PROCEEDINGS RESUME ON 13 MARCH 2002:

CHAIRPERSON: Morning ladies and gentlemen, we start this morning's session. My understanding that the first witness today is Mr Manual, is that right, Mr Gauntlett?

MR GAUNTLETT: That is so, Mr Chairman. Mr Chairman, if I can just briefly explain the presentation of evidence on behalf of the National Treasury. Ms Kathree and I instructed by Mr ... of the State Attorney appear for Treasury and the arrangement is that the Minister will initiate the evidence with a brief overview from a policy viewpoint followed by the Director-General who sits next to me and next to her is Mr Lesetso Ganyagu(?) who is the head of Economic Policy and National Financial Relations in Treasury and we are further assisted by other senior officials behind should it be necessary. The Minister, Mr Chairman, has come here specially for this and is obliged to return urgently to parliamentary debates. For that reason you are asked that your Commission is to excuse him during the course of the morning. The Minister would wish to make a solemn affirmation.

TREVOR ANDREW MANUAL affirms

EXAMINATION BY MR BROOKS: Mr Manual, you have kindly provided us with a statement which you will find in the bundle at page 82. If I could just like to take you through that. --- Yes.

Now your statement does not contain a CV. Could you just give us a very brief CV? --- Thank you for that. I was elected to Parliament in 1994 for a period of about two years as Minister of Trade and industry and have been Minister of Finance since 3 April 1996. Before going to Parliament I headed the ANC's Department of Economic Policy since from 1991 to the arrival of democracy in April 1994 and before that have done various things, a bit of civil engineering, detained for long periods and involved in policy work in Foundations.

Mr Manual, if I could ask you just to read from your statement please. To the extent that you wish to add to that please feel free to do so. --- Thank you very much. Mr Chairman, I am grateful to you and your colleagues for this opportunity to introduce the evidence on behalf of the National Treasury today. The Director-General, Ms Ramos, will give that evidence which will encompass a range of technical issues. These are macro economic in nature. While the focus of the terms of reference of the Commission does not fall directly on macro economic issues the evidence by National Treasury may shed light together with other evidence already before this Commission on the central issue indicated by the terms of reference, whether irregular transactions contributed to the rapid depreciation of the Rand last year. I would like to confine what I myself have to say to stating the broad policy directions currently pursued by Government which may be relevant to the Commission's work. The overall thrust of South Africa's economic policy since 1994 has been the pursuit of growth, job creation and redistribution, supported by re-integration with the global economy. While there are risks associated with it, globalisation offers potential for sustained broad-based improvement in living standards. Globalisation is characterised by rising trade and capital flows between countries. For the benefit of opening up trade opportunities between emerging markets and developed countries are fairly well established. Recent experience of volatile capital flows during the emerging market crises of 1998 and 1999 has led to calls for greater caution in the ... of the capital account. It has been broadly recognised internationally a gradual approach to capital account globalisation is advisable and should occur late in the process of economic reform. The Minister of Finance is head of the National Treasury, is charged with the co-ordination of macro economic policy, including exchange rate policy. In this capacity he or she would set exchange control policy with due regard to overall macro economic policy objectives and the sequence in economic reform. We have chosen a policy of gradual liberalisation of exchange controls based on a set of key policy and structural requirements. Firstly, it was imperative that the appropriate macro economic fundamentals be put in place. These include credible and sustainable fiscal and monetary policies, pro-growth trade and investment policies and a government spending programme that promotes redistribution and provides a safety net for the poor against the potential social costs of globalisation. Secondly, in an environment and global integration, large and rapid shifts in capital flows, it is essential for a sound and well regulated financial system to be in place. And lastly, we have chosen to follow a flexible exchange rate to act as a shock absorber against global developments. This helps mitigate the impact of potential economic contraction, especially in respect of .. (drops voice, inaudible). In the implementation of exchange control policy the Minister of Finance has delegated certain powers, functions and duties to the South African Reserve Bank. The Reserve Bank is responsible for the day to day administration and functioning of the Exchange Control Regulations. In delegating these powers the Minister of Finance relies on the relationship of trust that has developed over many years of effective co-operation. Only those exchange control applications that fall outside State policy parameters and require exemption from the Minister of Finance are referred to the National Treasury for consideration. The Exchange Control Department of the Reserve Bank received 36 634 applications for exchange control approval during the course of last year and this Commission has been advised or has been advised by Mr Bruce-Brand that this is out of a total of more than 5 million transactions that took place. Now, Mr Chairman, of the 36 634 applications received by the Reserve Bank, only 28 matters were referred to the National Treasury. The Minister of Finance is then called upon to apply his mind to the specifics of the transaction on a case by case basis. In his consideration the Minister draws on the recommendations of the National Treasury. These recommendations follow an extensive process of research and concentration. In making her determination the Minister is guided by its responsibility for the overall co-ordination of macro economic policy and the sequencing of economic reform. This entails a consideration of an array of factors, including the impact of the transaction on the country's balance of payments, the revenue base, the development of financial markets, the global competitiveness of South African companies and prospects for trade, investment and job creation. Ultimately each decision is guided by what is in the overall interest in the economy, what is advisable given the overall sequencing of economic reform. In looking back to the rapid course of events late last year regarding the exchange rate of the Rand, there will always be a temptation to engage in what in hindsight is of course an exact science. To the extent that it may be a consideration, my own sense is that a complex of factors was at play. The Commission has already heard expert evidence in that regard. I prefer not to venture further onto that terrain at this stage but in closing, Mr Chairman and Commissioners, I believe it is important to affirm the following: South Africa is committed to managing economic reform in a way which involves consistency, is considered and is directed at sustained growth. The task is complex. Circumstances are not always predictable. I believe it is however encouraging that our general policy approach should have evoked the confidence and even international regard as suggested by the expert witnesses who thus far testified before the Commission. I thank you.

No further questions.

<u>CROSS-EXAMINATION BY MR GAUNTLETT</u>: Mr Commissioner, may I just raise one aspect and ask a particular question and that is this, the Governor in his statement, Minister, yesterday said at page 46 and paragraph 114 that if the Reserve Bank had been aware of illegitimate transactions which may have had the effect of adversely affecting the value of the Rand, it would have investigated them. Now Minister, in relation to the fact that allegations which are later to be investigated in some detail by this Commission were made in the public domain by Mr Wakeford late last year, were you at any stage contacted and asked if you would investigate these internally? --- Mr Chairman, I was never approached in this regard. In the course my responsibilities there are approaches to me because apart from being head of the National Treasury, I am also responsible for other departments, the Statistics SA and the South African Revenue Service. Now with Stats SA having taken on the big task of sensus 2001, there were instances where individuals sought my advice on the issue and in the course of the administration of the Revenue Service there are a series of areas where individuals feel hard done by and would ask for advice with me to talk to somebody who is not of the Revenue Service and in respect of all of these I take these complaints from the public very seriously and give it due attention. And I am sure I would have done the same had this matter been brought to my attention by Mr Wakeford. He did not do so but now the Commission sits and I think we must leave it in the hands of the Commission to enquire as to the issues raised by Mr Wakeford and others and I think the terms of reference would allow it to enquire into that.

Thank you, Mr Chairman.

<u>CHAIRPERSON</u>: Minister, you are excused from attending at your leisure. --- Thank you, Mr Chairman.

NO FURTHER QUESTIONS

MARIA RAMOS d.s.s.

EXAMINATION BY MR BROOKS: Would you kindly look at your statement and your CV, if I could take you to that, you will find that at page 77 and further. Your CV, I it is a very good CV, I am even told that it is available in cover from comments made by your counsel this morning. Could you give it to us in a summary form please? --- I am sorry, it is a long CV, I do not often get the time to edit it. If I had I would have cut it down a few pages.

You do not need to apologise for that. --- I have an M.Sc in Economics from the University of London. I am presently, that is after doing B.Com Honours at Wits University with the very obscure thesis called.. (inaudible) Dual Decision Hypothesis which you asked me about earlier, I promise I will not go into the details of that thesis here this morning. Essentially I am the Director-General of the National Treasury. I have been Director-General since 1996, June 1996. Before that, for a year, I was Deputy Director-General of the National Treasury and immediately before that I was a research officer at the London School of Economics. I have, as you can see from my CV, also spent quite a lot of my time working for a financial institution both in general banking but also for a time as the international economist of the receiving room floor of First National Bank and I have attended numerous international courses and participate in a number of international fora, both in financial stability forum at one stage. I represent South Africa as a deputy on the G20 and I am alternate governor at IMF for the Republic.

