



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 and income redistribution through economic, fiscal and financial policies that stimulate investment and trade, create employment and allocate budget resources to targeted beneficiaries.
- prepare a sound and fiscally sustainable national budget and an equitable division of resources between the national, provincial and local spheres of government
- equitably and efficiently raise fiscal revenue as required through targeted and fair tax policy and other measures that ensure revenue stability and the efficiency and competitiveness of the South African economy.

◀ The Reserve Bank formulates and implements monetary policy and regulates the supply (availability) of money by influencing its cost. The Bank is also the custodian of the greater part of South Africa's gold and other foreign exchange reserves.

- manage government's financial assets and liabilities soundly through prudent cash management, asset restructuring, financial management and management of the debt portfolio
- promote accountability through effective and reliable financial reporting systems and internal controls
- contribute to improved financial management through promoting and enforcing transparency and effective management of revenue, expenditure, assets and liabilities in all spheres of government.

Financial policy framework

The Minister of Finance, Mr Trevor Manuel, presented the Budget for 2002/03 on 20 February 2002. The highlights were:

- growth slowed to 2,2% in 2001 and was expected to be 2,3% in 2002, rising to 3,3% in 2003 as the global economy recovers.
- Consumer Price Index excluding mortgage costs (CPIX) inflation was expected to average about 6,9% in 2002 before reverting to the target of 3% – 6% in 2003.
- real wages and productivity had increased by more than 20% since 1994, bringing better living standards to millions of people and improving the competitiveness of the economy.
- exports were increasingly diversified, with manufactured products up from 9% in 1990 to 27% of the total in 2001.

- following the depreciation of the Rand, both exports and inward investment were expected to strengthen in 2002 and the years ahead.
- South Africa's balance of payments and public finances were in good health, providing a firm foundation for sustainable growth and development.
- income tax cuts were expected to put R15 billion back into taxpayers' pockets, mainly benefiting low and middle-income workers.

Consolidated national and provincial expenditure: Functional classification¹⁾

	2001/02		2002/03		2003/04	
	Revised estimate	% of total	Budget estimate	% of total	Budget estimate	% of total
General government services and unallocable expenditure ²⁾	20 681,0	7,6	23 175,0	7,6	26 017,9	8,0
Protective services:	46 892,7	17,2	52 359,7	17,3	55 870,5	17,1
Defence and intelligence	18 052,6	6,6	20 589,8	6,8	21 659,3	6,6
Police	18 370,3	6,8	20 011,0	6,6	21 876,7	6,7
Prisons	6 838,9	2,5	7 199,3	2,4	7 762,6	2,4
Justice	3 631,0	1,3	4 559,6	1,5	4 571,8	1,4
Social services:	129 559,9	47,6	144 160,4	47,6	154 092,7	47,3
Education	55 394,6	20,4	59 518,7	19,6	63 939,5	19,6
Health	31 713,4	11,7	33 981,3	11,2	36 624,5	11,2
Social security and welfare	34 081,8	12,5	40 872,6	13,5	42 716,6	13,1
Housing and community development	6 646,2	2,4	7 863,6	2,6	8 641,3	2,7
Other ³⁾	1 723,9	0,6	1 924,3	0,6	2 170,8	0,7
Economic services:	26 992,1	9,9	31 596,1	10,4	33 311,8	10,2
Water schemes and related services	3 554,7	1,3	4 201,2	1,4	4 679,4	1,4
Fuel and energy	858,6	0,3	1 512,3	0,5	1 156,7	0,4
Agriculture, forestry and fishing	5 292,1	1,9	6 160,2	2,0	6 237,4	1,9
Mining, manufacturing and construction	1 358,1	0,5	1 463,7	0,5	1 663,2	0,5
Transport and communication	10 011,6	3,7	10 875,7	3,6	11 591,4	3,6
Other economic services ⁴⁾	5 917,0	2,2	7 383,1	2,4	7 983,8	2,4
Interest	47 515,1	17,5	47 502,9	15,7	49 844,8	15,3
Subtotal: Main budgets	271 640,8	99,9	298 794,2	98,6	319 137,6	97,9
Plus: Contingency reserves	-	-	3 300,0	1,1	5 000,0	1,5
Unallocated provincial reserves	-	-	294,5	0,1	278,1	0,1
Not classified:						
Amounts not allocated	-	-	700,0	0,2	1 500,0	0,5
Transfer to Umsobomvu Fund	-	-	-	-	-	-
Recoveries from the pension fund	-	-	-	-	-	-
Standing appropriations	-	-	65,0	0,0	156,8	0,0
Total estimated expenditure	271 940,8	100,0	303 153,7	100,0	326 072,4	100,0

1) These figures were estimated by the National Treasury and may differ from data published by Statistics South Africa.

The numbers in these tables are not strictly comparable to those published in previous years due to the allocable expenditure for previous years. Data for the previous years has been adjusted accordingly.

2) Mainly general administration, cost of raising loans and allocable capital expenditure.

3) Including cultural, recreational and sport services.

4) Including tourism, labour and multi-purpose projects.

Source: National Treasury



- individuals earning below R27 000 a year (R42 640 for those over 65) would not pay any personal income tax.
- the interest income exemption was raised to R6 000 (R10 000 for taxpayers over the age of 65).
- a tax allowance was introduced to encourage training internships in business.
- accelerated depreciation allowances were proposed to encourage business investment and employment.
- tax relief for small businesses was extended to encourage emerging entrepreneurs.
- the general fuel levy remains unchanged, while the Road Accident Fund levy was increased by 2c a litre.
- a packet of cigarettes would cost 34c more. Beer went up by 3,2c a 340 ml can, a 750 ml bottle of wine by 4,5c and a 750 ml bottle of spirits by R1,08. Duties on soft drinks were abolished.
- real spending on services was expected to grow by 4,1% a year over the next three years, while interest on debt would fall from 4,8% of gross domestic product (GDP) in 2001 to 4,1% in 2004/05.
- education remained the Government's first priority, rising to R59,5 billion in 2003, or 24% of non-interest expenditure.
- an amount of R31,8 billion went to police, justice and correctional services, while R20,6 billion was allocated to defence and the intelligence services.
- provinces will receive R132,4 billion in 2003, or 56% of the national Budget, including:
 - improved funding of tertiary hospital services and an enhanced response to HIV/AIDS
 - increases in old-age and disability grants (8,8%) and child support grants (18%), brought forward to April 2002
 - additional funding for roads, schools, clinics and rural development
 - assistance to municipalities, which was expected to grow by 18% a year, including support for water and sanitation, electrification, free basic services and local economic development.

Debt management

South Africa's debt, both domestic Rand-denominated bonds and foreign debt issues, enjoys increasing recognition on international capital markets and continues to attract a diverse range of investors.

This reflects the country's success in adopting sustainable fiscal and macro-economic policies, the evolution of a sound and transparent approach to debt management, the healthy balance of payments position and the maturity of South Africa's financial markets. In the course of the last two years, both Standard and Poor's and Moody's Investors' Service upgraded their ratings of South African debt, affirming their confidence in the country's macro-economic and fiscal management. These assessments contribute to broadening South Africa's international investor base and reinforce the favourable outlook for interest rates and the cost of capital.

South African foreign debt continues to trade at tighter spreads than the Emerging Market Bond Index, indicating that investors share the confidence expressed by international rating agencies and regard South Africa positively by comparison with its competitors.

The primary objective of domestic debt management has since shifted to the reduction of the cost of debt within acceptable risk limits, with diversification of funding instruments and ensuring flexible government access to markets as secondary goals. Recourse to foreign borrowing has been stepped up, allowing the fiscus to contribute to reducing the foreign currency exposure of the South African Reserve Bank in its forward market portfolio.

Domestic debt management reforms have addressed several policy and instrument gaps:

- Lower coupon bonds have been introduced, consistent with government's approach to reducing inflation in the years ahead.
- The Public-sector Borrowers' Forum was established in 2001.

- Co-ordination between monetary policy and liability management has been strengthened through more effective liaison between the National Treasury and the Reserve Bank.
- Regular meetings with the primary dealers, the Reserve Bank and the futures and bond exchanges provide a forum for ensuring a transparent and efficient bond market.
- Debt consolidation has reduced fragmentation on the yield curve and improved liquidity of the bench-mark issues. Illiquid bonds were consolidated into five liquid bench-mark bonds, thereby smoothing the maturity profile and reducing refinancing risks.
- The integrity and efficiency of the Government securities market have been strengthened through buying back illiquid bonds, including diverse 'ex-homeland' bonds of limited issue size.
- Inflation-linked bonds were introduced to diversify government's investor base and to signal confidence in government's macro-economic policy, while also providing an objective measure of inflationary expectations and benchmarks for other issuers.
- The 'Strips' (Separate Trading of Registered Interest and Principal Securities) Programme has been introduced, to increase demand

for the underlying instruments and encourage active portfolio management.

