

ECONOMIC NOTES

EASING OF EXCHANGE CONTROL REGULATIONS

An easing of exchange control regulations which will allow New Zealand residents to purchase foreign exchange for investment purposes was announced by the Governor of the Reserve Bank, Mr Spencer Russell on 21 December 1984.

However, purchases and sales of foreign currency must still be made through a trading bank or an authorised foreign exchange dealer and that the party concerned would be required to make a written declaration of the purposes of the transfer. This would allow the Reserve Bank to monitor currency movements and to compile statistical information.

While New Zealand residents had been able to purchase foreign currency for their current needs, for example for travel, there had been quite severe restrictions for many years on outward remittances to acquire assets such as shares or property. These restrictions were designed to conserve foreign exchange in the context of a generally over-valued exchange rate. With the move to a more appropriate exchange rate and market determined interest rates, these restrictions are considered to be unnecessary.

The new arrangements would permit New Zealand residents to purchase shares in overseas companies and would facilitate the setting up of New Zealand business enterprises overseas. However, they did not affect the Overseas Investment Regulations and overseas interests, who wished to take over New Zealand companies or to set up business in New Zealand, would still require the approval of the Overseas Investment Commission.

Owners of overseas scrip at present held by the Reserve Bank under the Controlled Securities Regulations were now free to uplift it and do with it as they wished.

BACKGROUND TO THE CHANGES TO EXCHANGE CONTROLS

Exchange controls were first introduced in New Zealand in December 1938 and have remained in one form or another since that time.

The general purpose was at first to assist in the conservation of foreign exchange reserves and to give an added measure of control over the flow of foreign exchange into and out of New Zealand.

Over the last decade there has been a general relaxation in the intensity of the controls in part reflecting the realities of a more complex international financial environment into which the cumbersome bureaucracy of exchange controls does not fit readily, and in part reflecting the recognition that such direct controls can never adequately suppress the consequences of inappropriate monetary, fiscal and exchange rate policies and are not a substitute for sound economic management.

In the current New Zealand environment much of the Exchange Control Regulations have become essentially redundant. For some years the administration of the Regulations has focussed on constraining outward capital remittances by New Zealand residents with the

rest of the exchange control regime doing little more than provide a means to authenticate the nature of the transactions undertaken and to provide statistical information.

The removal of interest rate controls and the devaluation in July have removed the only remaining rationale for exchange controls. It is no longer necessary to require New Zealand residents to confine their savings and investments to New Zealand. Already New Zealand is being recognised as an attractive investment location by non-residents. Given continuing sound economic management there is no reason why New Zealand residents should not enjoy the same freedoms that the residents of other developed nations enjoy in being able to make their own choices as to where they spend their money and invest their savings.

The effectiveness of exchange control as a means of impeding foreign exchange flows is also questionable. As was amply demonstrated in June and July of 1984 there is wide scope for foreign currency flows to occur even within the current account. It makes little sense therefore to focus control on the capital account in that situation.

Apart from the relative ineffectiveness in controlling foreign exchange flows, the Exchange Control Regulations impose inordinately heavy costs in compliance and enforcement of the rules. Within the Reserve Bank about 45 staff members were engaged full-time in administering the Regulations. The trading banks and foreign exchange dealers require a rather larger number of people for the same purpose. For the corporate sector involved in international trade there is also a very heavy cost in providing the detailed returns and information required to authenticate foreign exchange transactions.

In the year to March 1984 approximately 760,000 applications for exchange control approvals were received and processed by the Reserve Bank. Of that number about 100 (i.e. 0.013 per cent) were declined involving remittances equal to 0.011 per cent of total overseas exchange payments for that year. Increased delegations to the dealers would have reduced the Reserve Bank figures in more recent months although the paper work still has to be handled by the dealers. The work involved in administering the Regulations is further boosted by a vast amount of correspondence (not counted in the number of applications given above) by work involved in authenticating the proper receipt of export proceeds, and by the administration of the overseas share depository.

Fifty years of experience with exchange control has convinced most involved that the controls are generally ineffective. If applied with vigour they tend to be arbitrary, inequitable in their impact, and costly for both the administrators and the administered. Even vigorous application does not ensure they will be effective in restraining foreign exchange usage and channelling the available exchange through official channels.

Moreover, exchange controls are similar to import licensing in that they tend to confer a privileged position upon the holder of the exchange control permit. If enforced vigorously the controls ration the supply of overseas exchange but fail to tackle the fundamental problem of an excess demand for foreign currency. Thus exchange controls fail, other than perhaps for very

short periods, to help a country resolve its external difficulties and in the longer term set up counter-productive resource misallocation effects.

