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

By June 2004, several important milestones in financial management had been recorded:

- Regulations in terms of the Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000), were expected to be amended to align them with the Broad-Based Black Economic Empowerment (BEE) Act, 2003 (Act 53 of 2003).
- The Validation Board, which was established by National Treasury in 2001, had accredited 59 training courses in public finance.
- A new chart of accounts, modernising and streamlining the classification of government expenditure, was implemented in the 2004 national and provincial budgets and financial reporting systems.

- National Treasury's Asset and Liability Management Division successfully piloted an intergovernmental cash co-ordination arrangement in two provinces, through which surplus funds were deposited with the Corporation for Public Deposits, benefiting both the national fiscus and provincial treasuries.
- A comprehensive training programme for municipal officials was underway, giving further momentum to the implementation of the Municipal Finance Management Act (MFMA), 2003 (Act 56 of 2003).
- In consultation with the Department of Public Enterprises, National Treasury initiated a review of the treasury operations of approximately 15 State-Owned Enterprises.
- National Treasury, in co-operation with other departments, initiated a review of the mandates, products and risk management of development-finance institutions.

## Fiscal policy framework

The Minister of Finance, Mr Trevor Manuel, presented the Budget for 2004/05 on 18 February 2004.

### Tax proposals

- Personal income taxes were cut, benefiting taxpayers by a total of R4 billion. People under 65 years of age earning below R32 222 a year, or over 65 and earning under R50 000, would not pay income tax in 2004/05.

- Interest on income exemption was raised to R11 000 for people under 65, and to R16 000 for senior citizens.
- The transfer duty threshold was raised to R150 000. Stamp duties on mortgage loans were eliminated.
- The general fuel levy on petrol went up by 10c a litre, and the Road Accident Fund levy increased by 5c a litre. The diesel rebate for primary producers was increased by 15c a litre.
- A packet of 20 cigarettes cost 64c more, a 340 ml can of beer 4c more, wine went up 21c, and spirits 176c per 750 ml.
- *Ad valorem* excise duties were eliminated on recorded music, some cosmetic products, print film, watches and clocks, printers and photocopying machines.

### Main spending changes

- An additional R3,2 billion went to provinces and municipalities for the Expanded Public Works Programme and infrastructure development.

**Consolidated national and provincial expenditure: functional classification[1)]**

| | 2003/04 | | 2004/05 | | 2005/06 | |
|---|---|---|---|---|---|---|
| | Revised estimate | % of total | Budget estimate | % of total | Budget estimate | % of total |
| General government service and unallocable expenditure[2)] | 23 483,2 | 7,7 | 23 987,0 | 7,2 | 25 956,4 | 7,1 |
| Protective services: | 58 327,3 | 19,2 | 63 246,5 | 19,0 | 68 555,3 | 18,8 |
| Defence and intelligence | 22 366,0 | 7,4 | 23 089,0 | 6,9 | 24 966,3 | 6,8 |
| Police | 23 127,1 | 7,6 | 25 668,9 | 7,7 | 28 048,4 | 7,7 |
| Prisons | 7 898,7 | 2,6 | 8 833,8 | 2,7 | 9 484,8 | 2,6 |
| Justice | 4 935,6 | 1,6 | 5 654,8 | 1,7 | 6 055,7 | 1,7 |
| Social services: | 177 330,0 | 58,3 | 196 685,8 | 59,0 | 215 975,5 | 59,1 |
| Education | 69 824,2 | 23,0 | 75 862,2 | 22,8 | 81 086,4 | 22,2 |
| Health | 39 676,6 | 13,0 | 42 586,4 | 12,8 | 47 137,8 | 12,9 |
| Social security and welfare | 51 486,2 | 16,9 | 59 935,5 | 18,0 | 68 018,8 | 18,6 |
| Housing | 5 651,7 | 1,9 | 6 339,5 | 1,9 | 7 034,0 | 1,9 |
| Community development[3)] | 10 691,0 | 3,5 | 11 962,1 | 3,6 | 12 698,4 | 3,5 |
| Economic services: | 44 999,6 | 14,8 | 49 411,5 | 14,8 | 54 913,5 | 15,0 |
| Water schemes and related services | 5 832,4 | 1,9 | 6 149,5 | 1,8 | 6 796,2 | 1,9 |
| Fuel and energy | 2 264,1 | 0,7 | 2 460,6 | 0,7 | 2 795,4 | 0,8 |
| Agriculture, forestry and fishing | 6 635,9 | 2,2 | 7 109,2 | 2,1 | 7 904,9 | 2,2 |
| Mining, manufacturing and construction | 1 506,2 | 0,5 | 2 052,6 | 0,6 | 2 370,4 | 0,6 |
| Transport and communications | 16 284,8 | 5,4 | 17 328,8 | 5,2 | 18 897,3 | 5,2 |
| Other economic services[4)] | 12 476,2 | 4,1 | 14 310,7 | 4,3 | 16 149,3 | 4,4 |
| Subtotal: Votes and statutory amounts | 304 140,1 | 100,00 | 333 330,7 | 100,00 | 365 400,7 | 100,00 |
| Plus contingency reserves | - | - | 2 500,0 | - | 4 000,0 | - |
| Total non-interest expenditure | 304 140,1 | - | 335 830,7 | | 369 400,7 | - |
| Interest | 47 326,0 | - | 50 432,0 | | 53 986,0 | - |
| Total consolidated expenditure | 351 466,1 | - | 386 262,7 | | 423 386,7 | - |

1) These figures were estimated by National Treasury and may differ from data published by Statistics South Africa. The numbers in these tables are not strictly comparable to those published in previous years, due to the allocation of some of the 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

- R2,1 billion more was allocated to the HIV and AIDS treatment programme.
- BEE initiatives received R6 billion.
- R2,2 billion more went to municipal water, sanitation, electricity and refuse services.
- Provinces received an additional R19,7 billion for social grants, schools, hospitals and clinic services.
- R910 million more went towards the restructuring of universities and universities of technology.
- R700 million more was allocated for land reform, and R750 million for a new farmer-support programme.
- R1,9 billion more went to police personnel, vehicles, and Information Technology (IT) infrastructure in the fight against crime.
- A further R475 million was allocated to improve the efficiency of the courts and to cater for vulnerable groups.
- An additional R1,1 billion was allocated to the Department of Defence for peacekeeping operations in Burundi and the Democratic Republic of Congo.
- R850 million more went to the Department of Home Affairs to improve service delivery, especially in rural areas.

## 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 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 National Treasury and the South African Reserve Bank.
- Regular meetings with the primary dealers, the Reserve Bank, and the futures and bond

Developments in government's debt management in 2004 included the launch of two bonds:

- The South African Retail Bond was launched on 14 May 2004. It provides ordinary people with a safe, convenient and rewarding savings instrument for a period of up to five years. By 11 June 2004, bonds worth R114 million had been sold to more than 2 400 investors.
- Another Dollar-denominated bond was launched on 25 May 2004. The issue attracted highly competitive interest and was priced at 195 basis points above the underlying 10-year United States Treasury rate, confirming South Africa's status as a high-grade credit in the market, and further diversifying the investor base in South African bonds.

