IMF Working Paper

WP/97/157 INTERNATIONAL MONETARY FUND

Monetary and Exchange Affairs Department

Sequencing Capital Account Liberalization: Lessons from the Experiences in Chile, Indonesia, Korea, and Thailand

Prepared by R. Barry Johnston, Salim M. Darbar, and Claudia Echeverria[1]

November 1997

Abstract

This paper examines issues in sequencing and pacing capital account liberalization and draws lessons from experience in four countries (Chile, Indonesia, Korea, and Thailand). The paper focuses on the interrelationship between capital account liberalization, domestic financial sector reforms, and the design of monetary and exchange rate policy. It concludes that capital account liberalization should be approached as an integrated part of comprehensive reform strategies and should be paced with the implementation of appropriate macroeconomic and exchange rate policies.

JEL Classification Numbers: E52, F21, F31, G28

Keywords: Financial sector reform; currency convertibility; capital flows

Author's E-Mail Address: bjohnston@imf.org; sdarbar@imf.org; cecheverria@imf.org

---

[1]Salim M. Darbar was in the Monetary and Exchange Affairs Department at the time this paper was prepared and is currently in the African Department. The authors are grateful to Timothy Bond, James Gordon, Inci Otker, Mahmood Pradhan, Paulo Heuhaus, Robert K. Rennhack, and participants in an MAE Departmental workshop for their comments on an earlier draft of this paper.

Contents | Pages

Summary 4

I. Introduction 5

II. A Conceptual Framework for Orderly Capital Account Liberalization 5
A. The Need for an Integrated Approach to Capital Account Liberalization and Financial Sector Reform 6
B. The Need to Pace Capital Account Liberalization with Macroeconomic Policy Design 9
C. Consequences for the Pace and Sequencing of Capital Account Liberalization . 11

III. Selected Country Experiences with Sequencing Capital Account Liberalization 12
A. Chile 13
B. Indonesia 19
C. Korea 24
D. Thailand 29

IV. Lessons From the Country Experiences 34
A. Sequencing of Reforms 34
B. Macroeconomic Management of the Liberalizations 35

V. Conclusion 39

Tables

1. Chile: Sequencing of External and Domestic Financial Liberalization, 1985–96 . . . 14
2. Indonesia: Sequencing of External and Domestic Financial Liberalization, 1985–96 20
3. Korea: Sequencing of External and Domestic Financial Liberalization, 1985–96 . . . 25
4. Thailand: Sequencing of External and Domestic Financial Liberalization, 1985–August 1997 30
5. Averages of Selected Economic Indicators for Chile, Indonesia, Korea, and Thailand 36

Charts

1. Chile: Selected Macroeconomic Indicators, 1985–96 15
2. Indonesia: Selected Macroeconomic Indicators, 1985–96 21
3. Korea: Selected Macroeconomic Indicators, 1985–96 26
4. Thailand: Selected Macroeconomic Indicators, 1985–96 31
5. Capital Flows, Private Sector Credit, and Current Account Deficit, 1985–96 37

Appendix Tables

6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96 40
7. Chile: Selected Macroeconomic, Financial Sector, and Balances of Payments Indicators 50
8. Chile: Abstract of Exchange and Capital Control Regime as of April 30, 1997 51
9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96 57
10. Indonesia: Selected Macroeconomic, Financial Sector and Balance of Payments Indicators 67
11. Indonesia: Abstract of Exchange and Capital Control Regime as of July 31, 1997 68
12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96 72
13. Korea: Selected Macroeconomic, Financial Sector and Balance of Payments Indicators 89
14. Korea: Abstract of Exchange and Capital Control Regime as of August 31, 1997 90
15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997 96
16. Thailand: Selected Macroeconomic, Financial Sector and Balance of Payments Indicators 109
17. Thailand: Abstract of Exchange and Capital Control Regime as of September 10, 1997 110

References 114

SUMMARY

This paper examines the sequencing of capital account liberalization and draws lessons from experience in four emerging market economies—Chile, Indonesia, Korea, and Thailand. The paper provides detailed information on the sequence of reforms to domestic and external transactions for the period 1985–96, and in the case of Thailand covers the period leading up to the 1997 currency crisis. This information is reviewed against the background of developments in the balance of payments, and macroeconomic and exchange rate policies.

Broad conclusions and considerations for the approach to capital account liberalization are developed as a result of the country survey. First, there is a fundamental need to adopt a comprehensive and coordinated approach to reforms to the domestic financial sector and the capital account. Second, the management of capital flows depends on the overall incentive structure for such flows, with the configuration of interest rates and exchange rates, as well as the stage of development of the domestic financial systems, appearing to be critical.

The analysis throws some light on why the liberalization of capital flows was associated with a currency crisis in Thailand, which followed a policy of actively promoting capital inflows. At the same time, the strengthening of financial institutions and the development of indirect monetary instruments lagged the liberalization of the capital account in Thailand. Finally, Thailand's fixed exchange rate limited the autonomy of monetary policy in dealing with capital inflows and helped to create unsustainable expectations about the rates of return.

I. Introduction

Capital account liberalization can have significant benefits for economic growth and welfare. The benefits arise from: the improved ability to tap savings globally (at lower cost than using only domestic savings); allowing domestic economic agents freedom to choose how and where to borrow, invest, or exchange assets; improvements in resource allocation through increased competition for financial resources; and the increased availability of resources to support investment, and to finance trade, and other significant economic entities. At the same time, however, the opening of the capital account entails certain risks, if not accompanied by the necessary structural reforms and macroeconomic policies.

Against this background, attention needs to be paid to sequencing capital account liberalization with structural measures, especially in the monetary and financial sector, and to pacing liberalization in conjunction with the development of appropriate macroeconomic policies. This paper examines some of the general issues involved in the sequencing and pacing of capital account liberalization and draws lessons from the experience of emerging market economies which have liberalized their capital accounts and which have received large capital inflows—those of Chile, Indonesia, Korea, and Thailand. These countries were chosen in order to illustrate the diversity as well as some of the similarities of approaches toward capital account liberalization. The information reviewed is for the period 1985–96, but has been extended to 1997 in the case of Thailand to include the period leading up to the 1997 crisis.

A complete analysis of the role of capital account liberalization would require a comprehensive assessment of structural and macroeconomic policies. This paper focuses on certain interrelationships and key variables that are considered critical. Specifically, the study focuses on the interrelationships between capital account liberalization and (1) the development of domestic financial markets, instruments and institutions; (2) reforms to foreign exchange and trade systems; (3) the development in countries' balance of payments; and (4) the role of monetary and exchange rate policy.

The remainder of the paper is organized as follows: Section II discusses a conceptual approach to the orderly liberalization of controls on capital movements; Section III describes the specific country experiences 1985–96; Section IV reviews the lessons from these countries' experiences; and Section V provides the conclusions.

II. A Conceptual Framework for Orderly Capital Account Liberalization

The conventional view with regard to the liberalization of the capital account is that it should follow liberalization of the current account and the domestic financial system (see for example, McKinnon 1973, 1982; Frenkel 1982; Edwards 1984). Others have argued for simultaneous liberalization of the current and capital accounts (see for example, Little, Scitovsky, and Scott 1970; Michaely 1986; Krueger 1984). Hanson (1994) suggests that a stable macroeconomy and domestic financial liberalization to a significant degree are preconditions to international financial liberalization. While our own assessment does not necessarily contradict these views, the results of the survey indicates that the liberalization of the capital account and other aspects of economic and financial sector reform is a good deal more complex and not readily open to stylized presentations on sequencing. Different components and aspects of the capital account were liberalized at various stages, along with aspects of the current account and domestic financial sector in line with countries' overall macroeconomic objectives. In some instances liberalizing or easing of restrictions were in response to adverse macroeconomic developments. The survey does, however, lead to broad conclusions about the conceptual framework for an orderly liberalization of the capital account. This framework is discussed below.

A. The Need for an Integrated Approach to Capital Account Liberalization and Financial Sector Reform

The first broad conclusion from this survey is that there is a fundamental need for an integrated approach to capital account liberalization and financial sector reform. It is erroneous to draw sharp distinctions between the public policy approach to the deregulation of the capital account on the one hand, and the approach to the regulation and development of financial markets on the other. Rather capital account liberalization should be treated as an integral part of economic reform programs.

More specifically, the liberalization on direct investment is often a significant part of real sector reforms, while the liberalization of portfolio investment flows is often coordinated with financial sector reforms and the development of financial markets and instruments:

- Liberalizations of *direct investment* inflows have often gone hand-in-hand with reforms aimed at strengthening the real sector and export potential of the economy, including reforms to the trade and investment regimes, exchange rate adjustments to improve competitiveness, and liberalization of exchange controls on current international transactions. Such capital account liberalizations have aimed, for example, at supporting the development and restructuring of selective industries and sectors, through management and technology transfers, injections of foreign capital and liberalization of access to trade finance.

- Liberalizations of *portfolio capital flows* have tended to be coordinated with domestic financial sector liberalization and reforms—liberalization of interest rates, development of indirect monetary control procedures, and strengthening banks and capital markets.

There are a number of reasons for adopting a coordinated and comprehensive approach to financial sector reforms and capital account liberalization. First, from a macroeconomic and balance of payments perspective, the stage of development and the stability of domestic financial systems have key influences on the growth and composition of capital movements. Such factors are often as important, if not more so, in explaining the volume and nature of the capital flows than the particular regulatory framework for such movements. Countries with developed financial markets and institutions have been better able to attract portfolio capital flows than countries where such markets are just emerging. In some circumstances, concerns about banking solvency or inadequate regulatory frameworks have discouraged foreign investment or encouraged capital flight regardless of the capital control framework. Financial sector weakness may also contribute to currency crises to the extent the weaknesses are seen as limiting the scope or the willingness of authorities to use interest rates to defend the currency; or cast doubts on the prospects of the economy more generally (e.g., recognition that addressing financial sector weakness may have significant budgetary costs); or cast doubts on the political autonomy and integrity/governance of financial institutions.

Secondly, and conversely, the opening of the capital account can have important implications for financial markets and institutions. In many cases, the implications are positive in that the liberalizations help to develop deeper, more competitive and more diversified financial markets. The sophistication of domestic financial markets can also be improved if foreign financial firms are allowed to operate directly in the country. The greater volume of intermediation and increased competition that may accompany capital account liberalizations, however, may also increase pressure on previously protected domestic financial institutions and bring weaknesses to the fore in such institutions. Some countries have been confronted with banking crises when faced with sudden inflows and subsequent sharp reversals in capital flows. The banking sector problems may be exacerbated by significant open positions of banks, or their borrowers. In such cases, adjustments in interest rates and exchange rates can reduce the net worth of financial institutions if they have not developed adequate mechanisms to manage interest and exchange rate risks. Countries with sounder banking systems have been better able to handle reversals in capital inflows since under these circumstances of a strong financial system, banking weaknesses did not constrain interest rate and exchange rate policies.

Third, the efficiency of use of capital flows and thus the extent to which such flows contribute to sustained improvements in economic performance depends on the stage of development and efficiency of the financial domestic system. This in turn may depend on the existence of a well-regulated and supervised financial system, and the elimination of various sources of market failures that may be the legacy of previous financial repression. Consequently, there is a need for sequencing the liberalization of the capital consistent with the reforms of domestic financial markets and institutions.[2]

Fourth, successful and sustained opening of the capital account requires the existence of a minimum set of instruments, institutions and markets for the effective management of monetary and exchange rate policy with an open capital account. High capital mobility alters the effectiveness of different monetary instruments in achieving the objectives of monetary policy. On the one hand, instruments that impose a high cost or administrative constraint on

[2]For a discussion of the sources of such market failures and the need for supporting reforms, see Johnston (1997).

the banks—as is the case with credit or interest rates ceilings or high nonrenumerated reserve requirements—may be circumvented more easily by disintermediation through the capital account, and therefore become less effective. On the other hand, with an open capital account, monetary instruments which operate on the overall cost of money or credit in financial markets may be transmitted more rapidly to credit and exchange markets and allow the central bank to influence the decisions of financial institutions and markets that operate in its domestic currency, both locally and internationally. Indirect monetary instruments, such as open-market operations, therefore come to play a core role for the purpose of steering interest rates, managing the liquidity situation in the market, and signaling the stance of monetary policy.

Fifth, as a practical matter, the distinction between capital controls and financial regulations may not be straightforward. Indeed, many controls on capital movements are often exercised through regulations on the underlying capital transactions rather than the associated payments and receipts. A number of capital controls are in the form of financial regulatory measures, including reserve requirements which discriminate between residents and nonresidents, or may be the consequence of the particular regulatory frameworks for financial markets and financial institutions. An analysis of the regulatory factors influencing capital movements therefore requires a more complete understanding of overall financial regulatory frameworks, and the extent to which limitations on capital movements are an incidental consequence of the need to protect investors and exercise prudential oversight over financial institutions or a deliberate attempt to influence the volume of capital movements for macroeconomic and balance of payments reasons.

Finally, the dynamics of reforms might also argue for synchronization of domestic financial sector reforms and the liberalization of capital movements. Financial sector reforms often involve a rapid monetization of the economy and a period during which the growth of credit exceeds that of money as agents adjust to the elimination of financial repression.[3] Capital account liberalizations are often associated with initial surpluses in the capital account of the balance of payments reflecting the improved investor environment and the return of flight capital.[4] If confronted separately, each of these factors can create problems for monetary and macroeconomic management. However, if confronted together, the adjustments in the monetary and external sectors can be offsetting to some extent.[5] Thus, the more rapid growth of credit than money following domestic financial sector liberalization would, ceteris paribus, tend to place pressure on the balance of payments. This pressure may be offset through the return of flight capital that may accompany the liberalization of the capital account. Both adjustments of asset portfolios reflect the elimination of financial repression and are in this sense equilibrating. However, circumstances could also arise where the capital inflows

---

[3]See Bisat, Johnston, and Sundararajan (1992).

[4]See Johnston and Ryan (1994).

[5]See Johnston (1997).

contribute to a more rapid expansion in bank credits. In the latter case, simultaneous financial sector and capital account liberalization could compound the macroeconomic management difficulties. This is likely to be a particular concern when there is limited autonomy in monetary policy.

B. The Need to Pace Capital Account Liberalization with Macroeconomic Policy Design

The second broad conclusion from the survey is the need to pace capital account liberalization with macroeconomic policy. What is generally important for managing the volume of capital flows is the overall incentive structure that can give rise to such flows. This incentive structure will be influenced by a number of factors including the particular regulatory frameworks, and as already noted the stage of development and soundness of the financial systems. However, what is also critical is the configuration of interest rates and exchange rates.

As a general proposition, stock-flow portfolio analysis can be applied to analyze the factors influencing capital movements.[6] This framework is also useful in distinguishing between the short- and longer-run effects of capital controls. In the short-run, the "grit in the wheels" effect of capital controls might allow a country temporarily to reduce the rate of capital flows but over time investors will adjust their portfolios to reflect portfolio balance considerations. The longer-run impact of controls on capital flows will thus depend on whether the regulations increase or reduce risk adjusted rates of return. The observed capital flight in countries maintaining controls, and the observed net strengthening of the capital account when countries eliminate controls, suggests that capital controls are generally treated by investors as an additional risk factor. This leads to the seemingly perverse conclusion that a country restricting capital flows would have to maintain higher interest rates to compensate for the increased risks. Nevertheless, evidence from curb markets in countries with repressed financial systems would generally support this view. Thus, contrary to the usual assumption that capital controls can help reduce local interest rates and limit outflows, one of the major considerations in capital account liberalization is the management of the inflows that are likely to follow such liberalization in view of the decline in investor risk premiums. Similarly, the degree of protection that capital controls provide to individual markets and institutions will depend on the extent to which there would be second round portfolio adjustments. For example, capital flows into security markets are likely to have an expansionary impact on the balance sheets of domestic banks as well, because of liquidity effects and portfolio adjustments that would follow changes in relative interest rates and assets prices, even if there are controls on inflows to commercial banks.

---

[6]For an early discussion of stock-flow portfolio analysis as applied to international capital movements, see Mundell (1963). See also McKinnon and Oates (1966), and Branson (1974).

A portfolio balance approach is complemented with the covered interest rate parity condition which is the consequence of arbitrage between short-term domestic and foreign interest rates, and the discount on the currency in the forward exchange market. The covered interest rate parity condition can be written as follows:

$i_d = i_f + F_d$

where $F_d = \frac{e^f - e^s}{e^s} \times 100$, i_d is the domestic interest, i_f the foreign interest rate of the same maturity and F_d, the forward discount for that maturity, e^s is the rate of exchange (units of domestic currency in terms of a foreign currency) in the spot exchange market, and e^f the forward exchange rate on the date of maturity of the interest rate contracts. Thus, where the foreign interest rate and forward exchange rate are predetermined, a country could determine the domestic interest rate or the spot exchange rate, but not both.

With greater freedom of capital movements, short-term interest rates will increasingly be determined by the covered interest rate parity condition. An attempt to set both interest rates and exchange rates which are inconsistent with this condition could give rise to incentives for significant short-term capital flows. The potential magnitude of such flows will, inter alia, reflect the expectations for the currency and the particular exchange rate.

Thus, with increased capital mobility, the capacity to assign monetary and exchange policies to achieve different macroeconomic targets will be increasingly constrained. If monetary policy is targeted to constraining inflation, the exchange rate would not be free, for example, to be used as an expenditure switching instrument to achieve objectives for the current account. Fiscal policy could be used to influence the savings/investment balance to achieve such objectives but not monetary and exchange rate policy. Conversely, if the exchange rate is targeted to achieve objectives for the current account, or if the exchange rate is fixed, monetary policy would be left with little autonomy to achieve domestic stabilization objectives.

Assigning monetary policy, and consequently exchange rate policy, the task of domestic stabilization, may require that either exchange rates or domestic interest rates, or both, are allowed to become more flexible. Higher capital mobility may also result in greater volatility in interest rates or exchange rates in view of the sensitivity of capital flows to changes in market sentiment and the more rapid transmission of shocks and potential contagion affects. Greater flexibility of the exchange rate or interest rates may help discourage short-term speculative flows that exploit inconsistent interest rate and exchange rate alignments. Where capital is attracted by high domestic interest rates as part of a disinflationary program, temporary appreciation of the exchange rate may help to support the disinflationary strategy and allow for a more rapid lowering of domestic interest rates to international levels while meeting the inflation target. Once inflation and interest rates have been brought down, the exchange rate should also adjust to a level consistent with a sustainable balance of payments. The costs would depend on whether export performance would be seriously affected by a temporary appreciation in the exchange rate, as well as whether markets exit to hedge the risks of greater volatility.

One of the risks of assigning exchange rate policy to current account objectives and relying on fiscal consolidation to achieve domestic stabilization with an open capital account is that the authorities' freedom to deal with speculative short-term flows is likely to be quite seriously constrained by the limited short-run flexibility of fiscal policy. Countries have as a consequence resorted to capital controls in these circumstances. However, the extent to which capital controls can be used to manage the overall volume and structure of capital flows is questionable. Thus, the viability of such an assignment of instruments to targets also appears questionable with the increased volumes of capital flows.

C. Consequences for the Pace and Sequencing of Capital Account Liberalization

The consequences of the above analysis is that capital account liberalization should be integrated with the design of structural and macroeconomic policies. Maximizing the benefits from capital account liberalization while minimizing the risks requires a comprehensive approach to reforms.

A comprehensive approach will generally involve the coordination of the liberalizations of portfolio capital flows with domestic financial sector liberalization and reforms—liberalization of interest rates, development of indirect monetary control procedures, and strengthening banks and capital markets including through improved regulations. Lack of coordination between domestic financial sector and the capital account reforms can create distortions and regulatory incentives for capital movements that are unrelated to the underlying economic conditions, thus risking greater instability in capital movements. At the same time, there would be good reasons to coordinate liberalization of foreign direct investment with reforms aimed at strengthening the real sector and export potential of the economy, including reforms to the trade and investment regimes, exchange rate adjustments to improve competitiveness, and liberalization of exchange controls on current international transactions.

Where financial systems are weak, the preferred policy would be to address the institutional weaknesses in advance of, or concurrent with, the liberalization of the capital account. Countries may also need to rely temporarily on selective capital controls as part of their financial regulatory frameworks where their institutional capacity to implement prudential regulations that reflects international best practice is still developing. However, in view of the fungibility of capital, too much reliance cannot be placed on capital controls in protecting particular institutions and markets.[7] Consequently, it is important for countries

---

[7]For a discussion of the effectiveness of capital controls, see Johnston and Ryan (1994), Cardoso and Goldfajn (1997), and Dooley (1995).

where necessary to make rapid progress in strengthening financial markets and institutions generally.

A comprehensive approach would also require attention to the establishment of an appropriate and consistent mix of macroeconomic and exchange rate policies. This may well require a reorientation of monetary and exchange rate policy to provide appropriate autonomy of monetary policy in dealing with capital inflows.

Although in general it would be advisable to have well-planned and sequenced reforms, this does not necessarily imply a gradualist approach. Rather it calls for coordinated and concurrent reforms irrespective of the pace of the reforms. It also has to be acknowledged that in some cases a faster liberalization of the capital account than in other areas of the economic and financial sector reform program may be desirable. More rapid capital account liberalization can provide momentum to the overall reform process by weakening entrenched vested interests and the bureaucratic control on private sector activities. It can also help to develop markets by increasing competition and promoting a larger volume of capital flows. In such cases, faster liberalization of the capital account would require similarly rapid progress in the necessary concurrent reforms to domestic financial markets and institutions and in adapting the macroeconomic policy framework. Speeding up these reforms is desirable in any event in view of the limited extent to which countries can insulate themselves from the market.

III. SELECTED COUNTRY EXPERIENCES WITH SEQUENCING CAPITAL ACCOUNT LIBERALIZATION

This section discusses the four country experiences with capital account liberalization from 1985–96. For each country, a detailed country matrix describing the sequence of reforms to domestic and external transactions is provided in the Appendix with a summary of measures in the text. Domestic reforms have been grouped into reforms to: (a) the financial supervisory and regulatory framework; (b) the development of money markets and instruments; and (c) the development of capital markets, while external reforms are grouped into reforms to (d) the exchange market arrangement and system; (e) direct investment; (f) portfolio investment; (g) the trade regime; and (h) introduction of restrictions on capital flows. Items (e), (f), and (h) distinguish between capital inflows and outflows.[8] Appendix Tables also present selected macroeconomic and balance of payments indicators. For reference purposes, information on the stock position for the exchange and capital control regimes is also provided in the Appendix.

---

[8]Whether a capital control measure would impact mainly on capital inflows or capital outflows may not be straightforward. For example, a control on the liquidation and repatriation of foreign held capital, while strictly a control of capital outflows, has often been maintained for the purpose of discouraging capital inflows. Moreover, there is overlap between certain measures classified as exchange system measures and measures classified as changes in the capital control regime.

A. Chile

The sequencing of Chile's reforms of domestic and external transactions during the period 1985–96, is summarized in Table 1 and described in Appendix Table 6; selected macroeconomic and balance of payment indicators are presented in Chart 1 and Appendix Table 7. An abstract of the exchange and capital control regime as of April 30, 1997 is provided in Appendix Table 8.

After an earlier experience with rapid liberalization and a banking crisis, Chile followed a gradualist approach to reforms. During the period covering 1985–89, the reforms focused on the completion of the restructuring of the banking system, the establishment of indirect methods of monetary control, trade reform, increased scope of transactions by banks, establishment of the autonomy of the Central Bank of Chile (CBC), and the selective liberalization of direct and portfolio capital inflows. Later phases of reforms emphasized the development of financial markets, the adoption of more flexible interest rate and exchange rate policies, and selective relaxation of controls on capital inflows and outflows, accompanied by the introduction of controls on certain capital inflows mainly in 1991 and 1995.

Recovery of the banking system following the earlier banking crisis, and the reversal of the earlier trade protectionist policies, were given priority 1985–87.[9] As a result of the earlier banking crisis and external shocks, interest rate liberalization had been reversed. Following the completion of the banking restructuring, the central bank eliminated the practice of announcing indicative interest rates in 1987, and influenced the level of domestic interest rates mainly through open-market operations in its indexed instruments (PRCBs). Capital market activity which had been moderate, was promoted gradually: pension funds were allowed to invest part of their assets in selected domestic stocks beginning in 1985. In 1989, the law established the legal autonomy of the central bank.

Chile's liberalization of external transactions focused initially on trade liberalization, providing more liberal access to foreign exchange for current international transactions, exchange rate adjustment, and exchange market development. In 1985, previous tariff

[9]For a discussion of the banking crisis and official responses, see Velasco (1991). In 1986, the General Banking Law and the Organic Law of Superintendency of Bank and Financial Institutions were substantially modified to give banks a broader scope of transactions in recognition of new types of financial services and to reduce the risks of another banking crisis. In October 1989, Congress enacted a constitutional law establishing legal autonomy for the CBC, which gave the CBC the mandate to ensure the stability of the financial system.

Table 1. Chile: Sequencing of External and Domestic Financial Liberalization, 1985–96 1/

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Monetary Controls and Financial System												
Capital Market Development	x					x	x	x	x	x	x	x
Money Market and Instruments	x		x				X	x	x		X	x
Financial Supervisory and Regulatory Framework	X	X	x		X						x	
Exchange System, Trade and Capital Flows												
Exchange Regime	x 2/	x 3/		x 4/	x 5/		x 7/	X 8/		x 9/		X 10/
Exchange Market Arrangement and System	x	x		x		X 6/	x	x	x	x	X	x
Trade Reforms	x		X	x		x	x	x	x			
Liberalization of Portfolio Investment												
Inflows	X	x	X			x	x	x	x		x	x
Outflows						x	X	x	X	X	X	X
Liberalization of Direct Investment												
Inflows	X				x				X			
Outflows									X			
Restrictions on Capital Flows												
Inflows						x	X	x		x	X	x
Outflows						x			x			

1/ An x represents relatively minor measures and an X represents major measures undertaken that year.

2/ The peso was devalued twice, the exchange rate band was widened from 0.5 percent to ±2 percent, and the peso was adjusted daily by 1.7 percent per month until August. After August the peso was adjusted daily based on the previous month's inflation less external inflation.

3/ The peso continued to be adjusted daily based on the previous month's inflation less external inflation leading to a 10.5 percent depreciation during the year.

4/ The exchange rate band was widened from ±2 percent to ±3 percent on each side of the center rate.

5/ The exchange rate policy to seek a real depreciation of the peso was abandoned and the exchange rate band was widened from ±3 percent to ±5 percent. In addition, the estimated rate of external inflation used in adjusting the exchange rate was lowered from 0.4 percent to 0.3 percent.

6/ The parallel foreign exchange market became an informal legal market in which the exchange rate was freely determined.

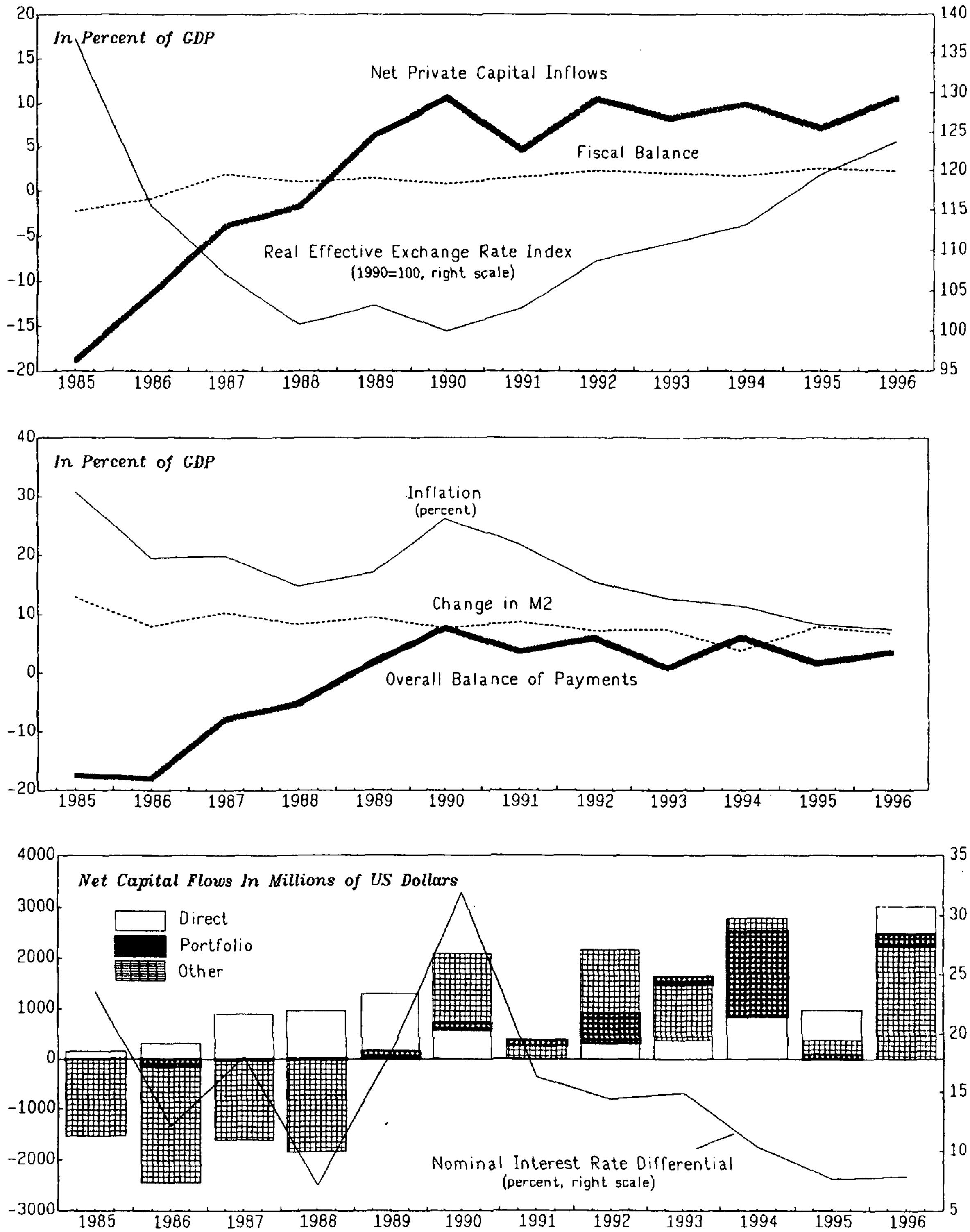
7/ The midpoint exchange rate was devalued three times during the year accumulating a total of 3.4 percent, and the reference rate of the peso was appreciated by 2 percent.

8/ The exchange rate arrangement of the peso changed from a peg to the U.S. dollar to a peg to a basket of currencies, the reference rate of the peso was revalued by 5 percent and the exchange rate band was widened from ±5 percent to ±10 percent.

9/ The midpint of the exchange rate band was revalued by 10 percent, and the weights of the reference currency basket were changed.

10/ The weights of the currency basket were changed, and the width of the exchange rate band was increased from ±10 percent to ±12 percent.

Chart 1. Chile: Selected Macroeconomic Indicators, 1985-96



Source: *IMF International Financial Statistics, Direction of Trade Statistics, and Information Notice System.*

increases[10] were rolled back in two steps and concurrently, the exchange rate was devalued to offset the impact of the lower tariffs, and to bring the exchange rate to a more realistic level. Limitations were eased on payments and transfers for current international transactions, and new instruments were introduced in the foreign exchange market.

Capital account measures were selective and focused initially on liberalizing capital inflows. In 1985, amendments to Chapter XIX of the foreign exchange regulations[11] permitted foreign direct investment inflows through debt/equity swaps. However, capital from these investments could not be repatriated for 10 years and profits for four years. Such swaps operations were further promoted in 1987, with the authorization of External Investment Funds.[12] Also under an amendment to Chapter XVIII of the foreign exchange regulations, nonresidents were permitted to purchase selected debt instruments, however, the source of foreign exchange and the conversions had to take place outside the official foreign exchange market. Allowable transactions were broadened in 1986, and in 1987, when nonresidents were permitted to invest in publicly offered instrument with the repatriation of the original capital after five years and no limit on profit remittances; and in 1989, the Additional Tax on the repatriation of profits by foreign investors under the Income Tax Law was reduced from 40 percent to 35 percent.

The capital account of the balance of payments showed a marked strengthening and recorded a surplus in 1989 reflecting much stronger foreign direct investment inflows (see Chart 1 and Appendix Table 7). In 1989, monetary policy was tightened to offset accelerating inflation, and portfolio capital inflows increased substantially reflecting the large interest differentials. In this context, the authorities abandoned their previous policy of seeking a real

---

[10]A 15 percent import surcharge was introduced on July 18, 1984, in addition to the existing 20 percent uniform import duty for products under 248 customs categories, partly replacing existing surcharges. The general tariff level was increased to 35 percent from 20 percent on September 22, 1984.

[11]The main legal framework for foreign investment in Chile was the Decree-Law No. 600, or Foreign Investment Statute, of 1974 as amended several times, and the Compendium of Foreign Exchange Regulations of the Central Bank of Chile, in particular Chapters XII, XIV, XVIII, XIX, XXVI, and XXVIII. For legal interpretations of the Regulations, see Mayorga and Montt (1995).

[12]Under the new mechanism, small external investors were able to participate in debt equity conversions without having to go through the case-by-case conditions normally applied to such operations.

depreciation of the exchange rate, and widened the band for the fluctuations in the exchange rate.[13]

Beginning in 1990, the authorities emphasized the development of domestic financial markets and instruments. Several measures were implemented to broaden and enhance the efficiency and competitiveness of the stock exchange and local security markets: Trading in futures contracts was introduced in 1990; pension funds could invest more of their assets in equities; and electronic screen-based trading and settlement systems began functioning in 1993. The following year the stock market introduced trading in options, and during 1995–96, the investment activities of pensions funds in the local securities markets were further liberalized. Concurrently, the money and foreign exchange markets were developed. The central bank enhanced its capacity to conduct monetary operations by widening the range of instruments and maturities used in open market operations.[14] Under new foreign exchange regulations, all foreign exchange transactions were permitted unless specifically prohibited by the central bank, and the parallel foreign exchange market became an informal legal market in which the exchange rate was freely determined.

In response to the large capital inflows recorded in 1990, the authorities began to liberalize capital outflows. In 1991, residents were allowed for the first time to use foreign exchange obtained in the unofficial market to invest abroad, and the period of investment after which capital could be repatriated by nonresidents was shortened to three years. In 1992, the pension funds were granted limited freedom to invest overseas, and remittances of profits and capital earned on foreign investments were allowed in advance of pre-existing schedules under certain conditions. Foreign inflows were also liberalized by allowing the issue of American Depository Receipts (ADRs), and in 1991 the arrangements for trading shares sold through ADRs were expanded and taxes on dividends were reduced. At the same time, new restrictions were introduced on certain capital flows. In 1991, the central bank introduced a 20 percent reserve requirement on new foreign borrowing except for trade credits with the objective of limiting short-term capital inflows. Subsequently, the reserve requirement was extended to most outstanding foreign borrowing and to foreign currency deposits, and increased to 30 percent. The stamp duties imposed on domestic loans were also extended to foreign loans.

Net capital inflows declined briefly in 1991 as interest rates were reduced, but recovered sharply in 1992. In response to continuing large capital inflows and upward pressure on the exchange rate, the reference rate of the peso was revalued, and modified from a peg to the U.S. dollar to a peg to a basket of currencies, and the fluctuation band for the

---

[13]Under the crawling exchange rate parity, the peso was devalued daily on the basis of the difference between domestic inflation in the previous month and expected external inflation. The exchange rate had also been widened in 1985 and 1988, see Table 1.

[14]See Alexander. et. al. (1995).

exchange rate around the central rate of crawl was widened from ±5 percent to ±10 percent. Inflation was constrained through continued fiscal consolidation appreciation, in the real exchange rate, and sterilized foreign exchange intervention.[15] (See Chart 1 and Appendix Table 7.)

During the period 1993–96, the pace of capital account liberalization accelerated with a greater emphasis on capital outflows; certain restrictions on capital inflows were also intensified. In 1993, the minimum period that capital must remain in the country was reduced from three to one year, and the time limit for remittances of profits was eliminated. In 1994, foreign portfolio investment outflows were encouraged by allowing life insurance companies, pension funds, banks and mutual funds to invest larger percentages of their portfolios abroad through the official market, allowing domestic banks to invest in financial institutions abroad, and granting individuals access to the formal exchange market for a limited set of capital transactions.[16] Capital outflows were liberalized further in 1995–96 by broadening the allowable assets and increasing the limits on foreign investments. Portfolio investment inflows were also encouraged by reducing the minimum size of ADRs issues, lowering the rating requirement for corporations issuing bonds on the international market, and modifying the 30 percent reserve requirement on foreign borrowings. At the same time, due to circumvention of the existing restrictions, the authorities intensified restrictions on certain other inflows. In 1994, reserve requirements on foreign borrowing were required to be held solely in U.S. dollars, and in 1995, the ceiling on credit in Chilean pesos backed by deposits in U.S. dollars was reduced to avoid a circumvention of the reserve requirement on foreign borrowing. The reserve requirement on foreign liabilities was extended to secondary market transactions in ADRs, and to all investment inflows that did not constitute an increase in the capital stock of the bank.

Chile's overall capital account strengthened, and there were much larger gross capital movements (Chart 1 and Appendix Table 7). Direct investments abroad increased to $1.1 billion in 1996, while foreign direct investment inflows increased to $4.1 billion. The net capital account strengthened to $6.3 billion (9 percent of GDP) in 1996. The current account balance fluctuated and showed some tendency to widen on average. The authorities repaid foreign debt, reducing the surplus in the overall balance of payments. The authorities

---

[15]Sterilization policies were used throughout the entire period but more heavily during 1990–92 (see Lee (1996)). The main instrument was the use of open market operations using central bank paper (1-year promissory notes). Longer-terms promissory notes (4- and 6-year) were used in 1992. Also in 1992 the central bank raised the real annual interest rate posted by the central bank on auction of its 90-day indexed promissory notes, and in 1993 a more active use of repurchase agreements was introduced.

[16]Regulations on the surrender and repatriation of foreign exchange earnings were also relaxed, and authorized exchange houses were also permitted to conduct forward and swap operations in the official exchange market.

continued to adapt the exchange rate arrangement, by revising the weights of the currency basket and widening the exchange rate band. The real exchange rate continued to appreciate and the inflation performance continued to improve (see Chart 1).

Chile's capital account liberalization appears to follow a distinct sequencing, with an initial focus on the completion of the restructuring of the banking system, trade reform, liberalization of the exchange system, and selective liberalization of capital inflows. Subsequently, the emphasis shifted to developing domestic money, bond and equity markets. The capital account liberalization was also combined with the evolution of macroeconomic policies and instruments: instruments for indirect monetary control were strengthen, the exchange arrangement modified to allow for greater flexibility of the rate within a crawling band exchange arrangement. Capital outflows were liberalized in response to a strengthening balance of payments. At the same time, as liberalizing longer-term capital outflows and inflows, Chile introduced selective controls on capital inflows; however, such controls were circumvented and had to be broadened progressively.