If exchange control restrictions on payments are severe, those people who have funds accruing overseas tend not to repatriate them but to hold them overseas either for their own use or for sale to other New Zealand residents. Once foreign exchange acquires a scarcity value in the hands of private owners (and this is what rigorously enforced exchanged control gives it) it is illegally held onto rather than converted to New Zealand currency; or alternatively it may be sought in the black market. Earlier experience suggests that official reserves may lose more because of these types of action than is saved from the expenditure discouraged or prevented by the exchange controls.

Now that interest rates in New Zealand are market determined; monetary and fiscal policies are being firmed up; the exchange rate is at a more realistic level; and overseas reserves have been rebuilt to a more acceptable level, the exchange control system has clearly become redundant. It is for these reasons that further relaxations in the controls have been decided upon.

MONETARY POLICY MEASURES: LIQUIDITY MANAGEMENT

The Reserve Bank released on 21 December, 1984, details of a number of measures which will affect the way liquidity management operations are conducted in future.

Discount Policy

Effective from Monday, 24 December 1984, the Reserve Bank will be prepared to buy on demand only Government securities with six months or less to maturity. The Bank will not be prepared to discount longer-dated stock, other than in exceptional circumstances. Previously, the margin at which the Bank would discount longer-dated stock was larger than for short stock and the Bank has not discounted any stock with more than six months to maturity since October. The Bank will continue to discount Government paper with six months or less to maturity on demand and at a pre-announced margin which will initially be the same as that currently applicable to short-dated paper — namely 1 percentage point above the selling yield. This margin will be adjusted from time to time in line with changing market conditions.

Treasury Bill Tendering

Treasury bills are in future to be issued by tender rather than on a tap basis. An outline of the way Treasury bill tenders are expected to operate was provided in a discussion note circulated to the market on 14 November 1984. It is intended that the tenders will be held weekly.

Open Market Operations

The Reserve Bank will in future be more active in dealing in the market for short-term paper on a day-to-day basis in order to smooth out any major unforeseen fluctuations in liquidity. With the overall stance of monetary policy being determined by the government stock tenders, it is intended that the Bank's open market operations should over time be more or less neutral.

Treasury Bill Tendering

Treasury bills are in future to be issued by tender rather than on a tap basis. An outline of the way Treasury bill tenders are expected to operate was provided in a discussion note circulated to the market on 14 November 1984. It is intended that the tenders will be held weekly on a Tuesday. Details of the bills to be offered will be announced one working day prior to the tender. It is intended that results will be announced at 4.00 p.m. on the day of the tender. Announcement of results will be made in the same manner as the announcement of tender details with a notice being posted in the foyers at branches of the Reserve Bank.

The term of bills to be offered will normally be 42, 91, 119 and 182 day maturities. All four maturities will not necessarily be offered at each tender. The choice of maturities will be determined on the basis of timing of expected liquidity drains from the system. While it is intended that those standard terms be adhered to, movement to other maturities may be made should such a movement be regarded as desirable. Bills will be offered for fixed terms from the date of settlement, rather than for fixed maturity dates.

The main differences from the stock tender system are:

- (i) an over-subscription facility of up to 50% in any maturity subject to a proviso that the total amount sold does not exceed the amount on offer (compared with 20% for the stock tenders);
- (ii) no non-competitive facility.

Interest on Settlement Balances

Effective from 1 January 1985, the Reserve Bank will pay an interest rate of 5 per cent on the deposits held with the Bank by those financial institutions which are engaged in the settlement process; namely the four trading banks and the Post Office Savings Bank. Previously no interest has been paid on settlement balances and the institutions have generally maintained only minimal working balances in their accounts at the Reserve Bank. In future, however, the advent of Treasury bill tendering may require institutions, as part of their portfolio management, to hold larger and more variable cash balances. The move to pay interest on Reserve Bank deposits reflects this change. The rate will be kept under review and may be adjusted from time-to-time as part of the overall liquidity management package.

Compensatory Deposits Scheme

A Compensatory Deposits scheme will be operated for the last time in March 1985. Under this scheme, the Reserve Bank has made deposits with the trading banks in the March and September tax flow periods in order to help smooth out the liquidity effects of the tax payments. Beyond March 1985 however, a specialist funding scheme of this type will not be provided. Rather, financial institutions will be expected to build up their holdings of liquid assets between the main tax collection periods in order to fund the drain which occurs every March and September. Treasury bill tender policy will reflect those seasonal needs, and, in addition, Reserve Bank open market operations should also play a more prominent role over these periods than in the past. The timing of the Government's borrowing programme through the stock tenders may also be adjusted to take account of at least the main tax payment period each March.