguised portfolio but possible to delegate provision of additional capital for existing investments.
	(b) Existing borrowing repayable in five equal annual instalments. (New borrowing repayable over five years to the extent that repayment cannot be met from the ration.)	Authorisation by Bank of England necessary.
	(c) Abandon the two-thirds requirement.	This rule is burden-some administrativel[y] and causes a good deal of bad feeling with those investors who are subject to it. (It applies only where the UK parent has a majority share-holding.)
2. Outward portfolio investment		
(a) Estimated at a maximum of £50 mn. annually.	(a) Official exchange to be allowed to meet the interest on foreign currency borrowing taken to finance portfolio investment.	At present interest has to be met from the income and any shortfall from investment currency.
(b) Nil	(b) In the case of portfolios financed by borrowing, investors no longer to be required to maintain cover in the form of foreign currency securities, the market value of which is at least equal to 115% of the borrowing.	Both of these changes will tend to reduce the premium in the investment currency market by encouragin[g] the use of borrowing and, in the second case, by releasing premiumworthy securities.

SCHEDULE OF PROPOSED EXCHANGE CONTROL RELAXATIONS (CONTINUED)

Area of relaxation	Proposed measure	Comments
3. Personal capital Estimated maximum effect:		
(a) £175 mn.once for all.	(a) Uniform emigration allowance of £200,000.	Would be delegated (as now).
(b) Negligible	(b) Uniform dependants' and gifts allowances combined at £10,000.	Would be delegated (as now).
(c) £10 mn.annually.	(c) £100,000 per annum in official exchange for holiday homes.	No premium on sale, even where premium originally paid. No further delegation possible while holiday homes restricted to one per family unit. This relaxation is recommended because the present restrictions require an excessive administrative effort to prevent a negligible capital outflow.
4. Miscellaneous	(a) Reintroduction of sterling finance for third country trade.	Monitoring would involve returns to the Bank of England.
(a)		In the case of:-
(i) £250 mn. once for all.	(i) by merchants subject to monitoring and, if need be, limits;	(i) the method of monitoring should be discussed with the appropriate trade association before implementation.
(ii) Say £400 mn.	(ii) by banks subject to monitoring and within a predetermined overall ceiling, to be reviewed from time to time.	(ii) both the method of monitoring and of liberalisation will need to be discussed with the banks before implementation.

SCHEDULE OF PROPOSED EXCHANGE CONTROL RELAXATIONS (CONTINUED)

Area of relaxation	Proposed measure	Comments
4. Miscellaneous (cont.)		
(b) £50 mn.annually.	(b) Remove restriction on import of gold coin.	

The Structure of Exchange Control

Exchange control restrictions are not applied to current account transactions because of IMF and other international obligations. However, these transactions have to be monitored to ensure that they are not capital transactions in disguise. Not all capital transactions are restricted - by and large non-residents are free to invest their capital in this country and to repatriate the income and liquidation proceeds. The brunt of our restrictive controls (as opposed to monitoring controls) therefore falls on capital transactions by residents. (But monitoring controls tends to complicate and introduce delays into the system.)

There are three broad categories of capital transactions which exchange control rules permit, subject to various conditions. They are outward direct investment, outward portfolio investment in foreign currency securities and certain specified personal capital transactions (emigration, holiday homes, gifts and legacies). Anything which cannot be accommodated under one or other of these headings is unlikely to be allowed - basically because anything else is likely to open the door further to short-term and/or speculative transactions (see paragraph 8 re leads and lags).

Outward Direct Investment

Most outward direct investment is financed from profit retentions (companies controlled by UK residents are expected to repatriate two-thirds of net taxes profits). Almost all the rest is financed by foreign currency borrowing - either by the subsidiary under parent guarantee or by the parent itself. Guarantees are rarely called and hence direct investment financed by the borrowing of subsidiaries rarely affects our market. Borrowing taken by the parent itself is repayable with official exchange to the extent that the parent can demonstrate that the investment had produced benefits received in this country across the exchanges. So far as outward direct investment is concerned, therefore, the principal and intended effect of Exchange Control

is to defer the initial cost to the reserves/official market. This illustrates one important characteristic of Exchange Control, namely, that it is focussed primarily on the UK's short-term external financial position.

Outward Portfolio Investment

Outward portfolio investment in foreign currency securities is allowed by means of investment currency or by means of foreign currency borrowing, subject to some fairly onerous conditions. Such foreign currency borrowing can be repaid only out of the sales proceeds of the securities or with investment currency. The effect of the controls in this area, therefore, is to ensure that no part of the cost can fall on the reserves/ official market at any time. (We did, of course, make a minor relaxation for certain EEC securities under which borrowing may be repaid with official exchange over five years.)

