



Chapter 10

Finance

Public finance

The Constitution of the Republic of South Africa, 1996 (Act 108 of 1996), lays down a framework for the division of responsibilities between national, provincial and local governments. It prescribes an equitable division of revenue between the spheres of government, taking into account their respective functions. It also creates an independent Auditor-General and an independent central bank, and sets out the principles governing financial accountability to Parliament and the annual budget process.

The objectives of the National Treasury are to

- advance economic growth, employment and income redistribution through appropriate macro-economic, fiscal and financial policies
- prepare a sound and fiscally sustainable national budget and an equitable division of resources between the national, provincial and local spheres of government
- raise the revenue required by the fiscus efficiently and equitably
- manage the financial assets and liabilities of the State soundly
- promote accountability through effective and reliable financial reporting systems and internal controls.

◀ The South African Mint has received a number of awards for the design and quality of its gold and silver coins. Many of these coins depict themes from South Africa's rich cultural and natural heritage. The company is 100% owned by the South African Reserve Bank and supplies the Bank with, on average, between 800 million and 1,1 billion coins annually.

Since 1994, several major reforms have been undertaken in the structure and organisation of South Africa's public finances:

- The introduction of a three-year Medium-term Expenditure Framework (MTEF) has brought greater transparency and certainty to the budget process, and has strengthened the links between policy priorities and government's longer-term spending plans.
- The statutory Budget Council, the Budget Forum and several supporting technical committees oversee budgetary and financial co-operation between the national, provincial and local spheres. The Financial and Fiscal Commission (FFC) plays an important independent role in reviewing and advising on intergovernmental financial relations.
- Following the creation of the South African Revenue Service (SARS) as an autonomous agency, tax administration has been overhauled, information systems modernised and audit and debt recovery capacity reinforced.
- Building on the work of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa, a wide-ranging programme of modernising and reform of the tax system is in progress.
- A unit has been established in the National Treasury to support national and provincial public-private partnerships, complemented by a municipal partnership initiative of the Department of Provincial and Local Government.

- Debt management has been put on a sounder footing, including the introduction of auction marketing arrangements for government securities and several successful foreign bond issues. As the South African bond market has matured considerably, opportunities have been created for more active management of the debt portfolio to reduce risks and servicing costs. A framework for the evaluation of project lending proposals has been agreed upon.
- The governance of public enterprises has improved through a protocol on corporate governance, which provides a point of departure for normalising the financial accounts and tax and dividend policies of major State-owned enterprises. The Treasury now plays a more active role in coordinating the borrowing plans of public enterprises.
- International fiscal and financial relations have been strengthened, both through

Functional classification of consolidated national and provincial expenditure and social security funds (R million)

	1999/00			2000/01			2001/02		
	Estimate	% of total	% of GDP	Estimate	% of total	% of GDP	Estimate	% of total	% of GDP
General government services and unallocable expenditure	20 207,8	9,0	2,5	22 275,8	9,0	2,5	25 708,7	9,5	2,6
Protective services:	35 667,5	16,0	4,4	40 975,3	16,7	4,6	45 778,1	16,9	4,6
Defence	12 021,1	5,4	1,5	15 242,4	6,2	1,7	17 308,3	6,4	1,8
Police	15 163,5	6,8	1,9	16 421,2	6,7	1,8	17 833,3	6,6	1,8
Prisons	5 418,8	2,4	0,7	5 986,8	2,4	0,7	6 473,5	2,4	0,7
Justice	3 064,1	1,4	0,4	3 324,9	1,4	0,4	4 162,9	1,5	0,4
Social services:	105 675,2	47,3	13,0	116 577,2	47,5	13,0	126 216,6	46,7	12,8
Education	47 648,5	21,3	5,9	52 763,5	21,5	5,9	58 509,1	21,6	5,9
Health	24 937,0	11,2	3,1	27 194,8	11,1	3,0	29 624,0	11,0	3,0
Social security and welfare	27 214,8	12,2	3,4	30 412,1	12,4	3,4	31 626,6	11,7	3,2
Housing and community development	4 963,6	2,2	0,6	5 186,3	2,1	0,6	5 303,7	2,0	0,5
Other	911,2	0,4	0,1	1 020,5	0,4	0,1	1 153,3	0,4	0,1
Economic services:	17 759,0	7,9	2,2	19 589,3	8,0	2,2	22 531,3	8,3	2,3
Water schemes and related services	2 602,8	1,2	0,3	3 050,6	1,2	0,3	3 250,7	1,2	0,3
Fuel and energy	255,9	0,1	0,0	207,1	0,1	0,0	187,3	0,1	0,0
Agriculture, forestry and fishing	3 473,8	1,6	0,4	4 499,0	1,8	0,5	4 723,4	1,7	0,5
Mining, manufacturing and construction	1 201,2	0,5	0,1	1 400,8	0,6	0,2	2 023,4	0,7	0,2
Regional development	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Transport and communication	7 542,6	3,4	0,9	7 609,4	3,1	0,8	8 607,4	3,2	0,9
Other economic services	2 682,6	1,2	0,3	2 822,5	1,1	0,3	3 739,1	1,4	0,4
Interest	44 289,7	19,8	5,5	46 185,8	18,8	5,1	48 138,0	17,8	4,9
Reserve	0,0	0,0	0,0	0,0	0,0	0,0	2 000,0	0,8	0,2
Total estimated expenditure	223 599,2	100,0	27,5	245 603,3	100,0	27,4	270 372,8	100,0	27,4

Source: National Treasury



participation in the major multilateral fora and through regional initiatives in the Southern African Development Community (SADC).

- The Public Finance Management Act, 1999 (Act 1 of 1999), was passed by Parliament, laying a new foundation for financial accountability in the public sector.

The Government has reprioritised its spending to deliver services more equitably and address infrastructure backlogs. This is reflected in commitments to financing low-income housing, the national school-feeding programme, water and sanitation projects, free primary health-care services, and enhanced small-business support.

Consolidated national and provincial revenue (including receipts of provinces, local government, social security funds and national skills development funds) amounted to 26% of gross domestic product (GDP) in 1999/00, and is projected to fall to 25% by 2001/02. Consolidated government expenditure increased from 27,5% in 1999/00 to 27,6% in 2000/01 and is expected to be 27,4% in 2001/02. Planned spending on public services has increased for 2000/01, reflecting higher GDP growth, robust revenue performance and lower projected debt service costs. The Government intends lowering the overall tax burden while strengthening tax administration and promoting fiscal equity.

In keeping with the macro-economic strategy announced in 1996, the budget deficit has been lowered to below 3% of GDP. The main budget deficit declined from 4,6% in 1996/97 to 2,0% in 1999/00 and is expected to increase slightly to 2,1% of GDP in 2003/04. Since 1993/94, the public-sector borrowing requirement has been reduced from 9,8% of GDP to 2,2% of GDP in 1999/00.

Debt service costs declined from 5,5% of GDP in 1999/00 to an expected 4,4% in 2003/04. Debt cost projections have recently been revised downward as a result of debt reduction and lower borrowing associated with State asset restructuring and the proceeds of privatisation.

Financial policy framework

The Minister of Finance presented the Budget for 2001/02 on 21 February 2001. The highlights were:

- Cuts of R8,3 billion in personal income tax, and higher exemption ceilings for interest on savings.
- The residence-based income taxation came into operation on 1 January 2001. This means that people resident in South Africa pay tax on income irrespective of where it is earned.
- The implementation date of Capital Gains Tax (CGT) was deferred from 1 April 2001 to 1 October 2001.
- The Government is well set to meet its target for Consumer Price Index Excluding Mortgage Costs (CPIX) of between 3 to 6% in 2002, with inflation expected to fall steadily throughout 2001.
- Tax incentives of R3 billion over four years for strategic projects.
- The National Treasury and the SARS are investigating economically and administratively efficient tax measures to encourage job creation. This will be aimed at reducing the cost of hiring new workers and encouraging formal employment. Some R600 million has been budgeted for this purpose. It will have positive effects on other government programmes, such as the Unemployment Insurance Fund, and ensure that their benefits are more widely available. The tax relief measures would be fully operational from 1 October 2001.
- VAT zero-rating for illuminating paraffin.
- Below-inflation increases in the fuel levy from 4 April 2001: 2,4 cents a litre on leaded and unleaded petrol, and 1,9 cents a litre on diesel.
- An increase in specific excise duties: beer and cider taxes by 6%, sorghum beer and sorghum flour by 5%, duties on other alcoholic beverages by 10%, and taxes on tobacco products by between 11,8% and 20,2% to maintain the 50% tax incidence.
- Duties on soft drinks and mineral water were reduced by 25%.

- Total spending of R258,3 billion is planned in 2002, with revenue of R233,4 billion.
- A planned Budget deficit of R24,9 billion or 2,5%.
- Economic growth forecast at a 'robust' 3,4%.
- The asset swap mechanism available to long-term insurers, pension funds, the unit trust industry and fund managers was terminated with immediate effect.
- Balance of payments deficit to average around 1% of GDP.
- The cost of servicing the national debt was expected to be R48,1 billion, or 4,9% of GDP.
- Vat and company tax remain unchanged.
- Privatisation to contribute R18 billion to debt reduction in 2002, R5 billion in 2002/03 and R5 billion in 2003/04.
- A special allocation of R16 billion over the next three years to strengthen social service delivery and enhance the capacity of provinces to deal with Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome (HIV/AIDS).
- Some R7,8 billion increased infrastructure spending towards repairing flood-damaged infrastructure, new investments in school-building, roads, water and sanitation projects and rural development initiatives.
- Provincial spending to rise by an annual average of 7,5% for the next three years.
- The South African Police Service (SAPS) received 6,9% more to fight crime over the next three years, while the Department of Justice and Constitutional Development was allocated an extra 12,7% over the same period.
- The Department of Defence received the first instalment of a R30-billion investment to modernise its equipment.

Personal income tax reductions mainly for workers earning below R80 000 a year were announced, improving the equity of the overall tax system. This was achieved by raising the primary rebate by 8,9% and changing the tax brackets, ensuring sizeable benefits for lower- and middle-income taxpayers. Workers earning less than R23 000 now pay no personal income tax, and a worker earning R70 000 pays about 12% less, increasing

his/her take-home pay by 3% (or an extra R140 a month).

The tax exemption on interest and dividend income was raised by R1 000 to R4 000 for people under 65, and to R5 000 for taxpayers aged 65 and over. This provides further tax relief to those living on modest fixed-interest and dividend incomes.

Debt management

During 2000, the National Treasury continued to concentrate on reducing the interest burden on national debt and to manage risks prudently in volatile market conditions. In March 2000, bonds linked to the consumer price index were introduced, further signalling government's commitment to achieving its inflation targets. The increasingly active debt management reflects the need to maintain liquidity and integrity under conditions of a declining government funding requirement. It is facilitated by the growing sophistication and efficiency of the South African bond markets. Switch auctions, introduced in November 2000, buy-backs of bonds, and a facility to 'strip' bonds into separate coupon and redemption cash flows, are among the measures that will be used to maintain and enhance the liquidity of the Government securities market.

The Government has tapped the public international bond markets regularly and is an established issuer, with a well-developed yield curve in both the Euro and Dollar currencies. The Government's foreign borrowing strategy will continue to focus on

- establishing sovereign benchmarks in key currencies in the international capital markets
- broadening and improving the quality of its foreign investor base
- lengthening and smoothening the maturity structure of its debt portfolio.

A risk-management framework is being developed. This entails the quantification and limiting of risks arising from exogenous factors and the development of benchmarks for government debt costs. All intergovernmental cash is coordinated through the Corporation for Public Deposits as from 2001, contributing to lower



borrowing costs at national and provincial level. This assists in optimising the Government's credit risk management.

Legislative matters

During 2000 and the first half of 2001, several Bills aimed at reforming the Government's financial management were introduced and Acts implemented:

The Public Finance Management Act, 1999

The Public Finance Management Act, 1999, as amended by Act 29 of 1999, came into effect on 1 April 2000 for all departments, constitutional institutions and public entities, except for certain sections exempted or delayed by the Minister of Finance.

The Act represents a fundamental change in government's approach to the handling of public finances, as it moves the emphasis away from a highly centralised system of expenditure control by treasuries. It holds the heads of departments accountable for the use of resources to deliver services to communities. It will also, in time, change the accounting base from cash to accrual.

