

Should Chilean authorities consider reforming the capital control regime in the future, one option for them can be:

- ◆ Investments under DL 600 be exempt from the interest-free deposit requirement and the one-year repatriation restriction.

Such a reform would not affect investments under Chapter XIV, which could be used for speculative purposes but would still be subject to both restriction.

One potential problem with the above suggested reform is that some speculative activity may be diverted from other forms of investment to direct investment. We do not think that this is a serious problem. Buying and selling assets acquired through DL 600 investments are likely to have significant transaction costs. This program would, therefore, not represent an attractive channel for speculative activity. Undoubtedly, attempts will be made to disguise short-term inflows as foreign direct investment to seek exemptions under the above suggested reform. It should be possible for the Foreign Investment Committee in Chile (which regulates investments under DL 600), however, to distinguish such flows from genuine direct investment in most cases.

If serious concerns still remain about the possibility that short-term funds would enter through DL 600 under the above suggested reform, then we suggest the following alternative reform:

- ◆ Investments under DL 600 be exempt from the interest-free deposit requirement.

This suggestion retains the repatriation restriction under DL 600, and such a restriction alone would provide a strong deterrent for speculative funds to enter this program. As discussed in section 3, speculative pressures intensify when a change in the exchange rate is expected in the near future. The expected payoff in such a situation is high for short-term investments but would fall significantly for investments that are tied up (due to the repatriation restriction) for one year. Thus, DL 600 investments would not be an attractive vehicle for speculative activity. The deposit requirement on these investments would simply be a device to generate revenue for Chile but would not serve any other purpose.