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Finance

Government's macroeconomic policies aim at meeting the challenges of South Africa's social and economic development in the context of an increasingly interdependent global environment. Increasing growth to a higher and more sustainable level of at least 6%, in line with government's Accelerated and Shared Growth Initiative for South Africa (AsgiSA), is a top priority.

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 government. 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 (AG) and an independent central bank, and sets out the principles governing financial accountability to Parliament, as well as the annual budget process.

National Treasury aims to promote economic development, good governance, social progress and rising living standards through accountable, economic, efficient, equitable and sustainable public finances.

Fiscal policy framework

The Minister of Finance, Mr Trevor Manuel, presented the Budget for 2006/07 on 15 February 2006.

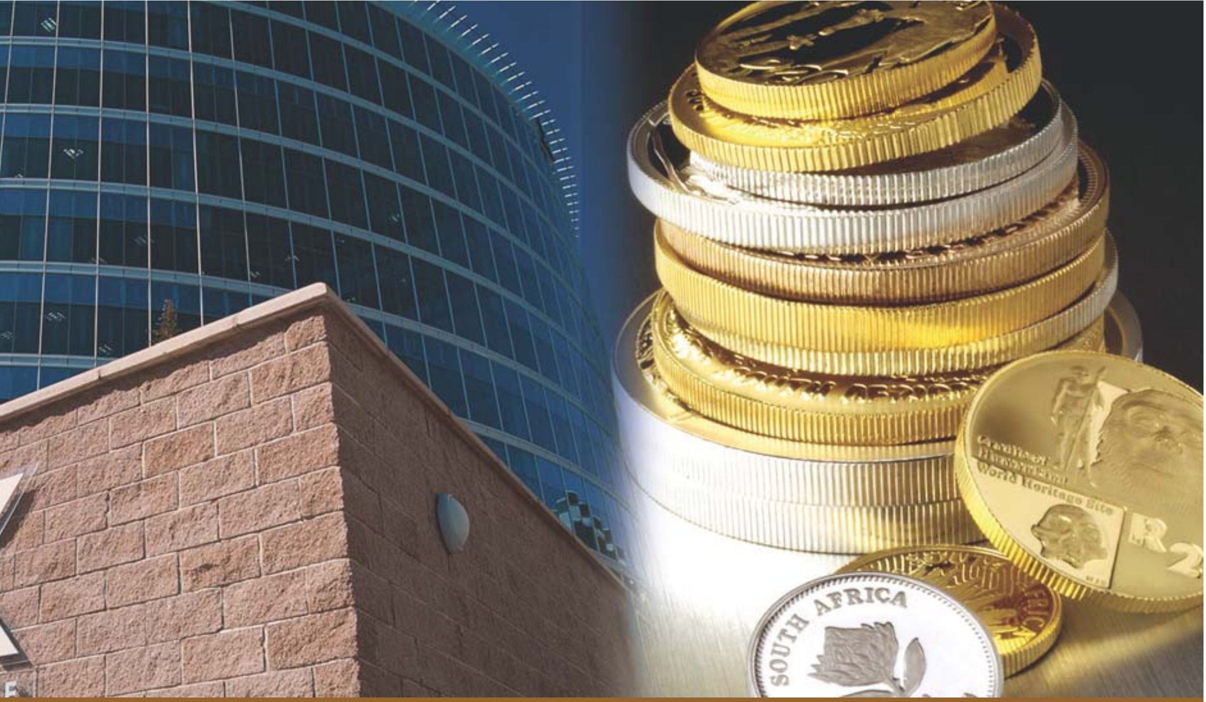
Tabling his 10th Budget in the National Assembly, he said the main Budget revenue in 2006/07 was expected to total R446,4 billion, with spending totalling R472,7 billion – resulting in a deficit of only 1,5% of gross domestic product (GDP).

Total tax relief in 2006/07 was expected to amount to R19,1 billion, of which R13,1 billion was in personal income tax relief to individuals.

The income threshold, below which no tax was payable by individuals, was raised to R40 000 for the 2006/07 tax year, and for taxpayers over 65 to R65 000 a year.

The maximum marginal rate of tax remained at 40%, while the threshold was raised from R300 000 to R400 000.

It was announced that the South African Revenue Service (Sars) would offer a tax amnesty to small businesses with a turnover of R5 million or less, which had not been compliant with the tax system. Taxes and penalties would be waived for the years of assessment ending on or before 31 March 2004,



subject to a non-disclosure penalty of 10% on taxable income for 2005. The first phase of the amnesty would come into effect between August 2006 and May 2007, focusing on the taxi industry.

The annual turnover threshold to qualify as a small business corporation rose from R6 million to R14 million, and the taxable threshold for the lower 10% rate would be increased from R250 000 to R300 000.

The small business income-tax-exemption threshold would also be raised from R35 000 to R40 000.

Tax on retirement funds would be halved from 18% to 9%, with effect from 1 March 2006.

The offshore foreign currency allowance for individuals was increased from R750 000 to R2 million.

On the spending side, the maximum old-age and disability grants and the Care Dependency Grant were increased by R40 to R820 a month, the Foster Care Grant by R30 to R590, and the Child Support Grant by R10 to R190 a month.

Other expenditure highlights for the Medium Term Expenditure Framework included:

- significantly increased spending on education, public health, social welfare services, housing and municipal infrastructure, local transport and water schemes
- R3,5 billion more for national roads and rail infrastructure, and R7,1 billion for the Gautrain project
- R5,4 billion to expand and equip police and improve courts' administration and the justice department's capacity
- R3,1 billion for defence modernisation and infrastructure
- R900 million to enhance foreign affairs capacity and the African Renaissance Fund
- R3,3 billion to improve the maintenance of government buildings.

Debt management

Sound macroeconomic policy and fiscal management have played a central role in building South Africa's reputation as a credible and competitive borrower. The approach to debt management has assisted in developing the financial sector as a source of capital for the public and private sectors. Improved access to capital and the development of specialised debt instruments for private borrowers have boosted domestic economic activity.

Government has focused on placing the management of national debt on a sound footing, and, as a result, debt-service costs have been reduced considerably. The fiscus has directly benefited from declining debt-service costs, which have freed additional resources for social

Consolidated national, provincial and social security fund expenditure: Functional classification[1]

	2004/05		2005/06		2006/07	
	Estimated outcome	% of total	Revised estimate	% of total	Budget estimate	% of total
General government services and unallocatable expenditure[2]	24 284,5	7,2	25 513,8	6,6	31 002,9	7,0%
Protection services:	**64 261,9**	**19,1**	**73 738,3**	**19,2**	**79 380,3**	**18,0**
Defence and intelligence	22 651,2	6,7	26 196,0	6,8	26 509,9	6,0
Police	26 787,9	8,0	30 792,7	8,0	34 286,4	7,8
Prisons	9 076,8	2,7	10 008,3	2,6	10 928,9	2,5
Justice	5 746,0	1,7	6 741,4	1,8	7 655,1	1,7
Social services:	**199 085,4**	**59,2**	**227 979,1**	**59,3**	**260 918,4**	**59,2**
Education	75 485,1	22,5	83 437,0	21,7	91 994,8	20,9
Health	42 319,4	12,6	47 751,8	12,4	53 515,6	12,1
Social security and welfare	62 462,5	18,6	74 303,4	19,3	81 896,3	18,6
Housing	6 544,2	1,9	7 666,3	2,0	9 051,7	2,1
Community development[3]	12 274,1	3,7	14 820,6	3,9	24 460,0	5,6
Economic services:	**48 565,3**	**14,4**	**57 451,6**	**14,9**	**69 397,1**	**15,7**
Water schemes and related services	5 792,8	1,7	6 108,7	1,6	7 231,2	1,6
Fuel and energy	1 902,9	0,6	2 823,7	0,7	3 204,0	0,7
Agriculture, forestry and fishing	7 127,8	2,1	8 572,8	2,2	11 218,0	2,5
Mining, manufacturing and construction	1 570,9	0,5	2 115,5	0,5	2 304,6	0,5
Transport and communications	17 862,4	5,3	19 875,7	5,2	26 796,0	6,1
Other economic services[4]	14 308,6	4,3	17 955,2	4,7	18 643,3	4,2
Subtotal:						
Votes and statutory amounts	**336 197,1**	**100,0**	**384 682,8**	**100,0**	**440 698,7**	**100,0**
Plus contingency reserves					2 500,0	
Total non-interest expenditure	336 197,1	–	384 682,8	–	443 198,7	–
Interest	48 851,2	–	51 160,0	–	52 049,0	–
Total consolidated expenditure	**385 048,3**	**–**	**435 842,8**	**–**	**495 247,7**	**–**

1) These figures were estimated by 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 allocation of some of the unallocatable expenditure for previous years. Data for the previous years has been adjusted accordingly.
2) Mainly general administration, cost of raising loans and allocatable capital expenditure.
3) Including cultural, recreational and sport services.
4) Including tourism, labour and multipurpose projects.

Source: ***2006 Budget Review***

expenditure. In 1998, for each Rand of revenue collected, government spent 24 cents to service debt. By 2005, only 12 cents of every Rand were being spent on debt service, and this will decrease to 10 cents per Rand by 2009.

Debt as a percentage of GDP has reached historic lows, which will increase the financial sustainability of the economy in coming years. Net government debt as a percentage of GDP is expected to decline over the medium term to 27,7%. Foreign debt as a percentage of total gross debt remains low at 13,4%.

This has contributed directly to an improved credit rating, enhancing South Africa's ability to borrow competitively in capital markets at lower rates of interest. All three major rating agencies upgraded South Africa's sovereign debt status to the top notch investment-grade ratings BBB during 2005. This translates into a lower-risk premium on South African investments, and further reduces borrowing costs.

With a stable economic environment and sophisticated financial markets, South Africa is one of a small group of countries that can finance its total borrowing requirement in the domestic market. The market has increased the attractiveness of South African assets to international investors.

Participation by international investors in the domestic bond market grew from below 11% in 2003 to more than 16,4% in 2005, reflecting positive global sentiment about the South African economy. As a result of the relative attractiveness of equity investments compared with bonds, turnover on the Bond Exchange of South Africa (Besa) declined marginally, from R8,4 trillion in 2004 to R8,1 trillion in 2005. In addition, an amount of R9,0 trillion of RSA domestic bonds traded through Euroclear.

Prudent debt management has also contributed to deeper and healthier capital and financial markets. The successful issuance of very long-term government bonds signals strong positive sentiment about the long-term future of the economy, and reflects a fundamental shift in the financing options available to South African business. The market-deepening impact of this policy is demonstrated by the expansion of the corporate bond market in recent years.

