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ADDRESS BY THE DEPUTY MINISTER OF FINANCE: NHLANHLA NENE ON THE IMPACT OF THE BUDGET ON THE TRANSFORMATION OF THE ECONOMY

5 MARCH – BULL NOSE MAPONYA MALL SOWETO

Thank you for this opportunity – it is my privilege to be in your company and to address you this morning. Meeting here in Soweto in a venue like this is an indication of how much progress has been made in transforming this country.

Last week we were fortunate to be visited by the world-famous growth economist Paul Romer. In his lecture, Professor Romer made two important points: firstly, that even with all the right raw materials, countries with the wrong 'rules of the game' fail to grow and develop. If the economic rules undermine productive, private enterprise, and if the political culture rewards connections over competence, an economy with high growth potential can fail. Secondly, he made the critical point that the political culture and economic rules that dominate are not immutable laws. Through strong leadership, governments can choose to fix the way they do business, and to promote more inclusive development.

Ladies and gentleman, the new South African budget – the first budget of the new administration – is about changing the rules of the game, about setting a new development path, and about giving concrete meaning to the President's *Year of Action*. At the core of this new development path is a commitment to keeping the rules that work and changing the rules that don't. It is about maintaining macro-economic stability, introducing interventions to promote employment, and applying new tools for making government more efficient and accountable.

We have been living in an era of unprecedented general prosperity and global integration. Over the past 5 years South Africa has benefited hugely from this integration with high growth and healthy public finances.

But, as the financial crisis has shown, the hard-won gains of the past 16 years can easily be reversed. Over 900 000 people in South Africa have lost their jobs since 2008. Public finances have also been hard hit with the main budget swinging from a surplus in 2007 to an expected deficit of 7.3 per cent of GDP this year. After successfully reducing debt over the past 13 years, the debt level is expected to approach its 1996 peak in just 5 short years.

The global economic crisis has demonstrated that the old patterns of growth, income distribution, regulation and governance do not meet the needs of the world economy. The growing weight of China and India in international trade signals a change in the global economic balance. South Africa must compete on the global platform, where progress is registered through hard work, effective organisation and clear leadership.

Sound policy foundations

Let me start by discussing the rules that have worked and will continue to be implemented. The South African government has a solid record of macroeconomic management, with successive layers of reforms since 1994 contributing to significant redistribution of income, expansion of social infrastructure and the broadening of opportunities for the population.

The prudent management of the public finances over the past decade – signalled by the low level of public debt – enable South Africa to support demand in the economy by sustaining public spending and growing infrastructure investment despite a significant fall in tax revenue. Without these measures, the social cost of the recession would have been far higher. We also recognise that, over the medium term, a recovery in consumer demand and private investment, job creation, and careful management of debt and inflation pressures are needed to place South Africa on a new growth path.

South Africa’s national net loan debt is expected to rise from 22.7 per cent of GDP in 2008/09 to about 44 per cent by 2015/16 before stabilising. As the economy recovers, so too will revenues, but with a lag. Recent research has shown that countries with high levels of debt tend to grow more slowly. The large budget deficit therefore has to be reduced gradually, lest we become caught in a situation of rising interest payments, higher interest rates, higher taxes and slower growth. Ensuring an orderly decline in the budget deficit will require a more moderate growth in public spending.

Part of South Africa’s success over the last decade can be attributed to the stabilising influence of the Reserve Bank’s inflation targeting policy. This policy will remain in place, although we will establish and maintain an open dialogue on this policy stance with our social partners. Part of this dialogue will no doubt require the Reserve Bank to demonstrate that inflation targeting necessarily takes into account a broad set of factors such as growth, employment and exchange rates. Price stability is important to people who have an income that cannot be augmented by other means when things go bad. Keeping inflation low is also an important part of ensuring a competitive real effective exchange rate, but this alone cannot raise our productivity. Competitiveness is driven over time by improving skills, reducing the costs of doing business, more efficient logistics systems and higher investment, which I will discuss shortly.

There are also considerable challenges in respect of financial markets. For many economies, including here in South Africa, financial market activity has grown enormously. And while this brings a range of important benefits, the recent collapse of asset prices has caused social and economic destruction. The crisis has exposed inherent problems in the models and regulation of the global financial system.

South Africa’s banking system was relatively sparred the impact of the financial crisis. This was partly due to relatively robust financial regulations that discouraged investment in risky sub-prime assets. We will continue to ensure that the financial rules within which our banks operate allow us to integrate with the global financial system without unreasonably risking people’s hard-earned savings.

