

Challenges of the International Monetary System and Response Options:

A South African Perspective

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Introduction

For purposes of this paper, the international monetary system may be described as the various mechanisms and institutions that underpin the exchange of different national and regional currencies in world trade and finance. The history of this system is well documented – see for instance Eichengreen (2010) and Lin, Fardoust & Rosenblatt (2012) – and proposals aimed at its reform are not in short supply.

It seems appropriate, as the world is confronted with the painful results of the current crisis, that this system be thoroughly and critically scrutinised. Many critics point out that the transmission of the crisis was facilitated by this system with its strong reliance on a handful of international reserve currencies, and with a number of very large or highly interconnected financial institutions conducting business in global markets ready to transmit and amplify weaknesses and imbalances across borders.

The focus in this paper is on the international reserve currency dispensation which could serve the world best. In particular, aspects of South Africa's experience with exchange rate reform, currency internationalisation and monetary integration are highlighted, attempting to extract elements that may be of relevance for the reform of the international monetary system. Apart from this issue there are further related issues of equal importance that are not covered in the present paper or are just touched upon in passing, such as the strengthening of the global financial architecture and the regulatory and governance dimensions thereof.

The first section below identifies a handful of shortcomings of the international monetary system. Thereafter the broader, mainly structural, weaknesses of the international financial system are briefly touched upon, before moving to the more immediate risks that result from the current, extraordinarily accommodative monetary policy settings in the major developed economies, whose currencies also serve as international reserve currencies.

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Attention then turns to South Africa's experience, outlining facts about South Africa's recent participation and integration in the international monetary and financial system, before turning more specifically to the country's experience with reform of the foreign exchange dispensation and currency internationalisation. Mention is also made of the challenges posed by membership or potential membership of regional integration arrangements and blocks, particularly where monetary integration is part of the agenda.

The subsequent sections outline views regarding the adjustment measures that other countries are already implementing, followed by an indication of preferences regarding the options for further orderly adjustment of the International Monetary System. This is followed by brief concluding remarks. To illustrate the approach of gradualism adopted by the South African authorities in the process of currency liberalisation, details of this process are provided in an appendix.

Key Shortcomings of the Current International Monetary System

While volumes have been written about the ailments of the international monetary system, three key shortcomings are highlighted in this section. Dedicated sections below will add further dimensions.

Dominance of a handful of currencies. The US dollar remains – by far – the most important single currency in the international monetary system. For instance, data from the IMF (2012) show that in the stock of global reserves identified by currency at the end of June 2012, the share of the US dollar stood at 62 per cent. That of the euro came to 25 per cent, with the pound sterling and Japanese yen both at approximately 4 per cent. That is not to say that this is a static picture. At the end of 2000, for example, the US dollar still commanded a share of 71 per cent in the total. Still, network externalities seem to underpin the persistence of dominant currencies in the international monetary system, with low liquidity premia, economic size and share in international trade and payments playing an important part in a currency's standing (Lin, Fardoust & Rosenblatt 2012: 16).

A constituent monetary union that has not yet stabilised. Monetary union formation involves difficult trade-offs, with political considerations often turning out to be more important than economic-technical ones. As observed in the euro area, a dispensation which works well in good times can present policy-makers with unintended consequences in difficult times. Creating monetary union mechanisms for adequate mutual support and discipline, with fiscal and regulatory dimensions, are particularly challenging. Problems experienced in a handful of constituent countries can furthermore have a disproportionate impact on the exchange rate of

the monetary union's currency, creating further imbalances within the currency area and between that currency and other currencies. This is further amplified in instances where other currencies have pegged their exchange rates to that of the monetary union. In turn, some of these other currencies may be those of monetary unions; the Central African CFA franc, used by six countries, and West African CFA franc, used by eight countries and both backed by the French treasury and pegged to the euro, are examples.

Currency volatility. Related to the previous points is the issue of currency volatility. While exchange rate flexibility provides an important adjustment mechanism which helps to deal with external and internal imbalances, exchange rates frequently overshoot. In turn this may lead to a number of economic ills such as costly resource misallocation, paralysis of investment due to amplified uncertainty, bouts of inflation or deflation, and big adjustments to monetary and fiscal policy.

Broader Weaknesses of the International Financial System

While scrutiny of the broader financial system weaknesses extends beyond the scope of the present analysis, the international monetary system cannot be separated from the broader international financial system; countering weaknesses in the one has implications for and involves the other.

The outbreak of the crisis in 2007/2008 and its spillover to the world economy culminated in much soul-searching among policy-makers, economists and regulators. The G-20 towards the end of 2008 recognised the most important weaknesses of the international financial system, agreed on principles for reform and adopted an Action Plan to Implement Principles for Reform (G-20, 2008). This action plan, which also suggests the areas considered as weaknesses, revolve around:

- Strengthening transparency and accountability
- Enhancing sound regulation
- Promoting integrity in financial markets
- Reinforcing international cooperation
- Reforming international financial institutions

These areas clearly merit prioritisation and careful attention. It is not the intention of the present analysis to detract from any of them. By way of a footnote, however, it should be recognised that even after dedicated implementation of the action plan some risks to the financial system would remain. All the frameworks in the world cannot eliminate the need for

judgement and the risk of a major policy mistake, such as inadequate recognition by national authorities of the systemic importance of a certain institution or market, or inadequate attention to potential ripple effects transmitted to other economies. However, they can moderate such risk significantly.

Challenges that Result from Extraordinary Economic Policy Settings in Major Developed Economies

Recognising the seriousness of the crisis and mindful of the need to support economic activity and the financial system, major developed economies eased policy considerably from 2008. Fiscal deficits widened, both to support crippled financial institutions and to conduct a strong countercyclical policy. Much of the countercyclical action was brought about by the automatic stabilizers built into the tax system and government expenditure programmes – these simply reacted to a particularly deep recession. However, because of the long duration and scale of the weakness in activity and the magnitude of the fiscal deficits, government debt-to-GDP ratios scaled new heights and ignited fears regarding sustainability in a number of countries. In several instances this has necessitated a painful reversal of policy with the introduction of fiscal austerity measures. In turn, these have been accompanied by voter dissatisfaction and in some cases, replacement of governments through the democratic process.

At the same time monetary policy has been eased considerably. In the major developed economies policy interest rates have been lowered to levels close to the zero lower boundary, and further liquidity has been pumped into the financial system through measures such as central bank purchases of bonds. In the US, policymakers have also taken the extraordinary step of indicating that the low interest rate policies are likely to stay in place for several more years.

These policies present their own set of difficulties to the international financial system. For instance, White (2012) notes that while the ultra easy monetary policies may have desirable short-run effects such as supporting economic activity, their longer-run effects may be quite undesirable, threatening the health of financial institutions and the functioning of financial markets, undermining the “independence” of central banks, and encouraging imprudent behaviour by governments. In fact he also expresses doubt regarding whether the desirable short-run effects will be forthcoming; not only may the transmission channels through which monetary policy normally operates be partly blocked, but expenditure by households and the corporate sector may not react as much to the lower interest rate environment as would normally have been expected.

For developing economies, a practical result of the very low interest rates in the developed economies is a quite significant nominal interest rate differential in favour of developing economy money market and capital market instruments. This encourages foreign investment inflows, not least in the form of portfolio capital, as a number of developing economies including South Africa have experienced in recent years.

While for capital-scarce developing economies the inflows of foreign investment may in principle be welcome, it could contribute to domestic interest rates falling too low from a sustainability point of view, altering the behaviour of domestic savers by for instance reducing the overall incentive to save and encouraging a redirection of savings from deposits and debt securities to substitute investment avenues. The behaviour of borrowers could also be impacted, with low interest rates leading to more borrowing and less discipline in the allocation of borrowed funds between alternative uses. An added complication is that strong foreign investment inflows may contribute to currency appreciation which, if overdone, could bolster imports and undermine the production and employment capacity of the domestic economy. Furthermore, exchange rate volatility may worsen under these circumstances – not least during the correction phase, when at some point in future the ultra-low interest rates normalise.