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 has 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 was introduced to increase demand for the underlying instruments and encourage active portfolio management.

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

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 National Treasury calls for quantitative analyses 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

National Treasury tables a significant amount of legislation in Parliament annually. Legislation tabled in 2003/04 and draft legislation for 2004/05 include the following:

- The Security Services Bill seeks to facilitate an efficient, fair and secure means of securities trading in the South African capital market by regulating a multiplicity of activities and institutions. The Bill will also enhance the power of the Registrar of Securities Services to regulate the systemic interdependence between the various participants in South African markets. For the first time, the Financial Services Board (FSB) will have authority over the buying and selling of unlisted securities, which is a major improvement with regard to consumer protection. It was

**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 |
| 1997 | -1,2 | 1,2 | 1,0 | 6,9 | -6,8 | -11,1 | 3,5 | 3,6 |
| 1998 | -0,9 | -0,8 | -11,7 | -8,9 | -16,1 | -17,0 | -15,3 | -9,3 |
| 1999 | -3,1 | -2,5 | -8,5 | -5,3 | -10,3 | -8,2 | -5,8 | -21,9 |
| 2000 | -2,1 | -2,2 | -5,1 | -3,0 | -11,4 | -5,6 | 2,0 | -16,2 |
| 2001 | 0,3 | 0,5 | -14,6 | -13,5 | -18,8 | -14,4 | -16,0 | -8,5 |
| 2002 | 2,3 | 0,5 | -20,9 | -17,2 | -18,8 | -22,2 | -23,1 | -16,3 |
| 2003 | 4,5 | 5,5 | n/a[4] | n/a[4] | 39,2 | 27,9 | 16,2 | 28,8 |

1) Change compared with preceding period.
2) Weighted average exchange rate against most important currencies.
3) Percentage changes of average.
4) Not available.

Source: South African Reserve Bank – *Quarterly Bulletin* expected to be passed in the second half of 2004.

- The Financial Services Ombudschemes Bill aims to improve the ability of consumers to enforce their rights and resolve any grievances they may have against the financial services industry. The Bill was expected to be tabled in the second half of 2004.
- The Financial Advisory and Intermediary Services Act, 2002 (Act 37 of 2002), came into effect on 30 September 2004. The Act will ensure that consumers are protected against unscrupulous peddlers of commission-based products that are either unaffordable in the longer term, or are unsuitable to the financial needs or profile of the consumer. It will also reduce the number of lapses and surrenders in the insurance industry that have resulted in unnecessary financial losses to consumers of long-term insurance products.
- In 2002, the Minister of Finance requested that a panel review the Draft Accounting Professions Bill. The panel completed its work in October 2003. It was expected that a draft bill on the regulation of auditors and draft amendments to the Companies Act, 1973 (Act 61 of 1973), was to be ready for public comment by August 2004.
- The Co-operative Banks Bill will seek to formalise the co-operative banking industry by affording it a legal standing in its operations. It will also aim to bring the industry into the regulatory framework, to afford its depositors the same safety and stability enjoyed by formal commercial banks' depositors.
- The Dedicated Banks Bill seeks to create a second tier of commercial banks, better able to serve the financial needs of a broader range of the population. It allows for a wider range of participants, such as retail companies, telecommunications companies and perhaps microlenders in the banking industry, by affording them banking licences with restricted banking operations. The entry requirements in terms of capital will be lower, but in return, the scope of their operations will be narrower, and permissible investments will largely be restricted to liquid assets.

## Debt Collectors Act, 1998

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 legally entitled to 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/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 of Finance may also, in terms of Section 26 of the Act, on the conditions he/she deems fit, exempt any person or category from the provisions of the Act.

As of 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, is committing an offence.

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

Business confidence in the first quarter of 2004 surged to its highest level in 15 years as a result of surging domestic demand following 2003's interest rate and tax cuts.

The Rand Merchant Bank/Bureau for Economic Research Business Confidence Index showed an eight-point rise to 69 points in the first quarter of 2004, compared with a 61-point rise in the last quarter of 2003.

The South African Chamber of Business' Business Confidence Index rose to a record 130,9 in September 2004, from 127,8 in August 2004 and 112,3 in September 2003.

### The Public Finance Management Act (PFMA), 1999

The 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.

National Treasury has embarked on several initiatives to assist departments with capacity-building and ensure the successful implementation of the PFMA, 1999.

Transforming public-sector financial management is one of National Treasury's key objectives. To this end, National Treasury has been implementing the PFMA, 1999 since 2000. It began implementing the MFMA, 2003 in 2004, and providing and managing appropriate systems for monitoring and managing expenditure.

Over the next few years, National Treasury will be commissioning high-quality short courses for all government officials, to build the necessary capacity to effectively implement the Acts.

It is rolling out financial management systems, which will ensure not only the transparency of expenditure, but also the effective and efficient use of scarce resources to achieve social transformation.

These systems for enhancing the integrity and effectiveness of supply-chain and expenditure management are part of the PFMA, 1999 implementation, and have been among National Treasury's most important reforms.

The implementation of the PFMA, 1999 within National Treasury is ongoing and suggests a good record. A risk-management exercise has been completed and a fraud-prevention plan developed. Internal controls and asset-management procedures have been implemented.

### Accounting Standards Board

The Accounting Standards Board was appointed in 2002 and is mainly responsible for the implementation of Generally Recognised Accounting Practice (GRAP) in government.

During 2003/04, progress was made in developing a framework for the preparation and presentation of financial statements. The draft standards for the following were issued for public comment:
- presentation of financial statements
- cash-flow statements
- accounting policies
- changes in accounting estimates
- errors and impairment of assets.

Over the medium term, the Board aims to develop and issue a core set of GRAP that will be available for implementation by all spheres of government.

## Financial Services Sector Charter

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

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

## State expenditure

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

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, with its recommendations and formulation of corrective actions. National Treasury closely monitors the performance of State departments and is obliged to report any deviations to the Auditor-General.

National Treasury furthermore maintains transparent and fair bidding processes, as well as accounting, logistic and personnel systems. It sets and maintains standards and norms for treasury and logistics, acts as 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, National Treasury must prescribe measures to ensure both transparency and expenditure control in each sphere of government, by introducing uniform treasury norms and standards. These treasury norms and standards aim at deregulating financial controls, by granting accounting officers of spending agencies more autonomy in financial decision-making within the ambits of impending financial legislation.

### Budget evaluation

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

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

### Early Warning System

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

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 National Treasury in a prescribed format. The information derived from early warning reports is used for advising the Budget Council and the Cabinet. The Minister of Finance is also kept informed of the early warning report results on a regular basis.

### Financial policies, systems and skills development

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

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, 2000 give substance to the content of the Preferential Procurement Policy Framework Act, 2000. This Act and its regulations are applicable to all three spheres of government.

The Minister of Finance issued the Code of Good Practice for Black Economic Empowerment (BEE) in Public Private Partnerships (PPPs) in August 2004.

