Tutorial Material for Personal Study

Prepared by
The Rapid Results College

S 352 86

THE RAPID RESULTS COLLEGE

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ECONOMIC AND MONETARY POLICY

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Your tutor has made the following changes to your set coded S1 86:

1. Reading (3) has been updated with a more recent review of the general state of the economy as well as the Reserve Bank Governor's Address for 1986. Please ignore the old reading (3) and study the new one enclosed.

2. Government Notice No. R603, published on 27th March 1986, introduced further exchange control regulations which are additional to the existing ones. These additional regulations (described below) are temporary in the sense that they apply from 1 April 1986 until 30 July 1987. They relate to the repayment of foreign debt and therefore are on extension of the unilateral stand-still (moratorium) announced on 1 September 1985.

   R1078 of 9 June 1986 further amended the regulations. All these changes have now been consolidated for you in the attached notes. Please ignore your old reading (5) and Appendix II and study the new reading (5) and Appendix II enclosed.

3. Reading (6) is now a bit dated so you can ignore this reading.

Please study these amendments carefully as they may well form the basis of an examination question.

Every success!

DIRECTOR OF STUDIES.

THE GENERAL STATE OF THE ECONOMY

This section of the reader gives an overview of the current economic conditions in the country. It is based on the Reserve Bank Annual Economic Report (published in August 1986), on several articles taken from the financial press, as well as on recent monthly economic publications of the major banks in the country.

This reading is followed by the Reserve Bank Governor's Address at the general meeting of the stockholders of the Bank held on 26 August 1986.

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CURRENT ECONOMIC CONDITIONS.

A. BACKGROUND

The South African economy experienced a cyclical downswing from the middle of 1984 to the middle of 1985. The encouraging recovery that commenced in the third quarter of 1985 was interrupted in the first quarter of 1986. Current indications are that the South African economy is still in the process of recovering, albeit slowly and erratically, from the 1984/85 recession.

The relative severity of the 1984/85 recession could be attributed to a concurrence of several long-run and short-run growth-depressing developments. Since the mid-1970's, cyclical forces of expansion and contraction in the South African economy have been superimposed on a fundamentally weaker longer-term growth trend. Since 1982 the economy's performance has slipped badly. Real GDP actually fell in 1982, 1983 and again in 1985; over the 5 year period ending 1985 real GDP growth averaged only 1,1% per annum.

Major causes of this long-run decline in the real rate of growth almost certainly are to be found in the decline in relative export volumes (i.e. in a weakening of the "pull" of rising exports as an incentive to the expansion of productive capacity), and in the deterioration of the terms of trade (as a prime determinant of real spending power and of the total availability of goods and services out of which further real investments are to be made).

South Africa is extensively involved in foreign trade - in 1985 exports represented the equivalent of 34% of GDP, and imports some 23%. A major factor in the drop in relative export volumes is that since 1980 the balance of economic advantage has been slipping away from primary producing economies towards the developed industrialised countries. This has left South Africa, like other countries with a similar economic structure, with deteriorating terms of trade and an unbalanced economy. Unfortunately, the South African economy has had an excessive reliance on the primary sector for exports. Mining has always been an important (albeit reducing) contributor to overall South African production (GDP). Gold's behaviour these past 15 years has been primarily responsible for the creation of the balance of payments constraint. While only contributing 8% of GDP, it contributed 37% of export proceeds and contributed still over 53% of funding for potential import requirements during 1985. If the gold price were to be stable or steadily rising, and its output equally stable or steadily rising, for ever and ever more, it would be no problem to have such an excessive exposure to one commodity. However, when world conditions change in a manner which introduces great periodic volatility into gold production and its price, the economy becomes excessively exposed.

Of late, however, there are encouraging signs that the world diamond market has recovered. Platinum, another very important exporter from this country, has performed very well over the 1985/1986 period, although dropping around mid-1986. The gold price has also shown some stability around the middle of 1986 and shown signs of strong increases in September. Coal is the main poor export performer at present. However, the savings on the oil import bill - the price of which has dropped substantially recently - should offset the drop in coal earnings.

B. FOREIGN TRADE AND PAYMENTS

On the whole, the current account has been showing a considerable surplus between 1985 and 1986. This is a marked improvement on the long-term deficit that was experienced between 1981 and 1984 (apart from a small surplus in 1983) due to the fall in gold price in that period as well as the longer-term trends in the world economic environment, which in the past few years have not generally favoured the primary-producing economies. As a consequence of the resultant large current account shortfalls, South Africa's foreign borrowings increased rapidly. By the end of 1984 the country had incurred substantial short-term foreign debt as well as long-term foreign debt which created a "window of vulnerability" for the economy. The depreciation of the rand increased the debt several times over. This laid the foundations for the debt crisis of 1985 and the traumatic events in the foreign exchange markets that have made the management of the economy and the control of inflation immensely difficult. (This topic is dealt with in detail elsewhere in this Reader).

Events flowing from this turned the country into a net capital exporter, something no economy at South Africa's stage of development can afford without suffering a major economic trauma. It enforced a short-term policy of curtailing domestic expansion in order to generate large current surpluses with which to repay offshore debt. The net outflow of foreign capital in 1985 was of the order of four billion dollars - almost as much as had come into the cournty in the previous four years.

Outflows of short-term capital were still high in the first half of 1986 and outflows of long-term capital were still being recorded. It would seem that the implementation of the debt "standstill" arrangements of 1985, and stricter application of the exchange control regulations, although necessary at the time, did not succeed in stemming the outflow of capital from South Africa. Many commentators believe that the main reasons for this are political rather than economic in nature.

C. BUSINESS CONFIDENCE AND THE POLITICAL SITUATION

The key to prosperity in a capitalist economy is confidence. If businessmen and consumers are confident, they will spend. Jobs and investment will follow. The crux of the economic problem in South Africa is lack of confidence in the country, which in turn stems from a marked deterioration of foreign perceptions of South Africa's socio-political stability and of the outlook for its economy.

Despite the beginnings of a slightly better turn in the economy in the latter stages of 1985, the first half of 1986 has been dismal. The reasons for the relapse in the slight recovery lie partly in the depressed state of consumer and company finances. High inflation that has been running close to 20% and reduced real salary and wage adjustments have left consumers with restricted spending options. Without confidence, consumers are unwilling to dip into savings, and loath to extend their use of credit, despite declining interest rates. There remains, in addition, a large core of the population who are simply without the means to consume at all. Unemployment has risen at an alarming rate. Despite unemployment programmes - special training and job creation programmes - instituted by the Department of Manpower, the unemployment figure (registered unemployed) was around 140 000. Some estimates of the total (registered and unregistered) unemployed go as far as 4 million. Many industries have, at best, stagnated in the past 2 years; personal as well as corporate bankruptcies and liquidations have been at a very high rate, and business morale is low. Overall, capital formation had deteriorated alarmingly.

As with most typical developing or newly industrialised countries, South Africa has a strong fundamental demand for foreign capital to exploit its solid resource base. It is quite obvious that without foregin capital inflows, it will be impossible for the country to break out of its economic and consequently, its political straitjacket to even begin to approach the levels of real growth that are essential if it is to meet the fundamental priority of finding jobs and food for its people. The problem is that foreign capital will come only with confidence, which hinges on greater political stability.

The focus of the national and international debate about the country's future direction is on South Africa's political predicament. The government needs to shed its inclination to regard economic and business issues as not only separate from, but also subordinate to political imperatives: Both elements are part of the same development process and in any successful strategy for the future equal weight and consideration must be given to them.

