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chapter 10

Finance

The Constitution of the Republic of South Africa, 1996 (Act 108 of 1996), lays down a framework for the division of responsibilities between national, provincial and local 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 and an independent central bank, and sets out the principles governing financial accountability to Parliament and the annual budget process.

The objectives of the National Treasury are to:

- advance economic growth and income redistribution through economic, fiscal and financial policies that stimulate investment and trade; create employment; and allocate budget resources to targeted beneficiaries
- prepare a sound and fiscally sustainable national budget and an equitable division of resources between the national, provincial and local spheres of government
- equitably and efficiently raise fiscal revenue as required, through targeted and fair tax policy and other measures that ensure revenue stability and the efficiency and competitiveness of the South African economy
- soundly manage government's financial assets and liabilities through prudent cash management, asset restructuring, financial management and management of the debt portfolio
- promote accountability through effective and reliable financial reporting systems and internal controls
- contribute to improved financial management by promoting and enforcing transparency and effective management of revenue, expenditure, assets and liabilities in all spheres of government.

The JSE Securities Exchange is the largest securities exchange in Africa and has a market capitalisation of several times that of all the other African markets combined.

Fiscal policy framework

The Minister of Finance, Mr Trevor Manuel, presented the Budget for 2003/04 on 26 February 2003. The highlights were:

- The police and the criminal justice sector were allocated R2,7 billion for more police members, streamlining of the justice process and improved protection of women and children.
- An additional R1,7 billion was allocated to universities and technikons, and for increased skills-development spending.
- Personal income tax was cut by R13,3 billion.
- A tax incentive for investment in underdeveloped urban areas was introduced.
- The Child Support Grant (CSG) will be gradually extended to children up to their 14th birthday, providing benefits to about 3,2 million more children. Increased

Consolidated national and provincial expenditure: functional classification[1]

	2002/03		2003/04		2004/05	
	Revised estimate	**% of total**	**Budget estimate**	**% of total**	**Budget estimate**	**% of total**
General government service and unallocable expenditure[2]	20 063	6,5	21 733	6,2	24 700	6,5
Protective services:	53 335	17,2	58 475	16,6	62 647	16,5
Defence and intelligence	20 763	6,7	22 481	6,4	23 203	6,1
Police	20 529	6,6	22 806	6,5	25 083	6,6
Prisons	7 313	2,4	8 077	2,3	8 843	2,3
Justice	4 730	1,5	5 111	1,5	5 518	1,4
Social services:	153 341	49,4	173 496	49,4	190 767	50,1
Education	62 757	20,2	69 063	19,7	74 329	19,5
Health	34 940	11,3	39 077	11,1	42 543	11,2
Social security and welfare	41 966	13,5	48 652	13,8	55 314	14,5
Housing	5 553	1,8	6 548	1,9	7 320	1,9
Community development[3]	8 125	2,6	10 156	2,9	11 261	3,0
Economic services:	36 242	11,7	43 650	12,4	45 585	12,0
Water schemes and related services	4 540	1,5	6 029	1,7	6 169	1,6
Fuel and energy	1 508	0,5	1 696	0,5	1 960	0,5
Agriculture, forestry and fishing	5 729	1,8	6 710	1,9	7 068	1,9
Mining, manufacturing and construction	1 503.3	0,5	1 821	0,5	1 977	0,5
Transport and communications	13 825	4,5	15 537	4,4	16 656	4,4
Other economic services[4]	9 137	2,9	11 857	3,4	11 755	3,1
Interest	47 250	15,2	50 985	14,5	53 079	13,9
Subtotal: main budget	310 231	100,0	348 339	99,1	376 778	98,9
Plus contingency reserves	0	0	3 000	0,9	4 000	1,1
Total estimated expenditure	**310 231**	**100,0**	**351 339**	**100,00**	**380 778**	**100,0**

1) These figures were estimated by the National Treasury and may differ from data published by Statistics South Africa. The numbers in these tables are not strictly comparable to those published in previous years, due to the allocation of some of the unallocable expenditure for previous years. Data for the history years has been adjusted accordingly.
2) Mainly general administration, cost of raising loans and allocable capital expenditure.
3) Including cultural, recreational and sport services.
4) Including tourism, labour and multi-purpose projects.

Source: National Treasury

allocations for primary-school nutrition were announced.

- Pension and disability grants were increased by R60 to R700 a month. The CSG was increased by 14% to R160 a month, effective from April 2003.
- Some R1,2 billion was provided for emergency food-relief projects.
- An additional R38 billion was allocated to provinces to finance higher social grants, textbooks, medicine, road maintenance, and to enhance the Government's response to HIV/AIDS.
- An additional R1,9 billion was allocated to accelerate land restitution.
- A further R1 billion went to expenditure on the National Research and Development Strategy for programmes relating to health, industrial biotechnology, food security and agricultural production.
- Municipalities received an additional R6,5 billion for free basic services, investment in municipal infrastructure, rural water supply and sanitation, and the expansion of employment in community services.
- Sin taxes were increased.

- The *ad valorem* duty on computers, which was 5% of the imported or manufactured price, was scrapped.

Debt management

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

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

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

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

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

- Lower coupon bonds have been introduced, consistent with government's approach to reducing inflation in the years ahead.
- The Public-Sector Borrowers' Forum was established in 2001.
- Co-ordination between monetary policy and liability management has been strengthened through more effective liaison between the National Treasury and the South African Reserve Bank.
- Regular meetings with the primary dealers, the Reserve Bank and the futures and bond exchanges provide a forum for ensuring a transparent and efficient bond market.
- Debt consolidation has reduced fragmentation on the yield curve and improved liquidity of the benchmark issues. Illiquid bonds were consolidated into five liquid benchmark bonds, thereby smoothing the maturity profile and reducing refinancing risks.
- The integrity and efficiency of the Government securities market have been strengthened through buying back illiquid bonds, including diverse 'ex-homeland' bonds of limited issue size.
- Inflation-linked bonds were introduced to diversify government's investor base and to signal confidence in government's macro-economic policy, while also providing an objective measure of inflationary expectations and benchmarks for other issuers.
- The 'Strips' (Separate Trading of Registered Interest and Principal Securities) Programme has been introduced to increase demand for the underlying instruments and encourage active portfolio management.
- State debt costs continue to fall as a share of government expenditure. It was projected to be 4,1% of Gross Domestic Product (GDP) in 2003/04 and is expected to decrease to 3,8% of GDP in 2005/06.

The liquidity in the domestic government-bond market, measured by the increase in the nominal trades, has improved substantially during recent years, especially since the appointment of primary dealers in government bonds in April 1998. The bond market

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

	Terms of trade[1]		Exchange rate[2]					
Period	**Including gold (5037Q)**	**Excluding gold (5036Q)**	**Nominal effective exchange rate[2]**	**Real effective exchange rate[3]**	**US Dollar**	**British Pound (5314Q)**	**Euro**	**Japanese Yen**
1996	1,4	-0,7	-11,2	-6,3	-15,1 -	14,0	-12,4	-1,5
1997	-1,2	1,2	1,0	6,9	-6,8	-11,1	3,5	3,6
1998	-0,9	-0,7	-11,7	-8,8	-16,2	-17,0	-15,2	-9,3
1999	-2,9	-2,3	-7,6	-4,6	-9,5	-7,3	- 4,3	-21,5
2000	-1,9	-2,0	-5,1	-2,9	-11,4	-5,6	2,2	-16,1
2001	0,1	0,3	-14,7	-13,6	-18,9	-14,5	-16,1	-8,5
2002	2,5	0,7	-19,6	-16,0	-17,1	-20,9	-21,9	-15,1

1) Change compared with preceding period.
2) Weighted average exchange rate against most important currencies.
3) Percentage changes of average.

Source: South African Reserve Bank – *Quarterly Bulletin*

turnover increased further to R10,6 trillion and R12 trillion in 2001 and 2002 respectively. The bond yields continued to decline from the highs of 22% in 1998 to single digits in November 2001, but reverted to double digits on the back of the Rand's decline in the last quarter of 2001.

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

Legislation

The National Treasury tables a significant amount of legislation in Parliament annually.

The legislative workload of the National Treasury can be subdivided into three categories, namely:

- legislation conceptualised and prepared in-house
- legislation prepared by regulatory bodies such as the Financial Services Board (FSB) and the Reserve Bank, with policy direction provided by the National Treasury
- tax legislation prepared in conjunction with the South African Revenue Service (SARS), with policy direction provided by the National Treasury.

Between April 2002 and July 2003, pieces of legislation prepared in-house by the National Treasury included the:

- Social Grants Appropriation Act, 2002 (Act 2 of 2002)
- Burundi Protection Support Appropriation Act, 2002 (Act 3 of 2002)
- Division of Revenue Act, 2002 (Act 5 of 2002)
- Appropriation Act, 2002 (Act 29 of 2002)
- Finance Act, 2002 (Act 48 of 2002)
- Adjustments Appropriation Act, 2002 (Act 73 of 2002)
- Gold and Foreign Exchange Contingency Reserve Account Defrayal Act, 2003 (Act 4 of 2003)
- Food Relief Adjustments Appropriation Act, 2003 (Act 5 of 2003)
- Division of Revenue Act, 2003 (Act 7 of 2003)
- Appropriation Act, 2003 (Act 18 of 2003).

By July 2003, Amendment Bills receiving parliamentary consideration included the:

- Special Pensions Amendment Bill
- Government Employees Pension Laws Amendment Bill
- Financial and Fiscal Commission (FFC) Amendment Bill.

