PART III

F. EXCHANGE CONTROL IN SOUTH AFRICA

The South African Reserve Bank

The SARB was established as the central bank of South Africa in 1921 in terms of the Currency and Banking Act No. 31 of 1920. This Act was replaced in 1944 by the South African Reserve Bank Act No. 29 of 1944. In 1989 the South African Reserve Bank Act No. 90 of 1989 (the SARB Act) was promulgated and is currently still in force as amended from time to time.

The bank has been privately owned since its establishment and presently has in excess of 650 shareholders.

The SARB Act provides that no individual shareholder may hold more than 10 000 shares of the total number of 2 000 000 issued shares. After the payment of certain amounts, amongst others, company tax, transfers to reserve and annual dividend payments which may not exceed ten cents per share, the surplus of SARB earnings is paid to Government.

The SARB Act provides for a Board of Directors with 14 members. The Governor and 3 Deputy Governors are appointed by the President for 5 year terms and are members of the Board. The President also appoints 3 other directors for a period of 3 years. The remaining 7 directors are representatives from various sectors of the economy and are elected by the SARB shareholders for a period of 3 years.

160. The Governor and Deputy Governors manage the day-to day affairs of the SARB.

Historical background to Exchange Control

Exchange controls have been in place in South Africa since 1939. The current governing legislation is set out in the Exchange Control Regulations promulgated in 1961 in terms of the Currency and Exchanges Act No. 9 of 1933.

162. Exchange controls in South Africa were applied more stringently during the apartheid era especially in 1985 when international sanctions, trade boycotts, disinvestment campaigns and the withdrawal of loan funding to South Africa exerted severe pressure on the balance of payments and the domestic economy as a whole.

163. The introduction of a dual currency system was meant to address some of the problems. The Financial Rand system was used for capital account transactions. Any outward transfer of funds other than normal trade related transactions, was subject to prior approval by the exchange control authorities.

After the first democratic elections in 1994 the new Government initiated the process of liberalisation of exchange controls. The first major step in this direction was the abolition of the Financial Rand in March 1995.

Role and Functions of the SARB

The Minister of Finance is responsible for exchange control policy. The SARB implements and administers such policy on behalf of the Government and also acts in an advisory capacity. The SARB and the Government are jointly responsible for determining exchange rate framework policy.

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Inflation targeting does require nominal exchange rate flexibility because South Africa has adopted a fully flexible exchange rate regime. There is no specific target for the exchange rate.

The SARB does however concern itself with the exchange rate but only to the extent that it has an impact on the inflation process.

The depreciation of the currency directly affects the price of imports in addition to possible secondary effects where high import prices have impacted on wage and other price increases.

The SARB is responsible for achieving the inflation target through the formulation and implementation of monetary policies.

The Monetary Policy Committee (MPC) of the SARB decides monetary policies.

178. The primary instrument of monetary policy available to the SARB is its influence on the level of short term interest rates through its refinancing system, which is called the repo rate.

179. The change in repo rate influences short term market interest rates in two ways: firstly it directly influences the marginal cost of funding of banks and secondly it reflects the SARB's monetary policy stance. Consequently it impacts on other interest rates in the market and can affect the exchange rate through its impact on domestic demand and capital movements.

180. The interest rate is not adjusted to influence the exchange rate but rather to influence in a pre-emptive manner, future inflation.

In the medium to longer term, successful inflation targeting should also contribute to a more stable exchange rate of the Rand.

The independence of the SARB and its autonomy is enshrined in the Constitution though regular consultation between the Bank and the Minister of Finance does take place.

G. LEGAL FRAMEWORK OF EXCHANGE CONTROL

The Currency and Exchanges Act

The Currency and Exchanges Act is the foundation of exchange control in South Africa. Section 9 (1) of the Act provides that:

> *"the Governor-General (the President) may make regulations in regard to any matter directly or indirectly relating to or affecting or having any bearing upon currency, banking or exchanges."*

Exchange Control Regulations

The Exchange Control Regulations are promulgated in terms of the Currency and Exchanges Act. The Regulations were promulgated on 1 December 1961 and amended from time to time.

The control over South Africa's foreign currency reserves as well as the accruals and spending thereof is vested in the Treasury. The Treasury is defined as the Minister of Finance or an officer in the Department of Finance who by virtue of the division of work in that Department, deals with any matter on the authority of the Minister.

Orders and Rules

From time to time the Minister of Finance issues Orders and Rules under the Exchange Control Regulations. The Orders and Rules contain various orders, Rules, Exemptions, Forms and Procedural Arrangements.

The Exchange Control Rulings

The Exchange Control Rulings are issued by the Exchange Control Department of the SARB and contain certain administrative measures as well as permissions, conditions and limits applicable to transactions in the foreign exchange market which may be undertaken by Authorised Dealers.