The Code sets a clear BEE framework for both public and private parties engaging in PPPs, creating certainty and ensuring a consistent approach.

It also provides a balanced scorecard with indicative targets and weightings for each element of the private party's equity structure, management, subcontracting and local socio-economic impact.

The Code further guides institutions on how to make appropriate decisions about BEE targets during the feasibility and procurement phases.

By August 2004, PPP projects worth more than R18 billion were in operation in a wide range of sectors.

Bids are evaluated according to a preference point system. A bidder can score a maximum of 80 or 90 points for price, while 20 or 10 points can be scored for contracting or subcontracting historically disadvantaged individuals (HDIs) and promoting/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 bidding system, and contributes to achieving RDP goals, including the promotion of small and medium enterprises (SMEs).

In terms of Section 76(4)(c) of the PFMA, 1999, the Supply-Chain Management Framework was published for comment at the end of October 2002. During 2003, comment was received and the regulations were promulgated on 5 December 2003.

The purpose of the Framework is to replace outdated procurement and provisioning systems in government with an integrated supply-chain management system, as well as an international best-practice process for appointing consultants.

## South Africa's anti money-laundering system

In April 2003, South Africa was assessed by the Financial Action Task Force (FATF), the international standard-setting body, to determine whether the country's anti money-laundering measures met international standards.

The FATF found that South Africa needed to meet the revised standard regarding the beneficial ownership of companies and legal entities, as well as implement measures to combat the financing of terrorism. These issues are being addressed, and the anti-terror financing measures are contained in the Protection of Constitutional Democracy Against Terrorist and Related Activities Bill.

South Africa has since become a member of the FATF.

Another measure aimed at combating money laundering is the implementation of the Financial Intelligence Centre (FIC) Act, 2001 (Act 38 of 2001).

The FIC became an autonomous and self-functioning government agency reporting to the Minister of Finance in 2003/04.

The mandate of the FIC is to track irregular financial practices, especially the proceeds of crime. The Centre receives reports from accountable institutions, which it stores and analyses. 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.

During 2003/04, the FIC received about 7 480 suspicious transaction reports from a range of accountable institutions, mainly banks and money remitters.

Another institution was created by the Act, namely the Money-Laundering Advisory Council, which is intended to provide the Minister with legislative advice. The Act identifies a range of 19 different business sectors which it defines as being accountable institutions, and which are most vulnerable to abuse by criminals. These include banks, *bureaux de change*, life insurance companies, stockbrokers, money remitters, as well as casinos, lawyers, accountants, investment advisers, estate agents and motor dealers.

In 2002, South Africa became a member of the Eastern and Southern Africa Anti Money-Laundering Group. 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 (FFC)

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 best advantage of its people.

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

## Public Investment Commissioners (PIC)

The PIC manages the largest asset portfolio in South Africa and is an increasingly important role-player in the financial services sector.

As at March 2004, the total assets under management amounted to R309 billion, mainly belonging to the Government Employees' Pension Fund.

Draft legislation was expected to be introduced in 2004 for the conversion of the PIC into a corporation, subject to the provisions of the Financial Advisory and Intermediary Services Act, 2002. As a public entity, the PIC will remain subject to the PFMA, 1999.

The PIC's strategic plans for the years ahead include expanding the role of the Isibaya Fund in infrastructure development and job creation.

Over the next three years, about R4 billion will be invested in public infrastructure, and about R2 billion will be invested in SMEs, with a strong focus on supporting BEE ventures.

The PIC will also embark on a process of broadening the geographic spread of properties owned on behalf of its clients. This initiative will amount to about R9 billion, and will be underpinned by an agreed policy regarding the funding of Black ownership of property through appropriate institutional vehicles.

## 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
- BEE
- competitiveness
- geographic spread of growth and development.

The strategy rests on three pillars:

- The first pillar consists of cross-cutting issues: 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, agricul-

ture, Information and Communications Technology, and cultural industries.

Government has adopted an integrated way forward that comprises 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.
- establishing an integrated financing institution focused on BEE and small business
- an integrated approach to the 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 placing a greater focus on micro-enterprises

The South African Revenue Service's (SARS) *Customs Compliance* Campaign was launched on 28 November 2003.

On this day, the Commissioner of the SARS, Mr Pravin Gordhan, met airfreight associations, road-freight associations, trade representatives, business chambers and other industry stakeholders to discuss the worrying levels of non-compliance within the import and export sector.

Stakeholder groups were also invited to join SARS in a co-operative venture aimed at addressing these problems, levelling the playing fields and establishing a precedence of good corporate governance for the future.

During the meeting, 24 businesses committed themselves in a Memorandum of Understanding to eradicate criminality and non-compliance with the law in the customs environment.

- 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
- 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 Programme, 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. (See chapter 7: *Economy*.)

## South African Revenue Service (SARS)

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.

### Tax system

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, 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 National Treasury and the 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 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.

### Agreements for mutual administrative assistance between customs administrations

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

## Sources of revenue

### Income tax

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

In South Africa, income tax is levied on South African residents’ worldwide income, with appropriate relief to avoid double taxation. Non-residents are taxed on their income from a South African source. Tax is levied on taxable income which, in essence, consists of gross income less allowable deductions as per the Act.

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.

Income tax returns are issued annually to registered taxpayers after the end of each year of assessment. The year of assessment for individuals covers a period of 12 months which generally commences on 1 March of a specific year and ends on the last day of February the following year. Companies are permitted to have a tax year ending on a date that coincides with their financial year.

However, the Act also provides for certain classes of taxpayers to have the 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 taxpayer 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 government's second-biggest source of income.

Effectively, VAT 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 the 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 took 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.

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

## Excise duty

Excise duty is levied on certain locally manufactured goods as well as their imported equivalents. This duty is levied as a specific duty on tobacco, liquor, and as an *ad valorem* duty on cosmetics, audiovisual 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 of only 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

SARS virtually met its revised revenue target of R303,3 billion for the fiscal year ending 31 March 2004. The preliminary revenue figure for the 2003/04 fiscal year was about R500 million short of the target.

Based on the revised target of R303,3 billion, the key taxes performed well, particularly corporate taxes which came more or less on target at R60,65 billion. As far as the two other principal sources of revenue are concerned, personal income tax (R98,2 billion) did surprisingly well and came in at the higher revised target. VAT came in slightly below the target of R81 billion. Customs duty was only slightly below the target despite a significant decline in the value of imports.

A significant feature of the collection effort in the 2003/04 financial year was the fact that SARS' enforcement initiatives contributed very significantly to the collection success. Significant sums of money were collected from initiatives on Pay-As-You-Earn system defaults, customs duty, corporate and structured finance disputes, and industry-based audits.

The continuous efforts of SARS to broaden the tax base, improve its service levels to taxpayers, and pursue vigilant enforcement initiatives contributed directly to the increased revenue yield, which will finance government's developmental agenda.