The Act emphasises

- regular financial reporting
- independent audit and supervision of internal control systems
- improved accounting standards
- greater emphasis on output and performance
- increasing accountability at all levels.

Flowing from the approval of a board implementation strategy in March 2000, a detailed Implementation Plan was approved by Cabinet on 20 September 2000. The first phase focuses on critical improvements in departmental financial management and ensuring compliance with the new legislation and its regulations. The second phase is aimed at long-term qualitative improvements, including the full implementation of generally recognised accounting practices.

Accounting officers prepared departmental implementation plans and submitted these to the National Treasury during 2000. Plans had to address the immediate priorities facing accounting officers, including:

- effectiveness of existing internal controls, based on an assessment of the risks facing the department
- arrangements for in-year management monitoring and reporting
- the extent to which systems and processes can ensure the efficient and effective management of revenue, expenditure, assets and liabilities
- the extent to which the internal audit and the audit committee are appropriately capacitated and functional
- delegation of responsibilities to relevant officials
- preparations to recruit a suitable Chief Financial Officer
- mechanisms to ensure suitable oversight of any public entities the department controls.

With effect from 1 June 2000, regulations in terms of the Public Finance Management Act, 1999, applicable to departments and constitutional institutions, have replaced the former Treasury Instructions. They provide for increased flexibility and place greater responsibility for decisions on departmental accounting officers. These regulations pertaining to salary deductions and public entities have since been consolidated to form one set of Treasury Regulations, and were published in the *Government Gazette* with effect from 9 April 2001.

The National Treasury recognises that the implementation of the Act and its regulations places considerable demands on accounting officers and departmental managers. A *Guide for Accounting Officers* was published in October 2000, providing an accessible account of the Act's requirements. It is supplemented by several other Treasury publications, including guidelines to departments on monthly and annual reporting.

The National Treasury, in collaboration with the South African Management Development Institute and the Institute for Public Finance and Auditing, is developing a new approach to financial management training. This long-term initiative involves detailed human resource development planning, course design and accreditation, and the build-

ing of relevant education and training capacity to meet diverse training needs.

The National Treasury is finalising proposed procurement regulations in terms of the Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000). Draft regulations were published for comments in the *Government Gazette* and provincial gazettes during June 2000. The comments received have been incorporated, and regulations were expected to be published in 2001. It gives effect to a constitutional provision stating that the Government must implement a procure-

ment policy in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. The constitutional provisions do not prevent government from implementing preferences for the advancement of previously disadvantaged people. Government departments will have to evaluate tenders in terms of an agreed formula, taking into account the tender price and other specific goals.

Taxation Laws Amendment Bill

The Taxation Laws Amendment Bill, 2001, was tabled in the National Assembly on

Budget estimates and revenue outcome, 1999/00 and 2000/01

R million	1999/00			2000/01			2000-01 increase (%) on revised estimates
	Budget estimate	Revised estimate	Deviation	Budget estimate	Revised estimate	Deviation	
Taxes on income and profits, including:	111 680	117 178	5 498	121 303	122 925	1 622	4,9
Personal income tax	82 650	86 200	3 550	87 821	86 400	-1 421	0,2
Company tax (other than mining)	19 690	20 000	310	22 668	26 025	3 357	30,1
Tax on retirement funds	5 100	5 700	600	5 800	5 800	0	1,8
Other	4 240	5 278	1 038	5 014	4 700	-314	-11,0
Taxes on payroll and workforce				1 400	1 300	100	
Taxes on property ¹⁾	2 885	3 574	689	3 338	4 004	666	12,0
Domestic taxes on goods and services, including:	71 075	70 980	-95	79 448	78 868	-580	11,1
Value-added tax	47 200	46 540	-660	52 858	54 000	1 142	16,0
Excise duties	9 350	9 095	-255	9 570	9 031	-539	-0,7
Levies on fuel	14 444	15 162	718	15 970	14 900	-1070	-1,7
Other	81	183	102	1 050	937	-113	512,0
Taxes on international trade and transactions	6 625	6 275	-353	6 500	8 189	1 689	30,5
Stamp duties and fees	1 621	1 590	-31	1 700	1 500	-200	-5,7
Total tax revenue	193 886	199 593	5 707	213 689	216 786	3 097	8,6
Non-tax revenue	3 546	3 019	-527	3 846	4 870	1 024	61,3
Capital revenue	21	43	22	386	35	-351	-18,6
Recoveries of loans and repayments	644	844	200	875	90	-785	-89,4
Grants	-	-	-	-	-	-	-
Less: SACU payments	-7 197	-7 197	0	-8 396	-8 396	0	16,7
Main budget revenue	190 900	196 302	5 402	210 400	213 386	2 986	8,7

¹⁾ Including demutualisation charge
Source: National Treasury



23 March 2001. The Bill introduces CGT in South Africa. It was proposed that the implementation date be 1 October 2001. The CGT will introduce greater equity to the tax system. CGT is a tax on the capital gain of assets at the time of disposal or deemed disposal. The capital gain is the difference between the selling and purchase prices of the asset. The Tax will be levied on individuals at a maximum effective rate of 10,5% and on companies at a maximum rate of 15%. The Tax will improve the efficiency and equity of the South African tax system.

The Financial Intelligence Centre Bill

The Financial Intelligence Centre Bill was introduced in Parliament in early 2001 and was referred for consideration to the Portfolio Committees on Finance and on Justice and Constitutional Development.

The Bill is aimed at combating money laundering activities, and establishing a Financial Intelligence Centre and a Money Laundering Advisory Council. It imposes certain duties on institutions and persons who may be used for money laundering purposes, and it provides for incidental matters.

Financial and Fiscal Commission (FFC)

The FFC makes recommendations to Parliament and Cabinet on the equitable division of revenue between national, provincial and local governments on an annual basis.

It was decided in September 1999 that the FFC would embark on Project 2001, with the aim of producing recommendations to national, provincial and local governments on an equitable sharing of the total revenue for three fiscal years, beginning in April 2001. Two new proposals, dealing with the issues of spending on social services and capital budgeting at a provincial level, were released for public comment by the FFC, including the recommended Costed Norms Approach to the Division of Revenue. The draft documents, which formed part of the Project 2001 research programme, were tabled in Parliament in April 2000.

Budget Council

The Budget Council consists of the Minister of Finance and the nine provincial executive committee members responsible for Finance. The Budget Council, as envisaged in Section 41(2) of the Constitution, aims at strengthening intergovernmental relations in addressing the financial challenges facing provinces in South Africa.

The mission of the Council is to ensure that the country uses the available resources productively, efficiently and equitably to the advantage of its people.

It recommends to the Cabinet the shares each province should receive after taking into account national priorities and FFC proposals.

Macro-economic strategy

The impressive recovery in the South African economy from global financial crises is indicative of a highly resilient economy. A range of strong economic indicators points towards further growth acceleration over the next few years. This recovery reflects a strong improvement in economic fundamentals, which include among other things:

- the decline in the inflation rate, which is expected to decline even further despite temporary distortions caused by higher food and oil prices
- sound fiscal policies and income redistribution
- the benefits of a lower-interest-rate environment
- benefits associated with stricter fiscal discipline, which will eliminate government dis-saving and pave the way for higher fixed investment spending.

There is a continued need for sound macro-economic management. In this respect, the Government aims to

- take the leading role towards ensuring sustainable growth through prudent economic management
- continue sound fiscal management
- implement policies to enhance the domestic savings performance of both the public and private sectors, with the aim of improving domestic investment

- adhere to agreed targets in order to reduce inflation even further
- further open up South African markets for domestic and international competition to enhance the competitiveness of the country's economy
- try to enhance international market access for domestic producers through regional and international trade agreements
- promote efficient financial markets through an appropriate regulatory environment. (See also Chapter: *Economy*.)

South African Revenue Service (SARS)

The SARS, in terms of the South African Revenue Service Act, 1997 (Act 34 of 1997), is an organ of State within the public administration, but an institution outside the Public Service.

It aims to provide an improved, transparent and client-orientated service to ensure optimum and equitable collection of revenues. Its main functions are to

- collect
 - all national taxes, duties and levies
 - revenue that may be accumulated under any other legislation, as is agreed upon between SARS and an organ of State or institution entitled to the revenue
- protect the borders against illegal importation and exportation of goods

Information

The SARS launched a R130-million, three-year revamp in an effort to improve efficiency, collect R14 billion in outstanding taxes and improve relations with taxpayers. The new structure will make the agency, which employs about 11 000 people, resemble a modern, large-scale banking operation.

Part of the new system will be an upgrade of the information technology systems with the aim of permitting the electronic submission of documentation.

Three separate categories will be created out of the functions currently centralised in 42 revenue offices around the country. The three new divisions will be processing, compliance and taxpayer relations.

Seven compliance centres will be established to proactively audit high-risk cases, conduct special investigations and recover outstanding debt. The compliance centres will also handle CGT.

The new system will be rolled out gradually, starting in 2001, and moving around the country in 2002 and 2003.

- advise the Minister on all revenue-related matters.

The Act established an advisory board, which acts as a consultative body for the Minister and the Commissioner of SARS on matters concerning the administration of the revenue-collecting system.

The SARS has made significant progress in enhancing its administrative capacity and overcoming important challenges to tax collection. It exceeded the printed revenue target of R212,2 billion by R7,4 billion, as well as the revised estimate of R215,5 billion by an additional R4,1 billion in revenue for the year ended 31 March 2001.

In 2000, the SARS was tasked with implementing the most extensive set of tax reforms in South African history. Other achievements include:

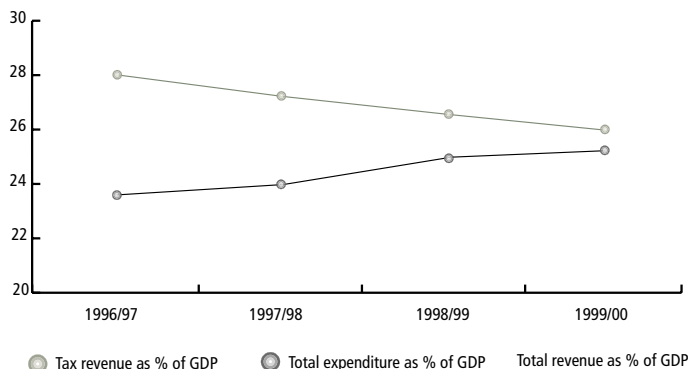
- The implementation of new trade agreements.
- A successful campaign against tax fraud in the retail industry.
- Risk-based inspections at border posts.
- The SARS became aware of serious tax and duty evasion within the electronics industry, perpetrated by means of undervaluation, double invoicing, and bribery and corruption of SARS officials. The SARS engaged the main role-players in that sector of the industry.
- The purpose was to obtain their co-operation so that self-auditing could be agreed upon and attained. This allowed for a shorter investigation period and a more efficient use of SARS's resources. Another noteworthy aspect of this investigation was that it involved all operational divisions within the SARS and also the SAPS and the National Director of Public Protections (NDPP). A total of R200 million in assessments was raised. Criminal charges were laid against eight people.
- The Constitutional Court upheld the prevailing right of SARS to collect outstanding tax while dispute resolution mechanisms are under way.

Sources of revenue

The main sources of income for the national



National government revenue and expenditure as ratio of GDP



The graph illustrates the reduction of the fiscal deficit and national government revenue and expenditure as a ratio of GDP.
Source: SARS

Government are taxes, both direct and indirect, on companies and individuals, and various duties, such as customs and excise duties.

The tax year runs from March 1 to the end of the following February.

In South Africa, income tax is levied on South African residents on the worldwide income, with appropriate relief to avoid double tax. Non-residents are taxable on South African-source income.

Tax is levied on taxable income, which, briefly, consists of gross income and less all deductions authorised by the Income Tax Act, 1962 (Act 58 of 1962), as amended. In the case of individuals, tax is levied on taxable income, which is determined in the same manner as that of companies.

Dividends and interest earned by any natural person under 65 years of age, up to R4 000 per annum, and persons 65 years and older, up to R5 000 per annum, are exempt from taxation.

Interest is exempt when earned by non-residents who are absent from South Africa for 183 days or more per year and who are not carrying on business in South Africa. (This exemption does not apply to residents of countries in the common monetary area.)