Between April 2002 and July 2003, the following pieces of legislation were prepared by regulatory bodies, with policy direction provided by the National Treasury:

- The Financial Advisory and Intermediary Services Act, 2002 (Act 37 of 2002)
- The Collective Investment Schemes Control Act, 2002 (Act 45 of 2002)
- The Insurance Amendment Act, 2003 (Act 17 of 2003)
- The Banks Amendment Act, 2003 (Act 19 of 2003).

The following regulatory Bills were tabled for parliamentary consideration in 2003:

- The Securities Services Bill
- The Financial Services Ombud Schemes Bill.

Tax legislation prepared in conjunction with SARS, with policy direction provided by the National Treasury, included the:

- Unemployment Insurance Contributions Act, 2002 (Act 4 of 2002)
- Taxation Laws Amendment Act, 2002 (Act 30 of 2002)
- Revenue Laws Amendment Act, 2002 (Act 74 of 2002)
- Gas Regulator Levies Act, 2002 (Act 75 of 2002)
- Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003 (Act 12 of 2003).

At the end of February 2003, the Minister of Finance, Mr Trevor Manuel, became the first Finance Minister to address the International Labour Organisation (ILO) in its 85-year history.

In his presentation to the ILO's Working Party on Social Dimension of Globalisation, in Geneva, Switzerland, Mr Manuel stressed the importance of multilateralism in addressing the challenges of globalisation.

The following tax Bills were tabled for parliamentary consideration in 2003:

- The Mineral and Petroleum Levies Bill
- The Revenue Laws Amendment Bill.

The Debt Collectors Act, 1998 (Act 114 of 1998), as well as its Regulations came into operation on 7 February 2003.

The Act provides for the establishment of the Council for Debt Collectors. The Council will exercise control over the occupation of debt collectors and legalise the recovery of fees or remuneration by registered debt collectors. In the past, a debt collector was not entitled to legally recover any amount from a debtor, and had to rely solely on the contract between him/her and the client for remuneration.

In terms of the Act, no person, excluding an attorney, an employee of an attorney or a party to a factoring arrangement, will be allowed to act as a debt collector unless he or she is registered as a debt collector in terms of the Act.

An employee whose duties are purely administrative, clerical or otherwise subservient to the actual occupation of debt collecting, is also exempted from registering as a debt collector. The Minister may also, in terms of Section 26 of the Act, on the conditions he or she deems fit, exempt any person or category from the provisions of the Act.

After 11 August 2003, a person who acts as a debt collector and who has not been registered as a debt collector in terms of the Act, will be committing an offence.

Once a debt collector has been registered, the Council will have jurisdiction over such a debt collector and can charge him or her and find him or her guilty of improper conduct. The Council has adopted a Code of Conduct which is binding to all registered debt collectors.

The Public Finance Management Act

The Public Finance Management Act (PFMA), 1999 (Act 1 of 1999), came into effect on 1 April 2000 for all departments, constitutional institutions and public entities.

The PFMA, 1999 represents a fundamental change in government's approach to the handling of public finances, as it shifts the emphasis away from a highly centralised system of expenditure control by the treasuries. It holds the heads of departments accountable for the use of resources to deliver services to communities. It will also, in time, change the accounting base from cash to accrual.

The Act emphasises:

- regular financial reporting
- independent auditing and supervision of internal control systems
- improved accounting standards
- greater focus on output and performance
- increased accountability at all levels.

The National Treasury has embarked on several initiatives to assist departments with capacity-building and ensure the successful implementation of the PFMA. These initiatives include:

Internal Audit Framework

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

Asset Management Guidelines

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

Provincial Good Practice Programme (PGPP)

In an attempt to provide direct assistance to provinces, the National Treasury initiated the PGPP. The sector-specific Chief Financial Officers' Forums (for the provincial Departments of Education, Health, Housing, Social Development and Transport) were established to improve the efficiency, economy and effectiveness of provincial departments by facilitating peer learning through the identification, documentation and communication of 'good practices' arising from collective experience. The immediate focus of the Programme is the development and use of measurable objectives, internal budget documentation, and the improvement of data quality and consistency. The deliverables of the Programme include the development of good-practice guides, the conducting of good-practice workshops, and the provision of training and support.

Appointment of members to the Accounting Standards Board (ASB)

The appointment of members to the ASB is seen as a positive step towards the implementation of the PFMA, 1999. The formal establishment and functional operations of the Board will contribute extensively towards the implementation of Generally Recognised Accounting Practice in national and provincial departments, public entities, constitutional institutions, municipalities and boards, com-

At the end of March 2003, President Thabo Mbeki hosted an *indaba* with leaders of South African big business. The Big Business Working Group is one of the groups that meet biannually with the President and Ministers to discuss matters of common interest.

The purpose of the meeting was to explore ways to accelerate the rate of growth and development in South Africa, and to ensure open and constructive communication between government and large corporations.

Representatives of the Big Business Working Group indicated that the Group was broadly satisfied with government's macro-economic policies such as the fiscal and monetary policy, and trade and industrial policy. While there were issues that will continue to be discussed and negotiated in detail regarding the actual implementation, there was broad agreement on the direction of macro-economic policy and micro-economic programmes.

missions, companies, corporations, and funds of other entities under the ownership control of a municipality.

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

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

Validation Board

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

Normative measures for financial management

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

- contributing towards the improvement of financial management in the public sector
- providing a benchmark for accounting officers, to assist them with the continuous evaluation of the quality of financial management within their departments
- enabling the National Treasury and the Office of the Auditor-General to report on progress made in the implementation of the PFMA, 1999 as well as the status of financial management within a department or in the public sector as a whole.

State expenditure

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

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

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

National Treasury

Treasury norms and standards

In terms of Section 216(1)(c) of the Constitution, 1996, the National Treasury must prescribe measures to ensure both transparency and expenditure control in each sphere of government, by introducing uniform treasury norms and standards. These treasury norms and standards aim at deregulating financial controls, by granting accounting officers of spending agencies more autonomy in financial decision-making within the ambits of impending financial legislation.

Budget evaluations

The National Treasury plays an important role in supporting the economic policy to which

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

Based on this limit, all national departments are requested annually to submit budget proposals for the following financial year to the National Treasury.

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.

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

Financial policies, systems and skills development

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

The services delivered support the following areas:

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

Procurement

The Preferential Procurement Regulations, 2001 give substance to the content of the Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000). This Act and its Regulations are applicable to central and provincial departments and local government.

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

The implementation of the Regulations enhances the involvement of HDIs in the public tendering system and contributes to achieving RDP goals, including the promotion of the small-to-medium enterprises sector.

By mid-2003, the National Treasury was in the process of establishing a supply-chain management (SCM) office to assume responsibility for the development of SCM policies and procedures, the regulatory framework for SCM, and the monitoring of compliance with policies and procedures.

South Africa's anti money-laundering system

South Africa has made considerable progress in developing an anti money-laundering and combating terrorist-financing (AML/CFT) environment. In 2001, Parliament passed the Financial Intelligence Centre (FIC) Act, 2001 (Act 38 of 2001), which consolidates previous legislation and introduces new AML/CFT measures. The Act seeks to implement measures that are in accordance with international standards set by the Financial Action Task Force (FATF).

The implementation of the Act is the responsibility of the National Treasury, and during 2003, the FIC was expected to become an autonomous and self-functioning government agency reporting to the Minister of Finance.

Two institutions were created by the Act, namely the Money-Laundering Advisory Council (MLAC), which is intended to provide the Minister with legislative advice, and the FIC. The mandate of the FIC is to track irregular financial practices, especially the proceeds of crime. The Centre receives reports from accountable institutions, and stores and analyses this information. 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.

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 advisors, estate agents and motor dealers.

The Regulations of the Act were approved in December 2002. They introduced reporting and compliance obligations for accountable institutions. All accountable institutions were obliged to submit suspicious transaction reports to the FIC with effect from 3 February 2003. Nearly 1 000 reports were received by mid-2003 and a significant number of disclosures were made to law-enforcement agencies for investigation. The FIC estimated that it would receive 3 000 reports during the 2003/04 financial year.

Additional measures came into effect on 30 June 2003, which included obligations for accountable institutions to identify their clients and keep proper records.

In 2002, South Africa became a member of the Eastern and Southern Africa Anti Money-Laundering Group (ESAAMLG). South Africa has also been attending meetings of the FATF as an observing member, and applied for FATF membership in 2002. As part of this process, South Africa agreed to undergo a mutual evaluation to access its compliance in terms of international standards. This was done in April 2003 as a joint FATF/ESAAMLG process.

The Egmont Group of Financial Intelligence Units invited the FIC to become a member of the Group after it conducted an assessment of the Centre.

Financial and Fiscal Commission

The FFC is one of the innovations of the multiparty constitutional negotiations that took place between 1992 and 1994. The Commission, which came into operation in April 1994, is a statutory institution and permanent expert commission dealing with intergovernmental fiscal relations.

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

Budget Council

The Budget Council consists of the Minister of Finance and the nine provincial executive committee members responsible for Finance. The mission of the Council is to ensure that the country uses the available resources productively, efficiently and equitably, to the advantage of its people.

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

Macro-economic strategy

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

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

Government's micro-economic reform strategy identifies six key performance areas or objectives:

- economic growth
- employment
- small business development
- Black Economic Empowerment (BEE)
- competitiveness
- geographic spread of growth and development.