Ms Ramos, if you could then go to your statement which starts at page 84 of the bundle and Ms Ramos, if I could just, before we deal with your statement tell you that in the last two days evidence has been given by representatives of the Reserve Bank, Mr Bruce-Brand, and by the Governor where you will find substantial overlapping in regard to your statement. So we are not going to be repetitive and when we get to those portions I will stop you, I will refer the commissioners to the repetitive parts and we will as it were pass forward on those parts of your statement so that we do not waste time. --- Thank you very much. I think I would appreciate it, I am sure the Commission would appreciate that as well. Then to start at paragraph 1 on page 4 which sets out essentially the role of the National Treasury in the South African economy. The National Treasury is the custodian of South Africa's financial resources guided by Government's overall policy objectives of economic growth, increased employment, socio-economic development, improved service delivery and transparent and accountable governments. The key objectives of the National Treasury are:

1. To advance economic growth and income distribution through economic, fiscal and financial policies that stimulate investment and trade, create employment and allocate budget resources to the ... (indistinct) beneficiaries.

2. To prepare a sound and sustainable national budget and an equitable division of resources between the three spheres of

government: national, provincial and local.

3. To equitably and efficiently raise fiscal revenue as required through a targeted and fair tax policy and other measures to ensure revenue stability and the efficiency and competitiveness of the South African economy.

4. To manage Government's financial assets and liabilities soundly through prudent cash management, asset restructuring, financial management and management of the debt portfolio.

Ms Ramos, could I just stop you there. Mr Commissioner, in regard to the debt management there is a separate appendix which you will find at page 70 and further. We are not going to read into the record because it is not relevant to the terms of the Commission but it is there for your reference should you require to have reference to it. Would you carry on please? --- And lastly, to contribute to improved financial management, to promoting and enforcing transparency and effective management of revenue, expenditure, assets and liabilities in all spheres of Government. Paragraph 2 is dealing with the legislative mandate of the National Treasury. The legislative mandate of the National Treasury is found in the Constitution and the Public Finance Management Act ("the PFMA") primarily and several other Acts of Parliament. The Minister is the head of the National Treasury, takes the policy and other decisions of the National Treasury except those decisions taken as a result of a delegation or instruction in terms of section 10 of the PFMA and the National Treasury's powers and functions are also set out in the PFMA and they include to promote national government's fiscal policy framework and the co-ordination of macro economic policies, to co-ordinate inter governmental financial and fiscal relations, to manage the budget preparation process, to exercise control over the implementation of the annual national budget, including any adjustment budgets, to facilitate the implementation of the Annual Division of Revenue Act, to monitor the implementation of provincial budgets, to promote and enforce transparency and effective management in respect of revenue, expenditure, assets and liabilities of departments, public entities and constitutional institutions and to perform the other functions assigned to the National Treasury in terms of the Public Finance Management Act. As part of its role, in co-ordinating overall macro economic policy, National Treasury is responsible for exchange control policy.

Ms Ramos, I would like to stop you there, on page 8 where we deal with the legislative framework of exchange control. Messrs Commissioners, first of all the reference to the Act, do you have a view about a page which refers to Act 1933.

CHAIRPERSON: Yes.

MR BROOKS: Could I just say, this is where we get to some duplication. If I could just give you references, if you could possibly just note it.

CHAIRPERSON: Yes.

MR BROOKS: Paragraph 4, the cross-reference is Reserve Bank, Volume 6, paragraph 6.1 at page 5. Whenever we refer to Volume 6,

Mr Commissioner, that will be Mr Bruce-Brand. I will call it Volume 6. Volume 7 is Mr Mboweni. So it is Volume 6, paragraph 6.1, page 5.
CHAIRPERSON: Thank you.
MR BROOKS: Paragraph 5
CHAIRPERSON: I do not think you need to give us, it will just take as long as it would have taken to read. We will pick up the references.
MR BROOKS: Then can I give you one more correction, at the bottom of page 8 the Act is 1961, not 1969. If I could just ask you to amend that.
COURT: And then paragraph 7, have we not gone through this before?
MR BROOKS: Paragraph 7 you will find in Volume 6 again, that is paragraph 1.1 and further at page 49 and further and that takes us through to the end of paragraph 7. If I could ask Ms Ramos, could you just read paragraph 7.8 and 7.9. --- Paragraph 7.8, the Reserve Bank annual financial statements, 31 March 2001, page 18 describe the Exchange Control Department as follows and I quote:

"The Department administers exchange controls on behalf of the Minister of Finance in terms of delegated powers. The Department's main functions are to implement, administer and monitor the provisions of the regulations as well as to collect, analyse and dissimilate information to policy makers about cross border foreign exchange flows. The 34 authorised dealers in foreign exchange who have been appointed by the National Treasury carry out the day to day administration of exchange controls."

And then paragraph 7.9, prosecution of exchange control regulations. The Exchange Control Department undertakes prosecution decisions for exchange control contraventions. National Treasury receives reports from the South African Reserve Bank on the matters which have been prosecuted and the progress in those matters.

And then paragraph 8, the cross-reference is paragraph 6.5 of Volume 6.
CHAIRPERSON: Yes.
MR BROOKS: And then paragraph 9 is again a duplication. You will find that at paragraph 6, 6.1 and further in Volume 6.
CHAIRPERSON: Yes.
MR BROOKS: And then paragraph 10 you will find at paragraph 6.9.1 on page 8 of Volume 6.
CHAIRPERSON: Yes.
MR BROOKS: And that takes us through to the end of paragraph 10 on page 18.
CHAIRPERSON: Have we not dealt with paragraph 11 before?
MR BROOKS: Yes, could I just, we have dealt with 11, could I please just ask you to add the following, the reference is Interim Constitution, if you refer to Mr Mboweni's statement, paragraph 7 at page 6, that must be read with paragraphs 8 and 9 of Mr Mboweni's statement.
CHAIRPERSON: That is Volume 7?
MR BROOKS: That is Volume 7. So that takes us to the end of paragraph 11. Paragraph 12 should be read with paragraph 22 at

page 20 of Volume 6.

CHAIRPERSON: Yes.

MR BROOKS: And then we get to paragraph 13 and I would ask Ms Ramos to deal with that. --- Paragraph 13 deals with the liaison between the Reserve Bank and the National Treasury and the first point of liaison is what is called Exchange Control Technical Committee and paragraph 13 deals with the meetings of that technical committee. So at paragraph 13.1: "Liaison with the National Treasury is maintained either directly or through the joint technical committee on exchange control. The technical committee consisting of officials of the National Treasury and Exchange Control Department as well as officials in other departments of the South African Reserve Bank may be co-opted, was formed to give consideration on an ongoing basis to adjustments in the exchange control system and to clear principals on day to day problems as they are encountered. Last year it was agreed that because of the complexity and the tax-driven nature of many exchange control transactions the National Treasury's tax policy unit and the South African Revenue Services should also be represented when matters with tax implications are discussed in this committee. In other words, if there are exchange control applications that may have a tax angle to them, these are discussed also with the our policy unit and South African Revenue Services. In order to promote closer liaison the Exchange Control Technical Committee has met on eight occasions during the period November 2000 to date. It is chaired by the Exchange Control Department of the South African Reserve Bank.

Ms Ramos, would you just stop there. Messrs Commissioner, paragraph 14 this should be read with paragraph 26 on page 21 of Volume 6, that is Mr Bruce-Brand and as read with Mr Manual's brief statement.

CHAIRPERSON: Yes.