In a global environment characterised by relatively low interest rates, and subdued inflation in major world markets, the yields on government bonds continued to fall in 2005. From a comparative perspective, as demonstrated in the difference in yield, South Africa's cost of capital has fallen to a level closer to that enjoyed by developed economies. The decline in yields also reduced the real interest rate differential between South African and equivalent United States (US) bonds, from a high of 220 basis points in January 2005 to a historic low of 45 basis points in December 2005.

Financing government's borrowing requirement at the lowest cost within acceptable levels of risk will remain a central priority in the period ahead. New emphasis will be placed on improving the financial performance and corporate governance of state-owned entities, enabling them to better contribute to the development of the country's infrastructure base, and to economic growth.

National Treasury has widened the scope of risk management from a market-risk analysis of the State's debt portfolio, to a government-wide risk-management approach, which identifies and quantifies risks to the fiscus.

Legislation

National Treasury tables a significant amount of legislation in Parliament annually. Legislation passed in 2005/06 included the:

- Appropriation Act, 2005 (Act 14 of 2005)
- Taxation Laws Amendment Act, 2005 (Act 9 of 2005)
- Taxation Laws Second Amendment Act, 2005 (Act 10 of 2005)
- Adjustments Appropriation Act, 2005 (Act 21 of 2005)
- Auditing Profession Act, 2005 (Act 26 of 2005)
- Special Pensions Amendment Act, 2005 (Act 27 of 2005)
- Revenue Laws Amendment Act, 2005 (Act 31 of 2005)
- Revenue Laws Second Amendment Act, 2005 (Act 32 of 2005)
- Additional Adjustments Appropriation Act (2005/06 financial year), 2006 (Act 1 of 2006)
- Division of Revenue Act, 2006 (Act 2 of 2006).

Legislation expected to be tabled in 2006/07 included the:

- Appropriation Bill
- Taxation Laws Amendment Bill
- Taxation Laws Second Amendment Bill

- Adjustments Appropriation Bill
- Revenue Laws Amendment Bill
- Second Revenue Laws Amendment Bill
- Pension Funds Amendment Bill
- Finance Laws Amendment Bill
- Municipal Fiscal Powers and Functions Bill
- Financial Institutions (Protection of Funds) Amendment Bill.

A number of other pieces of draft legislation were under consideration and expected to be tabled in the short and medium term, pending the outcome of policy, drafting and consultation processes. These include the:

- Public Finance Management Amendment Bill, which will amend the Public Finance Management Act (PFMA), 1999 (Act 1 of 1999), to address, among other things:
  - practical difficulties encountered in the implementing the PFMA, 1999
  - the incorporation of recent and intended budget-reform initiatives
  - improved financial regulation of public entities
  - the Direct Charges Bill, which will authorise certain withdrawals and payments from the National Revenue Fund as direct charges.

Public Finance Management Act, 1999

Transforming public-sector financial management is one of National Treasury's key objectives. To this end, National Treasury has been implementing the PFMA since 1 April 2000.

Measurable improvements in the quality of financial management in both the national and provincial spheres of government include, among other things:

- an improved linkage between planning and budgeting, whereby departments are now required to compile and table strategic plans that are consistent with their budget envelope
- strategic plans and budget documentation containing improved information on measurable objectives expressed in terms of quantity, quality and timeliness
- departments submitting monthly expenditure reports on actual expenditure incurred, as well as on projected expenditure for the remainder of the financial year
- risk-management processes now being implemented by institutions
- establishing internal audit functions and audit committees in all departments
- setting accounting standards in accordance with best accounting practices, both locally and internationally
- finalising and submitting financial statements to the AG within two months of the end of the financial year
- tabling annual reports in the legislature within six months of the end of the financial year.

Financial Services Sector Charter

The Financial Services Sector Charter was signed in November 2003, signalling a key milestone in the transformation of the financial sector.

The charter seeks to ensure the broad-based transformation of the sector, based on the following elements: human resource development (HRD), procurement and enterprise development, access to financial services, empowerment financing, ownership, control and corporate social investment.

Exchange rate of the Rand – percentage changes

	31 Mar 2005 to 30 June 2005	30 June 2005 to 30 Sep 2005	30 Sep 2005 to 30 Dec 2005	30 Dec 2005 to 28 Feb 2006
Weighted average*	-2,4	5,6	2,0	2,1
Euro	0.3	5,3	2,1	2,4
US dollar	-6,5	4,8	0,8	2,4
British pound	-2,5	7,5	2,6	1,7
Japanese yen	-3,4	7,5	4,3	1,5

*Against a basket of 13 currencies

Source: ***Quarterly Bulletin***

National Treasury

Financial expenditure

National Treasury plays a pivotal role in managing government expenditure.

It determines financial-management norms and standards, and sets reporting policy that guides the AG's performance. It also assists Parliament, through the Standing Committee on Public Accounts (Scopa), with its recommendations and formulation of corrective actions. National Treasury closely monitors the performance of state departments and is obliged to report any deviations to the AG.

National Treasury furthermore maintains transparent and fair bidding processes, as well as accounting, logistic and personnel systems. It sets and maintains standards and norms for treasury and logistics, acts as a banker for national departments, and oversees logistical control of stocks and assets.

Exchange-control reforms

National Treasury continues to follow a policy of gradual relaxation of exchange controls. In February 2006, the offshore foreign currency allowance for individuals was increased from R750 000 to R2 million.

Amnesty Unit

On 26 February 2003, the Minister of Finance announced an amnesty window to enable South Africans to voluntarily declare their foreign assets and to regularise such assets and tax affairs without fear of prosecution.

By February 2006, 42 672 applications had been dealt with, and a total of R68,6 billion in foreign assets disclosed. The regularisation of the foreign asset holdings and tax obligations of the vast majority of applicants means that they can now manage their financial affairs without fear of criminal or civil prosecution. It also raises the declared income tax base by some R1,4 billion, and contributes to the statistical records of Sars and the Reserve Bank.

The R2,9 billion in revenue raised through amnesty levies was assigned to joint public-private partnership investments in community infrastructure and business development in low-income neighbourhoods.

By May 2006, 20% of South Africa's companies fell in the 'super growth' category of firms that had grown considerably more than the average – up from 16% in 2005 and up from 12% in 2004 – according to Grant Thornton International.

The result placed South Africa in the top 10 on Grant Thornton's Super Growth Index, which ranks countries by proportion of super growth companies, for the third year running, reflecting the country's consistent economic growth over this period.

Retirement fund reform

At the end of 2004, National Treasury issued a retirement-fund reform discussion document for public comment. The key objective of retirement reform is to ensure that all South Africans receive an adequate income in their retirement. Many comments were received and a revised discussion paper was expected to be released in mid-2006. This will ultimately form the basis of a draft revised Pension Funds Act.

Treasury norms and standards

In terms of section 216(1)(c) of the Constitution, 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 evaluation

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 to submit budget proposals annually for the following financial year to National Treasury.

Early Warning System

The Early Warning System was first established in 1997. Any likely under- or overexpenditure is brought to the attention of the Cabinet so that the relevant minister can ensure that appropriate action is taken.

Introducing the system has also assisted in the monthly monitoring of provincial departments' expenditure trends, by having provincial treasuries report to National Treasury in a prescribed format. The information derived from early warning reports is used for advising the Budget Council and the Cabinet. The Minister of Finance is also informed of the early warning report results.

Financial policies, systems and skills development

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

It delivers services that 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
- developing financial management in national and provincial governments.

Procurement

The preferential procurement regulations give substance to the content of the Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000). This Act and its regulations apply to all three spheres of government.

In August 2006, the Governor of the Reserve Bank announced that the South African Reserve Bank and National Treasury would jointly chair the Group of Twenty (G20) in 2007.

The G20 was established in 1999 as a forum for the central bank governors and finance ministers of the world's major developed and emerging market economies to discuss issues around global economic development and financial stability.

Including both the G8 and the most influential emerging countries, the G20 is a key forum on global economic development and governance, covering two-thirds of the world's population and 90% of world output.

Bids are evaluated according to a preference point system. A bidder 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 promoting or achieving specified Reconstruction and Development Programme (RDP) goals. A contract is awarded to the bidder who scores the highest total number of points.

The implementation of the regulations enhances the involvement of HDIs in the public bidding system and contributes to achieving RDP goals, including the promotion of small and medium enterprises.

The Supply-Chain Management Framework replaces outdated procurement and provisioning systems in government with an integrated supply-chain management system, as well as an international best-practice process for appointing consultants.

Financial Intelligence Centre (FIC)

Government has adopted a strong stance on eradicating money laundering and financing terrorism in keeping with United Nations (UN) conventions and international standards. In 2001, it passed the FIC Act, 2001 (Act 38 of 2001), and in February 2005, it passed the Protection of Constitutional Democracy Against Terrorist and Related Activities Act, 2004 (Act 33 of 2004). The FIC started functioning in February 2003 as an autonomous government agency reporting to the Minister of Finance.

The Protection of Constitutional Democracy against Terrorism and Related Activities Act, 2004 came into operation on 20 May 2005. The Act makes the Republic of South Africa fully compliant with the UN Counter Terrorism Conventions and Protocols, as well as the African Union Convention on the Prevention and Combating of Terrorism. The Act makes terrorism and offences relating to terrorist activities, such as recruiting, assistance to commit terrorist activities and facilitating such activities, a general offence.

The mandate of the FIC is to:

- develop policy that gives effect to government's objectives of combating money laundering and financing terrorism
- identify the proceeds of crime and the financing of terrorism

- exchange relevant information with competent authorities and international equivalent organisations
- prevent and reduce the laundering of the proceeds of crime
- monitor compliance in terms of the Act
- advise the Minister of Finance on all of these matters.

The Act identifies a range of 19 different business sectors, which it defines as being accountable institutions, and which are most vulnerable to abuse by criminals. These include banks, *bureaux de change*, life-insurance companies, stockbrokers, money remitters, as well as casinos, lawyers, accountants, investment advisers, estate agents and motor dealers. These accountable institutions have a range of obligations, including implementing 'know-your-client' measures and reporting to the FIC when they identify suspicious transactions.

The centre analyses and stores reports from the accountable institutions. It then makes disclosures or information packages available to law-enforcement agencies for investigation. It may also make this information available to similar bodies in other countries.

In 2005/06, the FIC received 19 793 suspicious-transaction reports, bringing the total to 44 021 by mid-2006.

In 2002, South Africa joined the 14-member-strong Eastern and Southern Africa Anti-Money Laundering Group. South Africa also became a member of the Financial Action Task Force, which is the international standards-setting body. The FIC is a member of the Egmont Group of financial intelligence units, which facilitates the exchange of information, skills and technical assistance between financial intelligence units worldwide.