- State debt costs continue to fall as a share of government expenditure. It is projected to be 4,4% of GDP in 2002/03 and is expected to decrease to 4,1% of GDP in 2004/05.

The liquidity in the domestic Government bond market, measured by the increase in the nominal trades, improved substantially during recent years, especially since the appointment of primary dealers in government bonds in April 1998. The bond market turnover has increased further to R10,6 trillion and R12 trillion in 2001 and 2002 respectively. The bond yields continued to decline from the highs of 22% in 1998 to single digits in November 2001, and reverted to double digits on the back of the Rand's decline in the last quarter of 2001.

In actively managing its debt portfolio, the National Treasury is responsible for identifying, controlling and managing the risks to which government is exposed. A comprehensive risk management framework of the National Treasury calls for quantitative analysis to model, monitor and manage risk exposure. The framework provides for a set of benchmarks or reference criteria against which the structure and evolution of the debt portfolio can be tested and understood.

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 ²⁾	Real effective exchange rate ³⁾	US Dollar	British Pound (5314Q)	Euro	Japanese Yen
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	-11,8	2,8	3,3
1998	-0,9	-0,7	-11,7	-9,2	-16,1	-17,0	-15,3	-9,3
1999	-2,9	-2,3	-8,5	-5,1	-10,3	-8,2	-5,8	-21,9
2000	-1,9	-2,0	-5,1	-2,9	-11,4	-5,6	2,0	-16,2
2001	0,9	0,7	-14,6	-13,9	-18,8	-14,4	-16,0	-8,5

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



Legislation

The National Treasury has a demanding legislative workload. Between January 2001 and June 2002, the Minister of Finance tabled 19 pieces of legislation.

The legislative workload of the National Treasury can be subdivided into three categories: legislation conceptualised and prepared in-house; legislation prepared by regulatory bodies such as the Financial Services Board (FSB) and the South African Reserve Bank, with policy direction provided by the National Treasury; and tax legislation prepared in conjunction with the South African Revenue Service (SARS).

The following pieces of legislation were conceptualised:

- The Division of Revenue Act, 2001 (Act 1 of 2001), provides for the equitable division of revenue raised nationally among the national, provincial and local spheres of government for 2001/02.
- The Appropriation Act, 2001 (Act 18 of 2001), appropriated money for national expenditure in the 2001/02 financial year.
- The Financial Intelligence Centre Act, 2001 (Act 38 of 2001), provides for the establishment of a financial intelligence centre to act as the co-ordinating body to gather, analyse, interpret and disseminate information regarding money laundering.
- The Provincial Tax Regulation Process Act, 2001 (Act 53 of 2001), gives effect to Section 228 of the Constitution, 1996, which requires that national government should pass an Act of Parliament to regulate the imposition of provincial taxes.
- The Adjustments Appropriation Act, 2001 (Act 59 of 2001), is primarily used to register the shift of funds between programmes within a departmental budget vote and to appropriate for unforeseen and unavoidable expenditure.
- The Social Grants Appropriation Act, 2002 (Act 2 of 2002), appropriates an additional R2 billion for the Department of Social Development for the back payment to the

beneficiaries of social pensions from the date of application and not the date of approval. Everyone who applied successfully for a pension or grant after 31 March 1998 is entitled to claim the arrears due to him/her from the date that his/her application was attested.

- The Burundi Protection Support Appropriation Act, 2002 (Act 3 of 2002), appropriates funds to support the deployment of South African National Defence Force members, which commenced on 27 October 2001 to assist with peacekeeping initiatives. Funds were not for provided in the Department of Defence's budget and a dedicated Appropriation Bill was therefore required to allow the Department to deal with this unexpected expenditure.
- The Division of Revenue Act, 2002 (Act 5 of 2002), provides for the equitable division of revenue raised nationally among the national, provincial and local spheres of government for 2002/03.

The following finance bills, among others, were scheduled for consideration by Parliament in 2002:

- The Appropriation Bill provides for the appropriation of money for national expenditure in the 2002/03 financial year.
- The Local Government: Municipal Finance Management Bill aims to further regulate financial management on local government level similar to the Public Finance Management Act (PFMA), 1999 (Act 1 of 1999).

Of particular importance are the following:

- Regulatory legislation drafted externally, with National Treasury providing policy direction.
- The Financial Institutions (Protection of Funds) Act, 2001 (Act 28 of 2001), provides for various technical amendments to improve curatorship provisions, civil remedies for the registrar and general enforcement provisions.
- The Pension Funds Second Amendment Act, 2001 (Act 39 of 2001), provides for the conditional repatriation of surpluses in pension funds. The issue of surplus division

has become critical following recent court decisions.

- The Stock Exchanges Control Amendment Act, 2001 (Act 40 of 2001), enables a stock exchange to regulate price-stabilising mechanisms in its rules or listing requirements.
- The Pension Funds Amendment Act, 2001 (Act 65 of 2001), provides for various technical amendments to housing guarantees and the like and proposes to create loan facilities for people without access to bank loans.

The following regulatory bills were scheduled for consideration by Parliament in 2002:

- The Financial Advisory and Intermediary Services Bill provides for the authorisation of intermediaries in the financial services industry, codes of conduct and other enforcement measures. The Bill champions consumer protection as its essential element. It intends to achieve such protection by establishing entry requirements for persons wishing to participate in the business of financial intermediary services as well as establishing professional rules of conduct with which participants must comply. Provision is also made for the promotion of client education by the Registrar of Financial Service-providers (the executive officer of the FSB), assisted by other stakeholders in the financial services industry.
- The Financial Services Ombudschemes Bill provides for the recognition of voluntary ombudschemes and regulates the situation where consumer complaints fall outside an ombud arrangement.
- The Security Services Bill provides for the consolidation of the Stock Exchanges Control Act, 1985 (Act 1 of 1985), the Financial Markets Control Act, 1989 (Act 55 of 1989), the Custody and Administration of Securities Act, 1992 (Act 85 of 1992), the Insider Trading Act, 1998 (Act 135 of 1998), and certain provisions of the Companies Act, 1973 (Act 61 of 1973), into one single Act that will regulate all exchanges and related matters.

- The Collective Investment Schemes Control Bill will replace the Unit Trusts Control Act, 1981 (Act 54 of 1981), and the Participation Bonds Act, 1981 (Act 55 of 1981), and regulates all types of collective investment schemes where assets are pooled on behalf of investors.
- The Insurance Amendment Bill proposes various technical amendments to correct and improve the Long-term Insurance Act, 1998, (Act 52 of 1998), and Short-term Insurance Act, 1998 (Act 53 of 1998).

Taxation Acts

In July 2001, the Revenue Laws Amendment Act, 2001 (Act 19 of 2001), was promulgated.

This Act contains provisions to:

- subject the remuneration of directors of private companies to Pay As You Earn (PAYE)
- introduce a Strategic Incentive Programme, which is a targeted instrument to encourage projects that meet a number of necessary conditions and have significant direct and indirect benefits for the South African economy
- grant accelerated capital allowances to small business corporations
- allow capital allowances for airport infrastructure.

The Second Revenue Laws Amendment Act, 2001 (Act 60 of 2001), introduced refinements to the capital gains tax (CGT) legislation, and enabling provisions for Industrial Development Zones (IDZs) as far as customs procedures are concerned.

The Unemployment Insurance Contributions Act, 2002 (Act 4 of 2002), was promulgated in the first quarter of 2002 and provides for the collection of the bulk of Unemployment Fund contributions by SARS.

The Public Finance Management Act, 1999

The PFMA, 1999 came into effect on 1 April 2000 for all departments, constitutional institutions and public entities.



The PFMA, 1999 represents a fundamental change in government's approach to the handling of public finances, as it shifts the emphasis away from a highly centralised system of expenditure control by the 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 auditing and supervision of internal control systems
- improved accounting standards
- greater focus on output and performance
- increased accountability at all levels.