The strategy rests on three pillars:

- The first pillar consists of cross-cutting issues: human resource development (HRD), infrastructure, access to finance, technology, and research and development (R&D).
- The second pillar comprises a set of actions to improve efficiency and lower costs in three input sectors: transport, telecommunications and energy. In addition, access to these sectors needs to be widened to include all South Africans.
- The third pillar consists of growth sectors that demonstrate a high potential for growth and employment, namely tourism, exports, agriculture, information and communications technology, and cultural industries.

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

- Fine-tuning the micro-economic strategy.
- Continued managed liberalisation and infrastructure investment in key input sectors.
- Increased attention to the cross-cutting issues that underpin the strategy, including:
  - Clarifying the role of individual departments in sectoral HRD strategies.
  - Adopting a research strategy and allocating the necessary resources to implement it effectively. The Cabinet has already adopted a biotechnology strategy and the relevant Cluster was expected to table a relevant document on technology, innovation and boosting investment in R&D.
- Establishing an integrated financing institution focused on BEE and small business.
- An integrated approach to planning and implementation of infrastructure investment by government.
- Developing and implementing an employment-creation framework.
- Strengthening and co-ordinating government products and services to promote key growth sectors.
- An integrated strategy for small business development, emphasising co-ordination and refinement of existing initiatives, addressing access to finance, and a greater focus on micro enterprises.
- Implementing three components of the BEE strategy, namely an enhanced environment for BEE partnership programmes with the private sector; the establishment of a BEE Advisory Council; and a review of government procurement.

By April 2003, Statistics South Africa indicated that there were between two and three million economically active (some of whom are below the tax threshold) entities that were not registered for tax. In the 2003/04 financial year, the South African Revenue Service focused on bringing these elements into the tax net by comparing databases that reflect economic activity with internal databases of registered tax payers.

- Incorporating a specific geographical dimension into the micro-economic reform strategy, to tap the economic and human potential of all nine provinces by co-ordinating current strategies such as the Integrated Sustainable Rural Development Strategy, Urban Renewal Programme, Spatial Development Initiatives, Industrial Development Zones and Integrated Development Plans, as well as regional economic integration and the New Partnership for Africa's Development (NEPAD). (See Chapter 7: *Economy*.)

South African Revenue Service

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

It aims to provide an enhanced, transparent and client-orientated service to ensure optimum and equitable collection of 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 Finance on all revenue-related matters.

On 19 August 2003, the South African Revenue Service (SARS), in partnership with the South African National Council for the Blind (SANCB), launched a project to train visually impaired people as call-centre operators.

As part of its Corporate Social Investment Programme, SARS pledged to provide bursaries worth R1 million to 10 students for call centre training, after which they will be employed by the organisation. SARS will also implement an organisation-wide awareness campaign to educate its employees on working with people with disabilities and people with special needs.

Research undertaken by the SANCB shows that visually impaired people are the least employed group in South Africa, with the employment of this group in the corporate sector being as low as 0,28%.

Tax system

The National Treasury is also responsible for advising the Minister of Finance on tax-policy issues that arise at local, provincial and national government level. In its policy-advice function to government, the 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. In designing tax policies, co-operation between the National Treasury and SARS is of the utmost importance.

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

Capital Gains Tax (CGT) 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.

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

Transfer duty, estate duty, stamp duty, marketable securities tax, customs duty and

excise duty are also levied by the national Government.

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

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.

In the 2002/03 fiscal year, considerable progress was once again made in reaching agreements with other countries for the avoidance of double taxation in respect of income accruing to South Africa tax payers from foreign sources, or to foreign tax payers from South African sources. By June 2003:

- Comprehensive agreements were in place with Algeria, Australia, Austria, Belgium, Botswana, Canada, Croatia, Cyprus, the Czech Republic, Denmark, Egypt, Finland, France, Germany, Greece, Hungary, India, Indonesia, Iran, Ireland, Israel, Italy, Japan, Korea, Lesotho, Luxembourg, Malawi, Malta, Mauritius, Namibia, the Netherlands, Norway, Pakistan, the People's Republic of China, Poland, Romania, the Russian Federation, the Seychelles, Singapore, the Slovak Republic, Swaziland, Sweden, Switzerland, Thailand, Tunisia, Uganda, the United Kingdom (UK), the United States of America (USA), Zambia and Zimbabwe. An agreement with the UK extends to Grenada and Sierra Leone.
- Limited sea and air transport agreements existed with Brazil, Portugal and Spain.
- Comprehensive agreements were ratified in South Africa with New Zealand and Nigeria.
- Comprehensive agreements were signed but not ratified with Belarus, Rwanda and the Sultanate of Oman.
- Comprehensive agreements were negotiated or renegotiated, but not signed, with Botswana, Bulgaria, Estonia, Ethiopia, Gabon, Germany, Ghana, Kuwait, Latvia, Lithuania, Malawi, Malaysia, Morocco, Mozambique, the Netherlands, Portugal, Qatar, Spain, Swaziland, Tanzania, Turkey, Ukraine, the United Arab Emirates, Zambia and Zimbabwe. Where treaties were being renegotiated, the existing treaties remained effective until a new agreement was finalised.
- Comprehensive agreements were negotiated or renegotiated but had not been finalised with Bangladesh, Brazil, Saudi Arabia and Sri Lanka.

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

Agreements for mutual administrative assistance between customs administrations

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

By June 2003:

- agreements were in place with France, the UK and the USA
- agreements had been ratified in South Africa with Algeria, the Czech Republic, Mozambique, the Netherlands and Zambia
- agreements had been negotiated but not signed with Angola, Iran and Norway
- a number of countries had expressed the desire to negotiate similar agreements.

Sources of revenue

Income tax

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

In South Africa, income tax is levied on South African residents on their 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.

Companies are taxed at a rate of 30%. In addition to this, secondary tax is levied on companies at a rate of 12,5% on all income distributed by way of dividends. A formula tax applies to gold-mining companies. Small-business corporations (annual turnover limit will be increased to R5 million) benefit from a graduated tax rate of 15% on the first R150 000 of taxable income and can write off certain investment expenditure in the year in which it is incurred.

Small businesses also receive double deduction for expenses initially incurred, with respect to a new business capped at the first R20 000 of available deductions.

Main budget estimates and revenue outcome: 2001/02 and 2002/03

	2001/02			2002/03			2001/02 – 2002/03
R million	**Budget estimate**	**Actual outcome**	**Deviation**	**Budget estimate**	**Revised estimate**	**Deviation**	**(%) change**
Taxes on income and profits, including:	**131 582**	**147 310**	**15 728**	**155 740**	**162 500**	**6 760**	**10,3**
Personal income tax	90 122	90 390	268	89 982	93 200	3 218	3,1
Company tax	29 960	42 354	12 394	50 858	54 850	3 992	29,5
Secondary tax on companies	4 200	7 163	2 963	6 500	6 300	-200	-12,0
Tax on retirement funds	6 300	6 191	-109	6 900	6 900	–	11,5
Other	1 000	1 213	213	1 500	1 250	-250	3,0
Taxes on payroll and workforce	2 800	2 717	-83	2 950	3 300	350	21,4
Taxes on property	4 709	4 628	-81	4 585	5 335	750	15,3
Domestic taxes on goods and services, including:	**86 740**	**86 888**	**148**	**92 848**	**97 554**	**4 706**	**12,3**
Value-Added Tax	60 350	61 057	707	66 200	70 600	4 400	15,6
Excise duties	10 625	10 573	-52	11 067	11 302	235	6,9
Levies on fuel	15 310	14 923	-387	15 166	15 200	34	1,9
Other	455	335	-120	415	452	37	35,0
Taxes on international trade and transactions	9 427	8 680	-747	10 613	9 805	-808	13,0
Stamp duties and fees	1 585	1 767	182	1 770	1 600	-170	-9,5
State miscellaneous revenue	–	307	307	–	–	–	
Total tax revenue	**236 843**	**252 298**	**15 455**	**268 506**	**280 095**	**11 588**	**11,0**
Departmental revenue	4 657	4 088	-569	3 910	3 589	-321	-12,2
Transactions in assets and liabilities	50	4	-46	30	40	10	
Recoveries of loans and repayments	93	77	-16	900	164	-736	
Grants	–	–	–	130	117	-13	
Less: Southern African Customs Union payments	-8 205	-8 205	–	-8 259	-8 259	–	0,7
Main budget revenue	**233 438**	**248 262**	**14 824**	**265 217**	**275 745**	**10 529**	**11,1**

Source: Budget Review 2003

Income tax returns are issued annually to registered tax payers 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 year.

However, the Act also provides for certain classes of tax payers to have a year of assessment ending on a day other than the last day of February.

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

People who owe SARS tax are charged interest at a rate as published in the *Government Gazette* 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.

Value-Added Tax

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

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

The prices of goods and services must be quoted/displayed on an inclusive basis, which means that VAT has to be included in all prices on products, price lists, advertisements and quotations.

Customs duty

South Africa is a signatory to the Southern African Customs Union (SACU) agreement, together with Botswana, Lesotho, Namibia and Swaziland (BLNS countries). The five member countries of SACU apply the same customs and excise legislation, 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.

