The functions of the South African Reserve Bank and closer financial co-operation in Southern Africa

Address by Dr C.L. Stals, Governor of the South African Reserve Bank, at the Annual Award Dinner of the Botswana Institute of Bankers, Gaborone, 7 July 1995

1. Introduction

The major political reforms in South Africa that culminated in the democratic election for a new Government of National Unity in April 1994, introduced a new era of economic relations between South Africa and other countries on the African continent. These relations were for many years constrained by political differences and both South Africa and the other countries were frustrated in their efforts to benefit from the normal development of extended economic relations between nations.

The removal of these barriers by the events of 1994 brought South Africa face to face with the harsh realities of Africa. Many South Africans only now recognised that on the African continent, stretching from Cape Town to Casablanca, there were more than 50 countries; there existed massive poverty and there was a desperate need for enhanced economic development. Furthermore, the new South African situation itself, perhaps better understood and better exposed in the light of a new realism, also fostered new expectations and reared more urgent demands for an improvement in the living conditions of the millions of South African people living below the poverty line.

Initially, the challenge seemed to be an overwhelming one. The complexities of the situation were further deepened by the existence of a number of associations or groupings of countries on the continent created in previous initiatives towards greater economic co-operation amongst the African nations. The new South African Government was confronted with the difficult decision of where South Africa belonged in this myriad of associations and arrangements.

The Organisation for African Unity (OAU) provides a useful forum for political co-operation over the whole spectrum of African nations. The African Development Bank (ADB) provides a convenient vehicle, although in need of a major overhaul, for participation in the economic development process in all African countries. There are the Lomé Convention, establishing a firm relationship between a number of African countries and the European Union; the Preferential Trade Area (now Comesa); the Southern Africa Development Community (SADC) and the Southern Africa Customs Union (SACU), all providing for some form of regional trade co-operation. In the financial sphere, South Africa was invited to join the Association of Governors of African Central Banks, with its three regional subdivisions providing *inter alia* for an Eastern and Southern Africa Group; the future of the Common Monetary Area, consisting of four countries in Southern Africa, had to be reconsidered, and the opportunity arose for South Africa to join either the English or the French speaking African Groups on the Boards of Executive Directors of the International Monetary Fund and the World Bank. South Africa had to find a niche for itself in all these arrangements, and had to determine its role in the economic development process of the continent.

The South African Government of National Unity has made good progress over the past year in extensive negotiations over a wide front on South Africa's future Africa relations. The Government has, for example, in principle decided to join the African Development Bank and difficult negotiations are now in progress on the terms and conditions for South Africa's membership of this important institution. Negotiations with the European Commission on a Lomé-type of association for South Africa with the European Union have reached an advanced stage. Late last year, the South African Government also took the important decision to join the Southern Africa Development Community (SADC)*.

The decision to join the SADC is perhaps, at this stage, one of the more important indications of South Africa's keen desire to participate in economic co-operation in Africa. The SADC is confined to a number of countries in Southern Africa that are already within the existing ambit of the expanding South African economic contacts with Africa. It consists of a manageable core group of countries from which the process of economic co-operation can gradually be extended to incorporate also other countries further north on the continent. It includes all the members of both the South African Customs Union and the Common Monetary Area, and also other countries with which South Africa has, even in the adverse climate of the past, established extended trade and other economic relationships. It brings together a number of countries that can hopefully all benefit from greater co-operation in almost all spheres of economic activity.

South Africa has now been tasked with the responsibility of drafting a Financial Protocol for SADC. This Protocol must provide a basis for the financial co-operation amongst the members of this community, and must provide the necessary guidelines for the immediate and longer-term actions needed to achieve the objective of greater economic co-operation amongst the countries of the Southern Africa region.

The South African Reserve Bank has been actively involved in finding and defining a role for itself in the Africa initiative. The Reserve Bank believes that, against the

* South Africa has now become the eleventh member of SADC. The other ten members are: Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe.

background of the political developments of recent years and in support of the decisions recently taken by the South African Government, the Bank should now as a beginning concentrate its attention on the role that it can play in the active expansion of greater financial co-operation within the Southern Africa Development Community. This does not, of course, exclude closer financial co-operation with other non-SADC African countries where the Reserve Bank will also continue to extend relations, but then more on an *ad hoc* and bilateral basis.

