

EXCHANGE CONTROL*

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Exchange control is alien to our experience, and we are reluctant to admit it can be a legitimate instrument of economic policy. Most other countries have felt compelled from time to time during the Depression, World War II, and in the post-war period, to resort to this form of direct control of international transactions.¹ A variety of factors, alone or in combination, have prompted the imposition of exchange control, *e.g.*, large scale flights of capital, marked declines in exports, adverse shifts in the terms of trade, the need to conserve foreign exchange resources to finance a war, reconstruction or a program of economic development. Whether such factors justify the use of exchange control, as a temporary or permanent measure, and particularly whether exchange control makes more or less difficult the correction of basic dislocations which may be at the root of a country's balance of payments problems, are essentially questions for the economists. Perhaps one who is not an economist may, however, venture the observation that exchange control cannot be condemned or defended in the abstract; that the motivations and justifications for exchange control vary as the economic situation among countries or in a particular country from time to time varies.

Exchange control characteristically involves marshalling all or part of the foreign exchange earned by a country in a central pool controlled by the monetary authorities and rationing that foreign exchange among those who, for one reason or another, wish to make payments abroad.² The major source of foreign exchange is, of course, the proceeds of exports, but freights, insurance, tourism, emigrant remittances, royalties, payments on account of capital invested abroad and other invisibles may contribute a substantial share. Payments abroad are again largely for

*The purpose of this paper is to suggest the nature of the problems which exchange control raises for those engaged in foreign trade and investment. It is not intended as a technically precise or complete statement of the exchange control system of any country. References to specific regulations or practices are intended as illustrations only. The illustrations are drawn largely from the British experience because of Britain's importance in international trade, the status of sterling as an international currency, and the relative accessibility of the materials.

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¹Exchange control, as we now know it, had its inception in Central Europe during the early stages of the Depression.

²Any definition of exchange control is difficult to formulate, because of the great variation in the exchange control systems used in different countries and the variety of purposes they are designed to serve. The one offered here is incomplete in at least one respect, in that control of payments of a country's own currency to non-residents, and of transfers of such currency by non-residents, may be as vital to effective exchange control as the control of transactions across the exchanges. See the discussion of non-resident sterling, *infra*.

imports, but the counterpart of the same list of invisibles may require significant allocations from the pool.

Put another way, exchange control is the one form of control which covers the whole range of transactions which determine a country's balance of payments. Theoretically a country can, by exchange control, budget its foreign income and expenditures as it budgets its tax revenues and government expenditures, though practically there may be the same difficulty in avoiding deficit financing. By contrast, tariffs cover only transactions in goods and can, for a variety of reasons, be quite ineffective in that area. These considerations offer the obvious explanation for the popularity of exchange control.

Those engaged in trade with or investment in a country which imposes exchange control are of course vitally interested in all its effects on the country's economic position. Their immediate concern is, however, with the impact of specific regulations on their day to day operations. We can, given the theme of this symposium, perhaps best approach an assessment of that impact through the avenue of the status of exchange control under international law.

It is a fair generalization that customary international law does not require any country to provide facilities for the conversion of its currency.³ To put it concretely, if an American sells goods to a Britisher for sterling, the British are not required to give the American gold or dollars for his sterling, and if an American sells goods to a Britisher for dollars, the British are not required to make the dollars available for payment, unless some treaty obligates them to do so.⁴

The treaty which is of greatest significance in this area is, of course, the Bretton Woods Agreement⁵ setting up the International Monetary Fund. Generally speaking, that Agreement limits the power of member nations to restrict international payments for current transactions, but leaves untouched their power to control international capital movements.

Article XIX of the Agreement states that:

Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:

(1) All payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;

³ "... practically, the whole sphere of international economic relations, except where mutual concessions have been arranged by treaty, belongs to domestic jurisdiction." J. L. BRIERLY, *THE LAW OF NATIONS*, 75 (5th ed. 1955).

⁴ If the obligation is that of the government itself, *e.g.*, on government bonds held abroad, other considerations are involved.

⁵ Articles of Agreement, International Monetary Fund, Treaties and other International Acts Series 1501, Dept. of State Publication 2512, effective December 27, 1945.

(2) Payments due as interest on loans and as net income from other investments;

(3) Payments of moderate amounts for amortization of loans or for depreciation of direct investments;

(4) Moderate remittances for family living expenses.

The Fund may, after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions. Article VI, Section 3, provides that:

Members may exercise such controls as are necessary to regulate international capital movements * * *

These provisions leave one with many difficult questions. What is a capital movement, what is a control, what is a restriction, what is a current transaction, and when does it become current? The Agreement does not define a capital movement, and the committee reports contain nothing more illuminating than the observation "It will certainly be difficult to draw a line between controlling movements of capital and controlling transactions for trade purposes."⁶ With that one can certainly agree. If a British traveler takes out a hundred pounds, that is, presumably, not a capital movement; if he takes out a thousand pounds, it may be. If a British importer pays \$1000 for goods worth \$1000, that's not a capital movement; if he pays \$1000 for \$500 worth of goods, and arranges to have the seller deposit \$500 in the importer's account abroad, that certainly is.

