The U.K. exchange control: a short history

Exchange control, in one form or another, can be traced back for many centuries. For example, as early as 1299 there were restrictions on the import and export of currency into and out of England.[1] This article, however, is concerned with more recent history – the developments in exchange control during the last thirty years. It falls broadly into four parts. The first deals with the legal and administrative basis on which the control rests; and the second with the introduction of control during the 1939-45 War. The third section is concerned with the subsequent approach to convertibility, which resulted in non-resident holdings of sterling being freely convertible after 1958 and culminated in the United Kingdom's acceptance, in February 1961, of the obligations of Article VIII of the International Monetary Fund Agreement – marking essentially the removal of all exchange control restrictions on current transactions by U.K. residents. Finally, there is a review of developments after 1961.

Following the financial crises of the early 1930's, the application of exchange control became widespread overseas. Among the techniques employed were the requisitioning of foreign exchange earnings and the prohibition of exports of capital; also of importance were various compensatory and clearing agreements, of which Germany was the chief exponent. These developments gave many practical examples, which were useful in the contingency planning that took place in the United Kingdom in the years just before the war, of how an exchange control could function – the various clearing agreements setting the pattern for many of the bilateral payments agreements arranged by the United Kingdom during the war and in the early post-war years.

The main object of exchange control in this country was to conserve and increase the gold and foreign currency reserves, and to ensure that they were used for the maximum national benefit. This objective, however, had to be weighed against the desirability of interfering as little as possible with the earning power abroad of U.K. industry, merchants, bankers and other commercial interests. For in a country such as the United Kingdom, which is heavily dependent on overseas trade; which has an international trading and reserve currency; and which derives substantial earnings from international activities in insurance, banking, commodity dealing, and the like; there is a danger that exchange control could so hamper the country's earning power as to weaken, rather than to strengthen, the foreign exchange reserves. Throughout the past thirty years the control has been administered, so far as was compatible with the need to conserve foreign exchange, to cause as little damage as possible to the international use of sterling and to the country's overseas earning power.

The machinery of control

The legal basis for exchange control during the war was the Defence (Finance) Regulations, issued under the Emergency Powers (Defence) Act 1939. In October 1947, the wartime regulations were largely superseded by the Exchange Control Act, which remains the principal statutory authority for exchange control today.

The powers contained in the Act are vested in H.M. Treasury,

1 Noted in the 1966 Arthur K. Salomon lecture, sponsored by the Graduate School of Business Administration of New York University, given by Lord Cromer, former Governor of the Bank of England.

although the administration of the control has largely been delegated by the Treasury to the Bank of England. The Bank's role is thus solely that of an agent and, although the Bank interpret the rules of the control and advise the Treasury on matters of policy, responsibility for policy rests ultimately with the Treasury.

The need to avoid delay in commercial transactions has made it desirable for the Bank in turn to delegate to commercial banks a considerable degree of authority to handle day-to-day transactions. These banks, which are known as 'authorised banks', are allowed, among other things, to deal in gold and foreign currencies, to make payments to non-residents and to authorise transfers of securities. More limited authorities have been delegated to stockbrokers and solicitors (known as 'authorised depositaries'[1]) to enable them to deal with the large volume of work arising from security transactions; and to travel agents in the field of foreign travel.

Residence

For the purposes of the U.K. exchange control, people (and their assets) are classified according to the country in which they normally live; a distinction is drawn between the countries of the sterling area (referred to in the Exchange Control Act 1947 as the Scheduled Territories) and the rest of the world. There is no U.K. control over payments from the United Kingdom to residents of other parts of the sterling area. At the outbreak of war, the sterling area[2] was limited to those countries which were prepared to adopt a system of control on similar lines to that of the United Kingdom; in effect the sterling area was surrounded by a barrier – within which all transactions could take place freely but across which they were subject to control. At that time the sterling area consisted of the British Commonwealth, with the exception of Canada and Newfoundland (which were excluded because of their close links with the United States) and Hong Kong (later included), together with a few other countries with particularly strong financial and commercial ties with the United Kingdom.[3] Because sterling area countries held the bulk of their reserves in sterling (some of them held independent reserves in other currencies, but mainly as working balances) deficits and surpluses between them were settled in sterling and had little effect on the United Kingdom's gold and foreign exchange reserves.

In August 1940 the Treasury were given power to specify for exchange control purposes the residential status of any person or business. In determining the status of an individual, account was taken of his movements in the preceding years, his expressed intentions as to permanent residence, and to some extent his nationality; the status of a company was determined by where its business was carried on and where its central management and control lay, and not necessarily by its place of registration. The Treasury's powers to determine residential status were re-enacted in the 1947 Act; subsequently, responsibility for deciding individual cases was largely delegated to the authorised banks.