Financial and Fiscal Commission (FFC)

The FFC is a constitutional body established to give advice to Parliament, legislatures and organs of state on matters of intergovernmental finance. The commission, which came into operation in April 1994, is a statutory institution and permanent expert commission dealing with intergovernmental fiscal relations.

It provides recommendations annually on the division of nationally raised revenues. The recommendations are processed through Parliament, legislatures and the Cabinet through various committees, and are taken into account when sharing such revenues between the spheres and within each sphere. The FFC Act, 1997 (Act 99 of 1997), was amended to empower the commission to investigate the financial implications associated with new policies and functions, or the shifting thereof between spheres.

Any organ of state can also ask the commission for advice on a matter pertaining to finance and fiscal relations, especially such matters as borrowing and taxation.

Budget Council

The Budget Council consists of the Minister of Finance and the nine provincial members of the executive committees responsible for finance, while the Budget Forum is the Budget Council extended to include representatives of organised local government. The mission of the two fora is to ensure that there is cohesion between national policy priorities, division of nationally raised revenues, and planning and budgeting at provincial and local spheres of government.

The fora also allow the leadership of the three spheres of government to evaluate the performance of government on key national programmes, and where deemed necessary to agree on support initiatives that would ensure attainment of national goals.

Public Investment Corporation (PIC)

The PIC, a state-owned institution that manages public servants' pension funds, was corporatised under a new law that came into effect in April 2005.

The PIC Act, 2004 (Act 23 of 2004), which replaces the Public Investment Commissioners Act, 1984 (Act 45 of 1984), protects the PIC as a legal entity and enables it to operate as a modern, professional and world-class investment manager.

The State remains the sole shareholder of the PIC, which reports to Parliament's Scopa, and whose controlling board is appointed by the Minister of Finance.

The PIC continues to use its current asset managers, namely RMB Asset Management, Stanlib, Future-Growth, Sanlam Investment Management and Old Mutual Asset Management.

The biggest contributors to the PIC's assets are public servants through the Government Employees

Pension Fund (91,29%). Other contributions come from the Compensation Commission (3,20%), Associated Institution Pension Fund (2,61%), Unemployment Insurance Fund (1,65%), Guardian Fund (0,65%) and Political Office Bearers Pension Funds (0,13%).

Assets managed by the PIC grew from R221 billion in 2000 to R461 billion as at 31 March 2005.

PIC funding of Black Economic Empowerment (BEE) has resulted in better vesting for BEE ventures, while also netting good profits for the corporation.

Macroeconomic strategy

South Africa recorded strong positive growth during 2004 and 2005 with GDP growth rising to 4,9% in 2005. This is expected to continue over the medium term. The positive outlook is underpinned by the stable macroeconomic foundation laid during the previous decade. Prudent fiscal and monetary policy with a sustainable fiscal deficit, low inflation and reduced interest rates have improved South Africa's growth potential.

In 2004, government set out the objectives of halving poverty and unemployment by 2014. A growth rate exceeding 5% a year on average between 2004 and 2014 is necessary to achieve these targets. In February 2006, government introduced AsgiSA with the objectives of growing the economy and improving the labour-absorbing capacity of the economy, leading to shared growth.

The methodology employed involves identifying the 'binding constraints' to achieving growth objectives. AsgiSA has identified the following binding constraints:

- the relative volatility and level of the currency
- the cost, efficiency and capacity of the national logistics system
- the shortage of suitably skilled labour amplified by the cost effects on labour of apartheid spatial patterns
- barriers to entry, limits to competition and limited new investment opportunities
- the regulatory environment and the burden on small and medium businesses
- deficiencies in state organisation, capacity and leadership.

A number of decisive interventions aimed at addressing these constraints and at allowing government to achieve its objectives more effectively include:

- Macroeconomic issues, including reducing the volatility of the Rand, improved estimation of revenue collections in the budgeting process, and improved expenditure management.
- The rapid increase in infrastructure spending to improve the availability and reliability of infrastructure and to reduce the cost of doing business.
- Sector-investment strategies (or industrial strategies) to promote private-sector investment. The focus will be on rapidly growing labour-intensive sectors and sectors with BEE opportunities such as business-process outsourcing, tourism and biofuels.
- Skills and education initiatives to alleviate the pressing shortage of skills, including initiatives to improve skills in areas such as Science, Mathematics, engineering, management and information technology (IT).
- Second-economy interventions to bridge the gap between the First and Second Economy, including increased participation and broader access to opportunities and education.
- Public administration issues, including the reduction of costly institutional interventions.

Government is committed to achieving the objectives set out in AsgiSA. Higher and shared

It was announced in June 2006 that South Africa's Public Investment Commission (PIC) was to create a continent-wide 25-year equity fund to mobilise local and international investment for infrastructure development in Africa.

The PIC, which includes the Government Employees Pension Fund, has around R600 billion in assets under management, making it the largest fund-management initiative in South Africa. The fund will initially focus on transport, energy, water and sanitation, and telecommunications-infrastructure investments. It will focus on projects that can contribute to the regional integration of the continent, and that will have regional impact.

The PIC will spend around R1 billion on property development – mostly in shopping centres in South Africa's townships and rural areas – over the next three years.

economic growth will allow South Africa to achieve its social objectives, namely to reduce inequality and virtually to eliminate poverty.

South African Revenue Service

In accordance with the Sars Act, 1997 (Act 34 of 1997), the service is an administratively autonomous organ of state. It aims to provide an enhanced, transparent and client-orientated service to ensure optimum and equitable collection of revenue. 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 the illegal importation and exportation of goods
- facilitate trade
- advise the Minister of Trade and Industry on matters concerning control over the import, export, manufacture, movement, and storage or use of certain goods.

Tax system

National Treasury is responsible for advising the Minister of Finance on tax-policy issues that arise at local, provincial and national government sphere. In its policy-advice function to government, National Treasury must design tax instruments that can optimally fulfil their revenue-raising function, achieve economic and allocative functions, and strengthen redistributive and social-policy functions. This must be done in a manner that creates a basis for general political acceptability of the selected tax instruments. National Treasury and Sars co-operate in compiling tax policies.

In 2001, South Africa's source-based income tax system was replaced with a residence-based system. Residents are now taxed (subject to certain exclusions) on their worldwide 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.

International tax agreements for the avoidance of double taxation

International tax agreements are important for encouraging investment and trade flows between nations. By reaching agreement on the allocation of taxing rights between residence and source countries of international investors, double taxation agreements provide a solid platform for growth in international trade and investment, by providing a certain tax framework.

Agreements for mutual administrative assistance between customs administrations

These agreements cover all aspects of assistance, including the exchange of information, technical assistance, surveillance, investigations and visits by officials.

Sources of revenue

Income tax

Income tax is 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' worldwide income, with appropriate relief to avoid double taxation. Non-residents are taxed on 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.

The income threshold below which no tax is payable by individuals was raised to R40 000 for the tax year beginning March 2006, and for taxpayers over the age of 65 to R65 000 a year. Changes to the tax brackets resulted in significant relief for all taxpayers, with an estimated 49% of the benefit going to those who earn less than R150 000 a year, and 24% of relief going to the income bracket R150 000 to R250 000. The maximum marginal rate of tax remains at 40%, while the threshold was raised from R300 000 to R400 000.

The domestic interest and dividend exemption for taxpayers under the age of 65 was raised from R15 000 to R16 500, and for senior citizens the threshold increased from R22 000 to R24 500. The proportion of the exemption applicable to foreign-interest income and dividends was raised from R2 000 to R2 500.

A revised tax regime for medical-scheme contributions and medical expenses was introduced in the 2005 Budget. It had the effect of raising the tax benefit for middle- and lower-income earners, while restricting the tax allowance in respect of more expensive medical schemes. Taxpayers under 65 are not taxed on, or may deduct, contributions to medical schemes up to R500 for each of the first two persons covered under a medical scheme (taxpayer and one dependant) and R300 for each additional dependant. In addition, they can claim a deduction for medical-scheme contributions above the caps and any other medical expenses, to the extent that the total exceeds 7,5% of taxable income.

Taxpayers under 65 may claim all qualifying medical expenses where the taxpayer or the taxpayer's spouse or child is a handicapped person.

Taxpayers who are 65 years and older will continue to enjoy a full deduction of all medical expenses. These changes took effect on 1 March 2006.

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, which generally commences on 1 March of a specific year, and ends on the last day of February the following year. Companies are permitted to have a tax year ending on a date that coincides with their financial years.

Tax returns must be submitted to Sars within the specified period. A taxpayer may apply for an extension for submitting a tax return.

People who owe Sars tax are charged interest at a rate as published in the *Government Gazette* that is linked to the rate specified in accordance with the PFMA, 1999. Persons who derive income from sources other than remuneration, 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.

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

Turnover and payroll taxes levied by the regional service councils were repealed with effect from 1 July 2006. Local governments levy rates on the value of fixed property to finance the cost of municipal services.

Value-added tax (VAT)

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

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

The prices of goods and services must be quoted/displayed on an inclusive basis, which means that VAT has to be included in prices on all 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 (the BLNS countries). The five member countries of Sacu apply the same customs and excise legislation, the same rates of customs and excise duties on imported and locally manufactured goods, and the same import duties on imported goods. The uniform application of tariffs and the harmonisation of procedures simplify trade within the Sacu common customs area.

Import duties, including anti-dumping and countervailing duties, are used as mechanisms to protect the local industry.

The renegotiated Sacu Treaty is now in force and provides a new dispensation for calculating and affecting transfers based on customs, excise and a development component.

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

Efforts continue to improve the effectiveness of custom controls and trade facilitation.

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 as an ad valorem duty on cosmetics, audio-visual equipment and motor cars.

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

Excise duties are imposed both as a means to generate revenue for the fiscus and to change consumer behaviour.

Transfer duty

Transfer duty is payable on the acquisition of property by individuals at progressive marginal rates between 0% and 8%. With effect from 1 March 2006, houses costing less than R500 000 attract no duty. A 5% rate applies between R500 000 and R1 million, and 8% thereafter. The 10% flat rate for companies and trusts was reduced to 8%.

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

Estate duty

For the 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 estates of deceased non-residents consist of only certain of their South African assets.

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

Stamp duty

Stamp duty is levied on instruments such as leases of immovable property and unlisted marketable securities at different rates.

In February 2006, the threshold exemption for stamp duties on leases was raised from R200 to R500 per agreement, reducing the compliance burden for taxpayers and the administrative load on Sars.

Uncertified securities tax (UST)

UST at a rate of 0,25% is payable in respect of the issue of, and change in beneficial ownership in, any securities which are listed on the JSE Securities Exchange (JSE). In the case of unlisted securities, stamp duty is levied at the same rate of 0,25%. UST on the issue of securities was eliminated from 1 January 2006.