A further noteworthy complication of the ultra-low interest rates in the developed economies is the low rate of return on foreign exchange reserve holdings. Many developing countries have in recent years accumulated international reserves to become more robust in the face of international headwinds; however, the returns on such reserve holdings are currently very low. This raises issues concerning the expansion of the range of currencies and asset types which are acceptable as international reserve holdings.

South Africa's Experience with Exchange Rate Reform and Currency Internationalisation

This section first presents a number of salient facts about South Africa's recent participation and integration in the international monetary and financial system, before turning more specifically to the country's experience with reform of the foreign exchange dispensation and currency internationalisation.

Since the democratic elections of April 1994, South Africa has been welcomed back into the international fold, and has utilised the opportunity to strengthen its financial system and international financial linkages. The broad approach taken since then has been that the isolationism of the past should be avoided and that strong global linkages are important to nurture a vibrant, competitive economy on a path of sustainable development.

In the political sphere South Africa's status in a number of international organisations such as the United Nations and the Bretton Woods institutions was normalised in the early 1990s. In Southern Africa, South Africa joined the Southern African Development Community (SADC), a regional community of nations committed to development in which an important part of the earlier agenda had been standing up to South Africa; currently the focus is less political, with regional economic development and integration at the centre. Later South Africa became a G-20 member, and most recently also joined Brazil, Russia, India and China in the BRICS grouping.

With the political channels open, protectionism was reduced in order to expand South Africa's international trade. Import duties were lowered considerably, in the process also addressing the anti-export bias which had previously plagued the economy. Exports have risen from 22,1 per cent of gross domestic product (GDP) in 1994 to 28,8 per cent in 2011. Similarly, imports have increased from 19,9 per cent of GDP in 1994 to 29,4 per cent in 2011. While these structural increases are generally to be welcomed, they signify a more important role for the international business cycle in the determination of short-term economic activity levels in South Africa. Domestic policy-making is more subject to global outcomes over which South Africa has very little influence.

From abnormally low levels in the era of sanctions against South Africa, cross-border assets and liabilities have also expanded considerably. For instance, foreign liabilities have risen from 38 per cent of annual GDP in 1994 to 93 per cent in 2010. Over the same period, foreign assets have increased from 20 per cent of GDP to 76 per cent. Again, these trends signify an increased cross-border influence and dependence running in both directions.

Turning to South Africa's experience with exchange rate reform and currency internationalisation, the evolution of the South African foreign currency market is well covered in the literature, so that for present purposes only a summary will be provided. Following the demise of the Bretton Woods exchange rate system in the early 1970s, South Africa experimented with a number of alternatives (fixing the exchange rate of the rand against various currencies and in between also for a while against a basket of currencies). From January 1979 a system of managed floating was adopted. In the background a comprehensive system of exchange controls applied, inter alia resulting in a parallel exchange rate for the rand in dealings in rand assets between non-residents (the "securities rand" or "financial rand" exchange rate, distinct from the "commercial rand" which applied to import and export transactions). A broad range of imported goods were subject to permit control, apart from high import duties.

The intention from the late 1970s, mindful of the abuses which a parallel exchange rate brings and of the need to accept market discipline, was to move to a single, flexible, market-driven exchange rate of the rand. To do so was facilitated by the gold price bonanza of 1979-1981, which strengthened South Africa's overall balance of payments position. This made it easier to discontinue the direct permit controls over imports from 1980 and instead rely on import duties to protect local industries. The forward market for foreign currency was also bolstered as the South African Reserve Bank started to quote forward rates based on interest rate differentials rather than fixed premia. The separate exchange rate for non-residents was discontinued in 1983 as exchange control over non-residents was essentially abolished.

However, the liberalisation of the foreign currency market was set back in the mid-1980s. At that stage the authorities did not have a substantial buffer of gold and foreign exchange reserves, and the country's short-term foreign debt – much of it incurred by banks and other private-sector companies – had risen to high levels. International condemnation of the apartheid policy pursued by the South African government intensified during that period, resulting in financial sanctions and inability to roll over South Africa's short-term foreign debt. In August 1985 this resulted in the imposition of a foreign debt standstill by the South African authorities and the reinstatement of the financial rand parallel exchange rate as exchange control over non-residents was reintroduced. As could be expected, from that point on South Africa could no longer borrow freely in the international markets but had to repay its foreign debt obligations and therefore had to run a surplus on the current account of the balance of payments. Since political factors also inhibited South Africa's export performance, the country was pushed into a low-growth trap: South Africa barely managed an average real economic growth rate of 1 per cent per annum during the 1980s.

Over time the foreign debt under the debt standstill arrangement was gradually worked down and eventually fully repaid. Negotiations towards a fully democratic system of government progressed in the early 1990s, and a democratic election was eventually held in April 1994. Accordingly, sanctions fell away and international financial relations normalised. This made it possible for South Africa to again access international financial markets and from time to time incur a deficit on the current account of the balance of payments; in fact, on a calendar year basis the current account has been in deficit throughout since 1995 with the exception of two years.

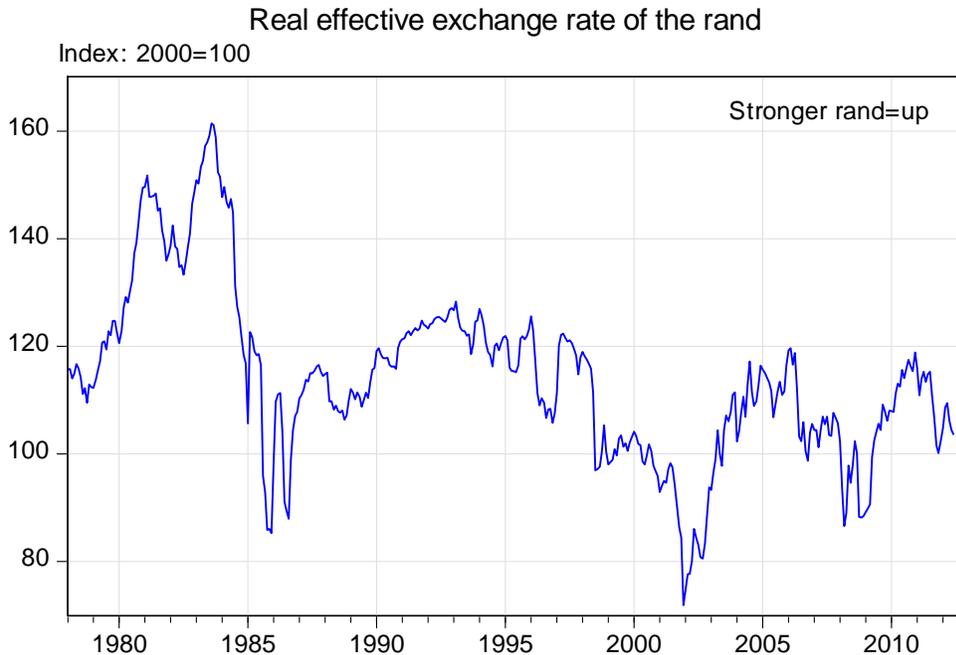
The absence of sanctions also facilitated a resumption of the process of foreign currency liberalisation. As indicated by the South African authorities in the mid-1990s, shortly after the democratic government came to power, their approach to currency liberalisation would be one of gradualism. The major controls over non-residents were lifted in 1995, leading again to

abolishment of the parallel “financial rand” exchange rate. Over the ensuing 17 years, controls over residents have been gradually relaxed but not abandoned. However, the focus has moved to reporting of transactions rather than prohibition, while simultaneously ensuring tax compliance. The limits set for transactions have been gradually raised to levels where they no longer effectively curtail the transaction possibilities of South Africans but for the wealthiest individuals. The limits on the foreign asset holdings of South African institutional investors such as insurance companies, retirement funds and unit trusts have also been raised over time, but these restrictions are of a prudential nature (given the largely domestic nature of these institutions’ liabilities).