The distinction between a control and a restriction is of fundamental importance. We normally speak of exchange controls, but it is exchange restrictions which the Agreement prohibits. The Agreement recognizes, however, that to restrict any payment requires that all payments be controlled, that is, be screened or scrutinized. On this point, the Committee reports are helpful. It was proposed at Bretton Woods that a provision be included in the Agreement reading:

"While imposing no restrictions on international payments, a member country may take the necessary measures to ensure that (a) Its foreign exchange holdings and its quota are used to pay for imports which are essential to its national economy. (b) The proceeds of exports from the member country are placed at the disposal of its foreign exchange authorities to be used for its essential requirements, thereby preventing what may, otherwise, constitute capital transfers."⁷

The Committee to which this was referred reported that "The

⁶ Proceedings and Documents of the United Nation's Monetary and Financial Conference, Bretton Woods, New Hampshire, July 1-22, 1944, Department of State Publication 2866, International Organization and Conference Series I, 3, Vol. 1 at 314, Second Report of Committee 2 on Operations of the Fund to Commission I, Document 234.

⁷ Proceedings, etc., *supra*, note 6, Vol. 1 at 279, Alternative D, Document 219.

objectives which Alternate D"—just quoted—"is intended to safeguard are fully protected under the proposed language."⁸

In other words, the screening of an import or export transaction, for example, to ensure there has been no under-invoicing or over-invoicing, with a deposit abroad to make up the difference, is not prohibited. This implies, however, that a country may—indeed, must, if its exchange control is to be effective—maintain an elaborate administrative organization for the screening of all transactions, with all the paper work, delays and disappointments this necessarily involves.

Then, what is a current transaction, and when does it become current? For the present, it's enough to note that the import and export of goods is certainly a current transaction, but when does it become current? It would be comforting if one could say that it becomes current when the contract is made, in the sense that the country could thereafter do nothing to prevent consummation of the transaction and payment for the goods. Unhappily, it is much more nearly true that there is no "current transaction" until imports have entered the importing country or exports have been shipped from the exporting country. In the language of the Committee, there is nothing in the Bretton Woods Agreement "which commits a member country to pursue any given commercial policy"⁹—or, in other words, import and export control and exchange control are quite different things.

The significant liberalization of world trade depends more on the elimination of import restrictions than of exchange restrictions. Import quotas, global and by areas or countries, are common. Many of the quotas are dictated by exchange considerations and commonly, like the British, frankly discriminate against the dollar area. Hence an American exporter to almost any part of the world must be certain that his customer holds a valid import license. More than that, too many countries have from time to time cancelled outstanding licenses, sometimes across the board. This undermines the integrity of the entire system, and seems excusable only if the till is really empty. Again, import licenses are sometimes issued for too brief a period for the transaction to be consummated in normal course, or for a period different from that of the authorized letter of credit, and extensions may be difficult to obtain. These and like practices require attention, but they lie outside the area of exchange control.

The crucial question that remains is what constitutes a restriction on "payments due in connection with foreign trade," if the import of goods is permitted and granting that screening the transaction is permissible. Certainly there is a restriction unless payment may be made

⁸ Proceedings, etc., *supra*, note 6, Vol. 1 at 545, Report of Ad Hoc Committee to Commission I on Article IX, Section 4 (Exchange Controls on Current Payments), Document 329.

⁹ *Supra*, note 8.

in the currency of the creditor country or a convertible currency. Also it seems that timely payment, in terms of the contract arrangements, is implied. On the other hand, it appears doubtful that requiring that the payment arrangements take a certain form, *e.g.*, that importers establish letters of credit in all instances, constitutes a restriction.¹⁰ Again, it seems clear that the importing country need not make the facilities of its money market available to finance imports.

The British exchange control system has always been quite unobjectionable in terms of these criteria. A British importer may make a payment by applying to an authorized bank and supporting his application with an import license, evidence of purchase of the goods and evidence of their value.¹¹ The importer must later establish that he has in fact used the exchange allotted to him to pay for the goods and has in fact imported the goods, but this needn't concern the American exporter. The requirement that the importer must produce "evidence of the value of the goods" apparently means only that he must establish that no over-invoicing is involved and is, therefore, a control and not a restriction.

Brazil, whose exchange situation tends to rise and fall with the price of coffee, has on the other hand imposed quite drastic restrictions. From time to time it has used a system under which, in certain situations, such as where a shipment was made to Brazil calling for payment against documents, the documents had to be delivered against payment in local currency, and a request for foreign currency could only then be made. The request was entered in a chronological list, and foreign exchange provided only weeks or months later. The risk of fluctuations in the exchange rate in the interval was on the drawee. The system was further complicated by a priority system, under which payments for certain categories of imports were preferred over other current transactions, and by the fact that the banks could provide exchange only from their own purchases of exchange, so that the time of payment depended

¹⁰ Greece at one time imposed this requirement, because its reserves were so low it could not risk a floating charge against them.