The 2003/04 financial year saw the launch of dispute-resolution mechanisms, improvements in

Interest rates charged in respect of outstanding taxes, duties and levies, as well as interest rates paid by the South African Revenue Service (SARS) decreased by one percentage point with effect from 1 November 2004.

The following interests rates apply:

- the rate at which interest is charged in respect of outstanding tax decreased from 11,5% to 10,5%
- the rate at which interest is paid to taxpayers in respect of refunds of provisional tax overpaid decreased from 7,5% to 6,5%
- the rate at which interest is paid to taxpayers on refunds of tax where an appeal is upheld in court or conceded by the Commissioner of SARS decreased from 11,5% to 10,5%
- the rate at which interest is charged in respect of outstanding Value-Added Tax (VAT) and at which interest is paid to vendors in respect of VAT refunds, decreased from 11,5% to 10,5%
- the rate at which interest is charged in respect of outstanding customs and excise duties decreased from 11,5% to 10,5%.

SARS' anti-evasion drive, the launch of the free e-Filing facility to businesses, and a comprehensive drive to improve the levels of taxpayer filing.

### e-Filing

On 15 September 2003, SARS launched the e-Filing service that allows South African businesses to submit their tax returns online. The initial concept of electronic filing was introduced in 2001 as a pilot project.

e-Filing reduces the administrative costs of filing tax returns, improves operational efficiency, reduces backlogs and paperwork, and increases the accuracy of taxpayer data. It gives effect to government's aims to reduce the cost of doing business in South Africa or, in this case, of being tax compliant.

Other benefits to corporate filers include detailed electronic records of all interactions with SARS, quicker turnaround times on submissions of returns, increased flexibility regarding payment options to SARS, an additional three to five-day window period to submit VAT payments, a dedicated call centre, and a reminder service via e-mail or the short message system.

Between September 2003 and June 2004, the number of registered filers increased from 72 000 to 98 300, the number of returns submitted grew from 66 000 to 182 000, and the value of payments made online to SARS increased from R2,5 billion to R5,5 billion.

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

### *Filing Season*

During 2003, SARS launched an educational and publicity campaign called *Filing Season* to assist in expanding the tax base and improving the culture of tax compliance in South Africa.

*Filing Season* is an extensive marketing and publicity venture to remind taxpayers of their responsibilities to submit their tax returns on time with the correct details, to ensure that their returns are assessed and processed timeously.

During the campaign, which entered its second year in 2004, SARS set up kiosks at its offices and at shopping centres around the country, staffed by officials and consultants to help customers complete their tax returns.

*Filing Season* also seeks to reduce the number of requests from taxpayers for extensions, and help customers complete their tax returns correctly. Thirty percent of tax returns received by SARS in the past were either incorrectly completed, partially completed or lacked the necessary substantiating documentation. This caused unnecessary delays for both taxpayers and SARS.

Each year, SARS attempts to simplify complex tax returns for salaried individuals.

Since its launch to demystify taxation in South Africa, and promote open communication channels between SARS and the taxpayer, the public's response to *Filing Season* has been overwhelming.

The 2003 *Filing Season* was a big success, with SARS receiving more than half of the almost four million returns before the July deadline.

On 13 September 2004, the South African Revenue Service (SARS) opened the Large Business Centre (LBC) at Megawatt Park near Johannesburg.

The LBC is designed to introduce a new era in the interaction between SARS and the country's largest corporate taxpayers, who are important contributors to economic growth and the fiscus.

Corporate income tax has increased steadily as a percentage of total revenue collections, from 11,9% in 1994/95 to 20% during the 2003/04 fiscal year.

Corporate taxpayers who will be serviced by the LBC include:

- companies listed on the JSE Securities Exchange
- parastatals
- unlisted companies with a turnover in excess of R250 million
- major financial institutions
- multinational corporations and their local branches.

## Gambling and lotteries

The National Gambling Board regulates the gambling industry in South Africa by ensuring that the viability, sustainability and integrity of the industry are attained and maintained.

The Board fulfils its mandate by:

- promoting uniform norms and standards that apply generally throughout South Africa, bringing about uniformity in legislation relating to gambling in the various provinces
- establishing and maintaining a national inspectorate
- monitoring the existence of any dominant or overconcentrated market share in the South African gambling industry
- advising the Minister of Finance and the provinces on gambling matters
- facilitating the resolution of disputes which may arise between the respective provinces regarding the regulation and control of gambling activities
- liaising with similar foreign international bodies.

The South African Advisory Council of Responsible Gambling was created to promote the culture of responsible gambling. It comprises regulators, civil society and the industry.

The National Gambling Act, 1996 (Act 33 of 1996), defines the regulatory framework of the industry. For instance, it limits the number of casinos that can be licensed to 40. There are provincial gambling boards in each of the nine provinces. These boards are responsible for issuing casino licences.

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 fourth anniversary in March 2004.

By 31 March 2004, more than R2,2 billion raised through the National Lottery had been allocated to over 5 000 beneficiaries.

- In 2003/04, some R1,26 billion was allocated to 1 802 beneficiary organisations.
- This amount was allocated according to the following categories:
  - Arts, culture and national heritage: 267 allocations amounting to R375,4 million.
  - Charities: 1 144 allocations amounting to R613,1 million.
  - Sport and recreation: 390 allocations amounting to R252,4 million. This included a R28,3-million cash injection for the 2004 National Olympic Team, and R10 million to the National Olympic Committee of South Africa by the Sport and Recreation Distribution Agency of the National Lottery Distribution Trust Fund (over and above the R5 million that had been granted for team preparation).
  - Miscellaneous purposes: one allocation amounting to R17,4 million.

## Auditor-General

The Office of the Auditor-General (OAG) exists as a State institution to support democracy. Two factors – independence and impartiality – are extremely important to the democratic process and are entrenched in the Constitution. This gives the OAG the strength to perform its functions and helps to ensure that the OAG's key stakeholders, Parliament, the provincial legislatures, government departments and public entities can rely on its work.

Nine provincial offices, in addition to the head office in Pretoria, enable the OAG to conduct audits at national and provincial departments, local governments, as well as a number of miscellaneous accounts all over the country.

The OAG has a budget of R589,7 million and 1 448 employees. These are divided into various centres of excellence that provide auditing services, corporate services, and specialised audit work, namely performance, forensic auditing, computer auditing and technical support. The OAG also boasts an impressive international auditing complement.

Public-sector auditing involves the investigation and evaluation of government and related institutions regarding financial-management practices, performance, and compliance with legal requirements. 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 the auditee has complied with laws and regulations, safeguarded public funds and assets, ensured that accounting systems are functioning properly, and spent public monies effectively.

The OAG contributed significantly to developments that would improve the regular reporting on national government accounts.

These include:

- Introducing a checklist to ensure that the level of service provided by the OAG is consistently of a high standard.
- Developing a financial-management capability model in terms of which financial management in the public sector can be assessed.
- Conducting research and developing a strategy for the auditing of performance information.
- Developing a manual on the auditing of compliance with relevant laws and regulations.
- Focusing on sustainable-development auditing to investigate the social and environmental aspects of business processes.
- 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 along Ministerial portfolio lines.