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, as from 1 August 2005, is 1% in respect of employers with an annual payroll in excess of R500 000.

Air-passenger departure tax

A tax of R120 per fee-paying passenger departing on international flights, and R60 per passenger departing to BLNS countries is payable.

Organisational performance

Sars collected R417,4 billion in taxes during the 2005/06 financial year, thus exceeding its revised target of R417,05 billion by almost R337 million, and its original target of R372,8 billion by R45 billion. The revenue haul will help trim South Africa's budget deficit for 2005/06 from 1,5% to 0,3% of GDP.

Personal income tax yielded R126 billion, company tax yielded R87,5 billion and VAT yielded R114 billion. Sars also collected R8,5 billion in transfer duties, R15,7 billion in excise duties, R18 billion in customs duties and R20,5 billion in fuel levies.

e-Filing

e-Filing (*www.efiling.gov.za*) is a secure service enabling taxpayers to submit their tax returns online. It removes the risks and inconvenience of manual tax returns. Not only can returns be submitted via the Internet, but users can also make secure tax payments online. There is also a facility to apply for tax directives, which can be obtained within 24 hours.

e-Filing in South Africa has been growing significantly since its inception, and has been delivering real business benefits to both the taxpayer and Sars.

The increased use of IT is part of Sars' longer-term objective to move towards a paperless environment where the electronic transmission of information will lead to better service delivery and accuracy.

Of the total number of returns submitted by the tax deadline on 14 July 2006, 23 000 were completed through e-Filing. By July 2006, more than 45 000 individual taxpayers had registered as e-Filing users.

Filing Season

Filing Season is an extensive marketing and publicity venture to remind taxpayers of their responsibilities to submit their tax returns on time with the correct details.

The campaign's educational focus aims to help customers complete their tax returns correctly. In the past, 30% of tax returns received by Sars were either incorrectly completed, partially completed, or lacked the necessary substantiating documentation. This caused unnecessary delays for both taxpayers and Sars. The successful Filing Season campaigns since 2003 have led to a decrease in the number of incorrect returns submitted to Sars, and to the growth of the tax register.

The register for individuals grew by 10% in the year ending March 2004, and by 8% in the years ending March 2005 and 2006.

More than 2,3 million South Africans submitted their tax returns in the filing season which ended on 14 July 2006. This was an increase of almost 20% from 2005.

Gambling and lotteries

The National Gambling Board (NGB) was established in terms of the National Gambling Act, 1996 (Act 33 of 1996), which was repealed on 1 November 2004 by the National Gambling Act, 2004 (Act 7 of 2004). The Act provides for oversight of matters relating to casinos, gambling, betting and wagering, and promotes uniform norms and standards in relation to gambling throughout South Africa.

The board aims to ensure uniformity, harmonisation and integrity of the gambling industry in South Africa, by ensuring compliance with the National Gambling Act, 2004 and with other relevant legislation.

The NGB achieves this by:

- creating and establishing uniform norms and standards
- creating and establishing rules and regulations
- conducting oversight evaluations of the performance of provincial licensing authorities (PLAs)
- evaluating the compliance monitoring of licensees by PLAs
- assisting PLAs in ensuring that unlicensed gambling activities are detected
- monitoring socio-economic patterns of gambling activity
- conducting research on addictive/compulsive gambling and the socio-economic impact thereof.

Compliance

The Central Electronic Monitoring System was established in terms of the Act to detect and monitor significant events associated with any gambling machines outside casinos.

The ongoing campaign against illegal gambling, spearheaded by the board, is supported by the PLAs.

In 2005/06, the board conducted 17 inspections at licensed casinos throughout the country to ensure compliance with the FIC Act, 2001.

The South African National Accreditation Standards (Sanas) ensure that all gambling laboratories that test gambling machines and devices in the country are accredited to comply with the International Organisation for Standardisation (ISO)/IEC 17025 and ISO 9000 and technical competency in line with Sanas.

Regarding horseracing and betting, operational betting rules for bookmakers were approved and adopted as the uniform set of rules to be used by all bookmakers throughout the country.

National gambling statistics

In an effort to provide comprehensive and user-friendly information about the gambling industry, the board developed the National Gambling Statistics Database which focuses mainly on primary statistics such as turnover, gross gambling revenue (GGR) and gambling tax. PLAs are required to submit primary statistics to the board quarterly, for analysis. The results for 2005/06 showed an increase in gambling activities around the country. The GGR increased by 16% from R9 918 million (2004/05) to R11 510 million (2005/06).

Responsible gambling

The National Responsible Gambling Programme (NRGP) integrates research and monitoring, public education and awareness, training, treatment and counselling. It is the only programme of its sort to be jointly controlled by a public/private-sector partnership, involving government regulators and the industry. The NRGP is supervised by the South African Responsible Gambling Trust, which was created by the South African Advisory Council on Responsible Gambling, an initiative of the board.

The NRGP researches the possible vulnerability of particular communities, with specific reference to the role of poverty, and how problem gamblers differ from normal gamblers. It also promotes public awareness of its multifaceted role through participation in various community-outreach projects.

The NRGP Treatment and Counselling Network is growing substantially. The problem-gambling counselling line has been greatly enhanced by the appointment of additional telephone counsellors, as well as significant upgrades to the telephone and data-recording system.

National Lotteries Board (NLB)

The NLB was established in October 1998 in terms of the Lotteries Act, 1997 (Act 57 of 1997).

The board's main activities are to:

- advise the Minister of Trade and Industry on the issuing of the licence to conduct the National Lottery
- ensure that the National Lottery and Sports Pools are conducted with all due propriety
- ensure that the interests of every participant in the National Lottery are adequately protected
- ensure that the net proceeds of the National Lottery are as large as possible
- administer the National Lottery Distribution Trust Fund and to hold it in trust
- advise the minister on percentages of money to be allocated in terms of section 26(3) of the Lotteries Act
- advise the minister on establishing and implementing a social responsibility programme in respect of lotteries
- administer and invest the money paid to the board in accordance with the Lotteries Act, 1997.

In its first five years, the NLB allocated R3 billion to over 6 100 beneficiary groups.

Between its inception in March 2000, and October 2006, R6,3 billion was contributed to the trust fund for good causes, of which R4,8 billion was allocated to more than 9 000 non-profit organisations.

In October 2006, the licence to operate the National Lottery was awarded to Gidani (Pty) Limited.

Auditor-General

The AG exists as a state institution to support democracy.

The AG is mandated by section 188 of the Constitution to audit and report on the accounts, financial statements and financial management of:

- all national and provincial state departments and administrations
- all municipalities
- any other institution or accounting entity required by national or provincial legislation to be audited by the AG.

In addition to these duties, and subject to any legislation, the AG may audit and report on the accounts, financial statements and financial management of:

- any institution funded from the national or a provincial revenue fund or by a municipality
- any institution that is authorised in terms of any law to receive money for a public purpose.

The AG has a budget of R885 744 248 and has 1 696 employees. These are divided into various business units that provide auditing services, corporate services and specialised audit work such as performance, forensic auditing, computer auditing and technical support. The AG also boasts an impressive international auditing complement.

The AG must submit audit reports to any legislature that has a direct interest in the audit, and to any other authority prescribed by national legislation. All reports must be made public.

Public-sector auditing involves the investigation and evaluation of government and related institutions regarding financial-management practices, performance and compliance with legal requirements.

Financial sector

South African Reserve Bank

The Reserve Bank and the Ministry of Finance form the monetary authority in South Africa. The Reserve Bank has been given a significant degree of autonomy in terms of the Constitution and must perform its functions independently. However, the Reserve 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 of money by influencing its cost. Monetary policy is guided by the objectives of the Reserve Bank, which are formulated to ensure financial stability. Consistently combating inflation is the cornerstone of the bank's policy. A formal inflation-targeting monetary-policy framework has been adopted since 2000.

Monetary policy is set by the bank's Monetary Policy Committee (MPC). The committee, consisting of the Reserve Bank's governors and other senior officials, usually meets every two months, after which the bank issues a statement indicating its assessment of the economy and policy changes, if any.

The Reserve Bank is responsible for:

- assisting government in formulating and implementing macroeconomic policy
- formulating and implementing monetary policy to achieve its primary goal 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 who represent commerce, finance, industry and agriculture. The President of South Africa appoints the governor, three deputy governors and three directors.

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

The main instrument for managing liquidity in the money market is the repurchase transactions (repo) rate, which 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 other 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.

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.

The Reserve Bank uses 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 regarding banking institutions' cash reserves; and controlling 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.

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.

Monetary policy

Growth in broad money supply (M3) rose during 2005 and early 2006, accelerating from 13% in the early months of 2005 to 21% in February 2006.

Banks' loans and advances to the domestic private sector remained relatively strong during 2005 and early 2006, registering average growth rates of 21% to 22%. Asset-backed credit (mortgage advances, leasing finance and instalment sale credit) constituted the bulk of the increase in banks' total loans and advances throughout 2005 and early 2006.

Growth in M3 and banks' total loans and advances was consistent with firm increases in nominal income, expenditure and wealth.

Following a reduction in the repo rate to 7% in April 2005, the Reserve Bank's MPC left the repo rate unchanged at its successive meetings until June 2006.

In June 2006, the repo rate was increased by 50 basis points to 7,5%. In August 2006, it was increased to 8%. October 2006 saw another increase of 50 basis points to 8,5%.

Financial Services Board (FSB)

The FSB is an independent statutory body financed by the financial services industry itself.

The FSB supervises the exercise of control over such institutions and services, in terms of several parliamentary Acts that entrust regulatory functions to registrars of long-term insurance, short-term insurance, friendly societies, pension funds, collective investment schemes, financial service providers, exchanges and financial markets.

The FSB promotes programmes and initiatives by financial institutions and bodies representing the financial-services industry to inform and educate users of financial products and services. It also acts in an advisory capacity to the Minister of Finance.

Included in such functions is regulatory control over central securities depositories and depository institutions 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 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. The executive officer can, in certain circumstances, also petition for the winding up, or placing under judicial management or curatorship, 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), 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 by advisory committees on financial services providers, long- and short-term insurance, pension funds and collective investment schemes. The Financial Services Consumer Advisory Panel was established to advise the FSB and Registrar of Banks on consumer-protection issues falling within the regulators' jurisdiction.

The FSB maintains a close relationship with all existing industry associations. It liaises with overseas regulatory organisations, and is a member of the International Organisation of Security Commissions, the International Association of Insurance Supervisors, the African Association of Insurance Supervisors and the International Network of Pension Regulators and Supervisors.

On the domestic scene, it liaises with bodies such as the Public Accountants and Auditors Board, Consumer Affairs Committee and various government departments, as well as with prosecuting authorities such as the South African Police Service, the Directorate of Special Operations, and the National Director of Public Prosecutions.