¹¹ E. C. (General) 53, July 11, 1952 as amended to July 11, 1955. The procedure is varied in certain circumstances, *e.g.*, when the goods have been entered to Customs before the application is made. Also payments for imports of tobacco, films and certain other commodities are subject to certain restrictions.

Exchange control was imposed in Britain on September 3, 1939, and continued until The Exchange Control Act, 1947 (10 & 11 Geo. 6, C. 14, Vol. XXIX, THE STATUTES REVISED, 26 *et seq.* (rd ed. 1950), became effective, by the Defense (Finance) Regulations. The Treasury and the Bank of England, by delegation from the Treasury, have from time to time issued regulations which have set forth, the day-to-day operating controls and restrictions. When the Defense (Finance) Regulations were in effect, many of these were embodied in a numbered F.E. (for Foreign Exchange) series; others were not so designated. Under The Exchange Control Act, 1947, the regulations have appeared primarily in two series, the E. C. (General) and E. C. (Securities) series. The Bank for International Settlements has from time to time published compilations of these regulations, and these compilations were used in preparing this paper.

in part on which bank was entrusted with collection. One could, of course, refuse to ship except against a letter of credit, but this involved a delay running into months before the requisite exchange was forthcoming, and was expensive for the importer.

Brazil also at one time refused to permit payment of bank charges and interest in anything but local currency. Its most disruptive innovation was, however, a regulation which required that all freight charges on imports be paid in the first instance in local currency, and this local currency could, among other things, be converted only into the foreign currency appropriate to the flag of the ship carrying the goods.

Restrictions such as these—and Brazil has by no means been alone in using them—are certainly not permissible under Bretton Woods. It is difficult to estimate what such practices have cost Brazilian importers and hence the Brazilian economy, although one can be sure that those selling to Brazil have raised their prices to some extent to compensate for the added risks. In the last case mentioned—the requirement that freights be paid in local currency—there is one indication. The Brazilian Conference promptly raised freight rates for shipments to Brazil 12%.

A moment ago the British were given high marks for the limited character of their restrictions on payments for imports into Britain. Now a caveat to that. British exchange controls do place a real barrier in the way of American exports to countries other than Great Britain. This arises from the control of non-resident sterling. Sterling is, of course, an international currency—what has been aptly called a key currency. The Treasury has always taken the quite understandable position that the payment of sterling to a non-resident is as significant for balance of payments purposes as the payment of foreign exchange to a non-resident. This because sterling in the hands of a non-resident represents a call on Britain's future exports in the same way dollars do. Or, to put it another way, exports paid for in sterling do not earn dollars.

During the war it became apparent that Britain could not pay, through sales of its exports, for all the imports it would need to carry on the war. It met this situation by entering into payments agreements—treaties, that is—with substantially all the neutral countries other than the United States and Switzerland.¹² These provided that all payments between Britain and the other country should be made in sterling, and should be made through certain so-called Special Accounts maintained in London.¹³ Sterling held in these accounts could be transferred only to another resident of the same country or to Britain. Special Account sterling was not blocked sterling—the non-resident could always obtain his own local currency from the monetary authorities of his own country

¹² Paul Bareau, *British International Payments Agreements*, in *THE PATTERN AND FINANCE OF FOREIGN TRADE*, p. 71 *et seq.*

¹³ The Special Account procedure was established by a Notice to Banks and Bankers, "Special Accounts," issued by the Bank of England, January 3, 1940.

for any sterling he acquired. It was anticipated, however, that substantial sterling balances would accumulate in the accounts, as they in fact did, and those balances constituted in effect loans—forced loans, if you will—to Britain.

The British were quite aware no such arrangements could be made with the United States. They accordingly made arrangements with the American banks with branches in London for establishing so-called Registered Accounts.¹⁴ These again were sterling accounts, to which any authorized payment in sterling to an American had to be made. Payments from the United States, on the other hand, for British exports or other purposes, could be made only in dollars or with sterling from one of these Registered Accounts. Sterling in a Registered Account—unlike sterling in a Special Account—could be converted into dollars at any time, and initially it was guaranteed that the conversion would be at the then official rate. There was, in other words, a guarantee against devaluation of the pound. This guarantee—though not the right to convert—was withdrawn when the Registered Accounts became American Accounts,¹⁵ and was not in effect at the time of the 1949 devaluation.

The Special Account procedure represented the extreme of bilateralism. Sterling earned by a Special Account country could be spent only in Britain. Later, the British Treasury experimented with what was termed administrative transferability—that is, it granted ad hoc permission for such transfers as from Swedish Special Account to Brazilian Special Account. In other words, it permitted Swedish importers to pay for Brazilian goods with sterling. Later still, so-called Transferable Accounts were established, again pursuant to treaties.¹⁶ Transferable Accounts were, like Special Accounts, sterling accounts, but different from them in the important respect that sterling in a Transferable Account could be transferred to another Transferable Account of another country.¹⁷

The important point about Transferable Sterling, for present purposes, is that the Transferable Account arrangements were in part prompted by the obligation assumed by the British in the Anglo-American Loan Agreement to make non-resident sterling convertible.¹⁸ Accordingly, currently earned sterling was made transferable to an Ameri-

¹⁴ The Registered Account procedure was established by a Notice to Banks and Bankers, U.S.A. and Switzerland, Registered Accounts, issued by the Bank of England July 18, 1940.