Based on the statistics of surveys conducted during 2001 and 2002, it appears that national and provincial departments have made good progress with most of the compliance aspects related to the implementation of the PFMA, 1999:

- 92% of departments have established internal audit units
- 82% of departments have established audit committees
- 81% of departments have conducted risk assessments
- 80% of departments have developed fraud prevention plans
- 86% of departments have tabled their annual reports and financial statements timeously in the legislature.

Although the surveys indicate positive compliance with the Act, discussions in the various forums have indicated that a stronger emphasis needs to be placed on capacity-building in order to achieve the more qualitative changes associated with the implementation of the PFMA, 1999. In this regard, the National Treasury has embarked on several initiatives to assist departments with capacity-building and to ensure the successful implementation of the PFMA. These initiatives include:

Internal Audit Framework

The Framework was developed to provide a set of internal audit guidelines that set the

tone to create the necessary impetus for a sustainable and effective internal audit mechanism in government. This Framework includes guidelines on risk management and internal controls and is based on the findings of a skills assessment of internal audit capacity in national and provincial departments.

Asset Management Guidelines

These Guidelines were compiled to provide a contextual view of asset management. The Guidelines also clarify fundamental concepts with an emphasis on financial management, accounting and reporting of assets.

Provincial Good Practice Programme (PGPP)

In an attempt to provide direct assistance to provinces, the National Treasury initiated the PGPP. The sector-specific Chief Financial Officers' Forums (for the provincial departments of education, health, housing, social development and transport) were established to improve the efficiency, economy and effect-iveness of provincial departments by facilitating peer learning through the identification, documentation and communication of 'good practices' arising from collective experiences. The immediate focus of the Programme is the development and use of measurable objectives, internal budget documentation and improving data quality and consistency. The deliverables of the Programme include the development of good-practice guides, the conducting of good-practice workshops, and the provision of training and support.

Appointment of members to the Accounting Standards Board (ASB)

The recent appointment of members to the ASB is seen as a positive step towards the implementation of the PFMA, 1999. The formal establishment and functional operations of the Board will contribute extensively towards the implementation of Generally recognised Accounting Practice in national and provincial departments.

Aligning Treasury Regulations with the King II Report on Corporate Governance in South Africa, 2002

In an attempt to ensure that Treasury Regulations are consistent with international best practices prevalent in the private sector, it was considered necessary to align these Regulations with the principles contained in the *King II Report on Corporate Governance in South Africa, 2002*. In this regard, certain concepts of the Report have been modified for adaptation in the Government finance arena and the Treasury Regulations have been amended accordingly.

Validation Board

The National Treasury has recently established the Validation Board in an attempt to exercise qualitative control over and to accredit training material presented by external service-providers. The Board accredits courses that meet the requirements and departments are accordingly informed as to who is offering courses of an acceptable quality. In this way, departments are made aware of courses that would be beneficial to employees and which would add value to their capacity-building initiatives. Such forms of accreditation are considered necessary due to the large number of training institutions offering public finance courses, of which the content quality is sometimes questionable.

Normative measures for financial management

The National Treasury, in consultation with the Office of the Auditor-General, is in the process of finalising normative measures for financial management. These measures are aimed at:

- contributing towards the improvement of financial management in the public sector
- providing a bench-mark to accounting officers to assist them with the continuous evaluation of the quality of financial management within their departments
- enabling the National Treasury and the Office of the Auditor-General to report on progress made with the implementation of

the PFMA, 1999 as well as the status of financial management within a department or in the public sector as a whole.

Financial Intelligence Centre

The aim of the FIC Act, 2001 is to introduce mechanisms and measures aimed at preventing and combating money-laundering activities. It will set up an anti-money laundering regime, which encourages voluntary compliance and self-regulation by institutions which otherwise may be exploited for money-laundering purposes. To this extent, the Act will complement the Prevention of Organised Crime Act, 1998 (Act 121 of 1998).

The Centre will co-ordinate policy and government's efforts to counter money-laundering activities. The Centre will act as a central repository of information on money-laundering activities, after which these reports will be provided to the country's law-enforcement authorities for further investigation and prosecution. The FIC will not be an investigating body.

To be effective, anti-money laundering policy requires a partnership between government, the private sector and supervisory and regulatory bodies which operate in the financial sector. This partnership is given practical expression in the Act through the establishment of the Money-laundering Advisory Council. The Council will facilitate public/private co-operation and will advise on the development of appropriate anti-money laundering policies. Although the Council will not have any executive or regulatory powers, it will be necessary for the Minister to consult with the Council before issuing regulations or exempting any accountable institution from the provisions of the Bill. The Council was launched in October 2002.

The FIC Act, 2001 places a number of obligations on a list of accountable institutions, encompassing some 19 different categories of business activities. Accountable institutions and reporting institutions are those companies and businesses which are considered



to be most susceptible to money-laundering activities namely banks, life insurance companies, foreign exchange dealers, casinos, estate agents and motor car dealers.

These accountable institutions will be required to implement internal administrative systems to ensure that they:

- know their customers
- report suspicious and certain cash transactions
- keep records of their customers and the transactions in which they are involved
- appoint compliance officers
- train employees to comply with the provisions of the Bill.

It is envisaged that the FIC will take approximately 36 months to become fully functional.

Financial and Fiscal Commission (FFC)

The FFC is one of the innovations of the Multi-party Constitutional Negotiations, which took place between 1992 and 1994. The Commission, which came into operation in April 1994, is a statutory institution and permanent expert commission dealing with intergovernmental fiscal relations.

The FFC is responsible for making recommendations to Parliament and Cabinet on the equitable division of revenue between national, provincial and local governments on an annual basis, giving advice on fiscal policies and taxes which provinces intend to impose, borrowing by local and provincial governments and criteria to be considered in determining fiscal allocations. Additional responsibilities can be designated by means of appropriate legislation.

Budget Council

The Budget Council consists of the Minister of Finance and the nine provincial executive committee members responsible for Finance.

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

Macro-economic strategy

The positive performance of the South African economy in the wake of a global slowdown is indicative of a highly resilient economy. The long-term outlook points towards further growth acceleration over the next few years, and reflects a strong improvement in economic fundamentals, which include, among other things:

- benefits associated with stricter fiscal discipline, which has resulted in lower budget deficits and which will eliminate government dissaving and pave the way for higher fixed investment spending,
- improved domestic competitiveness on foreign markets. This has led to significant improvements on trade and current account balances.

The Minister of Trade and Industry, Mr Alec Erwin, announced during a media briefing in February 2002 that Cabinet reaffirmed the micro-economic reform strategy in January. The strategy identifies six key performance areas or objectives:

- economic growth
- employment
- small business development
- black economic empowerment (BEE)
- competitiveness
- geographic spread of growth and development.

The micro-economic reform strategy rests on three pillars:

- The first pillar consists of cross-cutting issues: human resource development (HRD), infrastructure, access to finance, technology, and research and development (R&D).

- The second pillar comprises a set of actions to improve efficiency and lower costs in three input sectors: transport, telecommunications and energy. In addition, access to these sectors needs to be widened to include all South Africans.
- The third pillar is growth sectors that demonstrate a high potential for growth and employment, namely tourism, exports, agriculture, information and communication technology, and cultural industries.

Government has adopted an integrated way forward that consists of the following:

- fine-tuning the macro-economic strategy.
- continued managed liberalisation and infrastructure investment in key input sectors.
- increased attention to the cross-cutting issues that underpin the strategy, including among other things:
 - clarifying the role of individual departments in sectoral HRD strategies.
 - adopting a research strategy and allocating the necessary resources to implement it effectively. Cabinet has already adopted a biotechnology strategy and the Cluster was expected to table a document in Cabinet on technology, innovation and boosting investment in R&D.
- establishing an integrated financing institution focused on BEE and small business.
- an integrated approach to planning and implementation of infrastructure investment by government.
- developing and implementing an employment creation framework.
- strengthening and co-ordinating government products and services to promote key growth sectors.
- an integrated strategy for small business development, emphasising co-ordination and refinement of existing initiatives, addressing access to finance and a greater focus on micro-enterprises.
- implementing four components of the BEE strategy, namely an enhanced environment for BEE partnership programmes with the private sector; the establishment of a BEE Advisory Council; and a review of govern-

ment procurement.

- incorporating a specific geographical dimension into the micro-economic reform strategy to tap the economic and human potential of all nine provinces by co-ordinating current strategies such as the Integrated Sustainable Rural Development Strategy, Urban Renewal Programme, Spatial Development Initiatives, IDZs and Integrated Development Plans, as well as regional economic integration and the New Partnership for Africa's Development (NEPAD).