D. WHAT CAN BE DONE?

The August 1986 issue of the Standard Bank Review says the following:

"The current set of problems requires a consistent and co-ordinated approach in the political and economic spheres. In the former this means stopping or reducing unrest, by containing some pressures and releasing others, as well as dealing with international pressure more flexibly than is the case now. In the latter, it means doing what little can be done to ease cyclical weakness by orthodox means, while announcing a growth target and clear economic objectives plus a coherent manageable strategy to achieve them.

The starting point probably has to be in the political field. Economists may wish, with some impatience, to see the restructuring process of the economy move into top gear, but there are some occasions on which political factors come first, and this is probably one of them. The immediate challenge is to defuse domestic unrest and handle satisfactorily the immense international pressure bearing down on the country."

Another avenue lies in the re-orientation of industry towards exports, provided serious sanctions can be avoided. South Africa will be increasingly handicapped by the ongoing, gradual swing against primary commodity exporters. In time, the result of a policy of actively promoting export industries would be a substantial increase in the proportion of exports accounted for by manufactured goods, a higher level of value added in South Africa's industrial process, and a significant and more readily sustainable increase in national and personal wealth. It should also bring with it an increase in the domestic market for manufactured goods, through the multiplier effect.

Many commentators maintain that the simple expedient of cutting tax rates would have an excellent affect on the internal economy. The concomitant of this, however, would be a cut in the numbers employed by government - a politically unattractive option for government!

More recently, the economy has shown signs of stabilising and, by most conventional economic criteria, it should be capable of mounting a recovery. Monetary variables are under better control than they have been in the past, domestic liquidity is building up and interest rates are falling; the surplus on the current account is not only large but it shows promise of continuing. Under normal circumstances, these conditions would indicate that the economy is not only living well within its means but that it is ready to react positively to fiscal and monetary stimulation.

However, these are not normal times, and the big current account surplus is being soaked up by capital flight from the country. Monetary variables are under control because of the lack of willingness to incur debt for investment or consumption purposes. If these short-term improvements are to gain ground, however, the creation of improved confidence and a lengthening of planning horizons are essential. As one economist pointed out "We need a greater feeling of security. Government must get to grips with the political situation and provide an economic environment that comes somewhere near to realising its potential." Most economists believe that government lacks an overall strategy, applying measures on an ad hoc basis. The generally accepted view is that we need a structured and comprehensive plan covering all facets of the economy. More importantly, unless an appropriate, all-embracing political framework (enjoying widespread acceptance and popular support) can be created, the environment for long-term economic advancement will be unfavourable.

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RESERVE BANK GOVERNOR'S ADDRESS

AUGUST 1986.

Monetary and fiscal strategy during the past year

The economic situation in South Africa during the past twelve months has been greatly influenced by socio-political developments. Events such as the social unrest, the state of emergency and the intensified threats of disinvestment and economic sanctions, have brought about a deterioration in overseas perceptions of the domestic political and economic outlook. Misguided and distorted as these perceptions might be, they have resulted in a withdrawal by foreign banks of credits to South African banks and other business enterprises, a net outflow of capital in other forms, a depreciation of the rand, the imposition on 1 September 1985 of a "standstill" on the repayments due on the major part of the country's foreign debt, and the reintroduction of exchange control over non-resident equity investments in the form of the financial rand system. By exerting an adverse impact on domestic business and consumer confidence they have also contributed to the sluggish conditions that have prevailed in the economy throughout this period.

Moderately expansionary policy stance

Against this background the Reserve Bank and the Treasury have during the past twelve months applied an increasingly expansionary monetary and fiscal strategy. The purpose of this strategy was to encourage investment and consumer spending with a view to utilising the existing surplus capacity in the economy and raising production, employment and the rate of real economic growth.

As set out in detail in the Reserve Bank's *Annual Economic Report,* the economy reached a lower turning point of the business cycle round about the middle of 1985 and then moved into the early stages of a new recovery phase. This upswing, however, was sluggish from the start and faltered noticeably in the first quarter of 1986, before showing some recovery in the second quarter.

The question immediately arises why the monetary authorities saw fit to apply an expansionary strategy at a time when there was a large capital outflow, downward pressure on the rand and a high rate of inflation. The answer lies in the official assessment that these adverse developments were not the result of excess demand. The restrictive monetary policy of the preceding year had by the first quarter of 1985 achieved its objectives of eliminating overspending and transforming the deficit on the current account of the balance of payments into a large surplus. In these circumstances there appeared to be little danger of demand inflation rearing its ugly head again.

The temporary acceleration of the rate of inflation during the latter part of 1985 and the early months of 1986 was, in the official view, attributable mainly to the depreciation of the rand from its relatively stable level of around 50 US cents between late January and late July 1985 to between 36 and 38 US cents during most of the remaining part of the year. Unlike most other exchange rate depreciations, this particular one could clearly *not* be laid at the door of excess money creation and spending. It was caused by an outflow of capital that occurred for totally different reasons. In these circumstances a tightening of monetary policy would have contributed little to removing the underlying causes of the exchange rate depreciation and the inflation, and would merely have delayed the domestic economic recovery.

The more growth-oriented policy stance did not, accordingly, in any way imply a weakening of the official resolve to curb inflation. While accepting that a temporary increase in the pressure on the price level was inevitable after July 1985, the authorities were confident that once the depreciation of the rand came to an end, its "cost-push" influence would gradually peter out. Provided the re-emergence of excess demand could be avoided, they therefore expected the rate of inflation to decline later in 1986.

This has, in fact, happened. The quarter to quarter increase in the consumer price index (at a seasonally adjusted annual rate) accelerated from 13,6 per cent in the third quarter of 1985 to 27,2 per cent in the first quarter of 1986, but then declined sharply to 12,8 per cent in the second quarter.

Money supply targets

A major development in the field of monetary policy during the past year was the acceptance by the Government of the recommendations of the Commission of Inquiry into the Monetary System and Monetary Policy that the Reserve Bank should, with the concurrence of the Minister of Finance, set specific target rates of growth for one or more of the money supply aggregates.

The target decided upon and announced on 17 March 1986 was set in the form of a tolerance range for the rate of increase in the broad money supply, M3, of between 16 and 20 per cent between the fourth quarter of 1985 and the fourth quarter of 1986. From the point of view of curbing inflation, a lower target range would obviously have been preferable. But it was recognised that the targeting was being introduced under conditions of low growth and relatively high inflation, and that in the short term a balance had to be maintained between facilitating growth and curbing inflation. In these circumstances a target range of between 16 and 20 per cent was chosen for 1986 because it was considered high enough to accommodate a projected acceleration in the real economic growth rate during 1986 and into 1987, but low enough to ensure that the expected decline in the rate of inflation would not be frustrated by the emergence of new demand inflationary pressure.

The adoption of official money supply targets naturally rules out the setting of independent targets for either interest rates or exchange rates. That is because interest rates and exchange rates cannot be determined independently of the money supply or of each other. From this it follows that if effective control is to be exercised over the money supply and total monetary demand, interest rates and exchange rates must be flexible and free to reflect changing conditions in the financial markets.

From the beginning, however, it was made clear that the targeting exercise would be applied with flexibility and a "low profile". As recommended by the Commission, there will be no *rigid* and *overriding* "money rule" that implies leaving interest rates and exchange rates *completely* free to find their own levels at all times. Instead, the monetary authorities will continue to exercise discretionary judgement in deciding what combination of money supply, interest rates and exchange rates to aim at in any given set of circumstances. But this discretion will naturally be constrained by the need to avoid changing or breaching the M3 target so often that it loses its meaning.