¹⁵ F.E. 222, issued by the Bank of England June 30, 1945.

¹⁶ Bureau, *supra*, note 11, at 74 *et seq.*

¹⁷ The Transferable Account procedure was set forth in F.E. 259, Notice to Banks and Bankers, Transferable Accounts, issued by the Bank of England, February 27, 1947.

¹⁸ Financial Agreement between the United States of America and the United Kingdom, Treaties and other International Acts Series 1545, Dept. of State Publication 2676, effective July 15, 1946.

can Account in a current transaction. This was the limit of the obligation assumed by the British, and hence accumulated sterling balances were not covered, nor could currently earned sterling be transferred in a capital transaction. In practical terms, this meant that the rest of the world could buy goods from the United States with the sterling it earned by selling goods to Britain, and the British would give the Americans dollars for the sterling.

Britain accorded this degree of convertibility—the right to transfer to an American Account—to some countries even prior to the July 15, 1947 deadline fixed by the Agreement. It withdrew the privilege altogether on August 20 of the same year, for the simple reason it was losing gold and dollars at a rate no country could stand. Subsidiary explanations have been offered, but in essence it proved true that Britain lacked the resources to bridge the dollar gap for a fair share of the non-dollar world.

After this unhappy experience the Transferable Account system was partially dismantled, then rebuilt until now virtually all non-resident sterling—other than American Account sterling—is Transferable Sterling, which means that currently earned sterling is fully transferable, except that it may not be transferred to American Account.¹⁹ It remains true, in other words, that a Brazilian who acquires sterling by an export to Britain may use that sterling to buy goods from France, but not to buy goods in the United States.

It is worth noting that when the convertibility of sterling is discussed, it is in this limited sense—the right to use currently earned sterling to make payments to the United States in a current transaction—that the term is used. This degree of convertibility for sterling the British may achieve in the not too distant future, though the result of their first effort in this direction has certainly made them gun shy. The day when sterling is convertible as the dollar is convertible—that is, when a Britisher can go to his bank with a thousand pounds and exchange it for dollars for any reason—is not likely to dawn in our time.

The restrictions on the use of non-resident sterling are in violation of the Bretton Woods Agreement.²⁰ They restrict American trade in the sense that they make it impossible for those countries which sell to Britain to use the proceeds to buy from the United States. One may doubt, however, whether the removal of these restrictions would substantially increase American exports. One cannot increase the total supply of dollars available to the rest of the world by making sterling

¹⁹ The Exchange Control (Payments) Order, 1954, S.I. 1954, No. 325, March 17, 1954, as amended by S. I. 1954, Nos. 1133 and 1426 and S.I. 1955, Nos. 931 and 1296; E.C. (General) 63, March 20, 1954.

²⁰ Proceedings, etc. *supra*, note 6, Vol. 1 at 598, Minutes of Meeting of Commission I, Document 370.

convertible. Much the same may be said of the arrangements with certain countries which go under the name of the Sterling Area.

Exchange restrictions are not of great importance in so far as exports are concerned—countries having balance of payments difficulties are generally as anxious to encourage exports as they are to discourage imports. Let us refer simply to the British regulations on exports.

Under British law goods may not be exported unless the authorities are satisfied:

(a) that payment for the goods has been made to a * * * resident * * * in such manner as may be prescribed in relation to goods of that class or description exported to a destination in that territory, or is to be made not later than six months after the date of exportation; and

(b) that the amount of that payment has been made in such a manner as to represent a return for the goods which is in all circumstances satisfactory in the national interest.²¹

These provisions are backed up by certain enforcement provisions, designed to ensure that the goods are in fact sold and the payment received within the time indicated.

Several points involved in these provisions deserve comment. One is the reference to "payment in such manner as may be prescribed" for goods shipped "to a destination in that territory." This provision is, of course, the counterpart of those already described, governing American Account, Transferable and other forms of non-resident sterling. Briefly, exporters must receive from American importers either dollars or American Account sterling, and from importers in other countries the type of non-resident sterling appropriate to their country or, in a few cases, the currency of their country. Put concretely, a British exporter may not sell to an American importer for Greek sterling, and certainly may not sell to an American for drachmas.

Looked at broadly, one can understand why a country would not be interested in selling its exports to a hard-currency country for soft currency, and Britain is of course not alone in this attitude. The Bretton Woods prohibitions on restrictions on payments for current transactions apply to exports, but presumably the obligation is only to accept a convertible currency, or one's own currency—one is not required to accept rubles. The British regulations, in other words, offend against Bretton Woods only in so far as they restrict the use of non-resident sterling.