The OAG maintains close relationships with stakeholders such as National Treasury, the Accounting Standards Board, the Institute for Public Finance and Auditing, and the Public Sector Committee of the South African Institute of Chartered Accountants.

In accordance with the PFMA, 1999, the Auditor-General has the power to investigate and audit the activities of public entities without the approval of the chief executive officer (CEO) or board of directors if he/she considers it to be in the public interest, or upon receipt of a complaint. All the companies listed in terms of the PFMA, 1999 have to report on their financial affairs and performance. Among these are the South African Post Office, Eskom and Transnet.

# Financial sector

## South African Reserve Bank

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

The Reserve Bank formulates and implements monetary policy and regulates the supply (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 as 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.

The main instrument in managing liquidity in the money market is the repurchase transactions (repo) rate, the price at which the central bank lends cash to the banking system. The repo rate has become the most important indicator for short-term interest rates.

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

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

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

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

Estimates of revenue before tax proposals, 2004/05

| **R million** | **2003/04 Revised estimate** | **2004/05 Before tax proposals** | **% change** |
|---|---|---|---|
| Taxes on income and profits | 171 990 | 193 260 | 12,4 |
| Personal income tax | 98 200 | 110 000 | 12,0 |
| Company tax | 60 650 | 68 800 | 13,4 |
| Secondary tax on companies | 6 000 | 6 760 | 12,7 |
| Tax on retirement funds | 5 600 | 6 000 | 7,1 |
| Other | 1 540 | 1 700 | 10,4 |
| Taxes on payroll and workforce | 4 000 | 4 300 | 7,5 |
| Taxes on property | 6 520 | 6 970 | 6,9 |
| Domestic taxes on goods and services | 110 558 | 119 417 | 8,0 |
| Value-Added Tax | 81 000 | 89 500 | 10,5 |
| Excise duties | 12 715 | 12 799 | 0,7 |
| Levies on fuel | 16 350 | 16 500 | 0,9 |
| Other | 493 | 619 | 25,5 |
| Taxes on international trade and transactions | 8 800 | 10 476 | 19,0 |
| Stamp duties and fees | 1 450 | 1 570 | 8,3 |
| **Total tax revenue** | **303 318** | **335 994** | **10,8** |
| Department revenue | 6 068 | 5 944 | -2,0 |
| Transactions in assets and liabilities | 570 | 646 | 13,4 |
| Foreign grants (RDP* Fund) | 67 | - | 0,0 |
| Less: SACU** payments | -9 723 | -13 328 | 37,1 |
| **Main budget revenue** | **300 300** | **329 256** | **9,6** |

Source: *Budget Review 2004*
* RDP – Reconstruction and Development Programme
** SACU – Southern African Customs Union

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.

## Monetary policy

The framework for monetary policy was tightened and made more transparent by adopting formal inflation targeting in February 2000.

Inflation targeting is aimed at maintaining low inflation and has been successfully adopted by an increasing number of countries in recent years. 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). In mid-2004, a 3% to 6% target range also applied.

Following a review of the inflation-targeting framework, the Minister of Finance and the Governor of the Reserve Bank agreed on some technical refinements of the framework. These were announced on 12 November 2003. Prior to the announcement, the target range for CPIX inflation was set at an annual average of 3% to 6% over a calendar year, and was supposed to extend up to 2005.

Although the target range of 3% to 6% was maintained in 2004, the measurement option was changed to a continuous 12-month basis. Thus, CPIX inflation must remain in the target range at all times and this will apply at least until 2006.

The Reserve Bank's repo rate was maintained at 13,50% from September 2002 to mid-2003, to brake and then reverse the acceleration in inflation which followed the depreciation of the exchange rate of the Rand in 2001.

Besides the downward revision of the CPIX inflation data by almost 200 basis points in May 2003, the sustained conservative monetary and fiscal policies, and the significant recovery in the exchange rate were important factors in bringing down the inflation rate. Over the 13 months to April 2004, the production prices of imported goods in Rand terms declined significantly and the overall production price index also receded somewhat.

Developments in production prices were also reflected in consumer prices, as the 12-month CPIX inflation rate receded to levels within the target range, and registered 4% in December 2003 before accelerating marginally to 4,2% in January 2004, and further to 4,4% in April 2004.

Growth in the broad monetary aggregate M3 and banks' total loans and advances recorded 12-month rates of around 12% for most of 2003. Over the month-end of February 2004, growth in M3 accelerated significantly owing to cash received by non-bank domestic parties from coupon interest payments on government bonds, and the redemption of the first tranche of the R150 bond.

This trend was reversed somewhat in the ensuing months to April, mainly reflecting the reallocation of funds to other financial instruments. Banks' total loans and advances also decelerated during the early months of 2004 due to disintermediation when non-bank corporate parties issued bonds. Nevertheless, the growth in monetary aggregates and banks' total loans and advances were supported by brisk growth in domestic expenditure and lower nominal interest rates.

Against the background of these developments, the Reserve Bank's repo rate was reduced by a cumulative 5,50 percentage points during the period from 13 June 2003 to 11 December 2003. With the outlook for CPIX inflation remaining reconcilable with the target band, the MPC agreed to leave the repo rate unchanged at 8%, at its meetings held in February, April and June 2004.

In August 2004, the repo rate was dropped to 7,5%.

## Financial Services Board

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

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

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

Included in such functions is regulatory control over central securities depositories and depository institutions responsible for the safe custody of securities.

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

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

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

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

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

The FSB is assisted by an advisory board on financial markets, and advisory committees on financial services providers, long- and short-term insurance, pension funds and collective investment schemes. The Financial Services Consumer Advisory Panel was established to advise the FSB and Registrar of Banks on consumer-protection issues falling within the regulators' jurisdiction.

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

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

## The banking industry

At the end of December 2003, 39 banks, including 15 branches of foreign banks and two mutual banks, were registered with the Office of the Registrar of Banks. Furthermore, 44 foreign banks had authorised representative offices in South Africa. By the end of December 2003, banking institutions collectively employed 113 051 workers at 8 187 branches and agencies.

Four major banks dominate the South African banking sector, namely Amalgamated Banks of South Africa (Absa) Bank Limited, The Standard Bank of South Africa Limited, FirstRand Bank Limited and Nedbank Limited. These banks maintain extensive branch networks across all nine provinces and by the end of December 2003, constituted 80,9% of the total assets (R1 377,6 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 ser-vices, has gained importance. Nevertheless, several banks specialise in providing services in merchant banking, securities underwriting or other niche areas.

Online banking reached the one million mark in South Africa for the first time at the end of 2003. According to the World Wide Worx research report, *Online Banking in South Africa 2004*, the number of online bank accounts in South Africa grew by 28% in 2003. The number of online bank accounts reached 1,04 million and was expected to increase by more than 30% during 2004.