2. A framework for regional financial co-operation

Total financial activities in countries with more advanced financial systems are conducted at three distinctly different levels:

- At the top, the monetary authorities govern the system through their monetary policy actions. The monetary authorities will normally include the Finance Department of Government, the central bank and supportive regulatory and supervisory authorities.

- In the middle, financial markets serve the function of price determination and resource allocation. The financial markets usually include a capital market, a money market and a foreign exchange market. These markets are often further divided in specialised sub-markets such as an equity market, a bond market and a market for derivatives to provide more specialised services in the capital market.

- At the third tier there are the individual specialised institutions such as banks, insurers, finance houses and securities dealers to provide financial services to governments, businesses and the general public.

Cross-border financial co-operation amongst more advanced economies, for example within the European Union, will proceed simultaneously at all three levels, for example at the top level through the synchronisation of macro-economic monetary and fiscal policies, at the middle level through the integration of financial markets, and at the third level through the harmonisation of financial regulation and supervision.

Major divergencies in the stage of development reached at all three levels in the different participating members of any multi-national association can, however, create serious difficulties for both the more advanced and the less developed members of the community in the process of economic integration. Even within the European Union there is therefore continuous pressure for a more differentiated approach, or a multi-speed approach, in which the more advanced members can reach the ultimate objectives of economic integration much quicker than others that may need more time to bring particularly the second and third tiers of their financial systems to a more competitive level before moving into the integration phase.

In the eleven member countries of the Southern Africa Development Community there are at this stage still major differences in the structure of the overall financial system. These differences apply to all three levels of the system, that is, the monetary authorities, the markets and the financial institutions operating in each one of the eleven countries. Monetary authorities do not always have the same objectives; financial markets do not even exist in some of the members, and independent and competitive financial institutions must still be established, nurtured and developed in some countries.

Without pre-empting the Financial Protocol and decisions that Ministers of Finance of the SADC countries will have to take in the near future on financial co-operation amongst these countries, pragmatism leads to the conclusion that, at least in the initial stages, financial co-operation in Southern Africa will have to adopt a "bottom-up" approach. The attention must at first be focused on the establishment, the development and the improvement of financial institutions that can provide the basic financial services needed by both the private and public sectors of any developing economy. In those countries where such institutions already exist, the attention may shift more towards the improvement of financial markets where prices for financial services can be determined by underlying forces of supply and demand. Co-operation at the level of macro-economic policies, such as the harmonisation of interest and exchange rate policies, will not at this early stage be easy to achieve. As an objective for the longer term, this kind of co-operation should of course not be discarded and should continue to remain a major objective of the Community. The emphasis should, however, for the time being, rather fall on a reduction of the existing vast differences in the stage of development of the financial structures of the participating countries*.

3. Closer co-operation amongst the central banks of the region

If the foregoing analysis is accepted as a realistic point of departure, the programme of action in the short term for the central banks of the region must clearly be concentrated on co-operation at the micro or institutional level, rather than at the more ambitious level of macro-economic integration. A regular exchange of views on macro-economic trends and policies amongst members will be useful in support of the strategy, but should not form the main objective of the co-operation programme at this juncture.

In preparing the way for closer financial co-operation

* This approach is in line with the findings of the African Development Bank as published in its study *"Economic Integration in Southern Africa"* (1993).

amongst the SADC countries, the central banks of the region may be advised, by way of introduction, to acquaint themselves with the structures, philosophies and objectives of each other. The governors of the central banks of the eleven members of SADC can undoubtedly learn a lot from each other by exchanging views on a number of basic issues related to their own institutions, such as:

- the institutional framework within which each central bank operates;
- the relationship between the central bank and its government:
- the organisational structure of the institution;
- the human resource management and development policies;
- the accounting and internal financial management practices;
- the main objectives of monetary policy and the monetary policy model applied in each country;
- the responsibilities for bank regulation and supervision;
- the participation of the central bank in areas such as commercial banking, export promotion and development financing; etc.

The South African Reserve Bank is known to be a relatively independent institution. It is privately-owned and is fully autonomous as far as its staff and internal administration is concerned. Its link with Government is through its Board of Directors where Government has the right to appoint 7 out of 14 members, including the Governor and three Deputy Governors. The Bank works closely with the Minister of Finance, but has been given a full mandate by Parliament to manage domestic monetary policy issues on its own. The Bank therefore has been made accountable to Parliament. The Reserve Bank's main objective is to protect the value of the currency.