Exchange control during wartime

The exchange control imposed during the 1939-45 War was wide ranging in its influence: it affected the foreign assets of people living in this country; the sterling assets of those living outside the sterling area; and all monetary transactions between the United Kingdom and countries outside the sterling area. By the middle of 1940, the main features of the control, described below, had been established. Such changes as occurred during the rest of the war

1 The authorised banks are also authorised depositaries.
2 The sterling area was known in the 1930's as the sterling bloc. It then consisted of a somewhat larger group of countries (not entirely Dominions or parts of the British Commonwealth) which conducted a large part of their trade in sterling and held their reserves predominantly in sterling.
3 The Scheduled Territories now comprise the British Commonwealth (except Canada and Rhodesia), the Irish Republic, British Trust Territories, British Protectorates and Protected States, Iceland, the Hashemite Kingdom of Jordan, Kuwait, Libya, South Africa and South West Africa, and Western Samoa.

were directed mainly to closing loopholes that appeared from time to time, and to removing anomalies and inequities.

Trade

Imports from countries outside the sterling area were limited to some extent by lack of shipping space, and were controlled by means of import licences; so that exchange control was subsidiary to physical control. The licences were the concern of the Import Licensing Department of the Board of Trade; and when one was granted the necessary currency was made available or the transfer of sterling to a non-resident account permitted. To ensure that the goods were in fact imported, two copies of the application to pay for them had to be submitted. When payment was made in advance of import, one copy of the application form was sent to H.M. Customs, and in due course matched with the second copy, to which a copy of the Customs entry had been attached. If the goods had already arrived, a copy of the Customs entry had to be attached to the exchange control application. Where payment for imports into an overseas sterling area country was made through London, evidence of the approval of the exchange control in that country had to be produced.

Supervision of the proceeds of exports began in March 1940, when a limited control was introduced which required payment within six months, in certain currencies, for particular goods (all of which were good earners of dollars) shipped to certain countries. For U.K. exports, a form had to be produced to H.M. Customs by the seller or consignor of the goods; and the duplicate of this form had subsequently to be certified by an authorised bank, showing the manner in which payment had been received, and then lodged with the Customs. Arrangements were made to satisfy the requirements of local exchange controls where payment was made through London for exports from overseas sterling area countries. In June 1940, the scheme was extended to cover all exports to such countries as were specified by the Treasury – initially the United States and dependencies, Switzerland and Sweden, but later many other countries as well.

Trade by U.K. merchants direct from one country outside the sterling area to another was facilitated by the control, because of the earnings which would accrue; and payment for goods to be onsold by a U.K. merchant was allowed subject to supervision of the transaction by the merchant's bank and provided that the proceeds (usually in a similar currency to that which had been paid out) were received within six months.

Invisibles

Payment was generally allowed freely for such items as interest and dividends; for the transfer of profits by U.K. subsidiaries of foreign firms – after U.K. tax had been provided for; and for professional services, advertising, and so on.

Certain industries with international ramifications, however, presented special problems. As regards insurance, U.K. exporters were allowed to take out policies in the currency of their contract and U.K. residents were allowed to continue pre-war life policies in foreign currencies;[1] but all other insurance by U.K. residents had to be written in sterling or in a sterling area currency. Non-residents were allowed to insure in this country in any currency, provided that premiums were paid in the same currency – except for the insurance of fixed assets in the sterling area, which, during the war, had to be covered in a sterling area currency. Provisions were made –

[1] That is, currencies of countries outside the sterling area.

for example, by the setting up of trust funds abroad or by making deposits abroad – to enable U.K. insurers to demonstrate that they were in a position to meet any claims arising in foreign currency.

Agreement on rentals paid to American film producers was reached in November 1939; a limit was set on the amount which might be transferred to the United States in the ensuing twelve months, the unremitted balance having to be spent in the sterling area. Similar agreements were concluded in 1940 and 1941; but in October 1942 the accumulated unremitted funds were released and transfers were then allowed freely until 1947 when, as noted later, a balance of payments crisis made it necessary to restrict them again.

The oil industry posed a greater problem because of the size and complexity of its foreign currency requirements. Remittances to American companies for oil imports into other sterling area countries were dealt with in London on the basis of information supplied by the exchange controls of those countries, while the dollar requirements of British companies were supervised by the then Ministry of Mines.[1]

Resident capital

One of the objects of the control during the war was to mobilise all foreign currency assets, in cash or securities, which were at the disposal of U.K. residents. Any holdings of 'specified' currencies[2] – those deemed most useful for making payments abroad – had to be offered to the Treasury,[3] against payment in sterling at the official rate of exchange. Securities denominated, or payable, in such currencies ('restricted' securities) had to be registered with the exchange control,[4] but could be sold abroad provided that the proceeds in currency were offered to the Treasury. The transfer to non-residents of 'unrestricted' securities (*i.e.* those payable in sterling, or in a non-specified currency) was controlled, to ensure that the full value of the securities was paid from non-resident funds.

As noted below, many of the restricted securities, particularly those denominated in U.S. and Canadian dollars, were 'vested' in 1940, that is they had to be sold to the Treasury for sterling. Some of them were later sold abroad to provide finance for the war: those that remained constituted the Treasury's portfolio of dollar securities.

The occupation of Western Europe opened up the possibility of looted securities being sold on the London market for the enemy by neutral intermediaries; and after 13th May 1940 transfers of securities to or from non-residents required permission, and had to be accompanied by a declaration, supported by a bank or a member of a U.K. stock exchange, giving details of the transferor and transferee. Restrictions were also imposed on the issue of bearer securities, and on the conversion of registered securities to bearer form.

