THE BRICS AND ASIA, CURRENCY INTERNATIONALIZATION AND INTERNATIONAL MONETARY REFORM

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Challenges of the International Monetary System and Response Options: A South African Perspective

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ABOUT THE PROJECT AND PAPER SERIES

The BRICS and Asia, Currency Internationalization and International Monetary Reform

The disjuncture between global markets and an international monetary system (IMS) based on national currencies generates instability for global trade and finance. As the BRICS (Brazil, the Russian Federation, India, the People's Republic of China [PRC], and South Africa) and Asian countries have become more integrated into the world economy, their governments have become increasingly aware of fundamental problems or challenges in the current IMS.

In December 2012, the Asian Development Bank (ADB), The Centre for International Governance Innovation (CIGI) and the Hong Kong Institute for Monetary Research (HKIMR) co-hosted a conference in Hong Kong, China. The conference examined: a range of views on the fundamental systemic problems that are a catalyst for international monetary reforms; views from the BRICS and Asian countries, as well as regional considerations regarding the measures that key countries are already taking to respond to the challenges of the IMS, including currency internationalization; and options and preferences for orderly adjustment of the IMS.

The 10 papers in this series, authored by esteemed academic and policy experts, were presented at the conference in Hong Kong, China and were subsequently revised. These working papers are being published simultaneously by all three partners.

ABOUT THE AUTHOR

Johan van den Heever is head of Economic Reviews and Statistics, Research Department, South African Reserve Bank.

ACRONYMS

ADB	Asian Development Bank
BRICS	Brazil, the Russian Federation, India, the People's Republic of China and South Africa
CFA	*coopération financière en Afrique centrale*
CMA	Common Monetary Union
CIGI	The Centre for International Governance Innovation
FSB	Financial Stability Board
G20	Group of Twenty
HKIMR	Hong Kong Institute for Monetary Research
IMF	International Monetary Fund
IMS	international monetary system
JSE	Johannesburg Stock Exchange
PRC	People's Republic of China
SACU	Southern African Customs Union
SADC	Southern African Development Community

INTRODUCTION

For the purposes of this paper, the international monetary system (IMS) 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 — for instance, Eichengreen (2008) and Lin, Fardoust and 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 financial crisis, that this system be thoroughly and critically scrutinized. 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 that could best serve the world. In particular, aspects of South Africa's experience with exchange rate reform, currency internationalization and monetary integration are highlighted in an attempt to extract elements that may be of relevance to reform the IMS.[1]

The first section of the paper identifies a handful of shortcomings of the IMS. Thereafter, the broader — mainly structural — weaknesses of the international financial system are briefly touched on, followed by 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.

The focus then turns to the South African experience: facts about South Africa's recent participation in, and integration into, the international monetary and financial system are outlined, and, more specifically, the country's experience with reform of the foreign exchange dispensation and currency internationalization is explored. 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 IMS. This is followed by brief concluding remarks. To illustrate the approach of gradualism adopted by the South African authorities

1 There are further related issues of equal importance that are not covered in this paper, or are touched upon only in passing, such as the strengthening of the global financial architecture, and the regulatory and governance dimensions thereof.

in the process of currency liberalization, details of this process are provided in the Appendix.

KEY SHORTCOMINGS OF THE CURRENT INTERNATIONAL MONETARY SYSTEM

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

Dominance of a Handful of Currencies

The US dollar remains — by far — the most important single currency in the IMS. For instance, data from the International Monetary Fund (IMF) 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 percent (IMF, 2012). That of the euro came to 25 percent, with the pound sterling and yen both at approximately four percent. 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 percent in the total. Still, network externalities seem to underpin the persistence of dominant currencies in the IMS, with low liquidity premia, economic size and share in international trade, and payments playing an important part in a currency's standing (Lin, Fardoust and Rosenblatt, 2012: 16).

A Constituent Monetary Union That Has Not Yet Stabilized

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 that 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 is 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 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: examples are the Central African *coopération financière en Afrique centrale* (CFA) franc, used by six countries, and the West African CFA franc, used by eight countries, both of which are backed by the French treasury and pegged to the euro.

Currency Volatility

Related to the previous points is the issue of currency volatility. While exchange rate flexibility provides an important adjustment mechanism that 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 thorough scrutiny of the broader financial system weaknesses extends beyond the scope of the present analysis, the IMS 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. Toward the end of 2008, the Group of Twenty (G20) recognized the most important weaknesses of the international financial system, agreed on principles for reform and adopted an

Action Plan to Implement Principles for Reform (G20, 2008). This action plan, reflecting the weaknesses to be addressed, revolves around:

- strengthening transparency and accountability;
- enhancing sound regulation;
- promoting integrity in financial markets;
- reinforcing international cooperation; and
- reforming international financial institutions.

