Statement issued by Mr C.F. Liebenberg, Minister of Finance, on the abolition of the financial rand system

10 March 1995

The financial rand or dual exchange rate system as applied in South Africa at this stage had its origin in the exchange control measures introduced on 1 September 1985 to provide some protection to the domestic economy from the adverse effects of large capital outflows at that time. The measures then introduced provided for:

(i) a moratorium or temporary standstill on the repayment of about 60 per cent of the foreign debt of South Africa; and

(ii) a restriction on the convertibility into foreign currency of the local sale proceeds of non-resident-owned South African investments. These proceeds had to be retained in South Africa with South African authorised dealers in foreign exchange in the form of financial rand balances. Such balances were made freely transferable between non-residents and were also eligible for reinvestment in South African quoted securities and in other equity investments "as the authorities may determine from time to time".

The debt standstill arrangements, which in the beginning were applied to a total amount of US $13,6 billion, formed the subject of a series of subsequent Interim Debt Arrangements entered into between South Africa and its foreign creditors, providing for a gradual reduction in the amount of "affected indebtedness". In September 1993, when the amount still subject to these arrangements had declined to just more than $4 billion, a final rescheduling arrangement was entered into with foreign creditors, providing for the full redemption of the outstanding balance over the period 1994 to 2001.

The financial rand system, however, remained in force. Over the past year, and particularly since the Government of National Unity came into power in May 1994, South Africa's position in the international money and capital markets has changed dramatically. International punitive actions such as economic sanctions, investment restrictions and forced loan withdrawals have been repealed and South Africa has again been accepted as a normal member of the international community.

Since the middle of last year, persistent net capital inflows into the country have exceeded an emerging deficit on the current account of the balance of payments and have enabled the Reserve Bank to redeem part of its own foreign borrowings, and to replenish its depleted foreign reserves. Today, the Bank not only holds about R12½ billion of foreign reserves, but has also established foreign credit lines of about R16 billion, of which about R13 billion is unutilised at this stage.

Recently, the rates of exchange for the commercial and for the financial rand have started converging and the discount of the financial rand on the commercial rand has been below 10 per cent now for more than three weeks. These rates have, of course, been influenced by speculative transactions, but nevertheless indicate that only minor adjustments will be required now for a merging of the two rates.

Although the financial rand system has served South Africa well during the years of the country's economic isolation, it has many disadvantages and, in normal times, may even discourage new foreign investment in the country. The Government, supported by the Reserve Bank, is of the opinion that the underlying financial situation has now improved sufficiently to warrant the abolition of the financial rand system. The Government has therefore decided that, as from Monday, 13 March 1995, the exchange control restrictions on the free convertibility and repatriation of the local sale proceeds of non-resident owned South African investments will be repealed. The financial rand and the dual exchange rate system will thereby effectively be terminated.

As from Monday, 13 March 1995, South Africa will therefore have only one unitary exchange rate that will apply to both current and capital transactions between residents and non-residents. This one and only exchange rate will, as was the case in the recent past with the commercial rand exchange rate, be determined by market forces, and the Reserve Bank will continue to intervene in the foreign exchange market mainly to smooth out undue short-term fluctuations in the exchange rate.

The abolition of the dual exchange rate system is the first step of the Government of National Unity in its pursuit of full financial liberalisation and will remove yet another obstacle to new investment by non-residents in South Africa. At this stage the remaining exchange controls applicable to foreign investments by South African residents are not being abolished. Huge backlogs have developed over the many years of exchange controls and there is now a considerable pent-up demand with South African investors, particularly the institutional investors, for foreign assets. However, total foreign investment in South Africa will be closely monitored from here with the specific view to a gradual relaxation of the exchange controls applicable to residents.

The abolition of the financial rand system has one important implication for the debt rescheduling arrangements entered into with South Africa's foreign creditors in September 1993. These arrangements provided, inter alia, for:

"the retention of the existing option to creditors of converting debt into South African investments via the financial rand mechanism, with the proviso, however, that in the event of the financial rand being abolished before the expiry of the final arrangement, the Minister of Finance may in his discretion substitute a suitable other debt-for-equity swap mechanism."
(Statement issued by the South African Minister of Finance on 27 September 1993.)

With the re-introduction of full convertibility and the free repatriation of sale proceeds of foreign investment in South African securities, this debt-for-equity swap facility will obviously nullify the objective of the debt-rescheduling agreement. Until an acceptable alternative arrangement can be worked out, the facility for the conversion into equity of debt subject to the rescheduling arrangements will therefore be suspended.

The Governors and staff members of the Reserve Bank will tomorrow meet with the authorised dealers in foreign exchange, and with representatives of the Johannesburg Stock Exchange, the South African Futures Exchange and the Bond Market Association, to discuss the implications of this decision. It is not regarded as necessary to close any of the exchanges or the foreign exchange market next week. It should be possible to resume normal financial market operations on Monday with little disruption, and with a fully integrated floating unitary exchange rate for the rand. If necessary, the Governor of the Reserve Bank will issue a further statement on Monday morning on the arrangements for the implementation of the new dispensation.

This step should be seen as further evidence of the resolve of the Government of National Unity to pursue in a responsible manner, sound macro-economic policies that will preserve overall financial stability, create a friendly environment for foreign investment and promote and support sustainable economic growth in South Africa.