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ADDRESS TO PARLIAMENT ON THE BUDGET VOTES OF THE MINISTRY OF FINANCE

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Global developments and the South African economy

Madam Speaker, the last few weeks have seen heightened volatility in international financial markets and renewed concern about the size and sustainability of global growth and trade imbalances. And in hosting the World Economic Forum here last week, we have been reminded of shared international interests and mutual concerns: the global environmental challenges, management of trade and financial stability, the economics of debt and aid, the gap between rich and poor, the management of conflict and the politics of multilateral cooperation. Particularly welcome, I believe, is the opportunity to work with other governments and global business leaders in addressing barriers to accelerated investment and creating a climate for improved growth, employment creation and poverty reduction across the African continent.

In South Africa, we are similarly challenged by the complexity of bringing together our first and second economies, formal and informal activities, urban and rural neighbourhoods, inner city, suburb and township, wealthy and poor. Different aspects of these challenges are the responsibilities of the various organisations under the oversight of the Ministry of Finance. This is partly about building stronger institutions, it is about the social and economic linkages between increasingly integrated and inter-dependent communities, it is about measuring performance and progress against agreed objectives and targets.

These are the challenges we face together, whether the task is bringing small businesses and taxi operators into the revenue system, or measuring changes in income and living standards of households, or planning social and development spending programmes, or reviewing the structure and evolution of our financial institutions.

The South African economy is experiencing its longest economic expansion to date. The economy has now been growing for over six years. Years of concerted macroeconomic reform are yielding the desired benefits. A combination of high business and consumer confidence, low inflation and historically low nominal interest rates, has underpinned the current growth. Our growth, however, has been unbalanced. Expenditure has grown faster than domestic production thus leading to a current account deficit; the demand for skills has not been matched by supply; disadvantaged communities have remained marginalised from the mainstream of economic activity.

As I pointed at the time of the Budget in February, the global environment remains uncertain.

The 2006/07 fiscal year has begun inauspiciously, with sharp fluctuations in capital flows and consequential volatility in emerging market and developing country currencies, including a significant sell-off in rand-denominated assets. The rand has fallen to a lower level – around R6.50 to the dollar. However, sharper declines were experienced by Indonesia, Hungary, New Zealand, Iceland, and many other countries.

These fluctuations underscore the point that the world we live in holds few assurances. The interplay of markets, national regulations and international conventions help to shape the forces of globalisation. In the short term, national economies rely on their own safeguards – policy credibility, reserves, fiscal and monetary positions, the depth of their markets, and recourse to multilateral institutions (the IMF and World Bank) – to weather international financial contagion.

Over the medium-term, we can influence the international conventions and market regulations and the multilateral institutions in ways that benefit South Africa. We can help to build the regional and farther-flung economic ties and relationships that create deeper and wider markets that are more resilient to contagion. Most importantly, we can develop appropriate policies, regulatory structures and institutions, and help to build human capital for our domestic economy. Getting our policies right means that more rapid growth in investment, productivity and employment creation can lead to higher income and greater resources to withstand economic shocks.

Our policy challenge is partly about adapting to global imbalances that seem likely to persist for a considerable length of time.

It is apparent that by virtue of its relative size and role in the international financial system the US economy is able to maintain a large gap between its investment and saving, financed by capital inflows from the rest of the world.

A range of factors lie behind this structural feature of the world economy. One is that for many economies, including much of Europe and Asia, growth is fuelled by exports to the US, which results in current account surpluses and flows of capital back into dollars, in turn financing consumption in the US.

A gradual adjustment path out of this situation would require an increase in demand in the rest of the world and a decrease in US demand, associated with a significant depreciation of the dollar and a long-term correction of the large negative US debt position and its current account deficit.

The alternative to gradual, policy-induced adjustment is the build-up of the present unsustainable imbalances which carries the risk of an eventual "sudden stop" correction and slower growth across all economies.

The flow of capital into the US economy over the years has also contributed to low interest rates throughout the global financial system. Risk premia on emerging market assets and interest rates in emerging capital markets are low by historical standards. This means that there is little room for easing monetary policy in the event of a crisis, and that the build-up of credit to relatively unprofitable activities and to finance consumption may prove unsustainable.