Interest rate policy

In accordance with these declared policy principles, the Reserve Bank has since May 1985 reduced its Bank rate eleven times, from 21,75 to 10,5 per cent. This has helped to bring down the commercial banks' prime overdraft rate from 25 to 14 per cent. These interest rate declines have been fully reconcilable with effective money supply control. Measured over a period of twelve months, the rate of increase in M3 decelerated from 19,5 per cent in November 1984 to 7,6 per cent in July 1986. From the beginning of the monetary targeting "year" 1985/86 (i.e. from mid-November 1985) to the end of July 1986, the seasonally adjusted annual rate of increase in M3 amounted to only 7,9 per cent. Since these rates have been well below the lower limit of the target range of 16 per cent, they have provided both scope and justification for the progressive reduction of interest rates.

Present indications are that interest rates are unlikely to rise substantially in the months ahead. A clear upward tendency is likely to manifest itself only after the present economic upswing has gained considerable momentum and the demand for credit has increased strongly.

Fiscal policy

As set out in detail in the *Annual Economic Report*, fiscal policy played an increasingly important role in the expansionary policy "mix" over the past twelve months. On the revenue side this entailed, among other things, the early repayment of loan levies, reductions in income tax rates and in the import surcharge, and adjustments to the taxation of fringe benefits. And on the expenditure side, provision was made for increased outlays over a broad spectrum, including employment creation, labour training, the promotion of small business enterprises, drought relief, alleviation of social distress, the maintenance of order and stability, and constitutional, economic and social development. Some of these expansionary steps were introduced in the Budget of March 1986, while others were announced in September 1985 and in June 1986 in the form of additional stimulatory packages.

Foreign debt and capital outflow

Nearly twelve months have passed since the imposition by South Africa of a partial debt standstill and the reintroduction of exchange control over non-residents in September 1985. It is now possible to draw firmer conclusions about the *causes* and *consequences* of these watershed policy measures.

As many international bankers and other financial experts have repeatedly pointed out, the post-July 1985 capital withdrawal and the resultant depreciation of the rand were not caused by unsound balance of payments "fundamentals", and specifically not by "overborrowing". On the contrary, by all accepted economic criteria the combined foreign debt of South Africa's public and private sectors at that time of about US$23,7 billion was far from excessive. To mention just one figure, total interest *and* dividend payments to the rest of the world amounted to only about 13 per cent of exports of goods and services in 1985. This ratio is not only relatively low but has also remained within a range of between 10 and 13 per cent ever since 1946.

Moreover, during the year preceding the "standstill", South Africa had, on balance, been *repaying* substantial amounts of short-term debt, not borrowing more.

What did, however, represent a serious weakness at the time was the extent to which some South African banks had, in their foreign operations, engaged in "maturity mismatching", i.e. in "borrowing short and lending long", and in the related practice of maintaining excessive uncovered foreign exchange positions. When the banks were suddenly denied adequate access to foreign credits, these cracks in the walls were exposed and complicated the handling of the problem. For these unsound banking practices, improper bank management and inadequate banking supervision by the monetary authorities must take much of the blame. This is a deficiency in its own right that is in the process of being remedied. But the basic conclusion remains that the debt problem was not one of "overborrowing" but a "liquidity" problem caused by a sudden further deterioration in overseas perceptions of the South African socio-political and therefore economic situation.

There is also a better appreciation now that this liquidity crisis had little, if anything, to do with the abolition of the financial rand in February 1983 and the return to a unitary exchange rate system. Over the period of twenty-seven months from the beginning of 1983 until March 1985 as a whole, there was a net *in*flow of long-term capital in total of R2,7 billion and virtually no outflow of capital in the form of net sales by non-residents of South African shares to residents, despite the decline in the dollar price of gold during this period. An outflow under this heading of R1,3 billion in 1983 was almost completely offset by an *in*flow of R1,2 billion during the subsequent fifteen months. It was only from April 1985 onwards that funds again began to flow out through this channel, but the amounts involved at that stage were not large and would not by themselves have caused a major problem.

The credits withdrawn by foreign banks from July 1985 onwards were credits which, like all other loans, were always *commercial rand transactions* and never subject in any way to the financial rand arrangements. Their withdrawal would therefore have occurred irrespective of whether or not there was a financial rand system in operation. The financial rand was brought back in September 1985 only after it had become clear that the more drastic measure of a debt standstill would have to be imposed to deal with the credit withdrawals. It was then judged appropriate also to curb any possible accompanying outflow of non-resident equity funds.

Turning now from the *causes* to the *consequences* of the debt standstill and the reimposition of non-resident exchange control, some further conclusions can be drawn.

In the abnormal political and economic circumstances of the time these drastic steps were unavoidable. But while they succeeded in preventing certain types of capital and credit outflow, they also had some counter-productive effects. For example, certain South African debentures and notes issued abroad that might otherwise have been rolled over had to be repaid. In addition, as foreign credits for imports became difficult to obtain, some importers had to make cash payments "up front". In general, the expectation that in these circumstances the rand would depreciate produced unfavourable payment leads and lags, which are recorded in the balance of payments statistics as an outflow of short-term capital.

The result was that the net capital outflow of about R2,5 billion during the third quarter of 1985 was followed by an even larger net outflow of about R4,4 billion during the fourth quarter. During the first and second quarters of 1986 this outflow declined to R1,6 billion and R1,0 billion, respectively. In addition, as the Reserve Bank, the other banks and the Government repaid large amounts of short-term debt inside and outside the "net", foreign liabilities "related to reserves" declined by R2,3 billion during the first half of 1986. These large debt repayments and other outward capital movements more than neutralised the current account surplus and kept the exchange rate of the rand under pressure during most of this period.

The ways in which capital continued to leave the country despite the restraining effect of the debt standstill and the tightening of exchange control included loan repayments sanctioned in the national interest and leads and lags in current payments, which in the nature of the case do not contravene the exchange control regulations.

In similar vein it is now clear from the facts presented in the *Annual Economic Report* that the minor adjustments made to exchange rate procedures in January and December 1985, such as paying the mines in rand instead of dollars for gold bullion and compelling exporters to take out forward cover, had relatively little effect on capital movements and the exchange rate.

Exchange rate policy

During the past twelve months exchange rate policy has been a much discussed subject in South Africa. It is gratifying to note that there is now a better appreciation than before that in today's world of floating exchange rates the option of "exchange rate stability" is not open to us, and that even pegging the rand to a *single* foreign currency or to a "basket" of currencies would not be in South Africa's interests.

It goes without saying that, other things being equal, a more stable exchange rate is preferable to a less stable one. Exchange rate policy, however, cannot be determined independently of monetary and fiscal policies. And, since these policies have during the past year accorded priority to domestic economic growth, the exchange rate has had to adjust itself to this, rather than the other way round.

The basic *rationale* for the present system of managed floating is that, in a world of floating exchange rates, South Africa's industrial and general economic development will be best served by exchange rates that realistically reflect the underlying forces of supply and demand in the foreign exchange market and that *are accepted as realistic by the market*.

The exchange rate of the rand can therefore never be the chief barometer of economic well-being or of the success or failure of economic policy. In any analysis of the state of the economy, the rate of exchange is only *one* of many economic indicators that have to be drawn into the evaluation. Crucial, when all is said and done, is the behaviour of output, employment, wages and salaries, profits, exports, imports, prices and similar basic variables. And experience teaches us that these basic indicators perform better under a realistic than under an overvalued exchange rate.

