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Theoretical and Operational Study to Allocate Foreign Currency Through Exchange Control System

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Abstract

One of the most important policies concerning the adjustment of foreign trade is to allocate foreign currency by establishing an exchange control system. The mechanism of this would be so that the Central Bank operates or supervises all transactions concerning foreign exchange. However, the controlling system, like all other international systems of payment, operates with some adjustments and is therefore not settled in a net manner. It must be noted that although the controlling systems aim to fix the exchange rate, in reality these sanctioned laws are accompanied by different adjustments along with crawling pegged exchange rates and devaluation in the rate of exchange. The existing contradictions amongst the aims of the domestic and foreign economy, enforces us to find a suitable solution. One of the options is to allocate foreign currency by establishing an exchange control system. This system can be a suitable tool for confronting the damageable effects of foreign factors and conditions on the economy of a country. One of the main aims of these controls is to remedy the deficit of balance of payments and to allocate as best as possible the sources of foreign currency to the different economic sectors.

For the past few years in Iran, the control and allocation of foreign currency has been mainly concerned with the import quotas and the issue of import permits together with the allocation of foreign currency. These controls started in 1930 and continued throughout the years. The history of Iran's experience in this regard, and what followed shows the unsuccessful outcome of these procedures. We must bear in mind that the allocation of foreign currency through establishing an exchange control system should not only be concerned with dealing with the balance of payment deficit, absorbing the revenue from the non-petroleum exports or other economic problems. This should help a correct and timely use of other coordinating economical policies, especially the ones concerning expenditure-changing and expenditure-switching while achieving a synchronized foreign and domestic balance.

Keywords: exchange control system – allocate foreign currency- effective exchange rate – balance of payment deficit – Rial devaluation.

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Introduction

To determine and exercise the economic rate of the foreign currency, that is to say the rate which conforms with the productive situation of a country is a two sided affair. On one hand it signifies a great part of the economic situation of the country and on the other hand it affects a vast part of the prices. With the existence of non-equilibrium exchange rate, "allocating the foreign currency", subject to investment resources, a great part of society's consumptive resources will depend on planning rather than the market and the rates. Whenever the forces of supply and demand relating to the foreign currency market, act freely, there is a possibility of vast fluctuation in the currency rate which may lead to unstable conditions, hence a disturbance in the best mode of the allocation of foreign currency resources, causing negative effects in the domestic productions and more importantly foreign trade. This is the reason for the government resorting to "allocation of foreign currency by establishing an exchange control system", in order to prevent these fluctuations and the negative effects they may have on domestic economy, infant industries and balance of payments. This system is established by the Central Bank taking charge or supervising all foreign currency transactions (buy and sell). The exchange control can be divided into two categories: Direct Procedures, and Indirect Procedures. In the former, the government is directly involved in the foreign currency market and several rates exist. In the latter the policies concerning the interest rate, issuing import permits, taxes on imports and exports, deposit bestowing limitations on services related to international debts, foreign currency contracts, foreign currency exemption, International capital transactions and finally export awards and prizes are taken into consideration.

We have to bear in mind that the advantages of allocating foreign currency by establishing a control system does not outweigh its disadvantages. This system does not remedy the unbalance in the foreign currency market. International trade, even trade amongst developing countries confront many problems upon reverting to this system, moreover when dealing with capital flee, it causes obstacles in the incoming capitals. This article is a theoretical and operational study on the allocation of foreign currency by establishing an exchange control system, together with a survey of exchange control in Iran. The remainder of the paper is organized as follows:

After the Introduction, the equilibrium rate of the equivalence and its usages will be presented. Then the allocation of foreign currency and the control system in achieving domestic and foreign balance will be taken into account. Finally the aims of this procedure will be given. All the above mentioned will form the rest of this article. A mode for determining the foreign currency rate in the form of control system will be introduced. At the end of the article, the conclusion and summery will be presented.

1- Defining the Equilibrium of the Rate of Equivalence

Before any further presentation, the equilibrium exchange rate has to be defined. The equilibrium of the rate of equivalence adjusts the entry and exit of goods and concerns with services and capital of a particular country with the other countries, this adjusts the balance between incoming and outgoing current. The balance in the level of payment is a short term aim; obviously the government tries to achieve higher balances in the foreign payments in the long run. This is important so it is accepted to have some shortcomings (unbalance) of balance of payments for a short period.