The British have been, incidentally, much concerned at the ineffectiveness of this aspect of their controls. It is alleged that traders in other countries have purchased British goods for their own brand of sterling and resold the goods to the U. S. for dollars—a practice known

²¹ The Exchange Control Act, 1947, *supra*, note 11, Part IV, Section 23. See also E.C. (General) 45, March 1, 1951, as amended.

as shunting, which takes many forms and often involves certain irregular transfers of non-resident sterling and, in British eyes, a loss of dollars to Britain. All this is perhaps true, but the complaint seems odd coming from a country which has for centuries prospered through dealing in other people's goods. The British were, in fact, quite unmoved when the Brazilians complained that the British were reselling Brazilian coffee to the United States.

A second clause in the British law which deserves notice is the provision that payment must be received within six months. Some such provision is, of course, essential if the Treasury is ever to recover the proceeds of exports. Beyond that, the British regulations have always placed more or less severe restrictions on making available the facilities of the London market to finance trade.²² This has been one of the Treasury's most troublesome problems. On the one hand, it is anxious to encourage trade, and competition in the export market may be as much with respect to credit terms and facilities as price. On the other hand, credit facilities may be used to speculate against the pound, as was certainly true on a large scale before the 1949 devaluation.

Finally, there is the provision that, in effect, the price received for exports must represent "a return for the goods which is in all circumstances satisfactory in the national interest." No provision of the law provoked more controversy in Parliament than this, and it is at first blush shocking to any believer in freedom of contract. There is, however, no commoner form of evasion than the under-invoicing of exports, with an understanding that the difference will be deposited to the exporter's account abroad, and some such provision is obviously required to make the controls effective.

Irksome as these controls on payments for exports may be to the British exporters, they need not be an embarrassment to American importers, though they do make it impossible for Americans to purchase British goods for cheap sterling.

Let us turn now to the effect of exchange controls on foreign investment. The reference is not to foreign investment by residents of the country imposing exchange controls. They have had it as no one else has. Referring again to the British experience, British holders of American securities were required during the war to turn in their securities to the government, and a large part were liquidated, the

²² These restrictions go back to the first Notice to Banks and Bankers issued by the Bank of England after exchange control was imposed on September 3, 1939. See also E.C. (General) 67, April 28, 1954, as amended, Credits and Guarantees and Sterling Loans and Overdrafts to Non-Residents. The United States likewise imposes restrictions on the financing of foreign trade by American banks, but no one views this as an exchange restriction. See the discussion of Section 13 of the Federal Reserve Act in Ward and Harfield, *Bank Credits and Acceptances*, 3rd ed., 1948, at 124 and 125.

security holders receiving sterling for their holdings.²³ Those securities left have since been under close control, and any payment received on account of any such security has normally to be surrendered to the government for sterling. British holders of American securities have, however, been accorded the right to switch their holdings—a measure taken at least in part to keep them from holding on to a security when prudence dictated that it be sold. As to new investment abroad, there has never been a regulation which even suggested this was possible. British enterprises have from time to time been granted exchange to establish or expand foreign operations, but in each case this has been by special arrangement with the Treasury.

Our concern is primarily with American investment abroad, and the discussion will be limited to investment which involves the conduct of a business abroad, through a branch or subsidiary, excluding casual investment in the securities of a foreign corporation, important as that is in some areas.

First of all, it should be understood that such an enterprise will be subject to all the exchange restrictions imposed by the country in which it is operating, with respect to its imports and exports.²⁴ Enforcing such restrictions is, incidentally, a major problem for the authorities since, unless they wish to take over management of the enterprise, controlling the basis on which related organizations deal with each other presents very great difficulties.

An exception to this generalization must be made with respect to certain countries which have not required foreign-controlled companies to surrender the proceeds of their exports. Chile, Venezuela, Bolivia and Iran, among others, have used this system. In lieu of such accounting for the proceeds of exports they have required these companies to acquire their requirements of local currency at a special, higher rate, which in the extreme case, Chile, has been as much as five times the buying rate

²³ The authority to requisition securities was conferred by The Defense (Finance) Regulations, 1939 (S. R. & O. No. 1950), issued August 25, 1939, prior to the imposition of exchange control on September 3, 1939. Pursuant to the authority granted the Treasury issued a series of Securities (Restrictions and Returns) Orders and, beginning on October 14, 1939, a series of Acquisition of Securities Orders under which the securities were actually requisitioned.

²⁴ The British exchange control system, generally speaking, imposes controls on residents and exempts non-residents, rather than distinguishing between subjects and aliens. The Exchange Control (Branches and Residence) Directive, 1951, S.I. 1951, No. 962, May 31, 1951 provides:

"1. For the purposes of the Act any transaction with or by a branch of a business, whether carried on by a body corporate or otherwise, shall be treated in all respects as if the branch were a body corporate resident where the branch is situate.