But thus far, global growth has remained strong, and the pattern of growth – particularly the continued buoyancy of commodity prices – has been broadly favourable for the South African economy.

We need to be concerned, however, about two aspects of the current trajectory of South African growth. One is the exceptionally fast pace of credit expansion in the economy – including both household credit to finance consumption and rising debt levels of non-financial businesses. The second is that despite higher export prices, our overall mining production has been sluggish, and investment in new output capacity remains disappointing.

Participation in international institutions and regional development

Madam Speaker, let me draw attention briefly to several international aspects of our work in the Ministry of Finance, before turning to the policy implications of the current global environment.

The challenges of growth and development continue to be a central focus of our participation in multilateral initiatives. Forums in which we play an active part include the Southern African Development Community, NEPAD and the Growth Commission initiated by the World Bank. Strengthening Africa's representation in the International Monetary Fund, reinforcing the capacity of the African Development Bank and further work on debt reduction and improving the coordination of aid and development finance internationally are key priorities.

Statistician-General Pali Lehohla and Statistics South Africa are working with other countries through the Economic Commission for Africa to improve the calibration and measurement of social and economic trends across the continent.

Commissioner Gordhan leads the World Customs Forum, and our Revenue Service increasingly is involved in initiatives to strengthen tax collection capacity in other countries and to improve coordination between revenue authorities worldwide.

Through the Collaborative African Budget Reform Initiative, amongst other forums, we play a supportive role in improving budget systems and public finance management in our continent.

The South African presidency of the Financial Action Task Force (the international standards-setting body for anti-money laundering and terrorist financing) comes to an end this month, a task assigned by Cabinet to Prof Asmal. Under his exacting stewardship, a process has been initiated to raise the profile of a perspective from the "South" – issues related to illicit financial flows that matter to poor and developing countries.

Next year, South Africa will host the annual conference of the International Corporate Governance Network.

We will also host the G20 Finance Ministers and Central Bank Governors in 2007, providing a special opportunity to address pressing issues of mutual interest to developed and developing nations.

Fiscal and monetary policy implications

Madam Speaker, the potential for a sharp unwinding of the global imbalances and decline in commodity prices reminds us that in all financial crises the poor suffer most because there are few economic insurance mechanisms in place to help them with the income losses they experience.

With this in mind, our policies are partly aimed at reducing vulnerability to the more uncertain global environment and addressing the domestic imbalances created by the commodity price cycle.

An important element in this policy stance has been the Reserve Bank's programme of foreign exchange accumulation, bringing the gross reserve position to over US$23 billion. This precautionary strengthening of the nation's reserves reduces our vulnerability to financial uncertainty, taking into account the instability and unpredictability of portfolio capital flows and currency movements.

The fiscal policy response to high commodity prices and associated revenue flows is also important to consider. Commodity producing countries are obliged to use windfall gains from high prices to build budget surpluses, which can then be wound down over time to finance social and economic infrastructure and provide fiscal space for counter-cyclical demand management when prices fall.

The current fiscal environment in South Africa is one of exceptional buoyancy. Real growth in government expenditure after debt costs has averaged some 9 per cent a year over the past three years, and will rise by a further 8 per cent in 2006/07, averaging over 6 per cent over the MTEF period. However, we have seen a rise in underspending in some areas of public service delivery and infrastructure investment, signalling the need to address capacity constraints alongside continued budget increases.

A greater focus on ensuring that expenditure takes place according to plan is part of our current response to favourable fiscal circumstances, and reprioritisation must continue to direct resources to their most effective uses. The Treasury's fiscal policy and budget planning work is aimed at sustaining and enhancing long-term growth and development, and broadening participation in social and economic opportunities.

Better statistics for growth and development

But this work, Madam Speaker, relies critically on better measurement and better information.

This is the central mandate and responsibility of Statistics South Africa. As set out in the vote 13 summary in the Estimates of National Expenditure, there are four key objectives:

- To provide relevant statistical information to meet user needs;
- To enhance the quality of products and services;
- To develop and promote statistical coordination and partnerships; and,
- To build human capacity.

Statistics South Africa has set itself several strategic targets for the MTEF period ahead.

