Statement on banking supervision and exchange control

Issued by Dr Gerhard de Kock, Governor of the South African Reserve Bank

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After consultation with the Minister of Finance, the Reserve Bank has decided to take the following steps to increase the effectiveness of its application of Banking Supervision and Exchange Control:

(1) While the Banking Supervision Department and the Exchange Control Department will continue to operate as separate entities under their existing management, Dr A.S. Jacobs, as Senior Deputy Governor of the Bank, will assume specific responsibility for the *co-ordination* of the activities of these two departments.

(2) The Reserve Bank will further expand its Exchange Control Department and, in particular, the Inspection section of that department – a process that began some months ago. In October 1988 the total number of employees in the department was 184, of which only 33 were signing officers authorised to take decisions in regard to exchange control applications. Such applications, i.e. those which either come directly to the Reserve Bank or are referred to it by the banks, have in recent months numbered about 1 300 per week. Of the 33 signing officers, 7 were inspectors. By the beginning of February 1989 the total number of employees in the department had been increased to 193, of which 40 are signing officers, including 10 inspectors. Further expansion is planned, including the appointment of 5 more inspectors.

(3) The Banking Supervision Department is also being expanded. At present the Registrar and Deputy Registrar of Banks and Building Societies are supported by only 4 senior officials and another 14 more junior signing officers. More use will in future also be made by this department of qualified accountants.

The investigations conducted by the Harms Commission into certain alleged contraventions of the Banks Act and the Exchange Control Regulations have underlined the need not only for intensified and expanded banking supervision and exchange control but also for *improved co-ordination* between these two widely different control functions. The new measures are intended to meet this need.

At an earlier stage the monetary authorities had themselves taken note of an increased tendency to contravene both the Banks Act and the exchange control regulations, and had taken a series of steps to improve the effectiveness of Banking Supervision and Exchange Control. These include the following:

(1) The Banks Act was amended with effect from 22 July 1988 in order to extend the Reserve Bank's right of inspection to individuals or institutions *not* registered as banks or building societies but suspected of contravening the Banks Act by taking deposits from the general public. Previously the Reserve Bank's inspection rights were confined to *registered* banks and building societies.

(2) At a meeting of the Multilateral Technical Committee on Finance, which consists of representatives of the Republic of South Africa and the TBVC countries – Transkei, Bophuthatswana, Venda and Ciskei – held in Umtata on 6 September 1988, the unsatisfactory nature of the present regulation of banking business *across the borders* of the Republic and the TBVC countries was discussed and an enquiry launched into ways and means of improving the situation.

(3) At the request of the Minister of Finance a working group was set up in the second week of December 1988 to review certain completed exchange transactions in the light of information obtained regarding new techniques allegedly used to contravene the exchange control regulations. These techniques mainly involved over-invoicing and illegal use of the financial rand mechanism. This working group included, in addition to the Reserve Bank's principal exchange control officials and inspectors, also representatives of the Department of Finance and the Industrial Development Corporation, as well as a senior officer of the South African Police. The group was also authorised to co-opt individuals from the private sector in cases where they could contribute expertise that was not readily available within the Exchange Control Department itself. The two main purposes of this action are to identify possible contraventions for further investigation and, where necessary, to update and improve exchange control procedures in both the Reserve Bank and the other banks.

(4) During the course of 1988 the Reserve Bank's Exchange Control Department sought the co-operation of a number of government departments and the Institute of Accountants in devising techniques of curbing over-invoicing of imports and other fraudulent ways of transferring capital abroad. The Institute has already submitted certain recommendations and is pursuing its investigation further.

(5) The Reserve Bank has for some months now been reviewing the crucially important part played in the administration of exchange control by banks licenced as authorised foreign exchange dealers. The investigations of the Harms Commission have also underlined the need to ensure that these banks, which operate in the front line of exchange control, perform their control functions more diligently and effectively.

Exchange Control can never be a *substitute* for appropriate monetary and fiscal policies. In particular, it can never obviate the need for realistic interest and exchange rates. It is at best a *supplementary* measure.

Moreover, as the experience in other countries has demonstrated, exchange control is in the nature of the case an imperfect measure that suffers from certain inherent weaknesses. In its unanimous Final Report submitted in May 1985, the *Commission of Inquiry into the Monetary System and Monetary Policy in South Africa* put it as follows (paragraphs 12.27 and 12.28):

> "In South Africa's reasonably developed and sophisticated financial system, exchange control can be circumvented both legally and illegally in a number of ways. These ways include under-invoicing of exports, over-invoicing of imports, false or excessive commissions and so-called "transfer pricing" – the quite legal practice of deliberately distorting prices in transactions between related companies operating in different countries. The Commission naturally considered possible ways and means of effectively closing these loopholes, but reached the conclusion that, in general, such action would involve serious inroads into civil liberties, established judicial procedures and normal trade practices, with no guarantee of success, and could therefore not be recommended.
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> More important, exchange control can do very little to control short-term capital movements in the form of "leads and lags" in current foreign payments and receipts. These leads and lags are normal and perfectly legal and often assume large proportions in a major trading country like South Africa...."

Nevertheless, despite these inherent weaknesses of exchange control, the monetary authorities remain convinced that, given the stresses and strains in South Africa's foreign relations and specifically the existence of sanctions and disinvestment, exchange control over both non-residents and residents in respect of capital movements remains essential as a supplement to monetary and fiscal policies. *And as long as this is the case, the control must be made as effective as possible.* It is to this end that the Reserve Bank has taken the series of steps set out above.

All of this is being done, however, with due regard to the need to avoid the creation of an unduly large bureaucratic control structure with all the attendant "red tape", and to prevent the intensified application of exchange control from adversely affecting South Africa's foreign trade and general economic development.