

Address to the U S – South Africa Business and Finance Forum

“GEARING UP FOR THE FUTURE : THE CONTINUED RELEVANCE OF GEAR”

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In June 1996 we launched the government's macroeconomic strategy document, entitled, Growth Employment and Redistribution. If, at the time, one had advised us that within two years the gold price would have fallen by a third, and that the world economy would have suffered a financial meltdown whose only precedent was the events of 1929, we would have doubted their sanity.

Unfortunately, these things came to pass. A year after the Russian crisis and the contagion that South Africa suffered as a result of this event, it is time to reflect on our approach to macroeconomic policy and whether GEAR, as it is known in South Africa, has served us well over the intervening years.

The question at hand is what, if any, modifications should be made to the framework in the light of recent global developments.

Many of our European counterparts are trying to decide whether there is life after the Euro. Maastricht was the precursor to the Euro. Under the GEAR framework South Africa meets almost all the criteria set out in the Maastricht Treaty. Unfortunately, this did not protect us from the wave of uncertainty that swept the financial markets. It does, however, provide a very sound foundation for a rapid and sustainable recovery.

How should a country like South Africa respond to the challenges and opportunities that arise in globalization ?

President Mbeki, in his address to the OAU Assembly of Heads of State and Government in July said, “(the situation) calls for our conscious and deliberate intervention in the process of globalization, as Africans, to produce these results of ethics, equity, inclusion, human security, sustainability and development”.

A range of analogies have been used to describe the experience of smaller countries in globalization. These normally involve references to small boats in choppy seas or airplanes in turbulent skies. My preference is the analogy of the airplane. Assuming that the speed and efficiency of air travel is preferred to that of travelling by sea, policy makers need to ensure that the economy is more like a modern jet liner than the rusty propeller-driven hulks which serve little purpose besides points of study for aviation historians. President Mbeki, furthermore, entreats us to ensure that the plane is piloted – failing which you could never achieve the desired outcomes.

Does GEAR provide the South African economy with a modern jet liner, delivering the growth and development we require most efficiently? We believe it does.

The first theme that I would like to highlight is that our experience with GEAR has shown that there are no trade-offs between growth and development. A sound macro economic foundation is essential for the achievement of sustainable development. Despite our critics, we have stuck to the fiscal framework we outlined in 1996, and have at the same time achieved many of our social objectives. Since 1993, the fiscal deficit has fallen from 10.3% to the current 2.7% of GDP and the level of government expenditure has been stabilized as a proportion of GDP.

We have implemented a new structure of intergovernmental relations, created nine provinces out of the administrative chaos of apartheid. In the course of this,

we have also notched up significant successes – just last week we released an Intergovernmental Fiscal Review which details the turnaround in public finance management by our nine Provinces – from a position of deficit to the present consolidated surplus.

The government's commitment to reconstruction and development has at the same time never faltered. Many of the social objectives set out in 1994 have been achieved.

- Since 1994, the Department of Water Affairs and Forestry has brought 25 liters of potable water per person to 3 million people and has created 100 000 jobs every year. There are currently 1000 new water projects underway, expected to serve 4,9 million people.
- Land reform is gathering momentum. Under the land redistribution program 179 000 hectares of land had been transferred to approximately 33 000 households.
- Educational enrolment has increased by over 1.5 million since 1994, while the average number of learners per teacher has decreased from 40 to 34 over this period.
- The housing subsidy scheme launched in 1994 has contributed to the building of 629 000 homes. Approximately 904 000 subsidies have been approved since 1994, compared to what many considered an ambitious government target of 1 million.
- In a very short period of time South Africa has established a social safety net unparalleled amongst middle income countries.
The state currently provides a non-contributory old-age pension of approximately 75 dollars per month to all elderly people below a certain

income level. In 1998, a new social grant was introduced to provide assistance to care-givers of children under the age of seven.

The primary school nutrition program now reaches approximately 5 million children in poor communities, contributing to their nourishment, enhancing learning capacity and creating many employment opportunities.

- Primary health services have been expanded and are largely provided at low cost. Government has built 638 clinics over the last four years, introduced a cost effective essential drugs list and conducted successful immunization campaigns and HIV/AIDS awareness programs.

All these social objectives were achieved despite the demands of dismantling the inefficiencies of the apartheid system and rebuilding new and more effective institutions, in many cases from scratch. In this, South Africa's second term of democratic governance, the government has committed itself to be 'a nation at work'. The difficult task of laying the foundations has been achieved – the next five years will see these past successes built upon to ensure an even greater acceleration in the delivery of basic services to all. We will continue to communicate openly with South Africans about what remains outstanding by way of service delivery. We can only strengthen democracy by such communication , and by ourselves being at the helm of a constructive impatience about improving the quality of life of our people.