South African Revenue Service

In accordance with the SARS Act, 1997 (Act 34 of 1997), the Service is an administratively autonomous (outside the Public Service but within the public administration) organ of State.

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

- collect and administer all national taxes, duties and levies
- collect revenue that may be imposed under any other legislation, as agreed upon between SARS and an organ of State or institution entitled to the revenue
- provide protection against illegal importation and exportation of goods
- facilitate trade
- advise the Minister of Finance on all revenue-related matters.

Tax system

As from 2001, South Africa's source-based income tax system was replaced with a residence-based income tax system. With effect from the years of assessment commencing on or after 1 January 2001, residents are (subject to certain exclusions) taxed on their world-wide income, irrespective of where their



income was earned. Foreign taxes are credited against South African tax payable on foreign income. Foreign income and taxes are translated into the South African monetary unit, the Rand.

CGT was introduced from 1 October 2001. It forms part of the income tax system and includes capital gains made upon the disposal of assets in taxable income.

Value-added tax (VAT) is levied at a standard rate of 14% on all goods and services subject to certain exemptions, exceptions, deductions and adjustments provided for in the VAT Act, 1991 (Act 89 of 1991, as amended).

Transfer duty, estate duty, stamp duty, marketable securities tax, uncertified securities tax, customs duty and excise duty are also levied by the national Government.

Regional Services Councils levy turnover and payroll taxes. However, these taxes are at fairly low rates. Local governments levy rates on the value of fixed property to finance the cost of municipal services.

Agreements for the avoidance of double taxation

In 2001/02, considerable progress was made in reaching agreements with other countries on the avoidance of double taxation in respect of income accrued to South African taxpayers from foreign sources or to foreign taxpayers from South African sources. By July 2002, the position was as follows:

- Comprehensive agreements were in force 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, Uganda, the United Kingdom (UK), the United States of America (US), Zambia and Zimbabwe. The treaty with the UK extends also to Grenada, the Seychelles and Sierra Leone.

- Limited sea and air transport agreements existed with Brazil, Greece, Portugal and Spain.
- Comprehensive agreements were ratified in South Africa with Greece and Nigeria.
- Comprehensive agreements were signed but not ratified with New Zealand and the Seychelles.
- Comprehensive agreements were negotiated or renegotiated, but not signed, with Belarus, Botswana, Brazil, Bulgaria, Estonia, Ethiopia, Gabon, Germany, Kuwait, Latvia, Lithuania, Malawi, Malaysia, Morocco, Mozambique, the Netherlands, Oman, Portugal, Rwanda, Spain, Swaziland, Tanzania, Turkey, Ukraine, the United Arab Emirates, the UK, Zambia and Zimbabwe.
- Comprehensive agreements were negotiated or renegotiated but had not been finalised with Bangladesh, 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 agreements for the avoidance of double taxation with South Africa.

Sources of revenue

Income tax

Income tax is the Government's main source of income and is levied in terms of the Income Tax Act, 1962 (Act 58 of 1962).

In South Africa, income tax is levied on South African residents on their world-wide income, with appropriate relief to avoid double taxation. Non-residents are taxed on

Information

In November 2001, the total number of individual taxpayers registered in South Africa had increased by 3,4 million to 6,9 million.

their income from a South African source. Tax is levied on taxable income which, in essence, consists of gross income less allowable deductions as per the Act.

Companies are taxed at a rate of 30%. 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. Small business corporations (annual turnover of less than R3 million) benefit from a graduated tax rate of 15% on the first R150 000 of taxable income and can write off certain investment expenditure in the year in which it is incurred.

Income tax returns are issued annually to registered taxpayers after the end of each year of assessment. The year of assessment for individuals covers a period of 12 months

and generally commences on 1 March of a specific year and ends on the last day of February the following year.

However, the Act provides for certain classes of taxpayers to have a year of assessment ending on a day other than the last day of February. Companies are permitted to have a tax-year ending on a date that coincides with their financial year.

Tax returns must be submitted to SARS within 60 days from the end of the year of assessment or the date of the returns' issue. A taxpayer may apply for extension for the rendition of a tax return.

People who owe SARS tax are charged interest 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

Budget estimates and revenue outcome 2000/01 and 2001/02						
R million	Budget estimate	Revenue outcome	Deviation	Budget estimate (Prelim)	Revenue outcome	Deviation
Taxes on income and profits including:	121,303	126,145	4,842	131,582	145,081	13,499
Personal income tax	87,821	86,478	-1,343	90,122	90,236	114
Company tax	24,583	29,492	4,909	29,960	41,539	11,579
Tax on retirement funds	5,800	5,220	-580	6,300	6,189	-111
Other	3,100	4,955	1,855	5,200	7,117	1,917
Taxes on payroll and work-force	1,400	1,257	-143	2,800	2,705	-95
Taxes on property	3,338	3,979	641	4,709	4,631	-78
Domestic taxes on goods and services, including:	79,448	79,104	-344	86,705	86,394	-311
Value-added tax	52,858	54,455	1,597	60,350	60,846	-496
Excise duties	10,210	9,820	-390	10,625	10,327	-298
Levies on fuel	15,970	14,495	-1,475	15,310	15,110	-200
Air departure tax	180	86	-94	300	296	-4
Taxes on international trade and transactions	6,500	8,227	1,727	9,427	8,872	-555
Stamp duties and fees	1,700	1,562	-138	1,585	1,767	182
Total tax revenue	213,689	220,274	6,585	236,808	249,450	12,642
Non-tax revenue	3,846	3,592	-254	4,712	6,938	2,226
Capital revenue	386	10	-376	30	4	-26
Recoveries of loans and repayments	875	112	-763	93	77	-16
Less: SACU payments	-8,396	-8,396	0	-8,205	-8,205	0
Main Budget revenue	210,400	215,592	5,192	233,438	248,264	14,826

Source: South African Revenue Service



neration, e.g. trade, profession or investments and companies, are required to make two provisional tax payments during the course of the tax year and may opt for a third 'topping-up' payment six months after the end of the tax year.

Value-added tax

VAT is levied on the supply of all goods and services rendered by registered vendors throughout the business cycle. It is the Government's second biggest source of income.

Effectively, the tax is levied on the value added by an enterprise. As vendors levy and pay over the tax included in their prices, VAT is borne by the final consumer. VAT is also levied on the importation of goods into South Africa by any person. It is levied at the standard rate of 14%, but certain supplies are subject to the zero-rate or are exempt from VAT.

VAT is levied on an inclusive basis, which means that VAT has to be included in all prices on products, price lists, advertisements and quotations.

Customs duty

South Africa is a signatory to the Southern African Customs Union (SACU) agreement together with Botswana, Lesotho, Namibia and Swaziland (BLNS countries). The five member countries of SACU apply the same customs and excise legislation and the same rates of customs and excise duties on imported and locally manufactured goods. The uniform application of tariffs and the harmonisation of procedures simplify trade within the SACU common customs area.

Duties collected can be separated into two main groups:

- customs duty
- anti-dumping and countervailing duty.

South Africa has entered into agreements on mutual assistance between customs administrations. These agreements cover all aspects of assistance including exchange of information, technical assistance, surveillance, investigations and visits by officials. Agreements are in

place with France, the UK, Mozambique and the US. An agreement between South Africa and Algeria has been ratified. Agreements have been signed but not ratified with the Czech Republic and the Netherlands. Further agreements have been negotiated but not signed with Norway and Zambia.

Excise duty

Excise duty is levied on certain locally manufactured goods as well as their imported equivalents. This duty is levied as a specific duty on tobacco, liquor and hydro-carbons, and as an *ad valorem* duty on cosmetics, computers, televisions and audio equipment.

Relief from excise duty is available where excisable products are exported. In addition, relief is also available in respect of specific farming, forestry and certain manufacturing activities.

Transfer duty

Transfer duty is payable on the acquisition of property by individuals at progressive rates between 0% to 8%.

Transfer duty on property acquired by a person other than an individual, e.g. a company or trust, is payable at a rate of 10%.

All transactions relating to a taxable supply of goods and subject to VAT are exempt from transfer duty.

Estate duty

For purposes of estate duty, an estate consists of all property, including deemed property (e.g. life insurance policies, payments from pension funds, etc.) of the deceased, wherever situated. The estate of the deceased non-resident consists only of his/her South African assets.

The duty, at a rate of 20%, is calculated on the dutiable amount of the estate. Certain admissible deductions are allowed from the total value of the estate.

Stamp duty

Stamp duty is levied on certain financial transactions.