If the other effective factors in the balance of payments are stable, but the non-equilibrium rate rules over the money market, the level of foreign payments will lose its balance. If the official equivalent rate of payments becomes more than the equilibrium rate, then the real exports will diminish while the real value of imports increase. Therefore parallel to the increase of equivalent rate of one currency versus another, the worth of imports will increase while the real amount of exports decrease. Another word, in spite of higher rates of equivalence, the price of foreign goods in Rial will be lower than the price of the same domestic goods. The demand for foreign goods will thereby rise within the country and abroad. Foreign goods will be in demand instead of domestic goods, which will cause the increase of imports and the decrease of exports. The consequence of this situation will be deficit in the balance of payments. If this happens, the allocation of foreign currency to different economic sectors in the form of strict exchange control is proposed. The government will give priority to different sectors in order to adjust the foreign currency budget.

The rate of equivalence concerning services will be affected too and people will have the potential for buying in Rials, hence there will be an increase in traveling abroad for study, medical purposes etc. etc... On the other hand the foreigners will lose their purchasing power while confronting the Iranian currency, therefore will lose the incentive for entering the country for tourism or study. This may intensify the deficit in the level of payments. This is the other way around when faced with a lesser rate of equivalence. Beside the goods and services, the capital sector will be affected by this higher rate of equivalence. Since the exit of foreign and domestic capital becomes more profitable it will intensify and thereby show a reducing affect on the balance of payments.

It is now clear that whenever the official equivalence rate becomes higher than the equilibrium rate, we face deficit in the level of payments. The wider the gap between the equilibrium rate and the official rate the more deficits between these two rates. One of the ways to overcome this problem, especially for the countries with capability of an increase in production, is to devaluate the domestic currency versus other currencies. It is obvious that when this increase in the productivity and capacity of production is not possible, a continuous devaluation will cause severe disorders in the macroeconomics variables. When this happens it is best to revert to a temporary allocation of foreign currency through control system followed by the optimum allocation of foreign currency to different economic sectors. It must be noted that this procedure cannot be used on a long run basis, because it increases "on costs" and causes imposing cost and the prices will get out of hand, this may even decrease the productive potential of economic agencies. On the whole the disorders will be more conspicuous than before. This situation will definitely affect the value of domestic currency and truly devaluate it versus other currencies. In the case of voluntarily devaluation by government, and to determine the amount of changes in the equivalence rate, this will depend on the net elasticity of supply and demand of imports and exports. The elasticity of supply of the imports and exports will in turn depend on the degree of mobility of factor of production of the two countries. The price elasticity of the demand for imports and exports will be in accordance with the type of import goods and the existing substitution commodities.

Determining and enforcing the price of economic currency, i.e. the price in accordance with the productive situation of the country, on one hand indicates the vast part of the economic situation of a country and on the other hand it touches the prices. In spite of the non-equilibrium exchange rate, "allocating foreign currency resources", investment resources and an important part of the society's consumptive resources, is not dependent on the market and prices but on programming. Another word "allocating foreign currency resources" will be enforced by the monetary policy makers in order to achieve the best result. In this case the exchange rate is the only deciding factor regarding accounting purposes and does not have any economic application. In a competitive market the price indicates the supply and demand, another words abundance of factors and cost regarding the factors and production. Now if the exchange rate that effects a vast part of the prices is not based upon the real equilibrium rate, it will not be possible to use a great many parameters in the economy of a country and since the real value of prices is dependent upon the false value of exchange rate, hence it will not be possible for the economic agents to reach the optimum allocation of resources. That is to say allocation of foreign currency in this situation may not be fairly divided amongst the economic sectors. This will cause confusion and result in waste of resources. If the value of equivalence is more than the equilibrium rate, it will result in a flood of the import of cheap foreign goods and the decrease or loss of fierce competition of production of domestic goods. Considering the flood of cheap import and losing the competition, therefore leading to loss of profit and investment. In this case services section due to import of cheap goods and undirected capitals will increase their share of participation, but at the expense of the production sector. This will lead to inflation caused by supply side of economy.

The import of cheap goods will increase the demand for luxury items and will lead to inflation due to demand side of economy, therefore, this non-equilibrium rate, will change the "inter-sectional optimum economic allocation" at the expense of a great loss in the productive sectors.