In terms of the Income Tax Act, 1962 (Act 58 of 1962), as from 1 March 2000 people who owe the SARS money are charged inter-

est at a rate of 13%, while the interest rate at which the SARS refunds money it owes to provisional taxpayers is 9%. Persons who derive income from sources other than remuneration, that is a trade, profession or investments, as well as companies, must make two provisional tax payments during the course of the tax year. Provisional taxpayers may make a third 'topping-up' payment six months after the end of their tax year.

Tax on property donations is payable by the donor on the value of the property that is donated by him or her. It was announced in the 2001 Budget that the rate of taxation be reduced from 25% to 20% from 1 October 2001. The first R25 000 a year in donations is exempt from tax. Tax on royalties is levied at a rate of 12%.

Estate duty is payable on the taxable value of the estate above R1 million at 25%.

Transfer duty is payable by purchasers of fixed property. For companies, the rate is 10%. For individuals, the rate varies from 1% to 8%.

Companies were taxed at a rate of 30% for the 2000/01 tax year. In addition to this, a secondary tax is levied on companies at a rate of 12,5% on all income distributed by way of dividends. A formula tax applies to gold-mining companies.

Customs duties are levied on a wide range of imports, while excise duties are collected

on wine, beer, spirits, tobacco products, petrol and 'luxury' products.

The value-added tax (VAT) rate has remained at 14% since 1993.

A number of essential goods are zero-rated. VAT is levied on the supply of goods and services at all stages of the production and distribution chain, as well as on the importation of goods and certain services.

VAT is also levied on all financial services except premiums payable for life assurance policies; on contributions to pension, provident, retirement annuity and medical aid funds; and on compulsory charges built into the selling price of units in unit trust schemes.

On 16 November 1998 a new VAT export incentive scheme was introduced. This was effectively the first step in addressing tax evasion through fictitious exports, which the SARS estimates is costing the fiscus about R100 million a month.

The scheme provides for refunds on VAT on exports. The refund to the foreign purchaser will be made at the point of export to ensure that the goods actually leave South Africa. As from 4 January 1999, VAT has been imposed on all imports from South Africa's neighbouring countries. This step is part of the effort to clamp down on tax evasion. The moving of the collection points to the borders ensures a more efficient collection of VAT. It also reduces VAT losses through round-tripping, where goods were exported to Botswana, Lesotho, Namibia and Swaziland (BLNS) countries and then re-imported and sold in South Africa without VAT.

Information

The Deputy Minister of Finance, Mr Mandisi Mphahla, and American Ambassador, Mr Delano Lewis, signed a development co-operation declaration in December 2000, to mark United States Agency for International Development (USAID) assistance to South Africa. USAID provided more than R200 million (US\$26,2 million) in direct support to the South African Government for development priorities during 2000, bringing the total government-to-government development assistance amount to more than R1,6 billion (about \$226 million) since bilateral co-operation was established after the 1994 election.

- The arrangements ensure effective control by curbing fraudulent VAT refund claims on exports
- capturing and validating export and import statistical information
- anti-smuggling and control measures over illegal, restricted and prohibited imports and exports.

The collection of VAT on imports is effected at the port of entry and time of importation unless otherwise arranged through participation in a deferment scheme.

Proposals aimed at streamlining the VAT system and generating an additional R4 billion in revenue were implemented in 2000. These included increasing the threshold of annual turnover for compulsory VAT registrations from R150 000 to R300 000. A lower threshold of R20 000 annual turnover for voluntary registrations of VAT vendors was also implemented.

Successes

The SARS is intensifying its capacity to prosecute tax defaulters. Qualified legal officers have been appointed at regional and local offices to assist in this process.

Tax dodgers who are convicted face sentences of up to two years' imprisonment and/or fines of R1 000 per count of tax evasion. In addition to possible sentences for fraud, the Receiver of Revenue can also impose fines of up to 200% of the tax evaded.

The SARS has achieved considerable success in its base-broadening initiative, aimed at registering persons, businesses and employers and reducing the rate of non-compliance with tax legislation.

Tax-base broadening also involves cultivating a culture of voluntary compliance and changing the adversarial relationship between the tax collector and the taxpayer. The SARS is making progress in this regard by being visible, accessible and fair in its dealings with taxpayers.

The Minister of Finance announced an increase in the skills levy, from 0,5% to 1% of the payroll. This increase was expected to raise collections from R1,3 billion in 2000/01 to R2,8 billion in 2001/02.



A formal process to appeal against penalties or any other customs practice has been established. This enhances the facilitation of legitimate trade, and ensures higher levels of compliance.

Improved controls of Duty Credit Certificates detected fraud of R12,5 million.

The following trade protocol agreements were implemented:

- the SADC Protocol on Trade
- South Africa-European Union (EU) Free Trade Agreement
- Africa Growth and Opportunity Act.

A passenger risk profiling system was developed. The use of pre-arrival information has led to greater travel facilitation and higher detection of customs violations.

Customs

Control at border posts has been improved. The number of ports or places of entry and exit for commercial goods by road has been reduced from 52 to 19, and the infrastructure has been upgraded at all 17 designated land border posts between South Africa and the BLNS countries.

These border posts are Ramatlabama, Skilpadsnek, Kopfontein and Groblers Bridge in Botswana; Caledonspoort, Ficksburg Bridge, Maseru Bridge, Van Rooyenshek and Qacha's Nek in Lesotho; Vioolsdrif and Nakop in Namibia; and Mananga, Jeppes Reef, Oshoek, Nerston, Mahamba and Golela in Swaziland. Five railway stations (Upington, Mafikeng, Maseru Bridge, Germiston and Golela) were also prescribed as ports of entry and exit for clearance of cross-border movement of goods.

The number of airports with international status for cargo clearance was reduced from 12 to 10. They are:

- Johannesburg International Airport
- Durban International Airport
- Cape Town International Airport
- Port Elizabeth Airport
- Bloemfontein Airport
- Nelspruit Airport
- Upington Airport
- Gateway Airport (in Pietersburg)

- Lanseria Airport
- Mafikeng Airport.

Seven seaports were redesignated for cargo clearance:

- Richards Bay
- Durban
- East London
- Port Elizabeth
- Mossel Bay
- Cape Town
- Saldanha.

Excise

Excise forms part of the Indirect Taxes Section of the Operations Division. Changes are being made to ensure that, among other things, budgeted amounts are collected to ensure that smuggling and tax evasion are eliminated. Drug seizures to the value of R1,241 billion were made at various customs entry points. The SAPS and the Special Operations Division of the NDPP provided crucial assistance.

Double taxation agreements

In the 2000/01 fiscal year, considerable progress was once again made in reaching agreements with other countries for the avoidance of double taxation in respect of income accruing to South African taxpayers from foreign sources or to foreign taxpayers from South African sources. The present position is as follows:

- Comprehensive agreements are in place with Algeria, Australia, Austria, Belgium, Botswana, Canada, Croatia, Cyprus, the Czech Republic, Denmark, Egypt, Finland, France, Germany, Hungary, India, Indonesia, Iran, Ireland, Israel, Italy, Japan, Korea, Lesotho, Luxembourg, Malawi, Malta, Mauritius, Namibia, the Netherlands, Norway, Pakistan, the People's Republic of China, Poland, Romania, the Russian Federation, Singapore, the Slovak Republic, Swaziland, Sweden, Switzerland, Thailand, Tunisia, the United Kingdom (UK), the United States, Zambia and Zimbabwe. The treaty with the UK extends also to Grenada, the Seychelles and Sierra Leone.

- Limited sea and air transport agreements exist with Brazil, Greece, Portugal and Spain.
- Comprehensive agreements have been ratified with Greece, Nigeria and Uganda.
- A comprehensive agreement has been signed but not ratified with the Seychelles.
- Comprehensive agreements have been negotiated or renegotiated, but not signed, with Botswana, Bulgaria, Estonia, Ethiopia, Gabon, Germany, Kuwait, Latvia, Lithuania, Malawi, Malaysia, Morocco, the Netherlands, New Zealand, Oman, Portugal, Spain, Swaziland, Tanzania, Turkey, Ukraine, the United Arab Emirates, the UK, Zambia and Zimbabwe.
- Comprehensive agreements are being negotiated or renegotiated but have not been finalised with Bangladesh, Mozambique, Qatar and Sri Lanka. Where treaties are being renegotiated, the existing treaties remain effective until a new agreement is finalised.

A number of other countries have expressed the desire to negotiate double taxation agreements with South Africa.

Agreements for mutual administrative assistance between customs administrations

These agreements cover all aspects of assistance, including exchange of information, technical assistance, surveillance, investigations and visits by officials. During 2000, the text of agreements with the Netherlands and Norway was finalised. It is envisaged that a comprehensive network will be established in the future, as a number of other countries have expressed the desire to negotiate similar agreements.

International VAT agreements

During 2000, an agreement for the avoidance of double taxation, exchange of information and mutual assistance on VAT was signed with Lesotho.

Another is in the negotiation phase with Malawi, and a number of other countries in southern Africa have expressed the desire to negotiate similar agreements.

Transformation

The SARS launched *Siyakha*, a transformation programme aimed at aligning the operation with international best practices.

This is the first step toward the fundamental overhaul and transformation of the SARS operation and structure. *Siyakha*, which means 'we are building', was born out of a process of consultation with different stakeholders including the SARS and taxpayers.

Gambling and lotteries

The gambling industry in South Africa is regulated by the National Gambling Act, 1996 (Act 33 of 1996). The Act provides for the

- regulation and coordination of certain matters relating to casinos, gambling and wagering
- promotion of uniform norms and standards
- establishment of the National Gambling Board.

In September 1999 the Minister of Trade and Industry signed the National Lottery Licence agreement with Uthingo Management (Pty) Ltd, the official lottery operator. It is expected that the national lottery will generate more than R14 billion over five years, which will be used for reconstruction and development programmes, arts and culture, sport, charities and other causes.

The first lottery draw took place in March 2000. More than 5 000 retailers, covering all the magisterial districts in the country, were appointed to sell tickets. Sixty-four new millionaires were created in the first year of the Lotto's existence.

Part of Lotto sales revenue goes to good causes, including charities and government development projects. As part of the emergency funding under the National Lotteries Distribution Trust Fund, a total of R4,102 million was paid out to cash-strapped charitable organisations between December 2000 and January 2001. A total of 80 organisations qualified for grants under the criteria set in terms of regulations of the Lotteries Act, 1997 (Act 57 of 1997). Grants ranging from R1 000 to R500 000 were awarded to organisations throughout the country.



In addition to organisational activities and legal particulars, organisations had to provide verifiable proof that they were facing financial difficulties as a result of the suspension of previous lotteries and scratch cards with the implementation of the National Lottery.

By May 2001, some R350 million was available for distribution. By that date, 215 applications for funding had been received from charities, three from sport and recreation bodies, and six from arts, culture and national organisations.

State expenditure

The National Treasury plays a pivotal role in the management of government expenditure.

The National Treasury determines the financial management norms and standards and sets reporting policy that guides the Auditor-General in the performance of his/her audit. It also assists Parliament through the Standing Committee on Public Accounts as their agent in certain aspects of their recommendations and formulation of corrective actions. The National Treasury closely monitors the performance of State departments and is obliged to report any deviations to the Auditor-General.

The Treasury, furthermore, maintains transparent and fair tendering processes, as well as accounting, logistic and personnel systems. It manages and operates computer and Internet services, sets and maintains standards and norms for treasury and logistics, acts as banker for national departments, and oversees logistical control of stocks and assets.

Treasury

Treasury norms and standards

In terms of Section 216(1)(c) of the Constitution, the National Treasury must prescribe measures to ensure both transparency and expenditure control in each sphere of government by introducing uniform treasury norms and standards. These treasury norms and standards aim at deregulating financial controls by granting accounting officers of spending agencies more autonomy in finan-

cial decision-making within the ambits of impending financial legislation.

Budget evaluations

The National Treasury plays an important role in supporting the economic policy to which the Government has committed itself. It determines the macro limit on expenditure, which is then matched with requests from departments in line with affordability and sustainability of services.

Based on this limit, all national departments are requested to submit budget proposals for the following financial year to the National Treasury by using the detailed budget manual issued by the Treasury.