These areas clearly merit prioritization and careful attention. It is not the intention of the present analysis to detract from any of them. It should be recognized, however, 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 judgment 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 being paid to potential ripple effects transmitted to other economies. However, a sound framework can moderate such risk significantly.

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

Recognizing 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 counter-cyclical policy. Much of the counter-cyclical action was brought about by the automatic stabilizers built into the tax system and government expenditure programs — these programs 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 measures have been accompanied by voter dissatisfaction and, in some cases, the 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 United States, policy makers have 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 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. White also expresses doubt about 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 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 the inflow of foreign investment may, in principle, be welcome for capital-scarce developing economies, 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 the future, the ultra-low interest rates normalize.

A further noteworthy complication of ultra-low interest rates in the developed economies is the low rate of return on foreign exchange reserve holdings. In recent years, many developing countries have 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 that are acceptable as international reserve holdings.

SOUTH AFRICA'S EXPERIENCE WITH EXCHANGE RATE REFORM AND CURRENCY INTERNATIONALIZATION

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

Since its democratic elections in April 1994, South Africa has been welcomed back into the international fold, and has used 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 organizations, such as the United Nations and the Bretton Woods institutions, was normalized in the early 1990s. In Southern Africa, South Africa joined the Southern African Development Community (SADC), a regional community of nations committed to development. An important part of SADC's earlier agenda was standing up to South Africa; however, currently the focus is less political, with regional economic development and integration at the centre. Later, South Africa became a G20 member, and most recently also joined Brazil, the Russian Federation, India and the People's Republic of China (PRC) in the BRICS (Brazil, the Russian Federation, India, the PRC, South Africa) grouping.

With the opening of political channels, protectionism was reduced in order to expand South Africa's international trade. Import duties were lowered considerably, and in the process, the anti-export bias which had previously plagued the economy was addressed. Exports have risen from 22.1 percent of GDP in 1994 to 28.8 percent in 2011; similarly, imports have increased from 19.9 percent of GDP in 1994 to 29.4 percent in 2011 (South African Reserve Bank, 2012: S-146). While these structural increases are generally to be welcomed, they signify a more important role for the international business cycle in determining 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 percent of annual GDP in 1994 to 93 percent in 2010. Over the same period, foreign assets have increased from 20 percent of GDP to 76 percent (South African Reserve Bank, 2012: S-86, S-87). 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 internationalization, the evolution of the South African foreign currency market is well covered in the literature, so only a summary will be provided here. Following the demise of the Bretton Woods exchange rate system in the early 1970s, South Africa experimented with a number of alternatives (for example, fixing the exchange rate of the rand against various currencies and, in between, 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.

Mindful of the abuses that a parallel exchange rate brings and of the need to accept market discipline, the intention from the late 1970s was to move to a single, flexible and market-driven exchange rate of the rand. The gold price bonanza of 1979 to 1981, which strengthened South Africa's overall balance of payments position, facilitated the process. This made it easier to discontinue the direct permit controls over imports from 1980, and, instead, to 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 liberalization 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 the 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 one percent per annum during the 1980s.

Over time, the foreign debt under the debt standstill arrangement was gradually worked down and eventually fully repaid. Negotiations toward 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 normalized. This made it possible for South Africa once again to 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 since 1995, with the exception of two years.

The absence of sanctions also facilitated a resumption of the process of foreign currency liberalization. As indicated by the South African authorities in the mid-1990s, shortly after the democratic government came to power, their approach to currency liberalization would be one of gradualism. The major controls over non-residents were lifted in 1995, leading again to the abolition of the parallel "financial rand" exchange rate. Over the ensuing 18 years, controls over residents have been gradually relaxed, but not abandoned. However, the focus has moved to the 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 except 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).[2]

Up to mid-1998, the South African authorities actively intervened from time to time 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 1997–1998 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 dampen 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 dollars, and later to build the official reserves of the country to a more comfortable level. Naturally, while 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.

2 A chronology providing further detail of the gradual liberalization of exchange control in South Africa is provided in the Appendix .