Industry-wide net income after tax increased to 0,7% of total assets in 2003. As a percentage of equity, industry-wide net income after tax increased from 5,6% in 2002 to 10,9% in 2003. By the end of 2003, industry-wide net income before taxation had begun to increase to R15,8 billion, compared with R8,9 billion in 2002.

The change in focus of the regulatory authorities, from direct control to deregulation, has been accompanied by an emphasis on proper capitalisation, sound risk-management procedures and greater disclosure. South Africa adheres to the capital-adequacy guidelines for banks, issued by the Basel Committee on Banking Supervision under the auspices of the Bank of International Settlements. In South Africa, the requirement to maintain capital equal to the full ratio of 10% of risk-weighted assets became effective in October 2001. By the end of 2003, the banking sector as a whole had a ratio of capital-to-risk weighted assets of 12,2%.

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 underway 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, thus ensuring South Africa's continued adherence to best practice. The Bank Supervision Department envisages amending the regulatory framework 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 Bank Supervision Department proposes that such banks be subject to lower-entry criteria, but that their business scope be limited. 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 for example, to trade or invest in derivatives.

## 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 2002, the Micro Finance Regulatory Council (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 lenders' names 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.

By August 2004, the Apex Fund was in the process of being incubated at Khula and an interim CEO had been appointed. The Apex Fund will provide small loans to micro-enterprises, with a focus on women in rural areas.

The Department of Trade and Industry called for public submissions on the Draft Consumer Credit Bill in August 2004.

This followed after the Department found serious weaknesses in South Africa's R362-billion per year consumer-credit industry.

The Credit Bill aims to address consumer complaints, such as not being aware of the fees that are included in credit.

The Credit Bill will establish norms and standards for pre-contract disclosure and statements of account. The Bill also provides that credit insurance may not be capitalised upfront. It will also guarantee the consumer's right to be informed of reasons for the refusal of credit.

## 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 2004, 97 short-term insurers were registered. The total gross premiums written for 2003 (unaudited figures) amounted to R35,3 billion, while total assets amounted to R39,3 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. Life insurance is dominant. As at 31 March 2004, 78 long-term insurers were registered. The total net premiums received and outstanding for 2003 (unaudited figures) amounted to R156,8 billion, while total assets amounted to R822,1 billion.

The Financial Advisory and Intermediary Services Act, 2002 contains many of the provisions incorporated in the Policyholder Protection Rules. In 2004, the FSB was redrafting these Rules to ensure that there is no duplication of provisions.

## Other financial institutions

### Development Bank of Southern Africa (DBSA)

The DBSA's primary role in terms of the DBSA Act, 1997 (Act 13 of 1997), is to promote economic development and growth, HRD and institutional capacity-building.

This is achieved by mobilising financial and other resources from the national and international private and public sectors, for sustainable development projects and programmes.

The DBSA operates in South Africa, in the other Southern African Development Community (SADC) countries, and increasingly in the wider region of Africa south of the Sahara. Its mandate is focused on infrastructure, both via loans of its own funds and by acting as a catalyst for investments in partnership with the private sector.

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

Based on funds approved, and on DBSA disbursements, an estimated additional 24 732 and 12 417 employment opportunities will be created respectively. The impact on Gross Domestic Product is estimated at R4,3 billion and R2,4 billion respectively.

The high unskilled content of the employment impact (40%) is of importance in terms of addressing unemployment. Capital is one of the basic production factors, along with labour, resources and the entrepreneurship necessary for a functioning economy. To support the economic activity promoted by the DBSA's loan funding, an amount of about R11,13 billion of capital would have to be employed directly and indirectly. Indirectly refers to the capital that is used to produce material and other input supplied to those projects funded by the DBSA. This constituted around 6% of the total gross fixed capital formation of South Africa in 2003/04.

The DBSA is strengthening its role as a 'knowledge bank' and provides considerable support to clients in this respect, with a wide range of additional services, including development information, project appraisals, project-management support, various impact analyses, and policy development.

Successful sustainable development is dependent on building institutional capacity among recipient organisations, and the DBSA plays an active role in this respect with grants from the Development Fund for training and technical assistance at local government level.

By mid-2004, the DBSA *Vulindlela* (Pathway) Academy was being set up to provide direct training facilities for municipalities, supported by a local government resource centre and a wide-area computer network to link them to these facilities. Furthermore, the DBSA's development capacity and infrastructure allows it to act as a channel for development funds. The Bank's agency function is well established and 22 projects are managed on behalf of international and national development organisations.

## Land and Agricultural Development Bank (Land Bank)

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

The Land Bank's objectives are defined within its mandate, which requires that 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*.)

## Collective investment schemes

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

### Collective investment schemes in securities

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

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

Various collective investment schemes in South Africa offer similar ranges of investment plans, varying mainly as to the mimimum amounts accepted for investment and certain charges. There are two types of investment plans, namely the open-account or lump-sum plan, and the regular savings plan, which caters for regular monthly investments.

By December 2003, 27 managers administered the assets of 488 separate portfolios. Most of them formed part of South Africa's leading financial institutions. However, a number of independent managers have been registered. The market value of the underlying assets of open-ended schemes amounted to R227,7 billion (excluding intra-industry holdings of assets) at the end of 2003.

### Collective investment schemes in property

This type of scheme was previously known as property unit trusts. These schemes invest mainly in the shares of property-owing companies, direct property and certain other and foreign assets. Their issued participatory interests are listed on the JSE Securities Exchange (JSE). As at December 2003, there were seven schemes with an equal number of portfolios, with 2 443 billion participatory interests in issue, of which the market value amounted to R6,756 billion.

### Collective investment schemes in participation bonds

Formerly called participation bond schemes, several of these schemes are in the process of being wound down. According to the Reserve Bank, the amount invested with these schemes was R3 820 million as at 31 December 2003. However, by June 2003, only seven of these schemes had invested funds from the general public.

### Foreign collective investment schemes

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

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

## *Stokvels*

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

## Financial intermediaries and advisers

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

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

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

## Retirement funds and friendly societies

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

The total membership of all pension funds at the end of 2002 was 9 779 884, of which 8 567 479 were active members, and 1 212 405 were pensioners, deferred pensioners 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 decreased by 0,9% from R61 097 million in 2001 to R60 552 million in 2002. Total contributions to the State, Transnet, Telkom and Post Office funds decreased by 1,4%, while total contributions to self-administered, underwritten and industrial funds in the private sector decreased by 0,7%.

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

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

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

# Financial markets

## Primary capital-market activity

### Government bonds

National Treasury issued government bonds totalling R51,4 billion in the primary capital market during the 2003/04 fiscal year. Government bonds to the amount of R26,6 billion matured during 2003/04, which brought the net financing requirement in the domestic bond market to R24,8 billion.

The Reserve Bank, on behalf of National Treasury, auctions new issuances of normal funding government bonds on a weekly basis. During 2003/04, 47 government bond auctions were conducted. The amounts auctioned varied between R350 and R650 million per week, averaging about R600 million per week for the fiscal year. Auctions of floating rate notes and inflation-linked bonds were also conducted on an *ad hoc* basis, depending on market conditions.