Early Warning System

The Early Warning System was first established in 1997 to improve on the shortcomings of the earlier monitoring and reporting process on the Treasury's spending trends. Any likely under- or overexpenditure is brought to the attention of the Cabinet so that the relevant Minister can ensure that appropriate action is taken.

The introduction of the System has also assisted in monthly monitoring of the expenditure trends of provincial departments by having provincial treasuries reporting to the National Treasury in a prescribed format. The information derived from the early warning reports is used for advising the Budget Council and the Cabinet. The Minister of Finance is also kept informed on a regular basis of the early warning report results from the provinces.

Advisory services

The National Treasury and Department of Public Service and Administration represent government, as the employer, in the annual negotiations on the salaries and service benefits of public servants.

Financial policies, systems and skills development

The National Treasury is responsible for the financial management systems and training for government.

The services delivered support the following areas:

- financial systems, which comprise the Personnel and Salary System, Logistical Information System, Financial Management System, Basic Accounting System and Management Information System
- banking services and financial reporting for government
- financial management capacity development in national and provincial governments.

Procurement

The Constitution prescribes a fair, equitable, transparent, competitive and cost-effective procurement system. The State Tender Board functions in close collaboration with the private sector. All procurement via the tendering system entails a thorough evaluation of all requests by consumer departments as well as their recommendations for the awarding of tenders.

The National Treasury was elected to pilot a programme of procurement reform and supply management to give effect to the Preferential Procurement Policy Framework Act, 2000. It was to make the tendering system accessible to black companies and small, medium and micro enterprises.

As part of the public-sector procurement reform, Cabinet approved general procurement guidelines that are applicable for the whole public sector.

These guidelines prescribe five pillars on which all procurement should be based – value for money, open and effective competition, ethics and fair dealings, accountability and reporting, and equity. Cabinet also approved the introduction of the just-in-time delivery principle, which will include optimising and rationalising all government stores or warehouses.

The alignment of the procurement systems at national and provincial levels (to devolve accountability to accounting officers as prescribed in the Public Finance Management Act, 1999) will in due course lead to the abolition of all tender boards. Over the medium-term, a common service-provider will replace the (national) Office of the State Tender Board and will, *inter alia*, be responsible for the management of transversal contracts. Over the next two years, all decisions regarding *ad hoc* procurement contracts at national level will be devolved to accounting officers.

Auditor-General

The Office of the Auditor-General is one of the State institutions supporting constitutional democracy as set up by Chapter 9 of the Constitution. The Constitution guarantees the independence and impartiality of the Auditor-General.

The Auditor-General is appointed statutorily by the President as the independent audi-

Terms of trade and exchange rate of the rand – percentage changes

Period	Terms of trade ¹⁾				Exchange rate ²⁾			
	Including gold (5037Q)	Excluding gold (5036Q)	Nominal effective exchange rate ³⁾	Real effective exchange rate ³⁾	US Dollar	British Pound (5314Q)	Euro	Japanese Yen
1994	3,2	2,5	-7,6	-1,6	-8,0	-9,7	-9,0	-15,6
1995	-1,5	-0,5	-7,2	-1,5	-2,2	-5,1	-10,5	-10,0
1996	1,4	-0,7	-11,2	-6,3	-15,0	-13,9	-12,3	-1,9
1997	-1,2	1,2	0,4	6,5	-7,3	-11,6	2,8	3,3
1998	-0,9	-0,7	-11,7	-9,2	-16,1	-17,0	-15,9	-9,3
1999	-2,4	-2,0	-8,5	-5,1	-10,3	-8,2	-5,8	-21,9
2000	-1,4	-1,5	-5,1	-3,0	-11,4	-5,6	2,0	-16,2

¹⁾ Change compared with preceding period

²⁾ Weighted average exchange rate against most important currencies

³⁾ Percentage changes of average

Source: South African Reserve Bank – Quarterly Bulletin



tor of the executive authority. The Office of the Auditor-General became independent of the executive authority on 1 April 1993, and operates as a juristic body under appropriate parliamentary control, namely the Audit Commission.

The Auditor-General's appointment, conditions of service, powers, duties and related matters are covered by the Constitution and the Auditor-General Act, 1995 (Act 12 of 1995).

The Deputy Auditor-General is the chief executive officer (CEO) and accounting officer and is responsible for the efficient management and administration of the Office. Seven corporate executive managers assist the CEO.

The Office has a personnel complement of 1 350, and a budget of R418,8 million, and each year audits some 1 300 national, provincial and local government departments as well as a number of miscellaneous accounts.

Government auditing involves the investigation and/or evaluation of financial management practices, financial statements, performance, and compliance with requirements by government and related institutions. The objective is to form an opinion on whether the financial statements fairly present the results of the operations of an auditee at a given time and whether laws and regulations have been complied with. It also forms an opinion on control to ensure that public funds and assets are safeguarded, accounting systems are functioning properly, and public monies are spent effectively.

The Office contributed to significant improvements to the regular reporting on national government accounts. These include:

- accounting for environmental assets, especially fresh water.
- the formulation of principles and indicators for municipal performance reporting.
- the finalisation and imminent implementation of improved municipal accounting practices.
- preparation of draft formats for the annual financial statements required of accounting officers in terms of the Public Finance Management Act, 1999.

- accounting for assets and liabilities on departmental balance sheets, together with development of principles for consolidated annual financial statements.
- the Institute for Public Finance and Auditing, established in 1999 for the professional development of staff in government, is fully operational and is implementing an active programme of training. It has implemented a financial management improvement programme that is supported by the EU.

In accordance with the Public Finance Management Act, 1999, the Auditor-General has the power to investigate and audit the activities of public entities without the necessary approval of the CEO or board of directors, if he or she considers it to be in the public interest or upon receipt of a complaint.

All the companies listed in terms of the Act have to report on their financial affairs and performance.

Among these are the Post Office, Telkom, Eskom and Transnet. Provincial auditors are responsible for the management of all audits of provincial governments, specific statutory bodies and municipalities. They are also responsible for related reporting to the provincial legislatures and other provincial and local government institutions.

Financial sector

South African Reserve Bank

The South African Reserve Bank and the Ministry of Finance form the monetary authority in South Africa. The Reserve Bank has been given a significant degree of autonomy in terms of the Constitution and must perform its functions independently, although the Bank must hold regular consultations with the Minister of Finance. Its management, powers and functions are governed by the South African Reserve Bank Act, 1989 (Act 90 of 1989).

The Reserve Bank formulates and implements monetary policy and regulates the supply (availability) of money by influencing its cost. Monetary policy is guided by the object-

ives of the Reserve Bank, which are formulated to ensure financial stability. Consistent combating of inflation is the cornerstone of the Bank's policy. A formal inflation-targeting monetary policy framework has been adopted since 2000.

Monetary policy is set by the Bank's Monetary Policy Committee (MPC).

The Committee, consisting of the Reserve Bank's governors and other senior officials, held its inaugural meeting in October 1999. It meets every six weeks, after which it issues a statement indicating its assessment of the economy and policy changes, if any.

The Reserve Bank is responsible for

- assisting the South African Government in formulating and implementing macro-economic policy
- formulating and implementing monetary policy in such a way that the primary goal of the Bank is achieved in the interest of the community it serves
- ensuring that the South African money and banking system as a whole is sound, meets the requirements of the community, and keeps abreast of international finance developments
- informing the South African community and all interested parties abroad about monetary policy and the South African economic situation in general.

The Reserve Bank is managed by a board of 14 directors, seven of whom are elected by the shareholders of the Bank and represent commerce, finance, industry and agriculture. The President of South Africa appoints the governor, three deputy governors and three other directors to the Reserve Bank's board of directors.

The Reserve Bank acts as the central bank of South Africa and as banker to other banking institutions. It provides accommodation to banks and is the custodian of the statutory cash reserves, which all registered banks are required to maintain. It also provides facilities for clearing and settlement of inter-bank obligations.

On 9 March 1998, the Bank implemented a system of repurchase transactions (repos) as the main instrument in managing the liquid-

ity in the money market. The repo rate is the price at which the central bank lends cash to the banking system. The repo rate has become the most important indicator for short-term interest rates.

The repurchase agreements entered into between the Reserve Bank and banks are conducted on the basis of an outright buy-and-sell transaction, with a full transfer of ownership of the underlying assets. The system also provides for a 'marginal lending facility', which replaces the previous 'discount window'. This facility is available to banks at their initiative to bridge overnight liquidity needs.

The marginal lending facility forms an integrated part of the South African Multiple Option Settlement (SAMOS) system, which came into operation in March 1998.

This enables banks to make payments to and receive payments from the Reserve Bank, through their settlement accounts held in the books of the Reserve Bank, electronically. Daily settlements of inter-bank exposures are effected through the SAMOS system.

The movement to real-time settlements brought inter-bank settlement practices more in line with internationally-accepted standards. In terms of this system, all registered banks are able to open settlement and loan accounts at the Reserve Bank.

Payments through the system can only be made if a bank has sufficient funds in its settlement account. Such funds can be obtained through inter-bank transfers, re-purchase transactions, other types of liquidity-creating instruments of the Reserve Bank, or the marginal lending facility. The SAMOS system, however, allows the banks to receive funds obtained in the inter-bank market directly in their settlement accounts in the Reserve Bank's books.

The Reserve Bank has various instruments to achieve its objectives. These include changes in the marginal lending facility; open-market transactions, including selling its own debentures; changes in requirements with regard to cash reserves of banking institutions; and controlling the liquidity in the money market through repurchase transactions.



The Bank undertakes national and international transactions on behalf of the State, and acts for government in transactions with the International Monetary Fund (IMF).

The Reserve Bank is the custodian of the greater part of South Africa's gold and other foreign exchange reserves. Previously, all gold produced was sold to the Bank, which decided on the marketing of the precious metal, as well as on currencies and institutions in which foreign exchange reserves were kept. From December 1997, the Bank started to withdraw from the marketing of gold – a process that was completed by 2000.

The Reserve Bank issues banknotes (printed by the South African Bank Note Company, a wholly-owned subsidiary of the Reserve Bank) and controls the South African Mint Company (SA Mint).

Monetary policy

From about 1989, the main objective of monetary policy has been to secure a stable financial environment within which economic decisions are no longer influenced by high and variable inflation.

The Reserve Bank has therefore not applied monetary policy as a short-term counter-

cyclical instrument but has rather aimed at creating financial stability, which is seen as a necessary precondition for growth and development in the long run. To achieve the objective of low and stable inflation, the Reserve Bank adopted a policy framework, which was initially anchored by the setting of guidelines for growth in the broad money supply (M3). In later years, the predictability of the relationship between growth in the money supply and growth in the aggregate nominal income became less certain. As changes in the money supply became a less reliable indicator of changes in nominal income in the short-to medium-term, the Bank decided to attach less significance to the growth in M3. Instead, movements in other financial and economic indicators were also thoroughly assessed during deliberations on policy issues. Because changes in money and credit totals are major determinants of inflation in the long run, they were nevertheless still seen as important variables, which could be closely monitored by decision-makers.

The framework for monetary policy was tightened and made more transparent by adopting formal inflation targeting, in line with developments in many other central banks around the globe. At the reading of the Budget on 23 February 2000, the Minister of Finance announced that his Ministry and the Reserve Bank had agreed on an inflation target band of 3% to 6%. The objective is to bring inflation within this band by the year 2002. For targeting purposes, inflation will be measured by a new consumer price index called CPIX, which is derived by excluding mortgage interest costs from the headline consumer price index. Technically, the annual average rate of CPIX inflation for 2002 is targeted. The Reserve Bank has independence in adjusting its policies to achieve this target.

Despite the sharp rise in international oil prices in 2000, consumer price inflation in South Africa remained moderate. The rise in oil prices and the prices of imported goods led to an increase in the CPIX inflation measure to 8,2% for the year to October 2000. By December 2000, CPIX decreased to 7,6%

Information

The SA Mint was awarded a tender in January 2001 to supply low-denomination Euro currency coin blanks to several European countries. This came as Europe was moving towards the establishment of the Euro as a single currency.

The SA Mint had obtained fixed contracts with the Netherlands, Ireland and Portugal, after two years of competing against other mint companies for the supply of Euro coin blanks. The contract is for the production of one, two and five-cent pieces.

