MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA

Thanksgiving Day speech to the American Chamber of Commerce in South Africa

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Pravin Gordhan,

Minister of Finance

Republic of South Africa

Ambassador Donald Gips,

American Chamber of Commerce President Douglas Franke,

Master of ceremonies Chose Choeu,

Ladies and gentleman,

Thank you for inviting me to share your celebration of Thanksgiving with you!

Just as you celebrate triumph over adversity, the globe is not yet sure if it has overcome the adversity imposed by the recession on all parts of the world. Just as President Lincoln's declaration of Thanksgiving almost 200 years ago as a celebration of family, community and national solidarity, so the present requires us to demonstrate extraordinary solidarity with families, communities and nations in distress as a result of the recession.

We meet at a time of great challenges and uncertainty. The global economy has reached a nadir, but with the first signs of recovery evident. Economic growth has resumed, in both the US and South Africa, during the third quarter.

Yesterday's GDP data showed South Africa has exited its recession, growing at an annualised rate of 0.9%. Economic activity expanded in manufacturing, construction, government and some services, but trade and finance continue to contract, albeit at a slower rate. The economy is benefiting from a countercyclical fiscal policy, supported by the sound fiscal position prior to the crisis that has enabled government to sustain public services and expand investment through the recession. Interest rates have been cut by 500 basis points to support growth and today we hear that inflation has fallen below 6%, within target for the first time since March 2007. South Africa's appeal to international investors is evident with almost R100 billion in capital inflows this year.

These signs of improvement and confidence in the domestic economy are encouraging, but there are many important challenges facing South Africa's recovery. As in other countries, employment has fallen significantly. Almost a million South Africans have lost their jobs since the start of the year. These are the very real and human costs of the crisis. We must face this challenge head on and find ways to increase labour absorption in the economy.

At the same time the implication of the current "carry trade" is a matter of concern in South Africa and elsewhere. As the global recovery strengthens and growth returns, our uncertainty arises from the shape of the world economy that is unfolding during and after the recovery. It will be a world that exhibits more plurality in the number of countries that are able to link good economic policy to good growth rates to rising living standards to effective political voice in the international community.

But it also may be one in which the global economic powerhouses of the last decade, the United States and China, remain constrained by the build-up of imbalances that were the very symbols of their rapid growth. In addition, the inequalities and imbalances between the developed and developing world have become accentuated and require urgent attention.

The correcting of the global imbalances may take longer than we expect, and may be accompanied by volatility across a range of indicators that matter for global economic growth. This trajectory will be complicated by the task of reversing the extraordinary fiscal and monetary measures taken by many countries to allay the global recession.

There are also considerable challenges in respect of financial markets. The crisis exposed inherent problems in the models and regulation of the global financial system. The efforts of the G20 are directed at upgrading national regulatory frameworks, and strengthening institutions and cross-border regulatory arrangements through creating more formal mechanisms to co-ordinate the work of regulators across borders. This is the work assigned to the Financial Stability Board.

What we don't know is whether these efforts will be sufficient to allow the socio-economic benefits of creativity in the financial markets, and ensure that the all-too-frequent tendencies toward herd behaviour, irrational levels of leverage, and deceit, are minimised. For many economies, including here in South Africa, financial market activity has grown enormously. And while this brings a range of important benefits, the collapse of asset values can, and have caused social and economic destruction few political systems can survive unscathed.

This gives rise to my final challenge and uncertainty. That is, how will emerging market and developing economies address the policy challenge of reinvigorating economic growth in the short-term while sustaining progress on longer-term growth?

Economic growth in the developing world

Much has happened in the last two years to bolster the view that the current recession, emanating from imbalances in advanced economies, is a temporary but painful obstacle to robust future growth in emerging markets and the developing world.

We have seen significant, but not yet adequate, reforms in the IMF and the World Bank that make them more able to assist the developing world. But much still needs to be done by these institutions to change their approach to and relationship with developing countries.

Over the next few years it is critical that multilateral and bilateral donors assist countries in improving their administrative capacity to manage tax revenue and develop their tax base.