A primary focus area – recognising that statistics are neither perfect nor complete – is to maintain and restore trust in official statistics through improving the measurement of key indicators of economic performance, trends in prices, employment and job creation, life circumstances and service delivery and demographic and population dynamics.

Secondly, efforts will continue to be focused on building and strengthening our statistical infrastructure which forms the architecture on which all surveys are designed and conducted. Key initiatives include the development of an integrated business register, and compilation of a physical dwelling frame or address register.

Thirdly, it is important to create a professional organisation capable of meeting the increasingly complex challenges of statistics collection and analysis. Over the period ahead, we will see the establishment of an internship programme, initiation of a statistical training institute and embedding the international learning programme throughout the organisation.

We have also agreed on three key projects to be delivered during 2006/07.

The 2007 Community Survey

The first is a major Community Survey, to be conducted in place of the population census that was scheduled to take place in 2006. It will provide information at lower geographical levels than existing household based surveys, and will also contribute to building capacity ahead of the planned 2011 full population census.

The Community Survey will be conducted in February 2007 and will collect information from approximately 280 000 households over a period of six weeks. The results will be presented in November 2007. Approximately 20 000 fieldworkers will be employed, and the survey will provide information across several key social and demographic indicators aimed at measuring our progress towards the achievement of the Millennium Development Goals.

The data processing phase for piloting this survey is complete and the data quality assurance (QA) and editing work was completed at the end of May. Internal tabulation and analysis is underway and the two processes are planned to be completed by the end of June. A complete system debriefing will then be undertaken in August to inform the main survey in 2007.

The Community Survey will cost R 370 million in 2006/07 and R 102 million in the 2007/08 financial year.

Re-engineering the Labour Force Survey

The second major project this year is re-engineering the labour force survey.

This will provide more robust measurement of the dynamics of South Africa's labour market, the survey will be conducted quarterly instead of every four months, with results released after four weeks, and the content will be focused on critical labour market trends, in line with international practice. Research, design and development work will proceed over the year ahead, and the new quarterly survey will be launched in January 2008.

Income and Expenditure Survey

Thirdly, Stats SA is conducting an Income and Expenditure Survey (IES), with a particular focus on the spending patterns of South African households. Officially launched in September 2005, the IES is a 12 month survey of 24 000 randomly selected households from 3000 Primary Sampling Units across the country. Its main purpose is to update the basket of goods and services for the Consumer Price Index, and it will also provide important information on living conditions and poverty. Data collection of the IES will be finalised by September 2006 and processing by February 2007, and the survey will in future be conducted every three years.

Better statistics, Madam Speaker, are a critical resource for government planning and management of service delivery, are a key service to the wider public and community users, and most importantly are central to Parliament's understanding and oversight of our economic and social progress as a nation.

Key initiatives of the SA Revenue Service

Let me turn to key initiatives of the South African Revenue Service for the period ahead.

Small Business Amnesty

Since the announcement of the small business amnesty in the Budget Speech in February 2006, we have concentrated on getting the enabling legal framework in place and, most importantly, engaging with and listening to small business, including the taxi industry, and consulting them on the envisaged legislation.

The consultative process is wide ranging. Over the past few weeks there have been meetings with representatives and leaders of national, provincial and local organisations of small business and the taxi industry. Very constructive meetings have taken place with the SA National Taxi Association and further meetings will take place with the National Taxi Association.

I am pleased with the valuable guidance and feedback we have received. These will be taken into account when we finalise the Bill which the parliament committee is considering at present.

The Revenue Service will ensure that the great need for education, information and assistance that is being requested by small business will be addressed. Much work has already been done in this regard; and will in due course lead to the establishment of localised structures and processes to ensure sustainability and permanence as we move towards real partnerships with small business.

Tax and Customs Practitioners

Equally important, Madam Speaker, is the role and influence on our tax system of tax and customs practitioners. The integrity, professionalism and quality of the intermediaries are essential to our drive to create a sustainable culture of compliance in South Africa.

The public seeks their help for tax advice and preparation of returns and many take their guidance from the tax and customs practitioners on what is legally acceptable or not. These tax and customs professionals have a direct impact on taxpayer and trader compliance.

We view them as vital partners in strengthening South Africa's fiscal citizenship. We also believe that we can assist by continuously improving the service we offer and by making every effort to reduce red tape and compliance costs.