Personal Capital Movements

So far as the various personal capital movements are concerned, the rules vary according to the transaction: there is a ration of official exchange for emigrants but any balance of sterling assets is released after four years; holiday homes are restricted to one per family unit and, if bought from non-residents, must be paid for through the investment currency market; there is an annual limit on gifts, but legacies may be freely remitted in official exchange. None of these items is really important in terms of potential cost, but all need a degree of restriction in order to buttress other parts of the control.

Transactions by Banks

It would, of course, be impossible for Exchange Control to fulfil its objectives unless it also restricted banks' operations for their own account. Each bank is therefore subject to a combined limit on its open position against sterling and its spot against forward position in foreign currency.

The Effects of Exchange Control

The main practical effects of Exchange Control may be summarised as follows:-

(a) It defers the outflow of resident capital to finance direct investment overseas.

(b) It prevents the outflow of resident capital to finance portfolio investment overseas.

(c) It prevents resident and non-resident speculation against sterling by most of the more obvious methods.

However, there are powerful factors affecting the country's external position which Exchange Control does not, or cannot, control. Thus, there are no restrictions on payments for current account transactions, no restrictions on the introduction of non-resident capital into this country or its repatriation and very little chance of moderating leading and lagging within wide margins on either current or capital account, whether by residents or non-residents.

EEC Obligations

In practical terms our obligations under the Directives are to liberalise within the EEC direct investment, investment in real estate, specified personal capital movements (gifts, legacies, and various transfers and payments arising from emigration and immigration), trade credit up to five years, certain miscellaneous transactions of a minor nature and operations in quoted securities. We have Commission authority to maintain restrictions on outward direct investment, gifts by residents, purchase of holiday homes by residents, emigrants' capital and operations in foreign currency securities by residents.

EXCHANGE CONTROL IN G.10 COUNTRIES

SUMMARY

1. The IMF summarise the situation as:

	Exchange Control restrictions on:	
	Current Transactions	Capital transactions by residents
Belgium	No	No
Canada	No	No
France	No	Yes
Germany	No	No
Italy	Yes	Yes
Japan	No	Yes
Netherlands	No	No
Sweden	No	Yes
USA	No	No

Italian current account restrictions have little practical significance.

2. Capital

On the capital side the table above is concerned with transactions by residents. The attached country notes also cover operations by non-residents and indicate, where appropriate, other (non-EC) devices used to control flows. Many countries have arrangements to prevent "undesirable" investment in local industry. Non-resident issues on local capital markets are generally subject to some sort of control, not necessarily for external reasons.

In summary, and to the best of our knowledge, the individual country positions are:

(a) Belgium - Most capital transactions may be effected without restriction through the free market although certain operations including some direct investment attract the official rate.

(b) France - All capital transactions are subject to controls but these are operated very liberally to the extent that in most cases permissions are automatic. Lending to non-residents is strictly controlled.

(c) Italy - Inward and outward movements of non-resident capital are free. A deposit requirement (basically 50%) applies to outward transfers of resident-owned capital for both portfolio and direct investment. The issue of securities to non-residents is restricted.

(d) Japan - Inward direct investment is strictly controlled, inward portfolio requires approval which at present is usually given. Outward direct investment is subject to approval only for the banking and securities industries, while outward portfolio investment is subject to approval which is freely given. Lending to non-residents is controlled.

(e) Netherlands - Following major simplification in September 1977, most capital transactions either enjoy blanket freedom or are permitted by general licence. Borrowing from non-residents is still restricted and the issue of securities to non-residents also requires permission.

(f) Sweden - Control of outward direct and inward and outward portfolio investment is restrictive. Inward direct investment is relatively free.

(g) Canada, Germany and the USA - Apart from some residual restrictions on capital inflow in Germany there are no exchange controls in these countries.

Sweden appears to operate the most restrictive controls.

COUNTRY NOTES

BELGIUM

Controls are administered jointly with Luxembourg. From 1955 the authorities have relied largely on a two-tier spot foreign exchange market to influence capital flows. Since 1971 the system has operated broadly as follows:-

(a) current transactions (other than interest, profits and dividends) are settled through the official market;

(b) IPD, and the repatriation of certain foreign long-term investments, can be channelled through either market;

(c) other capital transactions must go through the free market, apart from certain direct investments and capital transfers which, when individually licensed, may go through the official market.

While, in theory, speculative pressures should be reflected mainly on the financial (free) rate, in practice the two rates rarely diverge significantly. The reasons for this probably include evasion of the cumbersome monitoring mechanism, substitutability between the two markets resulting from (b) above, intervention by the central bank in the financial market, and leads and lags in commercial payments.