The banking industry

At the end of December 2005, 34 banks, including 15 branches of foreign banks and two mutual banks, were registered with the Office of the Registrar of Banks. Furthermore, 47 foreign banks had authorised representative offices in South Africa. By the end of December 2005, the banking institutions collectively employed 122 135 workers.

Four major banks dominate the South African banking sector, namely Amalgamated Banks of South Africa (Absa) Bank Limited, which is internationally owned, the Standard Bank of South Africa Limited, FirstRand Bank Limited and Nedbank

> In 2006, the Minister of Finance, Mr Trevor Manuel, was appointed to serve on the World Bank's Commission on Growth and Development, which will highlight fundamental aspects of economic growth for the attainment of development objectives, and identify forward-looking growth policies.

Limited. These banks maintain extensive branch networks across all nine provinces, and by the end of December 2005, they constituted 83,8% of the total assets (R1 677,5 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.

Industry-wide net income after tax increased to 1,1% of total assets in 2005. As a percentage of equity, industry-wide net income after tax decreased from 14,7% in 2004 to 14,5% in 2005. By the end of 2005, industry-wide net income before taxation had begun to increase to R24,9 billion, compared with R22,5 billion in 2004.

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 of 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 2005, the banking sector as a whole had a ratio of capital-to-risk weighted assets of 13,3%.

At the Financial Sector Summit held in August 2002, the constituencies of the National Economic and Development Labour Council (Nedlac) agreed on broad principles for the reform of the South African financial sector. One of the elements of the agreement signed by the principals of the Nedlac constituencies in the summit, was the need to ensure access to basic financial services.

The object of the Dedicated Banks Bill is to make banking services available in areas and to consumers to whom such services have not been readily available.

The promulgation of this Bill is expected to create an enabling environment for companies interested in entering the banking system as savings and savings-and-loans banks, by lowering the entry requirements as prescribed in the Banks Act, 1990 (Act 94 of 1990). The licensing of interested companies as savings and savings-and-loans banks and their consequent provision of financial services will assist the banking industry and the nation in improving the broader market's access to services.

The microlending industry

The Department of Trade and Industry introduced the National Credit Act, 2005 (Act 34 of 2005), to allow the credit market to function in a robust and effective manner. The National Credit Act, 2005 replaced the Usury Act, 1968 (Act 73 of 1968), and the Credit Agreements Act, 1980 (Act 75 of 1980).

Main Budget: revenue

R million	2005/06 Revised estimate	2006/07 Before tax proposals	% change
Taxes on income and profits	228 730 000	260 740 500	17,2
Taxes on payroll and workforce	5 000 000	5 600 000	12,5
Taxes on property	11 120 000	13 462 000	23,4
Domestic taxes on goods and services	152 370 000	171 537 000	15,4
Taxes on international trade and transactions	18 960 000	23 600 000	42,7
Other taxes	870 000	974 000	-25,5
Total tax revenue (gross)	**417 050 000**	**475 913 500**	**17,5**

Source: ***2006 Budget Review***

A recent review of credit laws found that interest rate caps contained in the Usury Act, 1968 and Credit Agreement Act, 1980 have not been effective in protecting consumers. Credit allocation has been distorted to the detriment of low-income clients. In addition, some institutions have reduced transparency on the full costs of credit for poor clients by circumventing the caps through the introduction of credit life insurance and other charges.

Misleading disclosure, anti-competitive practices and very high costs of credit have subsequently undermined the potential benefit of access to credit. To a large extent, problems in the microlending industry are also a symptom of the failure of the banking sector to meet the needs of low-income earners.

Consumers have historically been subject to the high cost of credit and exploitative practices by unreputable credit-providers. The legislation focuses on consumer interest as government seeks to redress imbalances in the South African consumer credit market, and to create a more efficient market in which all South Africans will be able to have access to credit at affordable rates.

The National Credit Act, 2005 aims to regulate the granting of consumer credit by all credit-providers, including microlenders, banks and retailers. This new legislative framework created formal bodies referred to as the National Credit Regulator (NCR) and the National Consumer Tribunal, which will play a vital role in ensuring enforcement, promoting access to redress, and adjudicating contraventions of the Act. The Micro Finance Regulator Council, mandated to regulate the microlending industry prior to the establishment of the NCR, had 2 056 registered entities with a gross loan book of R22,9 billion by February 2006.

The National Credit Act, 2005 is envisaged to facilitate the creation of a fair, balanced and transparent credit market.

The NCR is responsible for regulating the South African credit industry. It carries out education, research and policy development; registers industry participants; investigates complaints; and ensures that the Act is enforced.

In terms of the Act, the NCR has to promote the development of an accessible credit market to meet the needs of people who were previously disadvantaged, earn a low income or live in remote, isolated or low-density communities.

The NCR registers credit-providers, credit bureaux and debt counsellors, and enforces compliance with the Act.

In terms of the National Credit Act, 2005, the National Consumer Tribunal was created from September 2006 onwards. The task of this independent body, whose members are appointed by the President, is to adjudicate various applications and to hear cases against those who contravene the Act.

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. By 31 December 2004, 96 short-term insurers had been registered. The total gross premiums written for 2004 (unaudited figures) amounted to R42 billion.

In essence, long-term insurance consists of life, assistance, sinking fund, health and disability insurance. Long-term insurance, and pension and provident funds are concerned with maximising investment results. Life insurance is dominant. As at 31 December 2004, 78 long-term insurers were registered. The total net premiums for 2004 (unaudited figures) amounted to R154 billion, while total assets amounted to R915,9 billion.

The Financial Advisory and Intermediary Services Act, 2002 (Act 37 of 2002), contains many of the provisions incorporated in the policyholder protection rules.

Other financial institutions

Development Bank of Southern Africa (DBSA)

The primary role of the DBSA, in terms of the DBSA Act, 1997 (Act 13 of 1997), is to promote economic development and growth, HRD and institutional capacity-building. This is achieved by mobilising financial and other resources from the private and public sectors, both nationally and internationally, for sustainable-development projects and programmes. The bank operates in South Africa, in the other Southern African Development Community (SADC) countries, and increasingly as a development agent and knowledge partner in the wider region of Africa south of the Sahara. Its mandate focuses on infrastructure in the wider sense – economic, social and institutional – both through loans of its own funds and by acting as a catalyst for investments in partnership with the private sector and other development-finance institutions.

Funding

The DBSA's capital and reserves at 31 March 2006 stood at R13 billion. The bank's financial resources are made up of the share capital contribution of National Treasury, borrowings in the financial markets, repayments on loans it has granted and internally generated funds. In addition to these resources, the bank mobilises loan capital from other international sources. It 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 raises funds from bilateral sources such as the German *Kreditanstalt für Wiederaufbau* (KFW), the Japanese Overseas Economic Co-operation Fund and the *Agence Française de Développement*.

Strategic direction

The bank has adopted a set of stretch targets over a 10-year period to give practical effect to its commitment to the strategic development agenda of South Africa, SADC, New Partnership for Africa's Development (Nepad) and the millennium development goals.

The DBSA's institutional vision and strategic plan – Vision 2014 – which is also guided by the bank's mandate, focuses on the following key goals:

- reducing poverty by half through economic development, comprehensive social security, land reform, and improved household and community assets
- reducing unemployment by half through new jobs, skills development, assistance to small businesses, opportunities for self-employment and sustainable community livelihoods
- massively reducing the incidence of tuberculosis, diabetes, malnutrition and maternal deaths, turning the tide against HIV and AIDS, striving to eliminate malaria throughout the region, and improving services to achieve a better national health profile and to reduce preventable causes of death
- positioning South Africa strategically as an effective force in global relations, with vibrant and balanced trade with countries of both the South and the North
- providing the skills required by the economy, building capacity and providing resources across society to encourage self-employment, good citizenship and a caring society.

The level of DBSA loan approvals in South Africa and the SADC region is projected to grow to R6 billion a year by 2014, thus creating a total of 127 000 jobs in South Africa, connecting 2,4 million households to one or more basic service, and contributing R22 billion to the local economy. Towards this end, it plans to invest R46 billion (loans and equity finance) in infrastructure development and, well over R1 billion in technical assistance, capacity-building grants and knowledge development or networking.

Strategic initiatives

The bank has strengthened and replenished the DBSA Development Fund, which is a dedicated capacity-building fund established as a section 21 company, to scale up and focus the bank's grant and technical support for local capacity-building in several areas, especially feasibility studies, project and programme development, systems design and development and training. It is also providing concerted financial and institutional support to Project Consolidate, a major local public-sector capacity-building initiative established by government and spearheaded by the Department of Provincial and Local Government.

The bank is assembling the Siyenza Manje task force, consisting of engineers and project managers working jointly with government, to augment Project Consolidate, to contribute to operational and strategic capacity in distressed municipalities, and to accelerate the roll-out of basic services. It is also actively working in the areas of local investment agencies and sustainable communities, and has extensive resources deployed in the research and knowledge management areas of sustainable development.

The bank has launched the Vulindlela Academy, a specialised institutional training facility dedicated to creating and upgrading skills required for the economy, in particular infrastructural delivery, and improved productivity and sustainability. The DBSA Vulindlela Academy is supported by a local government resource centre and a wide-area local government computer network to connect municipalities to a wide range of resources and facilities.

The bank has also positioned itself to provide strategic and financial support to the South Africa Football Association in planning and co-ordinating infrastructure development for the 2010 Soccer World Cup.

Land and Agricultural Development Bank (Land Bank)

The Land Bank operates as a development-finance institution within the agricultural and agribusiness sectors, and is regulated by the Land and Agricultural Development Bank Act, 2002 (Act 15 of 2002). The Land Bank provides a range of financing products to a broad spectrum of clients within the agricultural industry. Financing products include wholesale and retail financing to commercial and developing farmers, co-operatives and other agriculture-related businesses.

The Land Bank's objectives are defined within its mandate, which requires that it should achieve:

- growth in the commercial market
- growth in the development market
- business efficiency
  - service delivery
  - resource management
- sustainability.

(See Chapter 4: *Agriculture*.)

The Land Bank is the sole shareholder in the Suid-Afrikaanse Verbandversekeringsmaatskappy Beperk, which provides insurance to people indebted to the bank through mortgage loans.

The Land Bank's performance for 2005/06 was negatively affected by numerous factors, including depressed commodity prices, the strengthening of the Rand, and unstable conditions that affected farming produce.

During 2005/06, the bank concluded R986 million in BEE transactions. Afgri-Sizwe BEE consortium received R501 million of the total amount and Ushukela Milling received R485 million to acquire a strategic sugar-mill in KwaZulu-Natal. Some R8 million was allocated to chairs of agriculture at various universities while R3,5 million was made available for bursaries for previously disadvantaged students.