The contracts involve the supply of more than 200 million Euro coin blanks to each country. SA Mint is already supplying Euro coin blanks to Germany. Other countries South Africa supplies with blank coins include Egypt, Israel, Lithuania, India, Morocco and Singapore.

SA Mint also mints coins with a face value for many countries, including Argentina, Bangladesh, Brunei, China, Estonia, New Zealand, Namibia, Swaziland and Sudan.

The company is 100% owned by the South African Reserve Bank. The SA Mint supplies the Bank with, on average, between 800 million and 1,1 billion coins annually.

and a steady decline during the course of 2001 was expected.

Since early 1998, monetary policy has been strongly influenced by developments in the foreign-exchange market, but sight was never lost of the overriding objective of financial and overall price stability. In the wake of the emerging markets crisis, interest rates rose to record levels during the third quarter of 1998.

Interest rates have fallen steadily since October 1998. By early 2000, the private banks' prime overdraft rates had, for example, receded from a 1998 peak value of 25,5% to 14,5%. Similarly, in January 2000, the MPC reduced the Reserve Bank's repo rate to 11,75% – more than 10 percentage points below its peak value in 1998.

During 2000, monetary policy was only adjusted on one more occasion. In October 2000, the sustained rise in oil prices and a weakening of the exchange rate of the Rand increased the risks and fears of secondary rounds of inflation, pushing the 2002 inflation rate above the 3–6% target range. To demonstrate the seriousness with which the Reserve Bank would counter such potential overshooting, the repo rate was pre-emptively raised to 12%. The private banks, however, kept their prime lending rates unchanged.

Despite the generalised fall in international interest rates during the first quarter of 2001, the MPC maintained the repo rate at 12%. Although the international oil price had stabilised by the end of 2000, concerns remained about the possible impact on inflation emanating from the continued weakness of the Rand and the higher levels of domestic expenditure.

Reflecting the generally stronger performance of the South African economy, the year-on-year growth rate of the broad monetary aggregate M3 accelerated from a low point of 5,5% in August 1999 to 12,8% in March 2001. Improved consumer sentiment was evident in an acceleration in instalment sale credit, while stronger conditions in the property market underpinned a fairly rapid increase in banks' mortgage advances.

Financial Services Board (FSB)

The FSB is an independent statutory body financed by the financial services industry itself. It supervises the exercise of control over the activities of financial institutions and financial services, excluding banks and mutual banks. It acts in an advisory capacity to the Minister of Finance.

The FSB supervises the exercise of control over such institutions and services in terms of 1 416 parliamentary Acts, which entrust regulatory functions to the Registrar of long-term insurance, short-term insurance, friendly societies, pension funds, unit trust companies, stock exchanges and financial markets. These functions converge in the office of the Executive Officer, acting with the other members of the executive and heads of the various departments of the FSB's administrative infrastructure.

Included in such functions are the following: regulatory control over the participation bonds industry, certain trust and depository institutions, as well as central security depositories responsible for the safe custody of securities.

The FSB is also responsible for the financial supervision of the Road Accident Fund.

Excluded from the FSB's responsibilities are some areas involving listing requirements or public issues, takeovers and mergers.

The Insider Trading Act, 1998 (Act 135 of 1998), came into operation in January 1999 and provides for the establishment of the Insider Trading Directorate at the FSB. The Act makes it easier to impose criminal sanctions and, in addition, the FSB can take civil action against offenders.

In terms of the Insider Trading Act, 1998, the following entities nominated representatives to serve on the Insider Trading Directorate: the JSE Securities Exchange (JSE), the South African Futures Exchange (SAFEX), the Bond Exchange of South Africa (BESA), the Law Society of South Africa, and the South African Institute of Chartered Accountants. In addition, a person from the insurance and banking industry and two business persons



were also appointed to the Directorate. All the appointments were made by the Minister of Finance.

The Act confers wide powers of investigation on the FSB, including powers of interrogation, search and seizure. The findings of the investigations are placed before the Directorate on a two-monthly basis. The Directorate has the power to issue civil summons against offenders for the repayment of an amount of up to four times any profit made or loss avoided on illegal transactions.

A criminal conviction of insider trading can result in a fine of up to R2 million and imprisonment of up to 10 years.

The Executive Officer is provided with an armory of regulatory sanctions, including the cancellation of authorisation to supply financial services.

The Officer has formal powers of investigation to which criminal sanctions attach in the event of obstruction. It can apply to court for an interdict or curatorship of financial institutions if required. He or she can, in certain circumstances, also petition for the winding up or placing under judicial management of certain financial institutions such as insurers and pension funds.

These powers of intervention do not, however, take the risk out of an investment made at a financial institution. All investments carry some degree of risk, whether relating to business or general economic conditions.

The Inspection of Financial Institutions Act, 1998 (Act 80 of 1998), affords the FSB greater policing powers. The Act allows the FSB to obtain warrants for searching and questioning third parties who might have information about unregistered financial institutions, such as those providing insurance or investment services.

The FSB is assisted by an advisory board on financial markets, and advisory committees on long- and short-term insurance, pension funds and unit trusts.

It maintains a close relationship with all existing industry associations, *inter alia*, in respect of unit trusts, participation bonds, fund managers, insurance and pensions. It

liaises with international regulatory organisations and is a member of the International Organisation of Securities Commissions, the International Association of Insurance Supervisors, and the African Association of Insurance Supervisors.

On the domestic scene, it liaises with other bodies such as the Public Accountants and Auditors, Consumers Affairs Committee and various government departments, as well as with prosecuting authorities such as the Commercial Branch of the SAPS, the Investigating Directorate: Serious Economic Offences, and the NDPP.

The FSB Amendment Act, 2000 (Act 12 of 2000), seeks to change the Board's functions from 'exercising control' over financial institutions and services to 'supervising' their 'compliance with financial regulatory laws'. It also adds the function of promoting investor education.

The FSB will phase out the regulation of maximum insurance commission in the medium to long term. The commission, payable to intermediaries by or on behalf of insurers for the selling of insurance products in South Africa, is regulated by imposing a maximum level of commission calculated as a percentage of premium (also referred to as capping).

A financial system stability assessment by the IMF and World Bank has indicated that the continuing regulation of maximum commission is a weakness in the South African insurance industry and inconsistent with international best-practice.

The timing of decapping depends on a successful evaluation and implementation of the proposed Policyholder Protection Rules and Consumer Education Programme.

The Compliance Institute of South Africa, set up by the FSB, envisaged that new rules requiring disclosure of commissions and expenses that go into the costing of products alongside other product information would become effective in 2001. The Financial Advisory and Intermediary Services Bill will affect all financial service institutions. It requires financial service-providers to be authorised to operate in South Africa.

The banking industry

Currently 60 banks, including 15 branches of foreign banks, and three mutual banks are registered with the Office of the Registrar of Banks. Furthermore, 63 foreign banks have authorised representative offices in South Africa. The banking institutions collectively employ 122 700 workers at 6 486 offices.

Four major groups dominate the South African banking sector: ABSA Group Ltd, Standard Bank Investment Corporation Ltd, First National Bank Holdings Ltd and Nedcor Ltd. These groups maintain extensive branch networks across all nine provinces, and together hold 69% of the total assets of the banking sector.

The major banks offer a wide range of services to both individual and corporate customers. One-stop relationship banking, with its emphasis on universal banking, instead of isolated services, has gained importance. Nevertheless, several banks specialise in providing merchant banking services, securities underwriting or services in other niche areas.

South African regulatory authorities have pursued a market-orientated regulatory approach since 1980. Beginning in that year, previously applicable credit ceilings were abolished, interest rates were freed, and banks' previously high cash-reserve and liquid-asset requirements were reduced.

The cash-reserve requirement was, however, subsequently increased in March 1995, in order to tighten liquidity and to restrain the high level of credit extension.

Several new banks have been registered and competition has intensified, both among banks and between banks and other financial service-providers. With double-digit inflation up to the early nineties, the assets held in the banking sector have expanded rapidly, from R39 billion in 1980 to R819 billion in December 2000.

Profit margins were significantly reduced towards the end of the eighties, when intensified competition coincided with a relatively tight monetary policy. As a result, the industry consolidated and rationalised, and several

institutions merged with, or were acquired by, other banks. Effective utilisation of expensive technology, expertise and infrastructure also played a role in the rationalisation process.

Considerable costs were incurred in connection with this rationalisation. A large amount of non-performing debt was written off or provided for as a consequence of the recession between 1989 and 1993 and the turbulence in 1998.

By 2000, however, industry-wide net income before taxation had begun to improve, rising to R11,6 billion, compared with R3,1 billion in 1992.

Industry-wide net income after tax rose from 0,7% of total assets in 1992 to 1,1% in 2000. Industry-wide net income after tax as a percentage of equity dropped from 14% in 1992 to 13,1% in 2000.

The change in focus of the regulatory authorities from direct control to deregulation has been accompanied by an emphasis on proper capitalisation, sound risk-management procedures and greater disclosure.

South Africa adheres to the capital adequacy guidelines for banks, promulgated by the Bank for International Settlements. The requirement to maintain capital equal to the full ratio of 8% of risk-weighted assets became effective in January 1995.

By 2000, the banking sector as a whole had a ratio of capital to risk-weighted assets of 12,5%.

Many demands are now being made on South African banking institutions to extend their activities in South Africa in order to accommodate the banking needs of the underprivileged, and to provide more funds for housing, export financing, agriculture and small business development.

The considerable increase in demand for community-based banking during recent years led to the implementation of the Mutual Banks Act, 1993 (Act 124 of 1993), in January 1994. The Act, which aims to fill the gap between the informal and formal financial sectors, provides the broader community with access to sophisticated banking, whilst being directed towards community-based activities.



The two permanent mutual building societies existing at the end of 1993 became mutual banks (that is, banks without equity capital). Currently there are three mutual banks.

The regulations relating to banks were comprehensively revised and modernised during 2000, ensuring South Africa's continued adherence to best-practice. On-site supervision became fully operational, and measures to counter money laundering have been included in the Prevention of Organised Crime Act, 1998 (Act 121 of 1998).

The microlending industry

According to the Department of Trade and Industry, there are approximately 30 000 microlenders operating in South Africa, with an estimated turnover of R6,5 billion to R8,5 billion annually.

A process of regulating and enhancing the credibility of the microlending industry was initiated by the Minister of Trade and Industry a few years ago.

In May 1999, the Department announced changes to laws governing the industry. Amendments to the Usury Act, 1968 (Act 73 of 1968), include three provisions: capping interest rates at 10 times prime lending rate, increasing the loan ceiling from R6 000 to R10 000, and creating a system to compel microlenders to become members of a regulatory authority. Players in the industry were required to register with the Micro Finance Regulatory Council (MFRC) by 15 September 1999.

According to an Appeal Court ruling in July 2000, microlenders will no longer be allowed to hold the bank cards and personal identification numbers of their clients as security.

A National Loans Register for the sector was launched in November 2000 by the MFRC to enable assessment of the ability of prospective borrowers to afford repayments on loans. The Register will accommodate 1 000 MFRC-registered lenders with nearly 6 000 branches and a client base of more than 3,5 million borrowers.

Insurance companies

Short-term (non-life) insurance is concerned primarily with risk assessment. The contracts usually run from year to year and can be cancelled by either party. These contracts apply to engineering, guarantee, liability, motor accident, health, property, transportation and miscellaneous insurance. In 1999, the total assets of short-term insurers amounted to R60 billion (including the Road Accident Fund) according to the South African Reserve Bank.

In essence, long-term insurance consists of life, assistance (which includes industrial and funeral), sinking fund and disability insurance. Long-term insurance and pension and provident funds are concerned with maximising investment results, and life insurance is dominant. Once a contract has been entered into, it cannot be cancelled by the long-term insurer. According to the South African Reserve Bank, the total assets of long-term insurers were R664,5 billion in 1999.

The Insurance Second Amendment Act, 1998 (Act 51 of 1998), paved the way for the demutualisation of mutual societies into public companies. The two largest mutual insurance companies are Sanlam and Old Mutual. Sanlam demutualised in October 1998, and was listed as a public company on the JSE on 30 November 1998, with about two million members becoming shareholders.

Old Mutual demutualised in June 1999 and was listed on the JSE and London Stock Exchange on 12 July 1999.

New Policyholder Protection Rules came into effect under Section 62 of the Long-term Insurance Act, 1998, and Section 55 of the Short-term Insurance Act, 1998.