B. Indonesia

The sequencing of Indonesia's reforms of domestic and external transactions during the period 1985–96 is summarized in Table 2, and described in Appendix Table 9; selected macroeconomic and balance payments indicators are presented in Chart 2 and Appendix Table 10. An abstract of the exchange and capital control regime as of July 31, 1997 is provided in Appendix Table 11.

The economic reforms in Indonesia focused on reorienting the economy to reduce its dependence on the oil sector, expanding the role of the private sector, and encouraging the creation of a competitive non-oil, export-oriented industrial base that would absorb the rapidly growing labor force. The strategy entailed the pursuit of coordinated financial and exchange rate policies, aimed at providing a stable macroeconomic environment, accompanied by wide ranging structural reforms to promote sustained growth and economic diversification. Key elements of reform during 1985–96, included, gradual liberalization of direct investment inflows to promote non-oil exports and economic diversification, maintenance of a competitive exchange rate, trade liberalization and tariff reform, improvements in monetary management, and financial sector reform through liberalization of external inflows, promoting competition in the banking sector, strengthening of financial institutions, and encouraging the growth of the capital market.

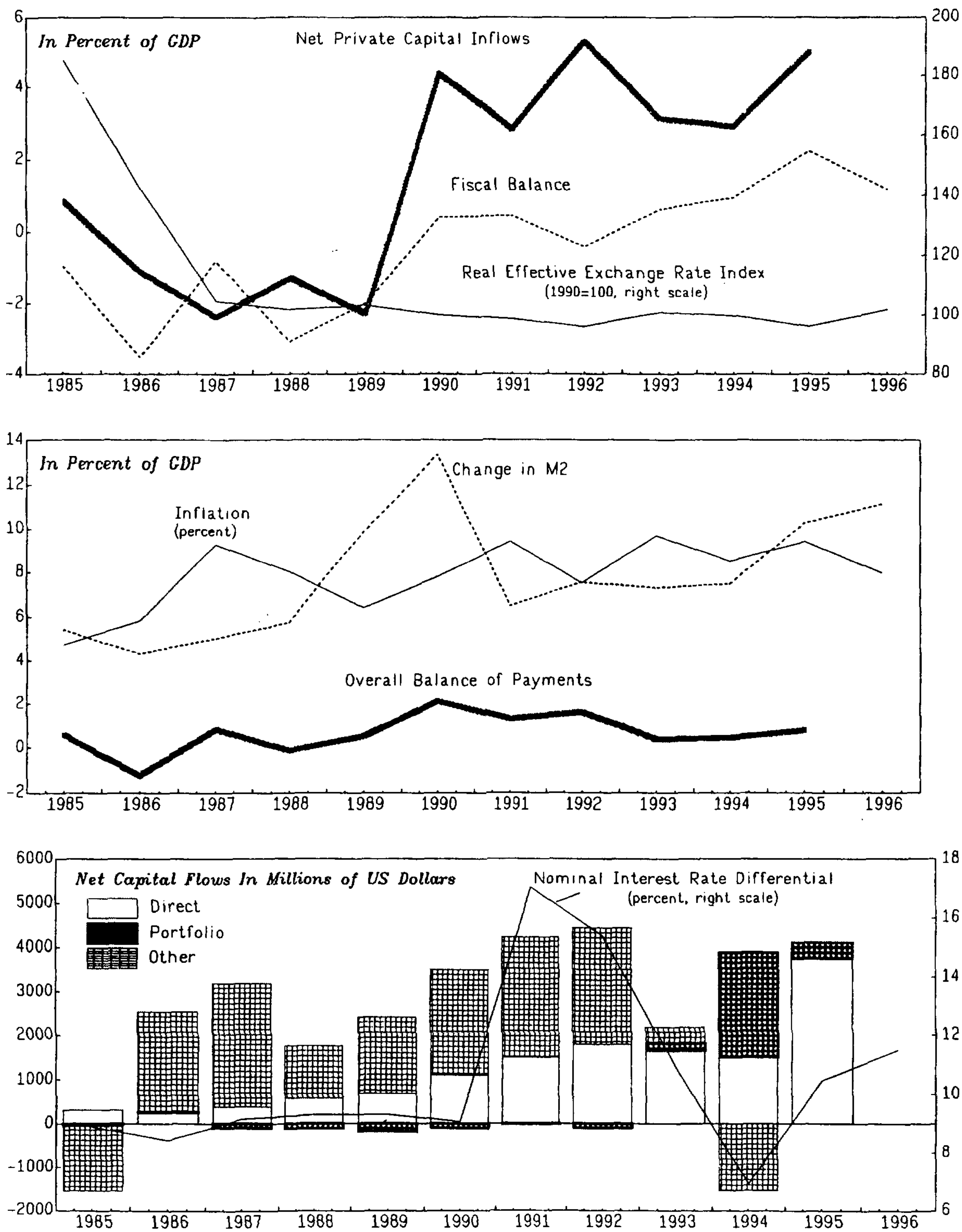
In 1985, Indonesia maintained a liberal regime for capital outflows by resident individuals and juridical entities, while prohibiting lending abroad by banks and financial institutions. Limitations on outflows through financial institutions remained in effect throughout the period (see Appendix Table 11). Selective controls applied to capital inflows; direct investment inflows were limited by domestic ownerships requirements; the purchase of equity by foreign investors in the local stock market was prohibited; and limits were imposed on foreign borrowings. Trade policy remained substantially protectionist.

Table 2. Indonesia: Sequencing of External and Domestic Financial Liberalization, 1985–96 1/

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Monetary Controls and Financial System												
Capital Market Development			x				x	x			x	X
Money Market and Instruments	x		x	X	x	x						
Financial Supervisory and Regulatory Framework				X	x	x	x	X		x	X	
Exchange System, Trade and Capital Flows												
Exchange Regime		X 2/	x							x 4/	x 5/	x 6/
Exchange Market Arrangement and System	x			X 3/	x		x					
Trade Reforms	X	x	x	x	x	x	x		x	x	x	x
Liberalization of Portfolio Investment												
Inflows					X			x				x
Outflows												
Liberalization of Direct Investment												
Inflows	X	x	x	x	x		x	x	x	x		x
Outflows							x					
Restrictions on Capital Flows												
Inflows							x					
Outflows												

1/ An x represents relatively minor measures and an X represents major measures undertaken that year.
2/ The Rupiah was devalued by 31 percent.
3/ Accepted Article VIII of the Agreements.
4/ Exchange rate movement allowed more flexibility. BI ceased to announce an indicative exchange rate in the morning and instead began announcing buying and selling rates at 3:00 p.m. computed on the basis of a basket of weighted currencies with a spread of ± Rp 15 (compared to ± Rp 10 previously).
5/ Exchange rate movement allowed more flexibility; the buying and selling rates computed on the basis of a basket of weighted currencies wit a spread of ± Rp 22 (compared to ± Rp 15 previously).
6/ Exchange rate movement allowed more flexibility; in June the intervention band was widened to Rp 118 (5 percent) and in September widened to Rp 192 (8 percent).

Chart 2. Indonesia: Selected Macroeconomic Indicators, 1985-96



Source: IMF International Financial Statistics, Direction of Trade Statistics, and Information Notice System.

Over much of the period, reforms focused on an opening of the real economy through a gradual promotion of direct investment inflows and liberalization of the tariff system as part of a restructuring of the real economy (see Appendix Table 9). Direct investment inflows were liberalized by expanding the fields where such investments were permitted, by limiting the equity ownership rules to production of certain goods and investments in certain sectors, and by lengthening the period after which a company had to revert to domestic ownership.

The exchange rate was depreciated in 1983 and subsequently in 1986, to bring it into line with market conditions as part of the economic restructuring package. Indonesia also liberalized payments and transfers for current international transactions and accepted the obligations of Article VIII in 1988. The foreign exchange market was developed and the selling of swaps in the foreign exchange market was liberalized. These reforms were associated with greater openness of the economy (as measured, for example, by the ratio of exports plus imports to GDP) and faster economic growth (see Appendix Table 10).

Reforms were undertaken concurrently in the financial and real sectors. These reforms focused initially on establishing the financial markets, institutions and instruments, for a more market-based system. Beginning in 1983, interest rates were liberalized and direct credit controls on the banking system were partially removed. Money market instruments were introduced in 1984. In 1987, institutional reforms were undertaken to strengthen the operations of the capital market, including reforms to the stock exchange and introduction of new capital market instruments. The authorities modified their monetary control framework by shifting toward targeting international reserves. They introduced daily auctions of money market instruments and allowed interest rates and the exchange rate to be more market determined.

The reforms in 1988 emphasized the functioning of the banking system, enhanced bank supervision and development of the money market. Financial sector reform was promoted by permitting greater foreign participation in the financial sector through the licensing of new foreign banks and branches, the creation of a level playing field for foreign and domestic banks, and permitting foreign participation in other types of financial institutions and in the insurance business (see Appendix Table 9). Additionally, reforms were undertaken to improve the functioning of the capital market, including by extending the role of the market in raising funds for investments, lengthening the maturity of money market instruments, and broadening the range of market makers.

Subsequently, in 1989, the authorities liberalized portfolio capital inflows by eliminating quantitative limits on banks' borrowing from nonresidents. Foreigners were permitted to invest in the stock market, and to acquire up to 49 percent of the ownership of listed stocks. Restrictions on direct investments inflows were also further relaxed and foreign direct investors were allowed to sell foreign exchange directly to commercial banks instead of through the central bank.

In 1990–91, the Indonesian economy began to overheat, the current account deficit widened, inflation accelerated, and interest rates rose substantially. However, in the context of the maintenance of a stable real exchange rate, the increase in interest rates was accompanied by a substantial inflow of foreign capital, and total net private capital flows registered a surplus in 1990 for the first time since 1985 (see Chart 2).[17] The foreign capital inflow was mainly in the form of commercial bank borrowing which was converted to domestic currency using the central bank's swap facility, thus contributing to an increase in the growth of money. Monetary restraint was supported by tightening of fiscal policy in order to curtail domestic demand pressures, however, inflation continued on an upward trend (Chart 2).

Concerned that the inflows through the banking sector were excessive and complicating macroeconomic management, the authorities reimposed in 1991 quantitative controls on off-shore borrowing by banks and state enterprises. They also introduced stricter limits on banks' open foreign exchange positions and reduced banks' foreign exchange swap positions as a percentage of their capital base. The limitations on public sector borrowing from abroad remained in place from 1992 to 1996. Nevertheless, the authorities continued to broaden the arrangements for foreign borrowing for trade finance by private entities, including sales of securities to nonresidents and liberalization of foreign direct and portfolio investment through the stock markets as part of their more general economic and financial sector development. These measures were undertaken concurrently with other measures to strengthen the domestic capital markets and the regulatory framework for banking operations.[18] In particular, in 1995–96, regulations were issued to strengthen financial institutions through the upgrading of accounting standards to ensure compliance with prudential guidelines and to safeguard against excessive risk taking through derivative tradings.

Large interest differential in the context of a stable exchange rate and very rapid growth in the domestic stock market continued to promote large net private capital inflows in 1992–96. These inflows took the form of both net direct and portfolio flows. The inflows were partly offset by a reduction in official capital inflows and by a widening in the current account deficit. Inflows were also sterilized through auctions of central bank paper and through swap operations in the foreign exchange market. Additionally, the authorities permitted somewhat greater exchange rate flexibility (1994–96).

In the first half of 1997, Indonesia continued to attract foreign investment flows. In response the central bank took measures to restrict the related credit growth including

---

[17]The total net private capital account is defined as net direct portfolio, and other investment minus net official capital plus net errors and omissions in the balance of payments plus an estimate of misinvoicing. For a discussion of this measure, see Johnston and Ryan (1992).

[18]A new banking law was issued, for example, in 1992 which provided guidelines consistent with accepted international banking.

through partial sterilization from sales of central bank certificates, increase in reserve requirements, and reduction in subsidized credit to public enterprises. Initially, Indonesia managed the regional currency crises that began in June 1997, better than its neighbors. This was attributed to stronger fundamentals, including a relatively smaller external current account deficit. Nevertheless, on July 11, 1997, to protect against speculation Indonesia widened the trading band for the exchange rate against the U.S. dollar to 12 percent from 8 percent. Subsequently, concerns also emerged about the stability of the banking system and the Indonesian rupiah came under speculative pressure, and was allowed to float. The authorities also took administrative measures to counteract the pressure on the exchange rate. Nonresidents' transactions in the forward market were restricted to $5 million per customer, and each bank's net open position in the forward market was limited to $5 million. The authorities also lifted the 49 percent limit on foreign ownership on new initial public offerings in September.[19]

C. Korea

The sequencing of Korea's reforms of the domestic and external transactions from 1985–96 is summarized in Table 3 and described in Appendix Table 12; selected macroeconomic and balance of payments indicators are presented in Chart 3 and Appendix Table 13. An abstract of the exchange and capital control regime as of August 31, 1997 is provided in Appendix Table 14.

Throughout the period, the Korean economy was characterized by significant government intervention and a financial sector which lagged the industrialization of the economy. The liberalization of the domestic financial system and the capital account was very gradual and selective, and a comprehensive plan was not adopted until June 1993. Monetary policy was conducted primarily through direct instruments, including ceilings on lending rates and guidance for lending to priority sectors. During the period, interest rate policy played little active role in external management. Developments in the balance of payments position, particularly in the current account, guided the government's interventions in the foreign exchange market and system, and with respect to transactions related to trade and the capital account.

Faced with a significant surplus in the current account balance of payments over the period 1986–89, the authorities progressively liberalized the import regime through a preannounced schedule of measures. Restrictions on payments for current international transactions were relaxed and Korea accepted the obligations of Article VIII in 1988. Capital outflows were also promoted by liberalizing direct investment, purchases of real estate

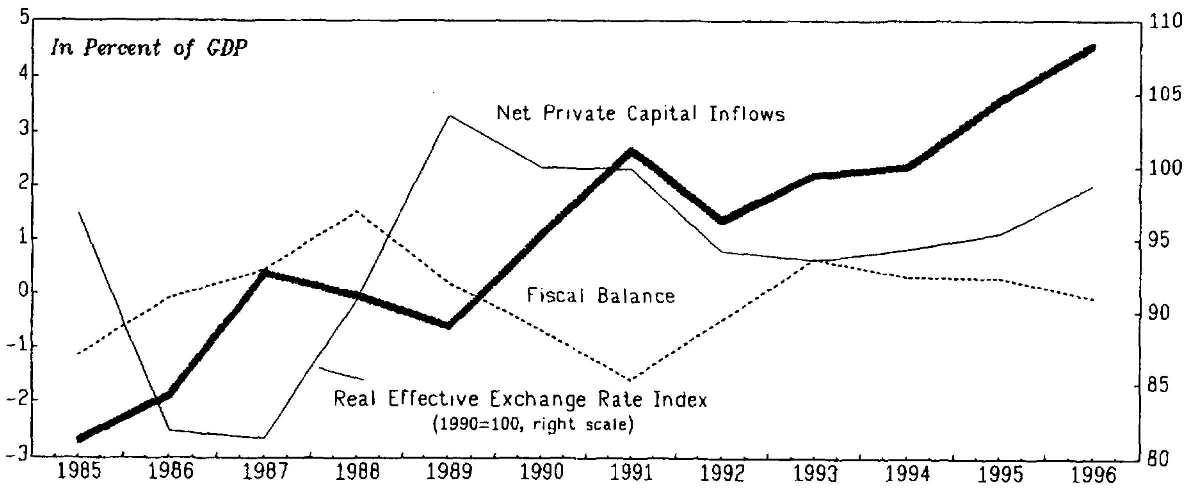
[19]In July the central bank imposed limits on banks' loans to real estate developers who wanted to purchase land and banks were not permitted to buy commercial paper from developers raising finance to buy land.

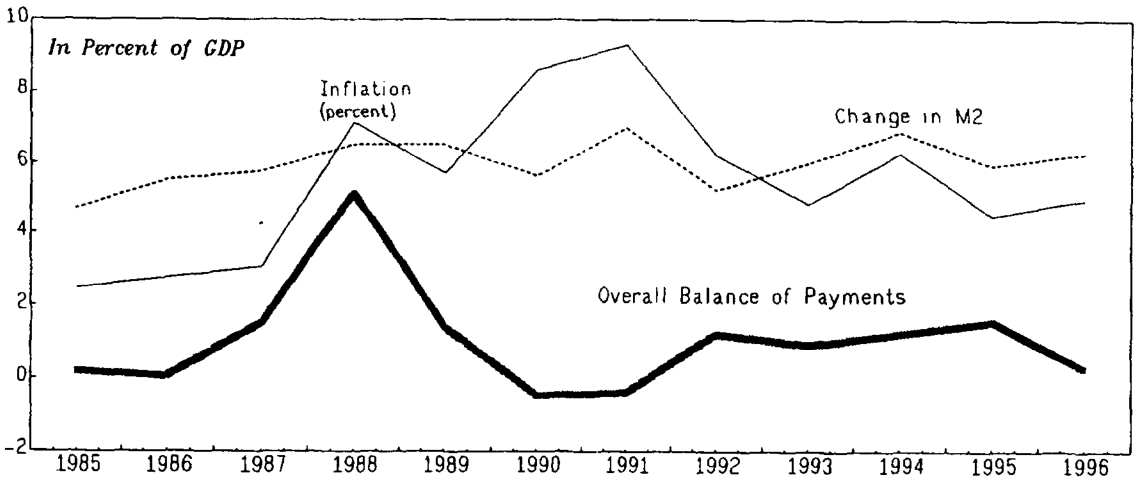
Table 3. Korea: Sequencing of External and Domestic Financial Liberalization, 1985–96 1/

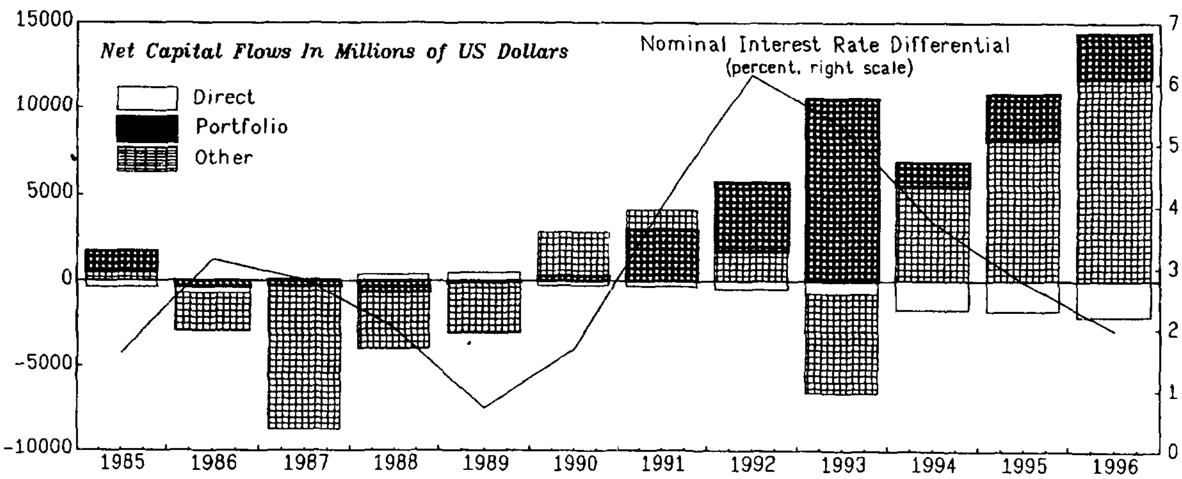
	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Monetary Controls and Financial System												
Capital Market Development		x	x	x	x	x	x		x		x	x
Money Market and Instruments	x	x	x	x	x	x	x	x	x	x	x	x
Financial Supervisory and Regulatory Framework	x	x			x	x	X	x	x		x	x
Exchange System, Trade and Capital Flows												
Exchange Regime						X 3/		x 4/	x 5/	x 6/	x 7/	
Exchange Market Arrangement and System	x	x	x	X 2/	x	x	x	x	x	x	x	x
Trade Reforms	x	x	x	x	x	x	x	x	x	x	x	x
Liberalization of Portfolio Investment												
Inflows	x				x		x	X	x	x	x	x
Outflows		x	x	x		x	x	x	x	x	x	x
Liberalization of Direct Investment												
Inflows	x		x	x	x	x	x			x	x	
Outflows	x	x	x	x	x			x	x	x	x	
Other Investment												
Inflows							x	x				
Outflows				x			x	x				

1/ An x represents relatively minor measures and an X represents major measures undertaken that year.
2/ Accepted Article VIII of the Agreements.
3/ Adopted the "market average exchange rate" (MAR) system. The MAR for the Korean won-U.S. dollar would be based on the weighted average of the previous day's interbank rates for the Korean won-US dollar spot transactions. During each busines day, the Korean won-US d exchange rate in the interbank market would be allowed to fluctuate within margins of ± 0.4 percent against the MAR.
4/ The margins within which the exchange rate for Korean won-U.S. dollars in the interbank market allowed to fluctuate daily around the M were widened to ±0.8 percent.
5/ The margins within which the exchange rate for Korean won-U.S. dollars in the interbank market allowed to fluctuate daily around the M were widened to ±1 percent.
6/ The margins within which the exchange rate for Korean won-U.S. dollars in the interbank market allowed to fluctuate daily around the M were widened to ±1.5 percent.
7/ The margins within which the exchange rate for Korean won-U.S. dollars in the interbank market allowed to fluctuate daily around the M were widened to ±2.25 percent.

Chart 3. Korea: Selected Macroeconomic Indicators, 1985-96







Source: *IMF International Financial Statistics, Direction of Trade Statistics, and Information Notice System.*

overseas, and certain portfolio investments outflows by institutional investors. At the same time, the central bank undertook various measures aimed at reducing net capital inflows, including by encouraging the early repayment of external borrowing, tightening of the regulations on foreign commercial loans and foreign bank borrowing, and imposing restrictions on the volume of foreign exchange that could be brought in and sold to domestic banks (see Appendix Table 12). The fiscal position was consolidated to facilitate repayment of official foreign debt. In spite of the exchange measures the overall balance of payments, however, registered a widening surplus as the current account surplus increased to reach 8 percent of GDP in 1988. The authorities used sterilization policies extensively mainly through the issue of large quantities of liquidity controls bonds and the reserve requirement on local currency deposits. The fiscal position also improved and the nominal and real exchange rate appreciated (see Chart 3).

Beginning in 1989, the current account balance of payments began to weaken reflecting the background of a weakening fiscal position (in an attempt to stimulate the economy), an appreciation in the real exchange rate, and rising inflation. The authorities responded by encouraging capital inflows. Some of the earlier measures aimed at limiting capital inflows were reversed—foreign exchange banks were allowed to raise funds offshore through certain instruments, and the limits on the amounts of foreign exchange that could be imported and sold to local banks were raised. The authorities also accelerated the liberalization of direct investment inflows, by lifting the ceilings on the amounts of direct investment inflows automatically approved; replacing approvals with notifications; providing tax incentives; and expanding the sectors where foreign direct investment was permissible. However, with increasing labor costs at home, foreign direct investment registered a net outflow in 1990 as enterprises continued to locate manufacturing abroad. Nevertheless, the financial account registered a surplus reflecting short-term inflows related to trade credits and borrowing for crude oil imports.

Over the period 1988–96, a range of reforms aimed at the development of the domestic money, security and foreign exchange markets. These measures paved the way for a broader opening of the capital account for portfolio capital flows in the 1990s. In 1988 the authorities allowed some initial interest rate liberalization; a four-stage plan for interest rate deregulation was announced in 1991, and a wide range of interest rates were liberalized in 1993. Interest rates on deposits of 1–2 years were liberalized in 1994, followed by liberalization of short-term deposits in two-steps in 1995. The financial system was developed through a number of measures, including strengthening bank supervisory procedures, promotion of a bankers' acceptance and forward exchange markets, development of market makers, and strengthening the regulations, trading procedures and transparency of the local security markets. Operational improvements were introduced in the capital market with the introduction of the "real-name" system for all financial transactions and the computerization of transactions in the stock market. Various steps were taken to improve and strengthen the regulation and supervision of the financial sector, including through revision of the General Banking Act and related prudential measures pertaining to accounting practices to promote transparency. Monetary stabilization bonds (MSB) were auctioned as opposed to being sold at administratively determined prices, and repurchase agreements using the liquidity control bonds become a major monetary instrument. Korea also moved from a multi-currency peg to the Market Average Exchange Rate (MAR) system to allow market forces to play a greater role in exchange rate determination; the margins for the fluctuation of the exchange rate were also gradually widened.

Concerning capital flows, Korea continued its policy of gradually promoting outflows by progressively liberalizing the limits on outward investments. The liberalization measures included extending the range of financial institutions which were eligible to invest abroad and the ceilings on their overseas investments; extending the range of business eligible for overseas direct investment, and liberalizing purchases of real estate; and allowing residents to retain larger foreign exchange balances abroad, and to invest directly in foreign government bonds and equities up to a limit. As regards capital inflows, in 1992 nonresidents were permitted limited access to the stock market and the types of securities which could be issued abroad by residents was expanded. The limits on foreign investments in Korea were gradually increased, and sectors and markets gradually opened to foreign portfolio investment. For example, total foreign direct investment in domestic equities was increased from 10 percent in 1992 to 12 percent in 1994, 15 percent in 1995, and 20 percent in 1996. In 1996, nonresidents were permitted to invest in domestic bonds through Country funds, and the Korean Bond Fund was listed on the London Stock Exchange.

The net private capital account strengthened sharply in 1991, reflecting an increase in foreign bond issues by Korean corporations, and in 1992 net portfolio inflows nearly doubled reflecting the partial opening of the stock market to foreign investors. Net portfolio investment inflows continued to strengthen in subsequent years, with net private capital inflows reaching $16 billion in 1995. Korea continued to be a net exporter of direct investment, but increasingly become a major net recipient of portfolio investment inflows. These inflows were offset by a weakening in the current account balance of payments, and an increasing surplus in the overall balance of payments. The exchange rate was permitted to adjust to some extent, however, the degree of adjustment tended to be limited. Nominal interest rates were also reduced, although with inflation higher than internationally, the interest differentials with foreign rates remained positive.

Notwithstanding the significant measures undertaken during 1985–96 toward a deregulated financial sector, Korea's financial sector and capital account transactions continued to be subject to many regulations and government intervention. Moreover, the extent of the effectiveness of certain reforms, for example, interest rate deregulation, is not very clear. Accordingly, further liberalization measures have been scheduled for 1997–2000, provided that stable macroeconomic conditions are maintained or the differential between Korean and international interest rates falls below 2 percent.[20]

---

[20]In the first half of 1997, several measures were taken to ease investment inflows. For

(continued...)

D. Thailand

The sequencing of Thailand's reforms of domestic and external transactions during 1985 to mid-1997 is summarized in Table 4, and described in Appendix Table 15; selec'ed macroeconomic and balance of payments indicators are presented in Chart 4 and Appendix Table 16. An abstract of the exchange and capital control regime as of September 10, 1997 is provided in Appendix Table 17.

At the beginning of the period under review, Thailand undertook a major adjustment effort: the baht was devalued by 14.8 percent in 1984, significant fiscal consolidation began and a decisive change was made in the orientation of trade and industrial policies toward export-led growth. Thailand gave priority to promoting capital inflows through tax and institutional reforms while concurrently developing its financial markets. This policy, together with large positive interest differentials and a fixed exchange rate, promoted large net capital inflows. Such inflows contributed to strong economic performance and an increasing opening of the economy. However, concerns about the sustainability of the exchange rate and the solvency of the financial system subsequently resulted in a sharp reversal of capital inflows and a currency crisis.

At the beginning of the period under review, Thailand maintained a relatively open capital account as regards to capital inflows. Under the Alien Business Law of 1972 and the Investment Promotion Act of 1977, the sectors for foreign investment and the screening requirement of such investments had been liberalized. Portfolio investments inflows were treated liberally, although initially exchange controls applied to the repatriation of interest, dividends, and principal. Foreign borrowing could be conducted freely but had to be registered with the Bank of Thailand (BOT).

Over the period, foreign inflows were further promoted through various measures, including: eliminating restrictions on foreign investments and foreign ownership of export orientated industries; the granting of tax incentives to encourage direct investments in special sectors; the granting of tax incentives to foreign mutual funds for investments in the stock market, and the creation of new closed end mutual funds; establishing of rules for foreign debenture issues by Thai companies; reduction of taxes on dividends remitted abroad; and allowing freely the repatriation of investment funds, loan repayments, and interest payments

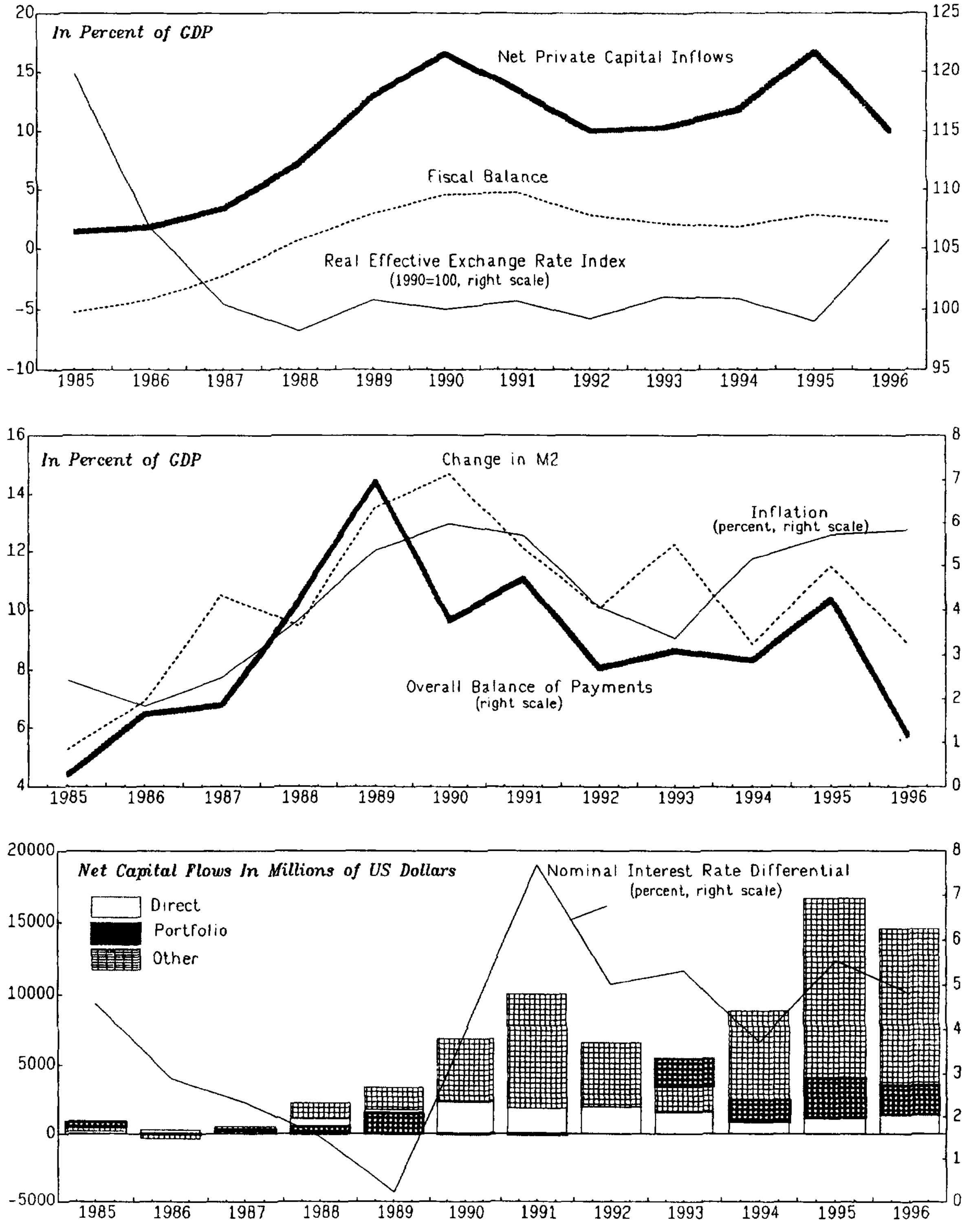
[20](...continued)
example, a capital increase of about $200 million was authorized for the Korea Fund; the limit on foreign ownership of Korean equities was raised from 20 percent to 23 percent; foreign investors were allowed to purchase nonguaranteed bonds of small- and medium-sized companies with maturities of 3 years and above and up to 50 percent of the issue; and restrictions on the usage of long-term loans with maturities of over 5 years brought into the country by foreign manufacturers were abolished.

Table 4. Thailand: Sequencing of External and Domestic Financial Liberalization, 1985-August 1997 1/

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Monetary Controls and Financial System													
Capital Market Development		x	x	x	x	X	X	X	x		x	x	X
Money Market and Instruments	x	X	x	x	X	X	x	X	x	x	X		X
Financial Supervisory and Regulatory Framewor	X			x				X	X	x	X	X	X
Exchange System, Trade and Capital Flows													
Exchange Regime													X 3/
Exchange Market Arrangement and System	x	x		x	X	X 2/	X	X	x	X	x		X
Trade Reforms	X		x	x	x				x			x	
Liberalization of Portfolio Investment													
Inflows	x	X				x		x	x				
Outflows	x					x	X	x					
Liberalization of Direct Investment													
Inflows	x						X	X					X
Outflows							x			x			
Restrictions on Capital Flows													
Inflows											x	X	
Outflows											x		X

1/ An x represents relatively minor measures and an X represents major measures undertaken that year.
2/ On May 4 the Government accepts Article VIII obligations of the IMF Articles of Agreement.
3/ The exchange rate arrangement of the Thai baht changes from being pegged to the U.S. dollar to a managed float.

Chart 4. Thailand: Selected Macroeconomic Indicators, 1985-96



Source: IMF International Financial Statistics, Direction of Trade Statistics, World Economic Outlook, and Information Notice System.

by foreign investors.[21] In 1992, the authorities approved the establishment of the Bangkok International Banking Facility (BIBF) which greatly eased access to foreign financing and expanded short-term inflows (see Chart 4); and in 1995 the Provincial International Banking Facility (PIBF) was established which could extend credit in both baht and foreign currencies with funding from overseas.

Payments and transfers for current international transactions were also progressively liberalized, and in 1990 Thailand accepted the obligations of Article VIII. Further liberalizations followed, with the removal of limits on the amounts of foreign exchange that could be purchased or brought in or taken out of the country, the relaxation of surrender requirements, and broadening the uses of nonresident baht accounts and resident foreign currency accounts.

In contrast to the promotion of capital inflows and the liberalization of the exchange system, controls on capital outflows by residents were liberalized only gradually. In 1990 commercial banks were allowed to lend limited amounts to nonresidents in foreign currency, and to approve the repatriation of proceeds from sales of securities; and in 1991 Thai residents were permitted to invest abroad or lend limited amounts to companies that had at least a 25 percent Thai equity participation. This limit was increased in 1994. Purchases abroad of capital and money market securities, foreign direct investments exceeding $10 million, and purchases of real estate remained subject to BOT approval. Insurance companies were permitted to invest abroad under certain circumstances but only up to 5 percent of their total portfolio, while locally issued mutual funds were restricted to investing their total portfolio in the domestic market.

The reforms of domestic financial markets focused initially on the development of the stock market. The Securities Exchange of Thailand (SET) was established in 1975, and the Securities Exchange Act was amended in 1984. A number of subsequent reforms aimed at developing the stock exchange: the Securities and Exchange Commission (SEC) was established in 1989; manual transactions were replaced with an automated trading system in 1991; and in 1992 the Securities Exchange Act and the Public Company Act B.E. 2535 were designed to support and promote the stock market. The Securities Exchange and Public Company Acts allowed public and private companies, listed and unlisted, to issue bonds, and the Thai Rating and Information Services (TRIS) was established as a credit rating agency to aid the development of corporate debt markets. Over the period the number of companies listed on the exchange more than tripled, and the annual average growth in the stock market capitalization was a remarkable 57 percent during 1987–94.

Following a crisis among the finance companies in the first half of the 1980s, measures to strengthen the banking system were introduced in 1985, including strengthened prudential

---

[21]Certain limitations on foreign ownership were retained on non-export orientated industries and on the maximum foreign ownership of companies listed on the stock exchange.

standards and improved on and off site monitoring. However, the banking system continued to have an oligopolistic structure which was reflected in large spreads between deposit and lending rates (see Appendix Table 16). Moreover, the 1997 banking crisis indicated that there were a number of financial sector weaknesses which were not fully addressed following the earlier banking crisis.

Interest rates and credit controls were liberalized gradually, and in 1992 the ceilings on savings deposits and lending rates were removed. Nevertheless, indirect monetary instruments were not well developed, and the authorities relied to a considerable extent on foreign exchange swaps to manage the liquidity effects of capital inflows. In the context of the fixed exchange rate regime, such swaps generally involved the central bank setting a forward exchange rate that did not deviate significantly from the spot exchange rate.

Thailand's promotion of capital inflows combined with a rapidly growing economy contributed to very substantial net capital inflows in the range of 9–13 percent of GDP between 1989–95 (a much higher percentage than the other countries reviewed in this paper). Net capital inflows were offset initially by repayments of official capital and subsequently by substantial deficits in the current account balance of payments which reached 8 percent of GDP in 1995. Nevertheless the growth of broad money and inflation increased along with the surpluses in the overall balance of payments and in spite of fiscal consolidation (see Chart 4).

The composition of capital inflows evolved over the period and appeared responsive to the regulatory reforms and incentives for capital flows. Net direct investment inflows contributed to the initial strengthening of the capital account, however net portfolio inflows became more important with the subsequent reforms to promote investments in the Thai stock markets, the establishment of the BIBF, and the large positive interest differential. A growing proportion of the net inflows were short-term in nature, reaching 60 percent of the total in 1995. Consequently in 1995, Thailand began to restrict short-term capital inflows by imposing 7 percent reserve requirement on banks' nonresident baht accounts. These restrictions were extended in 1996, inter alia, to cover new foreign borrowing of less than one year.

In 1996 growth and investment levels deteriorated in the face of an appreciating real exchange rate and capital inflows and exports declined sharply. The large current account deficit, high interest rates, and increasing inflation left the country vulnerable to external shocks and a shift in market sentiment. Moreover, serious weaknesses appeared in the financial system due to exposures to the properly sector and inadequate loan provisioning. High interest rates to counteract outflows aggravated the solvency and liquidity position of many banks and finance companies and resulted in intervention by the authorities to support the financial system. In July 1997, faced with a banking crisis, run on the currency, and large foreign exchange losses, the authorities floated the baht and adopted a managed floating exchange rate.