Marketable securities tax (MST)

MST is payable in respect of every purchase of marketable securities by a stockbroker on behalf of any person, at a rate of 0,25% of the consideration for which such securities are purchased.

Uncertified securities tax (UST)

UST is payable in respect of the issue and change in beneficial ownership of any securities, which are transferable without a written instrument and are not evidenced by a certificate. It is levied at a rate of 0,25% and will eventually replace MST.

Skills development levy

A skills development levy was introduced on 1 April 2000. This is a compulsory levy scheme for the funding of education and training. SARS administers the collection thereof. The rate was at 1,0% of payroll as from 1 April 2001 and is payable by employers who are registered with SARS for employees' tax purposes or employers who have an annual payroll in excess of R250 000.

Air passenger departure tax

A tax of R100 per fee-paying passenger departing on international flights and R50 per passenger departing to the BLNS countries is payable with effect from 1 November 2000.

Organisational performance

SARS has made significant progress in improving its administrative capacity and ability to address the challenges of tax collection. For the fiscal year ended 31 March 2002, total tax revenue exceeded the printed revenue estimate of R236,8 billion by more than R12,6 billion. The final outcome of revenue collections was slightly below the revised target of R249 billion for the 2001/02 fiscal year.

Due to excellent fiscal performance, R15 billion in tax relief was provided to individual taxpayers in 2002. Recent years have seen a marked decline in marginal rates for

corporates and individuals as well as the consolidation of income tax brackets to eliminate the adverse effects of inflation.

SARS has had considerable success in targeting and convicting tax evaders, thereby enhancing the overall tax compliance environment considerably.

In addition, SARS has also implemented a fundamental reform of its business operations through the *Siyakha* ("we are building") transformation process. This entailed the concentration of capacity in the core business functions of processing, service, compliance and customs administration, and the consolidation of common processes across tax types. The roll-out was initiated with a successful pilot project in KwaZulu-Natal in October 2001.

Other achievements include:

- the implementation of a new enforcement strategy that targets areas of high risk and aggressive tax planning practices. This has seen significant increases in the total revenue contribution of corporates through sector-specific enforcement action.
- the upgrade of border infrastructure and introduction of an informal dispute-resolution mechanism for customs.
- better customs control over the movement of goods and the establishment of anti-smuggling teams.
- the achievement of process efficiencies through the establishment of rapid processing areas, thereby improving turn-around times.
- the appointment of the SARS Commissioner as the chairperson of the World Customs Organisation.

From a customs perspective, SARS has been upgrading border posts in order to improve trade facilitation and better protect the public from trade in dangerous substances. Customs stepped up its anti-smuggling operations and targeted inspections.

Other initiatives in customs include the introduction of centralised registration, refund mobile units and a valuation database. A risk-based audit approach has been



introduced and differentiated service levels will be implemented through an accredited client scheme.

Gambling and lotteries

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

About 50 000 people are directly or indirectly employed in this industry, the majority of which are first-time workers.

Casinos, racing, gambling and wagering, excluding lotteries and sports pools, are functional areas over which the provinces and Parliament have concurrent legislative competence, in terms of Schedule 4 of the Constitution, 1996.

Substantial fixed investment is and remains a condition for a casino license and investments have to go beyond gambling. The Act provides for a maximum of 40 casinos nationwide and with 28 casinos operational throughout the country, investments of approximately R11,7 billion have been made, which include the establishment of conference centres for public use.

All gambling licences should ensure effective participation of the historically disadvantaged. On average there is equity holding of 43% by BEE companies.

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 National Lottery celebrated its second anniversary in March 2002.

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 duties. 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 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, 1996, 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 financial 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 government has committed itself. It determines the macro limit on expenditure, which is then matched with requests from departments in line with the affordability and sustainability of services.

Based on this limit, all national departments

are requested annually 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 Cabinet so that the relevant Minister can ensure that appropriate action is taken.

The introduction of the System has also assisted in the 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 Cabinet. The Minister of Finance is also kept informed on a regular basis of the early warning report results.

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 consist of 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 Preferential Procurement Regulations, 2001 were promulgated on 10 August 2001 to give substance to the contents of the Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000). This Act and its regulations are applicable to central and provincial departments and local government.

Tenders are now evaluated according to a preference point system where tenderers can score a maximum of 80 or 90 points for price, while 20 or 10 points can be scored for contracting or subcontracting historically disadvantaged individuals (HDIs) and for promoting/achieving specified Reconstruction and Development Programme (RDP) goals. A contract is awarded to the tenderer who scores the highest total number of points. The way in which the tender is evaluated, including the RDP goals to be promoted or achieved and the possible points in this regard, forms part of the tender documents.

The implementation of the regulations enhances the involvement of HDIs in the public tendering system and will contribute to achieving the RDP goals including the promotion of the small to medium enterprises (SME) sector.

The State Tender Board Act, 1968 (Act 86 of 1968), will be repealed during the course of 2002/03. This will pave the way to fully devolve the responsibility for procurement to accounting officers, as required by the PFMA, 1999.

The National Treasury is currently in the process of establishing a common service-provider to assume responsibility for the development of procurement policies and procedures, the regulatory framework for procurement and inventory management and the monitoring of compliance policies and procedures.



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, 1996. The Constitution guarantees the independence and impartiality of the Auditor-General.

The Auditor-General is appointed statutorily by the President as the independent auditor of the executive authority. The Office of the Auditor-General gained independence from 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, 1996 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. Six corporate executive managers assist the CEO.

The Office has a personnel complement of 1 400 and a budget of R492,7 million, and each year audits national and provincial departments, local governments 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 significantly to developments that would improve 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 PFMA, 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 implements an active programme of training. It has implemented a financial management improvement programme that is supported by the European Union (EU).

In accordance with the PFMA, 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, 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, 1996 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 objectives of the Reserve Bank, which are formulated to ensure financial stability. Consistent combating of inflation is the corner-stone 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, usually meets once a quarter, 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 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 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 the clearing and settlement of interbank obligations.

On 9 March 1998, the Bank implemented a system of repurchase transactions (repos) as the main instrument in managing liquidity 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 electronically make payments to and receive payments from the Reserve Bank, through their settlement accounts held in the books of the Reserve Bank. Daily settlements of interbank exposures are effected through the SAMOS System.

The movement to real-time settlements brought interbank 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 interbank transfers, repurchase transactions, other types of liquidity-creating instruments of the Reserve Bank, or the marginal lending facility. The SAMOS System, however, allows banks to receive funds obtained in the



interbank market directly in their settlement accounts in the Reserve Bank's books.

On 5 September 2001, the Reserve Bank adjusted its refinancing system by setting a fixed repurchase rate, in order to prevent any uncertainty about the Bank's monetary policy stance. The Bank also started weekly rather than daily auctions of repurchase funds and started to publish a South African Overnight Interbank Average (SAONIA) rate, primarily to develop and establish a reliable interest rate indicator of money market liquidity conditions and secondary to provide a suitable benchmark or reference rate for pricing in the money market. With effect from 1 April 2002, the SAONIA rate was redefined.

The Reserve Bank has various instruments to achieve its objectives. These include changes in the repo rate 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.

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 on 23 February 2000. Inflation targeting is aimed at facilitating the reduction of the inflation rate or the maintenance of price stability, and has been successfully adopted by an increasing number of countries in recent years. The Treasury and the Reserve Bank initially agreed on an inflation target band of 3% to 6% on average for 2002 for the CPIX. This target was left unchanged for 2003 when the Minister of Finance announced new targets in October 2001, and a lower target range of 3% to 5% was introduced for 2004 and 2005.

In 2001, the exogenous factors impacting on the inflation rate changed significantly. International oil prices declined from their October 2000 highs of around US\$35 per barrel, and the nominal effective exchange rate of the Rand became more stable. The sudden turn-around in the international economy, the extent of which took most observers by surprise, resulted in a generalised fall in interests

rates early in 2001. Until June, South Africa was one of the few countries which had not followed this trend. Although some of the external inflationary pressures had receded, forecasts at this stage showed that there was a possibility that the inflation target in 2002 would not be met.

However, by June it was clear that the global downturn was more prolonged than had originally been expected and that there was little domestic pressure on inflation. The inflation rate as measured by the CPIX had declined to 6,4% and all indications were that the target for 2002 would be achieved. The lower inflation rate also meant that real interest rates were rising and unless the Bank followed with lower short-term interest rates it would have implied a progressively tighter monetary policy. Given these factors, the MPC decided to reduce the repo rate by 100 basis point at its meeting in June 2001. The reduction in the repo rate resulted in a 75 basis point reduction in the prime lending rates of the banks, and in July a further 25 basis point reduction was effected.