Figure 1: Real Effective Exchange Rate of the Rand

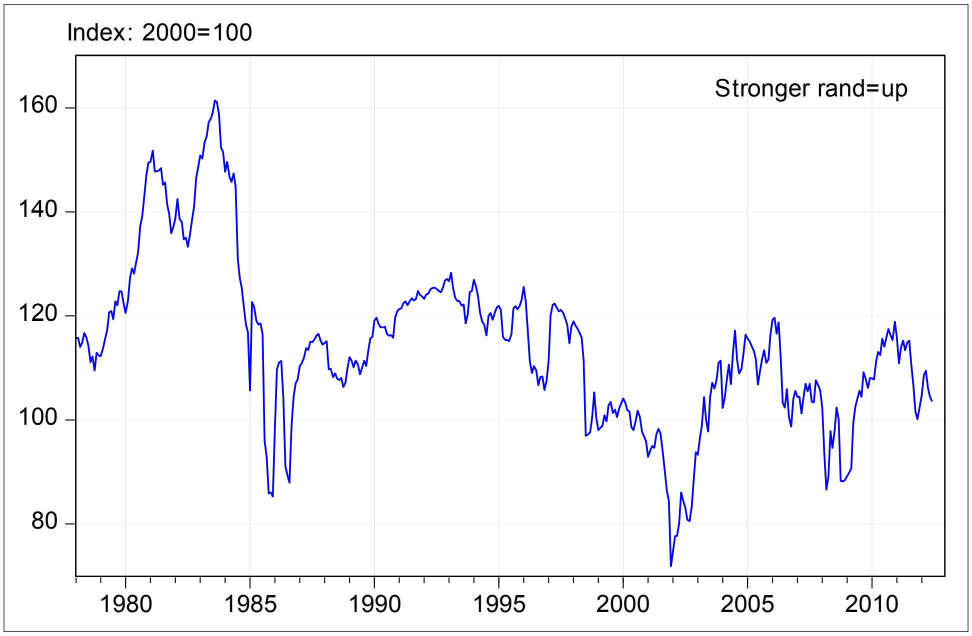


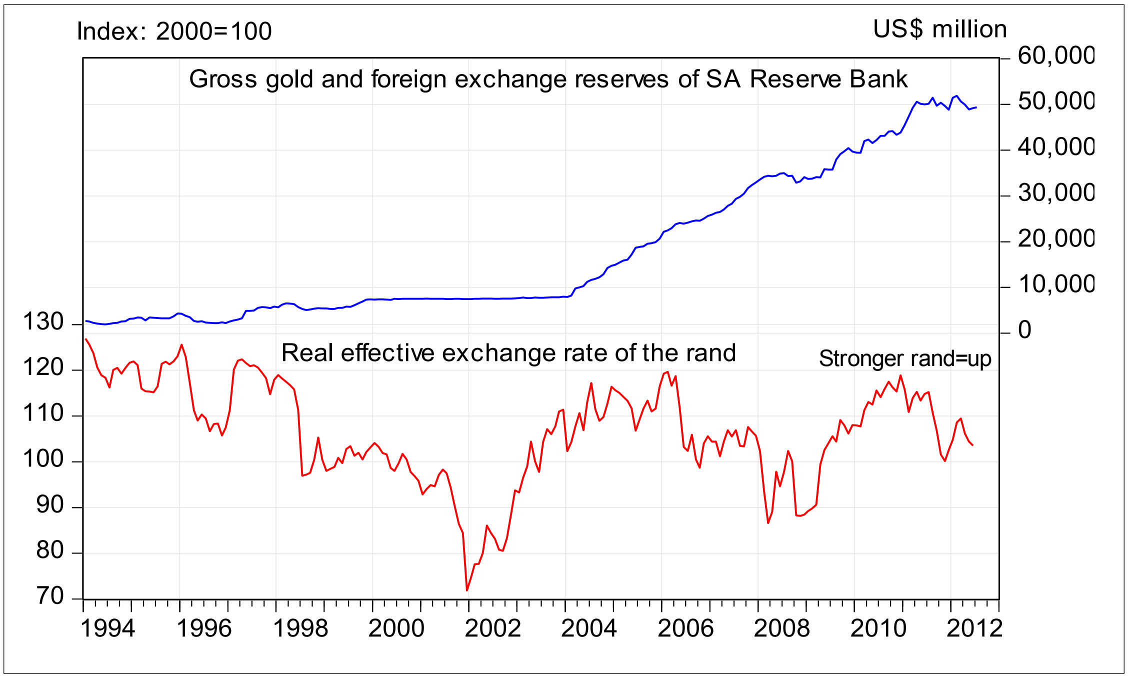
Figure 1 shows the evolution of the real effective exchange rate of the rand since the late 1970s. While the abnormally high gold price, high import duties and exchange controls contributed to a very strong rand in the early 1980s, sanctions, a debt standstill and the less favourable prices of gold and 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, which was brought about by a combination of factors. These factors, the topic of an official commission of inquiry 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 was held that the rand presented a 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 (at 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 Figure 2. Greater robustness in this area supports confidence and long-term thinking among market participants, which is helpful in moderating exchange rate volatility.