Because of the possibility of invasion, it was thought advisable in 1940 to ship to Canada those restricted securities, held by banks on behalf of U.K. residents, which were most easily marketable abroad. Staff of the Bank accompanied the first shipment, which formed the nucleus of the U.K. Security Deposit in Montreal. The Bank issued bearer deposit receipts to the owners of such securities, who could then dispose of them on the London market. The Security Deposit was wound up in 1945.

Towards the end of 1940, the Government found it necessary to mobilise a substantial part of U.K. holdings of U.S. securities for the purposes of war finance. This was done by vesting and was

1 Later the Ministry of Power.

2 Listed in an Order made just before the war as the currencies of the Argentine, Belgium, Canada, France, the Netherlands and the Dutch East Indies, Norway, Sweden, Switzerland and the United States. A year later the currencies of the Dutch West Indies, Belgian Congo, Newfoundland, Panama, the Philippine Islands and Portugal were added. This list was later varied at times, and since April 1967 all foreign currencies have been specified.

3 Later to an authorised dealer in foreign exchange.

4 Some 20,000 securities were registered, involving the completion of 1½ million forms.

mainly confined to portfolio investments. Because U.S. legislation prohibited the raising of loans by countries at war, it was necessary at first to resort to outright sales of these investments. In June 1941, however, special legislation in the United States enabled the Reconstruction Finance Corporation to make loans to foreign governments against the deposit of American securities as collateral; and in July the R.F.C. agreed to provide the U.K. Government with a loan of up to $425 million at 3%, of which $390 million was eventually borrowed. As collateral, the Treasury deposited some vested American securities, together with some shares in U.K. firms' American subsidiaries and associated companies and certain marketable American securities which, instead of acquiring outright through vesting, they borrowed on appropriate terms from U.K. holders. The loan was serviced from the income of U.S. branches of U.K. insurance companies and from receipts, both capital and income, arising from the securities deposited as collateral – the insurance companies, and the owners of those securities which had not been vested, receiving the sterling equivalent from the Treasury. The loan was finally repaid in 1951 and such of the collateral as was held privately was returned to the owners.

Non-resident capital

The placing of severe restrictions on sterling assets belonging to non-residents[1] was not an expedient which was welcomed, but it was felt to be necessary during the war for the protection of the country's reserves. The steps taken may be summarised under four main headings.

First, control was exercised over sterling securities held by non-residents. In the early months of the war, such securities could be sold freely, and the proceeds withdrawn. To prevent the loss of foreign exchange, licences were required for all such sales from 13th May 1940; and from 23rd May these licences were given only if the sale was made on a U.K. stock exchange and the proceeds reinvested in a sterling security of the same category as the one sold, and not of shorter date. From October 1943, however, non-residents were allowed to reinvest in any sterling security which matured in not less than ten years, and to remit the proceeds on maturity.[2]

Secondly, the Treasury were empowered in July 1940 to impose restrictions on assets where they were ". . . satisfied that any State is exposed to pressure from another State and in consequence action is being, or is likely to be, taken to the detriment of the economic position of the United Kingdom." This power was used at times to restrict the assets of certain countries and of their residents.

Thirdly, in November 1940, the proceeds of capital assets held in this country by non-residents – such as those arising from legacies, sales of real estate, etc. – were directed to blocked sterling accounts, whence they could be reinvested in government securities, the interest on which was allowed to be transferred to the holder.

Lastly, in November 1941, the Treasury took powers to block the bank accounts in the United Kingdom of foreign nationals, and of British subjects, who had lived in this country before the war but had then taken up permanent residence outside the sterling area. The assets of foreign nationals blocked under this regulation, and under that described in the previous paragraph, were partly released in October 1943.

1 Apart from those of residents in enemy countries, which were the concern of the Custodian of Enemy Property.
2 Remittances of dividends and interest were not restricted.

Credit to non-residents

At the outbreak of war, the regulations provided that credits involving the payment of sterling to a non-resident account had to be approved by an authorised bank and registered with the Bank of England; and banks were instructed to cancel credit or overdraft facilities not related to a definite commercial transaction. Some restrictions were placed on the financing in London of trade between neutral countries. From early in 1940, all sterling credits in favour of a non-resident, credits in foreign currency, and guarantees which, if implemented, would involve payment to a non-resident, had to be approved by the exchange control. In mid-1940, when non-resident holdings of sterling were classified into various types of account – noted below – it was provided that credits should be repaid from the appropriate type of account.

Gold and foreign exchange markets

In addition to their holdings of specified currencies, mentioned earlier, residents were required to offer for sale to the Treasury any gold bullion or gold coin in their possession. The London gold market during the war was allowed merely to collect and sell this gold to the Bank, or to buy from the Bank and sell to the trade gold needed for industrial purposes or for export in manufactured form.

Dealings in foreign exchange during the war were limited to 'authorised dealers' – who had to deal, in most currencies, at published official rates of exchange and to cover transactions with the Bank at the same rate – charging their customers a commission. Virtually all of the foreign exchange broking firms ceased to function; and in many cases their partners and staff were recruited by the Bank for work on exchange control.