The Reserve Bank would be pleased to see some appreciation of the rand in terms of other currencies, not least because this would help to bring down the inflation rate. Certainly, on a purchasing power parity basis, the rand is at present undervalued. It cannot be denied, however, that the depreciation of the rand during the past several years has greatly assisted the South African economy in adjusting to the exogenous economic and political shocks to which it has been exposed.

Among the main advantages of the depreciation of the rand have been the following: It has served to maintain the rand value of the gold output and of many other South African exports at a high level, thereby also boosting tax revenues. At the same time, it has provided additional protection to many domestic manufacturing firms competing with imports. It has also served to strengthen the balance of payments on both the current and capital accounts and to protect the official gold and foreign exchange reserves.

Banking and building society legislation and supervision

In the field of banking and building society legislation and supervision, considerable progress was made during the past year in the implementation of the recommendations of the Commission of Inquiry into the Monetary System and Monetary Policy.

- As provided for in the 1985 amendments to the Banks Act, the liquid asset requirements of banking institutions were redetermined in September 1985 at the lower levels of 20, 15 and 5 per cent of their short-term, medium-term and long-term liabilities to the public, respectively.
- The cash reserve requirement against the banks' short-term liabilities to the public was reduced from 8 to 5 per cent in April 1986, while that against medium-term liabilities was maintained at 2 per cent.
- The new capital requirements for banks, which are based differentially on the nature and risk of their various assets and other risk exposures, will become operative from January 1987. Any shortfall in respect of these requirements will be phased out over a period of time. These new capital requirements also cover the banks' contingent liabilities, including liabilities on account of foreign loans entered into on behalf of clients, and should make a material contribution towards preventing the unsound banking practices referred to earlier.
- Comprehensive new building society legislation has just been enacted, providing both for mutual societies and for proprietary or "equity" societies, i.e. societies that elect, in terms of the new legislation, to convert themselves into public companies. Building societies will in future be allowed greater discretion and flexibility in the composition of their liabilities and

assets, and will therefore become more like ordinary banks. They will accordingly be subject to the same cash reserve and liquid asset requirements as banks. For the rest, however, they will continue to be accorded special treatment, and the provision of housing loans will remain their main function. Societies unable to comply immediately with the new minimum capital (or reserve fund) requirement of 4 per cent of their liabilities to the public, will be accorded a certain grace period within which to do so.

– Draft legislation to provide for the transfer of the supervisory functions in respect of banks and building societies from the Office of the Registrar of Financial Institutions to the Reserve Bank, will be considered by Parliament during the current short session. If the enabling legislation is passed and promulgated, it is envisaged that the Reserve Bank will assume its new functions without delay.

Present situation and prospects

Any technical assessment of the present economic situation and prospects in South Africa must lead to the conclusion that in many important respects the scope now exists for a renewed cyclical upswing in the short term and a considerably higher real average rate of growth in the medium and long term.

– The current account of the balance of payments continues to show a large surplus. According to the latest revised figures, this surplus amounted to R5,9 billion in 1985 – the equivalent of 5 per cent of gross domestic product – and to an annual rate of R5,2 billion during the first half of 1986. For calendar 1986 a surplus of between R5 billion and R6 billion is expected.

– Between the end of 1984 and 22 August 1986 the South African economy repaid nearly US$3 billion of its foreign debt, while its exports increased substantially. On any purely economic assessment South Africa's present foreign debt situation would be judged fundamentally sound.

– The rate of exchange of the commercial rand – at present equal to about 38 American cents – remains undervalued on a purchasing power parity basis. This should be conducive to increased domestic economic activity *via* export promotion and import substitution. Moreover, this potentially expansionary force has received fresh impetus from the recent increases in the dollar prices of gold and platinum.

– The continued existence of unemployment and surplus production capacity suggests that the economy should be able to sustain a higher growth rate in the period ahead without the early emergence of serious bottlenecks.

– The rate of inflation, although still too high, has receded from its peak levels, and should tend downwards in the months ahead.

– The stance of both monetary and fiscal policy remains expansionary. There is considerable scope for increases in the money supply and total demand. The Reserve Bank stands ready to add to the cash reserves and credit-creating ability of the banking system by providing accommodation through its discount window and in other forms.

And yet the scope for more rapid economic expansion is not being utilised to anything like its full potential. In a situation in which economics and politics are inextricably entwined, the required spark of business and consumer confidence is still missing. In technical economic terms, the "inducement to invest" and the "propensity to consume" are for the time being inadequate to produce the desired upswing in the economy. After declining by 1 per cent in 1985, real gross domestic product is therefore not expected to increase by more than 1 to 2 per cent in 1986.

This state of affairs has, of course, been exacerbated in recent months by the intensified sanctions debate. It remains to be seen whether punitive trade sanctions will, in fact, be imposed against South Africa on a comprehensive scale. And even if they are, it is doubtful whether they can in practice be effectively applied.

What *is*, however, having an adverse impact on the South African economy is the *de facto* existence for more than a year now of *financial* "sanctions". These "sanctions" have resulted not from conscious decisions by governments or legislatures but from the deterioration over this period in overseas perceptions of South Africa's socio-political situation. Misinformed as foreign investors, bankers and businessmen undoubtedly are, they are clearly plagued by uncertainty and concern about the nature, extent and possible consequences of South Africa's domestic political problems. On balance, they have therefore been withdrawing capital and credits from South Africa for more than a year and a half now. Moreover, for political reasons, South Africa is not only denied normal access to credits from international financial institutions and central banks, but is also required to repay credits to the International Monetary Fund. By force of circumstances South Africa has therefore become a capital-exporting country.

This politically induced pressure on the capital account of the balance of payments is affecting the South African economy more adversely than trade sanctions are likely to do. It implies some combination of a weaker exchange rate, a higher level of interest rates, a higher inflation rate and a lower rate of economic growth *than would otherwise have prevailed.*

As long as the capital outflow continues, South Africa will have no choice but to run a large current account surplus. This is what we did in 1985, what we are doing again in 1986 and what we shall continue to do in 1987. The fact that we have been able to produce this surplus through an effective monetary and fiscal strategy represents a notable adjustment performance. But it stands to reason that the need to maintain a sizeable current account surplus for any length of time must inevitably restrict South Africa's longer-term economic growth. Achieving a large current account surplus year after year, by whatever means, implies a transfer of real resources to the rest of the world. This, in turn, means fewer goods available in South Africa for public and private investment and consumption, and therefore a lower long-term growth rate.

It is a matter of concern that the feeling of uncertainty has spread to South Africa's own entrepreneurs and the private sector in general. The large discount on the financial rand compared with the commercial rand (at present about 50 per cent) reflects the perceptions of overseas investors. But the continuation of the decline in real domestic fixed investment in plant, equipment and construction reflects the uncertainty of South African businessmen themselves.

This reluctance of the private sector to expand real fixed investment at a time when the cash flow of financial institutions is large and the stock exchange is booming, has understandably created frustration in official circles. Flowing from this, suggestions have been made that statutory and other measures be taken to *compel* insurance companies, pension funds, mining houses and other large economic groups to invest more in the desired job-creating directions. This is a matter that obviously calls for caution. While certain adjustments to taxation and financial legislation affecting these institutions might well be desirable for other reasons, attempts to *force* them to invest in low-earning high-risk directions could undermine their financial soundness and inflict harm on the economy.

Most private business and financial enterprises in South Africa are neither unpatriotic nor averse to making profits through expanding their business. The reason why they are not risking their shareholders' or borrowed funds in the required new investment activity is basically their uncertainty about the interrelated political and economic future of South Africa.

What is being done and what else can be done to eliminate the present apathy in the economy and to ensure more rapid economic expansion?