MR BROOKS: Please continue, paragraph 14. --- Mr Chair, I think the Minister has already been indicated and Mr Alex Bruce-Brand has already dealt with paragraph 14.1. But the total figure is 5,6 million, as we have already heard before, of foreign exchange transactions which took place in 2001, 99% of which were dealt with by the authorised dealers. As we also heard, I think previously, without prior reference to the Reserve Bank's Exchange Control Department. And as the Minister has already indicated, only 28 of the 36 000 applications that were referred to the Reserve Bank actually were then referred on to the National Treasury for the Minister's approval. 14.2, the National Treasury is reliant on the Exchange Control Department for compliance with policy parameters and in regard to the referral of matters outside policy, for the consideration of the National Treasury and the Minister of Finance. Applications by the Exchange Control Department are dealt with and filed in that office. It is only on rare occasions that the Exchange Control Department forwards to the National Treasury for information purposes only certain matters that it has considered. These tend to be applications that the Exchange Control Department had declined. The Exchange Control Department generally forwards matters to the Director-General and these are then referred through the division head of Economic Policy and International Financial Relations, Mr Ganyagu sitting on my right, to the responsible desk office, the Financial Regulation Chief Directorate. Depending on the complexity of a particular matter, and whether it impacts on the tax regime, the matter is then copied for comment to the Tax Policy Unit, to the Macro Economic Policy Unit and the International Finance Unit. Comments are made on the draft submissions, replied by the Financial Regulation Unit or by separate written memoranda or by e-mail from the commentators in these divisions. High profile applications, such as foreign listing applications, are dealt with in a multi-disciplinary approach involving all of the divisions referred to in 14.5 and again in 14.6. In certain instances consultations are also undertaken with outside consultants. A submission dealing with the applications will be compiled by a member of the Financial Regulation Unit and considered by the chief director of Financial Regulation, Mr Chris Malan, who is also in the team. The submission will then be referred to the division head, Mr Letsetso Ganyagu, for his recommendation. The submission is further referred to the Director-General for recommendation. After considering the submission, the submission is then referred by the Director-General to the Minister of Finance for his final approval. Let me deal next with exchange control policy in South Africa, first with a general policy overview. Domestic economic growth in many emerging market economies over the last few decades has been boosted by the process of globalisation in the form of increased economic linkages between different countries. Globalisation of the world economy has been driven by a variety of forces, rise in trading goods, increase in international capital flows, greater technological spill-overs and growing labour mobility. While there are risks associated with it, globalisation offers an opportunity to achieve sustained and door based improvements in living standards to the expansion of markets for goods and services, the spread of technology and expertise and the creation of jobs in export and connected industries. Increased capital flows from industrial team merging market economies have the potential to help fuel faster growth and narrow the gap in living standards. Increased capital flows tends to raise investment by supplementing domestic savings as well as allowing better risk diversification and greater consumption smoothly. In addition, foreign direct investment flows can provide technology spill-overs by the transfer of ideas. Capital flows also deepens domestic capital markets and raise growth to the more efficient allocation of resources amongst competing projects. But increased capital mobility and integration of financial markets has also led to increased productivity, particularly in the case of portfolio flows. For instance, private flows to emerging market economies almost halved as a result of the Asian crisis, falling from about 135 billion dollars in 1997 to roughly 70 billion dollars in 1998. Experience shows that capital flows are more prone to volatility in countries in which the appropriate institutional requirements are not in place, notably adequate financial supervision and consistent macro economic policies. Mr Chair, as the numbers suggests, capital flows are prone to volatility everywhere. However, we know that countries that have sound macro economic policies, well regulated and well capitalised banking systems and given the experience of the past few years, flexible exchange rates, are better able, these countries are better able to withstand this volatility. Put differently, they are better able to respond to these types of (indistinct) shocks. In countries where reforms are incomplete, for example as was the case in many of the East Asian countries in 1998, in Russia or more recently as we have all seen on our television screens in Argentina, the volatility in capital flows inevitably precipitates deep economic and financial crises. So yes, the increase in economic global integration as increased volatility but we also know that if your system is sound, if your economic policies are sound, countries are better able to withstand and respond positively to those external shocks. The overall thrust of South Africa's economic policy since 1994 has been the pursuit of growth, job creation and redistribution, supported by integration with the global economy. This has entailed greater integration though capital accounts and trade liberalisation underpinned by a range of domestic policies, all intended to guide the economy towards structural shifts required to benefit employment creating, international competitiveness and to minimise the social cost of this transition. When we talk about greater integration, I think it is important to see it in the context of what has happened to this economy in the last few years and maybe I can put this better by just reminding here that exports, for example, now contribute just under 40% of GBP. So this is a very open economy that depends increasingly on its ability to export and through increased exports also then big changes in the structure and overcoming one of the achilles heels of this economy which was the balance of payments constraint. So greater exports, better balance of payments position, greater therefore integration into the global economy. But there is also other areas of integration that we can point to and I see Governor Mboweni spoke about it yesterday in the evidence that he gave before this Committee. There is, of course, the fact that over the last five, six years this Government has been able to very successfully go into international capital markets and finance a portion of its deficit in these markets. That is another piece of evidence attesting to the greater integration of the South African economy into the global economy. And then, as my presentation suggests later on, there is also a lot of integration through trade liberalisation and current reform. Mr Chair, this is not covered in the notes but I think it is just important to contextualise the point on greater integration. Moving then to 15.5, Government's policy on exchange control liberalisation takes into account the realities of this increase into globalisation and integration. Greater integration clearly plays a role in turning the South African economy around. Average GDP growth from 1994 to 2000 was 2.7% per annum compared to 1% per annum over the preceding decade. Capital account liberalisation in the form of exchange control reform is one part of this global integration process. The approach of Government has consistently been one of gradual liberalisation. Since 1994 there has been a gradual lifting of exchange control restrictions on investment flows off shore by South African individuals, companies and savings institutions. It has been a very deliberate policy of a gradual liberalisation in the context of an overall macro economic reform and restructuring. A by product of fast economic isolation meant that the situation inherited in 1994 was one of relatively low levels of foreign asset diversification in the portfolio of South African residents as well as financial constraints on the ability of South African companies to compete globally. In other words, before 1994 as many people, if not most people in this room, will know the previous Government had absolutely no access to international capital markets save through the mechanism of trade finance. And so there was not, and the exchange control restrictions were very very strict, so there was very little ability for South Africans to diversify its portfolios or to borrow off shore. Low levels of foreign diversification, increased portfolio risk in pension funds or long term savings of an individuals while restrictions on global expansion leads to a poorer quality of company earnings, growth and concentrate industries in the domestic economy often making their uncompetitive. And they also, I think, ultimately lead to lower growth and employment in the economy. While increased capital accounts from liberalisation brings benefits in the form of diversification and global competitiveness, the timing and sequencing of such reforms is crucial. And we have had to take a number of issues into consideration when sequencing exchange control liberalisation. Perhaps before we go onto these issues, Mr Chair, it is important for us to remind ourselves that in the past few years there has been a very big shift in the foreign assets in the portfolios of South Africans generally, both personal, pension funds and companies and we have published the four numbers in our budget review last year that indicate that the personal sector, that personal sector foreign assets as a percentage of GDP, if one uses that as a measure of portfolio diversification, has shifted in 1995 from 15.1% to in 2000 approximately 53.2%. Now I think there is another important point to be made here that obviously as the exchange rate depreciates these assets are measured in foreign currency and they are often foreign currency assets and when you convert them into rands, then the percentage of those assets as a percentage of GDP will increase over time. But on the issue of diversification as well, it is important to keep in mind that portfolio diversification is an accepted principle in portfolio management and the issues here are about choosing a risk of return that suits a particular portfolio and so before 1994 the opportunities to hold anything else but South African rand assets in a portfolio just were not there, becoming part of that global environment means that some of those portfolios have had to change. I think the real challenge here is for us to ensure that in those changes in these portfolios we maintain and we will come back to those prudential limits which will ensure that the portfolio does not move so far out of line with the liabilities that have to be financed out of that portfolio if you are a pension fund company for example and that the return on those are maintained. Let me then return to paragraph 15.9.1 which is the issues which we have had to consider as we have liberalised and has opened up the capital account and the first of those has been that as we now know it is broadly recognised internationally, that a gradual approach to capital account liberalisation is advisable and should occur late in the process of economic reform. One such condition is that macro economic stability and financial reform are in place. Exchange control liberalisation should occur in line with the strengthening of the balance of payments and that is brought about by South Africa's integration into the global economy and again here one measure of that is the fact that our current account deficit has been pretty low despite the fact that we have had some good growth in the last few years. Increased trade and capital inflow provide the foreign currency reserves to be able to accommodate increased freedom in capital flows. Turning to the sequencing of exchange control reform. South Africa has followed a sequence of economic reform that is stated in 15.9.1 as being broadly endorsed internationally. Dealing with macro economic stability. A precondition for capital account liberalisation is credible and supported fiscal and monetary policy. This reduces the scope with domestically generated instability and capital flight. The objective of macro economic stability has now been achieved. The fiscal deficit has come down from over 5% in 1994/95 to 1.9% in 2000/2001 and it is expected to register 1.4% for the fiscal year that ends on 31 March. Government has also in agreement with the Reserve Bank agreed on an inflation target as the Governor spoke about yesterday of 3 to 6%, compared to a consumer price inflation of around 9% in 1994. On the tax policy side, tax administration and policy reforms have been co-ordinated with liberalisation policies. The relaxation of exchange control has been accompanied by key income tax reforms to protect the taxpayers and minimise tax prices that could encourage the export of capital. This is focused on the design and the implementation of rules to ensure the appropriate taxation of outward investment. This has primarily taken the form of a shift from source based to resident based income tax. Importantly social safety nets have to be in place. As we all know and as the prices in 1998 again showed an important component of the sequency of exchange control reform is to have a social safety net in place. This mitigates the possible negative impact on the poor of potential financial instability which could result from an ill considered pace of capital account liberalisation. South Africa is one of the most extensive social safety nets among emerging market economies. The social security grant system delivers income support to over 4 million poor South Africans making it the largest and most effective redistribution programme within Government. In addition, the child support grant reaches some 1,7 million children and is projected to reach 3 million by 2003. Spending on social services which includes education, housing and social development has consistently comprised more than 50% of consolidated national and provincial spending. Even during times of instability such as the 1998/99 emerging market crisis which incidentally saw many of the countries affected, South Korea, Indonesia, a number of the other countries affected, cutting back very dramatically on social and other expenditures on their budgets. An important component of the liberalisation programme has also been domestic financial markets and form and what has happened in this regard. Complete liberalisation and large capital inflows and outflows increase the danger of bank failures, if not properly managed. In these circumstances competent bank management, realistic valuation of bank assets, increased public disclosure and prudential reporting become important characteristics of a sound banking system. The objective of bank supervision and regulation under these circumstances should be to avoid any systemic risk to the banking system. In South Africa the capital account liberalisation has been accompanied by significant reforms to a robust financial market structure. Despite repeated episodes of exchange rate pressure and sharp depreciation, South Africa has been protected by a regulatory system that is well established and sophisticated in comparison with other emerging markets. This has been confirmed by a joint IMF World Bank Financial Sector Assessment Programme which has now taken place two years in a row and for which reports are available both in 2000 and 2001 as well as well as by the annual rating agency reports which are available from Moodie's SNP .. (indistinct). A further reform signals in 2001 in the form of a shift to prudential regulation will see exchange controls on life insurance and pension funds replaced by prudential limits on foreign investment.

