MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

ADDRESSING SOUTH AFRICA'S SOCIAL AND ECONOMIC IMBALANCES – BUDGETARY AND FISCAL POLICY CONSIDERATIONS

Standard Bank Emerging Financial Markets Conference
Sun City, 11 November 2004

Trevor A Manuel
Minister of Finance

As an emerging market, South Africa has rightly earned a reputation for sound fiscal management and a progressive opening up of its financial markets, within a prudent regulatory regime.

We have brought our budget deficit below 3 per cent of GDP, we have inflation now comfortably within our target range of 3 to 6 per cent, we have kept our balance of payments current account within moderate limits, we have seen capital market interest rates fall to their lowest levels in some 25 years.

Such prudence is comforting, of course, to bankers and investors.

But that does not, in itself, make it wise or sustainable. The budget deficit is an important measure of today's fiscal performance, but this is performance to what end?

Our real objective is something quite different, our policy goals are organized around a development agenda that aims to address the social and economic deficit that characterizes so much of our legacy and landscape. To put the question differently: our 2,4 per cent budget deficit: at what social cost?

Of course, this puts the focus on the long run trajectory of social and economic development. The budget numbers and the monthly price trends and trade statistics fuel the decisions of market participants for whom 45 minutes is a trading horizon and the long term ends on Friday afternoon. But social progress has to be measured decade-by-decade and generation-by-generation. And it is because of its contribution to progress over this time line that we chose, a decade ago, to put our fiscal policy stance and budget framework on a sound and sustainable platform.

There have been broadly three phases in the evolution of our public finances.

- During 1994 to 1996, following a period of recession and a rapid rise in the budget deficit, Government's Reconstruction and Development Programme was phased into departmental plans and budgets, and a comprehensive reprioritisation of public expenditure was undertaken. The new Constitutional order and its fiscal and financial institutions took shape. The average budget deficit stood at 4,7 percent and government debt was approaching 50 per cent of GDP.

- A period of fiscal consolidation from 1997 to 2000 saw the introduction of medium term expenditure planning, the drafting of the Public Finance Management Act, a strong focus on increasing transparency and accountability in the public finances, substantial investment in tax reform and revenue administration capacity and deliberate coordination of fiscal and monetary policy – leading to the adoption of an explicit inflation target. The budget deficit declined to 2,5 percent of GDP, public debt began to fall relative to GDP and average borrowing costs fell sharply.

- From 2001, a more expansionary fiscal stance has been adopted. Against the background of much improved fiscal management and the declining relative burden of debt service costs, both tax relief and an acceleration in public expenditure have contributed to strengthening the momentum of economic growth and social investment.

Successful fiscal consolidation, improved debt management and enhanced public sector spending capacity all contribute to the current growth-oriented fiscal stance, in part offsetting the impact of a disappointing international environment in 2002 and 2003 and the constraining impact of a strong rand currently. The 2004 Budget framework and the revised outlook published in the Medium Term Budget Policy Statement last month provide for strong real growth in non-interest expenditure – about 9 per cent last year and in 2004/05, and 6,5 percent next year. Debt service costs stabilize at about 3,6 percent of GDP. The budget deficit rises to 3,5 percent of GDP in 2005/06 before declining to 2,7 percent in 2007/08. The overall public sector borrowing requirement is expected to rise moderately to 4,6 percent of GDP, as parastatal capital spending gathers momentum.

On the strength of a healthy fiscal platform, in other words, we are able to budget for progressive reinforcement of public infrastructure and service delivery. Of course, it is not the aggregate numbers that are the measure of this progress, but the detail and the targeting of the spending we can accommodate.

In the October Medium Term Statement, which sets out the framework within which the 2005 Budget is now being prepared, we were able to announce the following:

- Marked increases in expenditure on social security, including continued growth in numbers of child support, disability grant and foster care grant beneficiaries – representing perhaps the largest non-contributory income redistribution programme amongst emerging market economies

- Completion over the next three to five years of our land restitution programme, while also stepping up agricultural support for emerging farmers

- Implementation of a new housing delivery strategy, emphasizing investment in sustainable communities

- Stepped up rehabilitation and maintenance of roads

- Further improvements in hospital infrastructure and administration

- Salary improvements for educators and police

- Improving the efficiency of our courts and justice administration, and expanding the South African Police Service

- Ongoing support for peace-keeping and development initiatives in Africa, and South Africa's hosting of the Pan African Parliament.

We will have the privilege of hosting the FIFA Soccer World Cup in 2010, and we will budget for a modest contribution by the fiscus to the infrastructure costs associated with this huge international event.

I mention the FIFA World Cup – although it is of course a unique event with its own particular requirements and financial dimensions – because it is a project that illustrates well some central features of the emerging market development challenge.

Firstly, we will closely observe how Germany manages the 2006 Cup, but we will not try to reproduce it in magnitude and style. For a start, we will have a ticket pricing strategy that recognizes the disparities in buying power of different segments of the potential market. Emerging markets can take on major international events or investments, but there are often important technological adaptations that have to be made.

Secondly, we have put considerable effort in our proposals for the 2010 Cup into maximising its development and tourism impact. Stadiums will be located in various centers, investment will be concentrated on long-lasting transport and hospitality infrastructure, communications capacity will be enhanced. This is much more that an event on the sports calendar, it is an opportunity to mobilize efforts around building and marketing South Africa more widely.