Customs and excise revenue collected in SACU is shared according to a formula that has been in place since 1969. Following eight years of negotiations, a new SACU Agreement was signed in October 2002. The new revenue-sharing formula was expected to take effect in the 2003/04 financial year and will ensure long-term sustainability of these transfer payments. SACU revenue shares for 2003/04 amounted to R9,7 billion, with an anticipated rise to R11,6 billion and R12,4 billion in 2004/05 and 2005/06 respectively.

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.

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

In 2003, efforts were doubled to improve the effectiveness of customs controls and trade facilitation. One of the highlights includes the commencement of a 24-hour operation for commercial traffic at Beit Bridge, the busiest border post in southern Africa.

Another development will be the implementation of the simplified and harmonised transit procedures in terms of the Southern African Development Community (SADC) Protocol on Trade. The SARS will also step up the fight against customs-evasion through a year-long national enforcement campaign. At the same time, SARS will double efforts to strengthen co-operation with legitimate traders who operate within the terms of the law.

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, televisions, audio 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, 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%.

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

All transactions relating to a taxable supply of goods 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 estate of a deceased non-resident consists only of his/her South African assets.

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

Stamp duty

Stamp duty is levied on certain financial transactions.

Marketable Securities Tax (MST)

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

Uncertified Securities Tax (UST)

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

Skills-development levy

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

Air passenger departure tax

A tax of R110 per fee-paying passenger departing on international flights and R55 per passenger departing to the BLNS countries is payable.

Organisational performance

The SARS has exceeded its revenue target of R280 billion set during the Budget speech in February 2003. This was announced in Parliament by the Minister of Finance, who said growth in tax revenue collected by SARS in the 2002/03 financial year amounted to R281 billion.

Recent years have seen a marked decline in marginal rates for corporates and individuals, as well as the consolidation of income-tax brackets to eliminate the adverse effects of inflation.

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

Other achievements include:

- The implementation of a new enforcement strategy that targets areas of high risk and aggressive tax-planning practices. This has resulted in significant increases in the total revenue contribution of corporates through sector-specific enforcement action.
- The upgrade of border infrastructure and the introduction of an informal dispute-resolution mechanism for customs.
- The achievement of process efficiencies through the establishment of rapid processing areas, thereby improving turnaround times.
- The appointment of the SARS Commissioner in 2003 – for the third time in a row – as the chairperson of the World Customs Organisation. This was the first time in the history of the Organisation that anyone had occupied the seat for three consecutive terms.

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

Other initiatives in customs include the introduction of centralised registration, refund mobile units and a valuation database. A risk-based audit approach has been introduced, and differentiated service levels will be implemented through an accredited client scheme.

On 27 June 2003, SARS and the United States Bureau of Customs and Border Protection (USBCBP) signed a co-operation agreement in Brussels, Belgium to secure trade between South Africa and the USA.

Subsequently, SARS and the USBCBP commenced with intensive preparations to improve security measures at South African ports to ensure the safety of exports from South and southern Africa.

The agreement forms part of South Africa's commitment to facilitate and boost economic ties between South Africa and the USA. In terms of the agreement, both parties will exchange information and work together to identify, screen, examine and seal high-risk containers, and station customs officials at each other's seaports that handle significant volumes of direct container traffic between the two countries.

Budget estimates and revenue outcome

Audited results show that the actual receipts for 2001/02 were R248,3 billion or 6,4% more than the original Budget estimate. Significant deviations from the original estimates include company tax up by R12,4 billion, secondary tax on companies up by R3 billion, and trade tax down by R747 million.

The revenue outcome of R278,3 billion for the 2002/03 fiscal year was R13 billion higher than the original Budget estimate of R265,2 billion. The main reasons for this increase are the higher-than-estimated increase of price levels in the economy, and higher-than-anticipated growth in the economy. Taxes on income and profits grew at an annual rate of 8,4% and contributed about 60% to the main Budget revenue. Taxes on domestic goods and services and international trade grew at annual rates of 11,1% and 12,2%, respectively.

2003 tax proposals

Sound structural changes since 1994 have created fiscal space for introducing tax-driven stimulus measures that seek to grow the tax base, create sustainable employment opportunities, and alleviate poverty. Personal income-tax relief for the period 1995 to 2002 totalled R48,9 billion. In support of economic activity, a tax holiday scheme was introduced in 1997, the corporate tax rate was reduced to 30% in 1999, and a split rate was introduced for small business in 2000.

Tax policy and enhanced revenue collection continue to contribute materially to improving growth prospects, development and employment creation through personal income-tax relief, encouragement of investment, measures to boost household savings, and reforms to stimulate enterprise development. The 2003 tax proposals provided for:

- personal income-tax relief of R13,3 billion, raising the minimum tax threshold to R30 000 and increasing the take-home pay of wage earners to encourage consumption and saving
- reducing the Retirement Fund Tax to protect savings, especially of low-income earners
- accelerated depreciation allowances for urban development zones, materially addressing urban decay, and the supply of affordable housing to the urban poor
- eliminating the dividend tax from foreign subsidiaries, thus encouraging capital inflow
- reduced excise duties on passenger vehicles and abolition of duties on computers, easing their cost for business and personal use
- inflation-related adjustments to alcohol and tobacco taxes, in keeping with government's social and health policies.

Gambling and lotteries

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

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

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

Substantial fixed investment is, and remains, a condition for a casino licence, and investments have to go beyond gambling. The Act provides for a maximum of 40 casinos nationwide. In 2003, 28 casinos were operational throughout the country. Investments of approximately R11,7 billion had been made, which included the establishment of conference centres for public use.

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

The Department of Trade and Industry was expected to submit a new Gambling Bill during 2003/04 to clarify the differences existing in legislation and administrative processes between provinces, particularly in respect of horse-racing. The licensing processes, costs, levels of taxation and types of bets allowed vary between provinces, creating confusion in the industry.

In September 1999, the Minister of Trade and Industry signed the National Lottery Licence Agreement with Uthingo Management (Pty) Ltd, the official lottery operator. The National Lottery celebrated its third anniversary in March 2003.

Lottery-ticket sales rose from R88,4 million in 1999/00 to R3,77 billion in 2002/03.

Amounts available for distribution to worthy causes amounted to R10,2 billion in 2000/01, R439,2 million in 2001/02 and R1,021 billion in 2002/03, while in the first three months of 2003, some R177,2 million was allocated.

During the 2002/03 financial year, the largest slice of funds was allocated to charities

– R344 million of a total of R367 million available for distribution. Sport and recreation received R211 million of the R224,6 million available. Spending on arts and culture amounted to R170 million of a distribution amount of R224 million.

Auditor-General

The Auditor-General is appointed statutorily by the President as the independent auditor of the executive authority. The Auditor-General's appointment, conditions of service, powers, duties and related matters are covered by the Constitution, 1996 and the Auditor-General Act, 1995 (Act 12 of 1995).

The Office of the Auditor-General was established in terms of Section 3 of the Audit Arrangement Act, 1992 (Act 122 of 1992). The Office of the Auditor-General gained independence from the executive authority on 1 April 1993 and operates as a juristic body under appropriate parliamentary control, namely the Audit Commission.

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

The Office has a personnel complement of 1 400 and a budget of R560 million, and each year audits national and provincial departments, local governments, as well as a number of miscellaneous accounts.

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

The Office contributed significantly to developments that would improve the regular reporting on national government accounts. These include:

- Accounting for environmental assets, especially fresh water.
- Formulating principles and indicators for municipal performance reporting.
- Finalising and implementing improved municipal-accounting practices.
- Assisting in the preparation of draft formats for the annual financial statements required of accounting officers in terms of the PFMA, 1999.
- Summarising the findings of all national entities into a general report on audit outcomes. This enables the user of the report to view the audit results among Ministerial portfolio lines.

The Institute for Public Finance and Auditing, established in 1999 for the professional development of staff in government, is fully operational and implements an active programme of training. It has implemented a financial management improvement programme which is supported by the European Union.

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

All the companies listed in terms of the Act have to report on their financial affairs and performance. Among these are the Post Office, Eskom and Transnet. Provincial auditors are responsible for the management of all audits of provincial governments, specific statutory bodies and municipalities. They are also responsible for related reporting to the provincial legislatures and other provincial and local government institutions.

Financial sector

South African Reserve Bank

The Reserve Bank and the Ministry of Finance form the monetary authority in South Africa. The Reserve Bank has been given a significant degree of autonomy in terms of the Constitution, 1996, and must perform its functions independently. 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.

The Reserve Bank formulates and implements monetary policy and regulates the supply (availability) of money by influencing its cost. Monetary policy is guided by the objectives of the Reserve Bank, which are formulated to ensure financial stability. Consistent combating of inflation is the 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 once a quarter, after which it issues a statement indicating its assessment of the economy and policy changes, if any.

The Reserve Bank is responsible for:

- assisting government in formulating and implementing macro-economic 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 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 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 the clearing and settlement of interbank obligations.

On 9 March 1998, the Bank implemented a system of repurchase transactions (repos) as the main instrument in managing liquidity in the money market. The repo rate is the price at which the central bank lends cash to the banking system. The repo rate has become the most important indicator for short-term interest rates.

The repurchase agreements entered into between the Reserve Bank and 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 trans-

actions, 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 with regard to cash reserves of banking institutions; and controlling the liquidity in the money market through repurchase transactions.

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

The Reserve Bank is the custodian of the greater part of South Africa's gold and other foreign-exchange reserves.