In response to the currency crisis sales of foreign exchange were restricted for all foreign exchange transactions except those applied to exports and imports of goods and services, and direct and portfolio investment. Banks which had been free to lend to nonresidents subject to open position limits became subject to temporary restrictions on baht lending to nonresidents. Forward outright transactions in baht with nonresidents, and the selling of baht against foreign currencies to nonresidents were temporarily restricted (see Appendix Table 15). However, such measures did not in general prevent the selling of the currency which continued to depreciate.

IV. Lessons From the Country Experiences

While the four country experiences reviewed here are diverse, the approach to and the consequences of the capital account liberalizations contain some lessons for managing such reforms.

A. Sequencing of Reforms

As regards the general approach to capital account liberalization, liberalizations of direct investment inflows were generally undertaken as part of broader strategies aimed at restructuring the real sectors of economies. These strategies included eliminating barriers to trade, initial exchange rate adjustments, liberalization of restrictions on current payments and transfers and acceptance of the obligations of Article VIII of the IMF's Articles of Agreement, as well as the liberalization and promotion of foreign direct investment inflows. Liberalizations of portfolio capital flows were generally coordinated with domestic financial sector reforms, especially the liberalization of domestic interest rates and moves toward indirect monetary instruments, strengthening of domestic security markets and reforms of domestic banking systems, and foreign exchange market reforms. In Chile and Korea financial sector reforms tended to precede capital account liberalization while in Indonesia capital account liberalization helped to promote the restructuring, and to improve the competitiveness, of the domestic financial system. The currency crisis in Thailand illustrates the risks when the approach to liberalization does not cover all the necessary concurrent reforms. In that case, the strengthening of financial institutions and the development of indirect monetary instruments lagged the liberalization of the capital account.

The approach to the liberalizations of capital inflows and outflows varied depending on the particular priorities adopted by the country. In the case of Korea, management of the current account balance of payments appeared initially to be the overriding consideration, and Korea sought to manage current account surpluses and deficits through regulatory and other changes which influenced capital inflows and outflows. Thailand actively promoted capital inflows while limiting outflows with the objective of supplementing domestic savings and promoting investment and rapid economic growth. Indonesia maintained a relatively liberal regime for capital outflows and gradually liberalized inflows with the aim of attracting foreign capital to assist the restructuring of its economy. Chile also liberalized capital inflows as part of its program of economic restructuring, and liberalized outflows in response to balance of payments considerations.

The pace of reforms varied. Chile and Korea followed a gradual approach to reforms. By contrast, Indonesia liberalized capital outflows early in the reform process; the liberalization of capital inflows occurred much later and more gradually. Thailand opened its economy to capital inflows, especially portfolio investment inflows, much more rapidly than the other countries surveyed but liberalized capital outflows only gradually.

B. Macroeconomic Management of the Liberalizations

Table 5 shows average comparative macroeconomic, financial sector, and balance of payments indicators for the four countries 1985–90, and 1991–96. In all cases, the capital accounts were more liberal in the second period than the first. In all cases, net inflows of private capital accompanied the capital account liberalizations and all countries recorded surpluses in their overall balance of payments. In all cases, portfolio investment flows dominated direct investments. Indonesia's balance of payments was less affected than the other countries by capital account liberalization, perhaps because restrictions on capital outflows had been liberalized much earlier in Indonesia. In all countries, with the exception of Korea, the surpluses were combined with fiscal consolidation.

The impact of the capital inflows on economic performance, however, varied between the countries. Chile reduced its current account deficit as well as inflation, and also brought down the interest differential with foreign rates and the real deposit rate. The growth of broad money and domestic credit to the private sector were generally constrained in the context of a managed floating exchange rate. In contrast, Korea and Thailand experienced rapid growth of money and domestic credit in the context of stable exchange rates against the U.S. dollar, and in both cases, inflation accelerated and the current account balance of payments weakened. Thailand also faced a currency crisis. In Indonesia, broad money and private credit also grew rapidly, inflation accelerated, the current account remained in deficit, and the Indonesian currency also came under speculative pressure.

How can the differences in performance be explained? One of the differences is that the ratios of broad money and private sector credit to GDP fell in Chile at the same time as private capital inflows increased as a percent of GDP, while the ratios of broad money and private sector credit to GDP increased significantly in the other countries (see Chart 5). Thus in Chile, for a time, net private capital inflows appear to have substituted for domestic intermediation, while in the other countries the inflows were associated with an increase in such intermediation, and with a rapid expansion in credit to the economy. In turn, this may explain the accelerating inflation and the weakening current account performances in the latter countries. Where the credit expansions were also associated with banking sector problems, this can create particular concerns about the efficiency of use of the capital inflows, and thus the sustainability of the balance of payments, and lead to a loss of confidence and capital outflows.

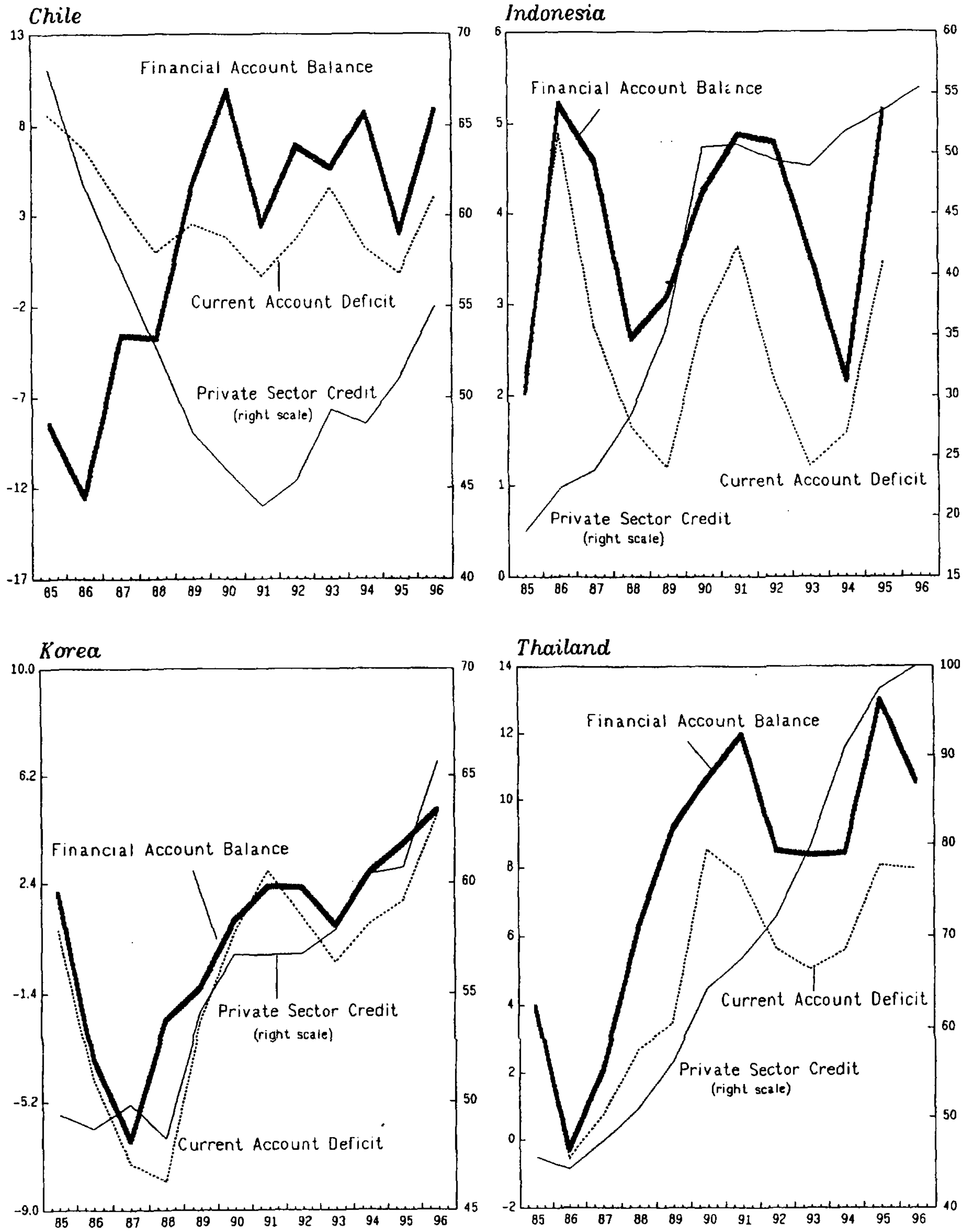
Table 5. Averages of Selected Economic Indicators for Chile, Indonesia, Korea and Thailand 1/

	Chile		Indonesia		Korea		Thailand	
	85–90	91–96	85–90	91–96	85–90	91–96	85–90	91–96
<u>Selected Economic Indicators</u>				(In Percent)				
Real GDP Growth	5.9	7.4	5.6	7.2	9.5	7.4	9.5	8.1
Inflation per Annum	21.3	12.8	7.0	8.8	5.0	6.0	3.6	5.0
M2 to GDP Ratio	39.4	38.5	31.0	46.4	36.7	42.3	62.3	77.2
Currency to Deposits Ratio	10.9	8.9	19.1	10.6	12.0	10.6	11.4	9.2
Fiscal Balance to GDP Ratio	−0.1	2.0	−1.7	0.8	0.0	−0.1	−0.6	2.9
Private Sector Credit to GDP Ratio	55.6	48.9	24.3	51.8	51.2	60.0	51.5	84.7
Exports plus Imports of Goods to GDP Ratio	48.2	46.6	38.2	43.5	60.3	53.4	53.5	68.9
Current Account to GDP Ratio	−4.0	−1.8	−2.6	−2.5	3.4	−1.9	−3.1	−6.6
Financial Account to GDP Ratio	−2.3	5.8	3.6	4.1	−1.8	2.8	5.3	10.1
of which: Direct Investment	2.9	1.7	0.6	1.3	−0.1	−0.3	1.4	1.2
Portfolio & Other Investment 2/	−6.5	5.5	0.8	2.4	−0.5	2.6	4.2	8.9
<u>Interest and Exchange Rates</u>								
Nominal Deposit Rate (percent per annum)	26.5	16.9	17.3	17.3	10.0	8.9	10.6	10.3
Real Deposit Rate (percent per annum)	5.2	4.0	10.3	8.6	5.1	2.9	6.9	5.3
Interest Rate Differential 3/	18.5	11.9	9.0	12.0	2.3	4.0	1.7	5.3
Lending/Deposit Spread	7.8	5.3	3.6	3.7	0.2	0.3	5.7	5.4
Official Exchange Rate per US dollar (end of period)	251.4	404.1	1640.8	2175.8	770.7	794.0	25.7	25.4
Real Effective Exchange Rate Index (1990=100)	110.6	92.2	122.9	98.8	92.4	96.0	104.4	101.1
<u>Balance of Payments</u>				(In Millions of U.S. Dollars)				
Current Account, n.i.e.	−803	−1,014	−2,238	−3,792	5,377	−7,730	−2,182	−9,428
Financial Account, n.i.e	−152	3,103	3,178	6,337	−2,515	11,454	3,668	14,216
of which: Direct Investment	692	988	551	2,030	−66	−1,190	953	1,474
Portfolio & Other Investment 2/	−1,017	3,018	737	3,731	−373	10,680	3,059	12,646
Net Errors and Omissions	−61	−252	−479	−1,235	−357	−162	618	−613
Overall Balance 4/	−1,015	1,837	462	1,310	2,555	3,613	2,104	4,175
Memorandum Item:								
Net Private Capital 5/	−235	4,569	−1,928	6,052	−460	11,717	5,177	16,860

Source: IMF International Financial Statistics, World Economic Outlook, Information Notice System, and IMF Direction of Trade Statistics, various issues.

1/ The averages cover the years were there is data available.
2/ Excluding official capital.
3/ Interest Differential = Deposit Rate – London Interbank Offer Rate on 3–Month U.S. Deposits.
4/ The overall balance includes: current account, financial account, capital account, and net errors and omissions. Capital account figures are not shown because they are zero throughout the period
5/ Total Capital = Direct Investment + Portfolio Investment + Other Investment – Official Capital + Net Errors and Omissions + Misinvoicing.

Chart 5. Capital Flows, Private Sector Credit, and Current Account Deficit 1985-96 (In Percent of GDP)



Source: IMF International Financial Statistics, and World Eco. Outlook.

What may determine the different monetary and credit developments? Part of the explanation may reflect the fact that Chile had implemented substantial financial sector reforms in the 1980s and adopted strengthened prudential standards earlier than in the other countries. The initial expansion in credit that often accompanies financial sector liberalization may therefore have occurred earlier in Chile than the other countries surveyed, and the strengthened bank supervision may have led to a better pricing of risks and avoidance of banking problems.

Secondly, all of the countries sought to manage capital inflows through their regulatory regimes. In the case of Thailand, the regulatory and institutional framework generally favored such inflows, while other countries sought to limit certain inflows or to liberalize them gradually. As a consequence, net private capital inflows were larger as a percent of GDP in Thailand than in the other countries and a large part of these inflows through the international banking facility were short term in nature, which may have increased Thailand's vulnerability to a reversal of such flows.

There is no strong evidence that the reintroduction of controls was particularly effective in limiting overall capital inflows. The capital controls may have influenced the composition of such flows, and thus have had some impact in determining whether the net inflows were directed to the domestic banking system. Chile actively sought to discourage capital inflows to the banking system. Indonesia and Thailand also became concerned by the volume of inflows to their banking systems, although in the case of Thailand this was late in the reform process. However, the impact on the growth of bank credit of the introduction of controls in Chile in 1991 and their subsequent intensification does not appear very evident in Chart 5, as private sector credit increased as a percent of GDP after 1991. Also, at a theoretical level it is not clear that a restriction on certain types of inflows would be particularly effective in limiting bank credit expansion in view of the potential fungibility of capital.

Finally, the exchange rate regime differed between the countries. The countries which appeared to manage better the capital inflows followed more flexible exchange rate arrangements. Such flexibility generally created greater autonomy for monetary policy in managing the effects of capital inflows and may itself have help to discourage short-term speculative capital flows. Part of Chile's successful management of capital account liberalization may be partly attributed to its more flexible management of the exchange rate within a preannounced crawling band. In contrast, Thailand's maintenance of a fixed exchange rate limited the flexibility of its monetary policy to constrain the growth of money and credit in the face of significant capital inflows. When combined with Thailand's policy of promoting capital inflows, the fixed exchange rate arrangement may have initially created unrealistic expectations about the rates of return. When market sentiment changed, the result was a sharp reversal of capital inflows.

V. CONCLUSION

Capital account can have significant benefits for economic growth and welfare. However, achieving the benefits of the liberalization while minimizing the risks requires attention to the sequencing of the reforms and the pacing of capital account liberalization to macroeconomic and exchange rate policies.

What is generally important for managing the volume of capital flows is the overall incentive structure that can give rise to such flows. This will be influenced by the regulatory regime for capital movements, the stage of development and soundness of financial systems, and by the configuration of interest rates and exchange rates.

This study therefore concludes that countries should adopt a coordinated and comprehensive approach to reforms, of which capital account liberalization is an integral part. Such a public policy approach requires attention not only to the sequencing of the regulatory and institutional reforms with the regulatory frameworks which impact on capital movements, but also the design of macroeconomic and exchange rate policies.

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1985	**Capital Markets** • Private pension funds permitted to invest part of their assets in selected domestic stocks. **Financial Supervisory and Regulatory Framework** • The process of recapitalization of the private financial system began in 1982 with the purchase of loan portfolios of banks up to an amount equivalent to 100% of the capital and reserves of each bank. This was followed in 1984 with the purchase of substandard loan portfolio of banks up to 150 % of capital and reserves of each bank initially for cash, and up to an additional 100% of capital and reserves for non-negotiable, non-interest-bearing central bank notes. This scheme was extended to intervened banks in 1985. Legislation was enacted that allowed the government to recapitalize directly up to 49% of the capital of each bank. These banks were then sold to the private sector through the state development company CORFO. • A debt restructuring agreement was reached with foreign commercial banks, the third of a series of six agreements, beginning in 1983. **Money Market and Instruments** • The Central Bank of Chile (CBC) announces an indicative interest rate for 30-day deposits.	**Exchange Market Arrangement and System** • In February the CBC announced that the exchange rate for the Chilean peso was devalued by 8.2% against the U.S. dollar. • In June the exchange rate of the peso was devalued again by 7.8%. At the same time, the CBC announced that the peso would be adjusted on a daily basis at a rate of 1.7% per month until August. After August, the rate would be adjusted daily on the basis of the previous month's inflation less an estimate of international inflation. The CBC also changed the width of the exchange rate band from 0.5% on either side of the daily rate to 2%. • The limits on travel allowances was raised from $200 to $500 for travel to neighboring countries and from $800 to $1,500 for travel to other countries. • Chapters XIX and XVIII of the *Compendium of Foreign Exchange Regulations of the Central Bank* were introduced in May. The amendments introduced two schemes for the purchase by foreign residents of specified Chilean foreign debt instruments in secondary markets abroad and their conversion into domestic peso obligations (see amendments below). **Direct Investment** • IF: Under *Chapter XIX*: Upon approval of the CBC, the foreign currency obligation can be exchanged into a domestic currency obligation, the proceeds of which must be used for direct investment purposes, with the intermediation of a financial institution. Special regulations apply to repatriation of such capital as well as to dividend payments, capital can be repatriated after 10 years and profits after 4 years. Profits of the first four years can be repatriated at 25% per year as of the fifth year. **Portfolio Investment** • IF: Under *Chapter XVIII:* Authorization was granted for residents and nonresidents to purchase selected debt instruments using foreign exchange not obtained in the official foreign exchange market, for conversion into pesos, without remittance rights. The peso assets could be used only to reduce domestic debt, third-party debt or to acquire specified assets or equity owned by domestic banks. Transactions under this chapter also need to be channeled through financial institutions, subject to an overall quota that would be assigned to the different institutions on the basis of an auction system. **Trade** • The uniform tariff rate was reduced twice from 35% to 30% to 20%. • A law was introduced giving exporters of specified export products an option of a subsidy equal to 10% of the net value of their sales not exceeding an overall value of $7.5 million, in lieu of benefits under the existing import duty drawback scheme.

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1986	**Financial Supervisory and Regulatory Framework:** • Two laws are substantially revised: the General Banking Law and the Organic Law of Superintendency of Banks and Financial Institutions. • The CBC restored five more banks that had been intervened in the private sector on a fully capitalized basis.	**Exchange Market Arrangement and System** • The official rate was adjusted daily during the year representing a 10.5% depreciation. • A subsidy granted for debt service payments on foreign currency debt contracted before August 6, 1982 for debts greater than $50,000 through the preferential exchange rate arrangement was gradually phased out between July 1985 and December 1986. • The CBC allowed banks to conduct future foreign exchange operations for options with maturity between 15 to 180 days on a very restricted basis. • The limits on travel allowances was raised from $500 to $1,000 for travel to neighboring countries and from $1,500 to $3,000 for travel to other countries. **Portfolio Investment** • **IF**: Restrictions on the use of peso assets (without remittance rights) by residents and nonresidents of debt purchased at a discount abroad with foreign exchange not obtained in the official market (under Chapter XVIII) were lifted.
1987	**Financial Supervisory and Regulatory Framework** • The last two intervened banks were sold to private investors through stock auctions between 1986–87, marking the end of the privatization phase. One state owned bank was not privatized or intervened during the banking crisis. **Money Market and Instruments** • The CBC eliminates its practice of announcing indicative interest rates for 30-day bank deposits and starts to set the rate on 90-day indexed promissory note (PRBC), a short-term central bank paper sold through auctions on demand.	**Portfolio Investment** • **IF**: Foreign Capital Investment Fund (FICE) Law was issued to attract foreign resources to be invested in publicly offered instruments. Original capital was allowed to be repatriated after five years, with no limit on profit remittances. All remittances not corresponding to the capital originally invested were subject to a 10% income tax. • **IF**: External Investment Funds under Chapter XIX were authorized. This made it easier for small external investors to participate in debt equity conversions without having to go through the case-by-case conditions normally applied to such operations. Transactions under this chapter were progressively restricted. • Chapter XVIII was modified to allow debt conversions by mortgage debtors, up to $6,000 without going through the auction system. **Trade** • A fund to guarantee loans granted to nontraditional exporters for capital requirements was established • Regulations governing imports from Free Zones were modified. • A preferential tariff treatment was suspended for those countries that had not adopted the new regional scheme of preferential tariffs. • A system of deferred payment was introduced for custom duties on imports of capital goods. • The list of goods eligible for export financing through rediscounts of the CBC was expanded. • A subsidy of 5% was introduced for export values between a certain value and the indexation of these values, which are to be adjusted annually.

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1988		**Exchange Market Arrangement and System** • The exchange rate band was widened from ±2% to ±3% on each side of the center rate. • Commercial banks are authorized to sell foreign exchange for payments of insurance premiums contracted in Chile up to $50,000; for larger amounts authorization is required from the CBC. • New minimum amounts for foreign exchange swap operations were set with the CBC. • The period for surrendering export earnings was lengthened to 90 days after repatriation, as long as the earnings were held as swaps or foreign currency deposits with Chilean resident banks. **Trade** • Custom duties were lowered across the board from 20% to 15%. • The maximum surcharge was raised from 15% to 20%. • The drawback subsidy for small exporters was reduced from 10% to 8%. • The fiscal credit under the system of deferred import duty payments was lowered to 11% from 15%.
1989	**Financial Supervisory and Regulatory Framework** • Congress enacted a constitutional law establishing legal autonomy for the CBC of Chile (October).	**Exchange Market Arrangement and System** • In July the authorities announced that the policy adopted in late 1988 of seeking a small real appreciation of the peso had been reversed. The peso continued to be devalued daily on the basis of the difference between domestic inflation in the previous month and estimated external inflation. To reverse some of the real appreciation that had occurred since 1988, the band around the central rate was widened from ±3% to ±5% and the exchange rate moved to the top of the band. • In September the authorities reduced the estimated rate of external inflation used in adjusting the exchange rate from 0.4% per month to 0.3%. **Direct Investment** • **IF:** The Additional Tax on the repatriation of profits by foreign investors under the Income Tax Law was lowered from 40% to 35%.
1990	**Capital Markets** • The stock market introduced trading in futures contracts.	**Exchange Market Arrangement and System** • The parallel foreign exchange market became an informal legal market in which the exchange rate is freely determined and access to the official market remained unchanged . • Proceeds from exports of goods and services, payments for imports of goods and services, debt-service payments, remittances of dividends and profits, and authorized capital transactions, including loan receipts are to be transacted through the official exchange market. • The repatriation period for export proceeds is extended to 120 days (up from 90 days). **Portfolio Investment** • **OF:** Chapter XXVI was added to the rules on International Exchange. Under this chapter individuals and legal entities, domiciles and resident abroad, and meeting certain conditions, were permitted to remit abroad proceeds from the sale of stocks of registered corporations domiciled in Chile that were purchased with funds abroad through the official exchange market. The remittance of dividends and profits accruing from such stocks was also allowed through the official exchange market. • **IF:** Under Chapter XXVI, American Depository Receipts (ADRs) are issued for the first time.

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1990 cont.		**Trade** • The minimum import financing requirement (120 days) is abolished. **Restrictions on Capital Flows** • New regulations were introduced whereby all capital transactions had to be reported to the CBC and remained subject to approval.
1991	**Capital Markets** • Pension funds permitted to invest a greater percentage of their assets in equities. **Money Market and Instruments** • Credits granted by foreign commercial banks to Chilean commercial banks as part of restructuring packages were exempted from the 20% reserve requirement (see Introduction of Restrictions). • An alternative means of satisfying the 20% reserve requirement on new foreign borrowing in the form of a special repurchase agreement with the CBC was established (see Introduction of Restrictions).	**Exchange Market Arrangement and System** • On June the authorities announced that the reference exchange rate of the peso appreciated by 2%. • The midpoint exchange rate was devalued three times in 1991 for a cumulative amount of 3.4%. • The maximum amount of time allowed for exporters to make their returns was increased from 120 to 150 days. • The time allowed for exporters to liquidate advance payments received on their sale of their products was extended from 90 to 150 days. **Portfolio Investment** • **IF:** Chapter XXVI was modified so that shares through ADRs could be traded and quoted, not only on official foreign stock markets but privately. • **OF**: Capital that entered through Chapter XIX, could be repatriated after three years instead of 10 years. The minimum holding period for *other* investments remained at three years under both: the Decree Law No. 600; and Chapter XIV which stipulates that capital brought into the country in the form of foreign borrowing must be sold through authorized banks when the investor has registered the transaction with the CBC. • **OF:** Under Chapter XIX foreign investors were allowed to sell their investments to domestic residents after paying a fee to the CBC. • **OF**: Chapter XII set out regulations and different channels for Chilean corporations to invest abroad Chapter XII was revised to permit Chilean individuals and juridical entities to use foreign currency of their own or obtained from the informal exchange market to invest abroad. Prior approval from the CBC was no longer required but the CBC had to be notified within 30 days of the investment. • **IF:** Taxes on dividends on investments were lowered to 42% from 49.5%. The tax credit on repatriation of profits was increased from 10% to 15%. • **OF:** The CBC authorized banking companies to acquire low-risk financial assets abroad with a maximum value of up to 25% of the public's foreign currency term deposits. **Trade** • CBC allowed banks to assign 60% (up from 40%) of their dollar deposits to finance foreign trade. • Banks were allowed to finance foreign-trade transactions between third countries belonging to LAIA. • The ad valorem import tariff was reduced to 11% from 15%. • Stamp duties imposed on domestic loans were extended to foreign loans.

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1991 cont.		**Restrictions on Capital Flows** • **IF**: A reserve requirement of 20% was first imposed only on all new *foreign borrowings*, except for credits that are provided directly to Chilean exporters by foreign importers. The reserve requirement was to be held at the CBC for a time related to the maturity of the credit, with a minimum of 90 days and a maximum of one year. • **IF**: The 20% reserve requirement was extended to all outstanding foreign borrowing, except for credits with maturity of less than six months, and time period for which the CBC would hold it was increased to one year, irrespective of the maturity of the foreign loan. The requirement on existing credits maturing between July and December were phased out. • **IF**: Stamp duties imposed on domestic loans were extended to foreign loans.
1992	**Capital Markets** • The Superintendent of Securities and Insurance announced the creation of a central securities depository to be implemented in stages beginning end-1993. **Money Market and Instruments** • Insurance companies are permitted to participate in the auctions of CBC promissory notes and Treasury bills. • The CBC modified the operating rules of auction system—clear all transactions at the cutting rate and no auction can be declared void. • The CBC introduced longer maturity (4, 6, 8, and 10 years) promissory notes and increased size of auctions.	**Exchange Market Arrangement and System** • The exchange system was changed from being pegged to the U.S. dollar to being pegged to a fixed basked of currencies consisting of the U.S. dollar, the deutsche mark, and the Japanese yen. The central exchange rate and the floating band are to be set daily according to the evolution of the value of the currency basket and the exchange rates of the currencies in the basket. • The reference rate of the Chilean peso was revalued by 5% and the band was widened from 5% to 10% on each side of the midpoint rate. • The CBC was authorized to intervene in the foreign exchange market and operate within the established 10% margin. • Exchange arbitrage operations undertaken abroad by banks were liberalized. Commercial banks were permitted to increase their foreign exchange exposure and deal in foreign exchange among banks, instead of only with the CBC. Foreign exchange could be bought for purposes of amortization of capital and payment of interest on debt duly registered at the CBC within 90 days after the due date. • Export proceeds over $2,000 were permitted to be surrendered through commercial banks. • Exporters were permitted to retain 10% (up from 5%) of the proceeds in special foreign currency accounts with a cumulative limit a year of $5 million from $500,000. • Commercial banks were authorized to sell foreign exchange using their term deposits in foreign exchange. • Limits on travel allowances were raised from $1,000 to $3,000 for neighboring countries and to $5,000 from $3,000 for travel to other countries. **Portfolio Investment** • **IF**: Qualified residents were authorized to obtain foreign credits by issuing bonds abroad. • **IF**: A-rated Chilean enterprises and banks were authorized to issue bonds in foreign markets. • **OF**: Pension funds permitted for the first time to invest abroad up to 1.5% of the total value of their assets. This percentage was increased again later in the year to 3%. • **OF**: Chapter XIX was amended to allow applications for advance remittances of profits and capital earned on foreign investment under certain conditions. • **IF**: In May the period of application of the reserve requirement on external credits entering under Chapter XIV was increased to one year from 90 days but the reserve requirement ratio for these inflows was left unchanged at 20% until August.

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1992 cont.		**Other Investment** • **IF:** In October, Chapters XIV and XXVI were amended such that external credit could be obtained through issuing of share-convertible bonds abroad. **Trade** • The limit on import payments above which the prior approval of the CBC would be required was raised to $100,000. • Limit on payments for invisibles was raised to $3,000 from $200. **Restrictions on Capital Flows** • **IF:** In August the reserve requirement on external credits was first extended to foreign currency deposits and then subsequently increased to 30% from 20%
1993	**Capital Markets** • An electronic screen began operating on the trading floor of the Stock Exchange and the Centralized Financial Clearing and Settlement and Operations Settlement systems started functioning. **Money Market and Instruments** • The CBC introduced auctions of 12, 14, and 20 years promissory notes.	**Exchange Market Arrangement and System** • The maximum period to surrender foreign exchange proceeds of nonfinancial services exports (insurance payments, shipping fees and other commissions) was extended by 90 days to 150 days, in line with that in force for merchandise export proceeds. **Direct investment** • **OF:** Under an amendment of Decree Law No. 600, the main vehicle for foreign investment in Chile, the minimum period for the remittance of capital and earnings was allowed after one year instead of after three years for all investment flows under this law. Remittances of profits were not subject to any time restrictions. • **IF:** The "guaranteed" corporate income tax (or "invariability rate") for foreign investors opting for a tax rate different from that used for domestic corporations (an option under DL 600 which is a rate guaranteed for the duration of the investment) is reduced to 42% from about 49.5%. • **IF:** The tax on gross revenue for payments to nonresidents for the use of patents and trademarks was lowered from 40% to 35%. **Portfolio Investment** • **OF:** The minimum period for the remittance of capital and earnings was allowed after one year instead of after three years for all investment flows also under Chapter XIX and Chapter XIV. Profit remittances from investments under Chapter XIX remained subject to certain restrictions until the full elimination of Chapter XIX in 1995. • **IF:** Corporations issuing bonds on the international capital market were required to obtain from a foreign rating company a credit rating that is equal to or better than the assigned to Chile. **Trade** • Documents required to provide information on imports that were previously issued only by the CBC were permitted to be issued by private agencies in respect of imports from LAIA member countries. **Restrictions on Capital Flows** • **OF:** Decree Law 600 is amended to clarify that access to the formal exchange market for the remittance of capital or profits abroad required the prior approval of the Foreign Investment Committee.

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1994	**Capital Markets** • The stock market introduced trading in options.	**Exchange Market Arrangement and System** • The midpoint of the exchange rate band was revalued by 10% and the weights of the reference currency basket were changed. • The ceiling on foreign exchange positions held by commercial banks was eliminated in November. • The CBC authorized exchange houses operating in the formal exchange market to carry out forward and swap operations. • The proportion of export proceeds that exporters were allowed to retain was raised to 15%, then to 25%, and again to 50%. The amount in a twelve month period was raised to \$10 million, then to \$15 million, and again to \$50 million a year. • The period to surrender foreign exchange from exports was extended from 150 to 180 days, then to 210 days and again to 270 days. **Portfolio Investment** • **OF:** Life insurance companies that have a BBB+ risk rating permitted to invest up to 10% of their resources in selected 32 countries. • **OF:** General insurance companies with a BBB risk-rating permitted to invest up to 15% of their resources in selected 34 countries. • **OF:** Mutual funds were authorized to invest up to 30% of their resources; but did not have to meet any risk criteria. Nor were they limited to a specific number of countries. • **IF:** It was made easier for nonfinancial enterprises to issue bonds in foreign markets or place ADRs abroad because their qualification rating was lowered to BBB+ from an A rating by the National Risk Classification Commission. In addition, the minimum amount of issue was halved to \$25 million and authorizatibn from the CBC was no longer required. • **OF:** The maximum amount that pension funds, insurance companies, and mutual funds were allowed to invest abroad was raised to 4% from 3% of their portfolio. • **OF:** The issuance of ADRs but not of bonds by banks was simplified: the minimum amount for each issue was lowered to \$25 million from \$50 million, and the requirement that the issuing bank be rated A by the National Risk Classification Commission was replaced by the requirement that it be rated BBB+ by two international rating agencies. • **OF:** The CBC published new regulations with respect to investment abroad by pension funds. Pension funds were permitted to invest up to 6% of assets in international markets. • **OF:** Chilean banks were permitted to invest in financial institutions abroad after obtaining authorization from the CBC and the Superintendency of Banks and Financial Institutions. The investment itself could not exceed 25% of the bank's capital plus reserves, and the banks risk-weighted assets could not exceed tenfold its effective patrimony. **Restrictions on Capital Flows** • **IF:** All reserve requirements on foreign borrowing were required to be held solely in U.S. dollars.

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1995	**Capital Markets** • The CBC allowed pension funds to invest up to 9% of their assets in risk -rating instruments. • The minimum risk rating requirement for instruments in which pension funds may invest was lowered from A- to BBB-. • The CBC raised the ceiling: (a) on pension funds' investment in domestic stock from 30 to 37% of their assets; and (b) on pension funds' investment in instruments issued by public finance institutions from 45 to 50% of their assets. **Financial Supervisory and Regulatory Framework** • The CBC introduced regulations for exchange houses and brokerage companies through which pensions funds can carry out domestic and foreign financial transactions. **Money Market and Instruments** • Banks and financial institutions are allowed to open a "liquid deposit account" in the CBC. • The CBC limited the access of financial institutions to its liquidity credit lines to the following amounts, calculated as the average amount of credit outstanding during a given reserve period: starting September 9, 90% of the amount assigned under the first tranche, and starting October 9, 60 % of that amount. • The CBC announced that its 90-day indexed promissory notes (PRBC) would be sold through bi-weekly auctions; auction of the 30-day promissory note (PDBC) would be limited only to banks and financial institutions which purchased PRBCs during the previous auction. These banks and financial institutions are allowed to purchase an amount equivalent to up to 10% of their PRBC purchases at a nominal interest. • Interest rates on daily indexed liquidity credit lines were lowered from 6.3 to 5.7% for the first credit tranche; from 6.55% to 6% for the second credit tranche, and from 7.05% to 6.5 % for the third credit tranche. • The CBC lowered the rate on daily deposits by commercial banks with the CBC from 5.22% to 5%. • The CBC raised the interest rate on its indexed liquidity credit lines from 5.7% to 6.7% from the first credit tranche, from 6% to 7% for the second credit tranche; and from 6.5% to 7.5% for the third credit tranche.	**Exchange Market Arrangement and System** • The CBC authorized exchange houses operating in the formal exchange market to purchase and sell foreign exchange in connection with ADR transactions (undertaken through Chapter XXVI). • Pension funds and insurance companies are granted access to the formal exchange market. • The CBC specified that mutual funds will not be granted access to the formal exchange market to carry out exchange operations related to their investments abroad. • The CBC authorized exchange houses operating in the formal exchange market to carry out exchange operations related to investment abroad by pension funds and insurance companies. • The CBC specified that the maximum amount of financial investment that banks and financial institutions can deduct from the foreign exchange position used to calculate their reserve requirement is equal to the maximum limit on such investments. • The CBC allowed exporters to no longer surrender export proceeds to the CBC, although they are still required to inform the CBC of these operations, until April 1996. • The obligation to surrender proceeds from foreign bond issues was eliminated. **Portfolio Investment** • **OF**: Chapters XVIII and XIX were eliminated, thus lifting the restrictions on the purchases of selected Chilean foreign debt instruments. • **OF:** Restrictions on the remittance of profits abroad and the three-year holding period for capital repatriation for selected Chilean foreign debt instruments was lifted. • **IF:** The CBC lowered the minimum amount required to issue ADRs to $10 million from $25 million for companies that already had issued ADRs abroad. • **OF:** A minimum country risk rating of BBB– was established for investment in foreign stocks by insurance companies. (This rating refers to the risk in the ceiling in which the stock is trading). • **OF:** The CBC raised the ceiling on investment abroad from 6% to 9% of total assets, with a subceiling of 4 1/2% in stocks and stock-based instruments. • **OF:** The CBC lowered the minimum risk ratings of foreign investment by banks and financial institutions from A– to BB– for up to 30% of the total allowed (Equivalent to 25% of the banks' capital and reserves, and BBB- for the remaining 70%. • **OF:** The CBC established the following ceilings on investments abroad by institutional investors: (a) for pension funds the ceiling was raised from 3% to 6% of their total assets; (b) for life insurance companies, 10% of their assets in foreign financial instruments, and up to 3% in urban nonresidential real estate; (c) for general insurance companies, 15% of their assets in foreign financial instruments, and up to 3% in urban nonresidential real estate; and (d) for mutual funds, 30% of their total assets, without reference to any minimum rating requirement or any specific number of countries. • The Superintendency of Banks and Financial Institutions was authorized to determine the time period during which banks will be required to adjust the ratio between their foreign investment and their total assets to the ceiling established by the CBC (transitory provisions).