A chronology providing further detail of the gradual liberalisation of exchange control in South Africa is provided as an appendix to this paper.

Up to mid-1998 the South African authorities from time to time actively intervened in the market for foreign currency to influence the exchange rate. However, attempts to stem the depreciation of the rand in the wake of the 1997/98 Southeast Asian crisis were disappointing, with the exchange rate falling considerably despite substantial selling of foreign currency into the market by the South African Reserve Bank, mainly in the forward market. The official intervention in the market seemed to amplify speculative activity in the market rather than dampening it.

Since then, active intervention with an exchange rate objective has been discontinued. The central bank has however bought a considerable amount in foreign currency rand over the years since 1998, first to get rid of a large oversold forward position in US dollar, and later to build the official reserves of the country to a more comfortable level. While naturally such buying of foreign currency must have had some effect on the exchange rate, at no stage have the South African authorities entered the foreign exchange market with an exchange rate objective or target in mind – the exchange rate has continued to be essentially market determined.



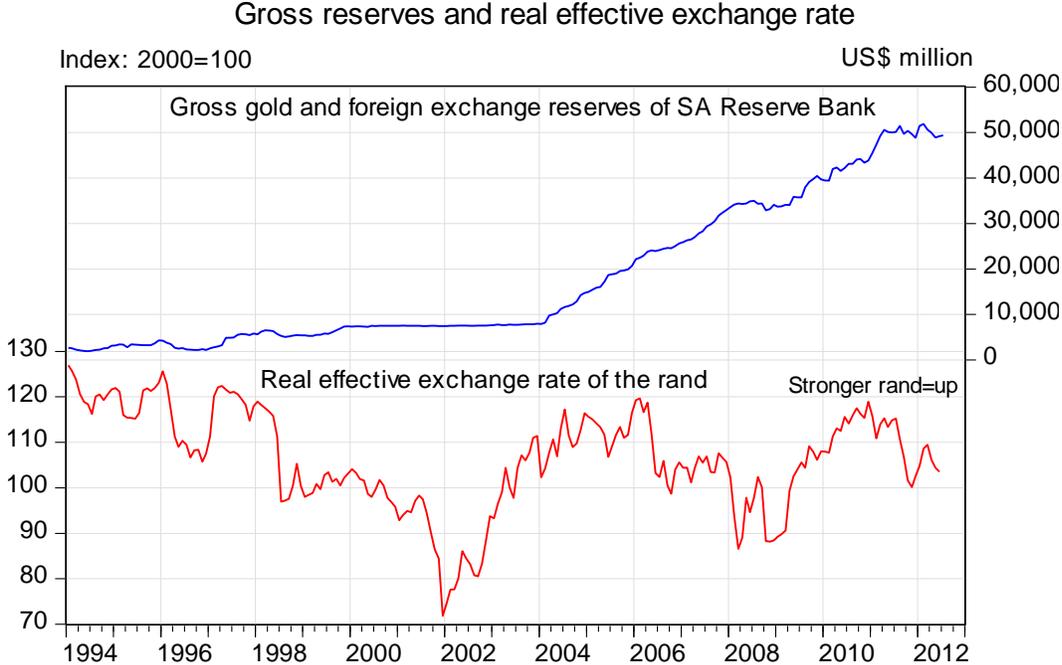
The accompanying graph shows the evolution of the real effective exchange rate of the rand since the late 1970s. While the abnormally high gold price, high import duties and exchange controls contributed to a very strong rand in the early 1980s, sanctions, a debt standstill and less favourable prices of gold and other export commodities led to a much weaker rand in the second half of the 1980s. Subsequently, volatility remained high although not quite as high as in the 1980s. Of particular interest is the extreme depreciation of the rand in 2001-2002, brought about by several factors in combination; these factors – they were the topic of an official commission of enquiry at the time - included speculation and uncertainty among market participants.

Strong export commodity prices and interest rate differentials in favour of rand assets contributed to rand strength in 2004-2006, much to the disappointment of South African exporters. Around the intensification of the international financial crisis in 2008-2009 the rand, like quite a number of other currencies, again depreciated notably. It recovered later in 2009 and appreciated further in 2010, again causing significant exporter discontent and protest since the stronger exchange rate of the rand in this instance coincided with a weakening of global demand.

Did the challenges of currency volatility prove insurmountable? The fluctuations in the external value of the rand have had a serious impact on resource allocation, planning, development and enterprise survival, and should not be underplayed. However, over time market participants learn, which helps to soften the swings in subsequent currency episodes. After the substantial

recovery in the rand following the extraordinary depreciation in 2001, for example, the conventional view became that the rand presents two-way currency risk, not just downside risk. With adequate hedging instruments, much of the foreign currency price risk can also be transferred to those willing (for a price) and able to assume it. Given enough freedom and responsibility, foreign currency market participants can develop and provide a helpful range of instruments. For instance, in South Africa forward cover can be provided several years into the future. The volatility issue has accordingly not been insurmountable, although the debate around this issue seems likely to continue in perpetuity.

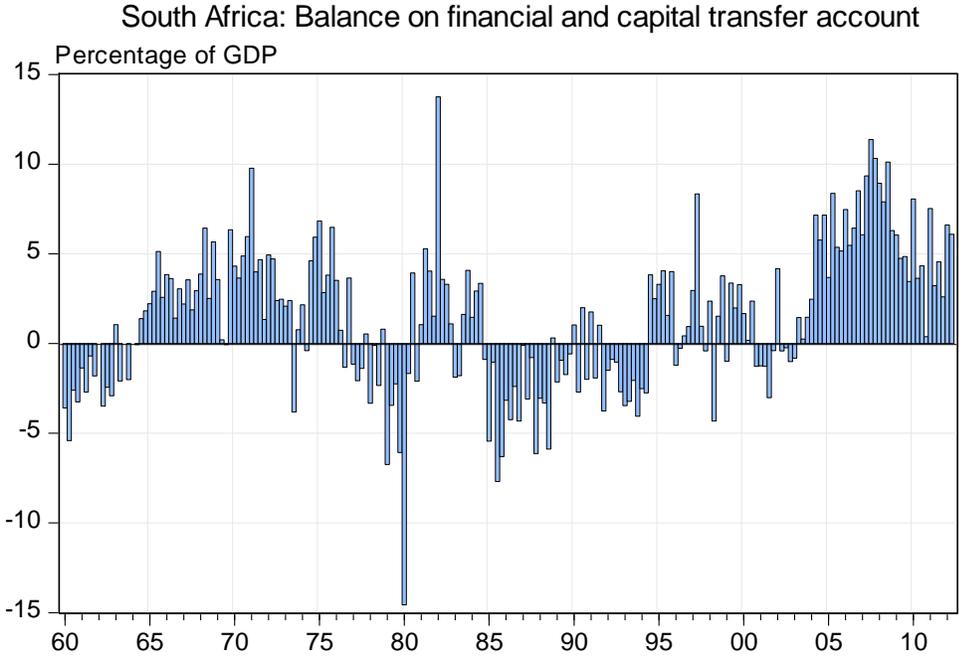
To help guard against excessive exchange rate volatility, the South African Reserve Bank worked down its initially large oversold forward position in foreign currency, and subsequently built up the country’s foreign currency reserves from precariously low levels earlier on. This is illustrated in the graph below. Greater robustness in this area supports confidence and long-term thinking among market participants, which is helpful in moderating exchange rate volatility.



A related issue is that of volatility in capital flows; the accusation is that the international monetary system fuels rather than counters such volatility. In this regard it must be noted that the world, once characterised by capital controls on the private sector and large-scale engagement by governments and public enterprises in cross-border borrowing and lending, has moved on. While public enterprises and governments are still active in international borrowing, the private sector’s role has escalated in most countries. Secondary markets have also evolved

and with it the options for portfolio investment available to international investors, and capital controls have been softened or removed. A decentralised, private-sector driven system of foreign investment cannot be expected to behave in an orchestrated way, in contrast to a system dominated by the public sector and capital controls.