Figure 2: Gross Reserves and Real Effective Exchange Rate

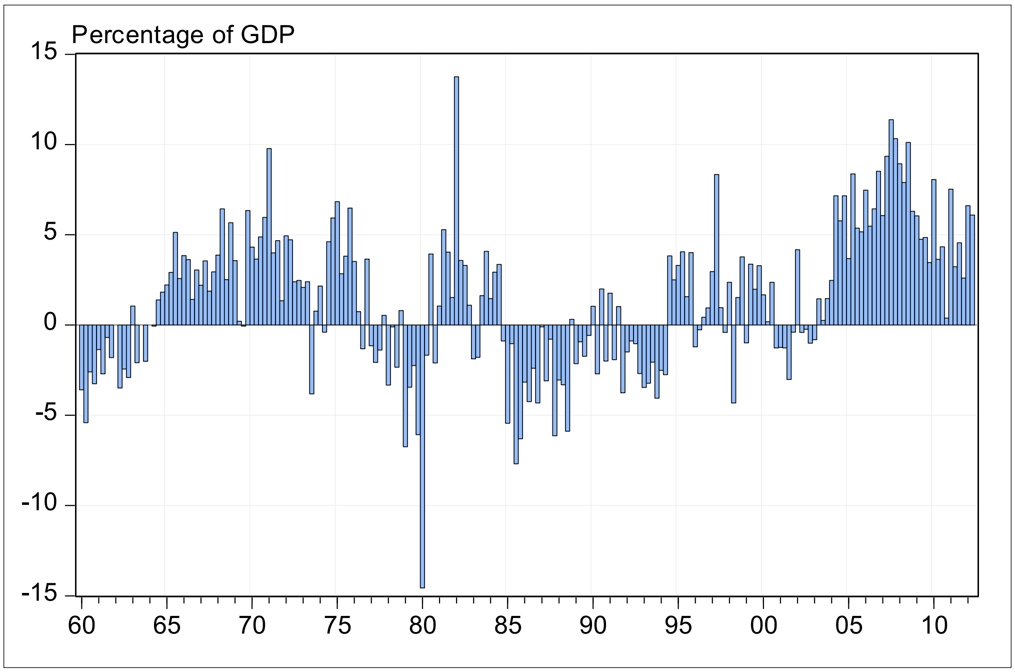


A related issue is the volatility in capital flows. The accusation is that the IMS fuels, rather than counters, such volatility. In this regard, it must be noted that the world — once characterized by capital controls on the private sector and large-scale engagement by governments and public enterprises 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 evolved and, with this, the options for portfolio investment available to international investors. Capital controls have also been softened or removed. A decentralized, 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 since they have financed 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 that contribute 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.[3] In order to deal with these capital flows, 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 and foreign currency developed over many decades, are liquid and facilitate the efficient flows of funds through the system.

3 As indicated before, in earlier years financial sanctions also had a considerable bearing on capital flows.

Figure 3: South Africa — Balance on Financial and Capital Transfer Account



This leads to a final point: successful currency internationalization 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 SADC, consisting of 14 African countries — 12 broadly south of the equator on the African continent, plus the nearby island countries Mauritius and Seychelles.

In a discussion of the IMS, 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 percent 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 each have 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, giving them 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 that they sacrifice because of their allowing the rand to circulate as legal tender within their borders.[4]

While this arrangement has worked well since the mid-1970s (and, in the case of Namibia, since the early 1990s), 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 recently happened with the Great Recession, which started in 2008, and resulted in a need for fiscal austerity measures that 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 that brings are 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 bloc — 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 bloc, 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 the rand as their only currency before introducing national currencies following their independence. This is quite different from the situation in the SADC, where the individual countries (with the exception of the CMA) all have their own currencies and independent monetary policies. Yet the SADC has an ambitious economic integration program, including monetary integration. The process of monetary integration that is being pursued in the SADC broadly resembles the monetary integration process that 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, ratio of public-sector debt to GDP and

4 See Van den Heever (2009).

the ratio of the balance on the current account of the balance of payments to GDP.