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1995 cont.	• The CBC raised the rate on commercial banks' liquidity deposit accounts with the CBC from 5% to 6%. • The CBC moved from fixing the rate on its 90-day indexed paper to fixing the interest rate on its overnight operations with commercial banks.	**Restrictions on Capital Flows** • **IF:** The ceiling on credit in Chilean pesos backed by deposits in U.S. dollars was reduced from 150% to 70%, to avoid a possible by-passing of the one-year 30% reserve requirement on foreign borrowing. The ceiling on credit in Chilean pesos backed by deposits in U.S. dollars was further reduced to 10%. • **IF:** The 30% reserve requirement on foreign liabilities was extended to secondary transactions of ADRs. • **IF:** The coverage of the existing 20% reserve requirement on foreign liabilities was broadened to include investment flows that do not constitute an increase in the capital stock but only a transaction of assets from residents to nonresidents.
1996	**Capital Markets** The CBC announced that for the trading of securities by pension funds, it would consider two formal secondary markets one domestic, and one external. The domestic formal secondary market would consist of stock exchanges, their brokers, and commercial banks with a risk rating of AAA- or higher on their long-term instruments and a rating of 1- or higher on their short-term instruments. The external formal secondary market would consist of stock and securities exchanges, further exchanges securities dealers and brokers authorized to trade in these exchanges as well as over the counter, open and closed end mutual funds, and banks authorized to receive deposits. **Money Market and Instruments** • The CBC limited the access of financial institutions to its liquidity credit lines to 30% of the amount assigned under the first tranche.	**Exchange Market Arrangement and System** • The composition of the currency basket used to calculate the central reference exchange rate of the exchange rate band was adjusted by increasing the weight of the U.S. dollar from 45% to 80%, while reducing that of the deutsche mark and Japanese yen from 30% to 15% and from 15% to 5%, respectively. • The width of the exchange rate band was increased from ±10% to ±12.5%. • The CBC lowered the threshold over which banks are required to provide detailed information on sources and destination of foreign exchange transactions from \$50,000 to \$10,000 per transactions. • The CBC allowed foreign exchange houses to sell up to \$15,000, or its equivalent in other foreign currencies, to any person for travel expenses, payments to international organizations, and payments for studies abroad. • The CBC required exporters to convert export advances into local currency through bank transfers on the formal exchange market, and banks to report such transactions to the CBC. • The CBC authorized debtors of external credits recorded under the Chapter VI to settle amortization interest, commissions, and expenses corresponding to these operations directly abroad with export proceeds. It was required that the CBC be kept informed of these transactions. • Mutual funds were permitted to use the formal exchange market to make investments abroad. • Debtors of credits recorded under Chapter IV were allowed to access in advance the formal market to prepay the credits or maintain the resources in account abroad which could be given in guarantee to the creditor. **Portfolio Investment** • **OF:** The CBC eliminated the restrictions on the share of mutual fund assets that can be invested abroad. • **OF:** Several times in 1996 the authorities expanded the list of foreign investments in which domestic institutional investors are allowed to invest (including domestic pension and mutual funds). • **OF:** The CBC granted individuals unrestricted access to the formal exchange market for transactions up to \$15,000 a month. • **IF:** External credits destined exclusively to prepay foreign credits that were previously authorized and recorded with the CBC were exempted from the 30% reserve requirement, provided the weighted average terms of each credit and residual of the original credit were similar. • **OF:** The CBC granted individuals unrestricted access to the formal exchange market for transactions up to \$15,000 a month (also applicable to Portfolio Investment).

Table 6. Chile: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Controls and Financial System	Exchange System, Trade and Capital Flows
1996 cont.		**Restrictions on Capital Flows** • **IF**: The CBC limited the extension of outstanding foreign loans subscribed under Chapters VI and XIV to a maximum period of one year over their initial maturity. Receipts of foreign credits under Chapter XIV would not be obliged to repay these credits at their initial maturity since they still had access to the informal market. Fines of up to 4% of the value of the scheduled amortization were established to deal with late payments.

Sources: "Central Bank Annual Report" (various issues); "International Tax Summaries: A Guide for Planning and Decisions", Coopers and Lybrand (various issues); Annual Report and Exchange Arrangements and Exchange Restrictions, IMF (various issues); "Doing Business in Chile", Price Water House, 1995; "The Securities Market in Chile: 1980-1989", Superintendencia de Valores y Seguros, 1989; "Quarterly Report on Exchange Rate Arrangements" (various issues); and "Tax Laws of the World: Chile," Foreign Tax Publishers, 1989.

IF = Inflows; OF = Outflows

Table 7. Chile: Selected Macroeconomic, Financial Sector, and Balance of Payments Indicators

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Selected Economic Indicators						(In Percent)						
Real GDP Growth	2.5	5.6	6.6	7.3	9.9	3.3	7.3	10.7	6.6	4.2	8.5	7.2
Inflation per Annum	30.7	19.5	19.9	14.7	17.0	26.0	21.8	15.4	12.7	11.4	8.2	7.4
M2 to GDP Ratio	40.0	38.9	39.5	38.5	39.7	39.9	39.4	37.7	39.1	36.6	37.8	40.7
Currency to Deposits Ratio	11.4	12.2	10.8	11.0	10.0	10.1	9.2	9.5	9.2	9.4	8.5	7.7
Fiscal Balance to GDP Ratio	−2.3	−0.9	0.4	−0.2	1.8	0.8	1.6	2.2	1.9	1.7	2.5	...
Private Sector Credit to GDP Ratio	68.1	61.7	57.0	52.7	48.1	45.9	44.0	45.4	49.3	48.5	51.1	55.0
Exports plus Imports of Goods to GDP Ratio	41.7	43.0	46.5	51.1	54.0	52.8	49.5	47.1	44.5	44.9	47.6	46.1
Current Account to GDP Ratio	−8.6	−6.7	−3.6	−1.0	−2.5	−1.8	0.3	−1.6	−4.6	−1.2	0.2	−4.1
Financial Account to GDP Ratio	−8.5	−12.5	−3.6	−3.8	4.8	9.9	2.5	6.9	5.7	8.7	2.1	8.8
Interest and Exchange Rates												
Nominal Deposit Rate (percent per annum)	32.0	19.0	25.2	15.1	27.7	40.3	22.3	18.3	18.2	15.1	13.7	13.5
Real Deposit Rate (percent per annum)	1.3	−0.5	5.3	0.4	10.7	14.2	0.5	2.8	5.5	3.6	5.5	6.1
Interest Rate Differential 1/	23.6	12.1	18.0	7.1	18.4	32.0	16.3	14.4	15.0	10.3	7.7	8.0
Lending/Deposit Spread	8.8	7.3	7.6	6.1	8.2	8.6	6.2	5.7	6.1	5.2	4.4	3.9
Official Exchange Rate per US dollar (end of period)	183.9	204.7	238.1	247.2	297.4	336.9	374.9	382.3	431.0	404.1	407.1	425.0
Real Effective Exchange Rate Index (1990=100)	136.6	115.6	107.1	100.8	103.2	100.0	96.4	93.2	95.7	94.6	86.4	86.8
Balance of Payments						(In millions of U.S. Dollars)						
Current Account, n.i.e.	−1,414	−1,192	−735	−231	−705	−540	113	−700	−2,072	−644	142	−2,921
Financial Account, n.i.e	−1,395	−2,221	−742	−905	1,340	3,014	843	2,931	2,579	4,534	1,387	6,342
Direct Investment Abroad	−2	−3	−6	−16	−10	−8	−123	−378	−433	−926	−697	−1,080
Direct Investmnet in Rep. Eco, n.i.e.	144	316	891	968	1,289	590	523	699	808	1,773	1,668	4,091
Net Direct Investment	142	313	885	952	1,279	582	400	321	375	847	971	3,011
Portfolio Investment Assets	...	...	...	...	...	...	...	...	−90	−351	−14	−137
Portfolio Investment Liabilities	...	−78	−8	−8	80	353	186	452	820	1,259	49	1,240
Net Portfolio Investment	...	−78	−8	−8	80	353	186	452	730	908	35	1,103
Other Investment Assets	434	576	257	370	297	553	1,298	−273	460	−163	−49	−141
Other Investment Liabilities	−1,971	−3,032	−1,876	−2,219	−316	1,526	−1,041	2,431	1,014	2,942	430	2,369
Net Other Investments	−1,537	−2,456	−1,619	−1,849	−19	2,079	257	2,158	1,474	2,779	381	2,228
of which, Official Capital	1,322	378	380	−104	−602	−335	−6	131	−895	−405	−2,151	−2,094
Net Errors and Omissions	−67	225	−144	−121	−119	−140	300	316	−80	−741	−391	−917
Overall Balance 2/	−2,876	−3,188	−1,621	−1,257	516	2,334	1,256	2,547	427	3,149	1,138	2,504
Memorandum Item:												
Net Private Capital 3/	−3,115	−2,034	−814	−434	1,756	3,229	1,583	4,477	3,782	5,143	4,824	7,605

Source: IMF International Financial Statistics, Information Notice System, and IMF Direction of Trade Statistics, various issues.

1/ Interest Differential = Deposit Rate − London Interbank Offer Rate on 3−Month U.S. Deposits.
2/ The overall balance includes: current account, financial account, capital account, and net errors and omissions. Capital account figures are not shown because they are zero throughout the period.
3/ Total Capital = Direct Investment + Portfolio Investment + Other Investment − Official Capital + Net Errors and Omissions + Misinvoicing.

Table 8. Chile: Abstract of Exchange and Capital Control Regime as of April 30, 1997

	Exchange Arrangement
Currency	The currency of Chile is the Chilean peso.
Exchange rate structure	Unitary.
Dual	There are 2 foreign exchange markets: the official market, through which debt-service payments, remittances of dividends and profits, and authorized capital transactions, including loan receipts, must be transacted; and the informal market, through which all transactions not required to be channeled through the formal market take place. The formal foreign exchange market consists of commercial banks and exchange houses and other entities licensed by the Central Bank of Chile (CBC).
Classification	
Managed floating	In both exchange markets, economic agents are free to negotiate rates; the CBC conducts transactions in the official exchange market within margins of 10 percent around the reference rate. The exchange rate of the Chilean peso is adjusted daily on the basis of changes in the value of a basket of currencies calculated from a set formula (0.45 U.S. dollar, 0.46 deutsche mark, and 24.6825 Japanese yen) and the differential between domestic and foreign rates of inflation, adjusted for the estimated differential in productivity growth between Chile and its trading partners (2 percent a year). In January 1997, the margin around the reference rate was increased to 12.5 percent, while the composition of the basket was modified to 0.8 U.S. dollar, 0.24435 deutsche mark, and 5.911 Japanese yen.
Forward exchange market	Yes.
	Exports and Export Proceeds
Repatriation requirements	Receipts from copper exports of CODELCO (state copper company) must be deposited in the account of the Copper Stabilization Fund at the CBC; withdrawals are permitted only under prescribed circumstances. Debtors of internal credits recorded under Chapter VI of Title II of the Compendium of Rules on International Exchange (CEIR) are authorized to settle interest, commissions, and/or expenses corresponding to those operations effected directly abroad with export proceeds. The CBC must be informed of these settlements.
Surrender requirements	No.
	Proceeds from Invisible Transactions and Current Transfers
Repatriation requirements	Yes.
Surrender requirements	Proceeds from selected transactions (e.g., royalties and copyright fees, commissions, proceeds from insurance, and other benefits related to foreign trade) are subject to a 100 percent surrender requirement.
	Capital Transactions
Controls on capital and money market instruments	
On capital market securities	
Purchase locally by nonresidents	Nonresidents can invest in domestic securities in 3 ways:
	(1) Through acquisition by foreign investment funds (FICE). These are formed by foreign capital and administered by an open society established in Chile. Investments

Table 8. Chile: Abstract of Exchange and Capital Control Regime as of April 30, 1997

	cannot exceed 5 percent of social capital in any 1 company and 10 percent of the funds' total assets. These funds cannot invest more than 40 percent of their portfolios in equities of the same holding period, and all FICEs as a group may not hold more than 25 percent of the equities of the same open society. Other requirements for FICEs are a 5-year minimum holding period, a profit tax of 10 percent, and some portfolio restrictions that vary with the duration of the holding period;
	(2) Through a financial investment (purchase of fixed income securities and equities). These are, however, subject to a reserve requirement of 30 percent for 1 year, and a minimum holding period requirement of 1 year and to the general income tax law. Equities that have American Depository Receipts (ADRs) can be acquired in the country and co nverted into ADRs. These transactions are also subject to the 30 percent reserve requirement. The issuance of primary ADRs is exempt from the above restrictions, but the issuers are subject to minimum international rating requirements and there is a minimum amount to be issued;
	(3) Through loans. These can also be used to finance the purchase of securities in the country. They are subject to a 1-year reserve requirement of 30 percent, a 4 percent tax on interest payments, and a 1.2 percent stamp tax.
Sale or issue locally by nonresidents	Proceeds from the sale of domestic securities by nonresidents are subject to the 1-year holding period requirement if the capital inflow entered as a financial investment. The sale of equities that are the property of foreigners due to the ADR mechanism is possible, since Chilean ADRs can be converted into domestic stock. However, the resources obtained through the sale must be repatriated. ADRs issued from equities directly acquired in the Chilean stock market (also called secondary ADRs) are tightly restricted, both for the authorized period for acquiring stocks domestically and for the authorized period for acquiring foreign exchange after a local stock sale. All the associated foreign exchange operations must be effected through the formal exchange market. Issuance of foreign securities by nonresidents is subject to the same procedures applied to domestic securities. In practice, no foreign securities are traded domestically. Once the respective taxes have been paid, profits may be transferred freely without delay.
Purchase abroad by residents	Except for banks and pension funds, there are no restrictions on the acquisition of international fixed-income assets and current account deposits. The associated foreign exchange must be acquired in the informal market. Pension funds are authorized to hold up to 9 percent of their funds in foreign assets, including a variety of fixed-income assets and company shares up to 4.5 percent of the fund. Investments by life insurance companies are limited to 10 percent of their technical reserves and risk net worth.
Sale or issue abroad by residents	Residents can issue equities and bonds abroad, and the associated foreign exchange operations must be effected through the formal exchange market. Equities can be sold according to the rules that regulate capital inflows through the mechanism of ADRs. Primary ADR issues are only subject to minimum amounts (US$25 million the first time, and thereafter US$10 million), and to 2 minimum international risk-rating requirements, for long-term debt of BBB+ for banks and BBB for other firms.
On money market instruments	
Purchase locally by nonresidents	In general, these acquisitions are authorized for nonresidents, but there are regulations governing the mode of inflow. The associated capital inflow liquidation and the subsequent repatriation of proceeds must be effected through the formal exchange market. Acquisition through external loans are subject to a reserve requirement of 30 percent, a tax on interest of 4 percent, and a stamp tax of 1.2 percent. Acquisition through FICEs is subject to a minimum holding period of 5 years in addition to a 10 percent profit tax. In the case of fina ncial investments, there is a 30 percent 1-year

Table 8. Chile: Abstract of Exchange and Capital Control Regime as of April 30, 1997

	reserve requirement and a minimum holding period of 1 year, and they are subject to the general income tax law.
Sale or issue locally by nonresidents	These transactions are not authorized and neither is the promotion of these or other financial services from abroad. To operate in the domestic financial market, the company must be registered and established, and must have brought in capital for operational purposes. The legal mechanism used is the creation of a Chilean agency of the foreign corporation.
Purchase abroad by residents	The acquisition of money market instruments by individuals and nonfinancial companies is not restricted. However, the formal exchange market is not available for these operations.
Sale or issue abroad by residents	These transactions are subject to a reserve requirement of 30 percent.
On collective investment secur ities	
Purchase locally by nonresidents	These purchases are considered financial investments subject to a reserve requirement of 30 percent for a year and a minimum holding period of 1 year. Funds that enter Chile through an FICE are subject to a minimum holding period of 5 years.
Sale or issue locally by nonresidents	These transactions are not permitted. To operate in the domestic financial market, the company must be registered and established, and must have brought in capital for operational purposes. Once this has occurred, the sales of collective instrument securities are subject to the same domestic rules as any other investment, with no restrictions on the repatriation of profits.
Purchase abroad by residents	There are no restrictions for nonfinancial agents, but there is no access to the formal exchange market for these purposes. Pension funds are also restricted by the type of fund (mainly to avoid leveraged and hedged funds), country risk, regulation, liquidity, experience of the fund, and participant's concentration. Investments are also subject to certain limits: they should not exceed 4.5 percent of the pension fund, and variable income securities from any issuer should not exceed 2 percent of the fund.
Sale or issue abroad by residents	In practice, Chilean mutual funds (open funds) and investment funds (closed funds) are not offered directly abroad. To operate abroad, such funds must meet the existing regulations of the foreign country. Domestically issued instruments can be sold to nonresidents, but funds must be repatriated. These inflows are considered a financial investment subject to a reserve requirement of 30 percent annually and a 1-year holding requirement. FICEs that come into Chile under foreign ownership may be sold and traded in the New York or the London stock exchanges. The capital committed by the FICE must remain invested in Chile for 5 years.
Controls on derivatives and other instruments	
Purchase locally by nonres idents	The market is not well developed. Nonresidents cannot participate in the local market for currency derivatives.
Sale or issue locally by nonresidents	To operate, foreign agents must have resident status.
Purchase abroad by residents	The CBC regulates currency and interest rate derivatives taking place in foreign markets. Interest rate derivatives do not exist in the local market and are not regulated. Speculative positions with derivatives abroad can be taken by nonfinancial institutions that acquire the foreign exchange in the informal market. Banks can cover themselves in currency derivatives up to the level of the underlying asset or liability position that needs to be covered. In the case of interest rate derivatives, banks are only allowed to cover mismatches between assets and liabilities. Pension funds and insurance companies are only allowed to cover themselves against currency volatility up to a maximum of their foreign financial investments on a currency-by-currency

Table 8. Chile: Abstract of Exchange and Capital Control Regime as of April 30, 1997

	basis.
Sale or issue abroad by residents	Derivatives for currency and interest rates exist for operations with foreign agents in over-the-counter operations, with security dealers or brokers that are authorized by the foreign authorities, or with foreign banks. There is access to formal spot exchange markets for hedging purposes. Currency and interest rate options are allowed, except for banks. For residents, including banks, other derivative contracts (interest rates, currencies, and commodity prices) are permitted up to the amount of the underlying external asset or liability position that needs to be covered. However, these contracts cannot be effected on the formal market, except by banks and institutional investors.
Controls on credit operations	
Commercial credits	
By residents to nonresidents	All types of nonfinancial agents (except pension funds and insurance companies) are allowed to engage in international trade lending, but these operations must be effected through the informal exchange market.
To residents from nonresidents	Commercial credits can be contracted with foreign banks and financial entities under a 30 percent reserve requirement charged on an average balance and subject to a 4 percent tax on interest. Export advances and direct supplier credits to importers are exempted from the reserve requirement. Associated foreign exchange transactions must be effected through the formal exchange market.
Financial credits	
By residents to nonresidents	Operations by insurance companies, pension funds, and institutional investors are restricted. Others must operate through the informal market. In April 1997, access to the formal market was extended to all credits.
To residents from nonresidents	Financial credits can be contracted with foreign banks and financial entities, subject to a 1-year 30 percent reserve requirement, a 4 percent tax on interest, and a stamp tax of 1.2 percent. Under Chapter XIV of the CEIR, debtors may use the formal market to prepay credits or to maintain the resources in an account abroad as a guarantee to creditors. Such funds are exempt from the 30 percent reserve requirement, provided the weighted average of the terms of each credit and the residual of the original credit are similar.
Guarantees, sureties, and financial backup facilities	
By residents to nonresidents	These transactions are not allowed except for banks, which have to be authorized by the CBC. Only the following operations can be guaranteed or backed up by banks: external credits received by domestic enterprises, financial credits, the issuance of documents abroad, and forward contracts with authorized agents abroad.
To residents from nonresidents	Yes.
Controls on direct investment	
Outward direct investment	Restrictions exist in the case of ownership in a foreign company, investments in a project, or establishment of a company abroad. Investments may be made: (1) through the formal exchange market, in which case the CBC grants approval but the investment is subject to a 120-day profit repatriation while avoiding double taxation; or (2) through the informal exchange market, where the CBC must only be informed. There are also some limitations on the purchase of equities and foreign direct investment through the formal exchange market, in which case the CBC may give authorization to proceed, depending upon the specific information it is provided about the investment. There is a diversification requirement that allows a maximum investment in subsidiaries and branches in 1 foreign country of 20 percent of the capital and reserves of a local bank. Investment abroad in foreign subsidiaries and

Table 8. Chile: Abstract of Exchange and Capital Control Regime as of April 30, 1997

	branches must be deducted from the local cap ital base.
	Investment by commercial banks is limited to 25 percent of each bank's capital and reserves, and restricted to bills and bonds issued or guaranteed by foreign governments
	or central banks and private enterprises with a minimum long-term international debt risk rating (and its equivalent for short-term debt) of BBB.
	Pension funds and insurance companies are subject to a minimum long-term international debt risk rating of BBB. In April 1997, the following transactions were permitted in the formal market: investments abroad, including acquisition of real or financial assets; and participation in companies and in contracts for the exploration and exploitation of domestic resources. There is, however, a reporting obligation to the CBC. Repatri ation of investments, including profits, were exempted from the 30 percent reserve requir ement.
Inward direct investment	Capital contributions to new establishments or shares in existing ones are subject to a 1-year minimum holding period and a minimum amount of US$10,000. Projects of significant size may be undertaken; there is a minimum holding period of 1 year, and the investor enjoys favorable taxation treatment with regard to the choice between the general income tax law or the guaranteed payment profit tax of 42 percent. There is also guaranteed access to the formal exchange market for repatriation.
Controls on liquidation of direct investment	Investments must be held in Chile for at least 1 year to qualify for repatriation. After that period, it must be demonstrated that the assets were sold and applicable taxes paid.
Controls on real estate transactions	Yes.
Purchase abroad by residents	Purchases are permitted through the informal market, but insurance companies can invest only 3 percent of their reserves and risk net worth.
Purchase locally by nonresidents	Purchases are treated as a financial investment and are subject to a minimum investment requirement of US$10,000, a reserve requirement of 30 percent, and a minimum holding p eriod of 1 year.
Sale locally by nonresidents	The investment must have been held for 1 year in Chile and it must be demonstrated that the asset was sold and applicable taxes paid.
Provisions specific to commercial banks and other credit institutions	
Borrowing abroad	Banks are permitted to obtain foreign trade credits subject to a reserve requirement of 30 percent against the average balance. They may also obtain financial credits with a reserve requirement of 30 percent for a year.
Maintenance of accounts abroad	Nonbank financial institutions are not allowed to maintain accounts abroad. Banks may hold foreign time deposits within the margin for financial investment abroad. External current accounts are not restricted.
Lending to nonresidents (financial or commercial credits)	Banks are only allowed to grant loans related to foreign trade. However, they can purchase debt instruments and sovereign bonds issued abroad. Time deposits are considered part of the margin for financial investments. Banks satisfying a capital adequacy ratio of at least 10 percent may acquire stocks of foreign banks or establish branches abroad. Deposits, loans, and other assets of Chilean banks with foreign banks of Chilean ownership cannot exceed 25 percent of the capital and reserves of the foreign bank.
Lending locally in foreign e xchange	Banks are only permitted to grant foreign exchange credits associated with foreign trade. However, they may grant loans or acquire securities denominated or expressed in foreign exchange provided they remain within the open position limits.

Table 8. Chile: Abstract of Exchange and Capital Control Regime as of April 30, 1997

Purchase of locally issued securities denominated in foreign e xchange	These purchases are subject to open position limits.
Differential treatment of nonresident deposit accounts and/or deposit accounts in foreign exchange	
Reserve requirements	The requirement for foreign currency deposits, for both time and current account deposits, is 30 percent. The requirement for domestic currency time deposits is 9 percent.
Liquid asset requirements	Yes.
Interest rate controls	By law there are ceilings on interest rates for both domestic and foreign currency loans. Those ceilings are defined as one-and-a-half times the average market interest rate.
Investment regulations	Foreign financial investments by commercial banks are limited to 25 percent of each bank's capital and reserves, and are restricted to bills and bonds issued or guaranteed by foreign governments or central banks and private enterprises. The general minimum long-term international debt risk rating (and its equivalent for short-term debt) for the financial instruments is BBB-, and up to 30 percent of the 25 percent margin can be invested in BB-instruments. The foreign exchange needed to invest abroad must be obtained in the fo rmal exchange market.
Open foreign exchange position limits	The limit is 20 percent of capital and reserves. This margin includes derivative and spot instruments, foreign investment, assets and liabilities issued abroad or denominated in foreign exchange. Additionally, there is a foreign financial investment ceiling of 25 percent of the capital and reserves of each bank, a maximum investment in subsidiaries and branches abroad of 20 percent of the capital and reserves of domestic banks, and a requir ement that the balance of all acquisitions and sales of foreign exchange for a bank be positive.
Provisions specific to institutional investors	Pension funds and insurance companies may hold only foreign instruments of a minimum international long-term risk rating requirement of BBB. These investors may also acquire foreign instruments guaranteed by the U.S. Treasury, such as Brady Bonds. Acquisition of equities and variable income assets by pension funds is restricted to instruments in some international markets. Specifically, there are rules on the transpa rency, regulation, and information of the stock exchange where these instruments can be acquired. However, for insurance companies, the possible stock exchange options are wider; insurance companies can invest in markets where there is a daily average of at least US$10 million of equity transactions. Mutual funds may use the formal exchange market to make investments abroad.
Limits (max.) on portfolio invested abroad	Pension funds may invest up to 9 percent of their resources abroad. Life insurance companies may invest their technical reserves and their risk net worth with global limits of 10 percent in financial investments and 3 percent in real estate. The limits for general insurance companies differ from those of the life insurance companies only in the case of financial investment abroad. The limit for the former is 15 percent. In April 1997, pension funds were permitted to invest up to 12 percent of their resources abroad.
Currency matching regulations on assets/liabilities composition	n.a.
Other controls imposed by securities laws	No.

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1985	**Money Markets and Instruments** • Interest rates are market determined (liberalized in 1983) and money market instrument (SBIs) was introduced in 1984. • Introduced standardized form of banker's acceptances (SBPUs) in February.	**Exchange Market Arrangement and System** • Government provided opportunity to foreign investors engaged in exports to obtain export credits at low interest rates through foreign exchange banks in Indonesia. **Direct Investments** • **IF**: Procedure simplified: Since April 1985 proposal for new project has to meet only 14 procedural requirements compared with 25 in the preceding year. • **IF**: Certain fields closed to foreign direct investments might be opened if entire production exported. **Trade** • Import tariff schedule revised—tariff ceiling was reduced substantially, with tariff rates ranging from 0% to 60% compared with 0% to 225%, previously; the number of tariff categories was also reduced from 25 to 12 (March). • A value-added tax of 10%, which is applicable to the c.i.f. import price plus the tariff, was also introduced. Luxury goods and other specific goods were to incur higher import duties or specific taxes.
1986		**Exchange Market Arrangement and System** • On September 12, the *Rupiah was devalued* by 31% from Rp 1,134 per U.S. dollar to Rp 1,644 per U.S. dollar. **Direct Investments** • **IF**: Government permitted foreign direct investment companies to extend their operations for 30 years after expansion approval (previously they were permitted to operate for 30 years from their actual establishment. • **IF**: If foreign direct investment companies met certain criteria they were eligible for treatment equivalent to the domestic investment scheme. This allowed foreign direct investment companies to market their products locally, and to obtain working capital credit from commercial state banks and Indonesia's Development Bank. • **IF**: Equity ownerships rules were relaxed for companies exporting all their products, or were located in remote areas, or facing high business risk, or investing at least $10 million. Initially foreign ownership could be as high as 95%, although after five years of operations it was to be reduced to at most 80%. Additionally, to encourage companies to reinvest their profits in Indonesia they were allowed to purchase shares of any existing enterprise and were not limited to those established with foreign participation, or under the domestic investment scheme. • **IF**: Foreign investors were permitted to invest in certain enterprises established under the domestic investment scheme who needed additional capital. • **IF**: To encourage exports, foreign investors were allowed to increase their share to 95% in an enterprise, although after five years the shares were to revert back to its original composition.

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1986 cont.		**Direct Investment** • **IF**: The investment priority list was revised and a wider sector was open to foreign direct investment. In addition, foreign investors were allowed to invest in sectors reserved for domestic investors as long as they were cooperative entities. **Trade** • Accepted GATT Code on subsidies and countervailing duties. • Firms that export at least 85% of output could import input free of licensing restrictions and were exempt from import duties. • Import licensing was liberalized on 321 CCCN items (mostly manufacturing), or 25% of restricted items. • Changes in import duties became applicable to 333 products: Tariffs were reduced for imports not produced domestically and temporary surcharge imposed on 33 items.
1987	**Capital Markets** • Listing requirement on the Jakarta Stock Exchange (JSE) were simplified. Measures introduced to improve institutional framework and operation of capital market institutions (for example, underwriters, guarantors, and stock traders). • Bearer securities introduced. **Money Market and Instruments** • Interest rate allowed more flexibility. • Modification to money market procedures to strengthen Bank of Indonesia's (BI) ability to regulate liquidity. BI makes daily decisions to inject or withdraw liquidity, through daily auctions in SBIs and SBPUs. • The government introduced the Over the Counter market. • SBPU discount ceilings were eliminated. • State owned enterprises were forced to transfer part of their deposits to BI from state-owned banks.	**Exchange Market Arrangement and System** • Exchange rate was allowed more flexibility. **Direct Investments** • **IF**: The transfer period of majority ownership from foreign to local was extended from 10 to 15 years with a possibility of further extension of five years. • **IF**: Companies exporting at least 65% (reduced from 85%) of their output were allowed to be established with a minimum of 5% local ownership which had to be raised to 20% in 10 (previously five) years. • **IF**: Foreign companies in bonded zone and exporting 100% of output were allowed to be established with a national ownership of a minimum of 5% without the requirement to subsequently raise the local share of ownership. • **IF**: Government expanded the number of sectors open to foreign investment. • **IF**: Ownership rules were relaxed further to permit companies with foreign investment to be treated equally as those established under the domestic investment scheme—allowing them to sell output in the domestic market and to obtain working capital credit from state-owned commercial banks and the State Development bank. To qualify national ownership was required to be 51% (reduced from 75%) or 45% (reduced from 51%) provided at least 20% was sold through the stock market. • **IF**: Abolished license requirement for limited domestic purchases. This made it easier for foreign companies to purchase domestic products as inputs (previously two licenses were required now only one). • **IF**: Companies with Presidential approval no longer had to obtain prior approval from the Capital Investment Coordinating Board to make imports. Only submission of a master list to authorized surveyors is required. • **IF**: To promote non-oil/gas exports, particularly manufacturing, companies established with foreign investments were allowed to export products manufactured by other companies and to establish joint-venture companies which would export manufactured goods.

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1987 cont.		**Direct Investments** • **IF**: Some enterprises under the domestic investment scheme or established through foreign direct investment, whose outputs were mostly exported were awarded permanent licenses. Some were exempt from licensing requirements if they were expanding or diversifying within the same industry. • **IF**: Foreign direct investment companies exporting more than 65% of their output were allowed more freedom in hiring foreign experts. **Portfolio Investments** • **IF**: Government announced plans to allow foreign investors to purchase securities on the stock market and on the over-the-counter bourse. **Trade** • Import licensing was liberalized for 202 CCCN items (non-batik textiles), representing 89% of restricted non-batik imports (January). • Import licensing was liberalized for 18 CCCN items (iron and steel sector), representing 13% of restricted iron and steel sector imports (January). • Goods were freed from non-tariff restrictions and were included in 111 tariff classifications (approximately 50% were steel and aluminum products; December). • Due to removal of non-tariff barriers, tariffs were increased on 91 CCCN items and tariffs were reduced on 65 items (December). • Import duties were lowered on 65 CCCN items (December). • Export licensing procedure was simplified (December).
1988	*A Financial Policy Package introduced on Oct. 27, 1988*. It included the following measures; expected to promote mobilization of funds, export of non-oil/gas commodities, efficiency in financial institution and banks, and a more efficient monetary management as well as a climate conducive to the development of the capital market. *A Financial Policy Package introduced on December 20, 1988*. It was directed at further encouraging the development of the capital market and financing companies so as to mobilize more long-term funds to finance investment. **Financial Supervision and Regulatory Framework** • To strengthen prudential bank supervision: legal limits established on financial institutions' exposure to individuals or groups of borrowers and supervisory responsibility for rural credit transferred to BI from Agricultural Development Bank. • State banks, regional development banks, private national banks, and cooperative banks were permitted to open new branch offices throughout the country.	**Exchange Market Arrangement and System** • Article VIII was accepted on May 8. • The branch offices of foreign exchange banks, which were previously not allowed to manage foreign exchange, could do so now by simply informing BI. • Swap premium shifted to market-based determination and maximum maturity extended from 6 months to 3 years. **Direct Investments** • **IF**: Foreign investors were allowed to establish joint ventures in the setting up of new financing institutions such as factoring companies, venture capital, securities trading, and consumer financing with a maximum share of 85% of the paid up capital. • **IF**: The government allowed joint ventures in the insurance industry but foreign partnership was limited to 80%. These companies were also allowed to offer life insurance policies either in rupiah or in foreign currency. • **IF**: Joint venture banks were also permitted with the foreign partner allowed at most a 85% share.

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1988 cont.	**Financial Supervision and Regulatory Framework** • NBFIs and foreign banks were permitted to open one branch in each of seven cities, and joint-venture banks (with maximum foreign participation of 85%) could be established by foreign banks already represented in Indonesia. • New private banks may be established anywhere in Indonesia, while rural credit banks may be established outside main cities and municipalities. Two new private banks were licensed between October and December. • Requirements to become a foreign exchange banks were eased. • Foreign banks were allowed to establish sub-branch offices. • Foreign banks were now allowed to introduce rupiah savings scheme which were previously prohibited. **Money Market and Instruments** • Reserve requirements was reduced from 15% to 2% on foreign currency deposits and on current liabilities. Time and saving deposits of all banks are now categorized as current liabilities. • To increase competition, public enterprises allowed to hold up to 50% of deposits at non-state financial institutions. • New sub-branch offices of foreign banks were required to extend a major portion (at least 50%) of their credits to finance non-oil/gas exports. • The share of export credits extended by the joint-venture bank should at least be 50% of outstanding credits. • Maximum maturity of money market securities extended to 6 months. • Weekly auctions of money market instruments introduced to supplement daily auctions. • Several banks and NBFIs authorized to act as market makers along with FICORINVEST. • NBFIs authorized to issue rupiah CDs.	**Trade** • NTBs replaced by tariffs on 300 products (including fertilizers, plastics, and most types of steel). • Tariff rates reduced on 86 products and increased on 72 products. 22 products which were previously subject to specific duties, were made subject to ad valorem tariffs.
1989	**Money Market and Instruments** • Previously, private national commercial banks were allowed to extend investment credit up to a maximum of 20% of their total lending and 10% of their equity for each borrower. For foreign banks, the maximum amount was 35% of their total lending. Under the new regulations the old limits have been removed and all commercial banks including foreign banks, are required to take into account the new regulation on legal lending limits.	**Exchange Market Arrangement and System** • Foreign direct investment companies may now sell their foreign exchange from their foreign exchange account directly to foreign exchange banks and do not have to sell it to BI as previously. **Direct Investments** • IF: To influence foreign direct investments the government replaced the priority list with a negative list. • IF: The minimum investment requirement was lowered to $250,000. • IF: Foreign investors may own 100% of the shares if investing in the bonded zone of Batam island and are exporting 100% of their output. Five years after commercial production at least 5% of the shares must be sold to Indonesian partners.

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1989 cont.		**Portfolio Investments** • **IF**: Government regulated the purchase of stocks by foreign investors. Foreign investors are allowed to purchase up to 49% of stocks in the primary market or up to 49% of stocks listed on the bourse and OTC. However, foreigners are not allowed to purchase stocks issued by private banks. • **IF**: Since April, foreign exchange banks and NBFI are no longer subject to ceilings on off-shore borrowings. However, their net foreign exchange open position must not exceed 25% of their own equity. **Trade** • The Harmonized System (HS) was adopted. Rates of tariffs and import surcharges on several products were modified. • State monopoly to import maize was revoked.
1990	**Capital Markets** • Steps to further develop the capital market. Presidential Decree (Nov. 10) and Ministry of Finance Decree (Dec. 4), issued that provide new structure and policy framework (see below in 1991). **Financial Supervision and Regulatory Framework** • Joint-venture banks and foreign banks permitted to open branch offices in Batan Island. **Money Markets and Instruments** • Measures introduced to reduce liquidity credits extended by BI. Liquidity credits will only be provided for activities which support cooperatives, investment, and the achievement of self sufficiency in food.	**Trade** • Licensing requirements for 371 goods, including certain machinery steel products, electronic products, and pharmaceuticals were removed (restrictions on about 1300 items still remain). • Tariffs on 2,363 products (out of 7,176 products) were reduced; tariffs above 40% virtually eliminated (about 400 items remain). • Split tariffs eliminated; surcharged on 53 products (out of 223) removed. • Import tariff on 224 products raised. • In accordance with GATT subsidized export credits abolished.
1991	**Capital Markets** • BAPEPAM's function modified. Responsible for regulatory and supervisory aspects of the market and to protect the investors interests. Powers increased to perform responsibilities. • Based on principle of self-regulations, the operational role of Bapepam was transferred to private companies—PT Jakarta Stock Exchange (JSE) and PT Subrabaya Stock Exchange (SSE). **Financial Supervision and Regulatory Framework** • Measures to strengthen regulatory framework of the banking system to be implemented over a two-year period were announced: stricter conditions for obtaining banking licenses and opening overseas branches; compliance with capital adequacy requirements; mandatory provisioning for doubtful or nonperforming assets; reduction in limits on banks' net open positions; and more detailed reporting by banks to BI.	**Exchange Market Arrangement and System** • BI reduced the individual banks' swap limit from 25% to 20% of capital. In November 1991, BI started to provide two types of swaps—the liquidity type and the investment type (maturity more than 2 years). Liquidity swaps are initiated by BI while the investment swap is initiated by the banks. **Direct Investment** • **IF**: The government revised the direct investment negative list (items reduced to 60 from 70). • **IF**: Government allowed foreign investors to own a maximum of 80% of the capital stock. • **IF**: Government allowed venture capitalist to participate in the foreign direct investment scheme on a temporary basis and not to exceed 10 years.

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1991 cont.	**Financial Supervision and Regulatory Framework** • Banks were required to keep the net open position in foreign currency including their off-balance sheet accounts at or below 20% of capital. • 80% of all foreign exchange loans was to be allocated to businesses earning foreign exchange.	**Direct Investment** • **IF**: Government widened the scope of opportunities available to foreign direct investors. The minimum investment requirement of $1 million for setting up export oriented enterprises was lowered to $250,000 if it involved the participation of cooperatives or small-scale economic groups. The share of the small scale participant should be 5% at time of initial investment, but must be raised to 20% in 10 years and to 51% in 15 years. • **IF**: Special concessions were granted to export oriented foreign investment in eastern Indonesia to enable them to hire foreign workers • **OF**: Commercial banks (not NBFIs) are allowed to open overseas branches or representative offices and undertake equity participation in banks and other financial institutions abroad. To be eligible the bank must have the status of a foreign exchange bank for at least one year. Additionally, the banks rating classification for overall performance and capital adequacy for the last 24 months should be at least sound for 20 months and fairly sound for the remaining months. **Restriction on Capital Flows** • **IF**: A Foreign Commercial Borrowing Management Coordinating Team was established by Presidential Decree No. 39, in September. Ceilings on foreign commercial borrowings were introduced (on 10/12/91). This applied to Bank Indonesia, State Bank, Commercial banks, private companies, and State-owned companies. Borrowings not subjected to ceilings or coordination included those required for regular trade, or in the context of money/capital market less than $20 million per creditor or depositor and not intended to finance new projects or expand projects related to public entities. Borrowings by private companies to finance private projects not related to public entities was also not subject to ceilings or coordination. • **IF**: Banks' short-term foreign exchange liabilities (up to two years, excluding trade related financing) was limited to 30% of capital. **Trade** • Import restrictions replaced by tariffs on 322 items (in particular agricultural and vehicle assembly products), reducing proportion of imports subject to administrative restrictions to 12% from 15%. • Maximum tariff rate on finished goods was reduced to 30% from 40% and on intermediate goods to 15%. Number of items with tariffs higher than 35% was reduced. All these measures reduced total number of tariff items to 9,303 from 9,492 and the average (unweigthed) tariff rate to 20% from 22%. • Surcharges on 137 products (out of 542) were removed.

