MINISTRY OF FINANCE

REPUBLIC OF SOUTH AFRICA\

Address to the IIF Open Program conference on Basel II and Risk Management: Meeting International Standards

Johannesburg, South Africa

6 April 2005

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Members of the Institute of International Finance, delegates, guests and friends,

I am delighted that you have chosen Johannesburg, eGoli, our "city of gold", as the venue of your first meeting for African financial professionals, and I am particularly pleased that you have chosen a topic and a conference programme that is so apposite for our times.

Africa faces huge challenges.

If we are to meet these challenges – in promoting peace and security, in building democratic institutions, expanding trade and industrial investment, building modern transport and communications networks, deepening our financial systems – we need to learn from international experience, we need to understand international standards, we need to adapt these to our context, we need to have realistic and well-sequenced programmes for implementing change and managing accompanying risks.

Your conference programme focuses on one set of challenges for our continent – how to address the capital adequacy and related standards of Basel II, how to implement critical risk management issues and how to develop appropriate regulatory capacity. This is a profoundly important agenda, one which has exercised some of the finest minds in our finance ministries and central banks for several years, and which we know calls for a step-by-step programme of reform over many years to come. It is reassuring, but also a little alarming, to know that there are still gaps in this fabric even in the leading centres of global finance.

In welcoming you to South Africa, I'd like to share a few thoughts on the wider economic growth and development challenge before us, and before the African continent, and perhaps suggest some dilemmas for managing financial sector reform in our context. You will appreciate that we are interested in the health of our banks, not just out of sympathy for the wellbeing of financial institutions themselves, or even their shareholders, important as these interests might be, but because healthy banks have a part to play in the robustness of the broader economic and development outlook.

South Africa has earned a reputation for sound monetary and 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.

We have achieved moderate growth of the economy, and there is encouraging evidence of an acceleration in the pace of job creation.

A decade ago, it was clear what had to be done macroeconomically. We had to stabilize the fiscal balances, we had to dismantle the exchange controls and trade barriers of an over-protected siege economy, we had to steady the inflation trajectory, we had to redirect public spending towards investment in skills and redressing the distortions of racially skewed social services, we had to reverse the decline in infrastructure investment. There were varying opinions on the details of the macroeconomic framework and of course there were those who regarded the whole strategy as distastefully Washingtonian. But in retrospect these were the right things to do: and by 2001 we were able to adopt an expansionary and pro-growth fiscal stance, in a context of renewed business confidence, a declining debt-GDP ratio, moderate inflation and a healthy balance of payments.

For the decade ahead, these foundations will remain in place – an open economy, competitive markets, a sustainable deficit, a broad-based tax structure, spending plans informed by transparent social and economic policies. But nobody actually lives in the mythical "fundamentals" of financial analysts and commentators. The habitable structure is what counts, even if the foundations need reinforcement from time to time. The construction project now under way involves design and engineering challenges of considerable complexity, addressing microeconomic reform challenges, enhancing the institutions and culture of government activities, addressing qualitative as much as quantitative dimensions, and yielding returns progressively over many years to come.

Let me give four examples.

First, there is the challenge of reconstructing the urban landscape. As many of you will know, there is a long history of geographic fragmentation and spatial irrationality to overcome in the South African physical landscape. The dynamics of urban conglomeration, how cities evolve over time, are hugely important for both the efficiency and competitiveness of economies and the quality and character of ordinary people's lives.

Let's try to visualize the landscape of the cities in which our children and our grandchildren will live and work and play. What do we need to do to realize the vision of our dreams and not our nightmares?

We have to build transport networks that are safe and convenient and efficient. We have to arrest the decay of inner cities and accommodate more diverse kinds of trade and commerce. We have to promote job creation near the places where people live. We have to extend access to water, sanitation and affordable electricity, and give greater momentum to both the pace and quality of housing construction.

Over the past decade we have steadily stepped up the flow of resources to support municipal infrastructure investment and services. Progress in building houses, connecting water pipes, installing electricity and improving roads and sewerage systems has broadly kept ahead of a comparatively rapid growth in household formation, but there is still a long way to go.

There are immense investments required to make an integrated urban landscape a reality. There are public infrastructure requirements, but there is also a large opportunity for private investment in housing improvements, commercial and office space, industrial and recreational facilities. This is what the Financial Sector Charter refers to as "transformational infrastructure" – investment that changes the quality of ordinary people's lives. For municipalities, the regulatory environment has to be reformed in important respects, and there are still planning gaps. You can't expect private investors to make transformational investments if they don't yet know where the high street is. But the reconstruction of our cities is a joint responsibility, and the role of private finance is recognized in our new Municipal Finance Management Act. In South Africa – and elsewhere in Africa – it is imperative that the structure of both public and private investment in the infrastructure of our cities should deepen considerably over the years ahead.

Having talked about the cities, we have to consider also the rural landscape. It is a mistake to think that development policies are either focused on promoting urban growth or on agriculture and the rural poor. Productivity of the rural landscape is in fact closely bound up with the efficiency and the economic needs – food, resources, recreation – of the city. The challenge of redressing a distorted and fragmented landscape is even more stark in the rural heartland.

We are steadily addressing a portfolio of some 75 000 land restitution claims, and the 2005 Budget provides for a significant rise in allocations for this programme over the next three years. A new grant to provinces has been introduced to strengthen agricultural support to emerging farmers, so that as the longer term land reform programme gathers momentum it will be complemented by appropriate interventions to maintain farm output and improve productivity. The Land Bank is increasingly active in extending credit to black farmers and supporting a more diverse client base.

Again, there are transport and market access issues to address. There are important shifts in priority of our agricultural research and advocacy programmes, new alignments in support services, reforms of the management and pricing of water and irrigation systems, and ongoing challenges in promoting food safety and quality assurance, managing pests and disease risks and promoting access to international agricultural markets.