CHAIRPERSON: Ms Ramos, what does that mean, prudential limits? --- As I was pointing out earlier on, when you make choices about what assets to have in your portfolio, portfolio diversification, it is also important to understand that in the case for example of a pension fund, those portfolio investments have to finance the liabilities of the pension fund and prudential regulations really refer to limits set by the regulatory agencies for example. In many cases in addition to the limits set by the regulatory agencies, by the Boards of Trustees of individual pension funds, are the quantities and the categories of the assets that are held in that pension fund. So, for example, it is an accepted international norm that a pension often sets limits of say 15% of the assets of that fund can be held in foreign currency instruments. Sometimes those requirements include the quality of the asset that you can hold and for many years or for a number of years in the post 1994 South Africa could not sell South African Government bonds to pension funds in the United States because one of their requirements is that you have at least two investments grade ratings. At that point we only had one. Those are the kind of prudential limits and they are usually managed by the regulatory agencies which in our case would be the Financial Services Board. So that is what is meant by that. Turning to the strengthening of the balance of payments. The relaxation of exchange controls has to be managed in line with the country's balance of payments. Trade proceeds and capital inflows provide a source of foreign exchange within which the capital account should be managed if a major impact on the exchange rate is to be avoided. A gradual approach to liberalisation has to a large extent enabled the Government to manage the volume of capital outflows and allowed it to adapt the pace and the strategy of liberalisation in response to changing circumstances. The pace of liberalisation has taken into account factors such as expected capital inflows which are largely based on the investor sentiment towards emerging markets and domestic growth and economic and export production. The nett open forward position which has been spoken about and which I will to again later. The following reserve levels and the desired path for the real exchange rate. However it is important for us to note that the process of exchange control liberalisation is complex due to the size of the capital flows, the number of players in the market and the vast array of instruments available. Capital flows to emerging markets, including South Africa, have proved to be volatile in recent years in response primarily to global development. Imbalances in the Forex market are thus more often than not a consequence of drying up of the capital inflows due primarily to external factors rather than changes in capital outflows due to the effectiveness or ineffectiveness of domestic policies. Let me perhaps expand that a little bit. We heard through, it has become part of the international Lexikon the last few years this word, this concept of contagion and the issue of contagion has occupied much of the discourse in international fora, particularly in the wake of the 1998 financial crisis. Understanding why the collapse of the Russian economy or the South Korean economy would lead to a drying up of capital flows to Brazil or to South Africa for example has been part of the work that has been done by a number of international institutions. Much work has been done and I have been part of some of that work as has the Minister and our team in the treasury in places and in fora such as the Financial Stability Fora or the G20 that was set up recently, two years ago, to deal to issues pertaining primarily to emerging market economies. And there have been many many policy proposals in this regard to try and deal with the issue of contagion. Some of these proposals include for example the contingent credit line facility available at the IMF for economies which are doing well but are from time to time subjected to contagion which does not result from any imbalances in its domestic economy but happens because they are part and parcel of this emerging market universe which then becomes affected by something that has happened elsewhere in the world. So there has been many attempts and this is part and parcel of the ongoing work of these institutions, to try and understand how it is we limit contagion, particularly for those emerging market economies that are doing well, that is sound fundamentally with good economic policies and whose exchange rate or capital flows are from time to time impacted on but not generated by themselves. I think one of the, despite all the work that has been done and there are many many policy proposals as I have already mentioned in this regard, there is one underlying principal and that is that in the end as we have all found out, the only real insurance policy in the medium to long term are sound and sustainable economic policies which suit and meet the needs of your own economy. Trying to do things because they are internationally correct does not address local needs. Try to do things locally that do not meet the requirements of the international economy may also not work. So you have to choose a policy path that suits your economy, that allows you to integrate, that allows you to grow in that global arena. And I think that by and large that - I believe fundamentally that that is what we have done as a country in relation to a whole range of economic policies including the choices we have made in terms of exchange controls. Referring back to 17.1.3 an additional complication is introduced by the fact that while it is easy to pace of exchange control liberalisation in times of high capital influence, it is difficult or inadvisable to ties in exchange control liberalisation in times of low capital inflows and unlike corporate theft can make a lot of very interesting and adventurous decisions in a bull market and can correct those sometimes to great detriment of shareholders and workers in their market. Governments do not really have those choices and so they have to be careful about the choices they make in good times and in bad times. Such a move, for example, reversing or going back on liberalisation that has already been done would be perceived by investors as a reversal of a stated policy stance, to the increased investor uncertainty and ultimately further reduce the level of capital inflows. Since 1994 the level of foreign investments in South Africa has increased dramatically. Foreign investors have been a consistent source of both equity capital and direct investment demonstrating improved confidence in the South African economy. Following almost 10 years of capital outflows, South Africa has experienced capital inflows averaging around 6% of GDP per annum since 1994. Foreign direct investment in South Africa, as with other emerging markets, has tended to be lumpy in nature with much of it taking place in the form of a small number of large transactions related primarily to privatisation. Levels of inward FDI have increased from 0.1% of GDP in 1994 to around 1% per annum since 1995. And Mr Brooks has asked me what this is meaning in terms of real numbers. Well let me give you an indication, in 1994 FDI, inward FDI, was R1,3 billion. In 1997 on the back of the Telkom privatisation it increased to R17,5 billion, almost R17,6 billion to be more accurate. In 1999 it went to R9,1 billion. In the year 2000 it averaged out at R6 billion and then in 2001 because of the De Beers deal which I know the Governor again spoke about yesterday, FDI is approximately R57,5 billion. To it tends to be lumpy on the back of large transactions. Given the depth of the South African debt and equity markets, South Africa has been able to attract significant portfolio flows. Globally, however, equity flows have proved to be more important and more reliable. South Africa has furthermore benefitted from its waiting in important indices such as the Morgan Stanley Composite Index and the JP Morgan Emerging Market Bond Index which again featured yesterday as well. This has ensured the steady flow of foreign capital into the JSE securities and exchange and with positive net inflow has been recorded in almost every month since 1995. There were a few months in which we did not have positive inflows but these have been limited. The scale of inward portfolio investment in South Africa in the late 1990's was considerably higher than in other emerging market economies. Portfolio inflows totals R11 billion in 1995, R18 billion in 1996, R52 billion in 1997, R59 billion in 1998, R84 billion in 1999 and R12 billion in 2000. Now there has been some questions that have been raised in relation to particularly the shift from R84 million in 1999 to R12 billion in 2000. Let me elaborate on why these changes have taken place, if I may. Low portfolio inflows in 2000 were primarily due to two reasons. The first was the sell off of Government and parastatal bonds by non-residents and, secondly, a positive but slower accumulation of equity by non-residents. Purchases of roughly R27 billion in 2000 compared to nett purchases of around R52 billion in 1999. So there were changes both in bond flows but also foreigners, non-residents bought equities more slowly than they had although still positive inflows into the market in 2000. Mr Chairperson and commissioners, on page 39 the numbers I have read out were R11 billion in 1995, R18 billion in 1996, R52 billion in 1997, R50 billion in 1998. I understand that the number you have is R59 billion. The correct number is actually R50 billion. Perhaps before we carry on, chairperson, there has also been quite a bit of discussion on the depth of the South African financial markets and the liquidity of these markets and whether or not this is a good thing or a bad thing and I thought it might just be, if I may just for a minute or so, just talk a little bit about that and what that means for us. I think the first point to make is that South Africa, unlike many other emerging markets, and even some developed market economies, is internationally recognised for the liquidity and the depth of its capital markets. It is one of our strengths, not one of our weaknesses. We are one of the few emerging market economies with a yield curve going out over 20 years and more. We have in our government debt portfolio an average maturity of around eight years and I can assure the Commission that when we sit with our colleagues, not just from emerging markets economies but from some of the developed market economies, the average maturity of this portfolio is a thing that many of them wish they had.