For some African countries foreign aid is as high as 40 to 70 percent of public spending. Between 1980 and 2006, the net aid inflow to Africa (including debt relief) increased five-fold, remittances increased nine-fold and foreign direct investment increased fifty-fold. The average tax to GDP ratio in Sub-Saharan Africa increased from less than 15 percent in 1980 to more than 18 percent in 2005, but virtually the entire increase came from taxes on the natural resources sector, such as mining and oil companies. The revenue collected from other sources increased by less than 1 percent of GDP over 25 years.

Last week the African Tax Administration Forum was launched in Uganda. South Africa is the first chair of the Forum, and has worked with several African countries and developed country partners to establish the Forum and build the capacity of tax administrations.

Stable revenue flows will ensure stable public spending and less variable fiscal and tax policy. Sustaining economic growth, the creation of new firms and rising income levels, are critical ingredients for growing markets.

Tax systems are also proving to have an important role in helping to regulate financial market activity. New approaches to transparency in markets are needed and these are expected to shed light on riskier practices, and assist regulators in weighing risk across the range of previously unregulated products and activities. Tax authorities met recently in Beijing to discuss how reforms in transparency and tax havens, and secrecy rules or banks can be enhanced in order to curtail illegal activity.

Trade protectionism is a serious risk to global economic growth. South Africa's exports and imports are expected to decline by roughly 20 per cent in 2009 compared to 2008. How much is there to lose from a rise in protectionism? Quite a bit as it turns out. Exports to the US from Sub-Saharan African economies and from South Africa are equal to 8.7 and 3.6 percent of their respective GDPs. Fostering improved trade relations between the US and South Africa will be important and efforts should be made to develop a better bilateral trade agreement.

US total trade, imports and exports with Sub-Saharan Africa, reached US$104.6 billion in 2008. The US trade deficit with Africa was about US$67.5 billion in the same year. Nigeria, Angola, the Republic of Congo, South Africa, Chad, and Equatorial Guinea accounted for 97.2 percent of the U.S. trade deficit with Sub-Saharan Africa in 2008.[1]

Enhancing fair and balanced trade is essential to growing incomes and ridding the developing world of poverty. As Michael Spence's Commission on Growth and Development pointed out, the countries that have grown rapidly and sustainably for long periods have been those that have exploited the global economy – they have embraced the need to become productive enough to compete successfully in the vast global marketplace.

Economic growth also derives from investment, of course, and the Spence commission made much of the role of foreign direct investment. U.S. affiliated companies in Africa in 2006 reported estimated total assets of $116.6 billion, including $28.3 billion in

[1] In 2008, U.S. imports under the African Growth and Opportunity Act (AGOA) were
$66.3 billion, 29.8 percent more than in 2007. The top five AGOA beneficiary countries included Nigeria, Angola, South Africa, Chad, and the Republic of Congo. Other leading AGOA beneficiaries included Gabon, Cameroon, Lesotho, Madagascar, Kenya, Swaziland, and Mauritius.

Nigeria and $13.3 billion in South Africa. [2] U.S. affiliates in Africa attained worldwide sales of $70.9 billion, and net income of $14.6 billion.[3]

FDI was seen to be especially important for growth because it brings with it the knowledge that developing economies need to accelerate the process of growth. But FDI is not always easy to come by. Economic factors are critical but so is governance and institutional development. These tend to be the focus of work done by developing country governments to attract FDI. Economic factors are somewhat less tractable, but expanding public infrastructure is an especially important constraint to FDI in Africa. South Africa will play a more proactive role in collaborating on the development of the public infrastructure needs of the African market.

Economic growth in developing countries will need to centre more on developing local and regional markets, and on progress on the institutional capacity of governments to deliver better quality human, capital and network inputs. As you will see from our own commitment in South Africa, reducing corruption will play an important role in that process, especially where public procurement is a large part of the market. The business sector has a major role in combating corruption. For other markets, much greater efforts to increase the productivity of firms will be needed to increase the market share of local firms and increase employment and wages. These efforts must be backed up by public services that generate ever-better human capital.