The transferability of sterling

It was necessary to limit the transferability of non-resident holdings of sterling, mainly to prevent the development of free markets in which sterling might be traded at a discount – thus reducing the sterling area's earnings of foreign exchange. The control's policy was to restrict these free markets to a size which would make it impossible to settle commercial transactions through them. To this end, the United Kingdom concluded bilateral payments agreements with a number of countries (starting with the Argentine and Sweden towards the end of 1939). The countries concerned undertook to conduct their trade and other current transactions with the sterling area in sterling; to buy and sell sterling at official rates; and to channel the bulk of their payments through official sterling accounts known as Special Accounts – on which they would hold, on certain conditions, any surpluses that they had in sterling.

Different arrangements were made with the United States and Switzerland; U.S. and Swiss banks were allowed to open Registered Accounts, through which virtually all these countries' sterling transactions with the sterling area had to be routed. The balances on these accounts, however – unlike those on the bilateral Special Accounts noted above – could be converted into U.S. dollars and Swiss francs respectively.

Another type of restricted account was available for the conduct of sterling transactions between residents of the sterling area and residents of Central American countries which traded mainly on a dollar basis. These were known as Central American Accounts; sterling could be transferred freely between them, and to the sterling area – but not to countries covered by an agreement. A further type of limited account (the Sterling Area Account) was made available to private residents in Special or Registered Account countries, through which they might receive sterling income from and make personal payments to the sterling area; and some non-resident sterling accounts, which had been in existence before the network of bilateral payments agreements was set up, remained in being as Ordinary Accounts, though their use was greatly restricted.

As payments agreements were concluded, controls were extended to exports to the countries concerned; and the sterling proceeds of sterling area exports had to be received from the appropriate type of account. Broadly speaking, each category of non-resident sterling could be transferred only between residents of the country (or area) concerned or used for making payments to the sterling area. Countries not covered by agreements were able to transfer sterling between themselves and to the sterling area, but not to countries covered by an agreement. The agreements prevented a great deal of sterling held by non-residents from escaping into the free markets, and the scope of these markets was much reduced.

Transferability in the early post-war years

The wartime bilateral agreements were always intended to be temporary; and after the war the authorities sought to allow sterling to be used more freely again. The United Kingdom negotiated monetary agreements with countries whose currencies had a recognised international use before the war, and sterling payments agreements with those countries whose traditional method of settlement with the sterling area had been in sterling.

The monetary agreements provided for the acquisition by each monetary authority of the other's currency, at an agreed rate of exchange and usually up to an agreed limit, with provision for balances above the limit to be settled in gold. The sterling payments agreements were similar to the wartime bilateral arrangements, and provided for the other parties to hold sterling up to agreed limits. Each type of agreement allowed transfers of sterling to and from the accounts of another country (' third country ' transfers) if both signatories agreed; and there was usually provision for the opening of sterling accounts by individual non-residents, so that sterling payments had no longer to be conducted only through official accounts. The new non-resident accounts were designated by the name of the country concerned. Registered Accounts were replaced by American and Swiss accounts, balances on which were still convertible into U.S. dollars and Swiss francs at U.K. official rates.

Third country transfers were generally permitted by the control if the recipient country was short of sterling or was prepared to hold sterling without limit. Such facilities came to be described as administrative transferability. Permission for transactions that added to a third country's sterling balances was refused, however, if it seemed that these were at or near the point where the United Kingdom was liable to settle any further increase in gold. Transfers were allowed only for current transactions and, to avoid adding to the supply of sterling in the free markets, to those countries which observed official rates of exchange.

The first post-war move to convertibility

In July 1946, the Anglo-U.S. Financial Agreement came into force; and one of its provisions was that, within a year, sterling earned in current transactions should be transferable, for current purposes, anywhere in the world. In February 1947 a Transferable Account Area was established, confined to countries which were prepared to ensure that third country transfers through accounts of their residents were made only for current payments. By July 1947, seventeen countries had been included in this Area, and nineteen (including the Central American countries) in an American Account Area. Sterling could be freely transferred for current transactions between these thirty-six countries and to – but not from – the sterling area.

However, in the prevailing conditions of world-wide dollar scarcity, the demand after February 1947 to transfer sterling from Transferable Accounts to American Accounts – and thence, at the expense of the United Kingdom's reserves, into dollars – became too great; and in August 1947 the right of Transferable Account countries to use sterling to make payments to the dollar area was withdrawn. It also became necessary to prevent the undue accumulation of sterling by a number of countries with a strong balance of payments – the so-called hard currency countries – in the Transferable Account Area; and between August 1947 and June 1948 Canada, Belgium, Portugal, Italy, Uruguay, the Argentine and Brazil were excluded from the Area. Third country transfers of sterling to these countries again required exchange control permission.

Cheap sterling

The acute shortage of dollars and the strong demand for dollar goods in the years immediately after the war produced a marked lack of equilibrium in trade and payments between the dollar area and the rest of the world; and this led to various types of transactions in 'cheap' sterling.