2- "Allocation of Foreign Currency" and Exchange Control to Achieve Domestic and Foreign Balance

One of the important policies regarding adjustment of the foreign trade is "allocation of foreign currency through an exchange control system", however within the framework of Gold Monetary System, the Bretton Woods System, together with the floating exchange rate, enables an automatic equilibrium in the exchange rate by the mechanism of mobility of gold. In the "allocation of foreign currency through exchange control system", the balance in the foreign currency market is sacrifised for other aims like equilibrium in the level of balance of payments.

In the floating rate system, whenever the forces of supply and demand act freely, there is a possibility of a difficult period for the economy. In case of domestic disturbances like revolutions, war and such turmoil, the existence of a floating rate regime can lead to vast non-equilibrium in the economy; flee of capital which in turn will lead to a control system. In the control system, the Central Bank will be in charge of all transactions or will have strict supervision over them. However the control system like all other International payment modes cannot be absolute and is accompanied by some adjustments. Although the aim of control system is to establish a fixed exchange rate regime, but inevitably it will lead to several devaluation in the exchange rate. The history of the control system goes back to the First World War, when there was great need for foreign currency in order to continue the war, and so, different sectors were taken under control. In the great depression of the 1930's, this mode was mostly reverted to. It must be noted that in times of great deficit, it is necessary to implement this system, but there is no need if there is ample foreign currency revenues, since it will cause some problems, and many economists have criticized the control system.

3-The Aims of Allocating Foreign Currency through Exchange Control System

The conflict between domestic and foreign aims forces us to find a suitable solution. One of them is reverting to the above mentioned system in order to confront the improper effects of foreign factors on the domestic economy of a country. The most important aim of these controls is to remedy the deficit in the balance of payments and designate the foreign currency resources to the different economic sectors as best as possible. Whenever the forces of supply and demand of foreign exchange act freely, there is a possibility of fluctuation and its undesirable effect on the domestic economy and foreign trade. In this case governments revert to the "allocation of foreign currency through exchange control system", so as to support infant industries and deter capital flee and aid the balance of payments. In order to remedy the deficit in balance of payments and optimum utilization of foreign currency resources, the imports can be decreased while increasing the exports. Another aim for the control system is to aid the government's income as it will sell the foreign currency at a higher price while buying them at a lower price. Enforcing laws with different rates is always beneficial for the government. Another characteristic of this system is increasing the employment rate by limiting the imports. The increase in the domestic production can replace the imports; consequently the employment rate will rise. When heavy foreign debts exist and devaluation is not considered, reverting to the control system can be a solution. Firstly devaluation of domestic currency makes payment of foreign currency debts difficult; secondly since devaluation is always universally considered as a weak economy, then reverting to the control system rather than devaluation is more acceptable. Another aim of this system is facilitating development planning, confronting particular situations, or certain political periods. As mentioned before the main objective is dealing with the problem rising from the level of balance of payments and optimum use of foreign currency resources. It must be noted that the aims given above cannot justify a long term implementation of allocation of foreign currency through exchange control system. Moreover there is no guarantee of the optimum result by reverting to this system. In fact there are always difficulties arising due to this system together with fundamental criticism.

These problems may consist of:

-Bringing about costs and extra luxury loads.

-Changes in the relative equilibrium of prices.

-Disorder in the system of prices.

-Unsuitable effects on designating resources and distributing the income.

Moreover, the low rate of exchange rate will lead to non-economical use. Another point is not changing the bilateral payment contracts. Another dilemma, concerns the difference between the official and free rates will be a source of revenue for the government and other groups which will inevitably lead to the formation of the black market.

4- The Procedures of Allocating Foreign Exchange through Establishing a Control System

The procedures of exchange control can be divided into two categories, direct and indirect modes of control. In the former, the government directly controls the market and bestows several rates of foreign currency. In the latter, policies of the rate of interest, issuing import permits, import tax, import deposit, limitation upon the transaction services concerning the international payments, foreign currency contracts, foreign currency exemption, international capital dealings will be on the agenda. Finally prizes and awards will be considered.

4-1 Direct Procedures for the Control of Exchange Rate

A- Direct Involvement

The government becomes directly involved in order to fix the exchange rate in the market. There will be "over evaluation" and "lower evaluation" of the national currency versus foreign currency in order to fix the exchange rate artificially. The Central Bank becomes active in the exchange market and reverts to buying and selling of the desired foreign currency versus the national currency.