I am, therefore, pleased to announce that SARS will be launching a program to provide better accessibility and responsiveness to tax and customs practitioners. In the next few months SARS will engage with representative organisations to better understand their needs and tailor our service to best respond to these needs.

Among the initiatives being considered are: determining the preferred channels; the creation of dedicated access facilities; significantly increasing the number of filings and payments done electronically; and finding collaborative ways of reducing compliance costs.

We invite the representative organisations to join us in raising the integrity and standards of professionals in South Africa.

The General Anti-Avoidance Rule

Throughout this year, we have been engaged in an extraordinary dialogue with taxpayers and practitioners regarding the need for a new, stronger and more effective General Anti-Avoidance Rule. The protection of the tax base is a matter of fundamental fairness. It is also essential element in achieving fiscal independence. The debate has been extensive, vigorous, professional and constructive. There have been important points of agreement on the one hand, and points of disagreement and concern on the other – especially in connection with the unintended impact the new legislation might have upon legitimate or innovative business transactions. We will be releasing revised proposals in the near future for additional comment. The final draft will then be included in the Revenue Laws Amendment Bill that will be introduced in Revenue Laws Amendment Bill that will be introduced in Parliament later this year.

Green Paper on Customs Modernisation

Last year I alluded to the fact that the time was ripe for an overhaul of customs policy to ensure custom's alignment with Government's developmental aims and important international developments. Developments in the World Customs Organisation, the World Trade Organisation and SA's bilateral trade negotiations require a review of Customs policy and capacity. In addition, there are also new dangers facing SA in the form of illegal trafficking of prohibited goods, international crime, smuggling of cigarettes, drugs, counterfeit goods and other commodities, and money laundering.

South Africa's Customs capability must be both modernised and significantly increased if we are to both optimally facilitate trade to exploit trade opportunities unleashed by globalization and ensure better security of the trade supply chain and protection of our economy.

Today I have pleasure in announcing that we will shortly release a Green Paper on Customs Modernisation intended to initiate an inclusive and robust nationwide debate on the future role of customs and a collective commitment to the successful implementation of customs modernization. I also see this as an historic opportunity to forge a strong and sustainable partnership between all stakeholders and Government.

The challenge ahead of us is to ask the question: How best can Customs serve our country's importers and exporters and thereby contribute to economic growth? Our new customs policy has to help SA's exporters and importers engage in international trade and help grow our economy with both greater ease and better security.

National Treasury's role in enhancing public finance management

Madam Speaker, I spoke last year at this time of the challenge we face in strengthening the quality and effectiveness of public service management and delivery, and the importance of Parliament's oversight role in this regard. The Treasury's work on budget reform, monitoring and evaluation and improving financial management is focused on this challenge.

There is still much to be done, but over the past year we have seen considerable progress. Consolidated expenditure reports show that capital spending and infrastructure maintenance have improved markedly, and we are now seeing the fruits of better information flows, both on financial trends and non-financial data on service delivery. Quarterly financial reports and service delivery information published by the Treasury has contributed, for example, to the quality and relevance of public hearings on education, health, social development and other critical provincial functions. The National Council of Provinces should be commended for this initiative, and I am confident that this enhancement of public accountability will play a significant role in encouraging improvements in service delivery in the years ahead.

The Public Service Commission, in its recently published 2006 State of the Public Service Report, correctly notes that we have in place "sound legislation, regulations, systems and procedures…," but "what needs to be done now is to undergird the Public Service with the appropriate capacity that is critical to ensuring the alignment of its service delivery and sharpening its effectiveness." This is a theme that challenges all of us – in Parliament, in the executive and in every part of the national, provincial and local tapestry of government agencies and programmes. I would like to highlight just a few of the specific initiatives of the National Treasury focused on this objective over the period ahead.

Infrastructure delivery improvement

The Treasury vote includes R15 billion over the next three years in support of provincial infrastructure investment. The House may recall that at the time this grant was introduced, provincial capital expenditure had fallen to just 3 per cent of total provincial expenditure. It has increased to about 10 per cent of provincial budgets now, steadily contributing to better maintenance of schools, clinics, hospitals and provincial roads, in addition to continued investment in housing and municipal infrastructure.