To begin with, there is in operation the short-term expansionary monetary and fiscal strategy described in this address. If necessary, further expansionary steps in this field will be taken.

In addition, the authorities are proceeding with the actions they initiated some time ago to formulate and publish a broad *long-term* economic strategy for South Africa (not to be confused with a socialist "master plan"). This matter was referred by the State President to his Economic Advisory Council. It is the intention that this strategy will deal with the official approach to such matters as "inward industrialisation", export promotion, import substitution, manpower issues, rural development and the role of government in a market system in which private initiative and effective competition have important roles to play.

These short and long-term economic strategies are basic and essential. By themselves, however, they cannot provide an adequate solution to the present difficulties. Unless accompanied by action on other fronts, it is doubtful whether they can overcome the harmful effects of the existing financial "sanctions" and prevent the irrational and emotional forces behind the present sanctions and disinvestment campaigns from transforming South Africa into some form of "siege economy".

Paradoxically, a siege economy might well confer benefits on some domestic industries by reducing foreign competition. But as the experience in other countries has shown, these advantages would at best be limited and short-lived. A siege economy would inevitably tend to become a tightly regimented one subject to a maze of direct bureaucratic controls. This would limit the scope for private enterprise and effective competition to promote economic development and to raise standards of living. In the final analysis, the combination of a continuous capital outflow and a siege economy would be bound to have adverse effects on economic growth and stability.

What disinvestment and sanctions will *not* do – and on this issue there is much misunderstanding – is to achieve the *political* objectives of their proponents. Anyone who understands the power relationships and other political realities in South Africa must know that, far from accelerating the process of political and constitutional reform, disinvestment and sanctions would be bound to retard it.

The further reality is that to the extent that the South African economy is harmed by disinvestment and trade sanctions, the entire Sub-Saharan Africa would be adversely affected. And, as many objective studies have shown, the main sufferers would be Black South Africans and the other countries in the Southern African region.

All of this leads to the conclusion that, in addition to the implementation of appropriate short and long-term economic strategies, any formula for the restoration of confidence and prosperity in South and Southern Africa must include the continuation of the Government's programmes for maintaining law and order and for comprehensive further political and constitutional reform.

Far-reaching political reforms have already been brought about in South Africa in recent years. In view of the present close interrelationship between politics and economics in South Africa, the private sector has, I believe, acted correctly in encouraging the Government to proceed along this road. By the same token, the Government now has every right to expect the private sector to show more confidence in the future by utilising to the full the scope presently existing in the economy for increased investment and output.

The key to success lies in the creation of a positive vision of economic expansion in not only the South Africa of the future but also the entire Sub-Saharan Africa. We must lift our gaze beyond the debate of the moment, so much of it distorted by emotion and unhelpful to the long-term future of the region.

The potential for rapid economic growth and rising standards of living in this part of the developing world is enormous. Those who care to address this question in a positive spirit will detect a prize eminently worth striving for.

Great strides could be made towards realising this potential if South Africa, the other states of Southern Africa, the major industrial countries and international financial institutions could co-ordinate their development strategies for this region and, at the same time, provide the necessary incentives for private sector participation. Such economic co-operation could unlock the riches of the region to an extent undreamed of and shape a more prosperous and collaborative future for all of its states.

There is so much to be gained by so many from economic co-operation of this kind that it deserves pride of place as an ideal for all who are genuinely interested in the welfare of Southern Africa.

FOREIGN DEBT REPAYMENTS AND EXCHANGE CONTROL REGULATIONS

INTRODUCTION

In recent years, exchange rate movements have taken over from stock exchange performances as the principal indicators of international confidence in any one country. Given the rise in the level of internal social disturbances in South Africa in 1985 and the increasing political pressures from abroad, the Rand came under intense and increasing pressure.

Triggered by the withdrawal of credit lines by a number of foreign (mainly USA) banks, the decline assumed such proportions that the Rand fell to below 35 US cents on Tuesday 27 August 1985.

This led to the closure for five days (from 28.8. 1985 to 1.9.1985) of the foreign exchange market and of the stock exchange by presidential decree. The Proclamation relating to the closure is provided for you in Appendix I of this section of the Reader.

On 1 September, a Proclamation was published to the effect that a unilateral four-month "freeze" (moratorium) on the bulk of foreign debt repayments would be enforced. This measure was backed up by the re-introduction of the financial rand as the vehicle for investment and disinvestment by non-residents. On 3 October, the abovementioned Proclamation was amended by a further one, refining the rules laid down in the first set of Regulations. Subsequent notices on 23 December 85 and 27 March 1986 have brought in further changes. A consolidated version of these Regulations is contained in Appendix II. Please study it now and then return to this point in the Reader.

BACKGROUND AND EFFECTS

According to a statement issued on 2 September 1985 by the Minister of Finance (Mr Barend du Plessis), the objectives of these measures were to :

(a) create a stand-still period during which South Africa could negotiate in a responsible way with all parties concerned regarding the orderly repayment of the foreign debt of the country;

(b) ensure that the (then) surplus on the current account of the country's balance of payments would be used largely to meet the foreign obligations of all South African debtors in an equitable and orderly manner;

(c) discourage disinvestment by non-residents at the cost of the available foreign exchange reserves;

(d) facilitate an early resumption of domestic economic growth; and

(e) normalise South Africa's foreign financial relations as soon as circumstances permit.

HOW DID ALL OF THIS COME ABOUT? To answer this question is no simple matter and we shall have to take a backward glance at recent history, bearing always in mind that the exchange rate of the currency is a vital indicator reflecting the financial community's degree of confidence in the economy and its future performance.

Bear in mind, also, the fact that it was the refusal of overseas banks to extend lines of credit which finally left the authorities no choice but to intervene in the strongest possible way by introducing the "standstill" period and the two-tier system of exchange control. The problem was that the repayment was being insisted on at a pace faster than S A's ability to generate surpluses on the current account of the balance of payments.

A number of economists point out that the fundamental weakness of S A banks' recent foreign operations has been a mismatching of funds by borrowing short from overseas banks and lending long to S A clients. Foreign banks, apparently for some time had been scrutinising S A's foreign debt position, concerned that a serious bottleneck could develop in repaying the debts. This, they felt, could result from the growing short-term nature of the country's debt.

According to Mr Bethlehem of the JCI, South Africa has since 1981 faced a number of liquity squeezes accompanied by high domestic interest rates; for the short-term consideration of the Balance of Payments (BOP), the monetary authorities chose to drive borrowers offshore (i.e. to borrow overseas) by manipulating rates in the forward market. When the Rand stood at US $0,90 (1983/early 1984), this was felt acceptable, based as it was upon a belief that the currency had fallen as low as it could. This meant that borrowers who obtained funds abroad, erroneously thought they stood to gain both from lower rates of interest from abroad and an appreciation of the Rand. The US $ continued to strengthen against most leading currencies, including the Rand, due to a high demand for the $. When the Rand reached US $0,60, the same process occurred, this time in the belief that the Rand was undervalued and in line for an upward correction. Again they were wrong and the short-term debt to foreign banks continued to grow.

A related cause of the crisis was the pre-occupation, (prior to mid-1984) on the part of the authorities, with the BOP, especially as SA's net reserves had dropped dramatically. Concern about the domestic economy and especially the problem of inflation received too little attention. It was only in about mid-1984 that the authorities realised this and set about "damping down" the overheating economy; stringent hire-purchase terms and other measures were introduced and interest rates rose sharply; economic activity began to taper off, leading to higher levels of unemployment. Further exacerbating the situation is the fact that South Africa is a high inflation country trading with countries (UK, USA, West Germany etc.) which have relatively low inflation rates. Not only do S A prices rise faster than those in the USA, but they also rise faster than those of our other, and collectively larger, trading partners. To overcome this trading disadvantage, the Rand was also depreciating, bringing about an automatic adjustment. Some commentators believe that one way to bring about a firmer Rand is through domestic price stability (less inflation); they also believe that the best way to do that is through substantially reduced government spending.