A typical example of such transactions was the purchase by a non-resident of a sterling area commodity for sterling; the commodity was then sold for dollars at less than the ruling price, and the proceeds were used to buy dollar goods which could be sold in the merchant's own country at a profit which exceeded his loss on the sale of the sterling area commodity. Or a holder of Transferable Account sterling might buy dollar goods, at a premium, for sterling, the seller of the goods using the sterling to meet payments to the sterling area for invisibles, such as freight.

The sterling area's loss of dollars from these practices was considerable. They were checked to some extent by tightening the rules regarding the transferability of sterling within the Transferable Account Area, so that "current transactions" covered only payments to another country for goods and services originating in that country.

Other developments in the early post-war years

Meanwhile, certain current payments, which had been in abeyance during the war, began to be allowed again. A basic allowance for personal travel abroad was introduced in November 1945, of £100 per year for each adult and £50 for a child. This allowance was altered with the balance of payments situation (in 1952, for example, the allowance for an adult was only £25 and, indeed, from October 1947 to May 1948 it was withdrawn entirely), until the restrictions on spending for personal travel were removed in 1959.[1] Transfers to meet the needs of relatives and dependants abroad were allowed on a limited scale (cash gifts to persons abroad were not allowed until 1958 except on compassionate grounds); and charitable bodies were allowed to remit funds, other than for capital purposes, to relieve distress in war-damaged European countries.

1 They were reimposed in 1966, as noted later.

Certain commercial payments, such as those for royalties and for service charges, were also resumed – although in general, unless they were under pre-war agreements, they were only permitted where increased U.K. exports were likely to result. The rules on insurance were relaxed in 1947 and residents were then allowed to insure in any currency – except for life cover, which still had to be written in sterling.

Payments on account of the oil industry were a continuing problem. By 1950, increased production by British companies left fewer opportunities for American companies to supply the U.K. market; and because sterling was not freely transferable, U.S. companies were already unable to sell oil elsewhere for sterling. After discussions, which took account both of the sterling area's shortage of dollars and of the American need for European markets, a series of agreements was reached between the U.K. Government and the individual American oil companies. The companies would be paid partly in dollars and partly in sterling for their exports to the sterling area, the dollar content being related to the dollar proportion of the cost of British companies' production; the American companies' sterling receipts, from sales both to the sterling area and to third countries, were available only for the purchase of goods and services in the sterling area or in the oil-producing countries. These arrangements, which were centralised through London, continued until non-resident sterling became convertible at the end of 1958.

A fresh agreement on film rentals paid to American producers was concluded in 1947. A limited sum was allowed to be transferred in dollars; in addition to this sum further remittances in dollars were allowed, equal to the earnings of British films in the United States. The remaining receipts had to be used for specific purposes, including film production in this country. Agreements on similar lines – but excluding the setting-off of British film earnings in America – continued to be made throughout the 1950's.

Restrictions on capital account continued. Emigrants from the United Kingdom were allowed, after 1945, to transfer £5,000 of their total assets per family to the new country of residence (in annual instalments over four years), any remaining funds in the United Kingdom being controlled. In 1948, the entitlement was reduced to £1,000; and although it was raised again to £5,000 in 1950 for those going to Europe, it was not fully restored for emigrants to North America for another ten years.

Residents' holdings of those restricted securities which had not been vested came under a 'custodianship scheme' provided for in the 1947 Act. This controlled certain categories of sterling and foreign currency securities held in the United Kingdom, whether owned by residents or non-residents, by requiring their deposit with an authorised depositary; securities held outside the country by residents had to be transferred to the order of an authorised depositary. The securities concerned comprised all bearer securities and those on which interest was payable by coupon; and registered certificates issued by a registrar, or transferable to a register, outside the sterling area. Until they had been deposited, the securities in the United Kingdom could not be transferred, nor could interest or redemption monies be collected. The authorised depositary had to complete a declaration that there had been no enemy interest in the securities since 2nd September 1939 and, where they were held in the name of a resident of the sterling area, a declaration that the owner was so resident. A pool of securities was thus built up whose ownership and freedom from enemy interest was established, and which could be dealt in freely. The import of all bearer securities, and the export of all securities, was controlled – those imported having to be vetted for ownership before being put into circulation.

No official exchange was allowed for portfolio investment outside the sterling area, although the proceeds of capital assets – such as real estate, restitution payments, legacies, etc. – were allowed to be invested in foreign currency securities instead of being sold on the official exchange market. Currency was provided for direct investment outside the sterling area only where it promised to increase sterling area exports, or to expand or develop sterling area interests abroad, and where control remained in the United Kingdom.

Relaxations were made in respect of blocked sterling accounts in 1946 and 1947; and from the beginning of 1950 non-residents were given the right to repatriate direct investments which, when they were made, had been approved by the exchange control. The restrictions on granting credit to overseas residents were steadily reduced; and by the middle of 1946 all pre-war types of documentary credits, including credits covering trade between third countries, were allowed – provided that they were self-liquidating within 120 days and used to finance the movement of goods. Restrictions on other forms of credit – such as mail credits, the discount of approved trade bills, and credits covering refinance of sterling area exports – were gradually removed.