This is not necessarily the ideal structure for all central banks in the SADC community. Before we can proceed to the higher level of macro-economic monetary policy harmonisation, however, some convergence on the basic philosophy of central bank functions and operations may be necessary.

The South African Reserve Bank has over many years supported and contributed to the development of the money and capital markets in South Africa. The Reserve Bank was, for example, instrumental in the creation of the National Finance Corporation (NFC) way back in 1949. The NFC represented the first specialised money market institution in the country and paved the way for the development of an active inter-bank market in call money and short-term surplus cash funds of the public and the private sectors. Today, South Africa is known for its sophisticated and well developed financial markets and the role of the Reserve Bank in these markets has become more detached. As a second area for discussion, and following the normal standard structure of financial systems in the more advanced economies, the role of the central bank in the development of domestic money and capital markets can be pursued.

Important changes are now being introduced to the structure of the capital market in South Africa. The Johannesburg Stock Exchange will, for example, in November this year undergo major changes to provide *inter alia* for corporate ownership, for dual capacity trading and for electronic screen trading to supplement, or replace, the conventional open-outcry system on the floor. Plans are also afoot for the separation of the equity and the bond markets.

From the official side, the Reserve Bank is now giving attention to the need for minimum capital adequacy requirements against risk exposures arising from securities dealing transactions. This is of particular importance now because of the possible large-scale direct involvement of banking institutions in the stock exchanges. The South African authorities are also committed to a further relaxation of the exchange controls which could have interesting implications for the money and capital markets.

Part of the objective of the Southern Africa Development Community with closer financial co-operation is, of course, to remove restrictions on the flow of funds between its members. Developments in the South African money and capital markets at this stage are, therefore, of vital importance for the other members of the Community.

The role of each central bank in the establishment of sound and well-managed banking institutions in its own country provides a third important subject for discussion by the governors of the central banks of the SADC countries. For private banks to extend their activities across borders, there must be some harmonisation in the central bank approaches towards bank regulation and supervision.

Work already done within the East and Southern Africa Banking Supervisors Group (ESAF) provides a basis for the extension of co-operation in this area amongst the SADC members. The South African Reserve Bank already committed itself to co-operation in this field by presenting a course on Bank Supervision for ESAF members in Pretoria during September last year. The South African approach with bank supervision and regulation is based on international standards as laid down by the Basle Committee on Bank Supervision and is directed mainly towards the management of risk exposures in individual institutions. In allowing South African banks to establish branches or subsidiaries in other countries, the Bank Supervision Department of the Reserve Bank will be comforted by the knowledge that their counterparts in host countries apply at least the same minimum financial disciplines in their supervision as we do.

A fourth area for exploration amongst the central bankers of the region is the involvement of these institutions in international financial relations. In this regard, a number of items can be placed on the agenda for discussion, such as:

- the management of the foreign reserves;
- the exchange rate system followed by each country;
- the role of private banks in the management of the foreign reserves; and
- the use of and repatriation facilities for the bank notes of other members in the region.

South Africa has the advantage (or is it a disadvantage?) of having a relatively well-developed foreign exchange market with an average daily turnover of more than 6 billion US dollar. The exchange rate of the rand is determined mainly by market forces, but with fairly regular intervention by the Reserve Bank with the intention to smooth out undue short-term fluctuations. The Reserve Bank does not fix spot exchange rates and does not quote rates by itself – intervention takes place on the initiative of the Bank at ruling market rates. The Bank does, however, still quote a rate for forward foreign exchange transactions but is in the process of withdrawing itself at least partly from the forward foreign exchange market. In view of the SADC objectives of closer economic co-operation amongst the member countries, the foreign exchange rate practices and policies followed by the individual countries in the region will eventually become a crucial part of the proposed Protocol for Financial Co-operation. The South African Reserve Bank is keen to share its experiences in this area with other central banks in the Community.

A closely related area for negotiation is the exchange controls still applicable in the various member states. A number of the member countries of SADC are now involved in serious programmes of exchange control liberalisation. In the case of South Africa, no exchange controls are applied to current account transactions and no restrictions exist on capital movements by non-residents. South Africa does, however, still apply fairly extensive controls on the outward investment of capital by residents. These controls also apply to investments by South African residents in other African countries, with the exception of the members of the Common Monetary Area Agreement*.