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1992	**Capital Markets** • Commercial banks allowed to issue securities through the stock exchange. **Financial Supervision and Regulatory Framework** • Issued new banking laws to replace laws issued in 1967. • Eliminated all specialized categories of financial institutions. • Initiated phased reduction plan of banks' equity participation in nonfinancial institutions. • Permit bank ownership by foreigners (up to 49%). • State banks were converted to limited liability companies with up to 49% in private ownership. • The supervisory authority of the BI was strengthened. • Stricter disclosure requirements were established. • Improved accounting standards were established. • New insurance laws were issued on 2/11/92.	**Direct Investment** • **IF**: Items on negative foreign direct investment list were reduced to 51 from 60. • **IF**: 100% foreign ownership was permitted for (i) projects worth at least $50 million; (ii) projects located in the 14 less developed provinces; and (iii) projects situated in a bonded zone with 100% of output exported. • **IF**: All new investments (except oil and gas, banks and nonbank financial institutions) were required to have the prior approval of the Investment Coordinating Board (BKPM). • **IF**: Foreign banks were allowed to hold up to 85% of the equity of a nonbank financial institution (NBFI). NBFIs were not permitted to compete with the commercial banks. • **IF**: Only Indonesian citizens were allowed to have the right to own land. However, foreign investors may acquire the right to build, right to use, and the right of exploitation. **Portfolio Investment** • **IF**: Foreign investors were allowed to purchase equity in commercial banks on the condition that they not hold the majority stock. **Trade** • Import licensing restrictions were reduced from 703 to 464—replaced with tariffs (mostly in manufacturing). • 40% of existing import surcharges were removed. • Krakatau Steel's monopoly import rights were eliminated. • The ban on the export of unprocessed logs, raw skins and hides, and raw rattan was lifted, and export taxes on these items were introduced instead.
1993		**Direct Investment** • **IF**: Licensing procedure simplified by requiring less paper work and decentralized some responsibilities. • **IF**: 100% foreign ownership permitted for projects worth at least $2 million if produce inputs or components for other industries. • **IF**: Divestment of 100% ownership allowed to start in the eleventh year (instead of sixth). Divestment to be carried out in 20 years and could be transacted through capital market. • **IF**: For certain categories of investment, local ownership required to reach 20%–51% (previously 5%–20%) within 20 years, in particular, large investments (above $50 million). Government revised the negative list—reduced, restricted, or closed sectors from 51 to 33. • **IF**: Maximum length of land leases increased to 30 years with easy renewal. **Trade** • Items subject to restrictive import licensing requirements were reduced to 430 from 470. • Tariffs were lowered on 221 items (mostly machinery, equipment, paper, and paper products), generally by 5%. • NTBs removed on 77 steel products. Imports surcharges removed on 58 steel products (accounting for 35% of steel imports).

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1993 cont.		**Trade** • Tariffs and surcharges lowered on 72 glass products, 19 chemical products, 5 copper products, and certain machine tools. • Tariffs and surcharges removed completely on inputs for electronic components industry. • Regulation eased governing import of used machinery. • Restrictions on imports of pharmaceuticals substantially relaxed. • Duty drawback system for exporters simplified.
1994	**Financial Supervision and Regulatory Framework** • New regulation to strengthen prudential supervision by central bank—bank examination may include examination of debtors and of bank subsidiaries operating in the financial sector. • New regulation provide basis for operation of an independent rating agency that will provide more objective information to investors. • Banks net open position in foreign currency including their off-balance sheet items increased to 25% from 20% of bank capital and open position requirement no longer applied to individual currencies.	**Exchange Market Arrangement and System** • Exchange rate movement allowed more flexibility. BI ceased to announce an indicative exchange rate in the morning, and instead began announcing buying and selling rates at 3:00 p.m. computed on the basis of a basket of weighted currencies with a spread of ± Rp 15 (compared to ± Rp 10 previously). **Direct Investment** • **IF**: Foreign investors may retain a majority of the shares in the joint ventures indefinitely. Foreign share may be as high as 95% with no further divestment required. There is no minimum capital investment requirement. Foreign ownership equivalent to 100% was permitted for certain categories of investment for an initial 15 year period. After that some Indonesian ownership (greater than 0%) was required either through private placement or through capital market. Foreign investment is permitted in joint ventures in vital sectors, e.g., ports, power generation, and telecommunication. Foreign investors were allowed to locate operations anywhere in the country. • **IF**: Foreign companies already operational were allowed to buy shares of other foreign companies or local companies. • **IF**: Enterprises in bonded zones to subcontract locally outside zone. **Trade** • Import facilities of up to two years were granted to enterprises who undertook capacity expansion of at least 30% or greater. • NTBs were removed on 27 product lines and applied to five new alcohol-based products resulting in 270 items remaining under restricted imports. • Import surcharges were removed from 108 items and reduced for 13. The same surcharge continued to apply for the remaining 99 items. • Import duties were raised on 38 tariff codes related to alcoholic products. • Import duties were lowered on 739 items including manufactured and agricultural products.

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1995	**Capital Markets** • Computerized trading was introduced on the Jakarta Stock Exchange. • Subrabaya Stock Exchange and the over-the-counter market merged to encourage participation by small investors. **Financial Supervision and Regulatory Framework** • New regulations to promote better compliance with prudential principles and encourage self-regulation were issued, including those: on exchange of information between banks to facilitate banking operations and provide greater safeguards; credit policy guidelines to commercial banks to improve compliance with prudential lending principles; pertaining to issuance and trading of commercial paper to lower risks borne by banks; guidelines on use of information technology to ensure secure transactions and backup systems to provide continuity of banking services; those allowing the central bank to screen owners and managers of banks to preserve public confidence and integrity in the banking system. • New regulation was issued to ensure public receives accurate and greater disclosure of financial conditions of banks and requires banks to standardized internal audit function. All banks with assets over Rp 10 billion must have their financial statements audited by public accountants approved by the central bank. Published annual financial statements must be based on audited financial statements. • New regulation authorized to strengthen operations of pension schemes, including submission of financial reports audited by public accountants • New regulation passed to enhance supervision of finance companies covering borrowing, equity investment, and reporting. • New regulations issued on derivative transactions by banks to limit risks; banks limited to dealing only in foreign exchange and interest rate derivatives; equity derivatives may be approved by BI on a case-by-case basis; banks required to give weekly report to BI on derivative transactions.	**Exchange Market Arrangement and System** • Exchange rate movement allowed more flexibility. The buying and selling rates computed on the basis of a basket of weighted currencies with a spread of ± Rp 22 (compared to ± Rp 15 previously). • BI terminated the provision of investment swaps. **Trade** • Tariffs lowered on 6,030 items of a total of 9,398 items. • Imports of 81 items previously restricted to selected importers could be now imported by general importers.
1996	**Money Markets and Instruments** • BI increased the reserve requirements to 3% from 2% to be held at BI. • BI introduced various improvements in its clearing operations in Jakarta as a first step toward implementing an electronic clearing system in 1998. • BI introduced several improvements in its accounting system, including, consolidating deposits held by commercial banks at BI into one account per bank and internal accounting operations of BI and regional offices were brought on-line.	**Exchange Market Arrangement and System** • Exchange rate movement allowed more flexibility. In June the intervention band was widened to Rp 118 (5%) and in September widened to Rp 192 (8%). **Direct Investment** • IF: Foreign ownership of shares of securities companies was raised to 85% of paid-in capital. **Portfolio Investment** • IF: Mutual fund companies may now be 100% foreign owned.

Table 9. Indonesia: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1996 cont.	**Capital Markets** • New capital market act passed on Nov. 10, 1995 and enacted on Jan. 1, 1996. Supporting regulations and decrees issued on Dec. 30, 1995. Under this Act, banks may act as custodians and trustees with the approval of supervisory agency BAPEPAM; mutual funds now allowed to be established; BAPEPAM given powers to conduct criminal investigations and impose sanctions; simpler trading and book-entry settlement guaranteed by clearing institution. • To stimulate bond market transactions, the rate of tax on interest income from bonds to be sold in the stock exchange, was set at 15%. Previously, interest income was subject to a progressive rate which ranged between 10% and 30%. • The Indonesian Stock Deposit Clearing Corporation (DEI), which functioned as the clearing, guaranteeing, and settlement institution, was transformed into the settlement and custody institution. It also changed its name to Indonesian Stock Deposit Custodian Corporation. • The Indonesian Stock Clearing and Guarantee Corporation (KEPI) was established to function as the clearing and guaranteeing institution. • To boost trading on the SSE, the SSE implemented the Surabaya-Market Information and Automated Remote Trading (S-MART), which will enable members to conduct transactions from their offices. It also extended trading hours by one hour. **Financial Supervision and Regulatory Framework** • BAPEPAM introduced new regulation on financial reporting to improve transparency; guidelines cover the design, coverage, and requirements of financial statements to be submitted by issuers of stocks or public corporations to the public and Bapepam. These financial statements were required to conform to accounting standards and regulations in effect in the capital market. • Government introduced regulations to promote mutual funds as a means of mobilizing investor funds, including, new income tax regulations for mutual funds and regulations concerning reporting of proper market value of mutual funds. • The government introduced regulations concerning the procedure of revocation on operating licenses, dissolution, and liquidation of problem banks. This regulation describe specific steps to be taken to try and save a problem bank. If no solution is found the BI may propose to the MOF to revoke the bank's operating license.	**Trade** • Tariff was reduced by 5% and 15% (mostly 5%) on 428 products, mainly capital goods; simplification of tariff code with removal of 1,100 items; reduction in import licensing, mostly steel; export taxes removed on processed animal leather, aluminum scrap alloy, and sandalwood; extension of duty drawback facility to goods supplied by existing exporters to firms in export processing zones. • Tariff increased by a 20% surcharge on propylene and ethylene imports. • Preferential duty arrangements established for approved national car manufacturers. • Import payments were allowed to be undertaken using LCs opened in foreign exchange banks with payments due within 360 days. • The discount facility for export drafts was extended to suppliers of export-related products and the discount rate was reduced. Exporters (and export suppliers) were permitted to sell their export proceeds to the BI, and to discount export drafts with a remaining maturity of between 30 and 720 days with drafts being rediscounted in rupiah or dollars. Based on local LCs, suppliers of export-related goods could seek bank drafts and sell them to the BI, provided their remaining maturity was between 30 and 90 days. • Fully owned foreign firms allowed to export manufacturing, forestry, farm, fish, and mining goods; and foreign firms allowed to import capital goods and raw materials for export from export processing zones. • General importers were permitted to import nine categories of goods previously restricted to producer importers. • The maximum limit for export of goods was exempted from customs export declaration documentation raised to Rp 100 million from Rp 10 million. • Pre-shipment inspection of exports by surveyors was discontinued; all inspection was undertaken within the framework of the customs act. • Requirements and procedures for certification of origin on goods exported from Indonesia were simplified as follows: number of legal requirements reduced to 4 from 31; number of supporting documents to be attached reduced to 2 from 4; number of agencies permitted to issue certificates of origin increased to 3 from 2; and number of officials vested with authority to issue certificates of origin increased to 3 from 1.

Sources: Report for the Financial Year, Bank Indonesia, (various issues); Annual Report on Exchange Arrangements and Exchange Restrictions, IMF, (various issues); Indonesia - Recent Economic Developments, IMF, (various issues). Doing Business in Indonesia, (various issues); Price Waterhouse; and International Tax Summaries: A Guide for Planning and Decisions, Coopers and Lybrand International Tax Network, (various issues). IF = Inflows, OF = Outflows.

Table 10. Indonesia: Selected Macroeconomic, Financial Sector, and Balance of Payments Indicators

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Selected Economic Indicators						(In Percent)						
Real GDP Growth	2.5	5.9	4.9	5.8	7.5	7.2	7.0	6.5	6.5	7.4	8.5	7.2
Inflation per Annum	4.7	5.8	9.3	8.0	6.4	7.8	9.4	7.5	9.7	8.5	9.4	8.0
M2 to GDP Ratio	23.9	26.9	27.2	29.6	35.0	43.3	43.7	45.8	43.4	44.9	48.3	52.5
Currency to Deposits Ratio	24.1	24.2	21.0	17.6	15.7	12.1	10.4	10.7	...	...	...	...
Fiscal Balance to GDP Ratio	−1.0	−3.5	−0.8	−3.1	−2.0	0.4	0.4	−0.4	0.6	0.9	2.3	1.2
Private Sector Credit to GDP Ratio	14.1	16.4	18.7	22.3	23.8	50.6	50.7	49.5	48.9	51.9	53.7	55.8
Exports plus Imports of Goods to GDP Ratio	33.0	31.9	39.9	38.5	40.8	44.8	47.2	47.8	41.2	40.7	42.8	41.1
Current Account to GDP Ratio	−2.2	−4.9	−2.8	−1.7	−1.2	−2.8	−3.7	−2.2	−1.3	−1.6	−3.5	...
Financial Account to GDP Ratio	2.0	5.2	4.6	2.6	3.1	4.2	4.9	4.8	3.7	2.2	5.2	...
Interest and Exchange Rates												
Nominal Deposit Rate (percent per annum)	18.0	15.4	16.8	17.7	18.6	17.3	23.3	19.6	14.6	12.5	16.7	17.3
Real Deposit Rate (percent per annum)	13.3	9.6	7.5	9.7	12.2	9.7	13.9	12.1	4.9	4.0	7.3	9.3
Interest Rate Differential 1/	8.9	8.4	9.2	9.3	9.3	9.1	17.0	15.4	10.9	6.9	10.5	11.5
Lending/Deposit Spread	...	6.1	4.9	4.4	3.1	3.3	2.2	4.4	6.1	5.2	2.1	2.0
Official Exchange Rate per US dollar (end of period)	1,125.0	1,641.0	1,650.0	1,731.0	1,797.0	1,901.0	1,992.0	2,062.0	2,110.0	2,200.0	2,308.0	2,383.0
Real Effective Exchange Rate Index (1990=100)	165.2	142.6	104.3	101.8	103.3	100.0	98.7	96.2	100.9	99.8	96.3	101.0
Balance of Payments						(In millions of U.S. Dollars)						
Current Account, n.i.e.	−1,923	−3,911	−2,098	−1,397	−1,108	−2,988	−4,260	−2,780	−2,106	−2,792	−7,023	...
Financial Account, n.i.e	1,782	4,177	3,481	2,217	2,918	4,495	5,697	6,129	5,632	3,839	10,386	...
Direct Investment Abroad	...	...	...	...	...	...	...	...	−356	−609	−603	...
Direct Investmnet in Rep. Eco, n.i.e.	310	258	385	576	682	1,093	1,482	1,777	2,004	2,109	4,348	...
Net Direct Investment	310	258	385	576	682	1,093	1,482	1,777	1,648	1,500	3,745	...
Portfolio Investment Assets	...	...	...	...	...	...	...	...	...	...	...	...
Portfolio Investment Liabilities	−35	268	−88	−98	−173	−93	−12	−88	1,805	3,877	4,100	
Net Portfolio Investment	−35	268	−88	−98	−173	−93	−12	−88	1,805	3,877	4,100	...
Other Investment Assets	...	...	...	...	...	...	...	...	...	...	...	...
Other Investment Liabilities	1,507	3,651	3,184	1,739	2,409	3,495	4,227	4,440	2,179	−1,538	2,541	...
Net Other Investments	1,507	3,651	3,184	1,739	2,409	3,495	4,227	4,440	2,179	−1,538	2,541	...
of which, Official Capital	1,345	2,886	2,537	1,756	2,604	218	1,287	770	552	137	131	...
Net Errors and Omissions	651	−1,269	−753	−933	−1,315	744	91	−1,279	−2,932	−263	−1,790	...
Overall Balance 2/	510	−1,003	630	−113	495	2,251	1,528	2,070	594	784	1,573	...
Memorandum Item:												
Net Private Capital 3/	739	−901	−1,810	−12,090	−2,165	4,663	3,302	6,789	4,943	5,131	10,097	...

Source: IMF International Financial Statistics, Information Notice System, and IMF Direction of Trade Statistics, various issues.

1/ Interest Differential = Deposit Rate − London Interbank Offer Rate on 3−Month U.S. Deposits.
2/ The overall balance includes: current account, financial account, capital account, and net errors and omissions. Capital account figures are not shown because they are zero throughout the period.
3/ Total Capital = Direct Investment + Portfolio Investment + Other Investment − Official Capital + Net Errors and Omissions + Misinvoicing.

Table 11. Indonesia: Abstract of Exchange and Capital Control Regime as of July 31, 1997

Exchange Arrangement

Currency	The currency of Indonesia is the rupiah.
Exchange rate structure	Unitary.
Classification	
Managed floating	The exchange rate is determined by Bank Indonesia (BI) under a system of managed float, under which the bank announces a daily "conversion rate band" (for official transactions with foreign exchange banks, government, as well as with supranational institutions), and an "intervention band" consisting of buying and selling rates that are computed on the basis of a basket of currencies. The conversion rates are set so that the buying and selling rates are within 2 percent of the previous day's closing spot market rate. The spread of the intervention band was increased on June 13, 1996, to Rp 118 (5 percent) from Rp 66, and to Rp 192 (approximately 8 percent) on September 10, 1996. The intervention band was further increased to Rp 304 (12 percent) on July 11, 1997. The U.S. dollar is the intervention currency.
Forward exchange market	Forward and swap transactions are conducted at rates fixed bilaterally between the BI and the banks concerned. In July 1997, forward foreign currency trading by domestic banks with nonresidents was limited to US$5 million per customer.

Exports and Export Proceeds

Repatriation requirements	No.
Surrender requirements	No.

Proceeds from Invisible Transactions and Current Transfers

Repatriation requirements	No.
Surrender requirements	No.

Capital Transactions

Controls on capital and money market instruments	
On capital market securities	
Purchase locally by nonresidents	The purchase of shares is limited to a maximum of 49 percent of total shares issued by an individual company listed on the Indonesian Stock Exchange.
Sale or issue locally by nonresidents	The Capital Market Act (1995) does not differentiate issuers by nationality. Both resident or nonresident issuers have to comply with the public offering requirements, one of which is that issuers must be Indonesian legal entities. There is no explicit restriction on nonresidents on public offering of securities in the Indonesian market.
Sale or issue abroad by residents	No restriction applies as long as the shares are not listed on the Indonesian Stock Exchange. If those securities are listed on the Indonesian Stock Exchange, they initially should comply with the Capital Market Act and with the requirement on the maximum percentage of foreign ownership of shares. However, Indonesian companies do not issue shares but rather American depository receipts (ADRs) in the U.S. capital market and global depository receipts (GDRs) on the London Stock Exchange.

Table 11. Indonesia: Abstract of Exchange and Capital Control Regime as of July 31, 1997

On money market instruments	
Sale or issue locally by nonresidents	These transactions are prohibited.
Sale or issue abroad by residents	Banks require approval from the COLT for issuance of instruments with maturities over 2 years or for amounts exceeding $20 million a year a creditor; however, total issuances should not exceed 30 percent of the bank's capital.
On collective investment securities	
Purchase locally by nonresidents	No person may purchase more than 1 percent of any fund.
Controls on derivatives and other instruments	Derivative transactions other than those associated with foreign exchange and interest rates are prohibited. However, derivative transactions in equities are only allowed with prior permission from the BI on a case-by-case basis. In July 1997, forward foreign currency trading by domestic banks with nonresidents was limited to US$5 million per customer.
Purchase abroad by residents	Banks are obliged to enter into a written agreement with their clients and explain the risks involved. Losses over 10 percent of banks' capital must be reported to the BI.
Sale or issue abroad by residents	Same regulations as for purchases abroad by residents apply.
Controls on credit operations	
Commercial credits	
By residents to nonresidents	In general, there are no restrictions on the granting of credit by residents (excluding banks) to nonresident entities.
To residents from nonresidents	Resident entities, especially nonbank private sectors, may borrow from nonresidents; however, they have to submit periodic reports to the COLT of the BI on their borrowing. The following are subject to authorization by COLT: (1) borrowings related to development projects using nonrecourse, limited recourse, advance payment, trustee borrowing, leasing, and similar financing; (2) borrowings related to development projects with financing based on BOT, B&T, and similar schemes; and (3) borrowings related to the government or a state company (including the State Bank of Pertamina), including in the form of government equity participation, guarantee for provision of feed stock supply, guarantee for products offtaker.
Financial credits	
By residents to nonresidents	In general, there are no restrictions on the granting of credit by residents (excluding banks) to nonresident entities.
To residents from nonresidents	Yes.
Guarantees, sureties, and financial backup facilities	
By residents to nonresidents	Banks are allowed to provide sureties and guarantees to nonresident entities only under the following conditions: (1) when there is sufficient contraguarantee from bona fide overseas banks (excluding overseas branches from the relevant bank); and (2) when there is a cash deposit valued 100 percent of the guarantee granted.
Controls on direct investment	
Inward direct investment	Several sectors are restricted: (1) foreign investment companies in infrastructure projects such as seaports, generation, transmission and distribution of electricity for public

Table 11. Indonesia: Abstract of Exchange and Capital Control Regime as of July 31, 1997

	use, telecommunications, shipping, airlines, potable water supply, public railways, and nuclear electric power generation should be established by way of joint venture between foreign and Indonesian partners, and the share of Indonesian partners should be at least 5 percent of the total capital issued at the outset of the company; and (2) a foreign investment company may be established as a straight investment, which means that 100 percent of the shares may be owned by a foreign citizen and/or entities. However, some of the company's shares must be sold to an Indonesian citizen and/or entities through direct placement and/or indirectly through the domestic capital market no later than 15 years after commencement of commercial operations.
	Foreign ownership of direct investments must begin to be divested by the eleventh year of production. For investments above $50 million, divestment of 50 percent must be completed within 20 years. For smaller investments, the divestment requirement is less stringent.
	All foreign enterprises are eligible to receive preferential customs duty treatment for imports of required raw materials for the first 2 years of production activity. Raw materials may be imported with no time limit. In addition, an enterprise exporting more than 65 percent of its production is free to hire foreign experts as needed to maintain its export commitments.
Controls on liquidation of direct investment	Investors are granted the right to repatriate capital, to transfer profits (after settlement of taxes and financial obligations in Indonesia), and to make transfers relating to expenses connected with the employment of foreign nationals in Indonesia and relating to depreciation allowances. The law provides that no transfer permit shall be issued for capital repatriation as long as investment benefits from tax relief are being received; at present, however, foreign payments do not require a transfer permit.
Controls on real estate transactions	
Purchase locally by nonresidents	According to Agrarian Law (1960), nonresidents are only allowed to buy land with the land title status "the right to use of land (Hak Pakai)," but since the land title of real estate in Indonesia is "the right to build on land (HGB)," they are not allowed to buy real estate. Nonresidents, however, are permitted to engage in inward direct investment in local real estate.
Provisions specific to commercial banks and other credit institutions	
Borrowing abroad	The COLT supervises all foreign commercial loan transactions. COLT's prior approval is required before any public enterprise, commercial bank, or public sector body may accept a loan from abroad. Resident banks or credit institutions, specifically the ones that deal with international trade and finance activities, are allowed to borrow abroad within limits. An annual borrowing ceiling is imposed by the BI for foreign commercial borrowing of more than 2 years' maturity. In addition, the prospective borrowers obtain COLT decisions for queuing on the international capital market before soliciting for such borrowings. Besides, banks may receive foreign commercial borrowing with maturities of no more than 2 years on a bilateral basis without prior approval from the BI, but the banks should maintain the total amount of such borrowings to a maximum of 30 percent of their capital. Trade financing, such as issuance of LCs, red clause LCs, supplier's and buyer's credits with maturities not exceeding 1 year and amounts of less than $20 million, are not considered borrowings that require approval from the COLT. Foreign commercial borrowings received by financial institutions, such as leasing companies, factoring companies, and consumer financing companies, may not exceed 5 times the company's net worth less its equity share.

Table 11. Indonesia: Abstract of Exchange and Capital Control Regime as of July 31, 1997

Lending to nonresidents (financial or commercial credits)	Banks are not allowed to grant loans, or financial or commercial credits, in either rupiah or foreign exchange, to nonresidents, including those with authorization from residents to obtain credit.
Lending locally in foreign exchange	Banks are permitted to lend locally in foreign exchange, subject to the requirement that 80 percent of the foreign exchange loans must be provided for export activity. Banks can also purchase locally issued securities denominated in foreign exchange, subject to the requirement that the securities must be investment grade and should not be issued by their groups. To do this, banks should take into account other exchange regulations, namely the regulation on net open position (NOP) aimed at prudential control, with the limits as follows: the average of total NOP, both on and off balance sheet, in a week must not exceed 25 percent of the bank's capital and the average NOP off balance sheet in a week must not exceed 25 percent of the bank's capital.
Purchase of locally issued securities denominated in foreign exchange	This is permitted but limited by open position limits.
Differential treatment of nonresident deposit accounts and/or deposit accounts in foreign exchange	
Interest rate controls	Banks are free to set their interest rates on both deposits and loans. In the case of taxes, revenues gained from interest of nonresident deposit accounts are taxed at 20 percent or at a percentage stipulated on the Tax Agreement between the government of Indonesia and the government of a nonresident entity, while the revenues gained from interest of resident deposit accounts are taxed at 15 percent.
Credit controls	Foreign exchange banks are required to allocate at least 50 percent of all foreign exchange credits to export-oriented businesses that earn foreign exchange.
Open foreign exchange position limits	The limits are: (1) the average total net open position, both on and off balance sheet, in a week must not exceed 25 percent of the bank's capital; and (2) the average net open position off balance sheet in a week must not exceed 25 percent of the bank's capital. In July 1997, each bank's net position in the forward market was limited to US$5 million.
Provisions specific to institutional investors	Insurance and reinsurance companies licensed in Indonesia are not allowed to invest abroad except for private placement in companies conducting insurance business overseas, such as insurance companies, reinsurance companies, insurance brokers, loss adjusters, etc. Indonesian mutual funds are prohibited from investing abroad.
Limits (max.) on portfolio invested abroad	Liabilities denominated in foreign currency of insurance and reinsurance companies exceeding assets denominated in foreign currency shall not be more than 10 percent of shareholders' equity.
Currency matching regulations on assets/liabilities composition	n.a.
Other controls imposed by securities laws	Foreign investors as a group may purchase up to 49 percent of the authorized and outstanding shares of an Indonesian company that has had a public offering.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1985	**Financial Supervision and Regulatory Framework** • Allowed 11 foreign bank branches to engage in trust business which domestic banks already did. **Money Markets and Instruments** • Interest rates on mortgages and convertible bonds were liberalized. • The issuing rate of prime enterprises, commercial paper was liberalized. • Special trust accounts for households were introduced that earn dividends depending on fund performance (March). • Two new deposits instruments introduced—free savings account and household installment savings account (April). • Certain share of lending required to be allocated to small and medium-sized industries. • Foreign banks were granted access to the discount window for export financing on the same terms as domestic banks. • The reserve requirement on foreign currency deposits was raised from 1% to 10% on 7/23/85 effective from July and again to 20% on 8/1/85.	**Exchange Market Arrangement and System** • Government reduced the limit of extra swap privilege of foreign banks' domestic branches. The guaranteed profit margin on swap transactions with foreign banks' branches was also reduced from 1% to 0.75% per year. • Residents were allowed to execute swap transactions with foreign financial institutions. • Monthly travel allowance for studying abroad was reduced from $3,000 to $2,000 per person and from $2,000 to $1,000 per family. • The central bank broadened the list of foreign currency loans that shipping firms were eligible for and lengthened their lending period for the purpose of repaying principal and interests of foreign loans. **Direct Investment** • **IF**: Foreign investors were granted access to 102 of 339 restricted sectors, raising the liberalization ratio for capital to 76.3% from 66.1%. Total number of sectors open to foreign investors rose to 762 from 660. • **OF**: Investments of over $1 million (previously $0.5 million) now had to be approved by the Overseas Investment Deliberation Committee. • **OF**: Overseas investment regulations were streamlined so as to encourage domestic firm's investment in the exploitation of overseas natural resources and the development of high technology. **Portfolio Investments** • **IF**: Korean companies were allowed to issue warrants and depository receipts in international capital markets under guidelines set by the government. The maximum issue was limited to 15% of the outstanding shares of the issuing company, and an individual foreign investor was limited to acquiring, at most 3% of any company's outstanding shares through the exercise of bond conversion or subscription rights. • **IF**: Value limit on investment trusts was raised to $200 million. **Trade** • Imports of 235 items were liberalized (ratio of liberalized to total imports rose to 87.7%). • Number of automatically approved import items was raised from 6,712 to 6,945 from a total of 7,915 (CCCN) items.
1986	**Capital Markets** • Exchange Equalization Bonds were introduced. • Six foreign banks were permitted to enter trust business. **Financial Supervision and Regulatory Framework** • Two foreign firms were allowed to underwrite fire insurance, previously reserved for Korean firms. • From August 21, the central bank prohibited foreign exchange banks from maintaining an over-sold position of spot foreign exchange as an effort to restrain excessive growth of reserve money.	**Exchange Market Arrangement and System** • Bank of Korea reduced the yield on swaps from 0.75% to 0.5%. Limits on each bank's foreign currency swap would be reduced by amount of CDs sold. General swap limit extended to new foreign banks was reduced to $10 million from $15 million per branch. The general swap limit for new branches of foreign banks already established in Korea was removed. The central bank also got rid of the additional extra swap which had been allowed for increase of paid-in capital or retained profits. • Authorization of expenses for emigration was delegated to heads of foreign exchange banks.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1986 cont.	**Money Market and Instruments** • The issuing rates on negotiable CDs, secured corporate bonds, and bank debentures were liberalized. • Guidelines on loans to small- and medium-sized firms readjusted upwards for foreign banks. Raised the obligatory lending ratio to small- and medium-sized firms to 35%. That is foreign banks were required to lend at least 35% of increased amount in loans to small- and medium-sized firms. • Foreign banks were allowed access to discount window for rediscounting of commercial bills and to issue CDs and CD loans.	• Regulations were tightened on acquiring foreign currency loans through domestic banks and foreign bank branches. The supply of foreign currency loans for repayment of principal and interest on overseas borrowing, with a period over three years was restricted to small and medium enterprises which have weak fund raising capabilities. • Foreign currency loan ceilings were introduced which set an upper limit on the loanable amount for a banks' foreign currency loans outstanding at the level outstanding on August 20, 1986 or $500 million, whichever is greater. **Direct Investments** • **OF**: Certain overseas investments not exceeding $200,000 were subject to automatic approval. **Portfolio Investments** • **OF**: Government directed financial institutions to repay foreign short-term borrowings and bank loans which had unfavorable terms. 1/ **Trade** • Tariff rate on crude oil imports was raised from 1% to 15% in three steps. • 302 items were removed from the restricted imports list and 1 item was added. Net effect raised number of automatically approved items from 6,945 to 7,246 (or from 87.7% to 91.5%) of a total of 7,915 items.
1987	**Capital Markets** • The Securities and Exchange Law and the Law on Fostering the Capital Market were revised in order to protect firms that go public from takeovers by limiting individual holdings of each company's shares and to facilitate corporate expansions by permitting firms to issue new shares at market value instead of at par as was done previously (December). • Nine more foreign bank branches were permitted to handle trust business during the year bringing the total to 19. **Money Market and Instruments** • Minimum denomination of CDs was lowered. • An over-the-counter (OTC) market was established. • The reserve requirement on residents foreign currency deposits was lowered from 20% to 4.5%, effective from February 20.	**Exchange Market Arrangement and System** • Monthly allowance for students abroad was raised to $1,500 from $1,000. In addition $500 and $300 was allowed for spouse and each child, respectively. • Foreigners employed in Korea were allowed to send their salary, except for basic living expenses, and retirement allowances to their home countries with approval from a foreign exchange bank rather than from Bank of Korea. • Korean residents could send up to $5,000 a year as living expenses to parents and children living abroad. • Korean residents could send up to $1,000 to relatives abroad for funerals or weddings, compared to $500 previously. • Koreans traveling abroad could carry $5,000 in cash for basic expenses regardless of purpose of travel. Additional $2,500 was permitted when traveling to countries whose currencies had appreciated significantly to the U.S. dollar. Credit card holder were allowed to charge all travel expenses without limit during business or official travel abroad. • The government abolished the restriction on the contract period for forward exchange transactions and permitted anyone holding a resident account to perform forward exchange transactions. In addition transactions using futures and options were allowed. • On November 1, the central bank reduced the fourth quarter swap ceiling that had been allocated to foreign bank branches by 10%. They also abolished the new swap facility of $10 million accorded to newly established foreign bank branches. • Inward remittances greater than $20,000 monitored to discourage speculation in stock market.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1987 cont.		**Direct Investment** • **IF**: 26 manufacturing sectors were opened for foreign direct investment, leaving 13 of 522 manufacturing sectors still closed. • **IF**: Certain tax privileges granted to attract foreign direct investment were reduced and after-investment controls relaxed to put foreign invested companies and local companies on an equal basis. • **OF**: The limit over which overseas investment was subject to consideration by the Overseas Investment Deliberation Committee was raised from $1 million to $3 million in May and further to $5 million in December. • **OF**: From December 28, overseas investment of $1 million was automatically approved. • **OF**: Restrictions on purchase of real estate abroad by Korean-owned companies were liberalized. **Portfolio Investment** • **OF**: From April 15, overseas investment for the purpose of obtaining payment of dividends or interest income without participation in management were allowed, if undertaken to obtain advance technology or to overcome difficulties faced by export firms. • **OF**: The government encouraged the early redemption of foreign borrowings on unfavorable terms by making foreign currency loans available for those companies wishing to redeem such foreign debt before its maturity. • **OF**: On September 1, the government raised the maximum amount of investment profit that might be held overseas without approval by the central bank from $10,000 to $500,000. • **OF**: The central bank made special foreign currency deposits with foreign exchange banks to encourage them to extend loans in foreign currency to companies importing machinery and equipment or redeeming foreign borrowings before maturity. **Trade** • The government shortened the period to 120 days from 180 days during which advance receipt of export proceeds might be obtained. Reduced the limit on such receipt by large companies from 3% to 1% of their export value over the previous calendar year. • Tariff rate on crude oil import was raised to 24.5%. • 167 items were removed from the list of restricted imports, raising the number of automatically approved items to 7,408 of 7,911 items. • A new Foreign Trade Act came into effect on July 1, which included a revised system of import protection. The Korea Trade Commission was established under the Act. • From February 13, items eligible for import on a deferred payment basis were reduced to goods on which a tariff rate of less than 10% was applicable rather than the previous 20%. Imports for exports use were also made subject to this restriction. • On April 1, the settlement period for import of crude oil on a deferred payment basis was shortened from 90 days to 60 days