Collective investment schemes

The Unit Trusts Control Act, 1981 (Act 54 of 1981), and the Participation Bond Act, 1981 (Act 55 of 1981), which regulated unit trust schemes and participation bond schemes, were replaced on 3 March 2003 by the Collective Investment Schemes Control Act, 2003 (Act 45 of 2003), which regulates all these schemes under the title of collective investment schemes. The structures of these schemes remained basically the same as before, although there is scope for other types of structures.

Collective investment schemes in securities

These open-ended schemes provide for a number of different types of portfolios in the equity, interest-bearing and money markets for those investors who may not have the time, money or expertise to invest successfully in these markets on their own.

The prices of participatory interests (previously known as units) are calculated at net asset value and published daily. Managers create participatory interests for sale to the public as and when the demand arises. Managers may also cancel participatory interests when investors sell their holdings of participatory interests to the manager. The manager is obliged by law to buy back any participatory interests offered to it, at a price determined within 24 hours of receiving a valid notice of a buy-back from an investor.

Various collective investment schemes in South Africa offer similar ranges of investment plans, varying mainly as to the minimum amounts accepted for investment and certain charges. 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 investments.

Collective investment schemes in property

Previously known as property unit trusts, these schemes invest mainly in the shares of property-owning companies, direct property, and certain other and foreign assets. Their issued participatory interests are listed on the JSE Limited.

Collective investment schemes in participation bonds

Formerly called participation bond schemes, several of these schemes are being wound down. According to the Reserve Bank, the number of schemes declined from 14 in December 2003 to nine in March 2006. The amount invested with these schemes was R3,5 billion as at 31 March 2006. Six of the nine schemes had invested funds from the general public, while individuals continued to be these funds' main investors.

Foreign collective investment schemes

Since 1998, foreign collective investment schemes have been allowed to market their products in South Africa, provided they obtain approval from the FSB.

Individual investors using their foreign exposure are the primary investors. At the end of 2003, 78 foreign schemes administering 433 different portfolios had obtained approval to market their products in South Africa. The amount accepted from South African investors amounted to R45,8 billion at the end of 2003.

Stokvels

Stokvels are co-operative rotating saving schemes that mobilise funds among mostly black communities for a variety of purposes. Rotating saving schemes similar to stokvels are also found in countries such as South Korea, Jamaica, Egypt and Japan. An estimated one million stokvels operate in South Africa.

Financial intermediaries and advisers

In accordance with the Financial Advisory and Intermediary Services Act, 2002, the Advisory Committee on Financial Services Providers, established by the Act, has focused its attention on finalising numerous pieces of necessary subordinate legislation (including the codes of conduct for different categories of financial services advisers).

As of 30 September 2004, financial advisory and intermediary entities are no longer able to conduct their business activities without being in possession of a licence issued by the FSB. The FSB was assisted by 12 representative-recognised bodies for the purpose of processing licence applications.

The Office of the Ombudsman for Financial Services Providers was empowered to adjudicate complaints by consumers relating to financial advice and intermediary services from 1 October 2004, when the Act came into full operation.

By the end of February 2005, the FSB had recorded the submission of about 14 500 licence applications in terms of the Financial Advisory and Intermediary Services Act, 2002.

Retirement funds and friendly societies

As at 31 December 2003, the FSB supervised 13 752 registered retirement funds and 180 registered friendly societies. These funds exclude the official State funds, Transnet, Telkom and some bargaining-council funds, none of which is registered in terms of the Pension Funds Act, 1956 (Act 24 of 1956).

The total membership of all pension funds at the end of 2002 was 9 779 884, of which 8 567 479 were active members, and 1 212 405 were pensioners, deferred pensioners or dependants. These figures do not reflect the total number of individuals who were members of funds, as some were members of more than one fund.

The total contributions received decreased by 0,9% from R61 097 billion in 2001 to R60 552 billion in 2002. Total contributions to the State, Transnet, Telkom and Post Office funds decreased by 1,4%, while total contributions to self-administered, underwritten and industrial funds in the private sector decreased by 0,7%.

Benefits paid decreased from R111,206 billion in 2001 to R72,492 billion in 2002. Amounts paid in respect of pensions, lump sums on retirement or death and resignations were included.

Total assets of the retirement-fund industry in South Africa increased by 3,7%, from R836 billion in 2001 to R867 billion in 2002.

The net assets of self-administered funds decreased by 4,9% from R370 billion in 2001 to R352 billion in 2002.

In order to contribute to the build-up of retirement savings, and taking into account that interest rates have stabilised at lower levels, the tax on retirement funds was reduced from 18% to 9% with effect from 1 March 2006, at a cost of R2,4 billion.

Regulatory reforms relating to cost disclosure, the structure of commissions and governance of funds were expected to be proposed in a policy paper. Government's pension reform aims to ensure that the benefits of the favourable tax regime are passed on to retirement-fund members in the form of improved returns, and that retirement savings are not depleted by excessive charges and penalties.

Financial markets

Primary capital-market activity

Government bonds

Net issuance of fixed-interest securities by the national Government in the domestic primary bond market amounted to R21,8 billion in 2005/06, compared with R31,9 billion raised in 2004/05.

The Reserve Bank conducts weekly nominal, inflation-linked and variable-rate bond auctions on behalf of National Treasury. In 2005/06, an average of R750 million was issued weekly, compared with an average weekly issuance of R900 million in 2004/05.

The conditions for issuances in the fixed-income market were conducive not only locally, but also globally, and the South African Government successfully issued a 10-year US$1,0 billion (R6,5 billion) denominated bond in May 2004 at a spread of 195 basis points over the benchmark US Treasury Bond.

In addition, R3,2 billion was drawn on the foreign-export credit facilities. Foreign bonds redeemed amounted to an equivalent of R5,3 billion, bringing net foreign bond issuance to R4,5 billion. This compares with gross foreign bond issuance of R14 billion in 2003/04, with redemptions totalling about R13 billion. In 2005/06, no foreign bonds were issued. The Government, however, successfully issued a 10-year R750 million (R5,5 billion) denominated bond in April 2006 at a spread of 81 basis points over the equivalent German government bond.

Three new fixed-income bonds were launched in 2005/06, namely the R205, R206 and R207 bonds. The R205 bond was issued in July 2005 with a variable coupon rate, maturing in 2012. By March 2006, R2,6 billion had been issued. The R206 bond was launched in August 2005, carrying a coupon of 7,5% and maturing in 2014. Over R4 billion was raised via the R206 bond during 2005/06. The R207 bond was launched in June 2005, with a coupon of 7,25% and maturing in 2020. By March 2006, R8,0 billion had been issued. National Treasury offered a split facility on the R194 government bond from 1 November 2005, similar to that previously offered on the R150 bond. The following bonds were also issued: the R007 bond (maturing on 28 February 2007), the R195 bond (maturing on 28 February 2008) and the R196 bond (maturing on 28 February 2009). A coupon rate of 10% applies to all three new bonds.

In May 2004, government also launched the RSA government retail bonds, with maturities of two, three and five years. From its inception to March 2006, government had raised a total of R1,9 billion through these bonds.

Government's total loan debt increased from R389,3 billion in 2003/04 to R428,1 billion in 2004/05. However, total gross loan debt as a percentage of GDP remained steady at 35,7%.

Non-governmental bond issuance

The outstanding nominal value of non-government loan stock listed on Besa increased by R42,43 billion in 2005, compared with an increase of R31,46 billion in 2004. This figure includes funds raised through other vehicles such as securitisation and short-term commercial paper. Total issuance related to securitisation and commercial paper amounted to R27,8 billion in 2005. Issuance in the non-government sector, whether through corporate bonds, securitisations or private placements, has grown significantly in the past few years. This can be attributed to more diverse instruments being used, declining interest rates, narrowing credit spreads indicating investor risk tolerance amid the search for yield, as well as credit upgrades for a number of corporate institutions. The South African corporate market is expected to grow as new asset classes emerge and new issuers continue to enter the market.

Eurorand bonds

Following four years of net redemptions, the Eurorand bond market expanded in 2004 and 2005. Improved liquidity conditions in the global financial markets led to improvements in eurorand bond market activities. Gross issuance increased to R10,1 billion in 2005, which is a 49% increase compared with the R6,8 billion issued in 2004, excluding a R1,0-billion issue not being regarded as a pure eurorand transaction. In 2005, R3,5 billion worth of eurorand bonds matured, resulting in a net issuance of R6,5 billion.

The renewed interest in this market can also be attributed to positive sentiment towards the Rand and an overall positive performance in global fixed-income markets in 2005. In the first half of 2006, gross issuance amounted to R1,4 billion, while R1,65 billion matured, bringing net redemptions to R250 million.

Germany's KFW dominated issuance in the Eurorand bond market, comprising almost 34% of total issuance during 2005. Other issuers were the European Investment Bank (EIB) (20%), Rabobank Nederland (11%) and Rentenbank (11%), while *Landsman Baden-Wuerttemburg* issued about 2%. The rest were issued by new issuers such as Eurofima, Swedish Export Credit, *Nordrhein-Westfalen, Bayerische Landesbank,* Dexia Municipal Agency and the Province of Ontario. The type of credit issued remained predominantly AAArated, and the maturity structure changed to longer-dated issues. The 2010 and 2013 bonds account for 56% of total eurorand bond issuance, while the rest is concentrated in bonds maturing in five years or less.

The spreads and yields at which these bonds were issued declined during 2004, with some bonds even issued at spreads below comparable South African benchmark government bonds. The 2013 bond, for example, was tapped by the EIB at a yield of 8,95% in January 2004, and was tapped again in November 2004 at a yield of 8,22%. While coupon rates were as high as 11% in 2003, they declined to between 10% and 8% during 2004.

Uridashi bonds

In addition to the issuance of eurorand bonds, the issuance of rand-denominated bonds by foreign borrowers in the Japanese uridashi market also continued to grow during 2005 and early 2006. An uridashi bond is a foreign-currency bond sold by a non-Japanese issuer to Japanese retail investors, and generally offers a yield that is more attractive than the yields offered on similar bonds issued in Japanese yen. Rand-denominated bonds were first issued in the Uridashi market in July 2004. The total nominal value of issues for that year amounted to R2,5 billion, followed by R8,8 billion in 2005 and R1,2 billion in the first half of 2006.