B- Multi- Rated System of Exchange Rate

The government bestows different rates for various import-export goods. Some items have high rates, while others low rates of exchange rate. Governments usually revert to this mode in order to encourage or discourage the import and export of various goods. Due to this policy the export of goods which have high rate of foreign currency, get some sort of financial aid. This will enhance the competitive power of these goods, hence a speedy development of these industries. Moreover this will decrease the import of goods which bear a high exchange rate. The importers of such goods are obliged to pay some sort of tax, due to high exchange rate. Generally speaking, high rate of foreign currency is proposed for the unnecessary goods, like luxury goods.

Export of goods with low rate of foreign currency will be limited because; it is as if the exporters pay a certain tax. Overall the low rate of foreign currency will be applied to those exporting industries with high competitive potential. On the other hand the import of goods with a low exchange rate will be encouraged, because the importers receive some sort of financial aid. These rates usually apply to fundamental goods, or those without elasticity of demand.

4-1-1 The Benefits of Multi-rated Foreign Currency, in the Framework of Allocation of Foreign Exchange

A- Since the developing countries have specialized in one or just a few good, therefore, fixing of exchange rate, and multi-rated foreign currency is welcomed. This system is one of the best procedures for ratification of the imbalance in the level of balance of payments.

B- The developing countries due to being small and easily affected by the market prices cannot influence the terms of trade, especially regarding the imports. Therefore the infant, indigenous industries will be protected within this system and their competitive potential will improve.

C- The financial markets in developing countries are limited and small; therefore the international capital movement is not that sensitive to the changing interest rate. Consequently, the multi- rated foreign currency, encourages the flow of incoming capitals, while slowing down its exit, this will conclude in the improvement in the deficit of the level of balance of payments.

D- The demand for imports and supply of exports in the developing countries especially in short run is inelastic, therefore the government is able to reach several decisions, with the aid of multi-exchange rate system, and with regards to the elasticity of supply and demand, e.g. if the demand for imports is inelastic, determining the exchange rate, lower than the equilibrium level will be helpful, on the other hand, if the demand for imports is elastic, higher exchange rate will be beneficial.

E- The fundamental changes, in the economical structure of the developing countries are the determining factor in the exchange rate for them. Therefore it can be said that it is not only the forces ruling the market that brings this about. This mode will cause a great gap, between the short run exchange rate clearing the market and the long run equilibrium exchange rate. This is the reason to justify the multi- rated foreign currency. Overall the developing countries revert to this system in order to direct the economy and reach their economical goals. Experience has shown that these countries do not tend to substitute the above procedures and replace it with a flexible exchange rate ruled by the market.

F- The multi-rated foreign currency system can improve the consumption pattern, because by reverting to this system, the import of luxury goods will decrease.

4-1-2 The Shortcomings of the Multi-rated System in the Framework of Allocation of Foreign Currency

A- The multi-rated system cannot be a permanent solution for the balance of payments problem. The implementation of this system can only decrease the deficit in the balance of payments, but in reality the adjustment forces weaken (sterile) the economy, deterring it from the necessary appropriate changes and movement of resources and production possibilities.

B- Multi-rated foreign currency system, will cause an uncertain atmosphere in the foreign transaction market (foreign currency), due to the government setting different rates on diverse goods. There is always a possibility of change in rates by the government, which in itself brings about uncertainty.

C- The multi-rated system is difficult and complicated. This is due to the fact that the government is forced to determine different rates for diver's goods, and this does not necessarily signify the real value of the rates. Moreover the government can never present an acceptable explanation for specific rates.

D- The multi rated system, distorts the allocation of optimum economic resources and their specialization because of the existing unequilibrium rates.

E- The revenue emanating from the multi-rated system is not clear and depends on the elasticity of demand for foreign currency which is not easy to calculate.

F- The disadvantages outweigh the advantages due to inelasticity of imports, and elasticity of exports of the developing countries.

G-The multi-rated system within the framework of exchange control, damages the growth of the exports of the developing countries, due to encouraging capital intensive of production modes.

4-2 The Indirect Procedures of Controlling Exchange Rate

The most important of the indirect procedures regarding allocation of foreign exchange, are as follows:

A- The Interest Rate Policy

Some kind of exchange control can be achieved by changing the interest rate. Whenever the government raises the interest rate, the foreign capitals are encouraged to be more domestically active, therefore the short term cash capitals pour into the country .At the same time this deters the outgoing flow of the capital and result in demand for the national currency. This in turn soars the value of the national currency versus other currencies. This rise in the interest rate is beneficial for the country concerned. However, the opposite prevails if the interest rate plummets. So a developing country can resort to the change in the interest rate in order to change its exchange rate.