From time to time the authorities have introduced temporary measures such as changes to timing rules for commercial payments and restrictions on the payment of interest on, and the growth in, certain non-resident deposits. No such restrictions are in effect at the present, although the rules on commercial payments (to counter leads and lags) are rigidly enforced.

CANADA

No exchange controls (since 1951). Inward direct investment is subject to approval by the Foreign Investment Review Agency.

FRANCE

Capital movements are subject to extensive controls but, in practice, are treated in a liberal manner.

(a) Inward direct investment by non-residents and by non-resident controlled French companies must be declared to the Ministry of Economics. Prior authorisation is required for most transactions involving the import of capital. Authorisation is usually automatic, subject to foreign currency financing conditions, which are liberally applied where a new company is being established, but more strictly to the purchase of or participation in an existing company. A transactions control is used to prevent "undesirable" investments, but does not apply to investments by residents of the EEC and of former French colonies and dependencies.

(b) Outward direct investment must be reported to the Ministry of Economics, and requires prior authorisation if a capital movement in excess of F.Fcs.3 mn. is involved. Again, authorisation is virtually automatic. Foreign exchange financing requirements (generally 50%) are only applied to investments in excess of F.Fcs.10 mn.

(c) Borrowing abroad generally requires the prior authorisation of the Minister of Economics. Lending abroad is subject to authorisation by the Bank of France; lending in francs is effectively prohibited. The prior authorisation of the Minister of Economics is required for most foreign issues on the French capital market.

(d) Inward and outward portfolio investment in quoted securities is freely permitted. For non-quoted securities, authority from the Bank of France is required.

After a period of almost complete liberalisation, extensive exchange controls were re-imposed following the 1968 disturbances. In the following five years, the controls were liberalised and tightened as need arose. An improvement in the external situation following the devaluation of the franc in August 1969 led to some relaxations, particularly on outward investment. The dollar crisis of early 1971 brought controls against inflows. A dual exchange market was introduced in August 1971, comprising an official market for trade, trade-related current

invisibles and current official transactions and a financial market for all others. The dual market was suspended and controls on trade transactions relaxed when France joined the snake in March 1973, and most current and personal transactions were liberalised in August 1973. Since then, the only changes have been minor amendments to the controls on direct investment.

GERMANY

There has been both resident and non-resident convertibility since 1958.

The strength of the economy has led to inflow, to which the authorities have responded with a variety of controls:-

(a) Discriminatory reserve requirements on banks' non-resident liabilities; these were suspended last May. Non-interest-bearing deposits were also required on companies' direct foreign borrowings in the early 1970s.

(b) Preferential outward swaps with the commercial banks, which were abandoned in 1971.

(c) Restrictions on interest payments on non-resident accounts (not currently in force).

(d) Bans on non-resident net purchases of securities; at present purchases of money market paper and securities with under four years to maturity are prohibited.

(e) Foreign borrowing required authorisation until 1974.

A two-tier market has been considered but rejected because of administrative difficulties.

ITALY

Although the Italians have aimed during the post-war period, and particularly in the late 1950s and the 1960s when the current account was regularly in strong surplus, to liberalise exchange controls, pressures in recent years have been such that a series of ad hoc measures have had to be imposed. Although there has been renewed liberalisation as the economy has stabilised, many restrictions remain. These include:-

1. Current transactions

(a) Visible trade: Advance payments for most imports must be made with foreign currency borrowed from authorised banks; a similar scheme for deferred export payments was abolished last year. Deferred payments arrangements on exports and imports were designed to benefit the official reserves.

(b) Invisibles: Travel allowances are fairly stringent, although additional allocations of foreign exchange can be granted for preferred purposes. There are also restrictions on exports of bank notes by non-resident travellers, and generally on exports of large-denomination notes.

2. Capital transactions

(a) Inward and outward movements of non-resident capital are free, other than certain loans which require authorisation.

(b) A deposit requirement applies to outward transfers by residents for direct and portfolio investments, financial loans, real estate purchases and personal capital movements; a non-interest-bearing lira deposit, normally equivalent to 50% of the transfer, is required, although in practice this is not applied for direct investments, for insurance companies, or for certain EEC transactions. Specific authorisation for direct investments is required in certain cases, but is normally granted. Resident portfolio investment in foreign financial institutions requires prior approval, although in practice investment in foreign funds authorised to be traded in Italy is free, such trading only being permitted if, for instance, Italian securities are included in the portfolio. Financial loans and credits (other than certain transactions with EEC countries) are severely restricted.

(c) Security issues by non-residents on Italian capital markets are normally restricted to international institutions.

Other attempts to ease pressure on the lira have included a short-lived dual foreign exchange market, severe import deposit requirements, taxes and deposit requirements on foreign exchange transactions, and an amnesty on illegally-exported capital.