Conditions in global bond markets and the demand for emerging market bond debt during 2003 favoured the South African Government's 10-year Euro Global bond, which was issued on 9 May 2003 at a competitive spread of 142 basis points above the comparable German *Bund*. An amount of R1,25 billion (R10,6 billion) was raised through this issuance. This Euro Global bond carries a coupon of 5,25% and matures in 2013. The Government took further advantage of the low global interest-rate environment, and concluded its foreign financing for the 2004/05 fiscal year by issuing a 10-year Yankee bond to the amount of US$1 billion on 25 May 2004. This bond was issued at a spread of 195 basis points above the comparable United States (US) Treasuries, the lowest spread ever on a US-Dollar-denominated bond issued by the South African Government in the US-Dollar market. This bond carries a coupon of 6,5%, the lowest coupon of all South Africa's US-Dollar-denominated bonds.

### Non-government bonds

The growth in the non-government bond market, which has gained momentum since 2000, grew at a fast pace during 2003 owing to the relative low cost of funding in the domestic bond market.

The outstanding nominal value of non-government debt, in particular bonds, increased substantially in 2003/04. For example, the amount of non-government bonds outstanding as at 30 April 2003 increased by R22,8 billion to R63,9 billion on 30 April 2004.

A particularly interesting development since April 2003 has been the substantial increase in securitised loans issued by domestic corporate institutions. These loans were mainly issued by financial institutions securitising components of their loan books, while a large retail group also securitised its credit-card business. The listing of short-term commercial paper also increased from R569 million in April 2003 to R11,2 billion in April 2004.

### Eurorand bonds

The appreciation in the exchange rate of the Rand during 2003 resulted in a decline of Eurorand bond issuances in 2003/04. Whereas R4,2 billion worth of Eurorand bonds were issued during the 2002 calendar year, the total issuances declined by R2,3 billion to R1,9 billion in 2003. However, activity in this market increased during the first half of 2004. Eurorand bonds to the amount of R4,1 billion were issued and R2,0 billion matured, bringing the net issuance during the first half of 2004 to R2,1 billion. The increase in the supply of Eurorand bonds during 2004 could, among other reasons, be attributed to a slow-down in the pace of appreciation in the exchange rate of the Rand from 2003, as well as renewed funding demand in this market after the negative issuances in 2003.

### Equity market

The total value of equity capital raised by companies listed on the JSE in the primary domestic and international share markets increased to a record level of R101,1 billion in 2002, mainly owing to the significant acquisition of assets during that period. It subsequently declined to R22,7 billion in 2003. In the 2004 calendar year to the end of May, R30,8 billion was raised.

## Secondary capital-market activity

### Domestic bonds

During 2003, yields on South African government bonds were mainly influenced by expectations of lower interest rates, owing to the significant appreciation in the exchange rate of the Rand. The yield on the short-term benchmark bond, the R150 bond, declined to below 9% in mid-June 2003 from as high as 10,70% in January 2003, in expectation of lower rates.

The actual reductions in the repo rate, totalling 550 basis points during the second half of 2003, gave further impetus to the declines in yields to record low levels during October 2003. On 29 October 2003, the yield on the R150 bond reached a low of 8,73%. The larger declines in short-term bond yields compared with longer-term bond yields caused the yield curve to normalise during the second half of the year.

From the beginning of 2004, further declines in bond yields were limited by perceptions that inflation would bottom in the near future, as well as by the increase in supply of government and corporate bonds. However, a factor that, to some extent, supported the longer end of the curve over this period was that investors started to lengthen the duration of their bond portfolios ahead of the short-term R150 bond's redemption in February 2004. On 28 February 2004, the R150 bond and its first leg (the R006 bond) matured, while the remaining outstanding amount was equally split into R151 bonds and R152 bonds.

Government bond yields started to increase in December 2003 after the smaller-than-expected increase in the repo rate at the December 2003 meeting of the Reserve Bank's MPC, as market participants became convinced that the easing cycle in monetary policy had bottomed.

As a result, yields on domestic bonds started to reflect the possibility of higher interest rates, causing yields to increase by 140 basis points until the middle of May 2004. However, positive inflation data supported yields during May and June 2004, while the significant appreciation in the exchange rate of the Rand ignited expectations that the Bank would probably postpone the expected interest-rate increases until 2005. The yield on the short-term R150 bond declined by 37 basis points, from 10,24% on 13 May 2004 to 9,87% on 30 June 2004.

The Bond Exchange of South Africa (BESA) recorded a total nominal turnover of almost R12 trillion in 2001 and 2002. However, turnover on BESA declined to R10,7 trillion in the 2003 calendar year. Government bonds comprised 93% of the market's turnover. In contrast with the lower turnover, the nominal value of bonds outstanding on BESA increased from R400 billion in December 2002 to R507 billion in December 2003. Market capitalisation increased from R473 billion to R577 billion over the same period. The number of listed bonds on BESA increased from 272 in December 2002 to 329 in December 2003, while the number of issuers increased from 40 to 44 over the same period.

Foreign investors' transactions in the secondary bond market declined marginally from 11,4% in 2002 to 10,7% in 2003. These investors sold South African bonds to the net amount of R8,1 billion during 2003, compared with a small net increase in their holdings of domestic bonds to the amount of R250 million during 2002. During the first half of 2004, foreign investors sold South African bonds to the net amount of R4,5 billion.

### Domestic equities

Domestic share prices, as measured by the all-share index (ALSI), declined by 19% during the first quarter of 2003, mainly as a result of the appreciation in the exchange rate of the Rand and the declining gold price. These two factors affected the resources sector most severely.

However, the ALSI recovered during the remainder of the year. After it reached an intra-year low level of 7 361 on 25 April 2003, it increased by 41,1% to 10 387 on 31 December 2003. During this period, the increase in the gold price to above the US$400-level outweighed the negative impact of the appreciation in the exchange rate of the Rand.

During the first half of 2004, domestic share prices remained relatively stable and the ALSI declined marginally by 2,7%. Turnover on the JSE, as measured in terms of the value of shares traded, reached a record level of R808 billion in 2002, and declined to R751 billion in 2003. Liquidity, as measured by the turnover as a percentage of market capitalisation, declined to 35,4% from 39,1% in 2002. Foreigners sold a net amount of R358 million worth of equities during 2003, but increased their holdings of domestic equities to the net amount of R10,3 billion during the first half of 2004.

## Money-market activity

The South African money market is an over-the-counter market in which a fairly large number of banks and other institutions participate actively. The Reserve Bank implements its monetary policy in terms of a system based on creating a shortage in the money market. The Reserve Bank refinances this shortage through weekly repurchase transactions with seven-day maturities at its policy rate, the repo rate, thereby influencing market rates. The daily liquidity requirement was maintained at a level around R10,4 billion during 2003 until roughly September, whereafter it increased to R13 billion in October 2003. This increase occurred when a further 25% of banks' vault cash ceased to qualify as statutory cash reserves. The level of the banks' liquidity requirement was maintained around R13 billion until June 2004.