Secondary capital-market activity

Domestic bonds

South African bond yields declined considerably between October 2005 and February 2006. The closing yields on government bonds declined to historically low levels on 20 February 2006, with the yields on two-year R194, four-year R153, nine-year R157 and 20-year R186 government bonds declining to 6,93%; 7,05%; 7,13%; and 6,81%, respectively. Factors that contributed to the decline in local yields include the firmer exchange value of the Rand, which served to lessen medium-term inflation concerns, and a lowering of the tax rate on interest income for the retirement-fund industry, announced in the February 2006 Budget speech. After being net purchasers of South African bonds to the value of R0,4 billion in 2004, non-residents were net sellers of bonds to the value of R10,7 billion in 2005.

From its lows in February 2006, in the months leading up to June, bond yields increased in reaction to a slightly weaker rand exchange value and external factors, such as increasing US Treasury yields as well as the potential for further US interest rate increases. In the first half of 2006, the cumulative value of non-residents' net purchases of bonds amounted to R7,7 billion.

The value of trading activity in the domestic secondary bond market at consideration amounted to R9,8 trillion in 2005, which was 3% higher than the R9,5 trillion in 2004. In the first half of 2006, the value of turnover on the bond exchange amounted to R6,4 trillion. Alongside the upward trajectory in bond yields from the end of February 2006, the daily average turnover reached R51 billion in February 2006 and accelerated further to a high of R67 billion in June.

Money-market activity

The South African money market is an over-the-counter market in which a fairly large number of banks and other institutions actively participate. The Reserve Bank implements its monetary policy in terms of a system based on creating a shortage in the money market.

The bank refinances this shortage through weekly repurchase transactions with seven-day maturities at its policy rate, the repo rate. Thus, the bank influences other market interest rates. The daily liquidity requirement in the money market was maintained close to R13 billion throughout 2005/06.

The Reserve Bank used mainly four types of open-market operations to drain surplus liquidity from the money market, namely issuing Reserve Bank debentures, conducting longer-term reverse repo transactions, foreign exchange swaps and outright sales or switches of government bonds. Furthermore, with the redemption of the R152 bond and coupon payments made to the Reserve Bank on various bonds during February 2005, the bank was able to permanently drain R3,1 billion worth of liquidity from the market.

Equity market

The total value of equity capital raised by companies listed on the JSE Limited amounted to R41,8 billion in 2004 and subsequently increased to R82,2 billion in 2005 and R49,1 billion in the first half of 2006. The number of new listings increased in 2005, from 17 to 19, while the number of delistings declined from 39 in 2004 to

35 in 2005. Fifteen new listings were recorded in the first half of 2006. Some 984 securities were listed on the JSE Limited at the end of 2005 compared with 873 at the end of 2004, increasing to 991 in the first half of 2006.

Domestic share prices, as measured by the all-share index (Alsi), increased to new highs during 2005 and the first half of 2006. From a low on 28 April 2005, the Alsi rose by 77% to set a new record high of 22 094 on 11 May 2006. The strong increase in share prices was led by the increase of 115% in resources shares (with platinum-mining shares increasing by 185% and gold-mining shares by 131%) and 57% in industrial shares, while financial shares improved by 52% over the same period.

Factors that influenced the market during this period were low domestic interest rates, positive economic fundamentals, prudent fiscal and monetary policies, high commodity prices, expectations of continued higher corporate earnings, general optimism in global equity markets, and strong demand from foreign and local investors. From its high in May 2006, the Alsi declined by 4% to the end of June alongside weaker global equity markets and a decline in commodity prices.

Turnover on the JSE Limited, as measured in terms of the value of shares traded, reached a level of R1 031 billion in 2004, and increased to a record R1 279 billion in 2005. In the first half of 2006, turnover amounted to R1 121 billion. Liquidity, as measured by turnover as a percentage of market capitalisation, decreased from 37% in 2004 to 36% in 2005, with market capitalisation increasing from R2 566,4 billion to R3 586,1 billion over the same period. Market capitalisation in US dollar terms increased by 24% from US$442,5 billion in 2004 to US$549,3 billion in 2005.

According to the World Federation of Exchanges, South Africa was in 16th position in the world league at the end of May 2006 in terms of market capitalisation in US dollar terms. Non-residents bought a net amount of R50,2 billion worth of shares during 2005 and increased their holdings of domestic shares by a net amount of R56,5 billion during the first half of 2006.

The JSE Limited's new interest-rate exchange, Yield-X, commenced trading on 28 February 2005. This interest-rate exchange is the JSE Limited's fourth electronic clearing and settlement platform, alongside equities, financial futures and agricultural products. Yield-X aims to open up the interest-rate market to new players and new products, encouraging liquidity and market diversification.

In addition, Yield-X seeks to ensure proper price discovery for interest-rate products in South Africa. At the heart of the new exchange is an anonymous central order book, allowing for trading via a single platform with automated trade matching and guaranteed settlement. The JSE Limited expects Yield-X to emulate the success of its equities and futures trading systems over time, establishing a sophisticated interest rate derivatives market for the country.

A major benefit of Yield-X will be the elimination of bilateral counter-party risk. The JSE, through clearing-house Safcom, will guarantee all trades and offer a cradle-to-grave audit trail. Yield-X will operate in a fully regulated environment overseen by the JSE Limited and the FSB. Yield-X is targeting a range of investors, from large institutional investors, banks, corporate treasuries and intermediaries, to smaller financial institutions and retail investors who may have been previously excluded from the interest rate market.

Domestic currency market

The South African Rand appreciated by almost 20% against the US Dollar during 2004. Although part of this appreciation was due to general US dollar weakness over this period, which caused most emerging-market currencies to appreciate, the Rand was also supported by domestic economic conditions such as the decline in the inflation rate, positive economic growth, improved sentiment and an increase in official foreign-exchange reserves.

South Africa's official gross reserves increased from US$8,1 billion at the end of January 2004 to US$15,9 billion at the end of March 2005. Demand for the Rand was also fuelled by foreign portfolio investment, particularly during the last quarter of 2004.

According to Bloomberg's annual ranking report, the Rand was the second-best performing currency against the US Dollar during 2004. The analysis comprises 60 currencies from developed as well as emerging-market countries. The only currency to marginally outperform the Rand was the Polish Zloty. The Rand also appreciated against other major currencies. Against both the Euro and the Pound, the Rand appreciated by almost 10% and compared with the Yen, the Rand appreciated by 13%.

Volatility conditions, as reflected by the implied and historical volatility indicators, rose to as high as 25,6% and 28,4%, respectively, in January 2004, but declined significantly during the rest of the year. At the end of December 2004, the implied and historical volatility indicators were at 14,9% and 13,4% respectively, indicating that volatility in the Rand exchange rate had subsided.

The average turnover in the domestic currency market increased from US$92,9 billion for the 2003 year as a whole, to US$98,0 billion for 2004. The average net daily turnover increased from US$7,7 billion to US$8,2 billion over the same period. These increases occurred mainly in the foreign exchange swap market, and were not out of line with global trends observed in the 2004 Bank for International Settlements survey of global foreign exchange activity. Domestic rand turnover comprises 0,42% of the global foreign exchange market.

During the first quarter of 2005, the Rand depreciated by almost 10% against the US Dollar, mainly as a result of developments in international currency markets. The main reason was the appreciation in the exchange rate of the US Dollar, which began early in January, caused by expectations that the Fed could increase interest rates at a faster pace than previously expected. This affected most emerging market currencies. In addition, commodity prices declined to lower levels during 2005 with a subsequent effect on the Rand, given that it is a commodity currency.

Exchange control

Exchange control is administered by the South African Reserve Bank on behalf of the Minister of Finance. The South African Reserve Bank is assisted in this task by a number of banking institutions that 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 South African 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 from R750 000 in February 2000 to R2 million in February 2006.

The following dispensations regarding exchange control are allowed:

Institutional investors

Part of the process of gradual exchange-control liberalisation and financial-sector strengthening is the shift to a system of prudential regulation governing the foreign portfolio investment of institutional investors, such as long-term insurers and pension funds.

Prudential regulations are applied internationally to protect policyholders and pensioners from excessive risk, and typically include restrictions on foreign asset holdings, set at a certain percentage of an institution's total assets or liabilities. As an interim step towards a prudential framework, the following will be implemented:

- Institutional investors will be allowed to invest, on approval, up to existing foreign asset limits. These foreign asset limits are 15% of total retail assets for retirement funds and long-term insurers. Investment managers registered as institutional investors for exchange-control purposes and collective investment scheme management companies are restricted to 25% of total assets under management.
- Institutional investors may invest an additional 5% of their total retail assets in Africa directly, by acquiring foreign currency denominated portfolio assets in Africa through foreign currency transfers from South Africa, or indirectly, by acquiring rand denominated foreign exposures via inward listed African securities.
- Foreign companies, governments and institutions may list instruments on South Africa's bond and securities exchanges.
- Institutional investors will be required to submit additional information when making an application for a foreign-investment allowance. The shift to prudential regulation requires improved data reporting on individual institutions' foreign investments and the foreign-diversification levels of the industry as a whole. The new regulation became operational on 1 May 2003, after National Treasury and the Exchange Control Department of the South African Reserve Bank, in consultation with the FSB, reached agreement with the respective

industries on the appropriate revised reporting standards.

South African corporates

The global expansion of South African firms holds significant benefits for the economy, including expanded access to markets, increased exports and improved competitiveness.

With effect from 26 October 2004, limits on foreign direct investment (FDI) by South African corporates were abolished. Exchange control approval is, however, required. Requests by corporations are considered in light of national interest, such as the benefit to South Africa's international reserves by, for example, generating exports of goods and services. The Exchange Control Department of the South African Reserve Bank reserves the right to stagger capital outflows relating to very large foreign investments, to manage any potential impact on the foreign exchange market.

Interest payments on loans raised abroad to finance or partly finance new approved foreign investments must be repaid from offshore resources.

As a further alternate mechanism of financing offshore investments, applications by corporates to engage in corporate asset or share-swap transactions will be considered.

Authorised dealers may also extend foreign currency-denominated facilities to South African corporates for financing approved FDI.

Emigrants' funds

A system of exchange-control allowances for the export of funds when persons emigrate has been in place in South Africa for a number of decades. Emigrants' funds in excess of the emigration allowance were placed in emigrants' blocked accounts to preserve foreign reserves. Reflecting the improved strength and resilience of the South African economy, these blocked assets are now being unwound. The imminent elimination of the net open forward position, and an increasingly diversified and growing export sector, create an environment that is conducive to dealing with the foreign reserve problems of the past. As such, the following applies:

- The distinction between the settling-in allowance for emigrants and the private individual foreign-investment allowance for residents has fallen away, and there is now a common foreign capital allowance for residents and emigrants respectively, of R2 million per individual (or R4 million in respect of family units emigrating).
- Emigrant-blocked assets are being unwound. Amounts of up to R2 million (inclusive of amounts already exited) are eligible for exiting without charge. Holders of blocked assets wishing to exit more than R2 million (inclusive of amounts already exited) must apply to the Exchange Control Department of the South African Reserve Bank to do so. Approval is subject to an exiting schedule and an exit levy of 10% of the amount requested.
- New emigrants wishing to exit more than R2 million (inclusive of amounts already exited) can similarly apply to the Exchange Control Department to do so, with approval subject to an exiting schedule and an exit level of 10% of such additional amount.