B- Issuing Import Permits.

One of the modes, countries with deficit payment resort to in order to limit imports, optimum usage of exchange resources, protect agriculture, industry etc. is issuing import permits by "allocating foreign currency and a foreign exchange budget". Out of all the countries using this method more than half, enforce this method for all goods, however, in some cases these permits are issued with less limitations. It must be noted that these permits are for the applicants' benefit, enabling them to obtain the necessary foreign exchange from other sources than the government or the official departments. However, the import limitations can help to reduce the balance of payment deficit.

C- Import Duties

Import duties invariably used by the developing countries and even industrial countries, and includes tariffs, commercial profits and duties. This can be designed in a more distinctive and pertinent way and there are vast possibilities in this regard. To reimburse the custom duties, in order to enable them to import raw material, is one of the possibilities. This should not weaken the market for the domestic raw material which may not be competitive in quality or value. Part of the import duties can be used to expand exports and other part of it such as duties on consumptive and capital goods can be considered as subsidies for export. Import duties can be used for protecting the infant industries. Protecting the infant industries can have direct or indirect modes, e.g. the import of raw material for the industry, can be exempt from custom and trade duties. There should be a condition for this, that within a certain time the finished goods should be exported. Free economic zones can benefit by these means, in order to absorb foreign capital and intensify foreign investment.

D- Import Deposit or Security

This procedure bestows duties or subsidy for imports. For several years few countries have used this method. The effective duty or subsidy signifies the difference between official rate of foreign currency (which has overvalued the national currency within the country) and the equilibrium rate. The import deposit is a kind of tax which its value can be considered as the ratio of lost productivity to the value of import.

E- Limitations in the International Payment Services Transactions

These limitations include limitations on tourist foreign currency, bill of lading, transportation of goods, bank services and services given by the non-residents. The services by the non residents include foreign draft, investment income and wages. In the services section (such as computer/ some structures of insurance/ construction and communication), which trade can replace foreign direct investment, the limitations can be so that to discourage foreign direct investment in the country. In such circumstances, in order to encourage the incentive for these kinds of investments, some advantages should be given.

F- Foreign Currency Contracts and Exemptions

In this procedure the exporters are permitted to keep part of their foreign currency revenue, and they are not obliged to sell it to the Central Bank, with the official rate. These regulations will effect the supply of foreign currency into the country. This advantage is often given to expand industrial exports in the developing countries. In giving the export foreign currency to the industrialists, we must pay attention to the limited use of the foreign currency and the selling rate. This exemption is in a way a declaration that the official rate of foreign currency is false and not profitable for any industrialist to sell his export revenue to the Central Bank.

G- The International Capital Transactions

In the developing countries these transactions bear some limitations, but out of every three country one resorts to a free system or uses relatively liberal means for capital transactions. These controls are usually used to a vast extend and effect the transactions of International trading bank and their reserves. Also, the real capital of residents will be effected (excluding banks). The incoming capitals are controlled to a lesser degree by this system; this is due to the shortage of foreign currency resources in these countries. All the same, these incomings too, are usually legible to a declaration, which should be presented to the Central Bank. Most of the considered controls for foreign direct investments should include the meticulous surveys concerning the foreign investment plans by the government. It must be noted the control on foreign exchange, regarding transfer of capital resources, which has become a common procedure, has not been effective in preventing the flee of capital. In some under debt countries, the exit of capital is to the extent that it forms a substantial part of the country's debt.

H- Export Awards

Export aid and awards increase the competitive drive of export goods and lead to more exports which in turn improve level of deficit in balance of payments. This mode will increase the purchasing power of domestic currency, hence a decrease in the exchange rate beneficial to the exporting country.

I- Introduction of an Index for Determining the Foreign Currency Rate in the System of Allocating Foreign Currency through Exchange Control

The nominal rate of exchange rate, which distinguishes the value of national currency versus foreign currency, cannot always be a suitable index for the exporters and importers, to estimate the amount of payments and receipts.