During March 1984, the Rand traded steadily in the US $0,80 region, at a time when the gold price fell through $400 and moved towards the $370 mark. By January 1985, it had dropped to $0,4190 (its lowest level to that date). This was due to the downturn in economic activity and increasing business pessimism and a continuing demand for a strong US $. The Reserve Bank took severe steps to stem the tide : a system was started permitting banks to deal directly with the Reserve Bank. Transactions of this nature (known as "outrights") gave banks another trading option which they never had before - it enabled them to by-pass the foreign exchange spot market if they so wished. This was in addition to the conventional "swap" arrangement which had been in force for some time.

For example, when a commercial bank uses the conventional swap facility to handle import orders, it draws dollars from the spot market and swaps them for future delivery by the Reserve Bank at a premium determined by the spot rate at the time of delivery. The new "outright" scheme was designed essentially to divert large import orders from the spot market and to reduce pressure on the exchange rate; the Reserve Bank effectively increased its ability to manipulate the exchange rate as it deemed fit by switching demand and supply of dollars between the forward and spot markets. This was done because of an earlier serious depletion of the country's foreign currency reserve due to the persistent selling of dollars by the Reserve Bank in order to stem the slide in the value of the Rand (gold swaps offered only temporary assistance).

Another measure adopted by the Bank was to inform the mining houses in January 1985 (who had up to then been paid in U S Dollars for the gold they produced) that only half of their gold proceeds would be paid out in dollars, which had to be repatriated to South Africa without delay.

The net effect of these measures was a much needed injection of dollars for the Bank's coffers. Armed with these dollars the Bank began to intervene in the market in order to smoothe out sharp falls or surges in the value of the Rand, for the sake of maintaining an orderly market.By late May 1985 the Rand was trading fairly steadily at between $0,54 and $0,49.

General market expectations have also played their part : it is believed that quite a few exporters in South Africa, expecting further falls in the value of the Rand, persuade overseas debtors to delay foreign currency payments to them in South Africa in the belief that the longer they wait the more Rands they will receive for that foreign currency. Simultaneously, demand for foreign currency on the part of S A importers increases because of their expectations that the longer they delay meeting their foreign obligations, the more Rands it will cost them. Thus, a LEADS AND LAGS position was built up against the Rand.

These leads and lags (based as they were on future expectations) were further exaggerated by the ability to repeatedly cancel and re-establish forward contracts (at one time a forward contract could be cancelled but not re-established).

Each downward movement of the Rand thus tended to "feed" upon itself, changing expectations for the worse, and thus causing an unusual demand for U S Dollars. On seeing the fall in the exchange rate, importers would go to the forward market to cover future commitments; this increased the demand for dollars in the already overstretched market and thus pushed the rate down even further. Exporters, on the other hand, cancelled forward contracts in the hope of being able to re-establish them at a lower and more attractive rate. (Bear in mind that the cancellation of a forward contract on export proceeds - which is an undertaking to supply U S dollars at a fixed Rand price at some time in the future - has the net effect of increasing the demand for dollars).

A further factor in the equation, causing the Rand again to come under pressure was the internal unrest in the country; very soon, purely political considerations began to dominate, as the following sketch - outline (suggested by the Financial Mail - September 6 1985) reveals :

DATE (1985)		EVENTS	APPROXIMATE VALUE OF RAND
July 20	:	State of Emergency imposed in 22 Magisterial Districts of S A.	$0,52
July 24	:	France announces suspension of new investment in S A	$0,52
July 26	:	U N Security Council votes for voluntary sanctions against S A	$0,50
August 1	:	Ten E.E.C. countries recall their envoys home for consultations. Also, violence erupts in Natal around this time.	$0,45
August 5	:	National Union of Mineworkers announces intention to call a miner's general strike	$0,44
August 8	:	Foreign Minister "Pik" Botha meets foreign labour leaders to outline reform package. Expectations rise re major announcement by State President at Natal Congress.	$0,45
		moving up to	$0,47

DATE (1985)		EVENTS	APPROXIMATE VALUE OF RAND
August 12	:	Minister Viljoen warns, the world must not expect too much	\$0,47
August 13	:	President's speech in Natal	\$0,45
August 19 to 21	:	Move by foreign banks to refuse to extend maturing short-term loans gathers momentum. Statements by Black Leaders creates further pessimism	\$0,45
August 27 (10p.m.)		JSE and Forex dealings suspended	\$0,37
Feb 20/1986	:	Debt rescheduling programme announced.	
April 15	:	± 75% of R420m due repaid.	

EFFECTS OF THE "CLOSE" AND "STANDSTILL"

The following summarises some of the views (which may be highly subjective or speculative) of certain leading commentators as reported in the financial press. R R C expresses no particular views of its own. (One should remember that during the remaining months of 1985 the authorities were negotiating with foreign banks about the repayment of the debt).

(1) These measures have been a setback for overall monetary policy and make it difficult or impossible to continue with a more relaxed and open approach as recommended in the de Kock Commission final report.

(2) S A's credit rating has taken a severe blow because of the unilateral declaration of a moratorium on repayments of the capital amounts of foreign debt. Suspending debt repayment is a serious step to take and is one from which it will be difficult to recover, irrespective of any change in political perceptions overseas. Loans in future will be very difficult to obtain.

On February 20, Dr Fritz Leutwiler who negotiated between SA and its major Foreign creditors, announced details of the debt rescheduling programme.

In terms of the deal struck with the 30 major banks, (there are still a large number of smaller creditors - about 230), South Africa has to pay five per cent of its short-term debt, equivalent to R1-billion ($500-million) within 12 months, and the group will meet again with SA's Standstill Co-ordinating Committee in February, 1987, to reassess the situation. In the meantime, an interest rate of 5% has been set on the balance, this is regarded as punitive.

(3) Foreign banks were given a good excuse with which to appease the overseas disinvestment lobby.

(4) If overseas confidence is not restored, further controls will be inevitable possibly leading to a siege economy. Further controls could conceivably be : more stringent exchange controls, greater and more direct controls on interest rates, import quotas, wage and price controls.

(5) These steps give the authorities more room to move with domestic policy objectives and will allow the economy to breathe more freely. This means, in effect that maintaining a sound BOP surplus in the latter part of 1985 was accorded less priority than in the first six or eight months of 1985. The bank rate was lowered and hire-purchase conditions were loosened to ease domestic restrictions on the economy. On the other hand, these relaxations will probably not help ease inflation.

(6) The measure which required local banks to repay foreign debts directly to the Reserve Bank caused some confusion. The Reserve Bank explained the position (in September 1985) as follows : Our intention is not to force dollars into the Reserve Bank. Rather it provides an opportunity for banks to transfer responsibility for matured loans to the Bank if they so wish; if, however, local banks can continue to "roll" loans, well and good. If foreign lenders should make it impossible for S A banks to roll loans, the S A bank may opt out and make a deposit with the Reserve Bank. The decision lies with the S A borrower and must be arranged with the foreign lender. In a Government Gazette of 23 December 1985 the Trusteeship of these funds was transferred to the Public Investment Commissioners (PIC) which will now handle the foreign debt account and accept payment by South African debtors on behalf of foreign creditors.