The Marshall Plan and the European Payments Union

As noted above, the first post-war attempt to re-establish the convertibility of sterling in terms of the U.S. dollar had to be brought to an end in August 1947. At much the same time, however, there began a series of developments in European economic co-operation, underpinned by American financial assistance, designed to remove some of the barriers to the liberalisation of trade and payments and to strengthen the economies of the major trading and industrial nations. The European Recovery Programme, which was inspired by a speech by the U.S. Secretary of State, General Marshall, was launched in the second half of 1947. American aid was extended to fourteen European countries, including the United Kingdom, through the Organisation for European Economic Co-operation set up in April 1948. To deal specifically with the problems of trade and payments, these countries participated in the Intra-European Payments Agreements, which operated from October 1948 to June 1950. The agreements provided for the establishment of drawing rights on creditor countries in favour of other O.E.E.C. countries which did not possess enough reserves to cover their expected trade deficits; and the drawing rights tended to perpetuate existing bilateral relationships between O.E.E.C. countries. The agreements were followed on 1st July 1950 by the establishment of the European Payments Union, within which balances outstanding between members were settled on a multilateral basis, with the automatic grant of credit to agreed limits.[1]

This removed the necessity for bilateral payments provisions in existing agreements between the United Kingdom and other E.P.U. countries. At the same time, the U.K. balance of payments had improved sufficiently to allow administrative transferability for current purposes over the greater part of the non-dollar world – the main exceptions being countries where free rates were quoted in

1 These developments will be described in more detail in a later article.

the exchange markets or where sterling was not freely accepted on the official market.

The approach to convertibility

The early 1950's marked the beginning of a second, more gradual, approach to the objective of making sterling convertible into any other currency. Throughout this period the Government's policy was to move towards liberalisation of payments, in line with the liberalisation of trade that was then taking place throughout the world. The United Kingdom took a leading part in the general European movement towards convertibility.

An important part of this policy was the re-establishment of organised U.K. markets in primary commodities, many of which had been closed during the war. It was impossible to grant full facilities to all commodity markets for making and receiving payments in foreign exchange, and it was necessary to reopen markets selectively. The schemes introduced before 1951, therefore, applied in the main to commodities produced largely within the sterling area. Those introduced in the years 1952-54, however, applied to commodities produced to a greater extent in countries outside the sterling area.[1]

Exchange control restrictions in regard to Denmark, Norway and Sweden were relaxed early in 1950, after the establishment of the Anglo-Scandinavian Economic Committee (later known as Uniscan); and these countries were given most of the substance of sterling area membership. Their residents were allowed to repatriate capital, and were given freer access to credit in London; exchange control was lifted from exports to these countries, and their currencies were no longer specified.

Other relaxations on capital account were slower to come. From March 1953, blocked sterling balances were allowed to be transferred between residents of the same country or monetary area; and from September 1955 transfer was permitted between all non-residents (except to those in Uniscan countries – to whom the blocked sterling arrangements did not apply – because such transfers would have opened up a channel for disinvestment by non-residents through the official exchange market). By then blocked sterling, or 'security sterling' as it was commonly known, was allowed to be invested in any U.K. quoted security denominated in a sterling area currency and redeemable in not less than five years, the proceeds still being remittable to the holder on maturity. Markets in security sterling developed in foreign centres; and these markets, which were mainly in terms of U.S. dollars, enabled non-residents to repatriate their capital – though at a rate of exchange which was nearly always at a discount on the official rate.

Credit facilities for non-residents were cut back in early 1952, during the balance of payments difficulties associated with the Korean War, but the restrictions were relaxed again in 1953 and 1954. Refinance facilities were also withdrawn in September 1957; in addition, sterling credits for trade between third countries were no longer allowed to provide for payment by usance drafts, and pre-finance facilities were restricted to goods traditionally financed in this way. Usance drafts for third country trade were restored early in 1959, and early in 1962 the refinance of sterling area goods was again allowed – now either by drafts up to 180 days or by overdraft.

The 1950's saw a gradual easing of the restrictions on U.K. overseas direct investment. The immediate post-war stringency

1 A description of developments in the commodity markets was given in an article in the September 1964 *Bulletin*.

gave way to a climate in which investments were allowed which would exploit U.K. firms' expertise, would secure sources of raw materials, or would safeguard existing U.K. assets or markets abroad. By 1956, practically no outward investment that was controlled from the United Kingdom and would show a reasonable economic advantage to this country was refused.

There was also some relaxation of the rules concerning residents' holdings of foreign currency securities. Switching from most foreign currency securities into a quoted security in the same currency, through a market in 'security dollars', had been allowed since 1947; and by 1954 switching was allowed from any non-dollar security into a quoted security in any foreign currency. The market in London for currency securities had grown considerably by then, partly because of purchases by U.K. residents through free markets in Kuwait and Hong Kong and partly because, as described earlier, the proceeds of some capital assets had been allowed to be invested in currency securities instead of being surrendered. The sale or redemption proceeds of non-dollar securities were known as 'soft' dollars, while those of dollar securities, which could still only be switched into other quoted dollar securities, were known as 'hard' dollars. As noted later, the two categories were amalgamated in 1962, to form 'investment currency'; and residents could then switch freely from one currency security to another, provided that it was quoted.