It has been observed that some countries under fixed exchange rate regime, utilizing the allocation of foreign currency through exchange control system, keep the value of their currency fixed. In cases of foreign imbalance, they do not have to devaluate or revaluate, but impose import and export duties, obtain foreign exchange contract, enforce additional taxes on foreign currency transactions, other controls or limitations on imports like deposits (in Rials), facilities and advantages toward exports, and preference rates for export (other factors has been mentioned before). All these ignite incentive for obtaining foreign currency through selling of goods and services abroad. The above factors cause the exchange rate for import and export payments to be different from the official or nominal rate of exchange; this is called "the effective exchange rate". The definition of this can therefore be summed up as follows:

"The effective exchange rate" is the number of units of domestic currency which 'literally' takes into account all limitations or facilities in the allocation of foreign currency through the control system, and is used versus a foreign currency for international transactions.

In the system of managed floating exchange rate or joint floating exchange rate, determining the value of domestic currency, through observations and surveys, versus other currencies is almost impossible, e.g. if the value of Dollar plummets simultaneously versus Euro and Yen but soars with regard to the Sterling Pound and Canadian Dollar, in this situation the change in Dollar is the average weight of the above mentioned changes (in this example, hypothetically only five currencies exist). Therefore since the dollar versus the floating currencies changes with various degrees, "an average weight", from the changes in every currency versus the dollar is needed to determine the changes in the dollar exchange rate.

"The average weight" can be estimated for all the main currencies, which is called, "the effective exchange rate". This too, can be defined as the average weight of the exchange rates amongst the domestic currency and the currency of the main countries it is "dealing" with, this will materialize through utilizing the weights for the equivalent value of the currency, by taking into account the relative importance of the trade of the domestic country with any other country in question. Another word "a weight" is needed to estimate the effective index of exchange rate. This will be registered as such:

$$EER \backslash \sum_{i=\backslash}^{n} \alpha_{it} R_{it}$$

EER = The effective exchange rate.
i = The number of exchange rates of the main currency.
R = The nominal exchange rate.
α = Displays the "weight".

Different weights can be used to estimate the average weight, therefore numerous effective rates, can be estimated for each currency. The weights used , depend on the aim of the estimation, e.g. if we want to calculate the effective exchange rate for import goods, the import share of the countries concerned, together with those of the domestic country, should be considered one weight. In this situation the effective exchange rate of import goods, will define the effects of the changing rate of exchange to import cost of the country.
Therefore α_i equals:

$$\alpha_i = \frac{\text{The value of Import Goods With } R_i \text{ Rate in terms of foreign currency}}{\text{The total value of imports in terms of foreogn currency}}$$

Now, if we want to calculate the effective exchange rate for export goods, the export share of each country versus another, should be calculated as one weight. In this case too, like before, α_i can be reached. In this situation, the effective rate for export goods, defines the average changes in the export cost of the country, to the foreigners. In economic surveys two more weights are used for estimating the effective exchange rate, they are:

A = α_i, shows the total value of import goods from each of the major countries, to the total value of the country's import-export.

B = α_i, equals the share of each country of major trade in the international trade relation.

In the empirical studies, the first two weights are usually utilized, to estimate the effective exchange rate of import goods and, the effective exchange rate of the export goods. This method can be used as a suitable index of "shadow prices of exchange rate" in the allocation of foreign currency through exchange control system, for different economic sectors and various goods.

6- Summery and Conclusion

Considering the theoretical reviews, the disadvantages of the allocation of foreign currency through exchange control system, outweighs its advantages and cannot remedy the impending losses. The control system is not a solution for the unbalance in the foreign currency market. The international trade and even trade between the developing countries, face problems due to the control system and when they have to confront capital flee they face difficulties regarding the incoming capital. As mentioned, under exchange control domestic policies are not allowed to act freely, and external fluctuations are more or less, transferred into the domestic economy scene. Contradictory to common belief, long run exchange control, does not bring about stability of exchange rate, and the continues changes of the said policies, will raise risks for the trade. The experiences of utilizing the allocation of foreign currency through exchange control system, in order to protect the domestic industries, has not been agreeable, and by bringing about the background for inefficient activities, it would distort the pattern of comparative advantage and price mechanism . Moreover, in spite of strict controls, and heavy punishments, for those evading the controls, there has been report of smuggling, corruption of administration and various departments, giving false reports concerning the amount and figures relating to the imports and exports, opening bank accounts abroad and collaborating with foreigners. Although by utilizing the allocation of foreign currency through exchange control system, there are less problems with regards to terms of trade when it is compared with the devaluation of domestic currency, but the expansion of smuggling some export goods can undermine the probable advantage. The smuggling of carpets with the present condition of Iran is a clear indication of this fact. This is when , parallel with the allocation of foreign currency control through exchange control system, a black market for foreign exchange and goods exist, forever evading the system, and expansion of non productive activities come to life. The allocation of foreign currency through exchange control system, is in need of expansion of bureaucracy, otherwise many complications will arise with regard to trade. Moreover as some economists indicate, the allocation of foreign currency through exchange control system, does not necessarily decrease the incoming flow of luxury and consumptive goods, and at the same time it does not mean, the incoming of intermediate goods and capital will increase. Decreasing luxury goods import may lead to some sort of inefficient production of the kind, consequently waste of production resources in the country.