In this regard South Africa’s experience has in recent years not been one of extreme short-term volatility in *overall* capital flows. Sizeable inflows have generally been recorded since 2004 and have been helpful, financing deficits on the current account. South Africa’s relatively low level of foreign debt, deep and liquid financial markets, and prudent monetary and fiscal policies contributed to these sizeable inflows. However, the mix of underlying components contributing to the aggregate net capital flow has been changing all the time, between direct, portfolio and other investment and between changes in foreign assets and in foreign liabilities. (As indicated before, in earlier years financial sanctions also had a considerable bearing on capital flows.) In order to deal with capital flows of which the composition switches frequently, it is helpful to have a strong banking system and a well-integrated set of financial markets so that funds can flow through the system efficiently without creating pockets of illiquidity. The South African banking sector and markets for bonds, shares, foreign currency developed over many decades, are liquid and facilitate the efficient flows of funds through the system.



This leads to a final point: successful currency internationalisation is facilitated by developing a range of reputable institutions, which may take considerable time and resources. The

reputation of the South African rand is supported by, *inter alia*, a solid legal system for settling disputes; an emphasis on transparency and good governance in the corporate sphere; high standards of accounting which are in conformity with international best practice; solid financial regulation and implementation of internationally agreed frameworks for supervision; a sound payment system which provides for real time gross settlement; and access to the Continuous Linked Settlement system. These building blocks come at a price and in some instances involve sacrificing at least some elements of national sovereignty or local flavour. On balance, however, it has been worthwhile to incur these costs, although a point has probably been reached where great caution should be exercised before adding further compliance costs to the financial system.

Challenges Posed by Membership of Regional Integration Arrangements, Blocks, Groupings and Forums

South Africa is a member of a number of regional integration arrangements. These include the Southern African Customs Union (SACU) with Botswana, Lesotho, Namibia and Swaziland; the Multilateral Monetary Area, also known as the Common Monetary Area (CMA), with Lesotho, Namibia and Swaziland; and the Southern African Development Community (SADC), consisting of fourteen African countries - twelve broadly south of the equator on the African continent, plus the nearby island countries, Mauritius and Seychelles.

In a discussion of the international monetary system attention should be paid to the CMA, being a currency union, and on SADC, being a potential currency union.

South Africa is the dominant economy in the CMA, responsible for approximately 95 per cent of the GDP in the region. In the CMA the South African rand is legal tender in all the participating countries, while Lesotho, Namibia and Swaziland also each has a national currency that trades at a one-to-one exchange rate with the rand. This arrangement forces the smaller economies to adopt short-term interest rates that are closely aligned with that of South Africa – they have very little freedom in monetary policy. At the same time they receive payments from the South African government, based on an agreed formula, to compensate them for the seigniorage which they sacrifice because of allowing rand to circulate as legal tender within their borders.

While this arrangement has worked well since the mid-1970s (and early 1990s in the case of Namibia), some of the smaller CMA economies have sometimes faced a challenge in maintaining the one-to-one exchange rate with the rand, notably when their government revenues suffered a setback in difficult economic times. This for instance recently happened

with the Great Recession which started in 2008, and resulted in a need for fiscal austerity measures which exacerbated the cyclical downturn in economic activity. In the absence of such austerity measures the individual country's foreign exchange reserves would be at risk of being depleted, leading to a forced devaluation of the currency. This could easily spiral out of control, since confidence in the one-to-one exchange rate with the rand and the stability which that brings is important in shaping economic decisions in the smaller CMA countries. Straining or breaking that confidence could lead to large outflows of deposits and investment funds more generally.

Accordingly South Africa, as the strongest economy in the currency block, has received requests for financial support from the country with the most fragile fiscal and foreign exchange reserve position. Dealing in a balanced way with such requests is of considerable importance to the success of a currency block, underlining the role of the core economy or economies in a regional integration arrangement. It also points at the need for fiscal and monetary integration to be considered simultaneously rather than each on its own; sometimes an appropriate fiscal transfer or smoothing mechanism may be crucial to ensuring the survival of the currency union. For instance, work on improving the SACU arrangements (in terms of which customs duties collected are distributed to the participating economies) is of considerable importance to the health of the CMA.

In the case of the CMA, the smaller participating countries all used rand as their only currency before introducing national currencies following their independence. This is quite different from the situation in SADC. In SADC the individual countries (with the exception of the CMA) all have own currencies and independent monetary policies. Yet SADC has an ambitious economic integration programme, including monetary integration. The process of monetary integration which is being pursued in SADC broadly resembles the monetary integration process which was used in the euro area: there are convergence targets for a number of macroeconomic variables, notably the inflation rate, ratio of the budget deficit to GDP, and ratio of public-sector debt to GDP, as well as the ratio of the balance on the current account of the balance of payments to GDP.

When SADC adopted the monetary integration programme in the early 2000s enthusiasm was high, as the strengthening of regional integration arrangements was high on the political agenda while the apparent success of the euro provided further inspiration. The monetary integration programme for SADC includes the meeting by SADC countries of a number of convergence targets from 2008 and of somewhat stricter targets from 2012, the establishment of a SADC central bank by 2016 and a single currency by 2018 (SADC 2003). However, the whole programme is currently being reviewed. The recent experience in the euro area has dampened

some of the appetite for monetary union. Many observers point out that in difficult times a monetary union that is not accompanied and supported by some form of fiscal union or fiscal federalism is at considerable risk. Furthermore, with considerable differences in economic structure, incomplete factor mobility and sometimes strongly divergent trends in the terms of trade in the various SADC economies, sacrificing an own exchange rate as an instrument of economic policy may, especially in difficult times, put too much strain on the economy and on other instruments of policy. The central bank governors of SADC have noted these considerations and are wary that a hastily concluded monetary union could in fact cause rather than dissolve frictions in the region. These observations are being taken into account in the current review of the SADC integration programme, and may at the minimum be expected to result in a sober reassessment of the target dates for monetary integration.

The implication of the above is that grand schemes towards monetary union should be treated with caution, and that the flexibility that an own currency and exchange rate offer should not be sacrificed lightly. In those instances where the weight of the evidence does indicate that monetary union would be beneficial, it seems essential to develop a joint framework for monetary and fiscal cooperation before launching the monetary union, rather than trying to do so afterwards when difficulties are encountered. Harmonising or unifying financial regulation and supervision would also be helpful in preventing later tensions and regulatory arbitrage.

Views Regarding the Adjustment Measures Related to the International Monetary System that Countries are Already Implementing

The dominance of the US dollar and to a lesser extent the euro in the international monetary system has already been outlined above in the section about key shortcomings of the system. Together they account for approximately 87 per cent of global reserves identified by currency, and adding sterling and the yen brings the cumulative total to 95 per cent.

With economic growth generally much stronger in the developing economies than in the mature economies, the developing countries' economic size and share in international trade and payments are expanding significantly. This suggests significant scope for a rebalancing of the leading currencies in the international monetary system. However, economies of scale are important in international finance and therefore size counts, not just growth rates.

The broad direction that China has embarked upon, to increase the international use of renminbi, should be welcomed. It is befitting to the size and importance of China in the global economy. For instance, China's share in global exports has progressed from 1,0 per cent in 1980

to 10,6 per cent in 2010, and its share in global imports from 1,0 per cent to 9,1 per cent over the same period (International Monetary Fund, 1981 & 2011).

If the initiative to increase the international use of the renminbi is taken to its logical conclusion, it would in time leave the world with an additional international reserve currency. Furthermore, that currency would be underpinned by an economy with a considerably stronger trend rate of growth than that of the traditional reserve currencies. Its business cycle would also, at times at least, be out of synchronisation with that of the USA, euro area and Japan, opening improved risk diversification possibilities to reserve managers and investors. Its interest rate levels would probably in nominal terms usually exceed that of the traditional reserve currencies, enhancing the range of return and risk options available to central banks' reserve managers and to international investors. From their perspective, therefore, that enhancement would constitute a significant positive development.