The Treasury plays an active role in capacity building through the Infrastructure Delivery Improvement Programme, which is a targeted technical support initiative focused on critical engineering and contract management skills and systems. In cooperation with the Construction Industry Development Board, a standard toolkit has been developed to assist in project management, diagnostic support is provided to identify bottlenecks and system failures and infrastructure planning and monitoring systems are implemented. Over the past year support has been provided to the nine provincial education departments, contributing to an 18,5 per cent increase in capital spending in 2005/06. The programme is currently being extended to public works and health departments.

Other aspects of infrastructure development will also enjoy sharpened attention over the year ahead. The Public-Private Partnership Unit has stepped up its training programme, with particular attention to developing parallel capacity in provincial treasuries. Systems and procedures for evaluation and appraisal of large infrastructure projects are the focus of a new working committee, also including provincial treasury representatives. This initiative focuses on the quality of information required for major infrastructure project planning and decision-making, within the context of our accelerated economic growth objectives, the need to prepare for hosting the 2010 World Cup and the importance of improving the design and maintenance of transport, communications, energy and water supply networks.

Municipal finance and investment in local development

Now that the Municipal Finance Management Act is in place, local government financial reforms and capacity building are under the spotlight. As with the implementation of the Public Finance Management Act in national and provincial departments, the emphasis in the initial years is on building appropriate institutions and capacity, training, guidance and technical support.

The Treasury has published over 20 circulars which give guidance to municipalities on budgeting, accounting systems, procurement and other aspects of financial management – so that municipal councils have suitable instruments at their disposal to hold their executive and management teams to account for the resources and services for which they are responsible.

In relation to capacity and training, work is in progress on a framework of formal qualifications for municipal financial management from entry-level to post-graduate standards. Currently, over 500 graduates are working in over 120 municipalities under the internship programme funded by the Financial Management Grant on the Treasury vote. Allocations of these grants will go to all 283 municipalities over the MTEF period ahead, contributing to meeting specific capacity building needs in each local authority while also supporting a coherent national programme of financial systems development, implementation, training, monitoring and evaluation.

Support for large municipalities through the Restructuring Grant continues over the next three years, and will be concluded in 2008. These allocations will be merged into the local government equitable share in the outer years of the MTEF.

Madam Speaker, I indicated in February that a new allocation in support of local public-private partnerships would be phased in this year, financed in part through the proceeds of the exchange control amnesty levy collected over the past three years. An initial call for proposals for the Neighbourhood Development Programme Grant resulted in 162 applications from 41 municipalities, and the first allocations will be made during the course of the next six weeks. The aim of this programme is to bring private sector investment in commercial, recreational and community services into historically under-served township residential areas – creating business and employment opportunities alongside improved services to local residents.

I need to emphasise that this is not an alternative source of funding for the bulk infrastructure and basic service delivery responsibilities of municipalities – these are already supported through the local government equitable share and the municipal infrastructure grant. The Neighbourhood Development Programme is for interventions that will be innovative and qualitatively different. It is about developing precincts that combine administrative and social service delivery with retail and commercial services; it will include support for several new multi-purpose community centres; it will include co-financing arrangements for infrastructure investment and improvements that contribute to local economic development and job creation.

We have received new ideas and detailed plans for such diverse communities as Tembisa, KwaThema and Kwatsaduza in Ekurhuleni, the Swalala and Kanyamazana precincts in Mbombela Munipality in Nelspruit, Mthonjaneni in KwaZulu-Natal – even a proposal for a “tri-district alliance” between the Northern and Eastern Cape and Free State provinces for a Gariep Tunnel Festival. Some of these proposals will need further refinement, but the prompt response of so many municipalities is a clear sign that the time has come for a major programme of shared public and private sector investment in improving the quality of life in low-income neighbourhoods.

The Public Investment Corporation

Alongside these direct initiatives, Madam Speaker, there is also the indirect contribution to local and regional development associated with sound trusteeship of public funds.

The Public Investment Corporation continues to be a formidable force in the South African investment landscape with close to R600 billion worth of assets under management.

Its portfolio include bonds, equities, properties and the Isibaya Fund which is a private equity fund focused on black economic empowerment. Two new initiatives deserve special comment.