These Rules provide protection for policyholders over and above that contained in the Acts. The Rules form part of consumer protection as it ensures that there is proper disclosure of the financial implications, risks and obligations when undertaking insurance contracts. Full details of commissions and charges are now compulsory.

In terms of these Rules, it will be an offence if intermediaries get policyholders to sign

blank or incomplete forms, only to have someone else complete the details later.

South African Special Risks Association (SASRIA)

SASRIA, previously known as the South African Special Risks Insurance Association, was established in 1979 following the implementation of political damage exclusion clauses on policies by local short-term insurers. SASRIA's perils have been extended to cover damage caused by non-political riot and public disorder, including labour disturbance, strike and lock-out, referred to as 'special risks'. SASRIA was converted into a public company, wholly owned by the Government, under the Conversion of SASRIA Act, 1998 (Act 134 of 1998). SASRIA operates through agent companies (56 short-term insurers) who issue special-risks policies to individuals and companies on SASRIA's behalf.

The Government will maintain its ownership in SASRIA for the next five years. At the end of that period, or before if appropriate, the Government will reassess the scope for privatising SASRIA and exiting the special risks insurance market. During the five-year period, the Government will work with the industry to establish a sustainable model to provide special-risks cover.

The plan also allows for the restructuring of SASRIA's capital base to optimise its financial efficiency. SASRIA will pay the Government a special dividend of approximately R3 billion and in return, the Government will provide a R1 billion guarantee to be accessed only if SASRIA suffers an extreme loss. The proposed capital structure maintains SASRIA's strong claims-paying ability, and has been fully validated by the Government's actuarial and financial advisors.

Following a comprehensive analysis of SASRIA and the special-risks market, the Government's advisors found that there was still significant uncertainty over the viability of SASRIA's privatisation and deregulation of the special-risks market.

A key concern of the short-term insurers is

their ability to commit to maintaining a presence in the special-risks insurance market in the event that capacity becomes unavailable in the international reinsurance markets. Under these circumstances, short-term insurers could find themselves forced to cancel or refuse special-risks cover, thereby leaving South African consumers and businesses with inadequate insurance protection.

Other financial institutions

Development Bank of Southern Africa (DBSA)

In terms of the Development Bank of Southern Africa Act, 1997 (Act 13 of 1997), the primary purpose of the DBSA is to promote economic development and growth, human resource development and institutional capacity-building by mobilising financial and other resources from the national or international private and public sectors for sustainable development projects and programmes. The DBSA operates in South Africa and in all SADC countries.

The Bank has gone through an extensive transformation process over the past years.

Its mandate is focused on infrastructure, acting as a catalyst for investments in partnership with the private sector. The Bank's capital structure and financial policy have been changed, and there is a comprehensive approach to risk management.

The capital base of the DBSA has been strengthened by the Government callable capital amounting to R4,8 billion, which can be accessed as and when it is required.

The financial resources of the DBSA are made up of the share capital contribution of the National Treasury, borrowings in the financial markets, repayments on loans granted by it, and internally generated funds. In addition to these resources, it mobilises loan capital from other international sources.

In 2000/01, the Bank raised R1,5 billion from the capital markets and bilateral sources. The capital-market bonds were funded in the domestic market through a R1-billion 16-year fixed-rate note maturing in 15 June 2016.



As part of its funding strategy, the Bank has established lines of credit with reputable and highly rated international institutions such as the African Development Bank and the European Investment Bank. It also funds itself from bilateral sources such as the *Kreditanstalt für Wiederaufbau*, Overseas Economic Co-operation Fund (Japan) and the *Agence Française de Développement*.

In a further move to strengthen the Bank's funding strategy, the Board of Directors approved the establishment of a R5-billion Domestic Medium-term Note programme to facilitate the implementation of the Bank's annual borrowing programme.

The combination of a strong capital base, good asset quality, improved risk management and strengthened financial policies ensured the Bank maintained its domestic 'Triple A' long-term and A+ short-term ratings from the international rating agency Fitch. It also succeeded in obtaining international investment ratings BBB- and Baa3 from international credit rating agencies Standard and Poor's and Moody's Investor Services respectively. These ratings are the same as the sovereign ratings of South Africa, and should further enhance the Bank's resource mobilisation activities.

The Bank increased its lending to local government to R8,0 billion and has become a principal source of funding for municipalities. Other highlights were the growing role of the Bank in SADC countries, with approvals of R5,5 billion (24%) made, engaging in 11 agency functions in projects such as spatial development initiatives and the National Electricity Regulator.

The co-funded projects the Bank invested in are estimated to annually add R2,1 billion to GDP and to provide 13 200 sustainable job opportunities over the long term (20 years).

Land Bank

The Land Bank provides a full range of retail and wholesale financial services for farmers and agribusiness at competitive rates. As a statutory development finance institution, the Bank fulfils a government mandate requiring it to

- support the development of all elements of the agricultural economy
- give special attention to the needs of disadvantaged people in the sector
- benchmark its operating efficiencies and service delivery against financial sector norms
- ensure self-sustainability.

(See Chapter: *Agriculture*.)

Participation mortgage bond schemes

About 14 organisations act as managers of participation mortgage bond schemes in South Africa. Investments totalled R4,1 billion on 31 December 2000, according to the South African Reserve Bank.

Stokvels

Stokvels are co-operative rotating saving schemes, which mobilise funds among mostly black communities for a variety of purposes. Rotating saving schemes similar to *stokvels* are also found in other countries such as South Korea, Jamaica, Egypt and Japan.

Unit trusts

Equity unit trusts, so-called open-ended trusts, are investment vehicles that provide a means of participation in the equity, bond and money market for investors who may not have the time, the money or the expertise to effect investments successfully in markets on their own capacity.

The price of units is calculated and published daily. Unit trust management companies create units for selling to the public, either directly or through independent financial advisers.

The management companies may create units in the trust to meet the demand from the public, or may cancel units in the trust when the public sell back their holdings of units to the management company. The management company is obliged to buy back any units offered to it and at a price determined within 24 hours of receiving any notice of a buy-back from an investor.

Various unit trusts in South Africa offer similar ranges of investment plans, varying main-

ly as to the minimum amounts accepted.

There are two types of investment plans, namely the open-account or lump-sum plan, and the regular savings plan, which caters for regular monthly savers.

At present, 34 management companies manage the assets of 323 separate unit trusts. Most of the companies are owned by South Africa's leading financial institutions, but recently a number of independent institutions were registered. The market value of net assets of the unit trust industry amounted to R118,6 billion (excluding 'fund of funds' and institutional funds) at the end of 2000.

The unit trust industry competes principally with long-term insurance companies, pension and provident funds, and investment trusts for such investments. The trust deed stipulates the investment objective of each portfolio and constrains the investment managers regarding the type of assets in which they may invest. The other type of registered unit trust scheme is property unit trusts. They mainly invest in shares of property-owning companies. Their units are listed on the JSE where investors can buy or sell them. By February 2000, there were nine management companies, managing 11 portfolios. The latest market value of all listed units is approximately R4,686 billion.

Financial markets

Primary capital market activity

During 2000, new issues of long-term fixed interest securities were held back by the relatively small borrowing requirement of the national Government and by the preference given to funding through lower-cost Treasury bills rather than through more costly long-term bonds. Funding by public-sector borrowers through the issuance of fixed-interest securities in the domestic primary bond market amounted to a net value of R6,7 billion for 2000, considerably less than the net amount of R9 billion raised in the same period of the previous year.

Private-sector borrowers are increasingly targeting the primary bond market to meet

their financing needs. Over the past year, the outstanding nominal value of private-sector loan stock listed on the BESA (excluding 'stripped' bonds) increased almost three-fold from R3,8 billion in December 1999 to R11,2 billion in December 2000.

Although South Africa has been assessed as an investment grade country by two major international credit-rating agencies, domestic borrowers were hesitant to access foreign debt markets in 2000. Possible explanations for this could have been fear of the cost implications of potential declines in the exchange rate of the Rand, and also the increased aversion to risk-taking in emerging markets by international investors. In the end, South African public-sector borrowers raised R10,1 billion through the issuance of foreign-currency denominated bond issues in 2000, up from R9,5 billion in 1999. The Government raised an amount of about R6,9 billion through two issues, the last of which was concluded in June 2000. One of the public corporations mobilised R3,2 billion in March 2000. In March 2001, the Government raised a further EUR 500 million.

Exchange-rate concerns also dampened enthusiasm for issuing Rand-denominated bonds in the Eurobond market during 2000. South African issuers completely abstained from issuing Rand-denominated bonds in the Euro market, whereas non-resident investors made net redemptions of such bonds to the value of R3,0 billion, compared with 1999 when net issues amounting to R2,6 billion had been made.

The total value of equity capital raised in the primary share market by companies listed on the JSE increased to R74 billion in 2000, almost twice as much as in 1999. The largest contribution in 2000 came from shares issued for the acquisition of assets not already listed of R44 billion.

Secondary capital market activity

Bond yields, which move inversely to the price of bonds, declined, on balance, during 2000. The monthly average yield on long-term government bonds declined by 107 basis



points from December 1999 to December 2000. After increasing from 13,5% in February 2000 to 14,8% in May, a general downward movement in bond yields followed, which was temporarily interrupted from August to October when, among other things, political developments in other parts of the southern African subregion, and concerns that higher inflation might follow the rise in the price of crude petroleum, and the persistent depreciation in the value of the Rand, caused bond yields to retrace part of their earlier declines.

By about mid-October 2000, in the aftermath of a decision by the Reserve Bank to raise the interest rate on repurchase transactions by 25 points as a gesture demonstrating its resolve to fight inflation, fears of higher inflation began to dissipate and it also became evident that political events in other parts of the African continent would not have any serious repercussions in South Africa. The announcement of the Medium-term Budget Policy Statement on 30 October 2000 further reaffirmed government's commitment to prudent revenue and spending policies, and subsequently bond yields resumed their downward movement, which continued into 2001. The monthly average yield on long-term government bonds reached 11,8% in March 2001 – its lowest level since 1983.

High volatility in bond prices caused the turnover in the domestic secondary bond market to rise from R8,8 trillion in 1999 to R10,5 trillion in 2000 – an increase of almost 20%. In December 2000, the nominal value of bonds in issue amounted to R418 billion with a market capitalisation of R425 billion, which included 209 listed bonds of 31 issuers.

Non-resident investors reduced their holdings of domestic Rand-denominated debt in 2000 because of increased aversion to risk-taking in emerging markets and heightened uncertainties over future domestic interest-rate and exchange-rate movements. On a net basis, non-residents sold bonds to the value of R14,3 billion in 1999. Net outright sales, as opposed to repurchase transactions, amounted to R11,7 billion in 2000, compared with

R13,5 billion in 1998 during the emerging-markets crisis. Non-resident investors were apparently somewhat less negative towards South African debt securities in 2000 than in the crisis year of 1998.

Share prices closed the year slightly lower than their opening levels. Year-on-year, the daily closing level of the all-share price index declined by 2,5% from the end of December 1999 to the end of December 2000. The monthly average price level of all classes of shares increased by 13% from December 2000 to February 2001, beating the previous record high of January 2000 by about 4%.

Volatile price movements through 2000 boosted trading activity in the secondary share market. Shares to the value of R537 billion were traded on the JSE in 2000, about 20% more than the previous record set in 1999. Liquidity, measured as turnover as a percentage of market capitalisation, reached a new level of more than 35% in 2000 compared to 34% in 1999.

Non-resident investors were far less interested in the South African equity market in 2000 than in 1999. On a net basis, non-resident shareholders bought R17,4 billion worth of shares in 2000, down from R40,6 billion in 1999. The negative turn in non-resident investor interest is best explained by a decline of 26% in the dollar value of share prices from January to December 2000.

Money markets

The South African money market is well advanced, with a fairly large number of banks and other institutions as active participants. Instruments traded range from traditional ones such as negotiable certificates of deposit and Treasury bills to those that only recently became popular, like forward-rate agreements (FRAs).

Banks are generally kept short of liquidity, ensuring that they have to borrow some funds from the Reserve Bank, which makes the Bank's accommodation rate more effective in influencing money-market interest rates in general.