Turning away from fiscal policy, it is clear to us that the other macro economic reforms we have implemented under the GEAR program also served us very well in the turbulent conditions of last year.

The second theme I would therefore like to raise is that of openness.

We have committed to creating an open economy. It seems clear that countries that have been more open to the world economy have prospered more than those that have been less open.

We have signed a free trade deal with the EU and will shortly ratify the SADC trade protocol in Parliament. These two agreements will have a dramatic impact on the structure of the South African economy. On these issues too, we are engaged in detailed communication – free trade agreements are never supported across all of society.

The SADC agreement lays the foundation for the emergence of a single regional market in Southern Africa, creating huge opportunities for firms throughout the region.

The former – the EU agreement – allows South Africa to catch up in terms of preferences with many other countries having trade relations with the European Union. South African firms will gain enhanced access to the second largest market in the world, while increasing competition in the domestic market should focus investment on areas in which South Africa has a comparative advantage.

Openness also implies opening previously protected domestic sectors to foreign investment. Specifically, foreign investment in state-owned enterprises allows for access to cutting edge technologies and increases the effectiveness with which these entities can deliver on the rollout of essential services. Private sector finance allows for investment in much needed infrastructure without further burdening the fiscus. We are committed to continue the restructuring and privatization process through both the sale of strategic stakes to international players and partnering with the private sector in infrastructure development.

On the capital account, South Africa remains committed to the gradual liberalization of the capital account. These controls will continue to be reduced in

a manner that does not destabilize the market, while ensuring that the financial system manages its risk exposure in a prudent manner.

This brings me to the third theme I would like to address, that of financial systems and their regulation. In globalization, with the instant payment system implied by e-commerce and the enormous complexity and sophistication of financial markets, ensuring that the financial system can handle rapid changes in the level of inflows and outflow is critically important.

In South Africa we have established certain principles:

- Firstly, as financial flows are far larger than central bank reserves, the rationale for defending the currency is questionable. The Rand, as a result, is a floating currency. This has many advantages. Most importantly, it avoids the type of exit problems associated with currency pegs. We are convinced that our banking system survived the difficulties of last year because the experience of currency movements in previous years had shown the Banks the value of having in place highly effective risk management systems and the need to be constantly conscious of the dangers of currency exposure.
- Secondly, we have established an independent central bank that determines interest rate policy on a day-to-day basis depending on underlying market conditions. Government will shortly be adopting an inflation-targeting regime to formalize the objectives of monetary policy and the level of instrument independence enjoyed by the Reserve Bank. This will serve to entrench the success we have already seen in attaining the goal of relative price stability. Consumer price inflation for August 1999 reached a year-on-year rate of 3,2% - the lowest level in 30 years.
- We have also taken a decision to no longer engage in forward transactions, and to reduce, over time, the Reserve Bank's existing exposure.

- We are also committed to ensuring that our financial markets continue to be well regulated and meet the standards set by international best practice.

This has entailed a busy program of legislative reform, as well as the restructuring and modernization of the South African financial exchanges.

We believe that the combination of a floating exchange rate, a sophisticated, modern, well capitalized and well-regulated financial market, and an independent central bank provide the best framework for the management of capital flows.

I would like to end my presentation here today by reiterating our commitment to the principles of macroeconomic policy as established in the GEAR, that I believe have set South Africa on a steady course despite the turbulence we might experience. These are that there is no choice between growth and sustainable development, our commitment to democracy demands that we attain both.

Government has achieved many of its social objectives while at the same time strengthening the macroeconomic policy environment.

South African policy makers have embraced openness and believe that South Africa's future lies in being a competitive participant in a globalized economy.

And finally, that we are committed to a world class monetary and financial framework to ensure that capital account liberalization is to our advantage, not disadvantage.

Amartya Sen, the 1998 Nobel Economics Laureate said, “ Political freedoms (in the form of free speech and elections) help to promote economic security. Social opportunities (in the form of education and health facilities) facilitate economic participation. Economic facilities

(in the form of opportunities for participation in trade and production) can help to generate personal abundance as well as public resources for social facilities. Freedoms of different kinds can strengthen one another.”¹

It is this compelling logic that gives the continuing rationale to what we seek with GEAR. For this reason then, the command is for full throttle ahead and we will fly according to the flight-plan we filed.

Thank you

¹ Amartya Sen, Development as Freedom