Thirdly, hosting the World Cup is not a government initiative, but is fundamentally a partnership between many role-players – in this kind under the umbrella of a sports federation. This is of course where development strategies so easily become self-defeating in emerging markets: governments fail to secure effective partnerships and shared responsibilities between the public and private sectors, too much is taken on by the fiscus, budgets get into difficulties and the whole project collapses in on itself. Or conversely – and this risk should equally be recognized – government's do too little to promote development, the business sector tries to find substitutes in providing housing, security, health care, social services, and is itself overwhelmed by the complexity of contracting for public services and the difficulties of operating in an administratively immature environment. Getting these partnerships right, a common understanding of shared and complementary responsibilities between the public and private sectors, is really the bedrock of the social and economic development project. And of course, between ourselves and the South African Football Association, there will be some tough talking about who does what and how much it will cost.

Fourthly, there are international sponsors and partners to consider. Without the international federation there would be no World Cup. But for us as an emerging market economy with limited resources and just a few years experience of hosting international events of any significance, this is a little daunting. Along with the international sports officials there is a veritable army of lawyers, accountants, financial advisors, and then a whole host of complementary merchants and carpetbaggers. And of course, the whole universe of development and social advancement is characterized by exactly this problem: many well-meaning advisors, many unscrupulous opportunists; multiple rewards, multiple risks. And so a lot of what we have done in managing the public finances and steering a progressive course in social and economic development is not particularly new or colourful, it is simply about sorting out good advice from bad, planning carefully and contracting with eyes wide open and a good lawyer close to hand.

Fifthly, you have to keep your eye on the ball.

And I needn’t remind you that in politics there are distractions, so that is always a challenge.

But the discipline of the budget process is a great help. Every year, I share with my Cabinet colleagues the task of reviewing our medium term spending plans, assessing new policy proposals and exploring revenue and financing options. The budget process is an intensive concentration of our minds on how we can address our social and development challenges within a responsible and sustainable fiscal envelope. And the second half of February comes around with relentless regularity, which is when Parliament expects full and open disclosure of these plans and programmes. That keeps our eye on the ball.

In the Medium Term Budget Policy Statement, setting out the strategic framework for the 2005 Budget, we highlight the following priorities:

- Accelerating the pace of growth of the economy, and in particular the rate of investment in productive capacity

- Promoting opportunities for participation of marginalized communities in economic activity, and improving the quality of livelihoods of the poor

- Maintenance of a progressive social security net, alongside investment in community services and human development

- Improving the capacity and effectiveness of the state, including combating crime and promoting service-oriented public administration

- Regional and international partnerships for growth and development.

We also emphasized the critical importance of sequencing issues: targeted incentives and public works programmes play a role in promoting investment and job creation in the short term, while investment in major transport infrastructure, spatial development reforms and an effective competition policy are key long term requirements; investment in education and training is similarly about long term productivity and human development; in the short term we can step up housing delivery, but in the longer term we also need to achieve a better alignment with spatial plans, job creation and community services.

All of these broad strategic policy challenges involve important kinds of cooperation and partnership between the public and private sectors. We have an active programme of formal contractual public-private partnerships – these now include several toll road concessions, long-term facilities management and accommodation services for government departments, information technology systems, non-clinical hospital administration and services, outsourcing of transport fleet management and operation of hospitality services in national parks and tourism sites.

There are also less formal partnerships in which the private sector plays a more proactive role. In keeping with commitments negotiated under the auspices of the Financial Sector Charter, signed in 2003, our major banks have recently introduced low-cost savings accounts that significantly improve the ease of access of poor people to the security and convenience of electronic banking. Small-business development, housing finance, support for emerging farmers, black economic empowerment and investment in social infrastructure will all in due course also benefit from Financial Sector Charter commitments.

These are areas of public policy in which government departments have various roles and responsibilities, and to which the annual budget makes considerable contributions.

But it is the combination of targeted public spending and expanding market-based opportunities that opens real opportunities for accelerating the pace of social and economic development in the decade ahead. Our Financial Sector

Charter provides a framework within which substantial capital resources of the banking sector and other financial institutions will be mobilized in pursuit of public policy purposes.

I am deeply mindful that the quality and impact of this mobilization of capital, over time, will be shaped by both private initiative and incentives, and the influence of government programmes and the regulatory environment. Our success in redressing our social and economic deficit will depend on this interface between public policy and private initiative in so many areas –

- Land reform, agricultural development and farmer support programmes
- Housing and investment in commercial and recreational infrastructure in townships and low-income communities
- Reducing the costs associated with retirement savings and improving preservation of benefits
- Small business support and expanding opportunities for small and medium-sized enterprises
- Broadening participation in black economic empowerment arrangements
- Improving the quality of education and the effectiveness of training programmes
- Extending access to health care and social development services.

Our success in managing the public finances is closely watched – the budget deficit is a notable indicator of this trajectory. In each of these areas of public policy, and in several others, of course, there are equally compelling indicators of social and economic progress. As an emerging economy, we have to measure progress not just on a single dimension of financial correctness but across a full spectrum of development indices.