Another important feature of the 1950's was the increasing freedom extended to the London foreign exchange market. The dealing arrangements during the war, described earlier, had first been modified in January 1947, when authorised dealers in foreign exchange were allowed to compensate their purchases and sales of specified currencies and to cover their net positions with the Bank at the close of each day. In December 1951, the Bank widened the spread between their buying and selling rates for the specified and Scandinavian currencies,[1] and authorised dealers were then allowed to deal with their customers and among themselves at market rates within the official limits, to deal in U.S. and Canadian dollars in the respective centres, and to resume arbitrage operations, both spot and forward, between those two currencies and sterling. They were also allowed to maintain open positions in foreign currency, both spot and forward, and to hold spot currency against forward commitments, all within limits laid down by the Bank. At the same time the Bank ceased to quote official rates for forward deals in the specified currencies, and forward quotations were free to move in response to supply and demand. Early in 1952, further relaxations permitted authorised dealers to deal in some European currencies, spot and forward, in the respective countries against sterling paid to or from accounts appropriate to those countries.

From May 1953 onwards, permission to conduct arbitrage was extended for spot transactions – and subsequently for forward operations up to three months – between the currencies of many E.P.U. countries – although it was not permissible (until 1958) to arbitrage between these currencies and U.S. and Canadian dollars. In April 1956, forward arbitrage in European currencies was permitted for periods of up to six months, and in June 1956 authorised dealers were allowed to buy from and sell to non-residents, either spot or forward, any foreign currency against the credit or debit of an appropriate sterling account, thereby giving all non-residents access to the London market.

1 As noted earlier, the Scandinavian currencies were no longer specified early in 1950; they were not specified again until 1954.

The London gold market, which had been closed since 1939, was reopened in March 1954:[1] this then became the normal outlet for sterling area producers and the source for domestic industry; and non-residents were free to buy or sell gold provided that payment was made in sterling bought with dollars, or available for the purchase of dollars. A new type of convertible sterling was introduced – Registered sterling – which could be obtained only through the sale of dollars or gold, and which was freely convertible into U.S. or Canadian dollars.

Also in March 1954, the Transferable Account Area was widened, to include almost all countries outside the sterling area and outside the U.S. and the Canadian dollar areas; and sterling which had accrued from current transactions became freely transferable within the Area. Sterling accounts were reduced to three broad groupings – those of residents within the sterling area, the Transferable Account Area, and the American Account Area and Canada.

Transactions in cheap sterling then again became troublesome. In February 1955, the Bank started to intervene in the New York and Zurich markets to support Transferable sterling; the rate was held at only a fraction below the official sterling/dollar rate, curbing the scope of the free markets and thus in effect virtually establishing convertibility.

Finally, on 27th December 1958, when the E.P.U. was replaced by the European Monetary Agreement, sterling on non-resident account became fully convertible into any currency. Transferable, American, Canadian and Registered Accounts all became simply External Accounts.

By the end of the 1950's, payments to non-residents in respect of current transactions could be made freely, subject only to formal permission. Restrictions still remained on transfers of residents' capital outside the sterling area; and on the transfer of the proceeds of sales of portfolio investments in the United Kingdom by non-residents.[2]

The formal recognition of sterling convertibility took place in February 1961 when the United Kingdom, in company with nine other countries, notified the International Monetary Fund of its acceptance of the obligations of Article VIII of the I.M.F. Agreement.[3] These obligations prevent members restricting current payments without the approval of the I.M.F. and require members, subject to certain provisos, to maintain the convertibility of their currencies. They may, however, by virtue of Article VI of the Agreement, apply controls to capital movements provided that these do not restrict current payments. The other international obligations relevant to exchange control are the codes applying to current and capital transactions adopted by the Organisation for Economic Co-operation and Development: with certain reservations and derogations, the United Kingdom has adhered to these codes.

Intensification of controls

The process of dismantling controls was halted, to a great extent, by the economic crisis of 1961, and there have been few relaxations since then. In May 1962, as noted earlier, the 'hard' and 'soft' dollar markets were amalgamated into one investment currency market, thus allowing residents to switch their foreign currency portfolio investments without distinction between dollar and non-dollar securities. More recently, in April 1967, the restrictions on non-residents' repatriation of capital were relaxed, when security sterling was unified with External sterling. Thereafter, non-residents

1 The London gold market was described in an article in the March 1964 *Bulletin*.
2 From April 1967, as noted below, non-residents have been allowed to convert the sales of such investments at the official rate of exchange.
3 Described in a note in the March 1961 *Bulletin*.

who sold sterling securities and certain other sterling capital items no longer had to repatriate the proceeds through the markets in security sterling, mentioned earlier. The rate for security sterling had for many years been at only a very small discount on the official rate, and it was decided that the restriction was not serving any useful purpose. Indeed, it was hoped that as sales proceeds could in future be repatriated at the official rate, there would be an increase in investment in sterling securities, which would help the balance of payments.