Local financial assistance to affected persons and non-residents

To improve access to domestic credit in financing FDI in South Africa or for domestic working capital requirements, foreign companies or foreign-owned South African companies are permitted to make greater use of local finance. With effect from 18 February 2004, foreign companies or foreign wholly owned subsidiaries can borrow locally up to 300% of the total shareholders' investment.

This ratio does not apply to emigrants, the acquisition of residential properties by non-residents or affected persons, and certain other financial transactions, such as portfolio investments by non-residents, securities lending, hedging, repurchase agreements, etc. In these cases, the 100% ratio still applies.

Launched on 25 October 2004, the Mzansi bank account was conceived out of the requirements set out in the Financial Services Charter. Mzansi is supported by Absa, First National Bank, Nedbank, Standard Bank and the Postbank.

By June 2006, Mzansi had led to the creation of 3,3 million new bank-account holders.

JSE Limited

Founded on 8 November 1887, the JSE is the sole licensed securities exchange in South Africa. In July 2005, after 118 years as a mutual association, the JSE celebrated its demutualisation and is now known as JSE Limited, a public unlisted company.

The management and control of the JSE Limited vests in the board, which has powers conferred upon it by the JSE's Acts, rules and the Constitution.

On 6 August 2001, the JSE Limited acquired the business and assets of the South African Futures Exchange (Safex), which is now incorporated into the JSE Limited in two divisions, namely 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.

Regulation

As the front-line regulator of its primary and secondary markets, an independent regulatory authority, the FSB, supervises the JSE Limited. The Issuer Services Division of the JSE Limited, together with two independent bodies – the Generally Accepted Accounting Practice (GAAP) Monitoring Panel and the Securities Panel Regulation – enforce compliance with GAAP and the protection of minority shareholders respectively.

The Insider Trading Directorate of the FSB operates a stringent enforcement programme, with the support of the JSE Limited, in respect of the secondary market. In turn, the JSE Limited regulates its listed companies and broking members by extensive rules and directives in line with the Securities Services Act, 2004 (Act 36 of 2004).

In November 1995, the JSE Limited permitted ownership by foreign and corporate members for the first time. The move, part of a broader deregulation package designed to entice local and international investors, parallels the London stock market's 'Big Bang' of 1986, although changes were phased in over time. These included closing the open-outcry market floor in favour of automated electronic trading, the introduction of fully negotiable commission, and dual-trading capacity.

International involvement

The JSE Limited is the largest securities exchange in Africa and has a market capitalisation of several times that of all the other African markets combined. It has the third-largest market for single stock in the world, the ninth-largest market for options and futures in the world, it accounts for over 75% of market capital in Africa, and its reserves grew from US$31 million in 1999 to US$83 million in 2005.

The JSE Limited 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 Committee of SADC Stock Exchanges (COSSE). The COSSE envisages an integrated real-time national network of securities markets in the region. The JSE Limited has offered its trading platform to these members, and the Namibian Stock Exchange has been trading on the JSE Limited's trading platform for the past eight years.

In addition, the JSE Limited has played an instrumental role in creating the globally prominent Code of Corporate Practices and Conduct (referred to as King II), a follow-up to the King I Code. The listings requirements of the JSE Limited now require that all companies provide a report in their annual financial statement on their level of compliance with King II, including progress on the novel stakeholder aspects of the code.

Consistent with the objectives of Nepad and by virtue of the JSE Limited's position in the southern African region, the JSE Limited remains committed to the concept of a Pan-African board, and is involved in trying to raise money to assist neighbouring countries to participate in this initiative.

Foreign investors

Since 1994, South Africa has restructured its economic policies to attract foreign investment. The transition has led to a significant improvement in the quality and inclusiveness of institutions. Prudent social reform has been coupled with accountable political institutions and sound macroeconomic management.

The economic rating agencies' reports confirm the presence of high levels of political stability. The JSE Limited plays a vital role in the South African economy by putting capital-providers in touch with capital-seekers. Thus, cash resources are channelled into productive economic activity, building the economy while enhancing job opportunities and wealth creation.

Listing on the JSE Limited enables capital to be raised for expanding the financing of new business and creating new employment opportunities. In addition, it provides a secondary market for dealing in securities by bringing together buyers and sellers in a manner that ensures transparent price discovery. In this way, new investment opportunities in the country are created.

During the February 2004 Budget speech, the Minister of Finance continued to further relax exchange controls by approving foreign companies seeking to issue securities on the JSE Limited and Besa. In line with the approval, international investors have unfettered access to securities listed on the JSE Limited:

- There are no exchange controls of any kind imposed on foreign investors or any non-resident parties.
- There are no limits on the repatriation of capital or income on foreign shareholders.
- There are no withholding taxes or other penalties applied to the repatriation of capital, interest or dividends by foreign investors.
- There are no foreign ownership limits on South African securities.
- There is no separate registration process for foreign investors. All shareholders are reflected in the dematerialised register. Purchases or sales of shares by foreign shareholders are reflected in its electronic share registry by insertion of a flag.
- South Africa has a free-floating exchange rate traded in all global financial centres. The currency is one of the most liquid among upper-middle-income countries, with currency equivalent to 24% of South Africa's annual GDP traded every day.

The currency is backed by an extremely liquid and deep sovereign bond exchange (not affiliated to the JSE Limited) to which foreign investors similarly have unfettered access. JSE Limited member firms and central securities depository participants offer custodian services to foreign investors.

Product developments

The JSE Limited launched the Social Responsibility Index (SRI) in May 2004 to focus on corporate social responsibility and sustainable business practices, and to encourage socially responsible investment in South Africa. The SRI measures the triple bottom line performance, in terms of environmental, economic and social sustainability of companies listed in the FTSE/JSE All Share Index.

The SRI criteria are customised to the South African and African context, and could be an aspirational benchmark for all organisations, regarding best practice in the triple bottom line.

Driven by the quest to demystify the market and the desire to broaden the national retail investor base by encouraging a wider spread of knowledge of the financial market and the growth of an investment culture in South Africa, the JSE Limited introduced the University Investment Challenge at the beginning of 2005. This concept is rooted in the JSE-Liberty Investment Challenge, which is a simulated trading experience designed to encourage secondary school learners to learn about the market by trading phantom portfolios.

New listing requirements became effective in September 2003. These stipulate that when listed entities wish to de-list, they must make an offer to minorities and obtain a fair and reasonable statement. Listed companies are required to comply with international financial reporting standards for all financial years, starting in 2005.

The Alternative Exchange, better known as ALTX, was launched in October 2003 as a parallel market or alternative exchange for small-to-medium and growing companies. It is Africa's first alternative

In June 2006, South Africa's only stock exchange, the JSE Limited, listed on its own exchange.

In a momentous occasion in the history of the exchange, guests were joined by Deputy President Phumzile Mlambo-Ngcuka, and wore a variety of hats in memory of the closing day of the old trading floor nearly 10 years before.

The JSE now joins an elite number of international exchanges – including the London and New York stock exchanges, *Deutsche Borse,* Nasdaq, Euronext, the Australian Stock Exchange, the Singapore Exchange and the Hong Kong Exchanges and Clearing – that have listed on their own markets.

For investors in South Africa and abroad, the move brings heightened transparency and visibility to the trading of JSE Limited shares, which in turn has the potential to improve their liquidity and tradeability.

market for innovative companies and investors. ALTX provides an attractive investment area for investors interested in the growth potential of smaller stocks. It is the sum of a partnership between the JSE and government through the Department of Trade and Industry.

The JSE Limited continually strives to run a low-cost, highly efficient market that offers a wide range of financial products to an ever-broadening investor community. It has served South Africa well for over 118 years and is now moving into the future, determined to take its place among the world's top exchanges.

Bond Exchange of South Africa

Besa is an independent financial exchange operating under a licence granted annually by the country's securities-market regulator, the FSB. Besa is responsible for regulating the debt securities market in South Africa.

Primary debt markets

Although primarily a government-bond market, Besa also lists Rand-denominated debt securities issued by local government, public enterprises and major corporates. On 31 December 2005, Besa had 479 fixed-income securities outstanding, issued by 71 borrowers, with a total nominal value of R637 billion. Just over 67% of this debt had been issued by central and municipal government, with a further 9% issued by parastatal and utility organisations. The remaining listed debt had been issued by companies in a wide range of sectors: banking, gold-mining, chemical, food, household goods and textiles, telecommunications and transport. Securitisation issues include vehicle, credit card, loan receivables, equipment receivables and mortgage products.

Vanilla bonds constitute the majority of Besa-listed instruments, but there are variations, including:

- fixed interest-bearing bonds with single and multiple redemption dates
- zero-coupon bonds
- consumer price index-linked bonds
- credit-linked notes
- variable interest-rate bonds or floating rate notes
- strip bonds
- commercial paper.

Besa has appointed the Listings Advisory Technical Committee to provide ongoing advice on its listings disclosure requirements and rules. The aim is to ensure that these contribute to the strengthening of investor protection and market confidence.

Market performance

The South African bond market is one of the most liquid emerging bond markets in the world. Turnover in listed debt declined in 2005, with volumes decreasing from R8,4 trillion nominal in 2004 to R8,1 trillion nominal, which is a 4% drop. The decrease in nominal turnover was also reflected in the lower number of matched trades for the year, which decreased from 328 000 in 2004 to 298 000 in 2005. Turnover in the spot market increased from 34,1% of total turnover in 2004 to 37,3% in 2005.

Although turnover figures for 2005 dropped significantly, the turnover velocity of listed debt instruments remained healthy at 13 times the market capitalisation for 2005.

While 95% of market turnover in 2005 was in government and utilities stock, there was an increasing amount of listings and turnover in corporate issuances and securitisations, which together accounted for 5% of total turnover in 2005.

STRATE Limited

The FSB registered STRATE Limited, the central securities depository for equities, in terms of the Custody and Administration of Securities Act, 1992 (Act 85 of 1992), on 20 September 1999. The depository is responsible for equities and fixed-income securities.

According to a report by GSCS Benchmarks Limited, which is represented by 10 global participating custodians, STRATE is rated sixth in the world in terms of settlement risk, and third in terms of custody risk. These benchmarks measure settlement, safekeeping and operational risk among central securities depositories in a range of major and emerging markets.

Acknowledgements

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