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1988	**Capital Markets** • Effective March 1, the Korean Stock Exchange (KSE) was transformed into a nonprofit membership organization. **Money Market and Instruments** • Interest rates on loans from banks and nonbank financial intermediaries, other than interest rates on loans subsidized by government funds, were fully liberalized. • Interest rates on time deposits with maturities of more than two years at banks, postal savings, and credit unions, and on time and savings deposits with maturities of over one year at mutual savings and finance companies were liberalized. • Yields on fund-type instruments, such as cash management accounts, bond management accounts, corporate money trusts, and pension trusts were liberalized. • Interest rates on repurchase agreements, commercial paper (face value greater than W 30 million and maturity more than 91 days), financial debentures, and corporate bonds were fully deregulated. • "New" commercial paper and conventional commercial paper were merged into one.	**Exchange Market Arrangement and System** • An additional $5,000 was permitted to be purchased from banks for travel purposes. • Limit on remittances abroad for funerals and weddings was raised to $5,000. • Payments for sales promotion by businesses to foreign experts was liberalized. • Korean residents were permitted to retain up to $5,000 upon return from overseas travel. • Effective February 16, banking institutions were not permitted to exceed the foreign currency loan ceiling limit for lending to small- and medium-sized firms and export firms as had been done in the past. However, loans for certain specific activities were excluded from this ceiling—loans for import funds for production facilities to diversify sources of imports and for early repayment of external debts. • Effective March 25, nonresidents were prohibited from exchanging into domestic currency amounts withdrawn from their nonresident foreign currency deposit accounts. • Effective March 25, the maximum amount of foreign exchange allowed to be brought in without the obligations of registering and reporting to tax authorities, by residents and nonresidents, was **reduced** from $30,000 to $5,000; this was further **reduced** to $3,000 on September 1. • Effective May 9, the central bank reduced the swap ceilings of foreign bank branches. It also reduced the guaranteed profit from 0.5% a year to 0.3% a year. • Sales of foreign currency by nonresidents to domestic foreign exchange banks was limited to a maximum of $20,000; **reduced** to $10,000 on September 1. • Effective September 15, overseas investment in the form of provision of technology or services were no longer classified as capital transactions but as invisibles and hence free from any post-check by regulations concerning overseas investment. • Accepted Article VIII (November). **Direct Investment** • **IF**: Advertising and motion picture distribution sectors were opened to foreign investment. • **IF**: Restrictions on foreign investment in the insurance industry were liberalized (joint ventures with the 15 largest domestic companies was still restricted). • **IF**: Foreign subsidiaries and joint ventures were authorized to import and distribute all products except for 12 restricted items. • **OF**: Effective March 25, any noncorporate private business was permitted to make investments, regardless of business type, of up to $1 million. Also, overseas investors were allowed to retain all investment profits in their host countries without prior approval from the central bank—the previous limit on such retention was $500,000. • **OF**: Effective November 1, the central bank raised the limit on automatic approval of overseas investments from $1 million to $2 million. **Portfolio Investment** • **OF**: The government permitted some domestic institutional investors to invest in foreign stock markets for their own account: up to $30 million by securities companies and $10 million by insurance and investment trust companies. • **OF**: Effective July 1, the government allowed investment in foreign securities, previously restricted to securities companies, by investment trust companies and insurance companies up to a maximum of $10 million. It also raised the maximum amount of investment permitted by securities companies from $10 million to $30 million.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1988 cont.		**Other** • **OF**: Foreign exchange allowance for emigrants was raised to $200,000 a household for current expenses and to $300,000 for investment purposes. **Trade** • Tariff rates on a large number of products were reduced during the year. • Restriction on imports by manufacturing firms partly or wholly owned by foreign investors were liberalized. • 275 items were removed from the list of restricted imports during the year raising the number of automatically approved imports to 7,680 of 7,911 items. • Import of beef was subject to a quota. • The BOK reduced the loanable ratio (i.e. the amount of funds that could be borrowed) for selected imports of machinery and equipment and for repayment of prior external or foreign currency loans.
1989	**Capital Markets** • More **foreign banks** were allowed to engage in individual trust business. • Effective December 30, in line with the 1988 plan for internationalization of the capital market, **foreign investors** were permitted to engage in direct transactions among themselves of Korean stock held in Korea which had been acquired through stock-related bonds (conversion of CBs issued abroad or excising the warrants of BWs issued abroad). **Money Market and Instruments** • The minimum maturity of CDs issued by banks to other banks, including development institutions, was reduced from 91 to 30 days. • A bankers' acceptance market for trade bills was established. • Legal barriers for the integration of the two call markets (the interbank market and the OTC market for nonbank financial institutions) were removed. • Three new commercial banks were established. • The Korean Exchange Bank was granted permission to change its status from a specialized to a nationwide commercial bank.	**Exchange Market Arrangement and System** • Effective June 2, the central bank set a ceiling of $200 million on special foreign currency loans that could be given to one firm during a year. • Effective December 1, the government introduced professional brokerage system in the foreign currency call money market in an effort to speed up development of the foreign exchange market. • Effective December 1, the central bank unified ordinary and additional swap ceilings. It also reduced the swap ceiling allocated to foreign bank branches at the end of the third quarter by 10%. • Effective December 1, the maximum amount of foreign exchange which might be brought into the country with no registration and subsequent reporting to the tax authorities by residents and nonresidents was **raised** to $5,000 from $3,000. • A U.S. dollar call market was opened. • Maximum amount of foreign currency nonresidents allowed to exchange into won at domestic foreign banks was **raised** to $50,000 from $10,000. **Direct Investment** • **IF**: Restrictions on foreign direct investment in six manufacturing sectors were removed. • **IF**: Amount of foreign investment permitted without deliberation of the capital review committee was raised to $5 million from $3 million. • **OF**: Effective February 13, the procedures and approval conditions for overseas investment were simplified. Balance sheets and three other documents for would-be investors were no longer required. In case the funds are loaned, repayment should be guaranteed by an international bank or an equivalent institution, and in the case of acquisition of securities, a would-be-investor should hold at least 20% of the equity or send a full-time executive to the overseas company. • **OF**: Effective June 2, overseas investments other than those in overseas real estate or personal investment, could now qualify for foreign currency loans. The maximum term of such loans was set at 10 years and the ceiling on them was fixed at 60% of the required funds for large firms and 80% for small- and medium-sized firms.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1989 cont.	**Financial Supervision and Regulatory Framework** • Effective September 20, the ceiling on overbought positions of foreign exchange banks was raised to 200% of the average value of bills purchased and held in the previous month for all foreign exchange banks. Previously, the above percentage could vary from 20% to 150% depending upon the type of foreign exchange bank. Additionally, the government required all foreign exchange banks to maintain overbought spot-exchange positions equivalent to at least 1% of the average value of bills purchased and held in the previous month (to be changed to 2% from January 1, 1990).	• **OF**: Effective August 10, business firms were allowed to invest in foreign real estates for business purposes. The expanded scope of possible purchases included parking lots for commercial purposes, hotels, sporting facilities, laundries, gas stations, research institutes, job training facilities and welfare facilities for employees. Previously, it had been limited to purchase of office buildings, factories, warehouse, exhibitions, employee residences and parking lots associated with offices. **Portfolio Investments** • **IF**: Effective December 1, foreign exchange banks were allowed to raise off-shore funds by issuing foreign currency denominated bonds or borrowing from the off-shore accounts of other domestic foreign exchange banks. The banks were authorized to underwrite foreign-currency denominated bonds issued by nonresidents and to purchase and sell them, or to lend or deposit them with the off-shore accounts of other domestic foreign exchange banks. • **IF**: The limit on equity investment by foreign securities firms was increased to 40%. **Trade** • The import surveillance list, which required approval of the Korean Traders' Association before an import license could be awarded was abolished. The system of emergency tariffs was abolished. Under the first phase of the Second Five-Year Tariff Reduction Program, the average tariff was reduced to 12.7% from 18.1%. • The BOK lowered and then raised to its original level the loanable ratios for special foreign currency loans for import funds for production facilities to diversify their sources of imports. • Effective November 17, the central bank removed the overall ceiling for the year of $5 billion on special foreign currency loans for import funds for production facilities to diversify import sources. For countries with a bilateral trade surplus the overall ceiling on special foreign currency loans for imports, was retained at $300 million for large firms while for small- and medium-sized firms it was raised from $500 million to $800 million.
1990	**Capital Markets** • Coupon rates of new corporate bond issues with a maturity of over three years deregulated. • Banks allowed to underwrite privately placed corporate bonds. • Effective June 11, the government allowed each of the three domestic investment trust companies to establish a matching fund in line with "Mid-Term (1988–92) Plan for Internationalization of the Securities Market". Capitalization of each fund was set at $100 million. Of this, $60 million was to be raised in international markets and the remaining $40 million domestically, with 70% of the funds being invested in Korean securities and the balance in foreign securities.	**Exchange Market Arrangement and System** • The "market average exchange rate" (MAR) system was adopted. The MAR for the won-U.S. dollar was established using the weighted average of the previous day's interbank rates for the won-U.S. dollar spot transactions. During each business day, the won-U.S. dollar exchange rate in the interbank market would be allowed to fluctuate within margins of ±0.4% around the MAR. • Restrictions on invisibles: Effective May 1, the right to purchase up to $5,000 in foreign currency was **withdrawn.** Foreign exchange banks were again required to enter the amount of foreign currency purchased by an overseas traveler in their passports. • Effective September 24, the upper limit on basic expenses for teenage overseas travelers was **reduced** from $5,000 to $2,000. No additional allowances were permitted for any overseas traveler whose stay abroad was less than 30 days. **Direct Investment** • **IF**: Effective January 1, the maximum amount of foreign direct investment in manufacturing that could be automatically approved was raised from $3 million to $100 million. • **IF**: Up to 99% foreign equity ownership in advertising firms was permitted. • **IF**: Wholesale business of toiletries and cosmetics was opened to foreign investors.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1990 cont.	**Financial Supervision and Regulatory Framework** • Law to convert investment and finance companies into: (i) banks; (ii) securities companies; or (iii) money market broker promulgated. **Money Market and Instruments** • Ceiling on CD issues were increased from 120% to 150% of net worth for specialized banks and for **foreign banks** to 150% of net worth or W 10 billion, whichever is greater. • The BOK introduced direct sales of MSBs to retail investors and changed the minimum trading unit of MSBs from W 10 million to W 1 million. • The maturity period of MSBs was extended to two years. • Effective March 8, reserve requirements on foreign currency deposits held in resident accounts were raised from 4.5% to 11.5%.	**Portfolio Investment** • **OF**: Effective March 2, securities companies who had an international securities business license were authorized to invest up to $50 million, up from the previous $30 million. Investment trust companies issuing international beneficiary certificates and insurance companies having total assets in excess of W 5 trillion, the ceiling on portfolio investment abroad was raised from $10 million to $30 million. • **OF**: Effective December 20, the central bank abolished foreign currency loans for the early redemption of foreign loans, in view of the current account deficit. **Trade** • Under the second phase of 1989–93 Five-Year Tariff Reduction Program, tariff rates on a large number of products were lowered, reducing the average unweighted tariff rate on total imports to 11.4% from 12.7%. • Effective September 1, the overall ceiling on special foreign currency loans for import funds for production facilities and for overseas investment funds was abolished. However, the overall ceiling on special foreign currency loans for imports from those countries running a bilateral trade surplus with Korea was raised from $0.4 billion to $0.8 billion for large firms and from $0.6 billion to $1.2 billion for small and medium firms. • Effective December 20, the central bank abolished foreign currency loans for import of production facilities for the import diversification scheme, in view of the current account deficit. • Effective December 20, the central bank revised the loanable ratios so that manufacturing and small and medium firms receive preferential treatment in importing facilities and equipment. The foreign currency loan system was reclassified such that firms were categorized as Manufacturing or Others instead of General and Special.
1991	**Capital Markets** • Effective September 16, nonresidents who had exchanged convertible bonds into stocks were permitted to sell them and to purchase stocks listed on the Korean Stock Exchange. • Foreign bank branches' entry into the trust business were eased. **Financial Supervision and Regulatory Framework** • The General Banking Act was revised and became effective December 31. • The Industrial Bank of Korea Act was revised and became effective December 31. • The Long Term Credit Bank Act was revised and became effective December 27. • The Act concerning the Merger and Conversion of Financial Institutions became effective March 8.	**Exchange Market Arrangement and System** • Documentation requirements for foreign currency deposits were liberalized. Firms whose annual external transactions exceeded $10 million were exempted from documentation requirements for foreign currency deposits up to 10% of their amount of annual foreign currency transactions (up to a limit of $100 million). • On May 6, won-dollar **forward contracts**, previously limited to overnight transactions were diversified to give 13 maturities ranging from one day to a year. • Documentation requirements for foreign exchange transactions up to $1 million between bank and nonbanks were eased. • The prohibition of sales of foreign currencies from foreign currency accounts for purposes of making domestic payments was abolished. **Direct Investment** • **IF**: Investments with a foreign participation of less than 50% in manufacturing projects were made subject to notification rather than approval. Decision whether or not to accept the investment is made within 30 days, in principle. Thereafter, two years are allowed for completion of the payment of the subject matter of investment. From January 3, 1992, this notification system was to be introduced in some service industries. • **IF**: The tax system was amended such that foreign-invested enterprises became wholly exempt from corporate income tax and their expatriate employees from income tax, for only three years following commencement of business operations. In the subsequent two years a 50% reduction on both these taxes was granted. Foreign investment was permitted in ventures involving importation of alcoholic beverages at the wholesale level.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1991 cont.	• Effective July 1, foreign exchange banks' compulsory overbought position in spot transactions was lowered from the previous 2% to 1% of the average outstanding of bills bought in the preceding month. This ceiling was abolished on January 3, 1992. **Money Market and Instruments** • A four-stage plan for **interest deregulation** was announced in August. The first phase was launched on November 21. • The following lending rates were liberalized: bank overdrafts, discounts of commercial paper (CP) and trade bills. • The following deposit rates were liberalized: CDs of banks and nonbank financial institutions (NBFIs). • Issue rate of corporate bonds with over two-year maturity. • Effective July 1, the ceiling limits on CDs set in June 1990 for **foreign exchange banks** were raised from 10 billion won or 150% of the sum of the paid-in-capital and reserves, whichever is greater to W 12.5 billion or 175% of the sum of the paid-in-capital, whichever is greater. Effective October 5, the limits were raised to W 15 billion or 200% of the sum of the paid-in-capital, which ever is greater. • Restrictions on activities of **foreign banks** eased significantly. They could now set up multiple branches under the same standards and procedures as those applied to domestic banks. Increase in the ceiling on foreign banks' paid-in capital. Increase in local currency funding opportunities for foreign banks. • Electronic information service introduced in the OTC market.	• **IF**: Restrictions on the scope of foreign investment in the retail sector were eased with the number of retail shops per investment increasing from 1 to 10 and the maximum permissible floor space per shop to 1,000 square meters from 700 square meters. • **OF**: Maximum amount of foreign currency loans for overseas investments was decreased from 60% to 40% for large firms and from 80% to 60% for small and medium firms. **Portfolio Investment** • **IF**: Effective March 2, nonresident Koreans were allowed to sell foreign currencies exceeding $50, 000 to entrust its proceeds to development trusts with a maturity of 2 years or more. Effective July 15 the limit was raised to $100,000 and would be abolished from January 3, 1992. • **IF**: Effective March 8, the government permitted the issuance of foreign currency denominated securities to finance the import of production facilities and equipment for which no domestic substitute is available. • **OF**: Domestic institutional investors were permitted to invest in securities issued by foreign governments and public organizations with a high credit rating. **Other** • **IN/OF**: Restrictions on financing options for overseas offices eased. Firms were permitted to raise funds abroad regardless of the amount, subject only to the approval of a class a foreign exchange bank. The limitation on the use of these funds were eased so as to include purchase of production facilities, and equipment for overseas branches and subsidiaries, the purchase (or construction) of office buildings using mortgage finance, and the refinancing of existing debt on more favorable terms. **Trade** • Imports of 93 items, mostly agricultural products, were liberalized in accordance with the 1989–91 import liberalization program. • The maximum amount of foreign currency loans were revised downwards for the following categories, effective September 6. For manufacturing firms the loanable ratio was reduced from 80% to 60% for large firms and from 100% to 90% for medium and small firms. Similarly for other firms they were reduced from 60% to 40% and 80% to 60%, respectively. For the purposes of redemption of principal of foreign currency borrowings the loanable ratio was reduced from 100% to 80%. For import of machinery for use in ship-building, it was lowered from 80% to 60% and co-financing from export-import bank from 100% to 80%.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1992	**Financial Supervision and Regulatory Framework** • Measures were introduced to increase transparency of regulations and procedures on bank supervision. • Investments in stocks by resident foreign financial institutions were subject to the same limits as those by institutions owned by nationals. Resident foreign financial firms were allowed to undertake over-the-counter transactions in listed bonds. • Foreign banks became free to become full members of the Korea Federation of Banks and the Korea Financial Telecommunications and Clearing Institute, the latter providing access to the nationwide electronic banking network (July). • Effective September 1, the oversold position ceiling of foreign exchange banks was raised from \$5 million to the greater of \$10 million, or 20% of the average outstanding of bills bought in the previous month. In addition, these banks were permitted to take oversold positions in spot transactions, which had previously been barred. The ceiling limit on such positions was set at the greater of \$5 million or 5% of the average outstanding of bills bought in the previous month. Foreign exchange used to hedge exchange rate risk on capital transactions was exempted from the limit on the overall overbought position. **Money Market and Instruments** • Effective May 1, the ceiling limit on CDs on **foreign bank branches,** which had been set at the greater of W 15 billion or 200% of the sum of in-country capital and reserves, were raised to the greater of W 17.5 billion or 225%, respectively. Effective December 19, the maximum maturities of CDs was extended from 180 days to 270 days.	**Exchange Market Arrangement and System** • Effective July 1, the margin within which the exchange rate of the won against the U.S. dollar is permitted to fluctuate was widened to ±0.8% around the MAR. • Effective January 3, 1992, residents' external remittances above \$10,000 would have to be reported to the Office of National Tax Administration instead of the previous \$15,000 and above. • Effective September 1, the range of **forward exchange contracts** that foreign exchange banks were permitted to enter into was extended. In the case of contracts with residents, forward transactions were also allowed for funds for overseas direct investment, operating funds for overseas branches of domestic financial institutions, funds for portfolio investment by institutional investors, and operating funds for domestic branches of foreign financial institutions. For contracts with nonresidents, funds for inward direct investment and stock investment were added to the list of eligible transactions. The objective of the extension of eligibility was to enable residents who conduct business overseas or foreigners who invest in Korea to manage exchange risk more efficiently. • Effective September 1, the ceiling on foreign currency deposits maintained by resident firms (which is based on the amount of external transactions) was increased to 10%. Companies with records of external transactions were exempted from documentation requirements irrespective of the amount of annual transactions (previously exemptions were granted only to companies with transactions of less than \$10 million). • In accordance with the revised Foreign Exchange Management Act of December 27, 1991, the relevant enforcement decree and the associated foreign exchange management regulations were revised and brought into force on September 1. • Restrictions on capital account transactions were also eased. Capital account transactions were reclassified into three groups: transactions requiring permission, transactions that need prior notification, and transactions not requiring approval or notification. Additionally, underlying documentary requirements for capital transactions were greatly simplified and made more transparent. • Effective September 1, remittances for emigration of up to \$100,000 was allowed for a householder and up to \$50,000 for each other member of the household. • For emigration under a business investment scheme, remittance of the excess amount was allowed where the minimum investment required by the country of immigration was higher than the combined sum remittable as emigration settlement expenses and business investment fund. **Direct Investment** • **OF**: Effective September 1, the government raised the ceiling from \$2 million to \$5 million on overseas direct investment subject to notification rather than permission. Also, direct investments in those countries with which Korea does not maintain diplomatic relations, until now requiring approval in all cases, were subject only to notification where the amount involved was less than \$5 million. • **OF**: The range of overseas direct investment to be examined by the Overseas Investment Deliberation Committee was reduced. Now only investments above \$10 million or on the restricted list were reviewed by them. • **OF**: Maximum amount of foreign currency loans for overseas investments was increased from 40% to 60% for large firms and from 60% to 70% for small and medium firms.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1992 cont.	• The maximum maturity of call loans was extended to one month from 15 days. • Expansion of over-the-counter interest rate and currency option transactions (in September 1992, banks were permitted to deal in interest rate and currency option trading on the over-the-counter market, though local firms were limited to call options only and options prices had to be "reasonable").	**Portfolio Investment** • **IF**: Effective January 3, the domestic stock market was opened to foreign investors, subject to certain limitations. Nonresidents were allowed to invest in any domestic stocks, unless specified in some particular act. A 3% limit on investment by an individual foreigner and a 10% limit on total foreign investment was imposed. In the case of public utilities companies and those companies in infant industry, however, the total foreign investment limit was set at 8%. • **IF**: Previously, types of securities that could be issued abroad by Korean residents were restricted to ordinary bonds, convertible bonds, bonds with warrants, and stock depository receipts. Effective September 1, the lists was expanded to include negotiable certificates of deposit and commercial paper. • In addition, the three-stage procedure for the authorization of the issue of these securities was reduced to a two-stage process—issuance approval and ex-post facto report (where as previously approval for issuance negotiation, issuance notification and ex-post facto report). Moreover, funds raised from issuance of these securities were permitted to be deposited either in a resident account established with the designated foreign exchange account or in an account with an overseas branch of a domestic exchange bank. • **OF**: Effective September 1, the government raised limits on portfolio investments abroad by domestic securities companies, investment and trust companies, and insurance companies. Securities companies and investment and trust companies could invest up to $50 million, and those dealing with international businesses up to $100 million. Insurance companies could invest up to $50 million, and those with assets in excess of W 5 trillion up to $100 million. **Other** • **IN/OF**: Restrictions on financing options for overseas offices eased. The previous limit of raising overseas funds by Korean subsidiaries of $5 million was completely liberalized. Overseas financing was previously limited to 11 items. Effective September 1, project eligibility was expanded to include the raising of funds for mergers and acquisitions involving foreign enterprises, funds for the purchase of commodities, etc. In addition, the limit on overseas financing by a local subsidiary was raised to an amount equivalent to 50% of the actual currency earnings of the relevant year. **Trade** • Imports of 43 products were liberalized. Import liberalization ratio for manufactured products had risen to 99.9% and that for agricultural products to 87.1%. • First the maximum amount of foreign currency loans were revised down to improve the balance of payments position and later adjusted upwards to influence equipment investment. Changes in loanable ratios of foreign currency loans (in %)

	Previous	1/17	8/21	10/16
Import of equipment				
Manufacturing				
Large firms	60	50	60	80
High-tech industries	--	--	80	90
Small and medium firms	90	70	80	90
Research institutions	80	70	80	90
Import of machinery and materials for use in planned shipbuilding	60	50	50	80
Co-financing with the EXIM Bank of Korea	80	70	70	80

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1993	**Capital Markets** • In February, a computerized on-line system of securities transaction was introduced in the stock market. **Financial Supervision and Regulatory Framework** • Effective August 12, a real-name system in all financial transactions was introduced; i.e., transactions include those involving deposits, installment savings, checks, CDs, stock and bonds must be made only in real names. • Increasing transparency of regulations governing mandatory lending to small- and medium-size enterprises. • Effective July 1, the ceiling on overall oversold position of foreign exchange banks was raised from the greater of $10 million, or 20% of the average balance of foreign exchange bought in the preceding month to the greater of $20 million, or 30% of the average balance of foreign exchange bought in the preceding month. • Effective October 1, for purposes of monitoring their overbought oversold position, banks were given the option of applying a 10% ratio to their capital base, instead of the existing ratio that is based on the volume of foreign exchange transactions. The differentiation between nationwide commercial banks and regional banks for purposes of monitoring foreign exchange exposure limits was abolished. **Money Market and Instruments** • Effective June 1, the ceiling on CDs for **foreign bank branches**, was raised to greater of W 20 billion or 250% of net worth. • Interest rates were liberalized on all loans (except policy loans), time deposits with maturities of two years or more, corporate and financial bonds with less than two years' maturity, and MSBs, treasury and public bonds. • An auction system was introduced to place MSBs. • Simplification of credit control criteria and procedures for large corporations were enacted.	**Exchange Market Arrangement and System** • Effective October 1, the margin within which the exchange rate of the won against the U.S. dollar is permitted to fluctuate was widened to ±1% around the MAR. • Effective January 1, the BOK abolished the temporary annual ceiling limits on loans handled by individual foreign exchange banks that were imposed to curb foreign currency loans when the balance of payments had deteriorated. • Regulations regarding forward transactions were further liberalized. • Effective April 1, residents were allowed to hold up to $10,000 in foreign exchange free of concentration requirements and to sell, deposit, or hold foreign exchange freely within that limit (previous limit was $5,000). • Effective July 1, the government raised the ceiling on individual domestic enterprises' foreign currency deposit holdings from 20% to 30% of external transactions recorded in the previous year. Effective October 1, these limits were abolished. • Effective October 1, the regulations on foreign exchange transactions including forward transactions were liberalized as follows: (i) the ceiling on foreign exchange deposits payable in domestic currency, which was exempted from the documentation requirement, was abolished; and (ii) forward transactions involving foreign or domestic currencies in amounts not exceeding $3 million were exempted from documentation requirements, provided that they are declared and conform to the "real demand" principle. • Effective October 1, it was possible to pay the overseas travel expenses of business travelers from deposits held in resident accounts under the company's name, whereas payment had previously only been possible from resident accounts held under the traveler's own name. • Nonresidents were allowed to hold free won accounts. • Effective October 16, the central bank raised the amount of foreign exchange reserves earmarked for supporting foreign exchange banks' foreign currency loans from $1 billion to $4 billion. **Direct Investment** • **OF**: Effective April 1, small-scale overseas investments of not more than $1 million no longer were investigated regarding there reasonableness of fund supply and the profitability of the investment project. Projects involving more than $10 million in which successive investments are made for a period of more than three years, the validity of the permission was lengthened from one year to three years. • **OF**: Effective December 7, 13 businesses were removed from the list of those in which overseas investment is restricted. Types of real estates where purchase was newly permitted comprised those held by insurance companies in connection with the management of their portfolios and residential housing for individual ownership by the staff of overseas offices. In addition, the government appointed the Korea Development Bank and the Industrial Bank of Korea as overseas investment authorization institutions. • **OF**: Effective April 1, the government abolished the approval renewal system under which approval had to be obtained for an overseas branch office from designated Class A foreign exchange bank every three years after its establishment. At the same time the remittance ceiling on the payment of operating funds was raised from $1 million to $2 million per year (this included funds for establishment expenses, maintenance and operating expenses, working capital for business activities and funds sources through overseas borrowing). **Portfolio Investments** • **OF**: Effective April 1, the government added investment and finance companies, pension funds and companies with a record of performance of external transactions is excess of $100 million to the category of institutional investors eligible to make outward portfolio investment.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1993 cont.		

- **OF**: Effective April 1, the government permitted enterprises with a record of performance of external transactions in excess of $100 million to hold foreign currency overseas, and it raised the limit on the foreign currency which may be held in foreign countries from $10 million to 10% of the value of external transactions (maximum $100 million). Previously, only general trading companies were permitted to hold foreign currency overseas. Also, the form of foreign exchange holdings overseas that had been restricted to bank deposits was allowed to diversify although real estate holdings are still barred.
- **OF**: Effective October 1, the government revised the investment limits upwards.

	Ceilings on portfolio investment abroad ($ millions) Previous	10/1
Securities companies	50	100
dealing with international business	100	200
Investment trust companies	50	100
dealing with international business	100	200
Insurance companies	50	100
with more than W 5 trillion in assets	100	200
Eligible companies (external transactions in excess of $100 mil)	10	10% of external transactions within past 12 months(max $100 mil.)
Pension funds and Investment and Finance companies	0	50
Individual investors aggregate portfolio investment through investment trust companies	0	50

- **IF**: Effective April 1, instead of obtaining permission before issuing foreign currency denominated securities, now it only needed to be reported. The range of eligible funding objects financed through these issues was expanded to included early repayment of external debt and funds for inducement of technology. Eligible issuers were widened as they included those that had recorded a net profit on a cumulative basis over the preceding three years where as previously it was required that they record a net profit in each of the previous three years.
- **IF**: Overseas branches of domestic banks were in principle prohibited from supplying loans to residents of Korea. Effective February 1, the government permitted them to extend loans to residents of Korea engaged in the trading of commodities future or financial futures.

Trade

- Effective January 1, manufacturing industries were eligible for foreign currency loans for all imports of production facilities and equipment.
- Effective January 8, the central bank began supplying foreign exchange reserves to support foreign exchange banks' foreign currency loans for the import of production facilities, such as those for the high-tech industry.
- Effective June 11, the central bank expanded eligibility to include imports of all kinds of manufacturing production facilities and of production facilities for research.
- Effective October 1, settlements of exports and imports (including reinsurance) in won were permitted for transactions up to the equivalent of $100,000.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1994	**Money Market and Instruments** • Interest rates on time deposits with maturities of one to two years, and on installment savings deposits with maturities of over two years were liberalized. • Bank of Korea Financial Wire Network was introduced.	**Exchange Market Arrangement and System** • The fluctuation limit of the won against the U.S. dollar was widened from ±1% to ±1.5% around the MAR. • Residents were permitted to hold foreign exchange freely without limit (once converted into won, foreign exchange can only be converted back to foreign currencies within the limits determined by foreign exchange sales of the past three months). • Residents were allowed to retain foreign exchange proceeds from exports without surrendering them to a foreign exchange bank or depositing them in foreign currency accounts in banks. **Direct Investment** • **IF**: Foreign firms were allowed to engage in business operation within three hours after submitting notification (previously this time requirement was 20–30 days). • **IF**: Rules governing land acquisition were liberalized. • **OF**: The number of businesses restricted from overseas direct investment was reduced to 14 from 17. • **OF**: The limit on the amount banks were allowed to approve for direct investment overseas was raised to $300,000. **Portfolio Investment** • **IF**: The ceiling on portfolio investment in stocks of Korean firms by nonresidents was raised to 12% from 10% of a firm's equity. • **IF**: The ceilings on the amounts that resident corporations and their branches operating abroad may borrow from nonresident financial institutions located abroad were abolished. • **IF**: The overseas borrowing limit for high-technology foreign-financed manufacturing companies was raised from 50% to 75% and then to 100% of the foreign-invested capital. General manufacturing industries were included in the types of foreign-financed companies that are eligible for short-term overseas borrowing. • **OF**: Overseas stock investments of institutional investors were liberalized (these include securities companies, investment trust and insurance companies). • **OF**: Direct overseas stock investments by residents up to a limit of W 100 million (W 300 million for general juridical persons) were allowed, and foreign direct investments in equity-linked bonds were allowed, including nonguaranteed convertible bonds issued by listed small and medium-size enterprises, up to an aggregate of 30% and individual bonds up to 5% of the amount of money listed (per company). Also, the purchase of government and public bonds, with interest rates comparable to international interest rates, were allowed in the primary market. • **OF**: The limit on the amount of foreign exchange resident business firms may retain abroad was increased to the equivalent of 30% of their total import and export values, with the maximum increased to $300 million from $100 million. • **OF**: The limit on the amount of investments foreign exchange banks are authorized to approve was raised to $300,000. • **OF**: Companies whose total export and import value exceed $10 million were given institutional investor status (investment limit was raised to $300 million, or 30% of the total export and import value, whichever is greater). **Trade** • The deferred payment period for imports of consumer goods was extended to 90 days from 60 days and for imports of raw materials for exports to 150 days from 120 days.; the upper limit on import and export transactions that can be settled in won was raised to $300,000 from $100,000.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1995	**Money Market and Instruments** • Following interest rates liberalized (July and November):Deposit rates offered by Banks, Mutual Credits, Credit Unions, Community Credit Cooperative, Mutual Savings, and Finance Companies on: time deposits (maturity less than 6 months); installment savings (maturity less than 1 year); mutual savings (maturity less than 1 year); and preferential saving deposits and company savings deposits maintained three months or more. • All lending rates liberalized. • More flexible operation of aggregate credit ceiling system; promote lending to non-manufacturing small and medium enterprises; abolished eligible enterprise system; abolished restrictions on real estate as collateral in connection with loans to small and medium enterprises; revised rule to limit bank's credit risk arising from extension of large credit to single party-limits lowered. • Maturity of CDs, Rps, and CP was lowered to 30 days from 60 days. Minimum denominations were also lowered. • Competitive bidding system initiated for banks purchasing MSBs. • Issuance of CDs by nationwide commercial and local banks raised from 100% to 150% of net worth and from 300% to 400% for specialized banks. • Issuance of CDs by foreign banks raised to greater of W 35 billion or 400% of net worth. • Banks could offer time and installed saving deposits of maturities of up to 5 years. The minimum maturity of installment deposits was shortened to 6 months. • Interbank financial network extended to include post office and agriculture, fisheries, and livestock cooperatives. • Loans to foreign exchange banks allocated from the Foreign Exchange Equalization Fund were now based on competitive interest rate bidding.	**Exchange Market Arrangement and System** • The fluctuation limit of the won against the U.S. dollar was widened from ±1.5% to ±2.25% around the MAR. • Individuals were not require to register foreign currency holding of $50,000 and above with foreign exchange banks • Firms involved in foreign trade with no record of foreign earnings were allowed to establish overseas offices after one year of having registered, whereas previously this was permitted only to firms earning foreign currency of more than $300,000. Settlement period on trade related transactions lengthened. • Individual residents permitted to purchase up to $10,000 or equivalent per year without restrictions. Current account payment of less than $5,000 could be made without supporting evidence of underlying real demand. For those staying overseas for over 60 days an additional $10,000 per month was allowed compared to $3,000 before. Resettlement allowances for those staying abroad over a year was raised from $20,000 to $50,000 including the travel allowance of $10,000. Donations to international institutions was now freely permitted up to $50,000 compared to $10,000 earlier which had required endorsement from relevant ministry. Limits on use of domestic credit card for purchases abroad raised from $3,000 per month to $5,000 per month for individuals and from $30,000 per quarter to $100,000 per quarter for firms. • The limit on the amount of domestic banknotes permitted to be imported/exported was raised to W 3 million. **Direct Investment** • **IF:** Investments in 53 sectors either newly permitted or extent of access greatly increased with effect from January 1. On November 15, 48 sectors concentrated in services and manufacturing out of 105 which had been barred or only partially opened to foreign direct investment were either fully opened or extent of participation widened. • **OF:** Number of sectors in which outward direct investment was restricted, was reduced to 3 from 17. Projects under $50 million require only notification, compared to $30 million previously. Projects of $50 million require approval from BOK subsequent to favorable review by the Overseas Investment Deliberation Committee. **Portfolio Investment** • **IF:** Total foreign investment by nonresidents in a listed company's outstanding stocks was raised from 12% to 15% and for public corporation from 8% to 10%. Investments in bonds through securities investment trust companies' beneficiary certificates was permitted up to $300 million. • **IF:** Overseas issuance of exchangeable bonds permitted, limited to 15% of total associated stocks. • **IF:** Limits lowered for small and medium sized firms on issuance of securities abroad. • **IF:** Eight leasing companies were permitted to undertake medium- and long-term borrowing overseas without intermediation from foreign exchange banks. • **IF:** Direct foreign borrowings by firms permitted to redeem debts or for imports if firms were engaged in social overhead capital projects or foreign invested high-tech firms—small- and medium-sized firms or public corporations permitted to borrow 100% directly and up to 90% permitted for large firms. • **OF:** Limits on outward portfolio investments abolished for Investment and Finance Companies and Pension Funds. Limits raised for corporations from W 300 million to W 1 billion and for individuals from W 100 million to W 500 million. Institutional investors were permitted to invest in foreign unlisted stocks up to 10% of their total investment holdings and 10% of total outstanding of any one issue. • **OF:** Institutional investors and other corporations were allowed to entrust up to $10 million and $300,000, respectively, to overseas nonresidents for asset management.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1995 cont.	**Capital Markets** • Financial Institutions could place orders through BOK-Wire system for purchase or sales of government or public bonds as well as the existing paper-based system. **Financial Supervision and Regulatory Framework** • Bank supervision guidelines were strengthened to include specific information on derivatives trading and Banks were instructed to follow new accounting standards to reflect derivatives trading. • Securities companies allowed to engage in foreign exchange transactions related to domestic stock investments by nonresidents.	• **OF**: Restrictions on resident holdings of overseas deposits eased; institutional investors allowed up to $100 million; other corporation allowed $1 million; and individuals allowed up to $30,000. • **OF**: Enterprises with external transactions in excess of $5 million (lowered from $10 million) may hold foreign currency overseas. Limits on overseas holdings on overseas construction companies raised from 10 to 20% of outstanding business contracts. • **OF**: Resettlement allowance for emigration was raised from $250,000 to $500,000 and from $300,000 to $500,000 to satisfy any related investment conditions. • **OF**: Domestic issuance of won denominated securities by international financial institutions allowed. **Trade** • Ratio of foreign currency loans for import of production facilities to large firms was reduced from 90% to 70%; reduced to 80% from 70% for commercial imports of used ships and aircrafts. To encourage development of engineering techniques, eligibility for foreign currency loans widened to include import of production facilities and equipment in engineering business. • Ratio of foreign currency loans available for import of machinery and equipment lowered to 70% from 90% of total cost in the case of manufacturing firms and to 70% from 80% in the case of non-manufacturing firms. • The deferred import payments period was extended as follows. For large enterprises, for re-exports to the general area to 180 days from 150 days; re-exports to the regional area to 90 days from 60 days; and for domestic consumption purposes to 90 days from 60 days for imports from the general area and to 60 days from 30 days for imports from the regional area. For small- and medium-sized enterprises, for re-exports to the regional area to 120 days from 90 days, and for domestic consumption purposes to 120 days from 90 days for imports from the general area and to 90 days from 60 days for imports from the regional area.
1996	**Money Market and Instruments** • The BOK lowered reserve requirement ratio in two steps, for demand deposits and time and savings deposits with a maturity of less than two years to 7% from 11.5%; for time and savings deposits with a maturity of two years or more to 4% from 8%; and on resident's deposits in foreign currency to 7% from 11.5%. • The reserve requirement ratio for certain long-term savings products was lowered to 2% from 3%. • The BOK removed the restriction on the size of the premium a bank could charge over its prime lending rate.	**Exchange Market Arrangement and System** • The government change the procedure required in making overseas payments for current account transactions from a system of validation by foreign exchange banks to a notification system, and abolished the need for service transactions to receive authorization. • Remaining underlying documentation requirement was abolished for forward exchange and financial futures transactions. However, transactions were still based on real demand. • Ceiling on the swap facilities provided to foreign banks' branches was lowered by 10%. • Procedures for remittance of funds for operation of overseas branches of domestic firms were liberalized. • Ceiling of $300,000 on the amount allowed to be deposited and withdrawn from the free won account for the purpose of current transactions was abolished. • Deposits overseas in won were allowed within the ceiling on the amount of won that could be carried out when traveling abroad. Also, residents were allowed to purchase and sell won within the ceiling on the amount of won permitted to carry out when traveling abroad at both the domestic foreign exchange banks overseas and at branches and subsidiaries of foreign banks.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1996 cont.	• Enhanced the efficiency of open market operations by increasing the use of competitive bidding system for repurchase agreements (rps) and sale of MSBs to 99% (from 76%) and 89% (from 33%), respectively. • Introduced MSBs with a maturity of two years. • Korea Money Brokerage Corporation (KMBC) was established as a specialist brokerage house that would not only broker call loans and money-at-call but also short-term money market instruments like CDs, RPS, and other bills. • Abolished guideline ratio for commercial banks' credit to the manufacturing sector. Regulations governing credit to select businesses for example, hotels and restaurants, were eased. • The BOK revised its rules for credit control on conglomerates. The BOK exempted the conglomerates ranking between eleventh and thirtieth largest from the rules for credit control. • To encourage credit to small- and medium-size enterprises, BOK introduced new credit evaluation standards. • Minimum maturity of trust account products was lengthened to 18 months from 12 months. **Capital Markets** • Stock index futures started trading on the stock exchange. • Securities companies and general investors were permitted to buy and sell in the domestic OTC market any securities in which overseas investment could be made. **Financial Supervision and Regulatory Framework** • In line with the opening and globalization of financial markets, the General Banking Act was revised to strengthen accountability of banks' management and increasing their soundness.	• The limit on won permitted to take out when traveling abroad was raised to W 8 million from W 3 million. • Individual remittances overseas of sums exceeding $10,000 per year must be declared to the BOK. The annual receipt of over $20,000 or the annual remittances of at least $10,000 for more than 3 years by an individual must be notified to the national tax administration. • The BOK introduced foreign currency swap system for foreign portfolio investment by securities companies, insurance companies , and investment trust companies. The swapped funds could be invested only in those instruments open to institutional investors. • Spot transactions conducted according to international practice. Won-Japanese yen spot and forward markets established. **Direct Investment** • **OF**: Restrictions on overseas investment in three real estate related sectors were eased. **Portfolio Investment** • Nonresidents were permitted derivative transactions between foreign and domestic currencies based on their real demand. • **IF**: Nonresidents permitted to open free-won accounts in overseas branches/subsidiaries of a foreign exchange bank. Won currency funds deposited in a free-won account were allowed to be withdrawn to invest in domestic stocks. • **IF**: The aggregate ceiling on investments in the stock market by nonresidents was raised to 20% from 15% and to 15% from 10%, on purchases of stocks of a listed firm and those issued by a public corporation, respectively. The ceiling on holdings by an individual was raised to 5% from 3%. • **IF**: Indirect investment in domestic bonds was allowed by means of a country fund. • **IF**: Access of nonresidents to the stock index of the futures market was allowed, but limited to 15%; limit was raised to 30% in November. • **IF**: Nonresidents were allowed to purchase and trade bonds with warrants. • **IF**: The Korea Bond Fund, capitalized at $100 million, was listed on the London stock exchange. • **IF**: For non-manufacturing small- and medium-sized firms, in certain sectors, restrictions on direct foreign borrowings was dismantled. • **IF**: Opening of branches by foreign companies involved in securities related business no longer required the approval of the Ministry of Finance; procedure replaced by acceptance through examination. • **OF**: Limits on overseas deposits for asset diversification purposes raised incrementally to $3 million and $50,000 a year for juridical persons and individuals, respectively. • **OF**: Limits on investments in foreign securities by individuals and general corporations were abolished. List of eligible investments was widened to include, unlisted foreign stocks traded in authorized OTC markets, CP issued by foreign enterprises, and CDs sold by foreign financial institutions. • **OF**: The extension of foreign currency credits abroad by resident institutional investors was liberalized. • **OF**: Limit on amount of foreign currency permitted to be held abroad by construction companies was raised to 30% of the balance of construction contract or $3 million, whichever is greater from 20% of contract or $2 million, whichever is greater.