Pan African Infrastructure Development Fund

We have to recognize that Africa's growth and development requires a renewed focus on development of the continent's infrastructure. The Pan African Infrastructure Development Fund will focus on attracting pension funds from the African continent, to invest in a 25-year infrastructure equity fund.

The infrastructure backlog on the continent is huge and it is clearly right that Africans should engage the challenge. Targeting the top 10 African pension funds suggests that the fund should be able to achieve a first closure of the fund with at least $1 billion of commitments by the end of the fiscal year.

An office has been established and a team put together to raise these commitments of $1 billion. International pension funds will be targeted for a second closure of the Fund which should bring total committed funds to about $3 billion.

The initial focus of the Fund will be transport infrastructure, energy, water and sanitation and telecommunication infrastructure investments. It will focus on projects that can contribute to regional integration of the continent and that will have regional impact.

Project Rural

Secondly, the PIC has created "Project Rural". This is the largest direct property investment fund focusing on township and rural shopping centres in South Africa. It has been achieved through the merging of the Community Property Fund, a well-established property fund, whose investors are union and parastatal pension and provident funds, and the retail properties owned by the Government Employees Pension Fund.

The fund has a combined asset value of R1 billion and is at the forefront of township and rural developments, with projects in the pipeline which will double the size of the fund over the next three years. This initiative clearly complements and support Government's broader urban renewal and rural development programmes.

Financial Intelligence Centre

I should also update the House on progress of the Financial Intelligence Centre. Its systems and procedures are beginning to yield positive results:

- The reports from accountable institutions are flowing in steadily;
- Institutions are enhancing their "Know Your Customer" obligations and other compliance requirements;
- Law enforcement shows steady improvement in financial investigations and an increase in money laundering prosecutions.

During the past financial year the FIC received a total of 19 793 Suspicious Transaction Reports (STRs), bringing the total to date to 44 021. This is an indication that the reporting systems are working, largely due to the seriousness with which the banks and other financial institutions have taken on their responsibilities.

However, there are several sectors which need to demonstrate further compliance. For example, the FIC will be closely scrutinising the casino and gambling sector and estate agents in the coming period.

The FIC will also be building even closer working relations with the supervisory bodies (such as the Banking Supervision Department of the SARB, the Financial Services Board, the National Gambling Board, et al) to ensure that an even and coordinated approach is taken to monitoring compliance. Consideration is also being given to ways in which less costly and more efficient ways to implementing “Know Your Customer” processes can be implemented.

The legal framework to strengthen oversight mechanisms must be examined and improvements made where necessary to facilitate measured responses aimed at remedying instances of non-compliance. Matters to be investigated include

- adequacy of the scope of supervisors' functions and objectives to include compliance with money laundering/ terrorist financing controls,
- expanding mechanisms to monitor compliance levels,
- expanding range of sanctions available to address compliance failures in order to improve flexibility and ability to select the most appropriate response for a particular situation,
- establishing the administrative structures to enable the functioning of these mechanisms.

Conclusion

Madam Speaker, the activities of the Finance Ministry and the departments and agencies under our oversight are wide-ranging and challenging. Deputy Minister Moleketi will elaborate on several important financial sector reforms, and the finalisation of the work of the Amnesty Unit. Let me, in conclusion, highlight several shared themes in all of this work:

- Institution-building is at the centre of our activities. This is not just about the organisations that report to the Ministry of Finance and their development, but is also about the larger challenge of institution-building, sound financial management and governance, right across the public sector and the economy more widely.

- The social and economic imperative that is the driving-force behind our activities is the construction of an integrated, equitable, shared economy, broadening participation, and opening up opportunities for all. This shapes what we measure, how we engage with taxpayers, what we plan to spend, how we aim to reform and transform the financial sector and its role in economic development.

- The quality and integrity of our work, the professional standards to which we aspire, remain paramount.

- Our activities are organised around clear objectives, and disciplined by targets and deadlines. The budget date, agreed with this House, is itself a most powerful discipline over all of us.

- Our work is increasingly broad in its scope – national and regional concerns, and international engagements shape our ideas and duties – but our progress towards accelerated growth, reconstruction, development and eliminating poverty is the foundation on which our activities rest.