JAPAN

Capital controls appear to be as follows:

(i) Outward direct investment: no formal approval is needed except in the banking and securities industries.

(ii) Outward portfolio investment: permission is freely given.

(iii) Inward direct investment in certain (mainly primary) industries has to be licensed. Licences are also needed where intended foreign participation exceeds prescribed percentages, and where the Japanese firm concerned does not consent. (Effectively, therefore, control can be tight.)

(iv) Inward portfolio investment technically requires approval but this is granted freely.

(v) Lending to non-residents is controlled. Yen bond issues can be made in Tokyo and by selected borrowers (mainly governments). Underwriters of such issues are subject to close official guidance, as is bank lending in foreign currency, and almost certainly in yen also. Banks must match 60% of outstanding drawings on medium- and long-term loans with borrowings of one year or more. Euro-yen bonds (only three so far) also require approval.

Capital controls are pervasive and have changed frequently since 1968. Laws are generally restrictive but particular restrictions can be eased administratively. (Legislation now imminent should make the system generally liberal, with exceptions.) Informal controls ("guidance") are of major importance.

In 1968 most capital transactions required prior approval. Subsequently the trend has been towards liberalisation, but with short periods when controls on inflows or, less frequently, outflows have been intensified.

Controls on inflows, notably 1971-72 and 1977-78, have included restrictions on purchases of Japanese securities, reserve requirements on non-resident free-yen accounts and controls over borrowing from non-residents. These have been accompanied by a more liberal approach to outflows, notably by opening Tokyo to foreign yen bond issues and encouraging syndicated bank lending in yen and dollars.

In the 1974-75 crisis, however, restrictions on inward

portfolio investment were relaxed and reserve requirements on non-resident free-yen accounts abolished. Controls over outflows were tightened (outward portfolio and foreign currency lending to non-residents).

NETHERLANDS

In 1977 the exchange control system was simplified by conversion to a "positive basis": with a few explicit exceptions all prohibitions under the Exchange Control Decree of 1945 were lifted by ministerial order. However, the legislation to enforce controls remains on the statute book. Restrictions currently include:-

(i) The placing of foreign issues in the Netherlands requires permission (in order to regulate pressures on the domestic capital market).

(ii) "Capital inflows resulting from borrowing require permission", so that undesirable upward pressures on the exchange rate can be countered; a ban on such borrowing was lifted in January.

(iii) Residents have to effect international payments through authorised banks, for monitoring purposes.

During the late 1950s the Dutch external position improved and by 1963 current transactions had been liberalised, most capital transactions had become subject to general license, and the capital markets had been re-opened for approved foreign bond issues.

The Dutch have over the years attempted to counter inflows by:-

(a) setting up a separate free foreign exchange market for capital transactions;

(b) restricting banks' net foreign liabilities;

(c) establishing a closed circuit for non-resident bond holdings, effectively preventing further foreign acquisitions;

(d) prohibiting interest payments on certain non-resident accounts and imposing negative interest charges on their growth; and imposing discriminatory reserve ratios on external deposits.

None of these controls is currently in effect.

SWEDEN

Although current payments are exempt from controls, many restrictions on residents' capital transactions remain. Outward direct investment requires individual authorisation, which is normally granted only if the balance of payments is to benefit. Transfers on emigration and real estate purchases abroad are subject to ceilings. Foreign borrowing by residents requires authorisation, but is normally permitted if its term exceeds five years and if it will bring long-term benefit to the balance of payments, but residents are not normally permitted to extend financial loans to non-residents. Authorised banks are given ceilings on their net external positions. Authorisation is not normally granted for residents to purchase foreign securities from non-residents.

Non-residents usually receive authorisation to make direct investments in Sweden, as long as not more than 50% is financed domestically, but issues of bonds and shares in Sweden are not normally permitted. Portfolio investments by non-residents in domestic currency securities are normally only permitted through switch operations. Non-residents can, however, freely purchase foreign securities from residents.

Exchange controls on capital transactions, in force since 1939, were initially primarily to assist domestic monetary policy, but over the past ten years or so have been maintained on balance of payments grounds. Indeed, in recent years the aim has been to encourage inflows, primarily through long-term borrowing.

USA

No exchange controls.

Between July 1963 and January 1974, an Interest Equalisation Tax was in force which was designed to increase the cost to foreigners of long-term borrowing on the US capital market: the tax rate was adjusted periodically. In February 1965 a Voluntary Foreign Credit Restraint programme was introduced to restrain the growth in foreign claims on US banks and non-bank financial institutions; and to limit the growth in company direct investment abroad. This programme was tightened in 1966, 1967, and again in January 1968 when controls on company investment were made mandatory and a moratorium was imposed on net transfers by US investors to developed European countries. All this was dismantled in 1974.