<u>CHAIRPERSON</u>: Are you meaning they have got a shorter .. (intervenes) --- They have got a much shorter maturity profile and in many cases are not able to finance their deficits in their domestic capital market. They are very dependent on international capital markets to finance their deficits, so they have got much much higher levels of foreign currency debt in their government portfolios, often well over 50%, 60% in fact and in some cases even higher than that. South Africa, on the other hand, can finance, as people in this room would know, its entire deficit in the domestic capital market and I am sure that there are many market participants who over the last two years wish we had because the fact that liquidity has been tightened has also meant a tightening of spreads which, from where we sit as a

borrower, is not a bad thing. It saves taxpayers money in debt service costs. But be that as it may, I think it would be important for us as Government to say that there is a very significant benefit in having deep and liquid capital markets. These also facilitate the process of investment and they create an environment for lowing the cost of capital and, importantly for Government, for lowing the cost of borrowing which then means that there is more revenue available on the Government's budget to spend on other things. Let me also say at this point that markets require, as we all know and this is why liquidity is important, both buyers and sellers and that some of these buyers and sellers are speculators but not all speculation is bad. And in fact speculators can help in making a healthy market. However, I suppose that we should remind ourselves of what Canes had to say in this regard in 1939 in Chapter 11 of the General Theory:

"Speculators do no harm as bubbles on a steady stream of enterprise but the position is serious when the enterprise becomes a bubble on a whirlpool of speculation."

Chairperson, therefore a matter of balance.

MR BROOKS: Was that written in 1939? --- This was written in 1939 and in fact if people in the audience are interested in reading Chapter 11 of the General Theory, it could have been written yesterday in relation to the discussions and the deliberations in this Commission over the last two weeks and I would imagine going forward. I can give you a copy. Chairperson, it is therefore a matter of balance. Speculators can help make a liquid market while there was a healthy demand for and supply of assets or currency and where the burden of the spread is tight. The deeper the more liquid the market, the more likely it will be that speculators will be bubbles on a steady stream. However, in thin markets or in one-sided markets, as was the case in the Rand market in November and particularly in December, speculators will have a greater impact even with very small transactions. It is important to recognise that if a market player, even if a market player has a clear and ascertainable commitment which they want to hedge, there must be somebody on the other side which is prepared to take that risk and so this is again a matter of balance. Markets need all players including speculators and I have already - the thing about Chapter 11 which I think is relevant for this Committee, is that it deals primarily with the issue of confidence and expectations and I guess confidence and expectations is often in the short term - remember Canes was a great believer that in the long term we are all dead but in the short term it is that confidence and those expectations that tend to drive the market players in one direction or another and in very thin markets that does have very negative impact. I wanted to make that point because there has been some debate here, both about speculators but also just about the nature of the South African capital markets and I think it is, as I have said, it is one of our assets, the fact that these markets are deep and liquid and so I think it is important just to remember that. Going back to the text at paragraph 17.1.8 .. (intervenes)

CHAIRPERSON: In the previous paragraph you talk about the obvious distortion of the De Beers deal on the outflows. Have you got a sense of what that was in relation to the R24 billion that you have put here? --- Yes, if you give me a minute. I can give it to you after tea, if that is alright.

And then the second question in regard to that same paragraph is you have spoken about the first three quarters of the year. In the fourth quarter have you an idea what happened in regard to the outflow of foreign portfolio investments, is that something that you can pick up also quite quickly or not? --- Chair, the quarterly bulletin will be published early next week, on Wednesday next week I think it is and the numbers would then be available.

Would be available, so we can get that from the Reserve Bank in other words? --- Yes, at that point.

MS QUNTA: My understanding was that the Reserve Bank yesterday, the Government did give us the input of the outflows in the fourth quarter. Mr Potgieter, do you recall that, we received figures yesterday?

MR POTGIETER: Yes.

MS QUNTA: They are on the record.

MR POTGIETER: In Mr Mboweni's statement.

MR BROOKS: I do not think they are the final figures, they will only be published in the quarterly report. --- I think there are estimates of it on page 25, paragraph 16.1.5 of the Government's input.

I think you were continuing with something else. --- 17.1.8, the large inflow of funds over the past few years has enabled the Reserve Bank to increase the country's official reserves from the equivalent of six weeks worth of imports of goods and services at the end of 1994 to 24 weeks at the end of 2001 and again the Government spoke about this yesterday. The increase in capital flows and the country's official reserves in recent years has been the main enabler of the substantial relaxation of exchange controls over this period. The re-entry of South Africa into globalised financial markets and the opening up to international competition has led to a sharp increase in the participation of non-residents in domestic financial markets. Non-residents are now responsible for about one-third of the turnover on the JSE and approximately one-eighth of the volumes on the bond exchange. This has caused share and bond prices as well as the exchange rate of the Rand to be increasingly affected by developments in the rest of the world. The transactions of non-residents have contributed materially to a substantial increase in financial sector activity. Annual turnover on bond exchange for example has increased from R2 trillion in 1995 to more than R12 trillion in 2001 while the total value of shares traded on the Stock Exchange has increased tenfold from approximately R60 billion to over R600 billion over the same period.

Can you just make that clear, those figures you refer to are in Rand? --- Yes.

Because there are references to dollars as well. --- Yes, the next paragraph but these are Rands. Our shares are still traded in Rands.