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

Monetary policy

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

The Reserve Bank has therefore not applied monetary policy as a short-term countercyclical instrument, but has rather aimed at creating financial stability, which is seen as a necessary precondition for growth and development in the long run. To achieve the objective of low and stable inflation, the Reserve Bank adopted a policy framework that was initially anchored by the setting of guidelines for growth in the broad money supply (M3). In later years, the predictability of the relationship between growth in the money supply and growth in the aggregate nominal income became less certain. As changes in the money supply became a less reliable indicator of changes in nominal income in the short-to-medium term, the Bank decided to attach less significance to the growth in M3. Instead, movements in other financial and economic indicators were also thoroughly assessed during deliberations on policy issues. Because changes in money and credit totals are major determinants of inflation in the long run, they were nevertheless still seen as important variables that could be closely monitored by decision-makers.

The framework for monetary policy was tightened and made more transparent by adopting formal inflation targeting. Inflation targeting is aimed at facilitating the reduction of the inflation rate or the maintenance of price stability, and has been successfully adopted by an increasing number of countries in recent years. The National Treasury and the Reserve Bank initially agreed on an inflation target band of 3% to 6% on average for 2002, for the Consumer Price Index excluding mortgage costs (CPIX). This target was left unchanged for 2003 when the Minister of Finance announced new targets in October 2001, and a lower target range of 3% to 5% was introduced for 2004 and 2005.

Amid a global downturn and little domestic pressure on inflation, the CPIX inflation rate had declined to below the upper limit of the 2002 target by September 2001, and at that time it was expected that the downward trend would be sustained, albeit at a slower rate. However, the pressure on the exchange rate, which had been present since 2000, had intensified in the second half of 2001, and the impact that this had on the inflation rate inevitably caused the CPIX to reverse its downward trend. The CPIX inflation rate moved outside the 2002 target to 6,3% in November 2001.

An important challenge for monetary policy during this period was resisting the temptation

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

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

Following the increase, monetary policy was tightened further during the subsequent three meetings of the MPC. In all cases the repo rate was increased by a further 100 basis points. By March 2002, it was clear that inflation expectations had been adversely affected by the depreciation, and that the impact of the depreciation on prices would not be limited to a once-off unavoidable first-round effect. In addition, there was concern about the continued high rate of growth in the money supply and credit extension, the state of the Balance of Payments, and the beginning of an acceleration in unit labour cost. This was against the backdrop of a world economy recovering from the downturn, with anticipated acceleration in the recovery. It was felt that tightening monetary policy at that stage, if successful in dampening wage and price increases, would avert the need for more drastic increases in the future.

By June 2002, the upward trends of inflation and inflation expectations had maintained their momentum, and unit labour-cost trends and money-supply developments remained unfavourable. By that time, CPIX inflation had moved above the 9% level and production price inflation (PPI) had reached almost 15%. There were, however, some positive indications that could have signalled a reduction in pressure on inflation, and that appeared to signal the peak of the interest-rate cycle at the time. These included the partial recovery of the Rand, the surplus on both the current and financial accounts of the Balance of Payments, the continued low level of capacity utilisation, and the fact that fiscal discipline was being maintained.

This relatively positive outlook appeared to be confirmed with the release of the production price index figures for June, which showed that PPI had declined. It was hoped that this would mark the turning point of the PPI and feed in with a lag to the CPIX. This appeared to bode well for the inflation outlook. Unfortunately, in July 2002, production prices resumed their upward trend. Apart from this setback, a number of factors contributed to the increasingly negative outlook for inflation when the MPC met in September 2002.

At the September meeting, the MPC had to take cognisance of the fact that not only was inflation rising at a faster rate than expected, but inflation pressures were also becoming more broadly based. It was no longer a case of rising food prices, but the price increases were becoming more generalised and had also spread to services. Furthermore, quarter-on-quarter CPIX inflation was even more pronounced. Apart from this, the oil price was keeping petrol prices high, and the risk of an attack on Iraq by the USA was likely to keep these prices at higher levels, with a risk of

further acceleration. The weaker exchange rate since June 2002 also clouded the inflation outlook.

Inflation expectations remained high, and there was increasing evidence that wage settlements were significantly higher in the third quarter than had been the case in the first half of the year.

The MPC also had to consider the fact that despite the previous increases in interest rates, growth in the monetary aggregates and credit extension had remained stubbornly high. On the positive side, despite fairly robust growth in demand, it was acknowledged that there was no sign of excess spending or production-capacity constraints. Although inflation was being driven primarily by cost-push factors, it was felt that this, combined with accommodating monetary developments, required a monetary-policy response from the Reserve Bank. The challenge facing the Reserve Bank was to increase real rates sufficiently to achieve its inflation objectives, at a minimum cost to the real economy.

After the September MPC meeting, the outlook for inflation was still uncertain. Although inflation was expected to peak by the end of 2002, factors such as higher wage settlements, high money-supply growth figures, stubbornly high producer prices, and questions over the sustainability of the exchange-rate recovery cast doubt on the strength of the expected downturn in the inflation rate. The outlook for a relaxation of the monetary-policy stance was also influenced by the fact that the targets for 2004 and 2005 were to decline to 3 – 5%, which added to the pressures on monetary policy.

In October 2002, the Minister of Finance announced a revision of the targets for 2004 and 2005. In his Medium Term Budget Policy Statement (MTBPS) he announced that it was decided to modify the targets by maintaining the target at 3 – 6% for 2004, and that the target of 3 – 5% would be suspended until further notice. Subsequently, in the February 2003 Budget speech, it was announced that the target for 2005 would also be maintained at 3 – 6%, and that the target for 2006 would be announced concurrent with the October 2003 MTBPS.

The November MPC meeting was the first meeting in 2002 at which interest rates were not increased. This decision was taken despite the fact that CPIX inflation was still rising, having reached a year-on-year rate of 12,5% in October, and an even higher quarter-on-quarter annualised rate of 12,7% in the third quarter. However, the prices of non-food goods appeared to be levelling off, although service prices, which are traditionally more sticky, were still accelerating.

There was sufficient evidence to suggest that the turning point in inflation had either been reached or was imminent. There were a number of fundamental factors that convinced the MPC not to raise rates further at that stage. These factors, included the significant slowdown in PPI; the strengthening of the external value of the Rand; the decline in international oil prices; slower growth in bank-credit extension; and a deceleration in the pace of growth in the more broadly defined money-supply aggregates. These factors had been a major cause for concern earlier in 2002. In addition, there were other factors which continued to be conducive to a lower inflation environment, including continued excess production-capacity in the economy, the lack of signs of excess spending, and continued fiscal discipline on the part of government.

There were, however, a number of upside risks highlighted by the MPC. The Committee was particularly concerned about high inflationary expectations, the high increases in some administered prices, as well as the faster growth in nominal unit labour cost. This latter factor was of particular concern given the strong relationship between unit labour-cost increases and inflation, and the possibility of a wage/price spiral combined with higher inflation expectations.

The relatively long gap between the November 2002 meeting and the meeting in March 2003 gave the MPC a chance to better assess the sustainability of the improved inflation climate. At the time of the meeting, there were more positive signs that the downward trend in inflation was sustainable. Apart from the fact that the CPIX inflation rate itself had appeared to be on a downward trajectory, PPI had declined significantly.

The Rand's recovery proved to be sustained, and money supply and underlying bank-credit extension-growth continued to moderate. Apart from a decrease in capacity utilisation, the MPC noted that although fiscal policy was expected to be more expansionary in 2003, the projected levels for the Budget deficit over the next three years would not present any difficulties for monetary policy. Two other factors that had improved the inflation outlook since the previous meeting were that the current account recorded a surplus in the fourth quarter, and that food-price increases, a major driver of inflation in the recent past, had shown signs of moderating. Although food-price inflation was still at a higher level than the average inflation rate, indications were that the downward trend would continue.

Despite this positive outlook, the MPC felt that it would be premature to be too complacent about inflation, and left the repo rate unchanged. The Committee was reluctant to reverse the policy stance, because certain risks were identified that could prevent or slow down the expected decline in the inflation rate. The major risk identified was that of the rate of increase in unit labour-cost which had risen considerably in the third quarter of 2003. Furthermore, it was felt that the publicity surrounding a number of recently announced increases in administered prices could have a negative impact on inflation expectations in general. Finally, the uncertainty surrounding the outcome and impact of the war in Iraq made it difficult to predict the short-to-medium term outlook for the recovery in the world economy and the behaviour of oil prices.

The MPC decided to reduce the repo rate by 100 basis points to a level of 11% effective from 15 August 2003.

On 11 September 2003, the repo rate was again reduced by 100 basis points to a level of 10%.

The course of future movements in the repo rate in either direction will continue to be judged by the Committee in the light of the outlook for inflation against the inflation target.

Financial Services Board

The FSB is an independent statutory body financed by the financial services industry itself. It supervises the exercise of control over the activities of financial institutions and financial services, excluding banks and mutual banks. The FSB also 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.

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. These functions converge in the office of the executive officer, acting with the other members of the executive and heads of the various departments of the FSB's administrative infrastructure.

Included in such functions is regulatory control over central security 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 Insider Trading Act, 1998 (Act 135 of 1998), provides for the establishment of the Insider Trading Directorate at the FSB. The Act makes it easier to impose criminal sanctions and, in addition, the FSB can take civil action against offenders.

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. He or she can, in certain circumstances, also petition for the winding up of, or placing under judicial management, certain financial institutions such as insurers and pension funds.