(7) There is the possibility of stagflation setting in. Population growth is increasing faster than economic growth; if no new foreign (longer term) loans are forthcoming (for political or other reasons) domestic savings will not be enough to fuel further growth. Higher interest rates, a weaker exchange rate, higher inflation and lower growth could well be the result.

(8) In adopting a "go-for-growth" approach in the latter part of 1985 the authorities recognised the importance of reducing social unrest and violence. In the longer term, however, an increase in economic welfare for all cannot be viewed as a substitute for further political reform. Without this, it is unlikely that confidence in the longer-term outlook for S A will be reinstated. External pressures will increase and politically-motivated capital outflows will continue. Failure to reinstate confidence will result in a cycle of inflation and currency depreciation (reflected in a poor Dollar/Rand exchange rate).

(9) Huge cuts in income taxes will go a long way to reinstating investor confidence in the S A economy.

STOP PRESS

As from Monday the 9th of December 1985, further foreign exchange controls were imposed, the net effect of which is that the gold mines will henceforth be paid only in Rands (instead of U S Dollars, and as from January 1985, instead of half in U S Dollars); furthermore exporters are now compelled to take forward cover on receivables within seven days of shipment of their export goods.

These measures were presumably introduced to combat the leads-and-lags situation described earlier this note.

APPENDIX I

PROCLAMATION

by the

State President of the Republic of South Africa

No. 150, 1985

PROHIBITION OF GOLD AND FOREIGN EXCHANGE TRANSACTIONS AND OF TRANSACTIONS IN STOCKS AND SHARES

Under the powers vested in me by section 9 of the Currency and Exchange Act, 1933 (Act 9 of 1933), as amended, I hereby make the following regulations:

1. Except with specific permission granted by the Minister of Finance, no authorised dealer in exchange may with effect from Wednesday, 28 August 1985, up to and including Sunday, 1 September 1985, enter into any gold or foreign exchange transaction or carry out any such transaction which has been entered into prior to the said date.

2. (i) No persons shall at any time during the said period open or keep open any stock exchange.

   (ii) No stockbroker as defined in section 1 of the Stock Exchanges Control Act, 1985 (Act 1 of 1985), and no person referred to in sections 3 (2) (c), 3 (3), 3 (4), 3 (5) or a person approved in terms of section 3 (3) (viii) (excluding the South African Reserve Bank) and 3 (4) (c) of the said Act, shall during the said period, whether or not on behalf of any other person, buy or sell, or otherwise deal in any stocks or shares as so defined.

3. Any person who contravenes any provision of regulation 1 or 2 shall be guilty of an offence and liable on conviction to a fine not exceeding R250 000 or to imprisonment for a period not exceeding five years or to both such fine and such imprisonment.

4. 28 August 1985 and ensuing days for as long as this Proclamation remains in force, shall be deemed to be public holidays in terms of section 2 of the Public

Holidays Act, 1952 (Act 5 of 1952), as amended, for the purpose of the carrying out of any obligation, the exercise of any right or the doing of any act, which is to be carried out, exercised or done on or not later than the said date, and which, as a result of the provisions of regulation 1 or 2, it is not practicable to carry out, exercise or do on the said date.

Given under my Hand and the Seal of the Republic of South Africa at Pretoria this Twenty-seventh day of August, One thousand Nine hundred and Eighty-five.

P. W. BOTHA,
State President.

By Order of the State President-in-Cabinet:

B. J. DU PLESSIS,
Minister of the Cabinet.

APPENDIX II

The following is a consolidated version of the sets of regulations contained in Proclamation R157 (of 1 September 1985), R603 of 27th March 1986, and R1078 of 9 June 1986:

PROCLAMATION

BY THE

STATE PRESIDENT OF THE REPUBLIC OF SOUTH AFRICA

The State President has, in terms of section 9 of the Currency and Exchanges Act, 1933 (Act 9 of 1933), made the regulations as contained in the Schedule.

SCHEDULE

1. In these Regulations, unless the context indicates otherwise-

"approved" means approved for the specific purposes of these Regulations;

"documentary bill" means a bill of exchange under which an amount is payable only against or after presentation of a specified bill of lading or any other similar document which serves as evidence of the despatch or receipt of specific goods or services;

"documentary letter of credit" means a letter of credit in terms of which an amount is to be paid or a bill is to be drawn or accepted only against or after presentation of a specified bill of lading or any other similar document which serves as evidence of the despatch or receipt of specific goods or services;

"foreign government" means any foreign government excluding the Government of the Republic of Transkei, Bophuthatswana, Venda or Ciskei;

"Public Investment Commissioners" means the Public Investment Commissioners established by the Public Investment Commissioners Act, 1984 (Act 45 of 1984);

"special restricted account" means an account opened with the Public Investment Commissioners for the purpose of the payment into such account of any amount which may in terms of regulation 2 not be paid to or in favour of, a foreign creditor.

2. No person shall with effect from 1 April 1986 until 30 June 1987 make any payment to any foreign creditor except payment in a special restricted account and except payment in respect of -

(a) an agreement entered into by an importer for the importation of goods or services, including payment for freight, insurance and other costs relating to such imports, provided-

(i) such goods or services were not delivered or rendered in the Republic prior to 1 January 1985; and

(ii) in the case of such goods or services which were or are delivered or rendered in the Republic during the period from 1 January 1985 up to and including 31 May 1986-

(aa) payment is made in terms of a documentary letter of credit or in terms of any acceptance or bill drawn under such letter of credit; or

(bb) payment is made directly to the foreign supplier of such goods or services or to a collecting banker on his behalf; or

(cc) payment is made in terms of a documentary bill accepted by the importer of such goods or services or by a banker on behalf of such importer;"

(b) interest in accordance with a rate and reasonable costs payable on outstanding loans as approved by the Minister of Finance or a person designated by him;

(c) (i) bearer bonds or bearer notes listed or quoted on any stock exchange on 28 August 1985, issued by or on behalf of the State or any other person; or

(ii) bearer bonds or bearer notes, as approved by the Minister of Finance or a person designated by him, issued by or on behalf of the State or any other person;

(d) loans guaranteed by a foreign government or an agency of such government;

(e) debts payable to international organisation of the United Nations or the Bank for International Settlements;

(f) the financial obligations of the South African Reserve Bank; provided that such obligations do not arise from a special restricted account as defined in the Exchange Control Regulations published by Government Notice R. 1111 of 1 December 1961, as amended, or from a currency transfer guarantee issued by the South African Reserve Bank prior to 2 September 1985;

(g) (i) new loans, including interest and costs thereon, all as approved by the Minister of Finance or a person designated by him, granted on or after 2 September 1985 to any person in the Republic and which are not for the replacement of an existing loan; or

(ii) such portions of loans, including interest and costs thereon, granted to any person in the Republic prior to 2 September 1985, which are drawn by or paid to the borrower on or after 2 September 1985 with the approval of the Minister of Finance or a person designated by him; and

(h) any amount approved in the discretion of the Minister of Finance or a person designated by him for this purpose from an account with a registered financial institution of a person resident outside the Republic.

(i) any payment of a current nature as authorized under the Exchange Control Regulations published by Government Notice R. 1111 of 1 December 1961, as amended.

3. A banking institution which has outside the Republic established or acquired a subsidiary or opened a branch office shall take the necessary steps to freeze and prevent the repayment by such subsidiary or branch office of liabilities of such subsidiary or branch office except in respect of-

(a) the repayment of such liability which is made out of the proceeds of the realisation of any asset which is held by such subsidiary or branch office outside the Republic; or

(b) the repayment of any liability, in respect of any single creditor, to an amount of less than 50 000 US Dollars (or an equivalent amount in any other currency), approved by the Minister of Finance or by a person designated by him.