188 The Rulings are amended from time to time by way of Exchange Control Circulars.

189 Authorised Dealers may deal with applications for foreign exchange received by them if the applications fall within the parameters outlined in the Rulings without reference to the Exchange Control Department.

The Exchange Control Manual

190 The Exchange Control Manual was first issued by the SARB in October 1990 to assist Authorised Dealers, their customers and other interested parties, by providing a general understanding of the purpose, scope and operation of the exchange control system in South Africa and in the CMA.

191 The Manual serves only as a general guideline and does not replace or supersede the Exchange Control Regulations, Orders and Rules or the norms and policies as applied by the Exchange Control Department.

Authorised Dealers

Certain banks have been appointed by the Minister of Finance to act as Authorised Dealers in the foreign exchange market. Such appointment gives them the right to buy and sell foreign exchange subject to conditions and within the limits prescribed by the Exchange Control Department of

the SARB. Authorised Dealers are not the agents of the Exchange Control Department but act on behalf of their customers.

Applications to the Exchange Control Department

193. Applications by customers of Authorised Dealers in forex which fall outside the scope of the Rulings must be referred to the Exchange Control Department for adjudication. The Exchange Control Department deals with each application on its own merit taking into account the information on record with the Exchange Control Department and within the parameters of detailed policy and norms. The records kept by the Exchange Control Department date back to 1939.

194 The decision of the Exchange Control Department including any conditions, if imposed, is furnished in writing to the Authorised Dealer and conveyed by it to the applicant.

195 The responsibility for ensuring that the execution of the transaction complies with any terms and conditions laid down by the Exchange Control Department lies with the applicant, though the application is made through the Authorised Dealer.

196 In certain circumstances, as for instance market sensitive transactions, the Exchange Control Department will entertain applications directly from the applicant.

197 Where approval is refused, resubmission is possible when a more senior official will review the application. In certain instances the department will grant an interview with the applicant and the Authorised Dealer during which the policy and norms are explained.

H. PURPOSE OF EXCHANGE CONTROL

The reason for the exchange control exist in order:

198.1 to ensure the repatriation into the South African banking system of all foreign currency acquired by residents of South Africa whether of a current or of a capital nature;

198.2 to prevent the loss of such foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa;

198.3 to effectively control the movement into and out of South Africa of financial and real assets (money and/or goods) while at the same time not interfering with the efficient operation of the commercial, industrial and financial systems of the country.

198.4 to avoid undue pressures on the country's gold and foreign exchange reserves, which in turn would result in serious domestic inflation, a weakening of the country's terms of trade with the rest of the world, the impoverishment of the domestic population, the retardation of the domestic economic growth rate and the distortion of the Rand equivalent of the South African foreign debt.

The Removal of Exchange Control in South Africa

The first democratic government ushered in by the elections of 1994 has paid particular attention to exchange controls in South Africa.

The South African Government decided on a gradual approach to the elimination of exchange control as opposed to what is termed a "big-bang" approach. A phased approach allowed Government more time to

implement other policy changes in order to achieve the preconditions necessary for a successful abolition of exchange control.

It had been decided by Government to proceed with the liberalisation of exchange control in the following sequence :

201.1 firstly, the abolition of exchange control on all current account transactions (import and export of goods and services) which has been done;

201.2 secondly, the abolition of exchange control on non-residents which has also been done;

201.3 thirdly, gradually becoming more lenient in the approval of applications for direct foreign investment by South African corporates. This is an ongoing process;

201.4 fourthly, allowing institutional investors to acquire foreign assets to diversify their total portfolio investments. This is also ongoing;

201.5 fifthly, to release immigrants' blocked funds which are funds or assets of an immigrant that are not transferable from South Africa and are physically controlled by an Authorised Dealer.

Remaining Exchange Controls in South Africa

Certain exchange controls remain. For the purpose of this report the relevant controls are the following:

202.1 foreign investments by South African corporates;

202.2 share placements by South African corporates;

202.3 foreign loans from outside the CMA;

202.4 import and export transactions by Authorised Dealers on behalf of South African importers;

202.5 forward exchange contracts with South African residents and non-residents;

202.6 customer foreign currency accounts.

Net Open Forward Position

The NOFP arose at a time in the history of this country when sanctions were in place against apartheid and the economy was marked by isolation from the rest of the world, low domestic savings and low foreign reserves.

In this environment the SARB had a mandate to intervene in the foreign market and was for many years responsible for providing cover against exchange rate fluctuations on behalf of the Government.

As early as the 1980's, attempts were made to extricate the SARB from the forward market but due to the prevailing political conditions this was not possible.

After the debt standstill in 1985, residents were increasingly reluctant to hold offshore debt because of the losses suffered on revaluation of foreign debts when the exchange rate depreciated by about 30% in 1985.

The strict exchange control requirements at the time prevented any resident from holding foreign currency and banks were permitted to do so