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

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

The FSB is assisted by an advisory board on financial markets, and advisory committees on financial service-providers, long and short-term insurance, pension funds and collective investment schemes. A Financial Services Consumer Advisory Panel was also 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, Consumers Affairs Committee and various government departments, as well as with prosecuting authorities such as the South African Police Service (SAPS), the Directorate of Special Operations and the National Director of Public Prosecutions.

The banking industry

At the end of December 2002, 42 banks, including 14 branches of foreign banks and two mutual banks, were registered with the Office of the Registrar of Banks. Furthermore, 52 foreign banks had authorised representative offices in South Africa. The banking institutions collectively employed 115 734 workers at 8 438 branches and agencies.

Four major groups dominate the South African banking sector, namely Amalgamated Banks of South Africa (Absa) Group Limited, Standard Bank Investment Corporation Limited, FirstRand Holdings Limited and Nedcor Limited. These groups maintain extensive branch networks across all nine provinces, and together hold 82% of the total assets (R1,101 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 declined to 0,4% of total assets in 2002. As a percentage of equity, industry-wide net income after tax decreased from 9,2% in 2001 to 5,4% in 2002. By the end of 2002, industry-wide net income before taxation had begun to decline

to R8,9 billion, compared with R10,5 billion in 2001.

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

South Africa adheres to the capital-adequacy guidelines for banks issued by the Basel Committee on Banking Supervision, under the auspices of the Bank for International Settlements. In South Africa, the requirement to maintain capital equal to the full ratio of 10% of risk-weighted assets became effective in October 2001.

By the end of 2002, the banking sector as a whole had a ratio of capital-to-risk weighted assets of 10%.

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

The regulations relating to Banks, which form part of South Africa's banking legislation, were revised during 2002, ensuring South Africa's continued adherence to best practice.

The Bank Supervision Department envisages amending the regulatory framework in order to allow for the establishment of different classes of banking institutions, such as second-tier and third-tier banks.

A project to consider the establishment of narrow and core banks was initiated during 2002/03. The objective is to increase competition in the banking sector, while also creating greater access to basic banking services, such as savings accounts and housing and educational loans to the under- and unbanked.

The Department proposes that such banks be subject to lower-entry criteria, but that their business scope be limited. In order to safeguard the stability of the banking system, it is envisaged that narrow and core banks would be subject to strict conditions, such as being permitted to take retail deposits, but not to trade or invest in, for example, derivatives. Draft legislation was expected in 2003.

The microlending industry

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

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

According to an Appeal Court ruling in July 2000, microlenders are not allowed to hold the bank cards and personal identification numbers of their clients as security.

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

Microlenders are also required to maintain a register of their appointed agents, who are expected to carry identification cards bearing the lender's name and the MFRC logo.

Creditors who violate the Code of Conduct are penalised and subjected to disciplinary measures in accordance with the MFRC's disciplinary processes.

The Deputy Minister of Trade and Industry, Ms Lindiwe Hendricks, addressed the MFRC National Microlenders Awards ceremony held in Johannesburg in November 2002.

The Awards aim to promote and encourage excellence and innovation in micro-enterprise lending, consumer education and housing finance.

Ms Hendricks said at the ceremony that the Department of Trade and Industry's Unfair Business Practice Unit had investigated numerous complaints about unscrupulous lenders. Between June 1999 and November 2002, the Unit had received close to 7 000 complaints.

Several of these were referred to the SAPS and arrests and convictions have taken place.

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. As at 31 March 2003, 96 short-term insurers were registered. The total gross premiums written for 2002 (unaudited figures) amounted to R31,5 billion and the total assets amounted to R38,6 billion (excluding the South African Special Risks Insurance Association Limited).

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, and life insurance is dominant. As at 31 March 2003, a total of 75 long-term insurers were registered. The total net premiums received and outstanding for 2002 (unaudited figures) amounted to R184,5 billion, while total assets amounted to R802,8 billion.

The Financial Advisory and Intermediary Services Act, 2002 (Act 37 of 2002), contains many of the provisions incorporated in the Policyholder Protection Rules. The FSB is in the process of redrafting these Rules to ensure that there is no duplication of provisions.

The FSB made a submission to the Minister of Finance to remove the statutory ceiling on the payment of commission to intermediaries on commercial and corporate business in the short-term insurance industry. Approval was granted on the grounds that the decapping would only become effective from the date on which intermediaries were licensed, as required in terms of the Financial Advisory and Intermediary Services Act, 2002.

Other financial institutions

Development Bank of Southern Africa (DBSA)

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

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

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

The financial resources of the DBSA are made up of the share-capital contribution of

the National Treasury, borrowings in the financial markets, repayments on loans granted by it, and internally generated funds. In addition to these resources, it mobilises loan capital from other international sources.

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

By March 2003, the DBSA had raised R3,2 billion from multilateral and bilateral institutions.

The scale of impact on the Bank's funding operations has been estimated using economic modelling techniques. Employment opportunities generated directly and indirectly through projects co-funded by the DBSA in 2002/03 were estimated at 42 000. The ultimate direct, indirect and induced impact on the economy of projects co-funded by the DBSA in 2002/03 was estimated as having added R8,4 billion to GDP.

The number of households expected to benefit from new infrastructure projects funded or co-funded by the DBSA in 2002/03 was estimated at 717 000. Income flowing to low-income households as a result of projects co-funded by the DBSA in 2002/03 was estimated at R1,2 million.

Land and Agricultural Development Bank

The Land and Agricultural Development Bank (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 the Bank should achieve:

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

(See Chapter 4: *Agriculture*.)

Participation mortgage-bond schemes

About 14 organisations act as managers of participation mortgage-bond schemes in South Africa. According to the South African Reserve Bank, investments totalled R3,8 billion on 31 December 2002.

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 other countries such as South Korea, Jamaica, Egypt and Japan. An estimated one million *stokvels* operate in South Africa.

Unit trusts

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

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

Management companies may create units in the trust to meet the demand from the public, or may cancel them when the public sell back their holdings of units to the

management company. The management company is obliged to buy back any units offered to it and at a price determined within 24 hours of receiving any notice of a buy-back from an investor.

Various unit trusts in South Africa offer similar ranges of investment plans, varying mainly as to the minimum amounts accepted.

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

By March 2003, 29 management companies managed the assets of 466 separate unit trusts. Most of the companies are owned by South Africa's leading financial institutions. However, a number of independent institutions were registered in 2003. The market value of net assets of the unit-trust industry amounted to R181 billion (excluding intra-industry holdings of assets) at the end of 2002.

Since 1998, foreign collective investment schemes have been allowed to sell their products in South Africa, provided they obtain approval from the FSB. Individual investors utilising their foreign-exchange allowances, as well as institutional investors seeking foreign exposure, are the primary investors. At the end of 2002, 76 foreign schemes managing 401 different portfolios had obtained approval to market in South Africa. These schemes had a total value of R55,5 billion.

The unit-trust industry competes principally with long-term insurance companies, pension and provident funds, and investment trusts, for such investments. The trust deed stipulates the investment objective of each portfolio and constrains the investment managers regarding the type of assets in which they may invest. The other type of registered unit-trust scheme is property unit trusts. They mainly invest in shares of property-owning companies. Their units are listed on the JSE Securities Exchange (JSE) where investors can buy or sell them. By December 2002, there were six management companies managing nine portfolios with a market value of all listed units of R6,4 billion.

Financial intermediaries and advisors

In preparation for the adoption of the Financial Advisory and Intermediary Act, 2002, major sections of which came into effect on 15 November 2002, the FSB underwent restructuring during 2002.

Part of the restructuring was the creation of a Financial Intermediary and Advisory Department which was finalised on 1 August 2002. The Act requires that a wide range of financial-service intermediaries and financial-service advisors in South Africa, in respect of a wide range of financial products which are listed in the Act, obtain a licence to carry out their activities. Only a small portion of financial intermediaries were included in the regulatory framework. The result of the adoption of the Act will entail that up to an estimated 20 000 financial intermediaries and advisors are required to apply for a licence to continue with their activities.

The aims of the Act are:

- enhanced consumer protection
- professionalisation of the financial intermediaries and advisors sector in South Africa.

The financial advisory and intermediary services' licensing process was expected to commence during June 2003. By no later than March 2004, all new licences in terms of the Act should be issued. The mechanisms for enhanced consumer protection provided for in the Act include the setting up of the Office of the Financial Advisory and Intermediary Services Ombud for consumer recourse, and the introduction of extensive, fit and proper criteria for financial-service intermediaries and advisors as well as Codes of Conduct to govern the activities of persons affected by the Act.

Retirement funds and friendly societies

As at 31 December 2002, the FSB supervised

14 239 registered retirement funds and 179 registered friendly societies. These funds exclude the official State funds, Transnet, Telkom and some bargaining-council funds, all of which are not registered in terms of the Pension Funds Act, 1956 (Act 24 of 1956).

The total membership of all pension funds at the end of 2001 was 9 533 846, of which 8 252 092 were active members and 1 281 754 were pensioners, deferred pensioners and 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 increased by 17,2% from R52 130 million in 2000 to R61 097 million in 2001. Total contributions to the State, Transnet, Telkom and Post Office funds increased by 15,2%, while total contributions to self-administered, underwritten and industrial funds in the private sector increased by 18%.

Benefits paid increased from R64 930 million in 2000 to R111 206 million in 2001. Amounts paid out 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 20,5% from R694 billion in 2000 to R836 billion in 2001.

The net assets of self-administered funds increased by 12,5% from R329 billion in 2000 to R730 billion in 2001.