2. A person or body of persons carrying on in the United Kingdom a branch of any business, shall, as respects such business as is carried on by that branch, be treated for all purposes of the Act as resident in the United Kingdom."

for the proceeds of other exports. Companies subject to such a regime have no problem in remitting profits or repatriating capital, but are in effect taxed, in foreign exchange, on another basis. Theoretically this system could work to the disadvantage of the country utilizing it, since it makes it profitable for the foreign companies to minimize their local expenditures, but there is little evidence that this has in fact resulted.²⁵

The British deny foreign companies access to the local capital market, either for bank loans or the public issue of securities.²⁶ They see no reason why their capital should be used to earn dollars for American companies. This seems to be purely a domestic regulation, not an exchange restriction. It is in any event a minor problem. The real concern is with the effect of exchange control on the remission of earnings and the repatriation of capital.

If we turn back to the Bretton Woods Agreement, we find that there may be no restrictions on "payments due as interest on loans and as net income from other investments" or on "payments of moderate amounts for amortization of loans or for depreciation of direct investments."²⁷ But "Members may exercise such controls as are necessary to regulate international capital movements."²⁸ These provisions leave something to be desired in clarity when one considers the range of payments which a foreign-owned subsidiary or branch may wish to make to its parent or home office. Payment of interest on loans and of normal dividends or profits is a current transaction, but query regarding dividends or profits which are paid from capital gains. Payments of the proceeds of sale of a subsidiary's stock, or arising from the sale of capital assets, are as clearly capital movements, and may be restricted. The meaning is not so clear with respect to the repayment of loans, since only "payments of moderate amounts for amortization of loans" are included among current transactions.

If we look at the record, we find, as might be expected, that American investors have had real difficulty both in remitting earnings and repatriating capital. The British practice is relatively liberal. The regulations provide, with respect to interest, dividend and capital repayments by British corporations controlled by nonresidents, that "Before making an announcement or dispatching any warrants, Registrars and Company Secretaries should apply in writing to the bank of England * * * and should furnish the relevant Balance Sheet and Profit and Loss Account."²⁹ This indicates that such payments are controlled, and

²⁵ W. John R. Woodley, *The Use of Special Exchange Rates for Transactions with Foreign Companies*, INTERNATIONAL MONETARY FUND STAFF PAPERS, Vol. III, No. 2, October, 1953, p. 254, *et seq.*

²⁶ E.C. (General) 4, October 1, 1947, as amended: E.C. (General) 67, *supra* note 22; Borrowing (Control and Guarantees) Act, 1946, 9 & 10 Geo. 6, C. 58, THE STATUTES REVISED, (3rd ed. 1950.) Vol. XXVIII, p. 72 *et seq.*

²⁷ and ²⁸ Article XIX and Article VI, Section 3, *supra*.

²⁹ E.C. (Securities) 11, August 3, 1955, paragraph 7.

implies they may be restricted. It is said, however, that "Current dividends require formal permission but are in fact remitted in dollars * * * * In fact, American companies operating in Britain have been remitting \$70-80 million a year in recent years, or about half their earnings after tax * * *"³⁰

A further British regulation provides generally that "where any payments whatsoever of a capital nature are being made, *otherwise than as provided in the original terms of issue*, by resident borrowers or issuers * * * application in writing should be made to the Bank of England * * *. It is emphasized that the terms of this paragraph cover not only repayments of capital but also payments which are in the nature of a distribution of capital assets, capital reserves or capital gains arising from the realization of assets * * *."³¹ These regulations must be read with those governing the sale of securities by non-residents, which provide generally that the proceeds must either be re-invested or be treated as Blocked Sterling.³² On the other hand, the British authorities have, since January 1, 1950, been prepared to enter into agreements permitting the repatriation of capital, including capital profits, with respect to investments made after that date.³³ The pattern of these regulations suggests a British interpretation of the requirements imposed by Bretton Woods, and an effort to approach, if not fully to comply, with those requirements.

Other countries have for extended periods provided no facilities whatever even for remitting earnings. Where priority systems have been used in allocating exchange, payments on account of foreign investments have characteristically been given a low priority. Where multiple exchange rates have been used, such payments have usually been possible only at the highest or one of the higher rates, which means in effect that a tax was levied on such payments. Where there has been an official exchange market, and a so-called free market, such payments have usually been possible only through the free market. Free market here is, of course, a misnomer, since on the supply side only such exchange as is not required to be sold in the official market may be sold in the free market. Hence the rate paid in the free market usually involves a very substantial premium over the official rate.

Foreign countries eager to attract American capital have come to realize that one can't bait the trap with the kind of cheese described, and have vied with each other in passing new laws designed to attract

³⁰ 171 *Economist* 820, June 5, 1954. It is said that at one time the British authorities applied an historical test, that is, took as a base earnings in the immediate pre-war, pre-control period in determining the earnings which might be remitted.

³¹ E.C. (Securities) 11, August 3, 1955, paragraph 8. *Underlining supplied.*

³² E.C. (Securities) 8, December 15, 1954, as amended to August 12, 1955, Part II, paragraph 5. Blocked Sterling is now transferable between non-residents, subject to certain restrictions.

³³ 171 *Economist* 820, June 5, 1954.