When the SADC adopted the monetary integration program 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 program for the SADC countries includes meeting 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 program 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 various SADC economies' terms of trade, sacrificing a national 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 the 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 program, and may, at the minimum, be expected to result in a sober reassessment of the target dates for monetary integration.

The implication here is that grand schemes toward monetary union should be treated with caution, and that the flexibility that a national currency and exchange rate offer should not be sacrificed lightly. In those instances where the weight of the evidence indicates 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. Harmonizing 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 IMS THAT COUNTRIES ARE ALREADY IMPLEMENTING

The dominance of the US dollar and, to a lesser extent, the euro in the IMS has already been outlined above in the section on key shortcomings of the system. Together the US dollar and euro account for approximately 87 percent of global reserves identified by currency, and when sterling and the yen are added, the cumulative total is brought up to 95 percent.

With economic growth generally much stronger in developing economies than in 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 IMS. However, economies of scale are important in international finance and therefore size counts, not only growth rates.

The broad direction that the PRC has embarked on to increase the international use of the renminbi should be welcomed; it befits the size and importance of the PRC in the global economy. For instance, the PRC's share in global exports has progressed from one percent in 1980 to 10.6 percent in 2010, and its share in global imports from one percent to 9.1 percent over the same period (IMF, 1981; 2011).

If the initiative to increase the international use of the renminbi is taken to its logical conclusion, in time, it would 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 synchronization with that of the United States, 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, the lack of familiarity with the financial system and with administrative, accounting and compliance processes in the PRC 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 free up the international use of the rand gradually, but 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 combatting money laundering and other ills.

From the PRC's perspective, it should be noted that with a more liberalized 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 worsening financial problems in major developed economies intensified, international investors often sold some of their assets in 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 the exchange rate of their own currency 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 that may hit the balance of payments from time to time.

A final point to be made is that internationalization, and eventually reserve currency status, are likely to bring about more international attention to, and criticism and politicization 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 IMS

It seems sensible to continue to allow for variable geometry and diversity in the IMS, 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 seem sensible. The expansion of the IMF's surveillance activities not only to cover individual countries, but also to provide multilateral surveillance reports, seems similarly 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 may continue to capture the limelight as reserve currencies, a number of processes are at work to change the landscape. Firstly, in the future more currencies are likely to command the economies of scale and solidity of reputation to serve as generally recognized 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, close substitute currencies are available with good liquidity characteristics and solid monetary and financial policies behind them. They offer 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' reserves 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 further mechanisms 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 straitjacket of fixed exchange rates (or, within currency blocs, 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 are 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 IMS 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 the 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 either including 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 IMS; the straitjacket of a fixed parity against a metal that is itself subject to significant changes in underlying supply and demand is more likely to raise friction than bring about 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 central banks that issue 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 likely differ from that of the mature economies. Diversification opportunities for foreign reserve managers would be of 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 cleared. Adequate attention has to be paid to the creation of institutions that support confidence in the currency and facilitate its use in international transactions.

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 liberalization 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 toward monetary union should be treated with great caution, mindful of the importance of an "own" national 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 recognized.

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 World War II 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.

The present control measures were introduced by way of the Exchange Control Regulations, as promulgated by Government Notice No. R.1111 of December 1, 1961, and amended up to Government Notice No. R.885 in Government Gazette No. 20299 of July 23, 1999 and Orders and Rules 1961, as published in Government Notice R.1112 of December 1, 1961 and amended up to Government Notice R.791 in Government Gazette No. 18970 of June 5, 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 was 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 that was inherent in the securities rand system, in 1978 the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa (the De Kock Commission) 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 or her 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 Johannesburg Stock Exchange (JSE) Securities Exchange South Africa, while other investments through that medium required the prior approval of the then Exchange Control Department (now Financial Surveillance Department or FinSurv). 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 toward the longer-term objective of a market-determined unitary exchange rate of the rand with limited exchange controls over residents only. From February 7, 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.

From July to 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 August 28 to September 1, 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 September 2, 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 authorized 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 authorized 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 South Africa and the major creditor banks, the implementation of which resulted in the amount of affected foreign indebtedness being reduced to zero as of August 15, 2001.

As a step along the indicated path of gradually abolishing exchange control, all such controls over non-residents were abolished by the termination of the dual exchange rate system on March 13, 1995, 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 South Africa.

In accordance with the principle of relaxing exchange controls, in June 1995 permission was granted to South African institutional investors (i.e., 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 five percent of total assets was applied, and in June 1996, this was raised to 10 percent of total assets. At the same time, they were permitted to transfer abroad three percent of their net inflow of funds generated during the 1995 calendar year within the overall limit of 10 percent of total assets. In March 1997, this latter concession of three percent was extended to the net inflow of funds during 1996, and the institutions that qualified for asset swaps were broadened to include regulated fund managers registered with the Financial Services Board (FSB). The 10 percent 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 percent of total assets under management.