On the downside, lack of familiarity with the financial system and with administrative, accounting and compliance processes in China could be a challenge to investors from other countries. Appeals for simplification of or doing away with application processes could also be expected. In South Africa the authorities have found it productive to gradually free up the international use of the rand but to require reporting of all transactions in foreign currency. This is helpful for the protection of the tax base, for statistical purposes and analysis of the market in foreign currency, and for combating money laundering and other ills.

From China's perspective it should be noted that with a more liberalised currency, transaction flows are sometimes difficult to explain and even more so to predict. Moreover, sometimes they can be counterintuitive. For instance, in the recent past when fears of a worsening of financial problems in the major developed economies intensified, international investors often sold some of their assets in the emerging-market economies and transferred the proceeds to their home countries – described by some as a flight to familiarity rather than to safety. Accordingly, the emerging-market economies could perversely face outflows of capital and downward pressure on their own currencies' exchange rates when prospects for the developed economies dim.

In this regard it is of great value to have a large pool of foreign reserves – it helps to calm sentiment and reduce volatility in the market for foreign currency. While it comes at an opportunity cost and carries some risk, the strength of the reserve holdings of the Chinese authorities is an important positive in dealing with the unexpected shocks which may hit the balance of payments from time to time.

A final point to be made is that internationalisation and eventually reserve currency status are likely to bring about more international attention to and criticism and politicisation of the monetary and exchange rate policies of the country issuing the currency. In setting these policies, global currency issuers are therefore likely to experience pressure to afford global externalities a more significant weight, beyond the requirements of the domestic economy.

Preferences on Options for Orderly Adjustment of the International Monetary System

It seems sensible to continue to allow for variable geometry and diversity in the international monetary system, and not to try to force a one-size-fits-all dispensation on all countries. Since individual country circumstances still differ widely at this point, this flexibility has considerable benefits. It is immediately conceded that it also poses challenges.

Strengthening the role of the IMF and expanding the pool of Special Drawing Rights and lending facilities overseen by the Fund similarly seem sensible. The expansion of the IMF's surveillance activities to not only cover individual countries but also to provide multilateral surveillance reports similarly seems helpful.

In addition, greater robustness in times of economic and financial stress may be provided by strengthening support arrangements within regional economic communities and other multi-country formations, as well as through bilateral arrangements. For instance, agreements on swap lines, pooling of reserves and other support mechanisms could contribute to orderly adjustment in settings smaller than the full global village, with the costs and benefits being experienced more closely by the participating countries. However, with such arrangements the devil unfortunately is in the detail.

While a limited number of currencies only may continue to capture the limelight as reserve currencies, a number of processes are at work changing the landscape. Firstly, more currencies are in future likely to command the economies of scale and solidity of reputation to serve as generally recognised international reserve currencies. Relatively rapid growth, especially in the larger developing economies, stands to create the scale of economic and financial activity needed to underpin credible reserve currencies. While other dimensions, such as a track record of sound monetary and financial policies, financial maturity and political stability may in some instances be difficult to address fully in the short run, the universe of reserve currencies is likely to expand going forward.

Secondly, beyond the key reserve currencies a range of close substitute currencies is available with good liquidity characteristics and solid monetary and financial policies behind them. This

offers opportunities for increased returns and risk diversification, which may lead to some central banks holding part of their liquid international assets in this form. For instance, government bonds and bills of a significant number of countries beyond the traditional reserve currency issuers are of sufficient safety and liquidity to be included in central banks' reserve asset portfolios. "Quasi-reserves" may blur the boundary between foreign reserves and other foreign assets, in the same way that quasi-money augmented the traditional narrow monetary aggregates.

Thirdly, sovereign wealth funds have emerged as a further mechanism through which governments accumulate foreign assets. While sovereign wealth funds generally give higher priority to return and less to liquidity in their international asset portfolios when compared with central banks, the dividing lines are not sharp. In extraordinary circumstances governments could call on the sovereign wealth funds (which they own) to inject international liquidity into the financial system beyond what central banks would be able to do on their own.

South Africa's experience suggests that a system of multiple reserve currencies and quasi-reserve currencies, with associated international transactions, store of value and unit of account functions, is quite workable. Important uncertainties and tensions remain in such a system, but the development of liquid markets for forward foreign currency, providing hedging opportunities up to several years into the future, softens these concerns. Orderly conditions and adjustment in such a setting are also facilitated by a sound and transparent framework for monetary policy, and by adequate buffers in the background – such as an appropriate level of gold and foreign currency reserves and the availability of swap lines and other contingent facilities. By contrast, the straightjacket of fixed exchange rates (or, within currency blocks, no exchange rates) can raise rather than lower frictions and tensions between economies, not least in tough times and in countries where the terms of trade is subject to considerable changes.

If in this context some emerging-market currencies were to obtain reserve currency or quasi-reserve currency status, it would provide welcome opportunities for further diversification and risk/return enhancement as structural, business cycle, monetary policy and fiscal positions in these economies will differ from those in the traditional reserve currency economies.

It seems sensible to pursue a continued, voluntary role for precious metals such as gold and platinum in the international monetary system, as part of the stock of liquid international reserve assets held by authorities. The precious metals have the huge advantage in times of stress and conflict of, unlike paper money, being their holder's asset without being another party's liability. Their liquidity and usefulness in times of turmoil are important characteristics,

adding to the robustness of their holders' capacity to engage in international trade and finance, and supporting confidence in general. Accordingly, many countries could productively contemplate the inclusion of precious metals in their stock of reserves, or increasing the magnitude of their holdings. However, a return to the gold standard or some other precious metal standard with fixed parities for currencies would weaken rather than strengthen the international monetary system; the straightjacket of a fixed parity against a metal that is itself subject to changes in underlying supply and demand would be likely to raise frictions rather than to bring stability. History also suggests that a return to a precious metal-based monetary system would not be efficient.

Conclusion

In a world of strong reserve currency concentration, it seems sensible and desirable to add to the number of such currencies. While the central banks issuing the major reserve currencies are all currently facing subdued economic activity, both the trend and cyclical dimensions of economic activity in the new reserve currency issuers would be likely to differ from that of the mature economies. Diversification opportunities for foreign reserve managers would further benefit since major reserve currency issuers are all currently pursuing exceptionally loose monetary policies while issuers of alternative reserve currencies would be likely to have less extreme monetary policy settings – removed from the zero interest rate lower boundary. However, building up to acceptance of an emerging-market currency as an international reserve currency would require many hurdles to be successfully crossed. Adequate attention has to be paid to the creation of institutions that support confidence in the currency and facilitate its use in international transactions.

As argued above, a number of further currencies may come to the fore as quasi-reserve currencies, also fulfilling some international transactions, store of value and unit of account functions. These could soften the lines of demarcation between reserve and other currencies as some central banks diversify into alternative foreign assets that are considered adequately safe and liquid.

Regarding currency liberalisation and development of the foreign currency market, a policy of gradualism has been adopted by the South African authorities and seems to have worked satisfactorily. Sound monetary and fiscal policies and the development of appropriate institutions and mechanisms to support confidence in the rand and enhance its international tradability have also paid off.

Finally, it seems clear that grand schemes towards monetary union should be treated with great caution, mindful of the importance of an own currency and therefore monetary and exchange rate policy as adjustment tools. At the very least, the fiscal dimension of the creation of a monetary union or supranational currency should be thrashed out fully before embarking on such a route, and the importance of appropriate sequencing and timing should be recognised.

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Appendix

Exchange Control in South Africa: Historical Background and Overview

Exchange control in the form of the Emergency Finance Regulations was first introduced in South Africa at the outbreak of the Second World War in 1939. The Regulations were at first largely limited to transactions with non-sterling area countries but later included transactions with members of the sterling area as well.

The present control measures were introduced by way of the Exchange Control Regulations, as promulgated by Government Notice R1111 of 1 December 1961 and amended up to Government Notice No. R.885 in Government Gazette No. 20299 of 23 July 1999 and Orders and Rules 1961, as published in Government Notice R1112 of 1 December 1961 and amended up to Government Notice R.791 in Government Gazette No. 18970 of 5 June 1998, issued in terms of the Currency and Exchanges Act, 1933 (Act No. 9 of 1933).