Now just for the record .. (intervenes) --- Despite all the attempts at dollarisation. R60 billion and R600 billion over the same period. In the foreign exchange markets volumes increased from a nett average daily turnover of $2,7 billion in 1995 to $10 billion in 2001. The scale of nett equity purchases on the JSE points to a substantial accumulation of South African equity on the part of foreign investors. Balance of payments statistics point to non-residents' ownership of roughly R170 billion worth of equity in both listed and non-listed South African companies at the end of 2000, compared with roughly R33 billion in 1994 and this links into these numbers that I think we have heard from a number of inputs to this Commission as well. To put this in perspective, foreign ownership of listed and non-listed equity in South African companies as at the end of 2000 equals 19% of GDP whereas in 1994 foreign ownership of equity in South African companies equalled just 7% of GDP. The London listing of certain large South African companies gave further impetus to this process of foreign investment. In all capital inflows in excess of some estimated R70 billion resulted from the increased foreign interest in the shares of these companies. Dividend payment on direct investments increased fro R14,5 billion in the year 2000 to an estimated R23,2 billion for 2001 based on the first three quarters of that year. However, the figure for 2001 is somewhat distorted by the De Beers transaction that took place in the middle of the year which saw the once off payment of an extraordinary dividend in return for a major injection of foreign capital in the form of the acquisition by Anglo American and, as I said, I will get detailed numbers of the deal. Increased dividends for outflow should be seen in the light of a steady and significant increase in foreign ownership of South African equity. While dividend payments have increased by some R9 billion in 2001 including the impact of the De Beers transaction, this as a result, there has also been substantial capital inflows. It should also be noted that dividend payments remain a relatively small proportion of the overall current account activity. Estimates for 2001 indicate that dividend payments are only one-tenth of the total size of export proceeds.

Mr Commissioner, would this be a convenient time to take the tea adjournment?

CHAIRPERSON: We will adjourn until 11:30.

COURT ADJOURNS:

PROCEEDINGS RESUME

MARIA RAMOS: s.u.o.

COURT: Thank you ladies and gentlemen. The Commission would like to proceed. You are still giving evidence. --- Thank you very much, Mr Chair.

We are in the process in relation to the numbers on the De Beer deal, we are in the process of giving those numbers from the Reserve Bank. So as soon as they come in, I will share them with the Commission.

Thank you very much. --- Turning to paragraph 17.2 which deals with trade flows:

"Another thrust of economic policy has been to strengthen the balance of payments through trade reform aimed at building exports. Trade reform steps since 1994 have included and I will just go through them very briefly:

* The substitution of former quantitative restrictions with import tariffs.
* The rationalisation of the tariff structure by almost halving the number of tariff clients.
* The abolition of import surcharges which was completed in October 1995.
* The phasing down of tariffs which began in 1995 by an average of one third over five years and lastly the phasing out of the general export incentive scheme or (indistinct) as it was known which was completed by the end of 1997.

Another important policy to us has been the expansion of market access to preferential trade arrangements with industrial countries and the pursuit of regional economic integration. The following developments in this regard deserve specific mention:

* The granting of generalised systems of preferences status by various developed countries, the US, the European Union, Japan, Canada, Norway and Hungary, which has brought preferential access to these markets.
* The signing of bilateral trade (indistinct) with several African countries (regrowing trade with neighbours as seen exports within the Southern African Customs Union USACO to the rest of the Southern African region or quadruple.
* The trade development and cooperation agreement with the European union came into force in 2000 and will see liberalisation of 95% of South Africa's experts to the European union in 2002/2003. In return South Africa will liberalise 86% of EU Imports over a 12 year period.
* The implementation by the USA of the African Growth and Opportunity Act in 2001 which provides for duty free access to the American market for selected South African products and some big successes in this regard so far.

The establishment of a free trade area among the 14 member states of the Southern African Development Community.

South African exports are undergoing a transformation primarily characterised by the growing significance of manufacturers. Over the last decade the preponderance of minerals in the South African exports has diminished reflecting a diversification of our export basket.

Contrary to what was feared initially, our tariff globalisation programme has not led to the industrialisation. Instead manufactured goods set to dominate our exports in the medium term. The bulk of South African manufactured goods exports go to industrial countries underscoring the view that our producers can compete successfully in sophisticated markets in Europe and the US. A good example of this is the automotive industry exports which continued to grow at record levels since 1995. We are now exporting BMW 3-series to the US for example. We are exporting the Mercedes C-class to the Japanese markets. So an enormous amount of progress in this regard.

Export have thus responded positively to the international opportunities and the depreciation of the rand since the opening up of domestic markets. Export volumes increased by compounded 6,1% per year since 1994 compared to just 2,3% on average in the period 1990 to 1993. If one excludes the period of the emerging market crisis in 1998/1999, export volumes have grown in real terms by more than 8% per annum on average since 1995.

The National Treasury expect this trend to continue as global growth recovers and forecasts in export growth of more than 6,5% in 2003/2004."

Let me turn now to a brief chronology of exchange control reforms and some of this has also been before this Commission before.

MR BROOKS: Ms Ramos, sorry if you can just stop there. Mr Commissioner, there is an annexure A which you will find at page 60 and then this was also dealt with by Mr Bruce-Brand. You will find that in volume 6, paragraph 21 at page 14 is the cross-reference. Carry on Ms Ramos. --- Does the Commission want me to then just note that? I do not necessarily have to go through it if it has already been heard?

CHAIRPERSON: It looks familiar to me but perhaps if you want to emphasise anything from a Treasury point of view, you may do so. But very largely we have this in evidence before us. --- Chair, I think this just sets out history. The Commission has heard it. So if we can then turn to paragraph 19 on exchange rate policy.

"19.1 Given the flexible exchange rate regime, the impact of lower net capital inflow last year was felt in the exchange rate which began to depreciate in the middle of 2001. The rate of depreciation accelerated in the wake of September 11 attacks in the US particularly as it became clear that events would weaken the US economy further than was anticipated."

Let me also say, Mr Chair, that it is not that the US economy had not already began to slow down quite significantly by September 11. It is just that the events of September 11 accelerated or appear to have deepened that slow down. I think we have made the point both in our budget review but certainly also in the minister's budget speech that it is not just the US economy that has slowed down. This is the first time since the mid 1970's that we have seen a slow down in all the major economies of the world - in the European Union, Germany for example, in Japan, it remains in a difficult situation and then the slow down in the US economy and I have said this before but in relation to the slow down in the US economy, there is also many

many different views out there of how fast this recovery is going to be and exactly what shape this recovery is going to take in the US economy and the reason why all of this is important for South Africa, is that obviously the fact that exports are an important part of the growth story in our economy, a growing global economy means that we can export more and therefore has a very sound and big impact on potential growth for the South African economy and so that is the relevance of mentioning that - the slow down in the US economy in this relation.

"In context of no new inflows of capital into emerging markets, investors withdraw funds from many countries. The flexible exchange rate allowed an orderly adjustment to the drying up of capital."

And perhaps here it is also important to remind ourselves that one of the things that characterised one of the factors that characterised the Asian crisis, is that by enlarge all of those economies at fixed exchange rates, some kind of a fixed exchange rate which .. and that has also been the case in Argentina which has just had to abandon the Peg but once you have locked into a particular exchange rate, the adjustment unless you have unlimited reserves or very large reserves as is the case with China and Hong Kong for example, having a fixed exchange rate, makes adjustments particularly for developing and merging market economies difficult to deal with.

So one of the things that South Africa has and have had for some time is a flexible exchange rate that acts as a shock absorber.

"The balance of payments has adjusted well. The total value of exports remaining higher than the total value of imports and thus preventing a sharp balance of payments crisis and again the history of this country has been a history of very large difficulties arising from growth resulting to large balance of payments, current account deficits which then need to be financed and because the capital inflows are not there, they can only be finalised by slowing down the domestic economy and the fact that we over that, that there has been a major structural change in the balance of payments, is an important change in the economy of South Africa and its economic structure.

Have the fixed exchange rate regime been in place, the withdrawal of capital would likely have provoked the major crisis as domestic and international investors increased speculative pressure and forced a large official devaluation and as we all know no one wants to take the responsibility for a devaluation."

Ms Ramos, sorry are you going on to paragraph 10? --- I am going on to paragraph 10.

Just before we go on to paragraph 20 and because this will form the basis of evidence given in the first week in April, if I could just go back to the chronology of the exchange control reforms. You have just emphasised one paragraph which you will find on page 53, Ms Ramos, paragraph 18.7. Could I just ask you to deal with that paragraph together with your footnote because that really takes us in due course to the (indistinct) allegations. --- Mr Chair, I must also say that this was also dealt with by Mr Alex Bruce-Brand.

I would just like you as well to emphasise because that takes us to the next step. --- Let me then read paragraph 18.7 and the footnote:

"In addition corporates are allowed to effect the transfer of South African funds for up to 10% of the cost of their investment in excess of these limits. Another important concession introduced in 2000 was corporate asset swops whereby South African companies were permitted to buy foreign companies using their shares as acquisition currency."