Financial markets

Primary capital-market activity

Public-sector borrowers reduced their outstanding domestic marketable bond debt in the first 11 months of the 2002/03 financial year. Net redemptions of fixed-interest securities amounted to R4,2 billion from April 2002 to February 2003, compared with net redemptions of R15,2 billion in the same period of the 2001/02 fiscal year.

In contrast, the outstanding nominal value of private-sector loan stock listed on the Bond Exchange of South Africa (BESA) increased rapidly in 2002 with a marked increase in the second half of the year. Fuelled by, among others, the low cost of funding in the bond market relative to the high cost of borrowing in the money market, and the dearth of public-sector fixed-interest securities, listed private-sector loan stock increased from R28,9 billion in June 2002 to R38,9 billion in December, and expanded further to R40,9 billion in March 2003.

Government raised R10,7 billion through foreign-currency denominated debt issues in the international bond markets in 2002/03, compared with R12,4 billion in 2001/02. In 2003/04, national government raised R10,4 billion in May 2003 through the issuance of a 10-year 1,25 billion Euro global bond at a coupon of 5,25% and a spread of 142 basis points over benchmark German bonds. With this issue, government took advantage of low international interest rates and foreign investors' appetite for high-yielding South African securities.

In 2002, new issues of Eurorand bonds by non-residents in the European bond markets tapered off as the strengthening of the exchange rate of the Rand discouraged unhedged issues. Net issues of Eurorand bonds, to the value of R1,3 billion in the first quarter of 2002, were followed by net redemptions of R2,7 billion in the ensuing three quarters, resulting in overall net redemptions of R1,4 billion for 2002 as a whole.

The total value of equity-capital raised in the domestic and international primary share markets by companies listed on the JSE increased strongly during 2002 as noted by the R28,1 billion raised in the third quarter of 2002. Equity financing amounted to R60 billion in 2002 compared with R24 billion in 2001.

Secondary capital-market activity

The abrupt depreciation of the Rand in December 2001 impacted negatively on the

outlook for domestic inflation. From then on, bond yield movements became more sensitive to changes in the exchange-rate of the Rand, and nominal yields reflected the reassessment of the exchange-rate risk premium. The monthly average yield on long-term government bonds increased from 10,3% in November 2001 to 12,6% in March 2002. By the end of March 2002, the market settled down and the mon-thly average yield on long-term government bonds declined to 9,9% in February 2003 when it reached its lowest level since 1980. The decline in bond yields was the result of, among others, the appreciation of the exchange value of the Rand and the improved near-term outlook for inflation. However, the bond market rally lost momentum from the beginning of March 2003, in response to the uncertainties created by the US-led invasion into Iraq, a slower than expected moderation of inflation, and increased recourse to funding in the domestic bond market as announced in Government's Budget for 2003/04. The monthly average bond yield increased slightly to 10,0% in March 2003 before declining to 9,9% in April 2003.

Trading activity on BESA declined by almost 2% from a record R12,4 trillion in 2001 to R12,2 trillion in 2002. In December 2002, the nominal value of bonds in issue amounted to R440 billion, with a market capitalisation of R473 billion which included 272 listed bonds of 40 issuers.

Non-resident transactions in the secondary bond market changed from net sales of R25,6 billion in 2001 to, albeit small, net purchases of R0,2 billion in 2002. Sentiment again turned negative as non-residents once more reduced their holdings of South African debt securities by R5,6 billion in the first quarter of 2003. Subsequently, net purchases of bonds to the value of R5,8 billion were recorded in April 2003.

The monthly average price level of all classes of shares listed on the JSE fell by 32% from an all-time high in May 2002 to April 2003. The general decline in share prices was primarily driven by the strength of the exchange rate of the Rand, which reduced the attractiveness of Rand-hedge shares and dampened the prospects of companies with exposure to foreign earnings. The monthly average price level of the resources sector fell by 36% from May 2002 to April 2003.

Turnover in the share market was buoyant in 2002 and the value of listed shares traded on the JSE amounted to a record R808 billion. Liquidity, measured as turnover as a percentage of market capitalisation, reached a new level of more than 46% in 2002 compared with 38% in 2001.

Non-resident portfolio investment in the secondary share market switched from a net inflow of foreign portfolio capital to the value of R5,4 billion in the first half of 2002, to a net outflow of R11,0 billion in the second half of the year. On balance, a net outflow of R5,6 billion was recorded for 2002 as a whole, followed by net sales of R2,0 billion in the first quarter of 2003 despite net purchases in February and March. In April 2003, non-residents increased their share holdings by R1,7 billion.

Money markets

The South African money market is well advanced, with a fairly large number of banks and other institutions actively participating. The South African Reserve Bank implements monetary policy in a system based on a shortage in the money market and uses this to make its repo rate effective in influencing money-market interest rates. The Reserve Bank accommodates private banks through weekly repurchase transactions at fixed-rate tenders with a seven-day maturity. Banks with short or long liquidity positions are accommodated by way of final clearing repurchase or reverse repurchase-auctions at rates that are 1,50 percentage points above or below the fixed repo rate.

In cases where the Reserve Bank has unintentionally under- or overestimated the market's liquidity requirement, supplementary repurchase or reverse tenders are conducted at the fixed repurchase rate. These tenders are mainly aimed at enabling banks to square off their short or long positions. They are conducted at the Reserve Bank's discretion and occur more frequently than the final clearing repurchase auctions and the regular weekly auctions.

The average daily liquidity requirement of the private-sector banks varied between R12,2 billion in January 2002 and R10,5 billion in November 2002. During the first quarter of 2002, conditions in the money market eased somewhat, in part because of the liquidity assistance the Reserve Bank provided to certain banks when they encountered large-scale deposit withdrawals. This easing was reflected in a decline of the average daily liquidity requirement to R11,0 billion in March 2002. In the ensuing months, liquidity conditions tightened again and the average daily liquidity requirement of private-sector banks increased to R12,2 billion in May, and R11,9 billion in July 2002. In January 2003, the liquidity needs of the private-sector banks declined to R10,6 billion from R11,1 billion in December 2002, but increased again to R11,2 billion in April 2003.

The Reserve Bank ensured the existence of an adequate daily liquidity requirement in 2002 and the first four months of 2003, by actively implementing various intervention techniques. These measures included foreign-currency swap transactions with private-sector parties. The outstanding amount of these transactions rose from R41,1 billion at the end of January 2002 to R54,8 billion at the end of August 2002. During the second half of 2002, the Reserve Bank curtailed the use of foreign-currency swap transactions with private-sector parties as a liquidity-draining instrument. This reduced the outstanding amount of foreign-currency swap transactions with private-sector parties from R54,8 billion at the end of August 2002 to R45,3 billion at the end of December and R30,5 billion at the end of April 2003.

The Reserve Bank increased the outstanding amount of its own debentures from R2,1 billion at the end of January 2002 to R7,7 billion at the end of December. Debentures with a maturity of three months were introduced in August 2002 and gradually increased to R3,0 billion by December 2002, reducing the amount of one-month debentures to R4,7 billion. Outstanding debentures amounted to R8,0 billion at the end of April 2003, divided between R4,4 billion with a one-month maturity and R3,6 billion with a maturity of three months.

The Reserve Bank also allowed the amount of reverse repurchase transactions in government securities to increase, on balance, from R5,8 billion in January 2002 to R8,6 billion in November 2002. This was reduced to R7,6 billion at the end of December 2002 as the strong demand for notes and coin drained an additional amount of R2,2 billion in liquidity from the money market during that month. At the height of the festive season, on 24 December 2002, notes and coin in circulation outside the Reserve Bank amounted to R42,1 billion or some R4,1 billion more than its corresponding peak in 2001.

When notes and coin began to flow back to the Reserve Bank, the reverse repurchase transactions were increased to R10,5 billion at the end of January 2003. These transactions were reduced to R10,0 billion at the end of February, but increased to R10,3 billion at the end of April. Out of that total, R6,3 billion worth of reverse repurchase transactions had a maturity of 28 days and R4,0 billion had a maturity of 91 days. The longer maturity had been introduced in June 2002.

The amount of vault cash that qualifies as a deduction when calculating banks' require cash-reserve deposits with the Reserve Bank was reduced further from 75% to 50% in September 2002. This drained about R1,7 billion from the money market, bringing the

cumulative money-market effect of the new vault-cash dispensation to some R3,5 billion since September 2001. The currently prevailing deductible proportion will be reduced by a further 25 percentage points per year over a two-year period.

On 2 April 2002, some changes were made to the composition of the South African Overnight Interbank Average (SAONIA) rate which had been introduced by the Reserve Bank on 5 September 2001. Some changes have since been implemented to improve the SAONIA rate as an indicator of money-market conditions. As an example, the revised SAONIA rate now comprises the average rate on unsecured interbank funding at market rates only, i.e. it excludes the interbank overnight funding raised in terms of special agreements among banks at the prevailing Reserve Bank repurchase rate. The previous SAONIA rate, now called the SAONIA+ rate, covers all unsecured interbank overnight funding, i.e. the weighted average of funding at the repo rate as well as the other funding rates. Since their inception, the SAONIA and the SAONIA+ rates have moved in close proximity to each other and have both displayed limited volatility. Relatively minor fluctuations in the rates usually occur shortly before the start of a new maintenance period when the minimum reserve requirements of the banking system are under review, and occasionally on or close to the last trading day of the month.

