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Address to the International Monetary Conference

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Minister of Finance

Trevor A Manuel, MP

Mr Walter Kielhoz
Our host Mr Jaco Maree
Distinguished guests
Ladies and gentlemen

Thank you for inviting me to address the International Monetary Conference. This is an intimidating forum with so many bankers, the custodians of so much of the world's savings, the providers of such a large range of financial services to clients ranging from governments to multilateral institutions, multinational corporations to the corner café, investment banks to the guy selling newspapers on the street corner. The process of evolution away from simple barter economies to cash, from hoarding monetary value under mattresses to putting money into a bank, from signing a cheque to entering a pin code is still very much work in progress. The process of financial deepening, with increasingly sophisticated products offered through increasingly diverse mediums is happening apace. For this reason, the banking system and banks in general have become an integral part of the genetic architecture of our economies and our societies.

It is a privilege to be able to talk to you today. You were addressed by President Mbeki on Sunday and he dealt with the complex processes of growth, development, and globalisation in the context of our shared humanity and an increasing interconnectedness. He also made mention of the contradiction between what are clear successes in growth and development alongside rising inequality, both in terms of income and wealth and in terms of opportunity.

I would like to talk you through a bit of our recent history with respect to economic policy. Today, South Africa is growing at about 5 per cent a year, a rate we've been able to sustain for over three years now. We now have rising employment, increasing living standards, sound fiscal management, a strong financial sector, robust and respected monetary authorities and strong institutions of oversight, regulation and law. How did we get here, what was the path that brought us to this point, and what are the prospects for growth and development going forward?

In answering these questions, my intention is certainly not to give you the impression that everything is fine in our economy or that we have reached the promised land. We still have huge economic and social challenges ranging from high levels of unemployment and inequality, we are still not creating jobs at a satisfactory pace and we still have institutional weaknesses in our ability to repair the myriad of microeconomic weaknesses that still hobble our economy. Nevertheless, it is important for the international financial community to understand these challenges and to understand the success factors.

Last year, the South African economy grew by 5 per cent, the highest rate of economic growth in 25 years. After years of rising unemployment, the unemployment rate has declined for three years in a row, with over a million jobs created in this period. All the major indicators of economic growth are showing that the present economic boom represents one of the longest sustained increases in income in about 40 years. What started off as a consumption boom has quickly translated into an investment boom, with private sector gross fixed capital formation now standing at its highest level since our records began, probably sometime in the 1950s.

This growth has been relatively broad-based with the share of income going to Africans rising to above 50 percent in 2005, from about 40 per cent in 1996. The number of black people entering what is called 'the middle class' increased by 30 per cent in a single year to 2.6 million last year. This represents a substantial shift in the purchasing power in South Africa towards the historically disadvantaged. According to a study by the Department of Trade and Industry, the number of small businesses has grown by 150 per cent since 1995 and 87 percent of these businesses are black-owned. The list of economic performance and confidence indicators runs a long way.

Our present economic performance is due to two main factors. Firstly, over the past decade, we have pursued policies that have put the economy on a sound footing, where it is able to grow faster, sustainably. Secondly, high commodity and a favourable international economic environment have benefited the South African economy, at a time when we have opened up our economy.

In the present mood of optimism in the economy, it is difficult to imagine a time when the economy was much weaker, literally on its knees, I would argue. In 1994, we inherited an economy from the apartheid government emerging from a deep recession. In the decade prior to 1994, the economy grew by just 1 per cent a year. Investment levels had fallen, money was leaving the country at a phenomenal rate and the agricultural sector was recovering from one the worst droughts in decades. The country's public finances were in a shambles, government was running a deficit of over 7 per cent of GDP and interest costs were approaching 20 per cent of the budget. Inflation was in the high teens and we had almost zero foreign exchange reserves.

The banking system was strong, but relatively small and isolated from the rest of the world. It served a small elite and it did this remarkably well. Millions of people, working people, did not have access to banking and financial services. Worse than all of these factors, we had a business community that was convinced that the new government would run the economy into the ground. This concern was so strong that President Mandela took the step of appointing as Finance Minister the same person who served immediately prior to our first democratic elections. When he resigned shortly thereafter, a person from the banking sector, well known to business, was appointed as Minister of Finance. In today's context, this seems an unusual step, but it reflected how seriously government took the negative perceptions about its ability to manage the economy.

When many of us were negotiating with the previous government prior to the 1994 elections, we were led to believe that the civil service was an organised, sophisticated machine able to implement the programmes of government. By 1996, this myth was shattered. We found a civil service that was inept, and lacked the capacity to deliver government's reconstruction and development programme.