And in the footnote we explain that:

"Subject to a condition that the onus is on the South African company to monitor the possible flow back of the shares into the South African market. If there is a flow back of shares, the Exchange Control Department reserves the right to call upon the South African company to refinance the transaction so as to maintain foreign reserve mutuality."

And I think Mr Alex Bruce-Brand, if I remember correctly, also made this point in his evidence on Monday.

Paragraph 20 this should also be read with Mr Mboweni's statement which you will find in volume 7, paragraph 82, page 28 and further. There is a reasonable amount of overlapping. --- yes, I will go through this because the losses on the forward book offer the account of the Treasury and the South African taxpayers. So I think it is important for us to go through that.

"The Reserve Bank had on occasions intervened in the foreign exchange market to support the value of the rand. One such occasion was during the 1998 emerging market crisis and the forward book rose from 13,9 billion dollars at the beginning of 1996 to a high of 25,3 billion dollars in September 1998. Since 1998 the NOFP has consistently reduced primarily by winding up forward book contracts. In 1999 an agreement was reached between the governor, Mr Mboweni, and the Minister of Finance to gradually eliminate the Net Open Forward Position. As stated in the joint statement by governor Mboweni and the minister on 21 December 2001, the NOFP is expected to be expanded entirely during 2002."

Mr Commissioner, that statement was referred to yesterday, you will find at page 65 of this bundle. Carry on, Ms Ramos. ---

"Since the exposure in the NOFP it is perceived by the market to be a risk. A reduction the NOFP lower South Africa's vulnerability to speculative attack."

It is believed that this in turn lowered South Africa's (indistinct) risk premium. Moreover, and one of the things that we are concerned with at Treasury and as the governor indicated yesterday, the losses on the forward book are for the account of the government as we have published in the budget review, we expect losses to total R27,9 billion for the period up to 31 March 2002. So these are by no means insignificant losses on this forward book and again this is one of those areas in which the government and the central bank have to work together and have to make policy changes which we believe in the medium to long term are in the best interest of the country and reducing the forward book eliminating this open risk as being a policy choice that has been made jointly between the government and the Reserve Bank.

"When the inflows were robust from 1998 to the early part of 2001, the forward book and the NOFP were reduced quickly. When the dollar inflows were lower, the South African Reserve Bank did not absorb dollars to wind down forward contracts.

As stated in the statement by the governor on 14 October 2001 the NOFP will be expanded only from cash flow derives from the proceeds of the government's offshore borrowings and privatisation. Accordingly it was a misperception of the market that the rand was a one-way bet based on the Reserve Bank's activity in absorbing dollars to reduce the NOFP.

In other words on the what the governor has said and was reiterated again in the joint statement between the governor and the minister, is that up to that point the Reserve Bank had bought dollars as they became available in the market from 14 October or somewhere near there onwards and the NOFP is to be reduced by government borrowing to finance deficit in the normal course of events or from the proceeds of privatisation and I think that that was an important statement to make.

Now I am also aware that there has been evidence in the Commission that perhaps we should not have - the Reserve Bank or the Government should not have made this so explicit. But Mr Chair you know this is a question of if you do not give the market information, you are not transparent and accountable. If you give the market information and you have given them too much information, in the end I think policy-makers make judgments and the judgment that was made at the time was that the market knows the size of the forward book and it would be important for us to tell the market that what have been happening until then in terms of the Reserve Bank buying dollars, was not going to be the case going forward and those were the choices that were made.

"In relation to this and at paragraph 20.5 you will see that the government increased its foreign borrowings in 2001 which included the syndicated loan of 1? billion US dollars and specifically to reduce the NOFP so that the Net Open Forward Position currently or at the end of January, stood at 2,9 billion US dollars."

Let me then turn to some concluding remarks, if I may.

"The government has been faced with the policy choice between a gradual and a rapid approach to the capital account (indistinct). The decision to follow a gradual approach as being informed by a number of factors. These factors include the need to ensure that stable macro economic conditions and adequate social safety net and a robust financial market infrastructure are in place so as to avoid potential economic instability analysing inequality. In following this path, government has had to make some difficult macro economic policy decisions.

Firstly, it had to ensure that the appropriate macro economic fundamentals are in place. This has involved far-reaching reforms of the fiscal framework and the management of corporate finances.

Monetary policy has been consistent in tackling the distortionary impact of high inflation. Trade reform and financial market developments have increased the flow of foreign currency into South Africa and government spending has been re-prioritised to increase spending on social services which promote redistribution and provide the safety net against the potential social costs of globalisation.

Secondly, in an environment of global integration it is essential for a sound and well-regulated financial system to be in place. Government has achieved this through ongoing financial market reform and the keeping the South African financial market standards consistent with international debt practice and again the (indistinct), the good capitalisation of our banks for example are acknowledged internationally.

Lastly, government has chosen to follow a flexible exchange rate to act as a shock absorber against global developments. Exchange rate adjustments helped to cushion the economy from external trade and capital flow shocks and mitigate the impact of economic contraction especially in respect of the poor."

Mr Chair and commissions, policy choices are always difficult to manage. There are many often competing priorities to be dealt with. We are having to make policy choices in a complex and often unforgiving world. So this is not a matter of waiting for a choice about one thing without (indistinct) for everything else you do and that is exactly the same in relation to exchange control policy. It fits into a broad range of policy choices at the centre of which lies the principle that South Africa is an open economy, a principle that was reiterated by the president in his opening of parliament speech in February this year. In this environment I think it is inevitable that from time to time there will be turbulence and I think essentially as South Africans and as policy makers, we must be confident that the policy choices we have made that the good performance that we have experienced with the economy over the last five/six years, enable us to keep a particular course, a course that we believe will support the ongoing growth and sustainable development that our economy needs and it is within this framework that choices have been made on exchange control policy and its gradual globalisation. It is an environment where we inherited very high walls of protection; whether those walls were in relation to exchange controls or to tariff protection, you cannot break down and bring down walls without experiencing from time to time some difficulty and some turbulence. But I think as policy makers I want to just reemphasise the point that as policy makers it is about making choices which we believe are in the needing to long term interest of our economy and I hope that our testimony before this Commission today suggests and it more than suggests but gives the Commission a sense that these choices are made after much deliberation and taking into consideration the complex set of issues and we believe that South Africa is well on course to complete in full integration into the global economy. I thank you all.

Ms Ramos, thank you. Could I just ask you to the extent that you have not stuck strictly to the text of your statement, will you confirm the content of that statement? --- Yes, I do.

Thank you.

MR GANTSHO: Ms Ramos, is there any specific reason on the rapid depreciation of the rand towards the end of the year other than the broad macro economic policies that you convinced me that they are in place, are there any specific reasons that you might want to highlight perhaps to the Commission? --- Mr Commissioner, I think that the point that I want to come back to is that, is the fact that we made policy choices and that we believe that those policy choices had been sound, good policy choices that will maintain the stability and the growth of the economy to the medium term. (indistinct) identifying exactly what happened in the last three months of last year. It is certainly difficult for us and I think the Reserve Bank has also attested to say that what happened to the exchange rate in the last three months of last year, can be attributed to a specific variable. There were a number of variables that play at the same time and certainly in our attempts to try and understand what was going on, we have been unable to say what caused it was A and not B. It was a complex set of issues not least of which is the confidence that South Africans have in their own country and their own economy and so it has been difficult for us to say there was one set of issues that led to the exchange rate depreciation that we saw last year. There were lots of things happening at the same time.

The second question, madam, relates to the sequence that you dealt with of deliberation of exchange controls with other changes such as policy changes that you have effected. The fear that I have, perhaps we can address it, is that going forward some of the companies that are listed abroad may have or will have benefited from the depreciation of the rand and that they are likely to show there are profits and therefore declare higher dividends and further that negative pressure on the rand. What influence do you have on the timing and the volume of the dividends that the independent are likely to declare sequencing declaration of dividends with the benefit that the economy would derive from the higher profits that they will be making? --- You know I think that we cannot tell shareholders and directors in companies when to declare dividends. I think those are decisions that are made by individual companies. I think it is important and I hope that we tried to contextualise the dividend issue because it is important to see the dividend issue not just in relation to the five companies that they have listed on the London Stock Exchange. It is important to see the dividend issue in the context of the fact that the stock market is about the third if not more of our stock market is owned by non-residents that as you globalise and as you integrate and as more of your capital, of your stock market and your equities market is hold and owned by non-residents, that there is going to be a concomitant increase in dividend outflows and I am hoping that what the shareholders of these companies and the companies that are listed on the London Stock Exchange, will be rational and they will decide in a rational manner on what is an appropriate dividend.