A new growth path

As South Africa emerges from recession, the policy focus is shifting from stabilising the economy to longer-term considerations.

Creating more jobs remains South Africa’s most critical challenge. There are far too many South Africans that do not work, with the bulk of the gains in national income inevitably going to those who are employed. Without higher growth and growth that is more inclusive, South Africa is not likely to address the high levels of poverty and inequality which persist 16 years into democracy. Over time, South Africa’s firms and factories, corporates and service providers, must absorb more labour, and include more people in economic activity.

The most significant rule of the game is that South Africa needs a more labour-absorbing growth path.

Equally important is ensuring that the workplace reflects the demographics of our society and that opportunities are afforded to black South Africans to have access to capital. Government needs to ensure that initiatives aimed at empowering black entrepreneurs are not abused and that these initiatives are readily accessible. It is my contention that black entrepreneurs have an important role to play in working with Government in creating a more inclusive society where people will no longer feel that they are at the periphery of economic landscape, but that they are part of the mainstream of economic activity. We have to ensure that broad-based black economic empowerment creates more opportunities for our people, that sourcing goods and services gives priority to small businesses in South Africa. We are also relooking at our tender processes such that value for money is derived, there is improved service delivery and leakages in the system are plugged.

Reducing unemployment

I am sure we all here this morning agree that as a nation we face a serious structural unemployment challenge, particularly acute for youth, and without much greater efforts to help young people into employment, millions of South Africans will not be able to play a productive role in society. Youth employment has fallen, with 48.3 per cent of the youth in South Africa being out of work. Research shows that firms are reluctant to hire inexperienced school leavers primarily because they lack basic skills and so their relative productivity is lower than the wage at which they start in employment.

A targeted wage subsidy will seek to provide the youth with the opportunity to build the required skills and experience. We will be engaging our social partners on this important matter and a discussion paper will also be released by the end of the month in this regard. Initiatives are also being put in place to improve information services to help the youth access jobs and training opportunities. The second phase of the expanded public works programme aims to create 4.5 million short term jobs lasting for an average duration of 100 days.

Supporting labour intensive industries

Making the economy more labour-absorptive will require raising productivity, boosting exports and promoting greater levels of savings and investment. India, China, Vietnam and Brazil, for example, are taking active steps to improve their competitiveness. South Africa too has to take steps to become more competitive. We cannot be left behind.

In developing a new growth path, progress also needs to be made in developing sectoral plans to raise employment and output. For example, South Africa needs a strategy to raise agricultural output, which will have positive benefits for rural employment. Similarly, a plan that removes obstacles to mining investment and exports could boost output and support job creation. These initiatives which are to set out new rules of the game are led by the economic sector and employment cluster of ministers, in consultation with industry stakeholders. Ultimately, poverty reduction is about developing people's capabilities and providing a growing economy in which they can work to improve their living conditions.

The budget tabled supports labour-intensive industries through industrial policy interventions, skills development, infrastructure investment, public employment programmes such as the Expanded Public Works Programme and a rural development strategy. Although some of these initiatives are not new, new rules pertaining to their implementation are to ensure greater impact and efficiency.

Additional funding is allocated to the Department of Trade and Industry for industrial policy interventions consistent with government's new Industrial Policy Action Plan. In particular, funds go to support investment and production in the automotive components and clothing and textile industries. The economic sector and employment cluster will focus on innovation and enterprise development which will contribute to increasing output, employment, productivity and exports in the long run. The Budget also provides funding for development of SMMEs, support for the tourism sector, and for investments in clean energy research and development.

Continuing public sector investment in economic infrastructure provides crucial support to the recovery and is essential to reduce bottlenecks and draw in private sector investment. Government and the state-owned enterprises continue to make large investments in electricity, road, rail and public transport infrastructure, increasing the long-term growth potential of the country and providing better services to all South Africans.

Expanding social security

The 2010 Budget reflects significant reprioritisation between spending areas and also within departments to fund new priorities and achieve targets. The priorities of government, guided by the medium-term strategic framework, are education, health, rural development, fighting crime and creating jobs. Given their importance, human settlements and associated infrastructure, and local government, have been identified as additional priorities.

South Africa's social security system has proven resilient during the turbulent economic conditions of the past year. Broad social security reform is proceeding along several tracks. The social assistance and social security agencies are examining ways to streamline administration, align systems and improve access to services. A no-fault insurance arrangement covering road accidents is being designed. Government is also working to design a universal savings arrangement, and to prepare the ground for national health insurance. New rules of the game are intended to ensure more inclusive development.