Table 12. Korea: Sequencing of Reforms in the Domestic and External Sectors, 1985–96

Year	Monetary Control and Financial System	Exchange System, Trade, and Capital Flows
1996 cont.	• To promote the restructuring of the financial industry, the "Act Concerning the Merger and Conversion of Financial Institutions" was extensively revised and retitled "Financial Industry Restructuring Act." This act empowers the regulatory authority to take corrective measures in the event of a financial institution failing and also simplifies the merger process. • Regulations governing the foreign exchange positions of banks were modified, whereby the basis of the calculation was related to the volume of transactions or capital, whichever is greater. The ratios with respect to capital were set as follows: overall overbought position, 15% of capital; overall oversold position, 10% of capital; and spot oversold position, 3% of capital or $5 million. • Entry barriers to foreign exchange business was lowered, including simplification of the licensing process. • The government revised the Foreign Capital Inducement Law and renamed it the Foreign Investment and Foreign Capital Inducement Law, to be effective from February 1997. Revisions were designed to induce larger inflows and bring the system into line with international standards. For example, the system of approval of foreign direct investment projects was converted to a system of notification.	• **OF**: The limit on the amount of foreign currency that can be held abroad by general trading companies was raised to 50% with the maximum of $500 million of the trading value from 30% with the maximum of $300 million. • **OF**: Ceiling of $10 million on loans that an institutional investor could extend to nonresidents was abolished; limits were set at $10 million and $300,000 for general trading firms and other firms, respectively. • **OF**: Head of emigrating family allowed to transfer up to $400,000 (previously $200,000); and other family members allowed to transfer up to $200,000 (previously $100,000). • **OF**: Resident foreign exchange banks and institutional investors were allowed to extend loans denominated in domestic currency to nonresidents up to W 100 million per borrower. • Domestic issue of Won denominated securities was expanded to include governments, local governments, public institutions, financial institutions, and enterprises of foreign countries; 50% of the total issue was allowed to be sold overseas. **Trade** • Export credits in the form of deferred receipts were liberalized. • The ceiling on export advances for large enterprises was raised, in two steps, to 20% from 10% of the export value of the previous year.

Sources: Annual Report, The Bank of Korea, (various issues); Annual Report on Exchange Arrangements and Exchange Restrictions, IMF, (various issues); Korea - Recent Economic Developments, IMF, (various issues). Doing Business in Korea, (various issues), Price Waterhouse; International Tax Summaries: A Guide for Planning and Decisions, Coopers and Lybrand International Tax Network, (various issues); and Securities Market in Korea, 1992, Korea Securities Dealers Association. IF = Inflows, OF = Outflows

1/ As a result, over the year, the refinance outstanding of the financial institutions decreased by $1.8 billion and bank loans totaling $1 billion were repaid before maturity (Annual Report, The Bank of Korea, 1986, p. 28).

Table 13. Korea: Selected Macroeconomic, Financial Sector, and Balance of Payments Indicators

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Selected Economic Indicators						(In Percent)						
Real GDP Growth	6.9	11.6	11.5	11.3	6.4	9.5	9.1	5.1	5.8	8.6	8.9	7.1
Inflation per Annum	2.5	2.7	3.0	7.1	5.7	8.9	9.3	6.2	4.8	6.3	4.5	5.0
M2 to GDP Ratio	34.8	35.3	35.9	36.8	39.3	38.3	38.8	40.0	42.0	43.5	43.8	45.7
Currency to Deposits Ratio	13.0	12.2	12.3	11.7	11.6	11.3	10.4	9.8	12.1	10.9	10.9	9.5
Fiscal Balance to GDP Ratio	−1.1	−0.1	0.4	1.5	0.2	−0.7	−1.6	−0.5	0.6	0.3	0.3	0.1
Private Sector Credit to GDP Ratio	49.4	48.7	49.9	48.3	54.2	56.8	56.8	56.8	58.3	60.8	61.2	66.0
Exports plus Imports of Goods to GDP Ratio	65.1	61.0	64.8	61.8	55.8	53.2	52.1	51.4	49.9	52.1	57.1	57.8
Current Account to GDP Ratio	−0.8	4.4	7.4	8.0	2.4	−0.7	−2.8	−1.3	0.3	−1.0	−1.8	...
Financial Account to GDP Ratio	2.1	−3.7	−6.6	−2.4	−1.2	1.1	2.3	2.3	1.0	2.8	3.8	...
Interest and Exchange Rates												
Nominal Deposit Rate (percent per annum)	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	8.6	8.5	8.8	7.5
Real Deposit Rate (percent per annum)	7.5	7.3	7.0	2.9	4.3	1.4	0.7	3.8	3.8	2.2	4.4	2.5
Interest Rate Differential 1/	1.6	3.1	2.8	2.0	2.7	1.7	4.0	6.0	5.3	3.8	2.8	2.0
Lending/Deposit Spread	0.0	0.0	0.0	0.1	1.3	0.0	0.0	0.0	0.0	0.0	0.2	1.3
Official Exchange Rate per US dollar (end of period)	890.2	861.4	792.3	684.1	679.6	716.4	760.8	788.4	808.1	788.7	774.0	844.0
Real Effective Exchange Rate Index (1990=100)	96.8	81.8	81.3	90.8	103.5	100.0	99.9	94.2	93.6	94.3	95.4	98.8
Balance of Payments						(In millions of U.S. Dollars)						
Current Account, n.i.e.	−758	4,747	10,092	14,538	5,387	−1,745	−8,291	−3,939	1,016	−3,855	−8,251	−23,061
Financial Account, n.i.e	1,935	−4,010	−8,963	−4,279	−2,640	2,866	6,714	6,969	3,188	10,610	17,221	24,025
Direct Investment Abroad	−587	−1,185	−540	−643	−613	−1,056	−1,500	−1,208	−1,361	−2,524	−3,529	−4,424
Direct Investmnet in Rep. Eco, n.i.e.	234	460	616	1,014	1,118	788	1,180	727	588	809	1,776	2,325
Net Direct Investment	−353	−725	76	371	505	−268	−320	−481	−773	−1,715	−1,753	−2,099
Portfolio Investment Assets	...	...	...	−37	−66	240	492	845	232	−230	−311	−2,414
Portfolio Investment Liabilities	1,738	−332	−296	−606	−2	82	2,442	4,857	10,298	7,097	11,136	16,787
Net Portfolio Investment	1,738	−332	−296	−643	−68	322	2,934	5,702	10,530	6,867	10,825	14,373
Other Investment Assets	−1,136	−738	−113	−1,958	−1,382	−2,330	−6,378	−2,515	−4,224	−7,627	−13,084	−11,822
Other Investment Liabilities	1,686	−2,215	−8,630	−2,049	−1,695	5,142	10,478	4,263	−2,345	13,085	21,233	23,573
Net Other Investments	550	−2,953	−8,743	−4,007	−3,077	2,812	4,100	1,748	−6,569	5,458	8,149	11,751
of which, Official Capital	1,989	−862	−7,092	−3,787	−2,098	−610	818	1,806	249	2,450	2,544	3,920
Net Errors and Omissions	−882	−546	1,185	−590	691	−1,998	757	1,101	−720	−1,704	−1,444	1,049
Capital Account Balance	−103	−114	−210	−353	−318	−331	−328	−407	−475	−437	−487	−598
Overall Balance 2/	345	241	2,364	9,719	3,488	−827	−770	4,181	3,534	5,101	7,576	2,063
Memorandum Item:												
Net Private Capital 3/	−2,547	−2,047	507	−74	−1,345	2,745	7,806	5,295	9,960	8,948	16,225	22,067

Source: IMF International Financial Statistics, Information Notice System, and IMF Direction of Trade Statistics, various issues.

1/ Interest Differential = Deposit − London Interbank Offer Rate on One−Year U.S. Deposits.
2/ The overall balance includes: current account, financial account, capital account, and net errors and omissions.
3/ Total Capital = Direct Investment + Portfolio Investment + Other Investment − Official Capital + Net Errors and Omissions + Misinvoicing.

Table 14. Korea: Abstract of Exchange and Capital Control Regime as of August 31, 1997

Exchange Arrangement

Currency	The currency of Korea is the won.
Exchange rate structure	Unitary.
Classification	
Managed floating	The exchange rate of the won against the U.S. dollar is determined on the basis of the weighted average of interbank rates for the won-dollar spot transactions of the previous day. During each business day, the won rate against the dollar in the interbank market is allowed to fluctuate within margins of ±2.25 percent against the market average rate of the previous day.
Forward exchange market	Foreign exchange banks may conduct forward transactions, futures transactions, swaps, and options between foreign currencies, as well as between the won and foreign currencies. There are no specific restrictions on the terms of forward contracts in respect of interbank transactions; however, the terms of forward contracts between foreign exchange banks and nonbank customers must be based on a bona fide transaction.

Exports and Export Proceeds

Repatriation requirements	Export earnings exceeding $50,000 must be repatriated to Korea within 6 months, except in specific cases. However, general trading companies licensed under the Foreign Trade Act and enterprises whose trade value in the previous year exceeded $5 million are allowed to retain overseas deposits up to 50 percent of this value within the limit of $500 million.
Surrender requirements	No.

Proceeds from Invisible Transactions and Current Transfers

Repatriation requirements	Yes.
Surrender requirements	Residents are permitted to hold foreign currency earned from invisible transactions, but once converted into won, a limit applies to reconversion. Residents and nonresidents must register domestic and foreign exchange they bring into Korea at customs if the amount exceeds the equivalent of $10,000. The importation by travelers of Korean currency in excess of W 2 million is restricted. The proceeds received by construction companies from construction activity abroad must be deposited in foreign currency accounts at domestic foreign exchange banks, and profits may be converted into won following the completion of each project. Domestic firms engaged in international construction and service businesses may deposit abroad up to 30 percent of the balance of their overseas contracts or $3 million, whichever is greater.

Capital Transactions

Controls on capital and money market instruments	
On capital market securities	
Purchase locally by nonresidents	Nonresidents may freely acquire listed stocks up to 5 percent individually and 20 percent collectively of the local number of shares issued. For convertible bonds issued by small- and medium-sized enterprises (SMEs), they may acquire up to 5 percent

Table 14. Korea: Abstract of Exchange and Capital Control Regime as of August 31, 1997

	individually and 30 percent collectively of the total value of convertible bonds. For other purchases, including public bonds designated by the Securities Exchange Commission, nonresidents require prior approval from the MOFE. In May 1997, the limit on foreign ownership of Korean equities was raised to 23 percent from 20 percent. In June 1997, foreign investors were granted access to nonguaranteed bonds of small and medium-size companies (maturities over three years and up to 50 percent of the amount listed) and of conglomerates (up to 30 percent limit of issue or a 6 percent individual limit).
Sale or issue locally by nonresidents	International organizations may issue won-denominated bonds in the domestic capital market; however, other nonresidents require prior approval from the MOFE in order to issue securities in the market. Nonresidents may sell those securities or the rights thereof that they were allowed to acquire.
Sale or issue abroad by residents	The issue of won-denominated securities abroad requires prior approval of the MOFE. Foreign-currency-denominated securities may be issued abroad by residents by submitting a report to the MOFE. The report of issuance is assumed to be accepted 7 days after submission unless notification to the contrary is made by the MOFE.
On money market instruments	
Purchase locally by nonresidents	Foreign investment funds and international beneficiary certificates established with the approval of the MOFE can purchase domestic money market securities without approval of the authorities. For transactions of money market securities between residents and nonresidents other than those mentioned above, approval of the MOFE is required.
Sale or issue locally by nonresidents	These transactions require MOFE approval.
Sale or issue abroad by residents	Certificates of deposit and commercial paper may be regarded as securities like equities and bonds by the Foreign Exchange Management Act (FEMA), Decree (FEMD), and Regulation (FEMR). These money market securities may be issued in won or foreign currencies. The issue of foreign-currency-denominated securities on a foreign money market must be filed with the MOFE. Investors who have been approved to purchase foreign money market securities are allowed to sell such securities.
On collective investment securities	
Purchase locally by nonresidents	The same controls as for capital market securities apply.
Sale or issue locally by nonresidents	The issuance of beneficiary certificates by trust companies, either in the domestic or the foreign market, is subject to MOFE approval. The approval system on the issuance of beneficiary certificates is designed especially to protect investors and may be regarded as a kind of prudential regulation. The size of the issuance of beneficiary certificates shall be established at an appropriate amount in consideration of the volume of the capital inflow resulting from the capital market opening.
Purchase abroad by residents	Such purchase is subject to approval by the MOFE.
Sale or issue abroad by residents	Issuance and sale of collective investment securities by foreign trust companies in the domestic market require MOFE approval. Although the purchase of domestic collective investment securities by nonresidents requires MOFE approval, nonresidents may sell domestic collective investment securities they have lawfully acquired.
Controls on derivatives and other instruments	
Purchase locally by nonresidents	Foreign investment funds or international beneficiary certificates established with permission from the MOFE may purchase domestic instruments and claims without

Table 14. Korea: Abstract of Exchange and Capital Control Regime as of August 31, 1997

	reporting. Also, foreign banks can purchase domestic instruments and claims from domestic foreign exchange banks. Other transactions require permission from the MOFE. Effective May 1996, stock index futures began to be traded on the existing stock exchange, and nonresidents' access to the market was allowed within certain limits.
Sale or issue locally by nonresidents	The issue of foreign instruments and claims on the domestic financial market requires MOFE approval. It is not necessary for nonresidents to obtain permission or submit a report when selling domestic instruments and claims once they are permitted to purchase them.
Purchase abroad by residents	Residents other than foreign exchange banks may trade through a foreign exchange bank within certain limits equivalent to actual demand.
Sale or issue abroad by residents	These transactions require approval by the MOFE.
Controls on credit operations	
Commercial credits	
By residents to nonresidents	SMEs, firms engaged in social overhead capital projects, foreign-financed firms with high technology, and domestic firms that wish to repay overseas borrowing earlier than contracted may borrow abroad. Foreign borrowing by these firms of more than $1 million and with maturities of more than 3 years is governed by the Foreign Capital Inducement Act. Foreign-financed companies are, in principle, subject to the same regulations governing foreign borrowing as other enterprises. Deferred receipt exports on a letter-of-credit basis, for which the settlement period is less than 3 years from the shipment of goods or signing of the export bill of exchange, are allowed without restriction. For settlement periods of more than 3 years, these exports are allowed in the following cases with validation from a foreign exchange bank: (1) when payment is guaranteed by the importing country's central government agency or central bank; (2) when they are covered by export insurance; and (3) when qualified foreign banking institutions, as designated by the BOK, open letters of credit and guarantee payment. Imports exceeding 360 days are allowed with the validation of a foreign exchange bank in cases where refund guarantees must be provided by the exporting country's central government agency, central bank, or qualified banking institution. Residents wishing to enter into lease contracts for assets other than real estate from nonresidents shall obtain validation from a foreign exchange bank.
To residents from nonresidents	All methods of settlement for trade in goods and services are free, except for those methods specified on the negative list under the FEMR.
Financial credits	
By residents to nonresidents	These credits require prior approval from the MOFE.
To residents from nonresidents	Foreign exchange banks may borrow abroad. Borrowing by high-technology, foreign-financed manufacturing companies is allowed up to 100 percent of the foreign-invested capital. Also, maturity is limited to 3 years or less, and limitations are imposed on the use of funds. Foreign borrowing repayable within 3 years is governed by the Foreign Exchange Act. The maximum maturity period permitted for deferred payments is 180 days for imports of raw materials for export production. In July 1997, the Ministry of Finance and Economy abolished regulations, in accordance with OECD rules, on the usage of long-term loans with maturities of over five years, brought into the country by foreign manufacturers.
Guarantees, sureties, and financial backup facilities	
By residents to nonresidents	Residents, other than banks, must obtain approval from the BOK, except for the follow-

Table 14. Korea: Abstract of Exchange and Capital Control Regime as of August 31, 1997

	ing cases: (1) when a foreign importer is granted an offshore loan by a foreign exchange bank to finance imports from a resident, and the said resident pledges a guarantee in foreign currency; (2) when a resident concludes a contract guaranteeing performance or bearing responsibility for the liabilities assumed by the nonresident, who in turn is providing a guarantee, such as bid bonds or other sureties, related to international bids or contracts entered into by a resident; and (3) when residents provide guarantees to serve as collateral for spot financing. There are no restrictions on the provision of underwritten backup facilities by the domestic institutional investors when they participate in an international underwriting syndicate.
To residents from nonresidents	Any resident may freely accept a guarantee relating to an overseas borrowing to finance an overseas investment from another resident, in which the surety for the guarantee is pledged by nonresidents. Other transactions related to the creation of credits arising from liability guarantee contracts between residents and nonresidents require approval from the BOK. Therefore, residents are free to take up financial backup facilities offered by nonresidents as long as the issuance of overseas securities has been properly reported.
Controls on direct investment	
Outward direct investment	For investments of up to $10 million, validation of a foreign exchange bank is needed; for amounts between $10 million and $50 million, notification to the BOK is needed. If the amount exceeds $50 million, approval of the BOK is needed, and the Overseas Investment Advisory Committee examines the investment plan to analyze the effects of the investment on the domestic economy prior to issuing an approval. In August 1997, the debt limits on corporations making overseas direct investments, whereby 20 percent of investments exceeding $100 million had to be financed by a firm's own capital, were abolished.
Inward direct investment	Equity participation is possible by increasing the amount invested in newly established or existing enterprises. Direct investment by means of mergers and acquisitions is not allowed. For the establishment and extension of a domestic branch of a foreign enterprise, approval from the MOFE is required for financial institutions; approval of the BOK is required for nonfinancial institutions and notification to the BOK for establishment of an office. Investments in public utilities, radio, and television are restricted. Direct investments are allowed in all industries, except those specified on a "negative" list, including about 5 percent of all industries listed in the Korean standard industrial classification and less than 1 percent of industries in the manufacturing sector. In general, foreign-financed companies are no longer required to set up partnerships with local firms. There are no restrictions on the maximum value of foreign investment. Tax privileges may be granted to foreign-financed projects that involve advanced technology. Tax privileges have been continuously reduced, and postinvestment controls have also been relaxed to treat foreign and local companies equally. All foreign direct investments, except those in industries on the negative list, are subject to a notification requirement. A notification is deemed accepted by a foreign exchange bank unless it advises to the contrary.
Controls on liquidation of direct investment	No.
Controls on real estate transactions	
Purchase abroad by residents	Overseas direct investments in the fields of lease and sale of real estate, construction, and operation of golf courses are prohibited. No approvals or notifications are required for acquisition of overseas real estate by foreign exchange banks, government authori-

Table 14. Korea: Abstract of Exchange and Capital Control Regime as of August 31, 1997

	ties, and residents if given as gifts or through inheritance from nonresidents. However, a notification to the BOK is required for the acquisition of real estate necessary for approved business activities costing up to $10 million. For real estate necessary for approved business activities exceeding $10 million, permission from the BOK is required.
Purchase locally by nonresidents	The following are not restricted: acquisition of domestic land or mortgages, leasing of domestic real estate by nonresidents, and acquisition of real estate or associated rights other than land by nonresidents from nonresidents. Notification to the BOK is required for the acquisition of real estate and its associated rights, including real estate acquired through inheritance or as a gift from nonresidents, and the establishment of fixed collateral not assuming the transfer of ownership. Approval of the MOFE is required for real estate acquisitions other than those specified above.
Sale locally by nonresidents	Approval from the BOK is required.
Provisions specific to commercial banks and other credit institutions	
Borrowing abroad	For reference, the foreign exchange banks are required to report to the MOFE the funding of maturities of 1 year or more and for amounts exceeding $10 million.
Lending to nonresidents (financial or commercial credits)	Foreign exchange banks may extend credits without restriction to nonresidents in foreign currency. Other credit institutions that used to be able to extend credits up to $10 million were allowed to extend foreign currency credits to nonresidents without restriction in 1996. Foreign currency loans by resident banks to nonresidents of less than $2 million are permitted freely. Loans ranging from $2 million to $20 million require ex post notification to the MOFE, and loans exceeding $20 million require prior notification to the MOFE. Other credit institutions may extend credits up to $10 million.
Lending locally in foreign exchange	There are loan ceilings according to the economic sector.
Differential treatment of nonresident deposit accounts and/or deposit accounts in foreign exchange	
Reserve requirements	Reserve requirements on foreign currency deposit accounts are 9 percent for resident accounts and 1 percent for nonresident accounts.
Open foreign exchange position limits	The limits are as follows: (1) overall overbought position, 15 percent of the total equity capital at the end of the previous month; (2) overall oversold position, 10 percent of the total equity capital at the end of the previous month or $20 million, whichever is greater; and (3) spot oversold position, 3 percent of the total equity capital or $5 million, whichever is greater.
Provisions specific to institutional investors	In addition to the foreign exchange laws or foreign exchange controls, all institutional investors have their own rules for asset operations. For example, securities companies must keep their proportion of the portfolio invested within 30 percent of their total assets. Insurance companies and securities investment trust companies can maintain their portfolio abroad within 10 percent and 30 percent of their total assets, respectively.
Limits (max.) on portfolio invested abroad	Institutional investors are permitted to hold deposits abroad for asset diversification purposes without a quantitative ceiling. General corporations and individuals are permitted to hold deposits abroad of up to $3 million and $50,000 a year, respectively.
Other controls imposed by securities laws	Restrictions imposed by the Securities Laws are as follows: (1) domestic securities investments by nonresident foreign nationals are regulated by "Rules on Sales and Purchases of Securities by Foreigners" established by the Securities Exchange Com-

Table 14. Korea: Abstract of Exchange and Capital Control Regime as of August 31, 1997

	mission (SEC). The main contents of the Rules include investment ceilings, investment procedures, and the management of foreign investors, etc.; (2) overseas securities investments by residents are regulated by "Rules on Sales and Purchases of Overseas Securities" established by the SEC. The main contents of the Rules include securities' eligibility for investment and transaction procedures, etc.; (3) issuance of overseas securities by residents are regulated by "Rules on Issuance of Overseas Securities" and "Rules on Management of Listed Companies on Overseas Securities Markets" established by the SEC. The main contents of the Rules include the eligibility of issuers, the use of funds raised by issuance, and the obligations of issuers on reporting, etc.; and (4) international securities transactions by residents are regulated by "Rules on Securities Business by Domestic Branches of Foreign Securities Companies" established by the SEC. The main contents of the Rules include the accumulation of retained earnings and the obligation of submitting financial statements, etc. The main contents of "Rules on Overseas Securities Business by Domestic Securities Companies" include the restriction on the investment of domestic listed stocks by overseas branches of securities companies.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1985	*Monetary Policy:* The government pursued a less restrictive monetary policy than in 1984 aimed at giving greater stability and flexibility to the financial system, as well as to promote priority economic sectors. This policy emphasized a change in loan policies of financial institutions and adapting the interest rate structure to economic circumstances. **Financial Supervisory and Regulatory Framework** • Regulations concerning rediscounting of finance company promissory notes were liberalized. • Regulations governing commercial bank sales of government bonds, held as required by branching regulations in the repurchase market , were liberalized. • Regulations concerning the rediscounting of promissory notes arising from exports, small industrial undertakings, and animal husbandry were liberalized (method of computing interest on promissory notes is changed). • BOT exempts interbank loans of up to 6-month maturity from a classification as a risk asset. • The Act on the Undertaking of Finance Businesses BE 2522 (1979) is amended by the Second Emergency Decree BE 2528 (1985) by providing a better legal framework for finance, and securities companies and credit fonciers. • To broaden participation in interbank markets, and increase the volume of transactions, commercial banks created the Bangkok Interbank Offer Rate (BIBOR). BIBOR operates along with the interbank market. **Money Market and Instruments** • Commercial banks are asked to cooperate and offer concessionary interest rates or discounts to priority sectors (including the allocation of more credit to these sectors). • The minimum maturity of promissory notes held by credit fonciers as collateral is increased. • BOT established a line-of-credit on overdrafts at commercial banks (to help commercial banks avoid excess liquidity). • BOT Requires commercial banks to cease paying interest monthly on time deposits.	**Exchange Market Arrangement and System** • **OF:** Regulations continue to exist on the repatriation of interest payments abroad. Prior approval from the BOT was required. **Direct and Portfolio Investment** • **IF:** BOT required every individual borrowing from abroad to register with the Bank within 7 days of making the loan agreement. **Portfolio Investment** • **OF:** Limits continue to be imposed on commercial banks' lending to nonresidents in foreign currency. **Trade** • Regulations regarding rediscounts of export bills are liberalized. Credit ceiling is increased from 50% to 60% of warehouse receipt value. • The BOT temporarily extended the rebate period for penalty fees levied against rice and tapioca exporters, from 60 to 150 days. • A surcharge of 10% of the c.i.f. value was imposed on imports of goods and services under customs tariff heading No. 95.08. • Regulations on the opening of letters of credit for imports were relaxed. • The BOT provided special assistance to exporters affected by the baht exchange rate adjustment by giving an exemption from paying penalty fees when unable to export goods within the specified time in the promissory notes. • Manufacturers of goods exported by international trading companies are allowed to rediscount directly at the BOT their own promissory notes issued against domestic letters of credit, sales contracts, or purchase orders received from promoted international trading companies (as an alternative to these intl. companies rediscounting their own promissory notes at the BOT and then giving the proceeds to the manufacturers within 60 days.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1986	*Monetary Policy:* The BOT continued with less restrictive policies with the aim at boosting the economy and investment, including official financial assistance to priority economic sectors. At the same time, the BOT helped improve the stability and financial position of financial institutions. **Capital Markets** • For interest paid on debentures Stock Exchange of Thailand (SET), the income tax (deducted at source) is 15% tax, lower than the personal income rate and excludable from personal assessable income. **Money Market and Instruments** • The BOT consolidated its two-tier rate into a single rate, maintaining the ceiling credit line at 1% of total commercial bank deposits. BOT used the 1985 base of deposit levels rather than the 1979 level. • The BOT added two more maturities for bond repurchases—90-day and 180-day to the existing four—1, 3, 30 and 60-day. • The CB reduced the refinancing rate of promissory notes arising from exports from 7%to 5% per annum, and those arising from exports of new products with no traditional markets and those issued by small exporters and small-scale industries, from 5% to 4% per annum. The financing rates were correspondingly reduced to 7% for all exports. • The regulation on refinancing of promissory notes arising from exports was amended. The maximum value for refinancing export bills issued against receipts was increased from 50% to 60% of the value assessed by commercial banks. • The penalty rate was reduced from 11% to 8%, bringing it in line with the rate in the money market. The decrease of the penalty rate was also accompanied by a relaxation of penalty collection methods.	**Exchange Market Arrangement and System** • The BOT increased the amount of foreign exchange a person going overseas can purchase to a more appropriate level, and increased the amount of foreign currency an authorized foreign exchange dealer can sell to such a person. **Portfolio Investment** • **IF:** The tax on income earned from mutual funds was lowered for nonresidents and juristic persons, if they used foreign funds transferred to Thailand to purchase them. • **IF:** For dividends and other forms of compensation earned from mutual funds, the government gives: (1) groups of persons not resident in Thailand a reduction in the income tax (deducted at source) from over 10% to no more than 10%. Such earnings are also excludable from assessable personal income; and (2) juristic persons or partnerships established according to foreign law and without business in Thailand a reduction in income tax (deducted at source) from 20% to 10%. • **IF:** For capital gains earned from selling shares in mutual funds listed on the SET, an investor received a reduction in the income tax (deducted at source) from 25% to 12.5%. To qualify an investor must use foreign funds transferred into Thailand to purchase the mutual fund shares. • **IF:** The BOT introduced a regulation requiring the registration of all private foreign borrowing at the BOT within 7 days of the signature date, and not after the loan funds were imported and sold to authorized banks.
1987	*Monetary Policy:* The BOT carried out policies to expand credit, to promote production, and investment, especially of small scale industries in rural areas, and to solve the problem of excess liquidity in the banking system. The BOT continued to promote stability of financial institutions and to encourage them to respond more flexibly to changing economic conditions. The *Sixth National Economic and Social Development Plan* is introduced (1987–91). The main objectives are: to increase efficiency of development, production and marketing and promoting equitable distribution of income. **Capital Markets** • The minimum margin loan ratio at 35% was set by the SET. Subsequently it was changed three times to 50%, 70%, and back to 50%.	**Trade** • In order to promote border trade, the license fee was reduced from B 20,000 to B 2,000 per license for those exporters residing in border provinces and exporting an amount not exceeding B 20,000 per day. • The maximum amount of each export and import transaction that is allowed without approval from the BOT was increased to B 50,000 for all kinds of merchandise goods in order to facilitate border trade.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1987 cont.	• Bonds issued by the BOT were exempted from business tax and stamp duty. • Maximum withholding tax on dividends and distributed profits from companies registered in the SET, mutual funds, and financial institutions set up under specific Thai law to provide credit were lowered from 30 to a rate not exceeding 15% of income. • Capital gains arising from transfers of debentures issued by non-government agencies in the SET, became subject to a 15% withholding tax at source on the excess of the return over the invested amount. **Money Market and Instruments** • The BOT revised the regulations concerning the amount of cash or promissory notes to be placed by clients as collateral against margin loans extended by finance companies. Instead of prescribing a fixed minimum rate of 25% of total borrowing, the requirement was changed to either 25% of borrowing or the ratio prescribed by the SET, whichever is higher. • The BOT revised the regulations on the financial facility extended to exporters by allowing the participation of commercial banks in joint credit extension, so as to help them adjust their liquidity positions. In this regard, the interest rate that the BOT charges commercial banks varies in accordance with their shares in total credits extended to exporters, e.g., 4%, 3%, 2%, and 1% a year for shares of 20%, 40%, or 80% respectively. However, the rate charged to customers by commercial banks remained unchanged at 7% a year.	
1988	*Monetary Policy:* The BOT implemented stricter monetary policy and at the same time emphasized the promotion of rural development by encouraging the diversification of credit extensions. **Capital Markets** • Dividends and distributed profits from companies or partnerships not registered with the SET were allowed to be excluded from other taxable income for the year-end assessment if tax payers consented to a 15% withholding tax at source (such income otherwise is subject to withholding at the personal income tax rate) • The business tax exemption period for sales of securities in the SET was extended for two years until the end of 1990. **Financial Supervisory and Regulatory Framework** • The BOT revised regulations covering financial institutions in order to facilitate their operations and raise their efficiency.	**Exchange Market Arrangement and System** • Commercial banks were authorized to open foreign exchange accounts and to accept deposits in foreign currencies at an amount not exceeding $5,000 from foreigners who were in transit or resided temporarily in Thailand within 15 days after their arrival. • The regulation governing the use abroad of credit cards and the collection of money therefrom, including withdrawal of funds through ATMs was modified. The change involved an increase in the ceiling for the use of credit cards in foreign countries to $2,000 in addition to the expenses which can be approved by authorized representatives on behalf of the Exchange Control Officer. **Trade** • Credit card holders in Thailand were permitted to use credit cards abroad for import payments by submitting an application prior to their departure.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1988 cont.	• To allow small entrepreneurs' access to working capital and to maintain stability of crop prices, the BOT modified regulations governing financial assistance to entrepreneurs in priority economic sectors and introduced new categories of credit extension. **Money Market and Instruments** • The BOT's total financial assistance line was raised from B 38.5 billion to B 40 billion, of which B 2 billion was allocated to small industries and to invest in agricultural and industrial activities in rural areas.	
1989	*Monetary* Policy: Monetary measures were focused on economic growth, income distribution, exports and investment promotion as well as internal and external funds mobilization. *The Sixth Plan* was revised because all its goals were attained sooner than planned. The revision aimed at sustaining high growth with stability to tackle major problems such as the trade and current account deficits, the widening of savings investment gap, and concentration of investment around Bangkok. **Capital Markets** • Income tax exemption amendments were made on interest from government bonds and on income from the transfer of government bonds inside and outside the SET. **Money Market and Instruments** • Interest rate ceiling on time deposits with maturity over one year was removed, while the interest rate ceilings on savings accounts and time deposits with one-year maturity or less and on lending rate were maintained.	**Exchange Market Arrangement and System** • The *first round of relaxation of foreign exchange regulations* is introduced. The maximum amount of: (1) Thai baht which an individual can bring into or take out of the country was increased to B 10,000; (2) Thai baht which could be sent through the money order service was increased to B 2,500 at a time; (3) foreign currency allowed to be bought from and sold to individual customer by commercial banks without prior submission of the Exchange Control form was increased to B 1,000 and B 500 respectively; and (4) foreign currencies which commercial banks were allowed to sell to expatriate families as well as a Thai nationals were raised to $5,000 per annum. • Commercial banks were given authorization to sell foreign exchange and transfer Thai baht into transferable nonresidents' baht accounts of foreign investors or borrowers of foreign loans who had registered the fund with the BOT. The transferred funds were required (1) proceeds from sales of shares in the SET financed with foreign capital, or (2) dividends transferred by registered or authorized companies on behalf of an investor. Repayments of principals, interest, other expenses related to foreign loans, dividends, and transfer of relevant certificates of share ownership were allowed without the BOT's approval. Sale of foreign exchange for bona fide transactions was limited to $500 or its equivalent without the submission of supporting document. Sale of foreign exchange was permitted for remittances of family expenses and savings up to a limit of $5,000. • Commercial banks were allowed to approve foreign currency purchases for various purposes, including the exchange of foreign currency held by foreign travelers into another currency up to $3,000 or its equivalent at market rates.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1989 cont.		**Trade** • Payments in domestic currency for imports and trade related services, such as freight charges and insurance premiums into nonresident transferable baht account could be approved by authorized banks on behalf of the competent officer. • Authorized banks were authorized to approve exchange control forms in connection with payments for imported materials for the manufacture of export products and with deferred import payments. They were also authorized to approve an exchange control form for exports under certain circumstances. • The limit on the value of imports and exports that do not require the filing of an exchange control form was increased to B 100,000 from B 50,000.
1990	*Monetary Policy:* Measures aimed at improving the financial structure and international payment system with a view to enhancing competition in the financial sector, reducing inflation, and inducing more flexibility in the asset-liability management of domestic financial institutions. Policies were also implemented to assist the development of financial instruments and investment in the capital market. **Capital Markets** • BOT revised a regulation to allow finance companies to invest a greater amount of their funds in registered or listed securities (from 60% to 100% of their capital funds). • BOT introduced new regulations for the setting up of security trading offices in the provincial areas. Eligible companies must have licenses to perform security brokerage service and be members of the SET. **Money Market** • The BOT removed the requirement on the minimum denomination of promissory notes that finance companies can issue (from B 5,000 to B 10,000 to zero). • The BOT lifted the official ceiling on interest rates charged to NBFIs on promissory notes (rate that was charged used to be 1% higher than that offered at bank accounts in commercial banks).	**Exchange Market Arrangement and System** • On May 4, the Government announced the acceptance of *Article VIII obligations of the IMF Articles of Agreement.* • A *second round, partial relaxation of foreign exchange regulations* was introduced. (1) Commercial banks were allowed to grant permission to all applications of foreign exchange transactions relating to international trade; (2) The maximum limits entrusted to commercial banks on foreign exchange applications relating to service account were raised; the maximum limit on traveling allowances was increased to $20,000 per trip, and the limits on family allowances and educational expenses were also increased to $50,000 per year; (3) Commercial banks were authorized to approve remittances of funds to families and relatives living abroad within the maximum limit of $100,000 per person per year and the limits of remittances of funds by emigrants were raised to $1 million per person per year); (4) Commercial banks were allowed to approve the repatriation of interest payments (net of taxes), payments for the repayment of foreign loans, and transfers of baht into and from nonresident baht accounts and into "transferrable" and "blocked" accounts for the purchase of foreign currency (up to $500,000 per transaction). • Commercial banks were allowed to lend to nonresidents in foreign currency not exceeding $5 million or its equivalent. • The maximum amount was allowed to be transferred to each nonresident Baht account was increased to B 5 million a day. **Portfolio Investment** • **IF:** Three new closed-end mutual funds were approved to mobilize foreign capital: Thai Capital Fund, Thai Equity Growth Fund, and Thai Emerging Fund, with maturity of 25 years. • **OF:** Commercial banks are allowed to approve the repatriation of proceeds from sales of securities.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1991	*Monetary Policy:* The BOT continued to implement cautious monetary policy to achieve a balanced growth of money supply and credit, and to keep the expansion in domestic expenditure in line with growth in production capacity. Measures to promote a more efficient financial system were also undertaken in step with the changing economic structure, both at home and abroad, as well as to prepare domestic financial institutions for competition with foreign counterparts. **Capital Markets** • The Securities and Exchange Bills were drafted. • The Thai Credit Rating Agency (CRA) to be established to support the issuance of financial instruments. • Computerized trading system was introduced in the SET. **Money Market and Instruments** • Policies were further pursued to allow interest rates to adjust in accordance with market mechanism. Preparations were made for the eventual removal of the ceiling on savings deposit and lending rates (see 1992). • Lending rates of banks and finance companies become subject to ceilings of 19% and 21%, respectively.	**Exchange Market Arrangement and System** • The *third round of the relaxation of foreign exchange regulations was undertaken* following the acceptance of Article VIII: (1) residents were permitted to purchase an unlimited amount of foreign exchange currency from authorized banks (with some exceptions); (2) the period for surrender of foreign currency receipts was extended from 7 to 15 days, or the amount could be deposited in foreign currency accounts with authorized commercial banks in Thailand (upon check that currencies originated abroad); and (3) the limit on foreign currencies brought into the country or taken out of the country was removed. Limits on Thai baht allowed to be taken out of the country were raised. • Foreign exchange earners were allowed to open foreign exchange account with commercial banks up to $500,000 for individuals and $2 million for corporations. **Direct Investment** • **IF:** The Investment Promotion Act was amended to induce more foreign investment. • **OF:** Thai investors can freely transfer up to a certain amount in U.S. dollar abroad for direct investment. • **IF:** Government allows 100% foreign ownership of firms that export all of their output. **Portfolio Investment** • **OF:** The maximum amount Thai residents can invest abroad or lend to companies abroad, which have at least 25% Thai equity participation was set at $5 million per year, without the authorization of the BOT. • **OF:** The repatriation of investment funds, loan repayments, and interest payments by foreign investors could be made without any restrictions. • **OF:** The tax on dividends remitted abroad was reduced from 20% to 15%. The tax on payments to nonresidents on income from royalties was lowered from 20% to 15%. **Restrictions on Capital Flows** • **IF:** Joint ventures and foreign ownership is restricted to a maximum of 49% in certain investment projects.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1992	*Monetary Policy:* Major monetary policies aimed at facilitating continued economic growth and development of the financial system and of Thailand into a regional financial center. The *Seventh National Economic and Social Development Plan is introduced* (1992–96). Its main objectives were to sustain economic expansion with stability, distribute income to regions, and to develop human resources. **Capital Markets** • The Securities and Exchange Act came into force in May 1992. All activities relating to securities business, including securities companies which were formerly under the BOT's supervision, now came under the supervision of the SET. • Afternoon trading was introduced in the Stock Exchange (July). • Unlisted companies were permitted to issue corporate bonds and debentures. **Financial Supervisory and Regulatory Framework** • Policies focused on the development of the financial system. Authorities deregulated financial institutions' operations and expanded their scope of operation. New financial acts were promulgated and existing ones amended, and a subsequent phase of exchange control deregulation was undertaken. • The government approves the establishment of the *Bangkok International Banking Facility (BIBF)*. Commercial banks registered to conduct international banking facilities were allowed to accept deposits or borrow in foreign currencies from abroad and from foreign banks or nonresidents; accept deposits or borrow in foreign currencies from abroad from foreign persons to lend foreign currencies in Thailand (limited to $500,000); conduct cross-currency transactions with overseas customers; give acceptance or guarantee debts in foreign currencies; deal in letters of credit when both buyer and seller resident abroad and import and export of goods did not enter or leave Thailand; and managing loan procurement of foreign currency loans from foreign sources. • The Financial Institutions' Lending Rate Act and the Commercial Banking Act were amended. Amendments were made to the second and third amendments of the Acts on the Undertakings of Finance Business, Securities Business and Credit Foncier Business. • Financial institutions were allowed to jointly establish mutual funds management companies, and jointly apply for such licenses. • The Public Company Act came into effect in June 1992. Regional offices of transnational corporations within Thailand were allowed to be formed.	**Exchange Market Arrangement and System** • The *fourth round of changes in exchange regulations* takes place. Changes include: (1) exporters were allowed to receive payments in baht from nonresident baht accounts in addition to those in foreign currencies, and could use such foreign currency receipts to pay for imports or debit foreign liabilities to nonresidents; (2) exporters were permitted to use the proceeds to service external obligations and pay for imports without depositing the proceeds in domestic banking accounts (previously proceeds were required to be deposited within 15 days of receipt); (3) residents could withdraw from their foreign currency accounts to repay debt on behalf of their subsidiaries, or transfer to creditors' foreign currency accounts at commercial banks in Thailand; and (4) expatriates temporarily working in Thailand were allowed to purchase foreign currencies to deposit in their foreign currency accounts at commercial banks. • The daily ceiling on foreign notes and coins allowed to be deposited in a foreign currency account was removed. • Government agencies, state organizations, or enterprises, or juristic persons established under specific laws were allowed to conduct any transactions through their foreign currency accounts. **Direct Investment** • **IF:** Under the Seventh Plan, foreign ownership requests were to be decided by the individual ministries on a case-by-case basis. • **IF:** Under the Seventh Plan, the criteria for granting tax incentives was designed to promote investment in special sectors. Exceptions were made for enterprises exporting at least 80% of their output. • **IF:** Commercial banks allowed to carry operations under the BIBF were given a tax break: the corporate income tax was lowered from 30% to 10%; exempted from the withholding tax on interest paid to a foreign depositor or lender on the deposit or loan used for offshore lending; exempted from specific business tax and municipal tax (the typical 3.3% tax on gross income); and exempted from stamp duty (typically 0.5%) not exceeding B 10,000. A IBF licensed bank remained subject to a 10% remittance tax on net profits sent out of Thailand.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1992 cont.	**Money Market Instruments** • The interest rate ceiling on savings deposits at commercial banks was abolished (January). • The interest rate ceilings on finance companies' and credit foncier companies' borrowing, deposits and lending together with the ceiling on commercial banks' lending were lifted (June). • The interest rate ceiling on mortgage lending to low income individuals was maintained for all loan contracts were made before June 1992. For commercial banks, the ceiling for such a loan was fixed at the minimum lending rate, and for finance companies and credit foncier companies, it was fixed at the maximum lending rate less 1.5%. • Commercial banks and finance companies were permitted to issue certificates of deposits.	**Portfolio Investment** • **IF:** In an effort to induce foreign investment in the Thai stock market, several taxes are reduced: dividend taxes, tax on interest payments from debentures to foreign juristic persons, and tax on capital gains from the sale of securities by juristic persons. • **OF:** Tax on dividends remitted abroad was lowered from 15% to 10%
1993	*Monetary Policy:* Monetary measures were implemented cautiously within the framework of a more liberalized financial market. The policy stance was somehow restrictive, the measures aimed at increasing the efficiency of the domestic financial markets and at facilitating growth. Measures aimed at ensuring that the adjustment in interest rates were consistent with monetary conditions, there were further measures on financial deregulation and liberalization of foreign exchange controls. **Capital Markets** • Financial Institutions are allowed to seek permission to undertake securities businesses limited to trading or placing debt instruments. • The SET introduced measures to improve the efficiency of its operations. • Rules and procedures on the management of new types of mutual funds were established. **Financial Supervisory and Regulatory Framework** • Thailand's offshore banking facility, the *Bangkok International Banking Facility (BIBF)* commenced operations. • The BOT relaxed some of the regulations governing the BIBF. This relaxation was extended especially to foreign commercial bank branches pertaining to required maintenance of assets in the country, capital maintenance, ratio of commitments to capital, and liquidity reserve requirement. **Money Market and Instruments** • The BOT reduced the bank rate and the refinancing rate on finance companies' promissory notes.	**Exchange Market Arrangement and System** • Authorities increased the limit on baht that can be carried to bordering countries and Vietnam, to not more than B 250,000. **Portfolio Investment** • **IF:** Rules governing the issuance of debentures in foreign countries, as well as subordinate debentures, were specified in order to increase alternatives for the private businesses in mobilizing funds. Issuers of such funds must obtain permission from the SET. **Trade** • The Export-Import BOT was established with the purpose to strengthen the financial standing of Thai export-oriented business.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1993 cont.	• The BOT gave a directive to commercial banks to announce the Minimum Loan Rate and Minimum Retail Rate. • The BOT provided financial assistance to the new investment projects, each with capital not exceeding B 200 million, that have been granted investment promotional benefits by refinancing, through commercial banks and the Industrial Finance Corporation of Thailand.	
1994	*Monetary Policy:* Aimed to support the stable economic expansion and development of the financial system. **Financial Supervisory and Regulatory Framework** • Regulations on, and requirements for, the expansion of financial institutions were introduced. • Permission was granted to open the Provincial International Banking Facility. Requirements for the issuance of the various types of securities, conditions and procedures related to mutual funds, guidelines for reports in information disclosure, requirements for the establishment of securities brokerage offices and branches of securities companies, revisions of regulations and procedures regarding the registration of securities and security holders, measures to maintain capital market stability, and revisions of other SET regulations, were introduced. **Money Market and Instruments** • The BOT raised the base interest rate and the discount rate (refinancing rate) for promissory notes of finance companies and finance and securities companies arising from agricultural, industrial and commercial activities. • The BOT required commercial banks to inform their customers in writing about the benchmark rate (Minimum Loan Rate or Minimum Retail Rate), and the margin added on to such rate, as well as to clearly post the deposit interest rate and the benchmark rates for credit.	**Exchange Market Arrangement and System** • The ceiling on the amount authorized banks are permitted to lend to nonresidents in foreign currency was eliminated. • Residents were permitted to use foreign exchange that originated abroad for servicing external obligations without having to surrender it or depositing it in a domestic bank account. • Foreign currency borrowed by residents from BIBF, or borrowed by nonresidents from authorized banks, or from withdrawal from nonresident baht accounts, could all be freely deposited in foreign currency accounts. • Limits on amount of foreign exchange that can be taken out for traveling expenses was eliminated. • Foreign exchange controls on the outward transfers of funds and lending in foreign currency were relaxed. • Authorities increased the limit on baht that can be carried to bordering countries and Vietnam, to not more than B 500,000. **Direct Investment** • **OF:** The maximum amount permitted for direct investment abroad by Thai residents or lending to companies abroad that have at least 25% Thai equity participation was increased to up to $10 million.
1995	*Monetary Policy:* Authorities tightened money policy to strengthen economic stability, at the same time financial reform measures were undertaken. **Capital Markets** • The authorities introduced Bank of Thailand Bonds, which are auctioned every week according to a preannounced schedule.	**Exchange Market Arrangement and System** • The authorities imposed constraints on bank lending including restrictions on non-priority lending in foreign exchange.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1995 cont.	**Financial Supervisory and Regulatory Framework** • The Provincial International Banking Facility (PIBF) was established. PIBFs funding must be from overseas like the BIBF, but PIBF can extend credit in both baht and foreign currencies. • Commercial banks with BIBF licenses were required to set up provisions for doubtful debts of 75% of the doubtful debt as of June 1994, and 100% as of the end of 1995. • Banks were not allowed to count loans in foreign currencies to purchase unused land or for personal reasons, as foreign assets, and only 50% of certain other loans could be counted as foreign assets, unless the borrower fully covered his exchange risk by buying the exchange forward at the same bank that extended the loan. • The BOT required banks to submit detailed information on risk control measures on trading in foreign exchange and derivatives. • The BOT adopted a new method of calculating nontrade net open foreign exchange position (on which there are limits set as a percent of capital) for foreign and locally incorporated banks. • Finance and securities companies' daily long and short foreign exchange positions were restricted to a maximum of 25% and 20%, respectively, of first-tier capital funds. • The maximum for commercial banks' average weekly net long and short foreign exchange position was reduced to 20% and 15%, respectively, of first tier capital funds, or $5 million, whichever is larger. **Money Market and Instruments** • The Bank Rate was increased by 1 percentage point to 10½%. The interest rate charged to finance companies on borrowing from the BOT under the securities repurchase agreement was also raised to the same level as the Bank Rate. • Authorities extended the coverage of the credit plan to include finance companies and banks in the BIBF. • The BOT improved the trading mechanism in the repurchase market whereby the prevailing best bid and best offer prices are matched continuously throughout the trading session. • The BOT permitted finance companies to issue bills of exchange or certificates of deposit denominated in foreign currencies, with maturity of over 1 year, to investors overseas or commercial banks authorized to undertake foreign exchange transactions.	**Restrictions on Capital Flows** • **IF:OF:** The authorities imposed a 7% reserve requirements on nonresident baht accounts and on finance companies' short-term promissory notes. The previous regulation required 2% minimum deposits with the BOT, and the remaining 5% in the form of vault cash and eligible securities.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1996	**Capital Markets** • The authorities introduced three rescue funds during 1995–96 to slow the stock market's decline. • Authorities allowed securities companies to apply for licenses to undertake comprehensive securities businesses under the rules of the SE Act B.E.2535. • The SEC increased the "initial margin" from 30% to 40%. **Financial Supervisory and Regulatory Framework** • The BOT revised the method for the calculation of finance companies foreign exchange position in regard to lending whereby borrowers bear the foreign exchange risk. • The minimum capital adequacy requirement for commercial banks was increased. • The BOT tightened further the limits on banks' net foreign exchange positions by excluding loans in foreign currency to certain high-risk sectors from the banks' assets. • The preferential tax rate on BIBF profits was reduced. • The BOT allowed financial institutions to choose custodians who have strong financial positions and network of services in important financial centers and are given a credit rating from Standard and Poor of not less than AA-. • The BOT requested commercial banks to report monthly figures on credit card services every 3 months instead of 6 months. • The BOT demanded that finance companies and finance and securities companies maintain liquid assets as deposits at the BOT. • The BOT required domestically incorporated commercial banks wishing to issue financial instruments to be counted as second tier capital fund to seek permission from the BOT not less than one month before offering for subscription. • The Royal Decree Regulating Affairs of the BOT (No.8) B.E.2539 was enacted. Under the new Decree, finance companies, authorized to undertake foreign exchange business upon obtaining a license, are allowed to purchase and sale foreign exchange with the BOT like that of commercial banks. • The BOT required foreign bank branches licensed to undertake businesses of commercial banking to maintain funds at not less than 7.5% of assets and contingent liabilities. • The BOT required domestic commercial banks to maintain capital funds at not less than 8.5% of assets and contingent liabilities and the first-tier capital funds shall not be less than 6% of risk assets.	**Restrictions on Capital Flows** • **IF:** A reserve requirement of 7% on banks' nonresident baht accounts with maturity of less than one year was imposed. • **IF:** A similar 7% reserve requirement was imposed on nonresident baht borrowing, with maturity of less than one year, by finance companies. • **IF:** A 7% reserve requirement was imposed on new foreign borrowing with maturity of less than one year, by commercial banks and BIBF banks. This reserve requirement applies also to nonresident deposits. The following types of borrowing were exempted from this reserve requirement: international trade financing, overdrafts and liabilities arising from currency trading and derivatives transactions, and nonresident deposits at the BIBFs. **Trade** • The three-year tariff reduction program covering about 4,000 product items, designed to reduce the average tariff rate from about 30% to 17%, ended in January 1, 1997.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
1996 cont.	• Finance companies, finance & securities companies, and credit foncier companies are required to maintain reserves at no less than 100% of doubtful assets within the accounting period ending in June 1996. • The BOT permitted BIBF to sign contracts against risks for the amount maintained as liquid assets such as buying forward or option against baht. • The BOT allowed foreign bank branches to include deposit maintained as liquid assets of BIBF in the calculation of foreign assets. The middle exchange rate announced by the Exchange Equalization Funds must be used in converting baht into U.S. dollars. • The BOT allowed foreign bank branches to maintain assets required under the Commercial Banking Act 2522 in foreign currency except for deposits at the BOT which have to be in baht. • The BOT prescribed that the amount of money which a commercial bank engages in any or several types of the following transactions, namely credit granting, investment and formation of contingent liabilities for any person, must not exceed 25% of its first-tier capital fund at the end of any day. • The Ministry of Finance issued a notification stipulating regulations governing the permission for finance companies to manage private funds. • The BOT issued a notification on financial assistance to six business undertakings. • The BOT set a standard for the calculation of risk weighted assets.	
1997-Aug.	**Financial Supervisory and Regulatory Framework** • The BOT required all financial institutions to submit daily reports of foreign exchange transaction with nonresidents, including all spot, forward and swap transactions, as well as purchase of debt instruments from nonresidents. • 16 of the 91 finance companies were suspended in June and forced to merge with new domestic or foreign partners, absorbed by 5 "core" finance companies, or liquidated after the due diligence process has been completed. • 22 finance companies were asked to raise new capital while two companies underwent negotiations with foreign investors. • A further 35 finance companies were suspended in August and were subject to similar procedures as those outlined in the June order. • Support to financial institutions was given through the Financial Institutions Development Fund (FIDF). Except for those suspended in June and August. • A compulsory contribution to the FIDF on all protected liabilities of financial institutions was introduced.	**Exchange Market Arrangement and System** • On July 2, the exchange rate system was changed to managed floating, whereby the baht was managed within an unpublished band. • All affected financial institutions were required to submit daily reports of foreign exchange transactions with nonresidents, including all spot, forward, and swap transactions, as well as purchase of debt instruments from nonresidents to the BOT. • In June, the baht proceeds from sales of stocks by nonresidents were required to be converted into foreign currency at the onshore exchange rate. The authorities introduced a two-tier currency market that creates separate exchange rates for investors who buy baht in domestic markets and those who bring it overseas. Effective September 8, 1997, the Thai authorities modified the exchange control regulation as follows: (i) foreign exchange earners were allowed to deposit their foreign exchange received in their foreign currency deposit account only if they have obligations to pay out such amounts to nonresidents abroad within three months from the deposit date; and (ii) exporters receiving packing credit from the Bank of Thailand through the Export-Import Bank of Thailand were required to sign a forward contract to sell their foreign exchange with a commercial bank selling promissory notes to the Export-Import Bank. The forward contract must specify the amount of foreign currencies in terms of baht, which can not be less than 50% of the face value of the promissory note.