Further challenges

Economic growth also has global dimensions affecting how countries can and will exploit the global marketplace. The need for many of the advanced economies to "exit" from their fiscal and monetary positions will tend to weigh on global growth, limiting the

[2] At year-end 2007, the U.S. direct investment position in Sub-Saharan Africa was $13.3 billion, 4.9 percent above the position at year-end 2006.South Africa ($4.8 billion), Mauritius ($2.9 billion), Equatorial Guinea ($2.2 billion), Angola ($876 million), Liberia ($456 million), and Gabon ($421 million) combined to account for 87.8 percent of the U.S. direct investment position in Sub-Saharan Africa.

[3] November 2008 *Survey of Current Business* (U.S. Department of Commerce, Bureau of Economic Analysis).

returns to developing country exporters, and increasing the intensity of competition in those markets. This is a matter of serious concern. The IMF and OECD forecasters expect the US economy to grow by 2.5 percent in 2010, yet high unemployment rates and higher levels of public debt suggest a slower recovery than any of us would like to see.

At the same time, we are more aware of new challenges, chief among them climate change, and how they affect our need for energy. It seems important to me that we begin to see more clearly how the short-term costs associated with climate change and energy supply should transform our economies in the long-run. This transformation is critical to thinking through the necessary private and public investments, and how such investments generate stronger economic growth now and in future decades.

New industries will emerge in the process and some of those that cannot survive without unsustainably low energy costs will begin to shrink. Part of our task as government is to ensure that growth can happen and that the path is smoothed, particularly by facilitating adjustment by incentivising it and offsetting some of its costs.

The global financial system

Let me turn now to the global financial system. Last year's global financial crisis saw the global financial system at the precipice. After the collapse of Lehman Brothers, pervasive uncertainty about the location and scale of losses resulted in domestic and cross-border liquidity drying up, credit markets seizing up and financial flows reversing resulting in highly volatile foreign exchange and liquidity flows. Despite virtually no exposure to sub-prime, South Africa was also greatly affected.

One of the key reasons for the crisis was failings related to effective co-ordination between different country regulators when supervising multinational financial institutions. Global governance around financial regulation was weak, insufficient to prevent the crisis and in dire need for reform.

Leadership through the crisis has come from the G20 – the group of the world's twenty most systemically important economies, which South Africa is a member of. In response to the crisis, the G20, through the Financial Stability Board is spearheading reform in the financial industry, promoting improved regulatory practices and preventative measures to reduce the probability of banking failures and systemic crises. In doing so, it is addressing many of the shortcomings of global governance and financial regulation that were important factors in explaining the crisis.

Important to reforming financial regulation is the move towards a macro-prudential approach to financial regulation. The previous approach that treated macroeconomic and financial stability separately failed to see the wider implications of rising risks in the shadow financial sector and failed to appreciate that economy-wide trends in credit growth, leverage and asset prices posed systemic risks. A macro-prudential approach focuses on identifying global macroeconomic and financial stability risks together.

The FSB has focused on strengthening the shock absorbers of the financial system and making the system more resilient. Under the auspices of the Basel Committee on Banking Supervision, this involves addressing capital and liquidity requirements that were, in general, woefully insufficient during the crisis.

New rules around the global capital framework will be phased in as financial conditions improve and economic recovery is assured, but will include:

- Raising the quality and level of capital held by banks to improve resilience,
- Reforming the Basel II capital framework to ensure that capital buffers are not pro-cyclical but rather countercyclical, and
- Given the damage created by leverage during the crisis, the introduction of a leverage ratio to supplement the Basel risk-based framework.

The extent to which global governance has failed is perhaps best illustrated in the raft of measures to improve regulation in the international financial system. The G20 progress report on Actions to Promote Financial Regulatory Reform details 58 items, many of which have a global dimension.

Conclusion

The global financial crisis and recession has reinforced the basic reality of globalisation – that our economies and our fortunes are inextricably linked. Advanced and developing economies, large multinationals and smaller local firms, are connected through a web of economic, informational, political, social and increasingly cultural ties that could be scarcely imagined 20 or 30 years ago. Some of these connections will change as the global economy recovers from our crises. And not all of those changes will be for the worse. There is much to reform and improve, in large measure to strengthen the ability of the poorer members of the international community to develop and realise a better standard of living. I am certain that you will work closely with us in coming years to achieve those common aims.

Thank you.