4. (a) Notwithstanding anything to the contary contained in any other law the Public Investment Commissioners shall have power and be obliged to open and administer special restricted accounts for the achievement of the purposes of these regulations.

(b) Any payment made into a special restricted account in terms of these regulations shall, to the extent of the sum so paid and upon the issuance by the Public Investment Commissioners of a confirmation of deposit, in relation to the deposit resulting from such payment, to the foreign creditor in whose favour such payment has been made, in a form approved by the Minister of Finance or by a person designated by him, operate as a valid discharge to the person so making payment."

(c) The sum standing to the credit of a special restricted account shall-

(i) bear interest which shall be calculated and be payable in a manner, and at a rate, which shall be determined from time to time by the Minister of Finance or by a person designated by him;

(ii) be a debt due by and be repaid by the Public Investment Commissioners in such manner and in such instalments and on such conditions as may be determined from time to time by the Minister of Finance or by a person designated by him, to the foreign creditor in whose favour such sum has been paid into the special restricted account;

(iii) until such time as it is repaid to the foreign creditor in terms of subparagraph (ii) or is paid to another person at the request of the foreign creditor-

(aa) be held and retained by the Public Investment Commissioners on such terms and conditions as may be determined by the Minister of Finance or a person designated by him;

(bb) be dealt with only in such manner and in accordance with such conditions as may be determined from time to time by the Minister of Finance or by a person designated by him.

(d) All the obligations and liabilities of the Public Investment Commissioners with regard to amounts paid into special restricted accounts and any resulting deposits shall be the obligations and liabilities of the State.

5. The Minister of Finance-

(a) or a person designated by him may, on such conditions as he may deem fit, exempt any person from any of or all the provisions of these regulations, and may at any time amend or withdraw such exemption or condition;

(b) may, on such conditions (which may include warranties, waivers, undertakings and guarantees) as he may deem fit, on behalf of the State enter into agreements with and make offers to such persons as he may deem necessary, with regard to any matter which directly or indirectly relates to payments which are prohibited in terms of these regulations.

6. These regulations shall be in addition to and shall not be in substitution of the Exchange Control Regulations published by Government Notice R. 1111 of 1 December 1961, as amended.

7. Any person who contravenes or fails to comply with any provision of regulation 2 or 3 or any condition referred to in regulation 5 shall be guilty of an offence and liable on conviction to a fine not exceeding R250 000 or to imprisonment for a period not exceeding five years, or to both such fine and such imprisonment.

8. (a) The regulations published by Government Notice R. 2868 of 23 December 1985, are hereby repealed.

(b) A special restricted account opened by virtue of the provisions of regulation 2 of the regulations repealed by subregulation (a), shall continue to exist and shall be deemed to have been opened by virtue of the provisions of regulation 2.

9. These Regulations shall come into operation on 1 April 1986.

Given under my Hand and the Seal of the Republic of South Africa at Pretoria this First day of September, One thousand Nine hundred and Eighty-five.

P.W. BOTHA
STATE PRESIDENT

By Order of the State President-in-Cabinet :

B.J. DU PLESSIS
MINISTER OF THE CABINET.

J.P. ROUX
SECRETARY OF THE CABINET.

ANNEXURE A

AMENDMENT OF THE EXCHANGE CONTROL REGULATIONS

The Exchange Control Regulations R.1111 of 1 December 1961, are hereby amended by -

(a) inserting the following regulation 4A after Regulation 4 :

"SPECIAL RESTRICTED ACCOUNTS AND PROHIBITION ON REPAYMENTS OF FOREIGN LIABILITIES

4.A. (1) In this regulation 'special restricted account' means an account opened with an authorised dealer for the purposes specified in the succeeding subregulations.

(2) No person shall, without the permission granted by the Treasury or a person authorised by the Treasury and in accordance with such conditions as the Treasury or such authorised person may impose, make a payment to or in favour of a person resident outside the Republic in respect of the repayment of any foreign liability except to make such payment to a special restricted account.

(3) Any payment made to a special restricted account in terms of this regulation shall, to the extent of the sum paid, operate as a valid discharge to the person making payment.

(4) Any interest payable on a credit balance in a special restricted account is calculated at a rate determined by the Treasury.

(5) No sum standing to the credit of a special restricted account shall be dealt with in any way except with permission granted by the Treasury or a person authorised by the Treasury and in accordance with such conditions as the Treasury or such authorised person may impose.

(6) The Treasury or a person authorised by the Treasury may grant exemption from the provisions of this regulation and may authorise the refund to any person of moneys paid by him into a special restricted account and to the extent of such refund no payment shall be deemed to have been made for the purposes of subregulation (3)".

(b) inserting the following regulation 14A after Regulation 14 :

"RESTRICTION ON PURCHASE AND SALE OF FINANCIAL RAND

14.A. (1) No person shall, without permission granted by the Treasury or a person authorised by the Treasury and in accordance with such conditions as the Treasury or such authorised person may impose, buy, receive, acquire or sell, deliver, dispose of or otherwise deal with any financial rand.

(2) For the purposes of this regulation 'financial rand' means -

(a) the local sale proceeds of South African assets owned by persons resident outside the Republic;

(b) funds so designated by the Treasury or a person authorised by the Treasury"; and

(c) amending regulation 22 of the regulations by substituting for the words "ten thousand" wherever they appear of the words "two hundred and fifty thousand".

NOTE:

What is the financial rand (Finrand) and how is it valued? The Finrand is the currency through which investments either enter or leave the country. Originally introduced in 1979, as an extension of the securities rand, it was designed to block heavy capital outflows. On the other hand, because it was invariably quoted at a cheaper rate than the commercial rand it was also an incentive to foreign investors.

The Finrand's price is expressed in terms of a discount, which is arbitrarily determined dividing the rand price of a local gold share by its dollar or sterling price on an overseas exchange. The resulting figure - the Finrand's price - is then subtracted from 100 in order to arrive at the Finrand discount. The quoted price, however, is a combination of both the calculation and demand in the market.

Thus, the Finrand is quoted at a discount to the commercial rand, and foreigners who are confident about S A's prospects will find investment relatively cheap.

The market for Finrands is predominantly London-based, with New York and Johannesburg acting as subsidiaries. Its supply consists primarily of the proceeds of sales by non-residents of securities and fixed investments while the demand consists of amounts sought for investment by foreigners.

Who and what will the Finrand affect? It affects non-residents only - for those who live in S A it's business through the commercial rand as usual, which should appease importers.

The one advantage that foreigners will have is with share investments. Although these investments are made through the Finrand, dividends are payable through the commercial rand which will in turn increase the foreign investor's returns.

The only operating difference between the Finrand now and prior to its abolition in February 1983, is with property. Whereas previously foreign investors could acquire property at Finrand rates and charge rent at the commercial rate, this no longer applies as property now has to be bought at the commercial rate.

When outflows are once again allowed, the ones who will lose are those who brought in capital between February 1983 and August 1985. This is because these funds were invested at the commercial rate but will be disinvested at the financial rate.

The supply and demand of the financial rand is determined by both political and economic factors, and these in turn influence the discount. Despite political factors being obvious, there are also those non-political factors which more directly determine its price. These factors include equities, the broad economic outlook, and interest rates.

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The Rapid Results College

Registered with the Correspondence College Council.

All students of The Rapid Results College are entitled to the benefits arising from the fact that the College is registered with the Correspondence College Council, and as such is pledged to high standards of tuition and service.