A deterioration of the capital account of the balance of payments during 1961 induced the South African authorities to block the repatriation of the proceeds of non-resident owned securities. As a result a second exchange rate for the rand, being the price in foreign currency at which blocked balances were being traded between non-residents, was brought about. Direct transferability of such balances were allowed from 1976. A market in these blocked balances, known as securities rand, developed. The rate for the securities rand generally stood at a substantial discount to the official rate. The amount of the discount, after allowing for the investment currency premium in the United Kingdom, corresponded to the difference between the Johannesburg and London prices of South African securities listed on both stock exchanges.

In view of its concern about the disincentive for foreign investment which was inherent in the securities rand system the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa (De Kock Commission) in 1978 recommended that the securities rand system be broadened to include other assets and be replaced by the Financial Rand system for capital transactions while there would also be a Commercial Rand for ordinary current transactions. This recommendation was accepted with some qualifications. The Financial Rand system, like the blocked and securities rand systems before it, laid down the terms and conditions on which the rand proceeds of sales of assets owned by non-residents in South Africa could be reinvested or transferred to another non-resident. The sale of a South African asset by a non-resident to a resident yielded a rand balance designated Financial Rand. To exchange this balance for foreign currency, through the intermediation of the market, another non-resident, wishing to acquire Financial Rand, had to be found. This seller transferred his rand balance to the buyer, who in turn settled the purchase consideration in foreign currency. The transaction therefore did not directly influence South Africa's foreign exchange reserves. Under the new system non-residents could freely purchase quoted stocks and shares on the JSE

Securities Exchange South Africa while other investments through that medium required the prior approval of the Exchange Control Department. The exchange rate for the Financial Rand was determined by supply and demand in the Financial Rand market and was normally well below the exchange rate of the so-called Commercial Rand.

The De Kock Commission regarded the Financial Rand system as an interim stage and a further step towards the longer-term objective of a market determined unitary exchange rate of the rand with limited exchange controls over residents only. From 7 February 1983 exchange controls over non-residents were abolished. This implied the disappearance of the Financial Rand and the dual exchange rate system. Steps were also taken to relax, simplify and "streamline" the exchange control regulations relating to residents, in accordance with the De Kock Commission's recommendations.

During July-August 1985 political developments and foreign reactions thereto, coupled with the withdrawal or non-renewal of credit lines extended by a number of foreign banks to South African banks or their clients, caused severe downward pressure on the exchange rate of the rand. As a result the Government announced the closure of the foreign exchange market and the JSE Securities Exchange South Africa from 28 August to 1 September 1985. This step was followed by the introduction of a four-month standstill period for most foreign debt repayments. Alongside the existing controls over current payments the Financial Rand system was reintroduced with effect from 2 September 1985. The reintroduction of the Financial Rand system meant that, as before, the local sale or redemption proceeds of non-resident owned South African assets could not be converted into foreign currency at the Commercial Rand rate of exchange but had to be retained in South Africa with Authorised Dealers in foreign exchange in the form of Financial Rand balances. Such balances were, however, transferable between non-residents and eligible for reinvestment in South African quoted securities and other investments as approved by the authorities.

South African residents who had to meet foreign debt repayment obligations were generally required to pay the amounts concerned in foreign currency into so-called special restricted foreign currency accounts maintained with an Authorised Dealer in foreign exchange. The bank concerned was then required to make a corresponding deposit in foreign currency with the South African Reserve Bank.

A series of consultations between South African representatives and major foreign creditor banks were held for clarifying technical aspects of the debt moratorium and for preparing its eventual replacement with arrangements for the orderly repayment of foreign debt. This resulted, inter alia, in a partial restructuring of South Africa's foreign debt and culminated in the conclusion in 1994, of the final debt arrangements negotiated between the Republic and the

major creditor banks, the implementation of which resulted in the amount of affected foreign indebtedness being reduced to zero as of 15 August 2001.

As a step along the indicated path of gradually abolishing exchange control, all such controls over non-residents were abolished by the termination on 13 March 1995 of the dual exchange rate system resulting in the disappearance of the Financial Rand. In terms hereof, the local sale proceeds of non-resident owned South African assets are regarded as freely transferable from the Republic.

In accordance with the principle of relaxing exchange controls permission was granted, in June 1995, to South African institutional investors (long term insurers, pension funds and unit trusts) to exchange through approved asset swap transactions part of their South African portfolio for foreign securities. At first a limit to enter into asset swaps by institutional investors of 5% of total assets was applied and in June 1996, this was raised to 10% of total assets. At the same time they were permitted to transfer abroad 3% of their net inflow of funds generated during the 1995 calendar year within the overall limit of 10% of total assets. In March 1997 this latter concession of 3% was extended to the net inflow of funds during 1996 and the institutions that qualify for asset swaps were broadened to include regulated fund managers registered with the Financial Services Board. The 10% limit applied to each individual unit trust was dispensed with and the unit trust management company itself could apply to acquire foreign portfolio investment by way of asset swaps for up to 10% of total assets under management.

With effect from 1 July 1997, portfolio managers that were registered with the Financial Services Board as well as stockbroking firms which were members either of the JSE Limited, the Bond Exchange of South Africa or the South African Futures Exchange and had approval to offer private client asset management services by the Committee/Executive Committee of the Exchange concerned could also apply to acquire foreign portfolio investments by way of asset swaps for up to 10% of the total assets under their management. Qualifying institutional investors could, in addition to the 3% foreign currency transfers referred to above, also apply to the then Exchange Control Department to avail of foreign currency transfers in 1997 of up to 2% of the net inflow of funds during the 1996 calendar year, to be invested on registered stock exchanges in any SADC member country. This dispensation was also subject to the overall limit of 10% of total assets applicable to asset swaps.

In March 1998 the overall limit of 10% was increased to 15% and the 3% pertaining to the foreign currency transfers was increased to 5% based on the net inflow of funds during the 1997 calendar year. Simultaneously the 2% pertaining to SADC countries was increased to 10%.

In February 1999 the respective limits of 5% and 10% pertaining to foreign currency transfers within the overall limit of 15% of South African assets was extended and long term insurers,

pension funds and unit trusts through unit trust management companies could effect foreign currency transfers during 1999 based on the net inflow of funds during the 1998 calendar year.

With effect from 23 February 2000 unit trusts through unit trust management companies could acquire portfolio investments up to 20% of their total assets under management whilst the limits of 15% of total assets for long term insurers and pension funds and 15% of total assets under management for fund managers were retained. The definition of assets applicable to pension funds, long term insurers and fund managers changed from total assets employed in South Africa to total assets or total assets under management.

In addition, long term insurers, pension funds and unit trusts through unit trust management companies could effect foreign currency transfers in 2000 of up to 10% of the net inflow of funds during the 1999 calendar year, subject to the overall limits of 15% and 20% of their total assets applicable to asset swaps.

It was decided to dispense with the asset swap mechanism as from 21 February 2001.

The cash flow dispensation to institutional investors in terms of which foreign exchange could be transferred from South Africa to acquire foreign portfolio investments, based as a percentage of the net inflow of funds during the previous calendar year, subject to the overall limits on institutional foreign asset holdings of 15% and 20% respectively, expired at the end of 2001 and was not renewed.

From 31 July 2003, as an interim step towards prudential regulation, the exchange control limit on foreign portfolio investment by institutional investors has been applied to an institution's total retail assets. The foreign exposure of retail assets may not have exceeded 15% in the case of retirement funds, long-term insurers and investment managers registered as institutional investors for exchange control purposes, and 20 % in the case of collective investment scheme management companies.

On 25 October 2005 the foreign exposure limit on collective investment schemes was increased from 20 per cent to 25 per cent of total retail assets, and for investment managers from 15 per cent to 25 per cent of total retail assets. This enabled South African residents to diversify their investment portfolios through domestic channels and enhanced the role of South African fund managers in facilitating the flow of funds to the continent.