South African farmers have adapted to significant reductions in trade protection, dismantling of collective marketing arrangements and phasing down of government subsidies. Agricultural output has remained buoyant and aggregate food security is not at risk. These strengths have to be preserved, while the rural landscape undergoes transformation of ownership and tenancy rights, improved protection of labour and promotion of opportunities for smaller scale farming units.

What are the financial implications? Land redistribution will continue to be a significant budget commitment for many years, but as we move beyond the restitution phase the fiscal contribution will increasingly need to be complemented by self-financing arrangements, while remaining within realistic limits in the inherently risk-prone agricultural debt environment. Again, I believe that the years ahead will see significant shifts in the balance and depth of both public and private sector financing of rural and agricultural development. Farming today is a comparatively capital-intensive industry – measured in terms of value-added, more capital intensive than either manufacturing or construction. But it is also a source of livelihood of proportionately large numbers of people, and agricultural productivity influences trends in food prices, which in turn influence everybody's cost of living. Creating healthy structures in land and farming debt markets, supported by appropriate risk-mitigation, need not loom large in the overall public finances, but it will be an important, growth- and equity-enhancing, area of reform.

Thirdly, a few remarks on financing infrastructure investment and restructuring of state-owned enterprises.

Our expectation is that general government fixed capital formation will grow by about 7 per cent a year in real terms over the next three years, while investment by public corporations, which has expanded by over 10 per cent a year since 2002, will continue to increase strongly. Having spent about R38 billion on freight rail infrastructure, rolling stock and ports over the past decade, Transnet expects to invest more than R40 billion over the next five years. Eskom has begun its recommissioning of mothballed coal-fired power plants, and will continue its expansion and strengthening of transmission networks. Drawing in part on experience gained in financing and managing the international partnership through which the Lesotho Highlands Water Project was completed, several important investments in water resource infrastructure over the next few years will be undertaken as ring-fenced self-financing projects. The first of these, involving a new dam on the Berg River, will bring a much-needed supplement to the Western Cape water supply system. Design work is near completion for major water projects in the Mpumalanga and Limpopo provinces.

For the next three years, we anticipate a widening of public sector borrowing from under 1 per cent of GDP in 2002 to about 4 per cent over the next three years, and interest on public debt will stabilize at about 4,5 per cent of GDP.

The acceleration in infrastructure investment cannot entirely be financed through debt. This is of course why the profitability and balance sheets of public enterprises are so important, but it is also why we have put considerable effort into developing a robust programme of public private partnerships, which bring private equity and non-recourse debt finance into selected areas of public infrastructure financing. Treasury projections indicate an increase in capital spending through public-private partnerships from about R2 billion last year to about R5,3 billion in 2007/08.

For the public finances, over the next decade, a substantial expansion in capital formation is a requirement for more rapid growth and development, and will in turn require innovative and well-considered financing strategies.

Fourthly, we need to reflect on the challenge of deepening social security and income protection.

We are currently stepping up our expenditure on social security, partly to meet continued growth in numbers of child support, disability grant and foster care grant beneficiaries. These social assistance programmes, amounting to some 4,5 per cent of GDP – represent one of the largest non-contributory income redistribution programmes amongst developed or developing countries.

Over the longer term, we need to give careful consideration to the evolution of the social assurance system. Many countries have chosen to finance collective pension arrangements, health care, disability and unemployment benefits through payroll taxes or social security contributions, variously imposed on employees, employers or both. These taxes raise the costs of employment, but on the other hand they contribute to stabilizing labour market participation. The benefit systems rely on centralized administration, which may be cost-effective but tends to inhibit innovation. In general, the social security system gives fiscal expression to a nation's sense of solidarity, provides an important vehicle for both saving and financing income security, promotes social stability and mitigates several categories of household risk.

Reform of the retirement funding environment, improved compensation for work-related injuries or death, reform of the structure of compensation for victims of road accidents, financing unemployment benefits and further evolution of the health insurance environment are separate, but related, elements of our social security reform challenge. Getting these reforms right, and implementing reform initiatives in the right order and within an appropriate and affordable financing framework, are formidable tasks.

The initiative taken by our major banks, in keeping with a core Financial Sector Charter commitment, to make banking affordable and accessible to all South Africans, has quite rightly been prioritized as one of the first steps on the road to broadening and deepening income security to all. By extending basic banking facilities to all, opportunities are broadened and costs are reduced for so many other kinds of income support and social assurance arrangements.

And more generally, I welcome this crystallization of a private business response to a public interest purpose. There will be varying roles for the public and private sectors in different parts of the social security system, and we need to concentrate efforts on finding the best possible combinations of resources, capacity, service delivery and cost-recovery.

Social progress has to be measured decade by decade, 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.

For the decade ahead, accelerating the pace of growth of the economy, and in particular the rate of investment in productive capacity, and promoting opportunities for participation of marginalized communities in economic activity, and improving the quality of livelihoods of the poor, are amongst the central challenges against which we will measure progress and the quality of public policy.

All of these broad strategic policy challenges involve important kinds of cooperation and partnership between the public and private sectors. 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.

The dilemma I would like to leave with you is simply this. The kind of partnership that I have sketched, relies in part on tough, detailed, contractual commitments – the kind of business in which bankers are on comfortable turf. But it also rests on a underlying relations of trust, a shared vision, a common platform of hope. This is not easily quantified and measured, it is not easily itemized on the agenda of a risk management committee.

In framing our capital adequacy requirements, and in building robust risk management institutions and regulatory procedures, there needs to be room also for our shared vision, our common purpose, and a platform of hope on which we agree to work together despite the uncertainties before us.