On the other hand facilitating the import of capital goods, with the aim of expanding exports, and decreasing the import of consumptive goods, is not necessarily the right move because; these in turn will increase the need for intermediary goods, which will inevitably lead to consuming products. On the whole the allocation of foreign currency, through exchange control system, should not be considered as the soul means of confronting the deficit in the level of balance of payments, and the optimum use of foreign currency resources. The right usage of expenditure and switching changing policies, will simultaneously, turn out to be the right solution for synchronizing internal and external equilibrium. The experiences of past years, in Iran, regarding the allocation of foreign currency through exchange control system, was mostly concerned with import quotas, issue of import permits, and allocation of foreign exchange. Necessity for the deposit of 90% of foreign currency of export revenue within twenty days after receipt to the authorized banks (in 1930).

-Utilizing the mechanism of foreign currency contract and imposing discrimination through it (in the years of 1942-1945).

-Import permit versus miscellaneous foreign currencies due to the services rendered (time of Nationalization of oil).

-Continuance of presenting foreign currency to official authorities (in the years of 1960-1973)

-Authorization for exemption of foreign currency contract to the Central Bank (in 1972).

-Necessity for presenting foreign currency contract (in 1979). -Change in the deadline for contract (in 1981).

-Advantage of exemption of part of contract concerning some goods (in 1982)

-Import permit versus export.-Possibility of opening a foreign currency account and granting bonuses for exports with Rial (in 1984).

-Prizes of encouragement when buying export foreign currency (in 1987).

-Annulment of foreign currency contract (in 1991).

-Reviving the foreign currency contracts and the necessity for registering orders, import deposits and import permit issue (in 1995).

The entire above mentioned, are intermittent and unsuccessful attempts by the government during the years, in a vain attempt to absorb the foreign currency income through the allocation of foreign currency through exchange control system.

A survey based on these experiences and the effects of these controls with regard to the goals, clearly indicates the unsuccessful results, when resorting to these procedures. Considering the aims in mind while resorting to the control system, the most important seems to be to establish equilibrium in the level of balance of payments and to absorb the foreign currency income resulting from the export of non-petroleum products. Obviously it is justifiable when preventing the capital flees, but it fails when the receipt of foreign currency and the revenue of non-petroleum exports are attempted. That is the reason, for always facing a deficit in foreign payment, except for exceptional periods like 1931 and 1941 and during the Nationalization of Oil. It must be noted, that the structure of imports-exports, together with a vast share of the oil revenues, included in the total of the incoming foreign exchange, is usually in such way that limits a vast part of the policies regarding the exchange controls. The costs regarding the inefficient protection, changes with enforcing the controls, and based on the domestic cost outweighs its benefits. The empirical studies in Iran have clearly shown that the allocation of foreign currency through exchange control system is not effective in curbing the inflation, and the diminishing incentives for exports is one of the main reasons for lack of success with regards to non-petroleum exports. The bilateral transactions and barter exchange deals, expansion of black market, evading the controls and the ever increasing smuggling are mostly due to the allocation of foreign currency through exchange control system.

In summery, it must be concluded that the allocation of foreign currency through exchange control system, should not be the only means of dealing with the deficit in the level of balance of payments, and absorbing the foreign currency revenues from non-petroleum exports and other economic problems. It is recommended that a correct, timely and simultaneous implementation of other coordinating economic policies too be taken into consideration, especially policies, concerning expenditure and switching changing policies, this may not only bring about foreign balance but at the same time domestic balance.

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