At its meeting on 20 September 2001, the MPC decided to reduce interest rates by a further 50 basis points. This was done against the backdrop of interest rate reductions in a number of other countries following the attacks on New York and Washington. At that time, the CPIX inflation rate had declined to 6% in August. Data on the real economy showed that both output and expenditure were not putting pressure on inflation, and the expectation was that the intensified global downturn would further reduce domestic demand pressures. In addition, the oil price started showing signs of weakness which, if sustained, could have offset in part the negative impacts of the Rand's depreciation.

CPIX inflation declined to below the upper limit of the 2002 target by September 2001, and at that time it was expected that the downward trend would be sustained, albeit at a slower rate. However, the pressure on the exchange rate, which had been present since 2000, had intensified in the second half of

2001, and the impact that this had on the inflation rate inevitably caused the CPIX to reverse its downward trend. The CPIX inflation rate moved outside the 2002 target to 6,3% in November 2001.

An important challenge for monetary policy during this period was resisting the temptation to use interest rate policy to defend the currency directly. For this reason, there was no change in the monetary policy stance during the worst of the exchange rate movements in November and December 2001. Nevertheless, monetary policy could not be impervious to the impact of exchange rate changes on the measured inflation rate in an inflation-targeting regime. Although monetary policy can do little to offset the first-round effects of exchange rate changes on the measured inflation rate, if the depreciation and initial price increase result in or threaten higher wage demands and further price-raising behaviour, then monetary policy could play a role in moderating these second-round effects.

An unscheduled meeting was therefore convened on 15 January 2002 to consider these developments and their impact on inflation and monetary policy. The outcome of this meeting was a decision to raise the repo rate by 100 basis points. The primary reason for this increase was pre-emptive, with the main concern at the time being the evidence of higher inflation expectations that could feed through to higher wage demands and further price increases. In addition, although excess spending in the economy was still relatively moderate, there were signs of excessive increases in the money supply and credit extension data.

By the time the MPC met on 13 and 14 March 2002, it was apparent that the adverse exchange rate developments during late 2001 were having a significant impact on the CPIX. Inflation measured in terms of this index was 7,1% in January 2002. The MPC felt that a further tightening of the monetary policy stance was justified to reinforce the January increase, and it duly increased the repo rate by 100 basis points to 11,5% per



annum from 15 March 2002. The Bank's forecasts show that the tightened monetary policy stance should enable the target of 3% to 6% increase in CPIX to be achieved in 2003.

Financial Services Board

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 several registrars 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, take-overs 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, 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 every two months. The Directorate has the power to issue civil summons against offenders for the repayment of an amount of up to three 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 for up to 10 years.

The executive officer is provided with an armoury of regulatory sanctions, including the cancellation of authorisation to supply financial services.

The executive 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), gives 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, among other things, 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 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 South African Police Service, the Investigating Directorate: Serious Economic Offences and the National Director of Public Prosecutions.

The FSB Amendment Act, 2000 (Act 12 of 2000), changed 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 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 Policy-holder Protection Rules and Consumer Education Programme, as well as the Financial Advisory and Intermediary Services Bill, 2001.

The banking industry

At the end of December 2001, 53 banks, including 14 branches of foreign banks, and two mutual banks were registered with the Office of the Registrar of Banks. Furthermore, 55 foreign banks had authorised representative offices in South Africa. The banking institutions collectively employed 120 527 workers at 10 437 branches and agencies.

Four major groups dominate the South African banking sector, namely ABSA Group Limited, Standard Bank Investment Corporation Limited, FirstRand Holdings Limited and Nedcor Limited. These groups maintain extensive branch networks across all nine provinces, and together hold 69,5% of the total assets (R1 047 billion) of the banking sector.

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

Several new banks have been registered and competition has intensified, both among banks and between banks and other financial service-providers.

Industry-wide net income after tax rose to 0,7% of total assets in 2001. As a percentage of equity, industry-wide net income after tax decreased from 14% in 1992 to 9,2% in 2001. By the end of 2001, industry-wide net income before taxation had begun to improve, rising to R10,6 billion, compared with R3,1 billion in 1992.

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 issued by the Basel Committee on Banking Supervision, under the auspices of the Bank for International Settlements. In South Africa, the requirement to maintain capital equal to the full ratio of



10% of risk-weighted assets became effective in October 2001.

By the end of 2001, the banking sector as a whole had a ratio of capital-to-risk-weighted assets of 11,4%.

Many demands are now being made on South African banking institutions to extend their activities in order to accommodate the banking needs of the underprivileged and to provide more funds for housing, export financing, agriculture and small business development. Several initiatives are under way to develop appropriate structures to provide access to finance to all sectors of the population of South Africa.

The Regulations relating to Banks, which form part of the South African banking legislation, were comprehensively revised and amended during 2001, 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.

The micro-lending industry

A process of regulating and enhancing the credibility of the micro-lending 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 the prime lending rate, increasing the loan ceiling from R6 000 to R10 000, and creating a system to compel micro-lenders to become members of a regulatory authority. Role-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, micro-lenders are not allowed to hold the bank cards and personal identification numbers of their clients as security.

In 2002, the MFRC instituted a new code of conduct for micro-lenders aimed at encouraging responsible lending. The guidelines of the code will compel micro-lenders to assess applicants' levels of financial commitments against the National Loans Register (NLR) before advancing a loan. The NLR was launched in November 2000 by the MFRC to enable assessment of the ability of prospective borrowers to afford repayments on loans.

Micro-lenders will furthermore be required to maintain a register of their appointed agents, who are expected to carry identification cards bearing the lender's name and the MFRC logo. Creditors who violate the new code of conduct will be penalised and subjected to disciplinary measures in accordance with the MFRC's disciplinary processes.

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 business, accident and health, property, transportation and miscellaneous insurance. In 2000, the total assets of short-term insurers amounted to R48 billion (excluding 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, health 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 R707 billion in 2000.

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 Policy-holder 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 policy-holders 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 policy-holders to sign blank or incomplete forms, only to have someone else complete the details later.

Other financial institutions

Development Bank of Southern Africa (DBSA)

In terms of the DBSA Act, 1997 (Act 13 of 1997), the primary purpose of the Bank is to promote economic development and growth, HRD 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 undergone 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.

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 2001/02, the DBSA used its lines of credit from the multilateral agencies for the R279,2 million it raised in that year.

The Bank's international rating was raised to the level of the upgraded government rating of Baa2 by Moody's Investor Services.

The scale of impact on the Bank's funding operations on the South African economy has been estimated using economic modelling techniques. Employment opportunities generated directly and indirectly through projects co-funded by the DBSA in 2001/02 were estimated at 42 000. The ultimate direct, indirect and induced impact on the economy of projects co-funded by the DBSA in 2001/02 was estimated as adding R8,9 billion to GDP. The number of households expected to benefit from new infrastructure projects funded or co-funded by the DBSA in 2001/02, was estimated at 620 000. Income flowing to low-income households as a result of projects co-funded by the DBSA in 2001/02 was estimated at R1,102 million.

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
- pay special attention to the needs of disadvantaged people in the sector
- bench-mark 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 R4,2 billion on 31 December 2001, 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. An estimated one million *stokvels* operate in South Africa.

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 indirectly 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 mainly 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.

By mid-2002, 29 management companies managed the assets of 400 separate unit trusts. Most of the companies are owned by South Africa's leading financial institutions. However, a number of independent institutions were recently registered. The market value of net assets of the unit trust industry amounted to R168 billion (excluding intra-industry holdings of assets) at the end of 2001.

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

In 2001/02, the reduced demand for loanable funds and funding through offshore borrowing resulted in a decline in the supply of new

public-sector debt securities in the domestic primary bond market. Net redemption of fixed-interest securities by public-sector borrowers amounted to R10,2 billion in 2001/02 compared to net issues of R2,5 billion in 2000/01.

The public sector's reduced demand for loanable funds was partly offset by growth in private-sector funding in the primary corporate bond market as private-sector borrowers increasingly targeted the primary bond market to meet their financing needs. The outstanding nominal value of private-sector loan stock listed on BESA almost doubled from R11,2 billion in December 2000 to R21,9 billion in December 2001 and rose further to R24,5 billion in April 2002.