In the longer term, exchange controls will not be reconcilable with the objectives of the SADC agreement, and will have to be removed for all economic transactions between the member countries.

A fifth area for useful discussion amongst the central banks at this early stage in the search for closer financial co-operation in Southern Africa is the development of national and intra-country clearing and settlement arrangements for financial transactions. The South African Reserve Bank is now in the process of a major revision of the South African national payments system. The intention is to provide for real-time settlement of large financial transactions on a gross basis, and for an improvement of the existing inter-bank clearing system through the extension of the uses of advanced modern electronic data processing techniques. The task team responsible for this project has the intention to design a final system that will be capable of also handling cross-border and intra-country settlements. It will be most useful for this team, led by senior Reserve Bank officials, to explore the potential needs of a future extended multi-currency clearing and settlement arrangement for use within the context of the SADC agreement.

In recent years, the South African Reserve Bank experienced an increasing need for training and education facilities, concentrated mainly on the development of central banking skills for the Bank's own internal staff. In the process, a South African Reserve Bank Training Institute was established with a small specialised full-time teaching staff where a number of courses in advanced central banking techniques and policies have been presented over the past eighteen months. The time has perhaps come to make these facilities available also to interested central bankers from neighbouring countries.

In addition, the Reserve Bank has extended its in-house training facilities to include a special cadet-scheme providing an opportunity for beginners in the banking world to gain some experience of the practical world of banking over a two-year period in the Bank's various Departments. The Bank has also introduced an enhanced management development programme with the intention to reduce the normal period of advancement from junior clerical to management level from an average of about 10 years, based on past experiences, to about 4 years. The staff of the Economics Department of the Bank also presented various courses to improve the basic economic literacy of the non-economic staff of the Bank with courses such as "Inflation and how to constrain it", "Wealth creation" and "Justice for all". The Reserve Bank is prepared to share its experiences in this regard with other central banks in the region.

A further area of inter-central bank co-operation at this juncture that will contribute to the laying of the foundation for future more ambitious schemes of economic integration, could be the exchange of basic economic data and information. Governor Hermans has in the past raised the need for some form of a joint data

*South Africa plus Lesotho, Namibia and Swaziland.

base, easily accessible for all central bankers in the region, and providing a comprehensive library of information that will be of use for all of those responsible for the implementation of monetary policy in their countries. Modern communication systems, such as the world-wide Internet System, make this ideal of the past an easier reality for the future.

This is not an exhaustive list of all the items for possible action on the agenda for closer financial co-operation at the central bank level in the Southern Africa Development Community. This is also by no means intended to be a finite strategy or declaration of intent for financial co-operation in Southern Africa. There are obviously more ambitious and more grandiose objectives behind the drive for closer economic co-operation in the region. We must, however, begin somewhere and a discussion on the existing functions, practices and policies of central banks provide to my mind a better "somewhere" to depart from than most of the theoretical, textbook models of regional integration or common market approaches that may, within the harsh realities of Africa, remain just objectives and ideals for many years to come.

4. Concluding remarks

Governments have now paved the way for closer economic co-operation amongst the eleven member countries of the Southern Africa Development Community. Initiatives are on the way for more formalised co-operation arrangements covering trade and labour relations, whilst South Africa is working on a draft Financial Protocol to cover financial and investment arrangements.

The central banks of the region will obviously have to play a very important part in the future development of SADC. Indeed, the success of financial co-operation will to an important extent be determined by the ability of the central banks to guide their national financial structures towards some convergence in a harmonised regional framework that could eventually lead to a more integrated system.

A number of common responsibilities of central banks in the region can be identified for inclusion in an advance programme intended to prepare the countries for closer financial co-operation. Some of these activities were mentioned in this address. Other central banks will surely be able to add some more. To facilitate this discussion, a formal Committee of Governors of the central banks of the members of the Southern Africa Development Community should now be established to serve as a forum for a continuing process of co-ordination of the actions needed to lead the countries of Southern Africa towards closer financial co-operation. I hope this Committee will be established soon to further develop the existing ties between the financial sectors of South Africa and Botswana, and between our two countries and all the other members of the Southern Africa Development Community.