In effect from July 1, 1997, portfolio managers that were registered with the FSB and stockbroking firms that were members 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 or Executive Committee of the Exchange concerned, could also apply to acquire foreign portfolio investments by way of asset swaps for up to 10 percent of the total assets under their management. Qualifying institutional investors could, in addition to the three percent foreign currency transfers, also apply to the then Exchange Control Department to avail themselves of foreign currency transfers in 1997 of up to two percent 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 percent of total assets applicable to asset swaps.

In March 1998, the overall limit of 10 percent was increased to 15 percent, and the three percent pertaining to the foreign currency transfers was increased to five percent, based on the net inflow of funds during the 1997 calendar year. Simultaneously, the two percent pertaining to SADC countries was increased to 10 percent.

In February 1999, the respective limits of five percent and 10 percent pertaining to foreign currency transfers within the overall limit of 15 percent 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 February 23, 2000, unit trusts through unit trust management companies could acquire portfolio investments up to 20 percent of their total assets under management while the limits of 15 percent of total assets for long-term insurers and pension funds, and 15 percent 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 percent of the net inflow of funds during the 1999 calendar year, subject to the overall limits of 15 percent and 20 percent of their total assets applicable to asset swaps.

The decision was made to dispense with the asset swap mechanism from February 21, 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 percent and 20 percent respectively, expired at the end of 2001 and was not renewed.

From July 31, 2003, as an interim step toward 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 percent in the case of retirement funds, long-term insurers and investment managers registered as institutional investors for exchange control purposes, and 20 percent in the case of collective investment scheme management companies.

On October 25, 2005, the foreign exposure limit on collective investment schemes was increased from 20 percent to 25 percent of total retail assets, and for investment managers from 15 percent to 25 percent 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 February 10, 2006, institutional investors were, on application, allowed to invest an additional five percent 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 February 20, 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 percent to 20 percent 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 percent of total retail assets under management.

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

With effect from December 14, 2010, the foreign exposure of retail assets was increased to 25 percent 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 percent of total retail assets under management.

With effect from March 1, 2010, authorized dealers were able to acquire direct and indirect foreign exposure up to a macroprudential limit of 25 percent of their total liabilities, excluding total shareholder's equity.

In March 1997, the South African Minister of Finance announced that from July 1, 1997, 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 authorized 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 18 years would be allowed to invest up to R200,000 abroad. This amount was increased to R400,000 in March 1998 and to R500,000 during February 1999. During February 2000, it was further increased to R750,000 and on February 15, 2006, the amount was increased to R2 million. On October 27, 2009 the foreign capital allowance increased to R4 million. On November 5, 2010 the foreign capital allowance of a one-off limit of R4 million was replaced with an annual limit of R4 million.

On February 20, 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 October 27, 2009, the single discretionary allowance increased to R750,000 per individual per calendar year. On November 5, 2010 the single discretionary allowance was increased to R1 million per individual, per calendar year.

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

As far as South African corporations investing abroad were concerned, the amount that could be remitted from South Africa was increased from R20 million to R30 million per new investment and to R50 million in respect of new investments in SADC countries in 1997. In March 1998 these amounts were increased to R50 million and R250 million, respectively.

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

On February 21, 2001, the amounts of R50 million and R250 million referred to above were 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 October 29, 2002 the existing limit of R750 million per investment into Africa (including the SADC) was increased to R2 billion per new investment. And on February 26, 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 corporations 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 October 26, 2004, the exchange control limits applicable to new approved foreign direct investments by South African corporations were abolished. South African corporations were allowed to retain foreign dividends declared after this date abroad. Foreign dividends repatriated to South Africa after October 26, 2004 may be transferred abroad again at any time for any purpose.

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

On February 20, 2008, the application process to make new outward foreign direct investments where the total cost of such new investments did 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 CMA of at least 25 percent, was replaced with the requirement that at least 10 percent 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 before the investment was made.

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

To further enable South African companies, trusts, partnerships and banks to manage their foreign exposure, they are 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 February 17, 2010, the South African minister of finance announced that private equity funds that were 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.

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

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

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

From October 25, 2011, South African companies are permitted to make bona fide new outward foreign direct investments outside their current line of business. Authorized dealers may, in terms of the current dispensation for investments not exceeding R500 million per applicant company per calendar year, also authorize 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 R500 million per applicant company per calendar year where such investment falls 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 was withdrawn.

