Description : THE HUYSAMER STALS INVESTMENT CONFERENCE
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Speaker : DEPUTY MINISTER GILL MARCUS

DRAFT SPEECH FOR THE DEPUTY MINISTER OF FINANCE, MS GILL MARCUS: TO BE PRESENTED TO THE HUYSAMER STALS INVESTMENT CONFERENCE, 18 NOVEMBER 1997

You have invited me to give you the Government's views on South Africa's current economic climate as well as the country's future prospects for 1998. In Government we have spent the last three years creating, what I believe is an enabling environment for higher and sustainable growth. We have created an appropriate institutional framework for sustainable growth and credible policy making. We have an appropriate set of policy's. We are restoring fiscal discipline, we are liberalising the foreign exchange regime, tariffs are coming down. Our industrial and export incentive schemes are now leaner and better targeted. Policies are also in place to deal with some of the worst injustices of the previous Government. A major electrification drive is well underway, a telecommunications campaign has begun. Schools and clinics are being upgraded. We have put training and skills development firmly on the Nedlac agenda. We are investigating in water projects from large dams to boreholes in remote villages. We are creating the context for growth.

Institutional Context

SA's current policy environment and growth prospects are fundamentally different to that prevailed prior to 1994. I would like to highlight four aspects of the policy environment that I believe put South Africa on a different growth plane.

The first and most obvious difference is the possibility and availability of foreign finance. This means that the balance of payments constraint is dramatically reduced, allowing the economy to sustain growth at considerably higher levels than in the past. Foreign investment will also play a critical role in increasing the overall investment level. On the basis of the normalisation of SA's capital account alone, I believe the economy's long run growth rate has probably increased to around 3%.

The second difference to policy making is the constitutionally entrenched independence of the Central Bank, and it's mandate to achieve price stability. I have yet to meet an economic who doubts the Reserve Bank's autonomy and determination to fight inflation. This knowledge plays an important part in building confidence and improving the efficiency with which the economy allocates resources over time.

The third difference that I would like to stress is the removal of exchange controls. We are all impressed at the lack of interest, when for the first time in 30 years, individuals were allowed to invest offshore on the 1st July 1997. The lifting of exchange controls removes one of the key uncertainties for foreign investors and in other countries has almost always resulted in an increased flow of savings into that country. Allowing individuals to optimise their investment's across currencies improves welfare, allocative efficiency and is an important discipline on policy makers.

The final and I think the most important difference is in the predictability and creditability of fiscal policy. Non of the above reforms can be effective, in the absence of appropriate fiscal policy. Given the enormity of the development and social challenge, the Government and the ANC's commitment to fiscal reform is a worthy achievement and one of that becomes the anchor for all the other reforms. Not only has the Government committed to fiscal discipline but it has mapped out the level of borrowing and taxation to the year 2000. Through the Medium Term Expenditure Framework the Government is now turning these aggregate ceilings into departmental allocations. This makes the overall targets more credible and gives the line departments the certainty over resources that allow them to focus on long term planning and delivery.

I would like to spend a few minutes describing the budget reforms currently being implemented.

Budget Reforms

The most important budgetary reform currently in progress in South Africa is the adoption of a multi-year expenditure planning framework, to be introduced as a three-year expenditure framework tabled alongside the 1998/9 national and provincial budgets. It is a co-operative undertaking of the national and provincial treasuries, in which all spending agencies have prepared their budget submissions on a three-year basis, making explicit the links between policy commitments and their expenditure estimates.

Deliberate forward planning and publication of medium-term estimates put the emphasis firmly on policy prioritisation. In the context of South Africa's post-apartheid transition, it is clearly right that this should be the central theme in budget reform. Our performance has to be measured by our success in bringing service to those denied them in the past. Publishing three-year forward budgets will be a major step forward in itself. It will greatly add to the transparency and credibility of our policy commitments. It will also mean that policy discussion, and the continued reprioritisation of spending commitments, will take place within a clear and agreed budgetary framework. New commitments will have to be accommodated with the available resource envelop - making explicit the choices and trade-offs involved.

There are those who have argue that our deficit reduction targets threaten our RDP commitments. In practice, our deficit reduction programme sharpens the reprioritisation process. It focuses the collective mind of government on its core business. And in some areas of government's business - in education, health and welfare services, for example - government is facing down its subsidisation of services to higher-income communities. These are difficult things to do - parents feel the pressure of rising school fees; homes for the elderly are having to find other sources of funding; hospitals can not offer unlimited access to expensive services. But we inherit a structure of public service that is manifestly unjust. The state cannot continue to spend more on meeting the social needs of the rich than the poor. Reprioritisation is partly about choosing a mix of public spending that is in tune with our needs and aspirations. It is also about fair rules of access and funding, phase in over a realistic period of adjustment.

Government departments have had to trim their spending programmes and re-think their longer term commitments. We have a decentralised system of financial management and accountability, in which spending agencies have full responsibility for keeping within their budgets. Departments are accustomed to keeping within their budgets. Where additional allocations have to be made, this is done transparently in an Adjustments budget towards the end of fiscal year. The rules is that only unforeseen and unavoidable additional spending is allowed.

Provinces are bound by similar rules. Provinces have independent fiscal standing, and have no recourse to the national fiscus. This is not just a question of maintaining fiscal discipline. It is also a Constitutional imperative. We have an agreed, equitable framework for sharing revenue between the national, provincial and local spheres of government.

As it turns out, several provinces and some local governments have indeed got into difficulties this year. The magnitudes involved are not yet entirely clear. Over the past few weeks, the Departments of Finance and States Expenditure have been working intensively with provincial treasury officials to develop a strategy for budget management over the rest of the year. Similar exercises have been undertaken where local authorities need to put their finances on a sound footing.