American capital. It is worth noting some of the ideas which have found their way into these laws. Most require approval of the investment or its registration with the authorities.³⁴ Some of such laws simply go all out, and guarantee the remission of all earnings and the repatriation of all capital. Others limit the amount which may be remitted or repatriated, or both, to a percentage of the capital invested. This appears to make some sense where the repatriation of capital is involved but little with respect to the remission of earnings, since a fair return on an investment in a water company is not the same as a fair return on an investment in a zinc mine. It is common to distinguish between new investments, made after the effective date of the law, and old investments. It is difficult to see the equity in this distinction and, there is much reason to doubt it makes practical sense, since those who have already invested in a country are most likely to make new investments there. Another distinction made is between original capital, reinvested earnings, and capital appreciation. Still another is between favored investments and ordinary investments, at times in terms reminiscent of the "dollar earner," "dollar saver", etc. categories of the Marshall Plan days,—that is, industries likely to earn dollars through exports, industries likely to save dollars through making the import of dollar goods unnecessary, and industries likely to require dollar expenditures for raw materials, equipment, etc.

Perhaps the most interesting development in this whole area is the resort to contracts between American companies and foreign governments on matters of foreign exchange. A notable example is the moving picture industry. A major part of the earnings of the American film industry comes from abroad, and no industry has felt the effects of exchange control more. The industry has, for much of the period since the outbreak of the war, operated in England pursuant to a series of contracts between the industry and the British government.³⁵ Characteristically these contracts have provided for remitting annually a flat amount—say \$17,000,000—plus certain added amounts, totalling \$6 to \$8,000,000, related to the earnings of British films in the United States, the expenditures of the American companies on film production in Britain, or the like. Any excess earnings—perhaps \$15,000,000 per year—could be used in Britain for certain specified purposes only.

³⁴ The British standard is said to be: "It is necessary that the project should be of sufficient benefit to the British economy to justify such dollar expenditure [on transfer of dividend or possible repatriation of capital] either because it will earn or save hard currency, or because it is a valuable addition to the country's industrial efficiency.*** New schemes [should] not involve unreasonable additional dollar outgoings for royalties, extra raw materials, payments to foreign technicians and similar charges." 171 *ECONOMIST* 320, June 5, 1954, quoting the Dollar Exports Council.

³⁵ 154 *ECONOMIST* 428, March 13, 1948; 154 *ECONOMIST* 468, March 20, 1948; 154 *ECONOMIST* 936, June 5, 1948; 161 *ECONOMIST* 361, August 11, 1951; 164 *ECONOMIST* 707, September 20, 1952; 173 *ECONOMIST* 154, October 9, 1954.

These relate primarily to production of films in Britain, but may be outside this area in certain instances and subject to certain controls. These agreements go far to explain why so many American film companies have been producing films in England. It is also true that the American companies have not found a satisfactory use for all their blocked sterling, and since the agreements have not included an exchange guarantee, allegedly suffered a heavy loss in the 1949 devaluation.

Oil is the most significant commodity in international trade. The production, refining and marketing of oil have never been governed by national boundaries. American companies carry on all these operations in the sterling area, and British companies do the same in the dollar area. To put it briefly, much American oil has a high sterling content, and British oil in turn has a high dollar content. A flat refusal by the British to buy from American companies could, in other words, be self-defeating, since the dollar cost of British oil could be as high as the dollar cost of American oil. This situation led to a series of agreements with the American companies concerned—Standard Oil of New Jersey, Arabian American and others.³⁶ These agreements were extremely complicated, but generally speaking resulted in the American companies being permitted to sell more oil for sterling and to spend that sterling for such purposes as the building of tankers in Britain and the payment of royalties to Saudi Arabia. In return they undertook to reduce the dollar content of their oil by increasing their expenditures in the sterling area, a process made easier by such steps as the building of the great refinery at Fawley, England, by a Standard of New Jersey subsidiary. The ultimate aim of these arrangements, from the British point of view, is to reduce the dollar cost of American oil to the profits of the American companies.

Another type of arrangement is that made by Standard Vacuum Oil with India, for building a refinery in Bombay. Standard undertook to form an Indian corporation, whose preferred would be sold to Indian investors and common taken by Standard. India guaranteed that the refinery would not be nationalized for 25 years; that the company would be allowed to remit its profits and meet its capital costs, and that it could import crude free of duty.

An American syndicate purchased 600,000 shares of Tanganyika Concession stock. The purchase was made in sterling at the official rate, and the British Treasury gave a guarantee that if the shares were sold, the sterling proceeds, up to the amount of the purchase price, could be converted at the official rate; anything over this could be converted but only at the security sterling rate. This arrangement is of particular interest

³⁶ 157 *ECONOMIST* 1262, December 3, 1949; 158 *ECONOMIST* 388, February 18, 1950; 158 *ECONOMIST* 1229, June 3, 1950; 159 *ECONOMIST* 137, July 15, 1950; 159 *ECONOMIST* 188, July 22, 1950; 160 *ECONOMIST* 394, February 17, 1951.

because it is the only instance encountered in which the British have in effect made a multiple-rate arrangement.

The cases cited are only a few among many examples of such private treaties.