In terms of the Reserve Bank's operational procedures, banks are accommodated through daily repurchase transactions. To manage their liquidity needs efficiently, banks are also allowed recourse to their cash-reserve balances. Using so-called contra-accounts they may on a daily basis borrow against their cash reserve deposits or hold additional cash reserves, as long as the average level of cash reserves during the one-month maintenance period equals or exceeds the minimum cash reserve requirement of 2,5% of their liabilities.

In addition to the repurchase auctions and contra-accounts, a marginal lending facility is also available to the banks. It is seldom used, since the Reserve Bank charges a penalty rate of five percentage points above the repurchase rate for such lending to the banks.

After fluctuating between R8,4 billion and R9,4 billion in the eight months from April to November 2000, the average daily liquidity requirement of the private banks increased to R10,2 billion in December 2000. It eased slightly to R10,0 billion in January 2001 and R9,2 billion in February, but increased to R11,0 billion in April 2001. Between April and November 2000, the Reserve Bank kept the daily liquidity requirement above R8 billion by actively implementing various intervention techniques.

The intervention strategy of the Bank was essentially aimed at counteracting the effects of liquidity injections into the money market, arising from increases in the Bank's net foreign-asset holdings and deficits incurred on the Bank's transactions in the forward foreign-exchange market. In its intervention in the money market, the Reserve Bank increased the outstanding amounts of foreign-currency swap arrangements with private-sector parties from R10,9 billion at the end of June 2000 to R22,1 billion at the end of April 2001. To reinforce its liquidity-draining operations, the Bank also increased the outstanding amounts of reverse repurchase transactions in government securities from R4,0 billion at the end of May 2000 to R5,0 billion at the end of November. For similar

reasons, Reserve Bank debentures were increased from R3,0 billion at the end of the first quarter of 2000 to R4,0 billion at the end of November 2000.

During the festive season at the end of 2000, money-market conditions were seasonally tightened by a considerable increase in the value of notes and coins in circulation outside the Reserve Bank. At the height of the holiday season, notes and coins in circulation outside the Reserve Bank reached a peak value of R34,7 billion on 27 December 2000 compared with the previous peak of R33,3 billion on 28 December 1999.

On balance, notes and coins in circulation rose by R3,2 billion from the end of November to the end of December 2000. The tightening effect of the increase in notes and coins in circulation was alleviated to some extent by decreasing the reserve repurchase transactions of the Bank from R5 billion at the end of November 2000 to R3,75 billion at the end of December. At the same time, Reserve Bank debentures in issue were reduced from R4 billion to R3 billion. When notes and coins began to flow back to the Reserve Bank during January 2001, the reverse repurchase and debenture levels were restored to their November 2000 values. In February 2001, the value of reverse repurchase transactions outstanding was raised marginally to R5,4 billion and further to R5,7 billion at the end of April 2001. Issues of Reserve Bank debentures were increased to R4 billion in February 2001.

The Reserve Bank continuously met in full the liquidity needs of the private banks during 2000. The only exception was on 17 October 2000, when the market was underprovided by R50 million in order to apply upward pressure, raising the repurchase rate of the Reserve Bank by 25 basis points. Full provision of the liquidity needs of the private banks usually sends a signal that the Reserve Bank considers the prevailing interest rate on repurchase transactions as appropriate.

Unlike the sometimes volatile bond yields, money-market interest rates were exceptionally stable during 2000. The Reserve Bank's



rate on repurchase transactions was adjusted on only two occasions: from 12% to 11,75% in January 2000, and from 11,75% to 12% in October. The three-month bankers' acceptances rate moved in a range of 9,83% to 10,93%, narrower by far than the typical range in the second half of the nineties.

At the beginning of October 2000, money-market interest rates began to rise somewhat when market participants became concerned about the inflationary consequences of high international petroleum prices and the depreciation of the Rand. Money-market rates generally edged higher when the repurchase rate of the Reserve Bank was increased on 17 October 2000, but peaked before the end of October and declined steadily over the ensuing period. The rate on three-month bankers' acceptances, for example, peaked at 10,31% on 26 October 2000 and then began to decline, reaching 10,23% on 28 February 2001.

When expectations of increases in money-market interest rates intensified in October 2000, the rates on FRAs rose. For instance, the rate on 9x12-month FRAs (indicating market expectations of rates on three-month instruments nine months hence) gained almost a full percentage point during the three weeks to 26 October when they peaked at 11,7%. News that the economy was performing better than had earlier been anticipated and that inflation was not widely expected to accelerate, caused the 9x12-FRA rate to recede to 10,15% by 28 February 2001. With the concurrent rate on three-month negotiable certificates of deposit at 10,53%, the FRA rates signalled market expectations of a slight decline in money-market rates over the next nine months.

Since February 2000, the private banks have kept the predominant rate on mortgage loans unchanged at its lowest level in 12 years, namely at 14,5%. The predominant rate on 12-month fixed deposits with banks remained unchanged at 8,5% from February 2000 to May, but was raised in two steps to 9,5% in July. Subsequently, this rate was lowered to 9,25% in September 2000, but restored to 9,5% in January 2001. These rate

movements narrowed the differential between banks' prime lending rates and the rate on 12-month fixed deposits, on balance, from 600 basis points in February 2000 to 500 basis points in January 2001.

Exchange control

Exchange control was first introduced in South Africa during World War II. This was part of the emergency finance measures adopted by the British Sterling Area to prevent large capital outflows and to protect foreign reserves.

The measures were applicable mainly to South African residents at first. From 1961, the capital transactions of non-residents were also restricted. In subsequent years, these controls were tightened or relaxed from time to time, depending on domestic and international circumstances. Exchange control is administered by the Reserve Bank on behalf of the Minister of Finance.

The Reserve Bank is assisted in this task by a number of banking institutions, which have been appointed by the Minister of Finance as authorised dealers in foreign exchange. These banking institutions undertake foreign exchange transactions for their own account with their clients, within limits and subject to conditions laid down by the Reserve Bank.

The Government is committed to an open capital market and the gradual relaxation of exchange controls. In new rounds of relaxations, the private individual investment allowance has been increased from R400 000 to R500 000 and then to R750 000 in February 2000.

Investment limits applicable to SADC countries have also been increased enormously. The SADC countries' limit of R250 million per new approved investment has not only been increased to R750 million but this now applies to Africa as well. The R50-million limit applicable to foreign investments elsewhere in the world was increased to R500 million per new approved investment.

In support of investment

- a new tax incentive is proposed for com-

- panies embarking on approved strategic industrial projects
- more favourable tax depreciation rules for small businesses in the manufacturing sector will apply
 - substantially increased allocations for capital spending by national and provincial departments are proposed.

JSE Securities Exchange (JSE)

The JSE was established on 8 November 1887. In November 2000, it changed its name to JSE Securities Exchange South Africa. The JSE is governed by the Stock Exchanges Control Act, 1985 (Act 1 of 1985), under the responsibility of the FSB. The JSE in turn governs its listed companies and brokers by extensive rules and directives. The JSE is the largest stock exchange in Africa, and has a market capitalisation of several times that of all the other African markets combined.

The JSE completed a major strategic review in March 2000, which identified 31 significant strategic projects to be completed to position itself as a world-class regional exchange and as southern Africa's gateway to the world's financial markets. This process, referred to as Gateway 2002, is well under way and responsible for the significant changes being evidenced at the JSE.

On 12 October 2000, members of the JSE approved a proposal to implement the first phase of the restructuring of the JSE, to take effect on 1 December 2000. A board of directors, which represents a broad interest base, was established and a CEO appointed. In addition, a new advisory committee structure was put in place, which will benefit from the participation of a wider spectrum of industry specialists. Previously, the JSE was directed by an honorary committee of 16 people with full voting rights and run by a full-time executive president. Portions of the JSE reserves and the accumulated surplus as at 30 November 2000 were capitalised in the form of JSE rights, thus forming a permanent capital base. The JSE is in the process of evaluating the merits of demutualisation.

The JSE is committed to promoting South Africa both regionally and internationally. In this regard, it has led the process of harmonising the listing requirements of the members of the SADC Committee of Stock Exchanges (CSE). The CSE envisages an integrated real-time national network of securities markets in the region by 2006. The JSE has offered its trading platform to these members, and Namibia has been trading on the Johannesburg Equities Trading (JET) for the past three years. The JSE has also signed Memoranda of Understanding with Namibia, Kenya, Ghana, Egypt, Nigeria and Mauritius, and hosted the annual conference of the African Stock Exchanges Association in September 2001.

The JSE uses order-driven fully automatic electronic trading on the JET system. The order book is organised on the principle of 'price/time' priority, where orders registered in the book are ranked first at the best price and then in time sequence of entry. The JET system has already resulted in significant improvements in trading volumes, transparency, price-formation liquidity and cost of trading on the JSE. The JSE recently signed Heads of Terms with the London Stock Exchange (LSE) to use their trading platform. This will allow the JSE to implement some new initiatives including new ideas in respect of the less liquid stocks on the JSE, which could not be done on JET. In terms of this agreement, certain key business benefits will also accrue to both parties, including reciprocal data distribution, access to the LSE's most liquid stocks on the JSE system, an easier dual listing process for South African companies (without the JSE losing the benefits of their trading volumes), and the possibility of remote membership.

A key extension of the LSE deal, although mutually exclusive, is the joint venture with global index-provider FTSE, announced on 3 May 2001. The JSE together with FTSE will provide internationally-recognised index products for the domestic and African markets. A significantly enhanced and expanded index series, to be named the FTSE/JSE Africa Series, will be developed for South African and African investors. The existing JSE indices



will be brought in line with international investment standards based on free float, total return indices and the FTSE Global Classification System, by the end of 2001. The JSE and FTSE will also develop a range of benchmark and tradable index products.

Share Transactions Totally Electronic (STRATE), South Africa's Central Securities Depository for equities, is 50% owned by the JSE. The other 50% is owned by Central Securities Depository Participants, consisting mainly of banks. STRATE enables the conversion to electronic records of ownership (dematerialisation) and to simultaneously deliver on payment through contractual guaranteed settlements. Settlement takes place five days after trading (T+5) on a rolling basis, with the objective of achieving T+3 by the end of 2002. STRATE will also result in the elimination of market claims for entitlements, which will make it a world leader in this aspect of its business. The new system is in line with international standards and risk parameters, for cutting costs and for eliminating the potential for fraud.

The dematerialisation process of equity script required for the STRATE system commenced on a limited basis in November 1999 and was launched in earnest in March 2001, to be completed by the end of 2001.

A proposal to acquire the SAFEX's principal assets and business was approved by the members of both SAFEX and the JSE in May 2001, respectively. The JSE firmly believes that the integration of South Africa's financial markets will generate the desired critical mass, cost-effectiveness and liquidity in the South African market, and will best position the JSE to compete internationally.

A re-write of the JSE listings requirements, effective from 1 October 2000, ensured total alignment with international best-practice. Particular emphasis was put on improved disclosure of companies and its directors, and corporate governance issues, in order to further promote both local and international investor confidence.

The real-time Stock Exchange News Service (SENS) has been in operation at the JSE since

August 1997 to enhance market transparency and investor confidence. The JSE listing requirements obligate companies to disseminate any corporate news or price-sensitive information on the Service prior to using any other media outlet. SENS is carried by all major wire services. The JSE introduced significant enhancements to SENS in 2001, to ensure easier use and speedier publishing of information by listed companies.

The JSE is keenly focused on product development and innovative ways of meeting the market's needs. The JSE is particularly focused on products which broaden the investor base and bring greater liquidity and depth to the market. In this regard, the JSE issued and listed the first Exchange Traded Fund (ETF) in South Africa, and became the sixth exchange in the world to do so. With the Initial Public Offering (IPO), a total of R2,6 billion was raised, making it the largest IPO to date in South Africa. The ETF, named the SATRIX 40, enables an investor to buy a single JSE-listed security, which gives investors the same return as buying shares directly in each company in the JSE's ALSI 40 Index. It was designed to broaden the JSE's investor base and increase market liquidity.

South African Futures Exchange (SAFEX)

SAFEX is a registered financial exchange established to regulate the trade of derivative instruments listed by SAFEX. The Exchange operates under a license, renewable annually, which is granted by the FSB. As a self-regulatory organisation, SAFEX is governed by the Financial Markets Control Act, 1989 (Act 55 of 1989), and by an internal set of Rules and Directives approved by the FSB.