South African companies are now permitted to acquire 10 to 20 percent equity and/or voting rights, whichever is 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 percent.

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

Exchange Control in South Africa: Chronology of Exchange Control Reforms

South African Resident Private Individuals: Foreign Capital Allowance (How Much a Person Can Invest Abroad)

Date	Amount
July 1, 1997	R200,000 (one-off/lifetime)
March 11, 1998	R400,000 (one-off/lifetime)
February 23, 1999	R500,000 (one-off/lifetime)
February 23, 2000	R750,000 (one-off/lifetime)
February 15, 2006	R2,000,000 (one-off/lifetime)
October 27, 2009	R4,000,000 (one-off/lifetime)
November 5, 2010	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.

Travel Allowance (Amount per Person per Year for Foreign Travel)

Date	Amount
August 24,1994	R23,000 (adult) R11,500 (child)
June 24, 1996	R60,000 (adult) R20,000 (child)
March 13, 1997	R80,000 (adult) R25,000 (child)
March 11, 1998	R100,000 (adult) R30,000 (child)
February 23, 1999	R120,000 (adult) R35,000 (child)
February 23, 2000	R130,000 (adult) R40,000 (child)
February 21, 2001	R140,000 (adult) R45,000 (child)
February 26, 2003	R160,000 (adult) R50,000 (child)
February 20, 2008	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
October 27, 2009	Within the R750,000 discretionary allowance per calendar year R160,000 for residents under the age of 18 years
November 5, 2010	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

Income Earned Abroad by South African Private Individuals

Private individuals (natural persons) are allowed to retain income accruing to them from foreign sources after July 1, 1997, abroad (previously it had to be repatriated).

Foreign Capital Allowance for Residents Emigrating from South Africa

Date	Amount
June 21, 1979	R100,000 through financial rand
May 5, 1990	From R100,000 to R200,000 (family unit) From R50,000 to R100,000 (single persons)
June 21, 1996	From R200,000 to R250,000 (family unit) From R100,000 to R125,000 (single persons)
November 19, 1997	From R250,000 to R400,000 (family unit) From R125,000 to R200,000 (single persons)
March 26, 2003	From R400,000 to R1.5 million (family unit) From R200,000 to R750,000 (single persons)
February 15, 2006	From R1.5 million to R4 million (family unit) From R750,000 to R2 million (single persons) On application, could exit additional funds in excess of the above limits, subject to payment of a 10 percent exit levy (effective February 26, 2003)
October 27, 2009	From R4 million to R8 million (family unit) From R2 million to R4 million (single persons)
November 5, 2010	R8 million per calendar year (family unit) R4 million per calendar year (single persons) 10 percent exit levy abolished

Asset Swaps

Date	Institutions	Limit	Additional Foreign Portfolio Investments through Cash Transfers
July 14, 1995	Institutional investors (i.e., long-term insurers, pension funds and unit trusts).	5 percent of their total South African assets	
June 21, 1996		10 percent of their total South African assets	Up to 3 percent of net inflow of funds during 1995 to be invested elsewhere in the world, subject to overall limit of 10 percent.
March 13, 1997		10 percent of their total South African assets	Up to 3 percent of net inflow of funds during 1996 to be invested elsewhere in the world plus up to 2 percent 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 percent.
July 1, 1997	The definition of qualifying institutions now includes portfolio managers that are registered with the FSB and stockbroking firms that are a member of the JSE, South African Futures Exchange (SAFEX) or the Bond Exchange of South Africa and have approval to offer private clients asset management services.	10 percent of their total South African assets	
March 11, 1998	Institutional investors (i.e. long term insurers, pension funds, unit trusts through unit trust management companies and fund managers).	15 percent of their total South African assets	Up to 5 percent of their net inflow of funds during 1997 to be invested elsewhere in the world, plus up to 10 percent of net inflow of funds during 1997 to be invested on registered stock exchanges in any SADC member country, subject to overall limit of 15 percent.
February 23, 1999		15 percent of their total South African assets	Up to 5 percent of their net inflow of funds during 1998 to be invested elsewhere in the world, plus up to 10 percent 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 percent.
February 23, 2000	Long-term insurers and pension funds.	February 23, 2000	Long-term insurers and pension funds.

Note: The asset swap mechanism was terminated with effect from February 21, 2001.