The Reserve Bank uses mainly three types of open-market operations to drain surplus liquidity from the money market, namely issuing Reserve Bank debentures, conducting longer-term reverse repo transactions and foreign-exchange swaps.

The Reserve Bank reduced its repo rate by 550 basis points to 8,00% from June 2003 until December 2003. These reductions were facilitated by a favourable short-term and long-term inflation outlook, emanating (mainly) from the appreciation in the exchange rate of the Rand during 2003 and 2004. Following these reductions in the repo rate, money-market rates also decreased substantially during this period.

## Exchange control

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.

The following dispensations 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 retail assets for retirement funds, long-term insurers and investment managers registered as institutional investors for exchange-control purposes, and 20% for collective investment scheme management companies.
- 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 National Treasury and the Exchange Control Department of the Reserve Bank, in consultation with the FSB, reached agreement with the respective industries on the appropriate revised reporting standards.

## South African corporates

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

Corporates are allowed, on application, to transfer up to R2 billion from South Africa for each new and approved investment in Africa, including the SADC, provided a longer-term benefit to South Africa can be demonstrated. In respect of investments elsewhere in the world, corporates are limited to the transfer from South Africa of up to R1 billion per new approved investment, subject to the same criteria. Consideration is also given to requests from corporates to utilise their local cash holdings to finance up to 20% of the excess costs of the new investment, where the overall cost of the investment exceeds the respective amounts of R2 billion and R1 billion.

The balance of the funds required is to be financed abroad by means of foreign borrowings, with consideration being given to such foreign borrowing being raised with recourse to, or a guarantee from South Africa implying that the local corporate's balance sheet may be used in the negotiation of such facility. To consider requests of this nature, the authorised dealer concerned must provide details regarding the foreign borrowing, e.g. denomination, amount, interest rate, term, etc.

Corporates will, on application to the Exchange Control Department, be permitted to utilise their South African resources to repay offshore loans raised after 18 February 2004 to finance or partly finance new approved investments.

Such transfers will, however, be limited to the greater of R1 billion (R2 billion in the case of Africa) or 20% of the total outstanding loan capital per investment, in any given year, provided that during the first two years of the loan's tenure, total funds transferred from South Africa do not exceed R1 billion per new investment (R2 billion in the case of Africa).

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

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

## Emigrants' funds

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

### Local financial assistance to affected persons and non-residents

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

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

## 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 goldfields were discovered in 1886. The Exchange itself was founded on 8 November 1887.

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 in two divisions, namely the Financial Derivatives Division, which covers the equity and interest-rate futures and options markets; and the Agricultural Products Division, which covers commodities futures and options on maize, sunflowers, soya beans and wheat.

### Structure

The JSE is the sole licensed securities exchange in South Africa. It is a voluntary association owned by member firms and is directed by a 12-member board.

Non-executive board members are elected by the rights holders of the JSE. The ordinary majority of the board members elect a chairperson and deputy chairperson from the non-executive members of the Board. The term of the non-executive members of the Board is three years and at least one-third of the committee must retire annually. The executive members of the Board hold office for as long as the CEO and chairperson may, in their discretion, determine. The management and control of the JSE vest in the Board, which has the powers conferred upon it by the Acts, the rules and the Constitution.

### Regulation

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.

## International involvement

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). The 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 six years.

### Foreign investors

There are no restrictions imposed on foreign investors on the movement of capital nor on the level of holding in companies listed on the JSE.

Foreign investors may be listed on the South African share subregister, in which case the securities could be held physically by either the investor or by the South African Central Securities Depositary Participants (CSDP).

JSE member firms and CSDP offer custodian services to foreign investors.

## Prospective developments

New listings requirements were announced in the first quarter of 2003 and became effective in September of the same year. The new listings requirements include that when listed entities wish to de-list they must make an offer to minorities and obtain a fair and reasonable statement. Listed companies are required to comply with International Financial Reporting Standards for all financial years, starting in 2005.

Alternative Exchange, better known as ALTX, was launched in October 2003 as a parallel market or alternative exchange for small-to-medium and growing companies. It is the sum of a partnership between the JSE and the Department of Trade and Industry. The ALTX is hailed as Africa's first alternative market, a growth exchange for young, innovative companies and investors.

The JSE launched the Socially Responsible Investment Index (SRI Index) in May 2004 as a means of focusing on corporate social responsibility and sustainable business practices, and to enable socially responsible investment in South Africa. The SRI Index is founded on environmental, economic and social sustainability and will measure the triple bottom line performance of companies listed in the FTSE/JSE All Share Index.

The SRI Index criteria are customised to the South African and African context, and could be an aspirational benchmark for all organisations, regarding best practice in the triple bottom line. The background and criteria document are available from the JSE website (*www.jse.co.za*).

# 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 2004, BESA had granted a listing to some 340 bonds issued by 50 borrowers, with a total nominal value of R509 billion. About 60% of this debt had been issued by central government. By comparison, there are listed corporate issues from diverse sectors including banking, gold mining, chemical, food, household goods and textiles, telecommunications and transport. Securitisation issues include vehicle, credit card, loan receivables, equipment receivables and mortgage products. Of the listed bonds, some 84% by value have been immobilised in the Central Depository Limited.

The evolution of sophisticated bond products in South Africa has been hampered by somewhat 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, but there are variations including:

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

BESA has appointed the Listings Advisory Technical Committee to provide ongoing advice on its Listings Disclosure Requirements and Rules. The aim is to ensure that these contribute to the strengthening of investor protection and market confidence.

### Market performance

The South African bond market is one of the most liquid emerging bond markets in the world. Turnover in listed debt declined in 2003, with volumes decreasing from R11,7 trillion nominal in 2002 to R10,7 trillion nominal, a drop of nearly 10%. The decrease in nominal turnover was also reflected in the lower number of total trades for the year, which decreased from 395 000 trades in 2002 to 356 000 in 2003. Turnover in the spot market decreased from 34,7% of total turnover in 2002 to 32,7% in 2003.

Although the turnover figures for 2003 dropped significantly, the turnover velocity of listed debt instruments remained healthy at 21 times the market capitalisation for 2003 (compared with 25 times for both 2001 and 2002).

Despite the majority of market turnover occurring in South African stock (95% of total turnover in 2003), the market has nevertheless seen an ever-increasing amount of listings and turnover in corporate issuances and securitisations (2,77% of total turnover).

Offshore turnover in listed debt that was settled locally amounted to R2,3 trillion, nearly 22% of total turnover, indicating that South Africa's local debt has significant attraction for international investors.

### 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 website (*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 transactions entered on the Exchange. The Fund provides members and clients with price-risk cover against a member default, to a maximum aggregate of R150 million. Since inception, no settlement defaults or claims on the Fund have been recorded.

## STRATE Limited

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

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

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Bond Exchange of South Africa
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Financial Services Board
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Land Bank of South Africa
National Treasury
Office of the Auditor-General
South African Reserve Bank
South African Revenue Service
*www.dti.gov.za*
*www.gov.za*
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