From 10 February 2006 Institutional investors were, on application, allowed to invest an additional 5% of their total retail assets by acquiring foreign currency denominated portfolio assets in Africa through foreign currency transfers from South Africa or by acquiring inward listed securities.

On 20 February 2008 the pre-application process was removed and replaced with a system of quarterly reporting and monitoring of foreign exposures by the then Exchange Control Department.

A clear distinction between the underwritten policies and investment-linked business of long-term insurers was introduced. The exchange control limit on foreign portfolio investment by retirement funds and the underwritten policy business of long-term insurers was increased from 15% to 20% of total retail assets.

Similarly, the foreign exposure limit on portfolio investment by investment managers registered as institutional investors for exchange control purposes, collective investment scheme management companies and the investment-linked business of long-term insurers was increased to 30% of total retail assets under management.

The dispensation available to institutional investors to invest an additional allowance equal to 5% of total retail assets into portfolio investment in Africa remained in place.

With effect from 14 December 2010, the foreign exposure of retail assets was increased to 25% in the case of retirement funds and the underwritten policy business of long-term insurers. Investment managers registered as institutional investors for exchange control purposes, collective investment scheme management companies and the investment-linked business of long-term insurers was increased to 35% of total retail assets under management.

With effect from 1 March 2010, Authorised Dealers were able to acquire direct and indirect foreign exposure up to a macro-prudential limit of 25% of their total liabilities, excluding total shareholder's equity.

In March 1997, the Minister of Finance announced that from 1997-07-01 individuals would be allowed to invest a limited amount of their savings in any manner abroad and in fixed property in SADC countries. Alternatively, they would be allowed to hold foreign currency deposits with South African Authorised Dealers in foreign exchange or with foreign banks outside South Africa within a defined limit. The abolition of quantitative limits for current account transactions, with the exception of travel allowances and a few minor other discretionary transactions, was also announced.

Private individuals resident in South Africa who are taxpayers in good standing and over the age of eighteen years, would be allowed to invest up to R 200 000 abroad. This amount was

increased to R 400 000 in March 1998 and to R500 000 during February 1999. During February 2000 it was further increased to R750 000 on 15 February 2006 the amount was increased to R2 million. On 27 October 2009 the foreign capital allowance increased to R4 million. On 5 November 2010 the foreign capital allowance of a once off limit of R4 million was replaced with an annual limit of R 4 million.

On 20 February 2008, in order to streamline the administrative controls on individuals a single discretionary allowance of R500 000 per individual per calendar year, for purposes of travel, study allowance, gifts, donations and maintenance was introduced. This discretionary allowance is in addition to the existing R2 million individual foreign capital allowance. On 27 October 2009 the single discretionary allowance increased to R750 000 per individual per calendar year. On 5 November 2010 the single discretionary allowance was increased to R1 million per individual, per calendar year.

Furthermore, with effect from 5 November 2010, the 10% exit levy in respect of liquid and/or the export of quoted securities of emigrants' blocked assets was withdrawn.

As far as South African corporates investing abroad were concerned the amount that could be remitted from South Africa was increased from R 20 million to R 30 million per new investment and to R 50 million in respect of new investments in SADC countries in 1997. In March 1998 these amounts were increased to R 50 million and R 250 million, respectively.

From 23 February 2000 corporates were, on application, allowed to use part of their local cash holdings to finance up to 10% of approved new foreign investments where the cost of these investments exceeded the current limits. In addition to the foregoing corporates who wanted to invest abroad could also apply for permission to make use of corporate asset/share swaps to finance these investments. Furthermore, South African corporates could utilise part of their local cash holdings to repay up to 10% of outstanding foreign debt raised to finance foreign investments, provided the foreign debt has been in existence for the minimum period of two years.

The amounts of R50 million and R250 million referred to above were, on 21 February 2001, increased to R500 million and R750 million, respectively. The latter amount not only applied to investments in the SADC but also to investments anywhere in Africa.

On 29 October 2002 the existing limit of R750 million per investment into Africa (including SADC) was increased to R2 billion per new investment. And on 26 February 2003 the R500 million for investment into countries outside Africa was increased to R1 billion per new investment. In addition, dividends repatriated from abroad by South African corporates were

eligible for an exchange control credit, which could, on application, be retransferred abroad for the financing of new approved foreign direct investments or new approved expansions.

With effect from 26 October 2004 the exchange control limits applicable to new approved foreign direct investments by South African corporates were abolished. South African corporates were allowed to retain foreign dividends declared after this date abroad. Foreign dividends repatriated to South Africa after 26 October 2004 may be transferred offshore again at any time for any purpose.

On 21 February 2007 the Minister announced that the exchange control requirement that South African companies must obtain a majority (i.e. 50% plus 1) shareholding in foreign entities and/or projects outside of Africa was replaced with a requirement that a shareholding of at least 25% is obtained.

On 20 February 2008, the application process to make new outward foreign direct investments where the total cost of such new investments does not exceed R50 million per company per calendar year, was withdrawn. The requirement for South African companies to obtain a significant equity interest in investments outside the Common Monetary Area of at least 25%, was replaced with the requirement that at least 10% of the foreign target entity's voting rights must be acquired. Where the total cost of foreign direct investment exceeded R50 million per company per calendar year, an application had to be submitted to the then Exchange Control Department prior to the investment being made.

On 27 October 2009 the R50 million limit was increased to R500 million. Applications below R500 million could be processed by Authorised Dealers, subject to all existing criteria and reporting obligations. The 180-day rule requiring companies to convert their foreign exchange, held in a C.F.C account, into Rand was removed.

To further enable South African companies, trusts, partnerships and banks to manage their foreign exposure, they are be permitted to participate without restriction in the rand futures market on the JSE Limited. This dispensation was also extended to investment in inward-listed (foreign) instruments on the JSE Limited and the Bond Exchange of South Africa.

On 17 February 2010 the Minister announced that private equity funds that are members of the South African Venture Capital Association, mandated to invest into Africa, could apply to the former Exchange Control Department for an annual approval to invest into Africa, subject to certain conditions.

The Minister also announced on 20 February 2008 that the name of the Exchange Control Department would change to the Financial Surveillance Department. The name change was, however, only implemented on 2 August 2010.

On 25 January 2011, it was announced that international headquarter companies who meet prescribed shareholding and asset criteria may register for approval with the Financial Surveillance Department to invest offshore without restriction.

On 29 August 2011 the Form F178 was withdrawn resulting in various amendments to the Exchange Control Rulings.

From 25 October 2011, South African companies are permitted to make bona fide new outward foreign direct investments outside their current line of business. Authorised Dealers may, in terms of the current dispensation for investments not exceeding R 500 million per applicant company per calendar year, also authorise requests by South African companies to make bona fide new outward foreign direct investments outside the current line of business of the applicant company. The Financial Surveillance Department will also consider requests by South African companies to make investments, excluding passive investments, in excess of R 500 million per applicant company per calendar year where such investment fall outside the current line of business of the applicant company. In addition, the prohibition of the transfer of additional working capital funding in respect of investments below R500 million per applicant company per calendar year is withdrawn.

South African companies are now permitted to acquire 10 to 20 per cent equity and/or voting rights, whichever is the higher, in a foreign target entity, which may hold investments and/or make loans into any CMA country. This dispensation does not apply to foreign direct investment where the South African company holds an equity interest and/or voting rights in excess of 20 per cent.

Source: South African Reserve Bank, Financial Surveillance Department, October 2012

Exchange Control in South Africa: Chronology of Exchange Control Reforms

1. SA Resident Private Individuals: Foreign Capital Allowance (How Much a Person Can Invest Abroad)

Date	Amount
1997-07-01	R200 000 - once off/lifetime
1998-03-11	R400 000 - once off/lifetime
1999-02-23	R500 000 - once off/lifetime
2000-02-23	R750 000 - once off/lifetime
2006-02-15	R2 000 000 - once off/lifetime
2009-10-27	R4 000 000 - once off/lifetime
2010-11-05	R4 000 000 - per calendar year. Requests to transfer funds in excess of this limit must be referred to the Financial Surveillance Department of the South African Reserve Bank.