The Government raised R12,4 billion through foreign-currency denominated bonds issued in the international bond markets in 2001/02, up from R2 billion in 2000/01. Government opened and completed its offshore borrowing programme for 2002/03 in April 2002, when an amount of R10,7 billion was raised through the issuance of a 10-year global Dollar bond.

Exchange rate concerns also dampened enthusiasm for issuing Rand-denominated bonds in the Eurobond market during 2001. 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 R1,6 billion in 2000 and R0,1 billion in 2001 compared with net issues of R2,2 billion in 1999.

The total value of equity capital raised in the primary share market by companies listed on the JSE declined from R74 billion in 2000 to R24 billion in 2001. The largest contribution in 2001 came from shares issued for the acquisition of assets not already listed for R13 billion.

Secondary capital market activity

Bond yields, which move inversely to the price of bonds, declined steadily since the emerging market crisis in 1998. The general decline in bond yields was supported by, among other

things, an improvement in inflation expectations, an easier monetary policy stance and a shrinking supply of government securities. The monthly average yield on long-term government bonds declined by 261 basis points from December 2000 to November 2001 when it reached its lowest level since August 1980. In December 2001, the general downward movement in bond yields was arrested when inflation expectations changed drastically following the steep depreciation of the exchange rate of the Rand and the monthly average bond yield increased to 12,6% in March 2002 – its highest level since January 2001. The mood in the market turned more positive and the monthly average yield receded to 12,5% in April. The decline in bond yields was supported by the appreciation of the exchange rate of the Rand, the conservative money policy stance and an ongoing lack of support of bonds in the domestic bond market.

Trading activity on BESA rose by 18% from R10,5 trillion in 2000 to R12,4 trillion in 2001. In December 2001, the nominal value of bonds in issue amounted to R444 billion with a market capitalisation of R471 billion, which included 222 listed bonds of 38 issuers.

Non-resident investors reduced their holdings of domestic Rand-denominated debt in 2001 because of, among other things, uncertainty over future exchange-rate movements. On a net basis, non-residents sold bonds to the value of R25,6 billion in 2001, but turned to net purchases of R1,6 billion in the first four months of 2002.

Share prices closed the year higher than their opening levels. Year-on-year, the daily closing level of the all-share price index increased by 25% from the end of December 2000 to the end of December 2001. The price level of all classes of shares on the JSE rebounded strongly from September 2001. The daily closing level of the all-share index increased by 56% from a 16-month low on 21 September 2001 to a record-high on 14 May 2002. Volatile price movements throughout 2001 boosted trading activity in the secondary share market. Shares to the value of R606 bil-



lion were traded on the JSE in 2001, about 13% more than the previous record set in 2000. Liquidity, measured as turnover as a percentage of market capitalisation, reached a new level of more than 38% in 2001 compared to 35% in 2000.

Non-resident investors increased their interest in the South African equity market in 2001 compared to 2000. On a net basis, non-resident shareholders bought R29,8 billion worth of shares in 2001, up from R17,4 billion in 2000.

Money markets

The South African money market is well advanced, with a fairly large number of banks and other institutions actively participating. 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 weekly 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.

Additional to the repurchase auctions and contra-accounts, a marginal lending facility is also available to 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 banks.

Money-market conditions were relatively stable during the first eight months of 2001 but tightened considerably in subsequent months. The average daily liquidity requirement of the private banks varied between R8,7 billion and R9,8 billion in the months from January to August but increased sharply, reaching R12 billion in December, R11,8 billion in January 2002 and R11,3 billion in February 2002.

The Reserve Bank kept the daily liquidity requirement fairly high in 2001 by actively implementing various intervention techniques, essentially aimed at offsetting the liquidity injections arising from the deficits sustained on forward foreign-exchange transactions by the Reserve Bank and, at times, flows arising from changes in the Bank's net foreign assets.

On 5 September 2001, a number of important changes were made to the Reserve Bank's refinancing system. The main repurchase auctions, which used to be conducted daily, are now conducted only on Wednesdays, providing funds for one week at a time at a fixed interest rate. The Reserve Bank may also conduct final clearing repurchase auctions although, in practice, these have been held rather infrequently. On 21 September 2001, a final clearing repurchase auction to the amount of R12 million was conducted and another for R350 million was held on 16 January 2002. Both these auctions supplied liquidity to the market and were priced at a margin of 1,50 percentage points above the ruling repurchase rate. Supplementary auctions (i.e. those tenders conducted when unforeseen liquidity flows caused the Bank's first-round forecast of the market's liquidity needs to be off the mark) have been far more frequent. Since September 5, these auctions ranged from a liquidity-providing tender of R650 million to a liquidity-draining tender of R966 million, all at the fixed repurchase rate.

The banks' required cash reserve deposits with the Reserve Bank were raised by almost R2 billion from late September 2001 on account of the reduced deductibility (from

100% to 75%) of banks' vault cash in calculating their required reserve balances.

To maintain the private banks' dependence on central bank funding, the Reserve Bank primarily stepped up the amount of outstanding foreign currency swap arrangements with private-sector parties. The amount of outstanding swaps rose sharply at the end of January 2002 as liquidity had to be drained following the liquidity expansion when government assumed liability for the US\$1,5 billion foreign loan previously arranged with the Reserve Bank as debtor. The Reserve Bank credited government's Tax and Loan Accounts with R17,5 billion, the Rand equivalent of the syndicated loan, necessitating off-setting measures to mop up this strong liquidity injection in the money market.

A further liquidity-draining operation undertaken by the Reserve Bank was an increase in the amount of outstanding reverse repurchase transactions in government securities with private-sector parties from R5 billion at the end of January 2001 to R6,6 billion at the end of October 2001. The Reserve Bank also allowed the amount of outstanding debentures to fluctuate between R3,4 billion and R5 billion from January to August 2001. As liquidity conditions tightened in the last months of 2001, the outstanding amounts of reverse repurchase transactions were reduced to R3,5 billion at the end of December 2001 and Reserve Bank debentures to R1,3 billion.

Notes and coin in circulation outside the Reserve Bank occasionally had a strong effect on the private banks' indebtedness to the Reserve Bank. At the height of the summer holiday season in December 2001, notes and coins in circulation outside the Reserve Bank recorded a peak value of R38,7 billion compared with a previous peak value of R34,7 billion in 2000. In order to alleviate these seasonal market pressures, the Reserve Bank scaled down its liquidity-draining operations by reducing to low levels the outstanding amounts of its own debentures and of reverse repurchase transactions in government securities.

During January 2002, notes and coin to an amount of R3,4 billion were returned to the Reserve Bank, easing money-market conditions and requiring increases in reverse repurchase transactions and Reserve Bank debentures to R6,6 billion and R2 billion respectively, at the end of January. The outstanding debentures were raised to R4 billion by the end of February 2002 and reverse repurchase transactions to R6,7 billion.

The repurchase rate of the Reserve Bank was lowered on three occasions during 2001 by a cumulative total of 250 basis points. The SAONIA rate, which was introduced by the South African Reserve Bank on 5 September 2001 to serve as a daily bench-mark for money-market interest rates, was calculated at 9,6% at inception. Subsequently, the rate fluctuated downwards and recorded a low of 8,77% on September 21 when the repurchase rate of the Reserve Bank was reduced. As liquidity conditions in the market became somewhat tighter towards month-end, the rate increased to 9,01% on September 28 and remained slightly below this level in the ensuing months. The SAONIA rate moved higher to reach 9,12% on December 24 as the money market tightened and expectations of an imminent increase in short-term rates intensified. It subsequently jumped by 87 basis points to 9,78% on 16 January 2002 when the increase in the repurchase rate became effective, but later moved even higher to 9,97% on February 28 when inflation expectations deteriorated noticeably.

Other money-market interest rates declined in the first nine months of 2001, but displayed a strong upward bias in the fourth quarter of the year. Along with the reduction in the repurchase rate, the rate on three-month bankers' acceptances declined from 10,26% at the beginning of the year to 9,64% on June 18 and to a lower turning point of 8,82% on September 25. In the last months of 2001, money-market interest rates began to move higher, largely in anticipation of an increase in the Bank's repurchase rate as a defensive response to adverse developments in the



foreign-exchange market. The rate on three-month bankers' acceptance increased to 9,58% on 21 December 2001, and after a short relapse rose further to 9,95% on 16 January 2002, when the Reserve Bank raised the rate on repurchase transaction. Subsequently, the rate on three-month bankers' acceptances rose to 10,03% on 28 February 2002.