The SAONIA rate rose from 8,44% on 10 January 2002 and briefly breached 12% on 28 June 2002, when some private-sector banks had to access the accommodation facilities of the Reserve Bank through the final clearing mechanism. In the ensuing months, the SAONIA rate moved even higher and reached 12,45% on 30 September. In the fourth quarter of 2002, the SAONIA rate firmed even further to fluctuate within a narrow range of between 12,48% and 12,78%, essentially emulating the steady behaviour of the Reserve Bank's repo rate. During the first four months of 2003, the SAONIA rate fluctuated within a range of between 12,31% and 12,88%. The rate amounted to 12,71% on 15 May 2003.

During 2002, the upward trend in other money-market interest rates was generally either in response to actual increases in the repo rate, or to inflation expectations hence anticipated increases in the repo rate. The 9x12-month Forward Rate Agreement (FRA) rate increased from 9,85% on 8 January 2002 to 12,97% on 27 March 2002. During the second quarter of 2002, the 9x12-month FRA rate steadily drifted downwards, signalling market expectations of potentially lower money-market interest rates later. The increase in the Reserve Bank's repo rate on June 2002 was seemingly fully discounted ahead of the announcement by the market, and the FRA rate consequently showed little variation in the aftermath of this tightening of monetary conditions.

October 2002 appeared to mark a turning point in the money-market rates as fears of higher inflation began to dissipate. However, at the beginning of 2003, mounting geopolitical tensions reversed the downward trend in money-market rates. The rate on three-month bankers' acceptances declined from 13,15% on 23 October 2002 to 13,03% on 8 November 2002, and by 11 basis points from 13,04% on 2 January 2003 to 12,93% on 19 March 2003. However, from the end of March, this rate moved higher and stood at 12,98% on 25 April 2003.

The tender rate on 91-day Treasury bills moved lower from 12,78% on 10 October 2002 and briefly fell below the 12%-mark in mid-November. During the second half of November 2002, the tender rate resumed its upward movement, rising from 12,28% at the end of that month to 12,74% on 14 February 2003, and remained around this level in the ensuing period to 14 May. The weekly amount of 91-day Treasury bills offered on tender was increased by R500 million to R1,5 billion from

31 January 2003, contributing to upward pressure on this rate.

The prime overdraft rates and the predominant rate on mortgage loans of the private-sector banks closely followed the changes in the Reserve Bank's repo rate during 2002. When monetary conditions tightened in the first nine months of 2002, these rates increased from 13% in early January 2002 to 17% in September – reaching their highest levels since July 1999.

Exchange control

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

The measures were at first applicable mainly to South African residents. From 1961, the capital transactions of non-residents were also restricted. In subsequent years, these controls were tightened or relaxed from time to time, depending on domestic and international circumstances.

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

The Government is committed to an open capital market and the gradual relaxation of exchange controls. The private individual investment allowance was increased from R400 000 to R500 000 and then to R750 000 in February 2000.

In terms of the announcement made by the Minister of Finance on 26 February 2003, the following liberalisations with regard to 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, institutional investors will be:

- Allowed to invest, on approval, up to existing foreign asset limits. These foreign asset limits are 15% of total assets for long-term insurers, pension funds and fund managers, and 20% of total assets for unit-trust companies. The previous restriction based on 10% of the prior year's net inflow of funds will no longer apply. The Exchange Control Department of the Reserve Bank reserves the right, however, to require a staggered transfer of such funds in some cases so as to maintain overall financial stability.
- 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 dispensation became operational on 1 May 2003, after the National Treasury and Exchange Control Department, 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 – expanded market access, increased exports

and improved competitiveness. In October 2002, the exchange-control allowance for foreign direct investment (FDI) into Africa was increased from R750 million to R2 billion, in line with South Africa's commitment to NEPAD. In order to facilitate the global expansion of South African companies from a domestic base, increased exchange-control allowances for direct investment are now being extended to investment outside Africa. The following new exchange-control limits apply:

- The allowance governing South African corporates' use of South African funds to finance new approved FDI outside Africa is increased from R500 million to R1 billion.
- The allowance for the use of South African funds for investment outside Africa is expanded from just the financing of new approved FDI to include 'top-up' funding for the financing of new approved expansions of existing FDI. This expanded dispensation is maintained in the case of investment in Africa.

The global expansion of South African firms also holds potential benefits in the form of future foreign-income streams. These potential benefits may not have been fully realised owing to tax and exchange-control disincentives to the repatriation of foreign dividends. As part of easing the exchange-control impediments, dividends repatriated from foreign subsidiaries are eligible for an exchange-control credit, which will allow them to be re-exported, upon application, for approved FDIs.

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 in order to preserve foreign reserves. Reflecting the improved strength and resilience of the South African economy, these blocked assets will now be unwound. The imminent elimination of the net open forward position and an increasingly diversified and growing export sector create an environment 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 allowance for both residents and emigrants of R750 000 per individual (or R1,5 million in respect of family units).
- Emigrant-blocked assets were unwound. Amounts up to R750 000 (inclusive of amounts already exited) are eligible for exiting without charge. Holders of blocked assets wishing to exit more than R750 000 (inclusive of amounts already exited) must apply to the Exchange Control Department of the Reserve Bank to do so. Approval is subject to an exiting schedule and an exit charge of 10% of the amount.
- New emigrants wishing to exit more than R750 000 (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 charge of 10% of the amount.

JSE Securities Exchange

The JSE was first established to provide a marketplace for the shares of the many mining and financial companies formed shortly after the Witwatersrand gold fields were discovered in 1886. The Exchange dates from November 1887.

It is regulated by the FSB under the Stock Exchanges Control Act, 1985 (Act 1 of 1985), and the Financial Markets Control Act, 1989 (Act 55 of 1989). The JSE in turn regulates its listed companies and brokers by extensive rules and directives. The JSE is the largest securities exchange in Africa and has a market

capitalisation of several times that of all the other African markets combined.

In November 1995, the JSE 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.

The JSE is committed to promoting South Africa both regionally and internationally. In this regard, it has led the process of harmonising the listing requirements of the members of the SADC Committee of Stock Exchanges (COSSE). COSSE envisages an integrated real-time national network of securities markets in the region by 2006. The JSE has offered its trading platform to these members, and the Namibian Stock Exchange has been trading on the JSE's trading platform for the past four years.

On 6 August 2001, the JSE acquired the business and assets of the South African Futures Exchange (SAFEX). SAFEX is now incorporated into the JSE as two new divisions – the Financial Derivatives Division, which covers the equity and interest-rate futures and options markets, and the Agricultural Products Division, which covers commodities futures and options on maize, sunflowers, soya beans and wheat. The rules governing trading and the settlement of trades on SAFEX have remained largely unchanged. This has many long-term advantages for both exchanges.

The 2002/03 financial year brought momentous technological change for the JSE following the completion of most of the 31 projects identified under the Gateway 2002 strategic plan. These changes represent a major milestone in winning local and international investor confidence.

Bond Exchange of South Africa

BESA is an independent financial exchange operating under an annual licence granted 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. By 31 March 2003, BESA had granted a listing to some 272 bonds issued by 43 borrowers, with a total nominal value of R442 billion (US$1 = R7,88 as at 31 March 2003). Approximately 60% of this debt has been issued by central government. By comparison, there are some half-a-dozen listed corporate issues, including Telkom SA Ltd, Iscor, Absa Bank Ltd, Investec Bank Ltd, Standard Bank of SA Ltd and Sasol Financing. Of the listed bonds, some 84% by value have been immobilised in the Central Depository Ltd.

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

- fixed interest-bearing bonds with single and multiple redemption dates
- zero-coupon bonds
- CPI Index-linked bonds
- variable interest-rate bonds/floating rate notes
- strip bonds.

BESA has appointed a Listings Advisory Technical Committee (Listech) to provide ongoing advice on BESA's 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. In 2002, the local market turned over its market capitalisation some 27 times.

Trading volumes recorded on BESA for the full year to 31 December 2002 exceeded R11,6 trillion, a marginal increase over that of 2001.

These local-trade figures for 2002 represent turnover of some 27 times market capitalisation. In addition to the trades concluded by BESA, some R383 billion was traded in the over-the-counter (OTC) off-shore market (for local settlement) during 2002, with a further R418 billion traded OTC, but settled through Euroclear and Clearstream rather than in South Africa.

The daily average turnover in 2002 amounted to some R46 billion per day (spot & repo).

Main indices

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

These indices are published daily by the Exchange on its web site (*www.besa.za.com*) and are widely disseminated to all members, the asset-management community and the media. These indices are used by the asset-management industry as the benchmarks for the evaluation of the performance of the funds under management.

Regulation

BESA is a licensed Exchange and together with its member firms must adhere to the Financial Markets Control Act, 1989 and a set of approved rules. As a self-regulatory organisation, BESA undertakes ongoing surveillance over all aspects of bond-market activity in South Africa.

Guarantee Fund

BESA maintains the Guarantee Fund to ensure, as far as possible, the performance of trans-actions entered on the Exchange. The Fund provides members and clients with price-risk cover against a member default, to a maximum aggregate of R190 million. Since inception, no settlement defaults or claims on the Fund have been recorded.

Acknowledgements

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Development Bank of Southern Africa
Estimates of National Expenditure 2003, published by the National Treasury
Financial Services Board
JSE Securities Exchange
Land Bank of South Africa
National Treasury
Office of the Auditor-General
South African Reserve Bank
South African Revenue Service
www.gov.za

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