I do want to make another point here and that is that you know, Chair, I said to somebody earlier in this week that we all want to go to heaven but none of us want to guide and you know when you open up an economy when you integrate an economy where you have South African firms which are big and could potentially be international players. Then you need to allow them to spread their wings. I think what we need in this country though is a good dose of being South African that South African companies be allowed to list on the London Stock Exchange hopefully will see themselves as South African companies listed on the London Stock Exchange and not British companies. These are companies who have grown up here, who brought their base here, who are still very large companies and very contributors to the taxbase of South Africa in the South African economy and so you know we cannot tell them when to declare dividends and how much to declare in the form of dividends but we can say that it is part and parcel of integrating that you are going to have companies who are going to have to list on the London Stock Exchange or on other stock exchanges and that what we want to see is an environment that those South African companies continue to grow their South African operations, expand internationally and that we will also over time, we have not seen the (indistinct) that is significant but hopefully over time as South African companies become big global players, you will see dividend inflows as well because these companies make profit, declare dividends, there are dividends that can flow into the country from the internationalisation of our companies. I mean .. (intervenes)

And also they will be taxed locally? --- And they will be taxed locally and I think a good measure of that, a good indication of that is the fact that if you look at the revenue for this year, for the 2001/2002 fiscal year, the bulk of that revenue come from corporate tax. In fact all of it had come from corporate taxes and so as South African companies grow and they internationalise, our corporate taxbase is also growing as a result of that. So this is a transition we have to both (indistinct) and there are going to be some difficult and unpleasant times at points. So I do not think that that should persuade us from becoming involved with the global economy.

MS QUNTA: Ms Ramos, if I can take you back to paragraph 18(7) on page 50. I just want to find out and if you are not able to answer the question, you can read the paper. You have in the footnote you say:

"Subject to a condition that the onus is on the South African company to monitor the possible flow back of the shares into the South African market."

When you say that my understanding is that the authorised dealer has to manage or supervise that aspect. That is the first question. Is the onus actually on the South African company, firstly; and at what point do they report that flow back? And I will make an example. If the company enters into the transaction, they may or may not know that there will be a flow back. They may not be able to place the shares with the long term investors and there might be some flow back. Are they obliged to report the possibility of a flow back at the point where the transaction is consummated or applied for clearance or do they do it once they became aware that there is in fact a flow back and are they then obliged to report it and to whom? To the authorised dealer or to the Exchange Control Department? --- I think that that is an important question but I do not know if Mr Bruce-Brand is best to answer that question simply because this is because this falls within the existing regulations, these transactions are not referred to the Treasury for approval and so I think the Reserve Bank would be in a better position to answer that question.

Because you see we did deal with it when he gave his evidence. I think and perhaps the question arises from the manner in which you have put it here and we did ask him a question I think and he said at the point where the Exchange Control Department becomes aware of the flow back, they may as you say in your second sentence, they then reserve the right to say okay you must good, you must do it that way. But if you are not able to answer it, perhaps he can. --- I think that the onus as the footnote indicates is on the corporate to through the authorised dealer would report to the Reserve Bank that there has been a flow black and so the onus is on the corporate who has availed itself of this particular facility to let the authorised dealer know and the authorised dealer then has to report to the Reserve Bank and the Reserve Bank then has to take an appropriate decision. I am sure that they would probably look at the files of flow back, the impact of the flow back on the transaction and on the basis of that then make a decision as to whether the transaction needs to be refinanced domestically for example.

My second question is: if you go to page 53 .. (intervenes)

MR GANTSHO: Sorry just a follow up question, Madam Commissioner. Does the Reserve Bank do any spot checks on the share register of these corporates for them to determine if there has been any flow back at all? --- Mr Commissioner, I want you to remind you that in terms of the Constitution the Reserve Bank is very independent. So I do not know if they do. I hope they do some spot checks but I am not keen on answering on their behalf if that is alright.

MS QUNTA: If I can take you to paragraph 20.4 and I know the Reserve Bank manages the Net Open Forward but you have raised it. So I am hoping this one you can answer. You make what I think is an important point that, and the Reserve Bank did say yesterday they managed the reduction of the NOSP in a prudent manner and you have indicated there when the dollar influence were lower, the Reserve Bank did not absorb dollars to wind that down and then off the cuff you say after 14 October, in accordance with what the statement said there that it would only be, the reduction would only be finance by offshore borrowings and privatisation, to your knowledge and again if you are not able to answer, please say so. After 14 October did the Reserve Bank use any proceeds other than the offshore borrowings and privatisations to reduce it because on the next page you indicate that it is 2,9 billion at the end of January 2001? --- I think to my knowledge no but I think the big reduction in the forward book came from the fact that the government access the 1? billion dollar facility that we had entered into. It was a joint facility between the government and the South African Reserve Bank and it was for 1? billion dollars. It was a three year facility and the government drew down that entire facility to reduce the forward book. We also did a bit more foreign borrowing on the government's account. In other words instead of financing some of the deficits in the domestic capital markets, we did some of that financing offshore in foreign currency and the proceeds of that to that inflow also helped to reduce the forward book further and those to my understanding have been the large inflows of us reduce the forward book down to the 2,9 billion in the last few months of last year.

When you say the last few months of last year, do you mean post 14 October? --- Well, we as the government, we have borrowed in the international capital markets throughout the year. We did issues earlier on in the market and generally government currency borrowing comes in and reduces automatically the forward book. We did a bit more of that in the last three months in the form of private placements in the last three months of last year and the 1? billion dollars was also drawn down and so that together has brought down the forward book.

So in effect and the reason I am asking you is that we heard evidence in the first week that part of the problem in the second half of 2001 was the fact that dollars were taken out of the market in order to reduce the NOFP. So I am trying to get clarity on that in the light of your statement on here whether after the 14th, that money was taken out? --- Madam Commissioner, I cannot answer on the day to day basis because we do not run the foreign exchange market on a day to day basis but I think the agreement that we have with the Reserve Bank is, and certainly the statement that was made by the governor and the minister was that the primary reduction of the forward book would come from government borrowing and from the proceeds of privatisation. I think you must also keep in mind that the reduction of the forward book has happened over a number of years and so although there is focus on it, it had already reduced very significantly. Could you remind me what it was in October? 4,9 billion dollars by October already. So the reduction to 2,9 billion was a big reduction but in relation to the magnitude of the reduction from over 25 billion dollars to 4,9 that is the context within which you are looking at this thing.

Thank you.

MR GAUNTLETT: May I ask one aspect briefly?

CHAIRPERSON: Yes.

MR GAUNTLETT: Ms Ramos, the minister testified earlier as you heard that he was getting no recognition of these allegations an opportunity to investigate them. I refer to the allegations which gave rise to this Commission of Inquiry. Was that the same for you and if so, will you indicate to the Commission what steps you personally took none the less to try and get to the heart of the matter? --- Chair, yes I was not given any prior sort of indication that there were these allegations. In fact I think I either heard them on the radio or I think I heard them on the radio one afternoon or one morning driving to work. Personally I did phone Mr Wakeford because obviously these are very large allegations and the reason why we are having a Commission now is because these allegations are serious allegations. I did phone Mr Wakeford and I think I left several messages for him on his cellphone. I contacted his office. In fact we made tentative arrangements to meet at his office, I think it was his personal assistant, with me and then Mr Wakeford could not make that meeting. So I never really, I never had one discussion with Mr Wakeford about these allegations. I think that as with the minister, you know, we in the Treasury take these kinds of allegations and complaints generally seriously. I think we proud ourselves in the fact that we are professionals. We work hard and had these allegations are being brought to my attention, we would have taken every step to investigate them and so they were not and we now again as the minister has indicated, have a Commission of Inquiry and I think that we have committed ourselves to giving as much evidence and in showing that the Commission of Inquiry is able to do its work and we will take the report from the Commission of Inquiry serious when it is produced and so .. but personally I was not given any prior indication and if I had been, I would have taken the necessary steps to investigate the allegations.

Thank you, Mr Commissioner.

CHAIRPERSON: Thank you. The Commission stands adjourned until 10:00 tomorrow morning.

PROCEEDINGS ADJOURN