It appears that poor personnel management has been one of the major causes of provincial spending increases. Provinces account for two-thirds of the government wage bill, but are not sufficiently involved in pay negotiations, determining staffing norms or ensuring efficient utilisation of personnel. The present voluntary severance arrangement has also probably reached the limits of its usefulness. Cabinet has agreed to take proposals for an affordable retrenchment package to the bargaining chamber, to facilitate ongoing public service personnel restructuring. Provinces are in the meantime implementing much stricter control of personnel recruitment, pay determination and temporary employment arrangements.

Welfare and social security programmes have also been an area of weak expenditure control. A consolidated pension database has now been established, and problems of fraud and mismanagement are being attacked more vigorously.

Policy Context

Whereas fiscal policy and budget reform provides the anchor to Governments approach to sustainable macro economic management, fiscal policy alone cannot achieve a 6% growth rate. The Government recognises the crucial need to reduce the level of unemployment and provide more people with the means with which to provide for their own welfare. To do this we need to understand the link between the historical performance of the economy and unemployment. The SA economy's inability to generate sufficient jobs can be traced to three basic macro economic problems.

The first is the early emergence of a balance of payments constraint during any growth phase. This implies a very limited domestic supply capacity, which limits growth and incidentally also rules out the possibility of pursuing an expansionary fiscal program.

The second problem is the decline in the level of investment and savings available to finance investment. Investment decline precipitously during the 19980's as a result of external constraints and excessive Government spending. A successful policy framework has to reverse this decline.

The third problem is the well know decline in the labour absorption ratio. Put simply the rising real cost of job creation. This can be seen as the result of policies, often involving the state that made capital artificially cheap and labour artificially expensive.

The Government's response to these challenges has been outlined in the GEAR document. They include inter alia policies to promote exports, including further tariff reform, policies to support investment, including a reduction in fiscal dissaving, incentives to attract investment, a commitment to restructure states assets and to liberalise exchange controls. It is believed that these policies combined with the reform of labour market regulation, will bring about more natural allocation of resources within the economy and that this will over time reverse the decline in labour absorption. In the short term government will play an active role in reducing unemployment through an increase the amount of money it allocates to short term job creation projects.

The GEAR program has already achieved some notable success. Exchange controls have been substantial reduced, trade reforms continue to be implemented, tax incentives to promote investment have been introduced and the fiscal program is being implemented. It is too soon to assess the long term benefits of these reforms, as the improved resource allocation feeds into higher growth over a number of years.

Prospects for 1998

Turning to the prospects for 1998. It would be inopportune for me to comment in detail at this stage on the long term impact of the recent turbulence in world markets that have rocked all countries, particularly emerging markets. But the Rand and our capital markets have shown considerable resilience in rather stormy circumstances. We have a policy framework, and economic growth potential, that should continue to attract foreign investment. We have a central bank and a financial industry that are equal to the challenges before us.

This is not to say that 1998 will be without its challenges, many of which will emanate from beyond our borders, if not from the heavens themselves. El Nino seems to set to deal a blow to our agricultural production and will once more require South Africa to avail its infrastructure to our northern neigbours for the importation of grain. For the first time in history perhaps we have had due warning of the drought which means that farmers will not incur needless debts, nor Government need to make special provision for support to farmers. If emergency support is necessary, it will focus on the poor rather than the rich.

Another area of concern is the persistent decline in the gold price. My econometricians inform me that the gold price is notoriously hard to predict as it follows a random walk. Unfortunately this walk seems to be downhill at the moment! A sustained weakness in the gold price will make it harder to sustain employment levels within the industry.

There is also talk of the difficulties in East Asian markets feeding into weaker world commodity prices, which would again affect our traditional exports.

Although this means that the current account of the balance of payments may deteriorate during 1998, we should not underestimate the sustained improvement in the export of manufactured goods over the last two years. Exports have grown rapidly and to a wide range of countries. For the first time in three decades South Africa is surrounded by countries at peace and growing at over 5per cent per year.

On the capital account the success with which our markets have survived the recent storm also indicate that South Africa will be able to attract more than sufficient foreign capital to cover the deficit on the current account. I also anticipate an increase in long term investment in response to the reduction in exchange controls, which will continue during 1998.

Turning to domestic demand, 1998 should show a sustainable recovery in the level of domestic demand now that the interest rate cycle has turned. I emphasise sustainable recovery, as Government spending will again be defined in accordance with the macro-framework. This means that the deficit will be reduced to 3.5 per cent and spending increasingly focused in areas of priority delivery.

Whereas agricultural output will disappoint, the rest of the economy is anticipated to stage a recovery. The healthy growth in manufactured output that has prevailed during 1997 is anticipated to accelerate during 1998. Inflation and credit are already entrenched on a downward path and this is anticipated to continue.

Conclusion

To conclude, the political transitions removed one of the greatest obstacles to growth, namely political uncertainty. Government has taken this further and taken steps to dramatically reduce the uncertainty associated with fiscal policy. The framework for growth has been further strengthened, with both deep seated institutional reforms and the adoption of policy reforms designed to enhance investment, growth and employment creation.

This will ensure stable prices and an economy wide improvement in the efficiency with which resources are allocated, resulting in higher returns and higher investment. We have removed many of the risks to citizens and investors that have in the passed dogged South Africa: namely political uncertainty, fiscal indiscipline, high inflation and the non-convertibility of the currency.

Many people have questioned whether South Africa can really achieve 6 per cent growth early in the next century as set out in the macro strategy. I think so. EI Nino and lower gold prices may reduce the growth rate in the near term, but we should not ignore the extent to which many of the constrains to growth have been lifted. Strong institutions and credible policies will continue to attract the capital that South Africa needs to achieve a higher growth rate.

I thank you.