Foreign Direct Investment Limits for Corporations

Date	SADC	Other Countries Outside the CMA
June 21, 1996	R20 million	
March 13, 1997	R50 million	R30 million
March 11, 1998	R250 million	R50 million
Since February 23, 2000, corporations were allowed to transfer additional funds from South Africa, up to 10 percent of the excess cost in instances where the total cost of the investment exceeded the above limits of R250 million (SADC) and R50 million (other countries), respectively.		
February 21, 2001	R250 million	R50 million
October 29, 2002	R2 billion (SADC and Africa)	R500 million
February 26, 2003	R2 billion (SADC and Africa)	R1 billion
October 26, 2004 Limits on foreign direct investment were abolished. The approval process continued to apply.	South African companies were required to acquire a majority shareholding of 33.3 percent in foreign entities within SADC and/or Africa.	South African companies were required to acquire a majority shareholding in foreign entities and/or projects outside of Africa (i.e. 50 percent + one).
February 15, 2006	South African companies were required to obtain a significant interest of at least 25 percent in foreign entities.	
February 20, 2008	The pre-approval process for foreign direct investment was removed for transactions totalling less than R50 million per company per year. Authorized dealers (banks) will administer the directives and guidelines on these types of investments. The exchange control requirement that a shareholding of at least 25 percent is obtained was replaced with the requirement that at least 10 percent 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 Exchange Control Department prior to the investment being made.	
October 27, 2009	The pre-approval process for foreign direct investment was removed for transactions totalling less than R500 million per company per year. Authorized dealers (banks) would administer the directives and guidelines on these types of investments. Where the total cost of foreign direct investment exceeded R500 million per company per calendar year, an application had to be submitted to the then Exchange Control Department prior to the investment being made.	
October 25, 2011	Approval could 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. The transfer of additional working capital and/or funding to enable a South African company to increase its 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 authorized within the same calendar year in which the original investment was approved and that it will not result in the overall limit of R500 million per applicant company per calendar year being exceeded. South African companies are now permitted to acquire from 10 to 20 percent equity and/or voting rights, whichever is 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 CMA.	

Tax Clearance Certificate

Date	Purpose
October 9, 1987 (C.206)	Required for emigrants to externalize funds.
July 1, 1997 (D.120)	Required for foreign investment by South African individuals to externalize funds.

The name of the Exchange Control Department was changed to the Financial Surveillance Department on August 2, 2010.

Authorized 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. Chronology last updated on September 4, 2012.

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ABOUT ADB

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.7 billion people who live on less than $2 a day, with 828 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

ABOUT HKIMR

Established by the Hong Kong Monetary Authority in August 1999, the Hong Kong Institute for Monetary Research (HKIMR) conducts research in the fields of monetary policy, banking and finance that are of strategic importance to Hong Kong, China and the Asia region.

The Institute is funded by grants from the Exchange Fund, with its annual budget subject to the approval of the Exchange Fund Advisory Committee. The Institute's objectives are to:

- Promote research on longer-term and wider policy issues/options of relevance to the monetary and financial development of Hong Kong, China and the Asia region.
- Foster cooperation and cross-fertilisation of research efforts between academics, analysts and the HKMA research activities, and to establish links and exchanges with research institutes in Hong Kong, China, the PRC and the regional economies.
- Facilitate central bank cooperation in research activities and contributing to policy analysis of strategic issues affecting monetary and financial developments in Asia.

ABOUT CIGI

The Centre for International Governance Innovation is an independent, non-partisan think tank on international governance. Led by experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI's interdisciplinary work includes collaboration with policy, business and academic communities around the world.

CIGI's current research programs focus on four themes: the global economy; global security; the environment and energy; and global development.

CIGI was founded in 2001 by Jim Balsillie, then co-CEO of Research In Motion (BlackBerry), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario.

Le CIGI a été fondé en 2001 par Jim Balsillie, qui était alors co-chef de la direction de Research In Motion (BlackBerry). Il collabore avec de nombreux partenaires stratégiques et exprime sa reconnaissance du soutien reçu de ceux-ci, notamment de l'appui reçu du gouvernement du Canada et de celui du gouvernement de l'Ontario.

6 ADB Avenue,
Mandaluyong City 1550, Philippines
tel + 63 2 632 4444   fax + 63 2 636 2444
www.adb.org

57 Erb Street West
Waterloo, Ontario N2L 6C2, Canada
tel +1 519 885 2444   fax +1 519 885 5450
www.cigionline.org

55th Floor, Two International Finance Centre
8 Finance Street
Central, Hong Kong
tel + 852 2878 1978   fax + 852 2878 7006
www.hkimr.org