Almost 14 million South Africans are now receiving social grants, and this number is set to increase in the coming years as a result of the extension of the child support grant to the recipients' 18th birthday. These grants provide an immediate and effective source of income support for poor households. The extension of child support will be phased in over the next three years, with additional allocations of R1.3 billion, R3.1 billion and R5 billion in 2010/11, 2011/12 and 2012/13 respectively. The number of children receiving the grant is expected to increase from 9.1 million in December 2009 to 11.5 million in March 2013.

One of the social security funds, the Unemployment Insurance Fund provides conditional income support or compensation to workers who are out of work. This fund has been able to cope with the increase in unemployment and the resultant increase in claims.

Government is also examining ways to improve access to health care and ease the burden on the public health system. Under consideration is a system of national health insurance that will build on existing resources in both the public and private sectors. Our public health sector has to begin functioning in a manner that improves the lives of our people and benefits those that need it most.

Improving education

South Africa's economic objectives, alongside social policy goals such as improved education, training and health outcomes, will contribute to a more effective redistribution of resources and capabilities. South Africa's numeracy and literacy level attainment for school children is unacceptably low by any standard, despite a high level of spending on education. Existing skills training programmes are often inadequate to support the needs of individuals and the economy.

Over the next three years, the new rules of the game involve reprioritising funding to address these challenges. Government aims to improve literacy and numeracy by providing workbooks in all 11 official languages for learners in grades R to 9. To improve the quality of teaching and to attract new talent to the profession, government has refined the occupation-specific dispensation for educators that was introduced in 2008.

Additional funding is being provided to the further education and training colleges. Government will promote higher training standards to meet the requirements of a changing economy, address the lack of training in certain skills areas, and systematically increase institutions' capacity to train larger numbers of people. Allocations to higher education institutions have grown from R7.1 billion in 2001/02 to R15.3 billion in 2009/10.

Performance and effectiveness of the state

Ladies and gentlemen, all the transformative steps that I've mentioned can only become reality if government becomes more accountable and effective.

In 2008 and 2009, public-sector salaries grew more quickly than anticipated. Part of this growth was necessary to adjust salaries for key categories of professionals. It is expected that there will be a commensurate improvement in the service delivery and performance of those public servants whose salaries were adjusted. In addition, public employment increased rapidly, especially in health, policing and education. Now that these adjustments have occurred, salary increases over the next three years will have to be more moderate to be able to sustain positive growth in employment and infrastructure spending.

The 2010 Budget process focused not only on where government could add more money, but also where savings could be made and spending reduced by postponing, cancelling or winding down low-priority and ineffectual programmes. Efficiency savings were identified in all departments, with spending on goods and services, travel, accommodation, conferences and catering strictly curtailed. The second phase of the savings exercise has begun, with departments assessing the role, purpose and effectiveness of their programmes and public entities, and whether those functions can be performed at a lower cost. The third phase, a comprehensive expenditure review, will be conducted jointly by the National Treasury and the Presidency, overseen by the Ministers' Committee on the Budget. To reduce corruption and to lower the costs of procuring goods and services, government intends to reform the procurement system.

A performance culture where people are held accountable for their actions, accompanied by clear, measurable outcomes related to key development priorities is fundamentally important. A new framework for accountability has been tabled by the President as part of the new developmental plan for South Africa. It sets out 12 clear measurable outcomes. This new approach, together with enhanced planning, monitoring and evaluation capacity, aims to give greater impetus to development and service delivery improvements, and to make a meaningful impact on the lives of South Africans.

Conclusion

In conclusion, the Minister of Finance has tabled a budget that addresses our most pressing challenges. It is key that government departments now utilise the funding provided to effectively implement and execute their respective contributions to the new growth trajectory.

The budget has generally been well received. Most analysts and commentators have recognised that the budget treads a fine line in a myriad of social, economic and political challenges. Other commentators have criticised the lack of perceived movement on inflation targeting, the threat of higher taxes in future and the sharp growth in national debt – concerns which I believe have been adequately addressed in the budget documentation.

The 2010 Budget clearly outlines the new rules required to make South Africa competitive in a fast-changing world. It proposes sensible and evidence-based solutions to our biggest challenges, and opens the door to dialogue and discussion about the type of economy and country we seek to have.

I thank you.