Now if we back away from this mass of detail, and look at the whole problem of exchange control broadly, what attitudes suggest themselves? It is suggested the only realistic approach is that other nations are likely to use exchange control for at least as long as we use the protective tariff, and we had best try to live with it. A good place to begin is to ask what it is about exchange control to which we particularly object. Is our real concern with import control, which may be dictated by exchange considerations and may have the effect of exchange restrictions? Is it the fact of exchange control, or certain administrative practices within the framework of certain exchange control systems, which trouble us? Is the problem of repatriation of American capital one problem, or many problems? Put another way, is the concern of an investor in British securities regarding his right to sell his securities and convert the proceeds into dollars, the same as the concern of Arabian American regarding its right to repatriate its investment in Saudi Arabia, or the copper companies to repatriate their investment in Chile? How much of the concern with repatriation is only a facet of the expropriation problem? What is the reason foreign countries are reluctant to concede the right of repatriation? Do they really want to freeze foreign capital within their borders, or are they simply interested in turning a demand deposit into a time deposit? How much of the problem is one of definition—of the distinction between invested capital, reinvested earnings and capital gain? Would we be interested in a proposal that Americans should be permitted to repatriate as much capital in a given period as Americans invested in that period—that is, a proposal looking to the equalization of capital movements? Need we insist that Americans receive the same treatment as the nationals of other countries? Or can we afford to recognize that the problem is essentially a dollar problem, and that any relaxation of restrictions in any part of the world is ultimately to our benefit? Are we really concerned that the drachma isn't convertible, or would we be content if the pound became convertible? To ask these questions is not to answer them, but thinking along these lines could be helpful in clarifying our attitudes.

What means should we use to bring about a relaxation of exchange restrictions? Certainly priority should be given the machinery of the International Monetary Fund. The Fund Agreement does not say—as, for convenience in exposition, some of the statements previously made in this paper suggest—that no member may impose restrictions on payments for current transactions, but that it may not without the approval of the Fund. Moreover, the Agreement provides for a Transitional Period during which members can maintain restrictions; that period was

nominally five years, but at the end of that period a member's obligation was only to consult with the Fund,³⁷ etc. The Fund is thus in a position to negotiate with its members to secure modifications of their exchange restrictions, and has in fact done effective work in this area.

What of multilateral or bilateral treaties? They have been used extensively by the European countries in a particularly effective way. The Fund Agreement speaks in the broadest terms, of capital movements and the like. Exchange restrictions are, however, a matter of detail, and the European nations have made detailed agreements on the relaxation of exchange restrictions in a single area, such as insurance.³⁸ Also, different countries impose exchange restrictions for quite different reasons, and their exchange control practices vary markedly. These considerations suggest the desirability of the step-by-step, bilateral approach. There is no objection to this so long as there is no effort to contract out of the obligations imposed by the Fund Agreement. We have used this approach, not only in the Anglo-American Loan Agreement, but in the Treaties of Friendship, Commerce and Economic Development we have made with many countries since the war.

What of the foreign laws described, designed to encourage American investment by offering certain guarantees of the remission of earnings and repatriation of capital? Presumably such laws can be repealed as easily as they can be passed. One would hesitate to rely on such laws, particularly those which promise the most. It seems obvious that no country is going to allow the repatriation of foreign capital at a time when it can't pay for essential imports, and one can hardly put much faith in a statute which says it will.

Finally, what of the private treaties American companies are making with foreign governments? They are worth watching, for indications of what those directly concerned feel is a reasonable arrangement in their situation. Note, for example, that in the Bombay refinery deal there was not a guarantee against expropriation, but only against expropriation within 25 years, and in the Tanganyika Concessions contract capital gains could be repatriated only at a lower exchange rate.

There is the obvious risk that, as a result of such arrangements, some American investors will receive better treatment than others. A country might well be reluctant to breach such an agreement where it would not hesitate to repeal a law or regulation. But more interesting is the question of the status of such arrangements under American foreign relations law. Will the State Department come to the assistance of American investors if such an agreement is breached? Will an agreement to make exchange available be likened to a debt? In at least one instance

³⁷ Article XIV.

³⁸ See the decision of the Council of the O.E.E.C. of May 3, 1950, on the liberalization of invisible transactions, reported in the *Board of Trade Journal*, May 27, 1950, p. 1098 *et seq.*

an American company was not willing to rely on such a contract, and instead made a forward exchange contract with the central bank for the amount of its investment.

It may seem to some that this paper reflects a too tolerant attitude toward exchange control. It should be remembered, however, that the discussion is confined to a limited area, and even with respect to that area is necessarily incomplete. More important, the emphasis has been on the impact of exchange control on Americans engaged in foreign trade and investment, rather than on the residents of countries imposing exchange control. Certainly the impact on the latter is far greater, to a degree which suggests that the pressure for the relaxation or abolition of exchange control will come primarily from within rather than from without. Finally, the illustrations have been drawn largely from the British experience, and it can be said of the British that, although they impose exchange control, they have not forgotten there are standards of decency in international financial transactions.