The principal steps to intensify exchange control, taken in 1961 and after, are described briefly below.

Direct investment

In July 1961 restrictions were imposed on direct investment in countries outside the sterling area. Fresh investment qualified for official exchange only if it would produce clear and commensurate benefits to U.K. export earnings and to the balance of payments in the short term, which was defined as within two or three years. The result was that companies which could not meet the criteria, and could not raise capital abroad in foreign currency, were precluded from investing. This caused difficulty for some companies, particularly those needing further finance for existing investments. From May 1962, therefore, companies whose investment did not qualify for foreign currency at the official rate of exchange were allowed to buy the currency in the investment currency market, described earlier, at the current premium (then around 3%). This was the first time that the investment currency market was allowed to be used other than for portfolio investment.

In 1965, further restrictions were placed on direct investment outside the sterling area. In April the criteria for obtaining official exchange were made rather more stringent; not only had there to be a commensurate return in the short term but this had to continue thereafter. And from July foreign currency could no longer be acquired at the official rate, even though the investment met the criteria. All direct investment had then to be financed either with investment currency or by borrowing foreign currency abroad.

In May 1966 the rules were tightened yet again, and the use of investment currency for direct investment was reserved for projects which could meet the criteria; all other investment had to be financed from foreign currency borrowing. This remains the position today.

The investment currency market

In April and July 1965, the right of U.K. residents to sell the proceeds of certain capital items, such as legacies and gifts, in the investment currency market – and to obtain the benefit of the sterling premium in that market – was withdrawn. The proceeds had to be sold instead at the official rate of exchange, thus benefiting the reserves rather than adding to the pool of investment currency.

Another step to improve the reserves, at the expense of the pool of privately-owned foreign currency securities, was taken in April 1965. Thereafter, 25% of the proceeds of all sales of foreign currency securities, including sales abroad for the purpose of switching investments, had to be sold in the official exchange market, leaving only 75% available for sale as investment currency or for reinvestment.

Property currency

From April 1965, U.K. residents were no longer allowed to buy property outside the sterling area for private use with investment currency, which had been permissible since April 1964. Instead, they were required either to buy the property for sterling from another resident or to purchase foreign currency in the 'property currency' market, at the current premium. This did not affect property deals by development companies, which continued to be dealt with in the context of overseas direct investment.

Sterling lending to U.K. companies owned or partly owned by non-residents

From July 1965, a more uniform control was exercised over sterling lending to finance non-resident interests in U.K. companies, mainly to ensure that the non-resident's share of the fixed assets of the U.K. company was financed with foreign currency, rather than with sterling raised in the United Kingdom. Except for companies engaged in certain types of activity – such as investment, property and importing – no restrictions were placed on the borrowing of sterling in the United Kingdom for the day-to-day operations of the company.

Travel

The more stringent exercise of exchange control was not confined entirely to capital items. From April 1965, a stricter check was kept on the provision of foreign currency for overseas travel, although this remained unrestricted for bona fide travel. In July 1966, however, a waiver was obtained from the United Kingdom's obligations under Article VIII of the I.M.F. Agreement, and a basic travel allowance was reintroduced for travel in countries outside the sterling area.

Cash gifts

In line with the introduction of a basic travel allowance, the amount of cash gifts that U.K. residents could make to residents outside the sterling area was reduced in July 1966 from £250 to £50 a year.

Prepayment for imports

Because of the tendency for imports into this country to be paid for earlier than had been the custom in the past, it was decided in July 1965 that payment should not normally be allowed before the goods were ready for despatch to the United Kingdom by the foreign seller.

The voluntary programme

Although this does not fall strictly under the heading of exchange control, a review of the post-1961 arrangements would not be complete without a reference to the measures taken in May 1966 in relation to the four main developed countries of the sterling area (Australia, New Zealand, South Africa and the Irish Republic). With the object of strengthening the U.K. balance of payments, and against the background of the very severe restrictions on investment in countries outside the sterling area, U.K. companies which had plans for investment in the four countries mentioned were asked whether such investment which did not satisfy the criteria applied to direct investment outside the sterling area (noted above) could be postponed for the time being; alternatively, if that was not practicable, whether the finance for such projects could be raised from local sources.

As regards portfolio investment, institutional investors were asked to ensure that, while the voluntary programme was in being, there should be no significant increase in their holdings of securities denominated in the currencies of the four countries. This request was extended to holdings of securities denominated in currencies of countries outside the sterling area.

Rhodesia

In connection with the imposition of sanctions against Rhodesia, that territory was excluded from the sterling area; and strict control was imposed on all payments by U.K. residents to Rhodesia and by residents of Rhodesia from their sterling accounts. Restrictions were also placed on other transactions undertaken by or on behalf of residents of Rhodesia, for example, those in securities.

Conclusion

This article has briefly reviewed the development of exchange control in the United Kingdom over the past thirty years. The objective of this control is to conserve foreign exchange and directly to improve the U.K. balance of payments and the reserves. The use made of it as an instrument of economic policy has varied over the years – according to the view currently taken of the need to conserve foreign exchange, and of the merits of direct, rather than indirect, action to this end.