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THE INVESTMENT EXPERTS

Can Your Offshore Investments Be Repatriated Back

To South Africa?

In January 2020 the rand was trading at R14 to the dollar. Three months later, as we were all confined to our houses, the value of the rand fell to R19 to the dollar for the first time in its history. In little over a year it strengthened to below R14. More recently the rand traded around R18.50 to the dollar collapsed to its lowest-ever level of R19.80 to the dollar and recovered to below R18.50 all in less than 40 days.

Given this volatility in the value of the rand, South African investors have increasingly looked abroad for stable financial assets. But what would happen if our government were to decide that this shouldn't be the case anymore? Could your financial services provider (FSP) be forced to repatriate your offshore assets?

In short, yes they would. Repatriation refers to the process of returning someone, or in this case something, back to its country of origin. If the South African exchange control laws were to be amended to require that South African citizens' offshore investments be repatriated, then all South African residents and entities would be required to comply with such regulation. If your FSP is a South African company, it would thus be forced to repatriate your assets. Additionally, such legislation would apply irrespective of the way the resident's assets were held offshore, whether the assets were held directly offshore or via a South African registered offshore platform. Individuals with offshore domiciled investments who did not repatriate such investments would be in breach of such legislation, i.e. even if the government can't force your overseas FSP to act, it can force *you* to act.

So why would the South African government take these drastic measures? To prop up the rand, of course. Emerging market economies have a long history of implementing capital controls to influence the value of their currency. Sometimes to the countries' benefit, and sometimes to its detriment. Let's look at an example of each. First up is Argentina.

Argentina is a prime example of how not to implement capital controls. In the wake of the global financial crisis, the Argentine peso lost roughly a third of its value. To stabilise the currency, the government imposed strict capital controls in 2011. The restriction was informally known as the "exchange clamp". The government hoped that by limiting the amount of dollars that could be purchased by individuals, it would help prevent a run on the country's foreign currency reserves. The peso instead proceeded to lose half its value over the next four years.

In 2015, after an election where the ruling party was ousted, the capital controls were suspended. The damage, however, had already been done. The plummeting peso resulted in skyrocketing inflation. To stop the value of their life savings from completely eroding away, Argentines began buying dollars in mass, which quickly depleted the country's foreign currency reserves. Left with no other option the government reimposed capital controls in 2019. This time, however, the peso wouldn't lose 50% of its value. Instead, it lost more than 80% of its value. Capital controls were clearly not the answer to Argentina's problems, but they were part of the answer to South Korea's.

During the global financial crisis, the value of the Korean won declined by roughly 60%. In 2010 the government imposed capital controls to stabilise the currency. Limits were placed on the amount of foreign currency its citizens could buy. The South Korean government began to supervise foreign exchange reserves and monitored foreign exchange markets in order to maintain stability. So far, they have been remarkably successful. The value of the won has stayed between 1 000 and 1 200 to the dollar for the better part of 13 years.

There is one key difference to note between the Argentine and South Korean examples. While both limited the amount of foreign currency their citizens could purchase within a given time, the Argentine authorities also discouraged their citizens from owning foreign assets, while the South Korean authorities did not. This meant that South Korean investors were able to invest offshore unimpeded. Most notably in the Chinese property market, which generated enormous profits throughout the 2010s, profits that were eventually repatriated back to South Korea. Willingly that is.

So how would repatriation affect South Africa? In the short term, it may have some benefits. The hundreds of millions of dollars, euro, and pounds which would come flooding back into South Africa would certainly strengthen the rand. If the government can then somehow convince those whose funds have been repatriated to invest in South African assets, this would surely drive the price of local assets to new heights. Unfortunately, that is a big IF. The long-term picture would likely look far less rosy.

The increase in the rand and South African assets would only be temporary. What little trust South Africans have in government would likely evaporate. Not to mention the trust of foreign investors. Desperate South Africans would also likely find ways to circumvent the exchange controls. As was the case in Argentina, where a black market for foreign currency has thrived in recent years.

With less demand for rands overall, the value of the currency would likely crumble. This would lead to higher inflation (even hyperinflation), which in turn would further reduce the demand for rands, a vicious cycle that is exceedingly difficult to stop once it has begun. At that point, the rand would likely trade closer to R100 to a dollar than to R10 to a dollar. This is not a pleasant thought to have.

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