Table 15. Thailand: Sequencing of Reforms in the Domestic and External Sectors, 1985–August 1997

Year	Monetary Controls and the Financial System	Exchange System, Trade and Capital Flows
Aug.- 1997 cont.	• The government announces it will not make available public funds to aid corporate and household borrowers, domestic or external. • Banks were required to make loan loss provisions on the basis of more stringent asset classification rules, and were allowed full tax deductibility for specific provisions required by the BOT (as part of the structural performance criterium set by the IMF). • Commercial banks and remaining finance companies were required to raise their capital in anticipation of possible further deterioration of their asset quality (as part of the structural performance criterium set by the IMF). • A 0.5% fee was introduced on the protected liabilities of financial institutions (as part of the performance criterium set by the IMF). After banking crisis is normalized, institutions will be allowed to make public their exit from the current protection scheme. **Capital Markets** • In March, the SEC orders a halting of trade in financial sector stocks. • In May, Thai commercial banks were offered to pool up to baht 50 billion to shore up the stock market. **Money Market and Instruments** • In March the BOT announces measures to issue zero coupon bonds to raise baht 100 billion to buy substandard assets from property developers and the Thai cabinet sets up an agency to manage a 100 billion baht rescue fund for property companies. • In April, the BOT cut lending rates to finance companies by 50-100 basis points aimed at helping any financial institution that had liquidity problems. • In May the BOT floats another baht 20 billion of seven-year zero-coupon bonds through weekly auctions. The government set aside another baht 10 billion for confessional mortgage loans to first time buyers. • In July, the FIDF lending rates were kept at above the highest deposit rate in the system and all liquidity support became subject to conditionality. • In August, the bank rate was increased from 10.5 to 12.5. • In August, deposit rates in the financial system were capped at 1 percentage point above the average deposit rate of the five largest commercial banks.	**Direct Investment** • **IF:** The restriction on foreign ownership of office buildings and condominiums was lifted in end-April 1997 in an effort to shrink the country's oversupply of real state. • **IF:** In April, foreigners investing more than B 25 million in the country were permitted to buy land. • **IF:** In April, the foreign ownership limit of 25% for financial institutions would be lifted on a case-by-case basis. **Restrictions on Capital Flows** • **OF:** The BOT temporarily limited baht lending to nonresidents through foreign exchange swap transactions, and all other transactions which could facilitate the build-up of baht position in the offshore market. These include direct loans, overdraft, currency swaps, interest rate swaps, forward rate agreements, currency options, and interest rate options. • **OF:** The BOT temporarily limited forward outright transactions in baht with nonresidents. • **OF:** The BOT temporarily limited selling baht against foreign currencies to nonresidents. • **OF:** Any purchases of foreign exchange from nonresidents before maturity of: baht-denominated bills of exchange, promissory notes, certificates of deposit, and other debt instruments such as debentures and bonds, must use the exchange rate prevailing in the domestic market on the purchase date. • **OF:** The BOT tightened a remittance ban in response to stock sales by foreign investment funds which were trying to acquire Thai currency for short-covering purposes. • The measures above were introduced in June and do not apply to foreign exchange transactions related to export and imports of goods and services, and direct and portfolio investment and are aimed mainly at short-term speculative activity.

Sources: "Central Bank Annual Report" (various issues); Annual Report on Exchange Arrangements and Exchange Restrictions, IMF, (various issues); "Quarterly Report on Exchange Rate Arrangements" (various issues); "Doing Business in Thailand", Price Water House, 1992; "The Thai Stock Market: Leading in Sustained Growth", Association of Members of the Stock Exchange, 1991; "Finance Industry in Thailand", Association of Finance Companies, 1991; "Foreign Direct Investment in Asia", by E.K.Y. Chin - Asian Productivity Organization, 1990; "Tax Laws of the World: Thailand", Foreign Tax Publishers, 1989; "Guide to the Investment Regimes on the Fifteen APEC Member Countries", 1993; "Thailand's Laws and Policies on Foreign Investments", S. Sathirathai, and Y. Sudharma - Current Developments in International Investment Law (ed) Ho Peng Lee, 1992; "Asian Stockmarket Factbook," SWIFT, 1994/95; and "The Emerging Asian Bond Market: Thailand", World Bank, 1995.

Table 16. Thailand: Selected Macroeconomic, Financial Sector, and Balance of Payments Indicators

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Selected Economic Indicators						(In Percent)						
Real GDP Growth	4.6	5.5	9.5	13.3	12.2	11.6	8.1	8.2	8.5	8.9	8.7	6.4
Inflation per Annum	2.4	1.8	2.5	3.9	5.4	5.9	5.7	4.1	3.4	5.2	5.7	5.8
M2 to GDP Ratio	56.2	59.3	62.2	61.3	65.0	69.8	73.1	74.7	78.9	77.8	78.9	79.5
Currency to Deposits Ratio	12.1	11.9	12.0	11.6	11.0	9.9	8.9	9.3	9.1	9.4	9.4	8.9
Fiscal Balance to GDP Ratio	−5.2	−4.2	−2.2	0.7	2.9	4.5	4.7	2.8	2.1	1.9	2.9	...
Private Sector Credit to GDP Ratio	45.6	44.3	47.4	51.1	56.3	64.3	67.7	72.1	79.8	90.9	97.5	100.1
Exports plus Imports of Goods to GDP Ratio	42.1	41.9	48.9	58.8	63.5	65.5	67.0	65.5.	66.1	69.0	77.0	69.0
Current Account to GDP Ratio	−4.0	0.6	−0.7	−2.7	−3.5	−8.5	−7.7	−5.5	−5.1	−5.6	−8.1	...
Financial Account to GDP Ratio	4.0	−0.3	2.1	6.2	9.1	10.6	12.0	8.5	8.4	8.5	13.0	...
Interest and Exchange Rates												
Nominal Deposit Rate (percent per annum)	13.0	9.8	9.5	9.5	9.5	12.2	13.7	8.9	8.6	8.5	11.6	10.3
Real Deposit Rate (percent per annum)	10.6	7.9	7.0	5.7	4.1	6.3	8.0	4.8	5.3	3.3	5.9	4.5
Interest Rate Differential 1/	5.2	1.3	−1.2	0.8	0.6	3.9	7.7	5.0	5.3	3.7	5.5	4.8
Lending/Deposit Spread	6.0	7.3	5.5	5.5	5.5	4.3	5.3	8.7	7.0	5.9	...	...
Official Exchange Rate per US dollar (end of period)	26.6	26.1	25.1	25.2	25.7	25.3	25.3	25.5	25.5	25.1	25.2	25.6
Real Effective Exchange Rate Index (1990=100)	119.9	106.9	100.5	98.2	100.8	100.0	100.7	99.2	101.0	100.9	99.0	105.8
Balance of Payments						(In millions of U.S. Dollars)						
Current Account, n.i.e.	−1,537	247	−366	−1,654	−2,498	−7,281	−7,571	−6,303	−6,364	−8,085	−13,554	−14,692
Financial Account, n.i.e	1,538	−131	1,062	3,840	6,599	9,098	11,759	9,475	10,500	12,167	21,909	19,486
Direct Investment Abroad	−1	−1	−170	−24	−50	−140	−167	−147	−233	−493	−886	−931
Direct Investmnet in Rep. Eco, n.i.e.	163	263	352	1,105	1,775	2,444	2,014	2,113	1,804	1,366	2,068	2,336
Net Direct Investment	162	261	182	1,081	1,726	2,303	1,847	1,966	1,571	873	1,182	1,405
Portfolio Investment Assets	...	...	...	...	...	...	...	...	−0	−5	−2	−41
Portfolio Investment Liabilities	895	−29	346	530	1,486	−38	−81	924	5,455	2,486	4,083	3,585
Net Portfolio Investment	895	−29	346	530	1,486	−38	−81	924	5,455	2,482	4,081	3,544
Other Investment Assets	−242	−150	141	269	−313	−164	352	104	−3,265	−1,027	−2,738	2,661
Other Investment Liabilities	722	−213	393	1,960	3,700	6,996	9,642	6,479	6,739	9,839	19,383	11,876
Net Other Investments	481	−363	534	2,228	3,387	6,833	9,993	6,584	3,474	8,812	16,645	14,537
of which, Official Capital	807	−419	196	121	−834	−1,938	255	−313	−165	−34	292	542
Net Errors and Omissions	103	598	248	411	928	1,419	431	−142	−230	87	−1,196	−2,627
Overall Balance 2/	104	713	943	2,596	5,030	3,236	4,618	3,029	3,907	4,169	7,159	2,167
Memorandum Item:												
Net Private Capital 3/	568	783	1,737	4,476	9,338	14,162	13,243	11,209	12,924	17,061	28,098	18,625

Source: IMF International Financial Statistics, World Economic Outlook, Information Notice System, and IMF Direction of Trade Statistics, various issues.

1/ Interest Differential = Deposit Rate − London Interbank Offer Rate on 3−Month U.S. Deposits.
2/ The overall balance includes: current account, financial account, capital account, and net errors and omissions. Capital account figures are not shown because they are zero throughout the period.
3/ Total Capital = Direct Investment + Portfolio Investment + Other Investment − Official Capital + Net Errors and Omissions + Misinvoicing.

Table 17. Thailand: Abstract of Exchange and Capital Control Regime as of September 10, 1997

Exchange Arrangement

Currency	The currency of Thailand is the baht.
Exchange rate structure	
Dual	Effective July 2, 1997, the authorities introduced a two-tier currency market that creates separate exchange rates for investors who buy baht in domestic markets and those who buy baht overseas.
Classification	
Managed floating	Up to July 1, 1997, the external value of the baht was being determined on the basis of an undisclosed, weighted basket of currencies of Thailand's major trading partners. Effective July 2, 1997, the exchange rate of the baht is managed within an unpublished exchange rate band. The band is based on a new-wider-currency basket. The baht-dollar reference exchange rate is announced daily based on the baht's trading average of the previous day.
Forward exchange market	Forward exchange transactions are carried out between commercial banks and customers and among the commercial banks. All forward transactions must be related to underlying trade and financial transactions. The forward premium in the baht-U.S. dollar rate is freely determined and usually reflects interest rate differentials. On September 8, 1997, exporters receiving packing credit from the Bank of Thailand through the Export-Import Bank of Thailand were required to sign a forward contract to sell their foreign exchange with a commercial bank selling promissory notes to the Export-Import Bank.

Exports and Export Proceeds

Repatriation requirements	Export proceeds exceeding B 500,000 must be received within 180 days from the date of exportation.
Surrender requirements	Foreign exchange proceeds must be surrendered to authorized banks or deposited in foreign currency accounts with authorized banks in Thailand within 15 days of receipt, except for proceeds used to service external obligations.

Proceeds from Invisible Transactions and Current Transfers

Repatriation requirements	Yes.
Surrender requirements	Proceeds must be surrendered to authorized banks or retained in foreign currency accounts with authorized banks in Thailand within 15 days of receipt. Travelers passing through Thailand, foreign embassies, and international organizations are exempted from this requirement.

Capital Transactions

Controls on capital and money market instruments	The sale or issue of securities is under the jurisdiction of the Securities Exchange Commission (SEC). Under the securities law, the same rules and regulations apply to both capital market securities (those with a maturity over 1 year) and short-term money market securities (those debt securities with maturity of not more than 1 year). Foreign issuers must comply with the same rules and regulations as local issuers. Under those regulations, any companies wishing to issue securities to the public need to be approved by the SEC and file the disclosure documents with the SEC for public access.

Table 17. Thailand: Abstract of Exchange and Capital Control Regime as of September 10, 1997

On capital market securities	
Purchase locally by nonresidents	Foreign equity participation is limited to 25 percent of the paid-up registered capital of locally incorporated banks, finance companies, credit finance companies, and asset management companies. The combined shareholdings of an individual and his/her related family members must not exceed 5 percent of a bank's paid-up registered capital and 10 percent of that of finance companies and credit foncier companies. Foreign equity participation is limited to 49 percent for other Thai corporations. In April 1997, the foreign ownership limit of 25 percent for financial institutions was lifted on a case-by-case basis.
Sale or issue locally by nonresidents	In June 1997, baht proceeds from sales of stocks by nonresidents were required to be converted into foreign currency at the onshore exchange rate.
Purchase abroad by residents	Purchases require approval of the BOT.
Sale or issue abroad by residents	The potential issuer must submit an application for approval to the SEC, and permission will be granted if the issuer can prove that the issue will only be traded overseas, both in the primary or secondary market. There are no restrictions associated with the transfer of proceeds on funds to service debt abroad. All debt-service payments can be made freely.
On money market instruments	
Sale or issue locally by nonresidents	Yes.
Purchase abroad by residents	These transactions require approval from the BOT.
Sale or issue abroad by residents	These transactions are not allowed. However, finance companies are allowed to issue negotiable certificate of deposit (NCDs) and bills of exchange in foreign currency with more than a 1-year maturity for sale to the public abroad or for sale to institutions that are authorized to operate in foreign exchange. The transfer of proceeds associated with these issues or the transfer of funds required to service these instruments can be made freely.
On collective investment securities	
Purchase locally by nonresidents	There are no restrictions on the purchase of securities offered by local fund management companies.
Sale or issue locally by nonresidents	The same regulations apply as for money market instruments.
Purchase abroad by residents	These transactions require approval of the BOT.
Sale or issue abroad by residents	The launching of funds requires approval from the SEC, both locally and abroad, and only local fund management companies are allowed to issue this instrument. In addition, funds managed by local firms will be deemed to have Thai nationality regardless of the nationality of the majority of the unit holders. The transfer of proceeds and the transfer of funds required to service these instruments may be made freely.
Controls on derivatives and other instruments	A securities company is not permitted to purchase or sell futures or options on securities either in its own name or for customers, or to engage in any business that is not a licensed securities business, unless the SEC issues a notification or grants an approval allowing such transactions or business.
Purchase locally by nonresidents	In June 1997, the Bank of Thailand introduced a series of measures to limit capital outflows. These included measures: (1) to limit transactions with nonresidents which could facilitate the build-up of baht positions in the offshore market, including direct loans, overdrafts, currency swaps, interest rate swaps, forward rate agreements, currency options, and interest rate options; (2) to limit outright forward transactions in baht with

Table 17. Thailand: Abstract of Exchange and Capital Control Regime as of September 10, 1997

	nonresidents; (3) to limit selling baht spot against foreign currencies to nonresidents; and (4) to require payment in U.S. dollars for any purchase from nonresidents before maturity of baht-denominated bills of exchange, promissory notes, certificates of deposit, and other debt instruments such as debentures and bonds, at the exchange rate prevailing in the domestic market on the purchase date. Financial institutions were also required to submit daily reports of foreign exchange transactions with nonresidents, including all spot, forward and swap transactions, as well as purchase of debt instruments from nonresidents, to the Bank of Thailand. The measures did not apply to foreign exchange transactions with genuine underlying business related to the export and import of goods and services, direct investments, and various types of portfolio investment in Thailand.
Sale or issue locally by nonresidents	The issuance of warrants or equity-related instruments and bonds by nonresidents in the local market is subject to approval by the SEC. The approval criteria is based on the soundness of the underlying stock. There is no discriminatory practice against nonresidents for participating in the financial market.
Purchase abroad by residents	The purchase of derivative instruments by residents and the transfer of funds require approval by the BOT.
Controls on credit operations	
Commercial credits	Credits may be contracted in the form of deferred payments, bilateral netting, or open accounts. Most payments are settled within 180 days of the exportation of goods.
Financial credits	
By residents to nonresidents	Only authorized banks are allowed to grant financial credits subject to the rule of net foreign exchange position. Residents may only grant loans to their affiliated companies if they own at least 25 percent of total shares in the company and up to $10 million a year without approval from the BOT.
To residents from nonresidents	There is no restriction on these credits. Repayment of financial credits to nonresidents can be made freely as long as residents have an obligation to pay to nonresidents in foreign currency.
Controls on direct investment	
Outward direct investment	Investments exceeding $10 million a year require approval from the BOT.
Inward direct investment	Foreign capital may be brought into the country without restriction, but proceeds must be surrendered to authorized banks or deposited in foreign currency accounts with authorized banks in Thailand within 15 days of receipt.
Controls on liquidation of direct investment	All proceeds can be repatriated without restriction upon submission of supporting evidence.
Controls on real estate transactions	
Purchase locally by nonresidents	These purchases, except those of condominiums, are not allowed with money that originates from abroad. In April 1997, the foreign ownership limit for condominiums was increased from 40 percent to 100 percent, and foreigners who invest more than B 25 million in the country were permitted to buy land.
Sale locally by nonresidents	Yes.
Provisions specific to commercial banks and other credit institutions	
Lending to nonresidents (financial or commercial credits)	Government financial institutions, except the Export-Import Bank of Thailand, are not allowed to practice foreign lending activities. Authorized banks in Thailand may lend to nonresidents in foreign currency without restriction.

Table 17. Thailand: Abstract of Exchange and Capital Control Regime as of September 10, 1997

Lending locally in foreign exchange	Commercial lending to particular industries denominated in foreign currencies can be partially (50 percent) included as foreign assets in order to recognize the potential risk that banks may not be fully repaid as exchange rate risk is heightened.
Differential treatment of nonresident deposit accounts and/or deposit accounts in foreign exchange	
Liquid asset requirements	Overall, commercial banks are required to hold liquid assets of at least 7 percent of their deposit base. The liquid assets comprise at least 2 percent in nonremunerated balance at the BOT, at most 2.5 percent in vault cash, and the rest in government and other eligible securities. Finance companies are also required to hold a 7 percent liquid asset ratio: 0.5 percent in non-remunerated balances at the BOT, and the rest in the form of deposits at banks located in Thailand, lending on demand to banks in Thailand, and eligible securities. For the nonresident baht accounts with a maturity of less than 1 year, commercial banks, finance companies, and finance and security companies are required to maintain 7 percent of their deposits at the BOT.
Investment regulations	Commercial banks are allowed to buy or hold shares in a limited company (including public companies) in an amount not exceeding 10 percent of the total shares sold and 20 percent of their capital fund. Banks can seek approval to hold shares above the 10 percent limit in the following cases: (1) companies set up for supporting functions; (2) companies that operate as financial arms, such as leasing companies and factoring companies; (3) companies set up to manage foreclosed properties; and (4) companies set up to manage projects that are beneficial to the economy, especially infrastructure projects.
Open foreign exchange position limits	The limit imposed is between –15 percent (for a negative balance) and 20 percent (for a positive balance).
Provisions specific to institutional investors	
Limits (max.) on portfolio invested abroad	Mutual funds and provident funds have to invest their total portfolio in the domestic market. The criteria for insurance companies to invest abroad are as follows: (1) the fund can be invested in equity and debenture issued by juridical persons incorporated under the ASEAN Agreement or the United Nation's Economic and Social Commission for Asia and the Pacific (ESCAP) Agreement to specifically operate reinsurance business; and (2) the funds may be invested in equity issued by nonresident juridical persons other than specified in (1) with approval from the authorities, and by using the surplus funds. Total investments under (1) and (2) must not exceed 5 percent of total assets.
Other controls imposed by securities laws	Under the Securities Act, there are no restrictions for nonresidents to have equity participation in Thai security companies. However, National Executive Decree No. 281 imposes a 50 percent limit on nonresident's equity participation in any company. Foreign security companies are permitted access to the Thai securities market in the form of representative offices whose roles are limited to providing research material for their parent companies. In addition, they are allowed to enter into joint partnership with Thai security companies and to provide professional consultancy services.

REFERENCES

Alexander, William, Tomás J. T. Baliño, and Charles Enoch, 1995, "The Adoption of Indirect Instruments of Monetary Policy," IMF Occasional Paper No. 126 (Washington: International Monetary Fund).

Bisat, Amer, R. Barry Johnston, and V. Sundararajan, 1992, "Issues in Managing and Sequencing Financial Sector Reforms Lessons from Experiences in Five Developing Countries," IMF Working Paper 92/82 (Washington: International Monetary Fund).

Branson, William H., 1974, "Stocks and Flows in International Monetary Analysis," in *International Aspects of Stabilization Policies*, Albert Ando, Richard Herring, and Richard C. Marston, eds., Federal Reserve Bank of Boston, Boston.

Cardoso, Eliana and Ilan Goldfajn, 1997, "Capital Flows to Brazil: The Endogeneity of Capital Controls," IMF Working Paper 97/115 (Washington: International Monetary Fund).

Dooley, Michael, 1995, "A Survey of Academic Literature on Controls over International Capital Transactions," IMF Working Paper 95/127 (Washington: International Monetary Fund).

Edwards, Sebastián, 1984, *The Order of Liberalization of the External Sector in Developing Countries*, Princeton Essays in International Finance, No. 156.

Frenkel, Jacob, 1982, "The Order of Economic Liberalization: A Comment" in *Economic Policy in a World of Change*, K. Brunner and A. Meltzer, eds., North-Holland, Amsterdam.

Hanson, James A., 1994, "An Open Capital Account: A Brief Survey of the Issues and the Results" in *Financial Reform: Theory and Experience*, G. Caprio, Jr., I. Atiyas, and J. Hanson, eds., Cambridge University Press, Cambridge.

Johnston, R. Barry, 1991, "Sequencing Financial Sector Reform" in the *Evolving Role of the Central Banks*, Patrick T. Downes and Reza Vaez-Zadeh, eds. (International Monetary Fund: Washington).

______, 1997, "The Speed of Financial Sector Reform: Risks and Strategies," in *Sequencing Financial Strategies for Developing Countries*, Alison Harwood and Bruce L. R. Smith, eds., (Brookings Institute Press: Washington).

______, and Chris Ryan, 1994, "The Impact of Controls on the Private Capital Account of Countries' Balance of Payments: Empirical Estimates and Policy Implications," IMF Working Paper 94/78 (International Monetary Fund).

Krueger, Anne, 1984, "Problems of Liberalization" in *World Economic Growth*, eds., A. Harberger, ICS Press, San Francisco.

Lee, Jan-Yung, 1996, "Implications of a Surge in Capital Inflows: Available Tools and Consequences for the Conduct of Monetary Policy," IMF Working Paper No. 53 (Washington: International Monetary Fund)

Little, Ian, Tibor Scitovsky, and Maurice Scott, 1970, *Industry and Trade in Some Developing Countries: A Comparative Study*, Oxford University Press, London.

Mayorga, Roberto, and Luis Montt, 1995, *Foreign Investment in Chile*, M. Nijhoff, Boston.

McKinnon, Ronald I., and Wallace E. Oates, 1966, *The Implications of International Economic Integration for Monetary, Fiscal, and Exchange-Rate Policy*, International Finance Section, Princeton, N. J.

______, 1973, *Money and Capital in Economic Development*, (Brookings Institution, Washington).

______, 1982, "The Order of Economic Liberalization: Lessons from Chile and Argentina" in *Economic Policy in a World of Change*, K. Brunner and A. Meltzer, eds., North-Holland, Amsterdam.

Michaely, Michael, 1986, "The Timing and Sequence of a Trade Liberalization Policy" in *Economic Liberalization in Developing Countries*, A. Choksi and D. Papageorgiou, eds., Basil Blakwell, London.

Mundell, Robert A., 1963, "Capital Mobility and Stabilization Policy Under Fixed and Flexible Exchange Rates," *Canadian Journal of Economics and Political Science*, Vol. 29.

Velasco, Andrés, 1991 "Liberalization, Crisis, Intervention: The Chilean Financial System, 1975–95" in *Banking Crisis: Cases and Issues*, V. Sundararajan and Tomás J.T. Baliño, eds. (International Monetary Fund: Washington)