SAFEX comprises two key divisions: Financial Markets Division, which covers the equity and interest rate futures and options markets, and the Agricultural Markets Division, which covers commodities futures and options on maize, sunflowers and wheat. Each division is owned by a separate set of members.

Membership of SAFEX is currently as follows:

- Financial Markets Division: 119 seats (93 members)
- Agricultural Markets Division: 84 seats (56 members).

An Executive Committee of up to 11 elected members, all with full voting rights, directs the Exchange. Additional non-voting nominees are also appointed to the Executive Committee. The FSB attends all executive meetings in its regulatory capacity. A full-time management team headed by the CEO carries out policy decisions made by the Committee. The members, who in turn represent their clients, and can be clients of the Exchange themselves, elect the Committee once a year.

For the year until end December 2000, total volume on all products amounted to 24,6 million contracts. This represented a 30% increase from 1999, almost double the increase for 1998/99. This is deemed most satisfactory by international standards. The Futures Industry Association currently ranks SAFEX as the 17th-largest-volume exchange in the world.

The combined resources of the two divisions have grown from an initial R3,4 million in 1990 to just over R155 million by June 2000.

The international nature of trading activity on SAFEX is becoming increasingly obvious, with approximately 50% of risk positions being held by non-residents. This is despite the fact that SAFEX has still been unable to secure the approval of the Commodity Futures Trading Commission for products to be traded by US-based institutions.

The Securities Exchanges Commission continues to be concerned about the concentration of ownership on the JSE. Further advances to the US regulations are being made in an attempt to reach an acceptable solution, which will go along the line of free-float equity indices.

In the first half of 2001, SAFEX was engaged in negotiations with the JSE on a possible takeover by the JSE.

Bond Exchange of South Africa (BESA)

BESA is a self-regulatory and independent body operating within the framework of the Financial Markets Control Act, 1989, and a set of Rules approved by the FSB.

BESA is directly responsible for ensuring the stability, security and regulatory administration of the bond market in South Africa, and regulates the bond trading activities of all its member firms. These firms hold seats on the Exchange, ensuring that ultimate control of the Exchange rests with the general body of members.

The Executive Committee, appointed annually in accordance with the Rules, directs the affairs of the Bond Exchange. The Committee has specific responsibility for strategic and business planning, the setting of corporate policies, the approval of significant contracts and the monitoring of the ongoing operations and performance of the Exchange.

Appointments to the Executive Committee are made directly and independently by BESA members. The Committee comprises market representatives drawn from the membership constituencies as well as two general member representatives elected at every annual general meeting.

A team of professional management and staff handle the day-to-day operations of the business.

Listed securities

Although primarily a government bond market, BESA also lists Rand-denominated debt securities issued by local government, public enterprises and major corporates. By 31 March 2001, the Exchange had granted a listing to some 250 bonds issued by 32 borrowers, with a total nominal value of some R421 billion.

More than 80% of this debt had been issued by central government. By comparison, there are about a half-a-dozen listed corporate issues, including Telkom SA Ltd, ISCOR, ABSA Bank Ltd, Investec Bank Ltd, The Standard Bank of SA Ltd, SASOL Financing, Stripco Ltd and INCA. Of the listed



bonds, some 99% have been immobilised in the Central Depository.

The evolution of sophisticated bond products in South Africa has been hampered by restrictive regulations, the relatively small size of the local market, and weak demand from both borrowers and investors. Vanilla bonds constitute the majority of BESA's listed instruments, and variations on this theme include:

- fixed interest-bearing bonds with single and multiple redemption dates
- zero coupon bonds
- CPI index-linked bonds
- variable interest rate bonds/floating rate notes
- domestic medium-term note programmes.

BESA has appointed a Listings Advisory Technical Committee (Listech) to provide ongoing advice on the Exchange's Listings Disclosure Requirements and Rules. This Committee will assist in ensuring that BESA's regulations remain comparable with international requirements, rules and best-practice in order to contribute to the strengthening of investor protection and market confidence.

Main indices

The Bond Exchange, in collaboration with the Actuarial Society of South Africa, has introduced a trio of bond indices which provide a simple yet accurate measure of total returns of representative bond portfolios, and provide benchmarks for historical performance. These indices (introduced in August 2000) replaced the previous bond indices used in South Africa.

The Total Return Indices comprise the

- All Bond Index (ALBI), consisting of the top 20 listed bonds, ranked by market capitalisation and liquidity (the ALBI also has four subsectors split by term to maturity)
- Government Bond Index, containing those bonds of the ALBI in which the appointed primary dealers are obliged to make a market
- Other Bond Index, comprising the remainder of the bonds in the ALBI.

These indices are published daily by the Exchange and are widely disseminated to all members, the asset management industry and the media.

Trading mechanisms

In South Africa, changing bond-trading patterns over the past few years have seen a gradual and continuing shift away from open outcry trading to screen/telephone trading. In 1998, trade on the floor declined to less than 10% of overall market volumes. As a result, the open outcry bond floor was closed in October 1998, and execution now takes place on the Exchange's Bond Automated Trading System (BATS) or via inter-dealer brokers (IDB), matched principal traders, and directly on screens managed by data vending firms.

Implementation of BATS for member firms commenced early in 2000.

This proprietary, wide-area system provides facilities for immediate on-screen execution of outright trades and repos, and also allows for the reporting of block trades and telephone trades. BATS is a quote-driven system and includes credit limit functionality, thereby allowing members to limit their exposures for all counterparties utilising the system.

By mid-2001, limited volume had been traded on-screen though BATS, possibly due to the fact that electronic trading is still something of a novelty in bond markets and the IDB trading.

Primary dealers

The National Treasury introduced a primary dealer system in 1998 to promote the effective distribution of government issues and to maintain a liquid secondary market in selected South African bonds. The 10 primary dealer banks are required to quote continuous two-way prices in seven key government bonds on request, although liquidity has been largely concentrated in two benchmark issues – the R150 and R153 bonds. All primary dealers must be members of the Exchange.

Market performance

The local bond market is one of the most liquid emerging bond markets in the world. In 2000, the local market turned-over the market capitalisation some 25 times. With the inclusion of the off-shore trading volumes,

this measure of market velocity touched 27 times the market cap.

The off-shore market comprises trades in Rand-denominated bonds (listed on BESA), which trades are concluded off-shore directly between non-members, but which are settled either in South Africa through the settlement agent network or via Euroclear and Clearstream. Of the total bond turnover (local and off-shore) recorded for 2000, being a figure of R11,6 trillion, some 25% was concluded between locally-based members and overseas clients, 4% was traded off-shore by non-members and settled locally, while some 3% was traded off-shore by non-members and settled in Europe.

Clearing and settlement

BESA adopted the Group of Thirty (G30) recommendations on clearing and settlement as a blueprint for the development of its own clearing operations. With the introduction in 1994 of a recognised clearing house, the Universal Exchange Corporation Ltd, BESA members were able to benefit from electronic trade reporting, matching and settlement. This process takes place each trading day, and is facilitated by the four settlement agent banks and the Central Depository Ltd, where some 99% (by value) of listed debt securities are immobilised.

With the change to a rolling+3 settlement system in November 1997, the Exchange achieved full compliance with all the G30 recommendations (the first Exchange in southern Africa to do so), and all but eliminated the key settlement and post-settlement risks faced by market participants. Although the market remains essentially wholesale in character and operates on a counterparty risk basis, BESA has developed a risk-margining methodology. When implemented, this will allow for the accurate measurement of all open exposures incurred by Exchange members across all markets.

By making use of a clearing house, a central securities depository and the settlement agent system, the Exchange offers protection from settlement failure and tainted scrip risk.

A Guarantee Fund with overall cover of R225 million (US\$1 = R8,05 by approximately March 2001) provides protection against retransaction price risk (in the event of member default) while fidelity cover held by individual members provides a minimum level of protection against fraud or theft perpetrated by employees of a member firm.

Investor protection

- Regulation: BESA is a licenced Exchange, and both the Exchange and its member firms must adhere to the Financial Markets Control Act, 1989, and to a set of approved rules. As a self-regulatory organisation, the Exchange undertakes ongoing surveillance over all aspects of bond market activity in South Africa.
- Price discovery: Trading takes place on BATS, via the more traditional screen/telephone mechanism or IDB screens. Investors can rely on the fact that their transactions are executed in an open and competitive securities market, where prices are open to the scrutiny of market participants.
- Ethics and dispute resolution: All member firms must adhere to a prescribed code of conduct in respect of their bond trading and the advertising of services. Trading disputes between members and clients must be reported to the Exchange, which provides mediation and arbitration mechanisms to ensure speedy resolution.
- Minimum admission standards: Applicants for membership must be incorporated in South Africa and must meet minimum capital and fiduciary standards. Registered officers and trading staff must comply with prescribed examination regarding ethical and work experience requirements prior to receiving authorisation.
- Capital adequacy standards: Member firms must maintain a minimum level of unimpaired capital to support their trading activity. These solvency standards are based on those of the EU and require members to make specific provision for the counterparty, large exposure and position risks



- involved in bond trading. The standards are strictly enforced.
- Fidelity cover: Although fewer and fewer members handle the cash and scrip of clients directly, all firms must still hold fidelity cover to cater for possible fraud or misappropriation by their employees. The independent auditors of member firms must report annually to the Exchange on the adequacy of such cover.
 - Immobilised securities: Investors are assured that the listed debt securities in which they invest have been screened by the FSB. All new listings must be immo-

- bilised in the Central Depository to obviate the possibility of tainted scrip being transferred. Settlement takes place electronically on a daily basis.
- Guarantee fund: BESA maintains a Guarantee Fund to ensure, as far as possible, the performance of transactions entered into on the Exchange.
- The Fund provides members and clients with price-risk cover against a member default, to a maximum aggregate of R225 million (US\$1 = R8,05 by approximately March 2001). Since inception, no settlement defaults or claims on the Fund have been recorded.

Acknowledgements

Bond Exchange of South Africa
Development Bank of Southern Africa
Estimates of National Expenditure 2001, published by the National Treasury
Financial Services Board
JSE Securities Exchange
Land Bank of South Africa
National Treasury
Office of the Auditor-General
South African Futures Exchange
South African Reserve Bank
South African Revenue Service

Suggested reading

- Abedian, I., A., and T. and Walker, L. *Promises, Plans and Priorities: South Africa's Emerging Fiscal Structures*. Cape Town: Idasa, 1997.
- Budlender, D. *The Women's Budget*. Rondebosch: Institute for a Democratic South Africa, 1996.
- Clark, I., Louw, E. and Myburgh, J. *More Small Business Opportunities in South Africa*. 2nd ed. Cape Town: Zebra Books, 1996.
- Development Funding in South Africa: 1998–1999*, Editors: V. Makinta and C. Schwabe. Pretoria: Human Sciences Research Council, 2000.
- Dolny, H. *Banking on Change*. Sandton: Penguin, 2001.
- Fölscher, A. and others. *Transparency and Participation in the Budget Process: South Africa: A Country Report*. Cape Town: IDASA, 2001.
- Fundamentals of the South African Financial System*. Students' Edition. Editors: L.J. Fourie, H.B. Falkena and W.J. Kok. Halfway House, Gauteng: International Thompson Publishing, 1996.
- Falkena, H.B. *Financial Policy in South Africa*. Halfway House: Southern Book Publishers, 1991.
- Falkena, H.B. *Fundamentals of the South African Financial System*. Halfway House: Southern Book Publishers, 1993.
- Human, P. and Horwitz, F. *On the Edge: How the South African Business Organisation Copes with Change*. Cape Town: Juta, 1992.
- Jones, S. *Banking and Business in South Africa*. Basingstoke: Macmillan, 1988.
- Kelly, M.V. *Financial Institutions in South Africa – Financial, Investment and Risk Management*. Cape Town: Juta 1993.
- Kok, P. and Pietersen, J. *Financial Services*. Pretoria: Human Sciences Research Council, 2000. (National Research and Technology Foresight Project).
- South African Financial Institutions*. Editor: H.B. Falkena. Halfway House: Southern Book Publishers, 1992.
- Whiteford, A. and van Deventer, D.E. *Winners and Losers: South Africa's Changing Income Distribution in the 1990s*. Pretoria: Human Sciences Research Council and Warton Econometric Forecasting Services, 2000.