In similar vein, the tender rate on 91-day Treasury bills was at 10,25% on 4 January 2001 but declined to 9,6% on June 18 and 8,83% on November 8. From the middle of November, the rate on Treasury bills rose to 9,47% on December 28. This rate then declined to 9,27% on 11 January 2002, but rose to 9,52% on January 18 on the first tender of Treasury bills after the Bank's repurchase rate was increased. In the subsequent tender, the Treasury bills rate increased, on balance, to 9,56% on March 1.

The FRAs also fluctuated downward during the first three quarters of 2001, with the rate on 9x12-month FRAs declining from 10,15% on 28 February 2001 to 8,42% on November 9. Probably in anticipation of a policy reaction by the Reserve Bank to the sharp fall in the exchange value of the Rand, the rate on 9x12-month FRAs climbed by 428 basis points to 12,7% on December 20. In the absence of policy reactions to the developments in the foreign-exchange market, the rate on 9x12-month FRAs moved lower to 9,85% on 8 January 2002, but rose to 11,1% in the aftermath of the Reserve Bank's decision to increase the repurchase rate. For the greater part of February, the 9x12-month FRAs were trading within a range of 11,2% to 12,08%, discounting further money-market interest rate increases in the near future.

Broadly following the downward movement of the repurchase rate in 2001, private banks lowered their prime overdraft rate in three steps from 14,5% at the beginning of 2001 to 13% by 25 September 2001. In January and March 2002, they responded to the increases in the repurchase rate by raising their prime overdraft rate. On 16 January 2002, the prime overdraft rate was increased by 100 basis

points to 14% and this was followed by a further increase of 100 basis points to 15% on March 18. This meant that, on balance, rates had changed very little during the past year, clearly contrasting the volatile interest-rate changes of 1998 and 1999.

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 protect foreign reserves.

The measures were at first applicable mainly to South African residents. 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 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. The private individual investment allowance was increased from R400 000 to R500 000 and then to R750 000 in February 2000.

South African corporate entities are allowed to invest up to R750 million in Africa and R500 million elsewhere.

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 also applies to Africa. The R50 million limit applicable to foreign investments elsewhere in the

world was increased to R500 million per new approved investment.

JSE Securities Exchange South Africa

The JSE, first established in 1887, is a voluntary association of members. It is regulated by the FSB under the Stock Exchanges Control Act, 1985 (Act 1 of 1985), and the Financial Markets Control Act, 1989 (Act 55 of 1989). The JSE in turn regulates its listed companies and brokers by extensive rules and directives. The JSE is the largest securities 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 in order 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 is responsible for the many significant changes at the JSE.

On 1 December 2000, the JSE implemented the first phase of the restructuring process. A Board of Directors representative of a broad industry interest base, was established and a CEO appointed. The Board replaced the old committee structure and the CEO took the place of the executive president. In addition, a new advisory committee structure was put in place, which will benefit from the participation of a wider spectrum of industry specialists. 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 and listing.

On 6 August 2001, the JSE acquired the business and assets of the South African Futures Exchange (SAFEX). SAFEX is now incorporated into the JSE as two new divisions – the Financial Derivatives Division, which covers

the equity and interest rate futures and options markets, and the Agricultural Products Division, which covers commodities futures and options on maize, sunflowers, soya beans and wheat. The rules governing trading and the settlement of trades on SAFEX have remained largely unchanged. This has many long-term advantages for both exchanges.

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 (COSSE). COSSE 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 the Namibia Stock Exchange has been trading on the JSE's trading platform for the past four years.

In 2001, the JSE entered into an alliance with the London Stock Exchange (LSE). As one of the pillars of the alliance, the LSE was to provide the JSE with core technology, namely the LSE trading system, SETS (called JSE SETS in respect of the JSE) and the LSE information dissemination system LMIL, (called InfoWiz in respect of the JSE). On 13 May 2002, the Johannesburg Equities Trading System was replaced with SETS. This trading platform has been divided into several functional segments to facilitate trade and efficient running of the market. Functional segments and sectors facilitate the setting of common trade parameters for instruments with similar characteristics.

InfoWiz is the LSE's information dissemination system. This system is responsible for broadcasting market and trading information to members and vendors. It describes what information is transmitted in the various messages that make up a Stock Exchange News Service (SENS) announcement. In particular, it focuses on the News Control and News Test messages. In addition to the provision of core technology, the alliance is also expected to bring additional key business benefits to both parties, namely 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.

The JSE also entered into a joint venture with global index-provider FTSE Limited in 2001. FTSE officially started calculating the FTSE/JSE Africa Index Series from 24 June 2002. The Series will introduce new ground rules, utilise the FTSE Global Classification system and for the first time, include the calculation of total return values. The new ground rules, which were circulated to the investing community for comment, were finalised by the FTSE/JSE Africa Index Advisory Committee in November 2001, along with the new reclassification and free float adjusted share totals. FTSE commenced to calculate certain FTSE/JSE Africa Indices using the free float methodology from 2 January 2002 and additional indices were added on 13 May 2002 when the JSE implemented its new trading and information dissemination systems. The existing JSE indices were 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.

The JSE and GL Trade announced in November 2001 that they had signed an agreement whereby GL Trade will provide the JSE with its professional trading front-end GL WIN for use on the JSE and the NXS. 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 busi-

ness. The new system is in line with international standards and risk parameters for cutting costs and for eliminating the potential for fraud. A rewrite of the JSE Listings Requirements, effective from 1 October 2000, ensured total alignment with international best practice.

SENS has been in operation at the JSE since August 1997 to enhance market transparency and investor confidence. The JSE Listings 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 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, becoming the 6th 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 SATRIX 40, enables an investor to buy a single JSE-listed security, giving investors the same return as buying shares directly in each company in the JSE's ALSI 40 Index. In February 2002, the JSE issued and listed two more ETFs, namely JSE/Actuaries Financial 15 Top Companies Index and JSE/Actuaries Industrial 25 Top Companies Index.

Bond Exchange of South Africa

BESA is an independent, self-regulatory organisation, and directly responsible for ensuring the stability, security and regulatory administration of the bond market in South Africa. It regulates the bond trading activities of all its member firms. These firms hold seats on the Exchange, thereby 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 BESA. 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 on-going operations and performance of the Exchange.

Listed securities

Although primarily a wholesale, government bond market, BESA also provides a forum for the listing of Rand-denominated debt securities issued by local government, public enterprises and major corporates. By April 2002, BESA had granted a listing to some 259 bonds, issued by 32 institutional borrowers, worth approximately R432 billion nominal. Nearly all listed bonds (about 84%) had been immobilised in the Central Depository Ltd.

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
- strip bonds.

Programmes listed or approved include the:

- Domestic Medium-term Note Programme
- Index-linked Programme
- Credit-linked Programme.

Main indices

BESA, 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 bench-marks for historical performance. The Total Return

Indices include the:

- All Bond Index (ALBI), comprising 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 South African bonds of the ALBI in which the appointed primary dealers are obliged to create 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

Trading takes place on the Exchange's automated trading system (BATS) or via interdealer brokers, matched principal traders and directly on screens managed by data-vending firms.

BATS is a quote-driven system and includes credit-limit functionality, thereby allowing members to limit their exposures for all counterparties utilising the system.

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 bench-mark issues – the R150 and R153 bonds. All primary dealers – must be members of the Exchange.

Market performance

The South African bond market is one of the most liquid emerging bond markets in the world. With the inclusion of the off shore trading volumes, this measure of market velocity touched 26 times the market cap.

Trading volumes recorded on the Exchange in 2001 exceeded R11,6 trillion, a marginal increase over 2000. These local trade figures for



2001 represent turnover of 27 times market capitalisation. In addition to on-Exchange trades, some R383 billion was traded in the over-the-counter (OTC) offshore market (for local settlement) during 2001 with a further R418 billion traded OTC, but settled through Euroclear and Clearstream (Cedel) rather than in South Africa. The daily turnover in 2001 amounted to some R47 billion per day (spot and repo).

Clearing and settlement

BESA adopted the Group of Thirty (G-30) recommendations on clearing and settlement as a blueprint for the development of its own clearing operations and was the first exchange in southern Africa to achieve full compliance.

BESA has developed a risk margining methodology which, when implemented, 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 R230 million (US\$1 = R10,6 approximately in April 2002) 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.

Acknowledgements

Bond Exchange of South Africa
Development Bank of Southern Africa
Estimates of National Expenditure 2002, 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 Reserve Bank
South African Revenue Service

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