2. Travel Allowance (Amount Per Person Per Year for Foreign Travel)

Date	Amount
1994-08-24	R 23 000 Adult R 11 500 Child
1996-06-24	R 60 000 Adult R 20 000 Child
1997-03-13	R 80 000 Adult R 25 000 Child
1998-03-11	R100 000 Adult R 30 000 Child

Date	Amount
1999-02-23	R120 000 Adult R 35 000 Child
2000-02-23	R130 000 Adult R 40 000 Child
2001-02-21	R140 000 Adult R 45 000 Child
2003-02-26	R160 000 Adult R 50 000 Child
2008-02-20	Within the R500 000 discretionary allowance, i.e. donations, maintenance transfers, monetary gifts and loans, travel allowance, study allowance, per individual per calendar year R160 000 for residents under the age of 18 years

Travel Allowance (Cont.)

Date	Amount
2009-10-27	Within the R750 000 discretionary allowance per calendar year R160 000 for residents under the age of 18 years
2010-11-05	Within the R1 million discretionary allowance per calendar year, including wedding expenses and foreign capital allowance for individuals. R200 000 for residents under the

	age of 18 years
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3. Income Earned Abroad by SA Private Individuals

Private individuals (natural persons) are allowed to retain income accruing to them from foreign sources after 1997-07-01, abroad. (Previously it had to be repatriated.)

4. Foreign Capital Allowance for Residents Emigrating from South Africa

Date	Amount
1979-06-21	R100 000 through Financial Rand
1990-05-25 - Family unit Single persons	From R100 000 to R200 000 From R50 000 to R100 000
1996-06-21 - Family unit Single persons	From R200 000 to R250 000 From R100 000 to R125 000
1997-11-19 - Family unit Single persons	From R250 000 to R400 000 From R125 000 to R200 000
2003-03-26 - Family unit Single persons	From R400 000 to R1.5 million From R200 000 to R750 000
2006-02-15 - Family unit Single persons	From R1.5 million to R4 million From R750 000 to R2 million On application could exit additional funds in excess of above limits, subject to payment of 10% exit levy (effective from 2003-02-26)

2009-10-27 - Family unit Single persons	From R4 million to R8 million From R2 million to R4 million
2010-11-05 - Family unit Single person	R8 million per calendar year R4 million per calendar year 10 per cent exit levy abolished.

5. Asset Swaps

Date	Institutions	Limit	Additional Foreign Portfolio Investments by way of Cash Transfers
1995-07-14	Institutional investors, i.e. long term insurers, pension funds and unit trusts.	5% of their total South African assets.	
1996-06-21		10% of their total South African assets.	Up to 3% of net inflow of funds during 1995 to be invested elsewhere in the world, subject to overall limit of 10%.
1997-03-13		10% of their total South African assets.	Up to 3% of net inflow of funds during 1996 to be invested elsewhere in the world plus up to 2% of net inflow of funds during 1996 to be invested on registered stock exchanges in any SADC member country, subject to

			overall limit of 10%.
1997-07-01	Definition of qualifying institutions now includes portfolio managers that are registered with the Financial Services Board (FSB) and stockbroking firms which are members of either Johannesburg Stock Exchange (JSE), South African Futures Exchange (SAFEX) or Bond Exchange of SA and have approval to offer private clients asset management services.	10% of their total South African assets.	

Asset Swaps (Cont.)

Date	Institutions	Limit	Additional Foreign Portfolio Investments by way of Cash Transfers
1998-03-11	Institutional investors, i.e. long term insurers, pension funds, unit trusts through unit trust management companies and fund	15% of their total South African assets.	Up to 5% of their net inflow of funds during 1997 to be invested elsewhere in the world, plus up to 10% of net inflow of funds during 1997 to be invested

	managers.		on registered stock exchanges in any SADC member country, subject to overall limit of 15%.
1999-02-23		15% of their total South African assets.	Up to 5% of their net inflow of funds during 1998 to be invested elsewhere in the world, plus up to 10% of net inflow of funds during 1998 to be invested on registered stock exchanges in any SADC member country, subject to overall limit of 15%.
2000-02-23	Long term insurers and pension funds. Fund managers. Unit trusts through unit trust management companies.	15% of their total assets. 15 % of their total assets under management. 20% of their total assets under management.	Up to 10% of their net inflow of funds during 1999 to acquire foreign portfolio investments in SADC and elsewhere, subject to overall respective limits of 15% and 20%.
Asset swap mechanism was terminated with effect from 2001-02-21			

6. Foreign Direct Investment Limits for Corporates

Date	SADC	Other Countries Outside the Common Monetary Area
1996-06-21	R20 million	
1997-03-13	R50 million	R30 million
1998-03-11	R250 million	R50 million
<p>Since 2000-02-23 corporates were allowed to transfer additional funds from South Africa of up to 10% of the excess cost in instances where the total cost of the investment exceeds the above limits of R250 million (SADC) and R50 million (Other countries) respectively.</p>		
2001-02-21	R250 million	R50 million
2002-10-29	R2 billion (SADC & Africa)	R500 million
2003-02-26	R2 billion (SADC & Africa)	R1 billion
<p>2004-10-26</p> <p>Limits on foreign direct investment were abolished. However, the approval process continued to apply.</p>	<p>SA companies were required to acquire a majority shareholding of 33.3% in foreign entities within SADC and/or Africa.</p>	<p>SA companies were required to acquire a majority shareholding in foreign entities and/or projects outside of Africa (i.e. 50% + 1).</p>
2006-02-15	<p>SA companies were required to obtain a significant interest of at least 25% in foreign entities</p>	
2008-02-20	<p>The pre-approval process for foreign direct investment was removed for transactions totalling less than R50 million per company per year. Authorised Dealers (banks) will administer the directives and guidelines on these types of investments. The exchange control requirement that a shareholding of at least 25% is obtained was replaced with the requirement that at least 10% of the foreign target entity's voting rights must be acquired.</p> <p>Where the total cost of foreign direct investment exceeds R50 million per company per calendar year, an application must be</p>	

	submitted to Exchange Control Department prior to the investment being made.
2009-10-27	<p>The pre-approval process for foreign direct investment was removed for transactions totalling less than R500 million per company per year. Authorised Dealers (banks) will administer the directives and guidelines on these types of investments.</p> <p>Where the total cost of foreign direct investment exceeds R500 million per company per calendar year, an application must be submitted to Exchange Control Department prior to the investment being made.</p>
2011-10-25	<p>Approval may also be granted to South African companies to make bona fide new outward foreign direct investments outside the current line of business of the applicant company.</p> <p>The transfer of additional working capital and/or funding to enable the South African company to increase their approved equity interest and/or voting rights in a specific foreign target entity is now also permitted. The transfer of such additional funding is subject to the provision that the additional funding is authorised within the same calendar year in which the original investment was approved and that it will not result on the overall limit of R500 million per applicant company per calendar year being exceeded.</p> <p>South African companies are now permitted to acquire from 10 to 20 per cent equity and/or voting rights, whichever is the higher, in a foreign target entity, which may hold investments and/or make loans into any CMA country. This dispensation applies to all countries outside the Common Monetary Area.</p>

7. Tax Clearance Certificate

Date	Purpose
1987-10-09 (C.206)	Required for emigrants to externalise funds
1997-07-01 (D.120)	Required for foreign investment by SA individuals

	to externalise funds
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The name of the Exchange Control Department was changed to the Financial Surveillance Department on 2010-08-02.

Authorised Dealers are allowed to submit applications to the Financial Surveillance Department of the South African Reserve Bank with regard to exchange control allowances that are not stipulated above as well as requests in excess of the limits.

Source: South African Reserve Bank, Financial Surveillance Department.

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