An analysis of the economy showed that the problems were not just cyclical. The economy was in a deep structural decline and that this decline began in the late 1970s. Formal sector employment was stagnant from the mid-1980s. Early signs of trouble appeared in 1996 when a series of rumours around President Mandela's health led to a fall in the currency. After a few months, the currency fell at the drop of a hat. Continuous capital flight meant that South Africa faced a severe balance of payment constraint. Ironically, today, even with a current account deficit at 6 per cent of GDP, capital markets are still willing to invest in our country.

South Africa was trapped in a boom-bust cycle. Any increase in economic growth or in investment led to a rise in imports. A lack of confidence in capital markets led to a fall in the currency. Partly to stem capital flight and partly to reduce inflation, interest rates had to be set at very high levels, further constraining economic growth. South Africa's savings rate fell below 15 per cent of GDP partly as a result of a rising tax burden and a large government deficit. In 1996, government was borrowing almost R1 billion a week.

On entering government, we soon realised that small adjustments were not going to be sufficient to right the ship. Fundamental changes were needed to ensure that we generated the resources to implement government's social and developmental programmes over a long and sustained period. In 1996, we launched GEAR – the Growth, Employment and Redistribution strategy. GEAR set out a range of policies covering fiscal policy, the labour market, education, skills development and trade. There is little disagreement that GEAR presented a difficult set of reforms for the economy. In essence, GEAR was aimed at putting the public finances on a more stable footing, reducing the costs to business, reducing interest rates through lower inflation, increasing investment in education and in infrastructure.

In a short space of time, we stabilised the public finances. We introduced inflation targeting, providing a clear anchor for monetary policy. A smaller deficit and lower inflation expectations played a key role in reducing interest rates, and lower interest rates have been essential to the present boom we are experiencing.

Through better revenue collection, government was able to reduce tax rates on both individuals and companies. It is worth reminding people that in 1994, the company tax rate in South Africa was 40 per cent, the secondary tax on companies rate was 15 per cent and the top marginal tax rate for individuals was 43 per cent. In 1995, the secondary tax on companies rate was raised to 25 per cent. By 2005, all of these rates were substantially lower. Lower tax rates, especially for individuals, are one of the reasons for higher consumption and investment spending that we are seeing today.

Improved revenue collection and better control over spending led to a fall in interest payments. However, this only started to happen about five years after we began cutting the deficit. Falling interest costs has allowed government to increase spending rapidly without raising taxes or borrowing more. Since 2000, public spending has risen by over 70 per cent in real terms. In a short space of time, we have increased the number of social grant beneficiaries from about 3 million to almost 11 million. We are now able to spend billions more on infrastructure, and have in many cases surpassed the targets we set for ourselves in 1994. Another factor contributing to the present rate of economic growth is the rising infrastructure spend of government, totaling R415 billion over the next three years.

Increased confidence in our economy means that we do not face a binding constraint on the balance of payments. We are now comfortably able to finance a much higher level of investment, providing the space for future growth. South Africa received R144 billion in capital inflows last year.

Presently, the surge of growth in the economy is leading to some supply constraints. This in itself can be a positive thing. It provides investors with clear signals of where investment opportunities are to be found. The public sector has a role to play in alleviating capacity constraints.

Areas where government is now focusing on include skills development and investments in the built environment covering amongst other sectors housing, public transport and water. For South Africa to sustainably grow faster, we must improve our export performance, especially in non-commodity sectors.

The financial sector was one of the first sectors to adopt a collaborative process to deal with the issue of our historically skewed ownership structure. An innovation in South Africa at the time, the financial sector came together with all major stakeholders and agreed to tackle empowerment issues in a multidimensional approach. The Financial Sector Charter was signed committing all participants to increase access to financial services, especially to the poor, to broaden ownership to include historically disadvantaged individuals, to invest in staff development, especially for black women and to invest in transformational public projects in townships such as transport, housing and retail developments. This charter is an example of how empowerment can be interpreted in a way in which all parties win.

The banks came together to introduce what we call the Mzansi account, targeted at low income people and providing certain basic services at low cost. To date we have over 3 million Mzansi account holders, notching up a major success in broadening access to financial services to low income people. Despite these successes, high banking charges are still an obstacle to even faster growth in the retail banking sector.

Economic policy has changed and evolved continuously since 1994, but the key objective of reducing poverty and raising the living standards of the poor has been a consistent one. Economic policy is about careful analysis to identify problems and develop targeted responses to fix them. As a country, we have shown that through partnerships, we can solve our problems. The financial sector has been a solid partner in many of our endeavours.

The economy is performing well, but we still have millions living in poverty and many more unable to get jobs. We cannot be satisfied with our performance until we have made a bigger dent in unemployment and poverty. We are not yet there…but we still have much to be proud of what we have achieved in such a short space of time.

I hope you enjoy the rest of the conference and get a chance to sample the warmth and hospitality that this city has to offer.

Thank you.