



MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA

**Address by Finance Minister Pravin Gordhan
at the 14th Annual National Internal Audit Conference
15 August 2011**

SOUTH AFRICA'S ECONOMIC OUTLOOK AND CHALLENGES

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Ladies and gentlemen,**

Good morning and thank you for the opportunity to address you this morning at the launch of the 14th Annual National Internal Audit Conference of the Institute for Internal Auditors.

We are privileged to be living through a dynamic, tumultuous, and challenging period in our history. A period which is full of dangers and yet full of possibilities. We are witnesses to, and participants in, some of the most intense efforts to refloat the world economy and, in particular, in our case, to increase our potential growth to new heights – 6%- 7% over a sustained period.

The developments we have witnessed in the US, Europe and also the large emerging economies over the past few weeks will have the effect of dampening growth and creating greater uncertainty. We face challenging economic times, both as a country and across the globe. These events have cast a shadow over the health and sustainability of the global economic recovery.

But what are some of the factors giving rise to these developments? As Roubini and others point out :

- “Unregulated capitalism is in crisis and we need to find a third way between the twin broken poles of Anglo-Saxon laissez faire and the traditional continental European model of a deficit-driven welfare state, returning to the correct balance between markets and the public provision of public goods”. (Roubini)
- “We are seeing rising income and wealth inequality, poverty, unemployment and hopelessness in both developed and emerging markets (EMs), and the U.S. has entered a new “Gilded Age,” with income and wealth inequality as high as at the onset of the Great Depression”. (Roubini)
- “There is a growing loss of confidence among investors in the adequacy of official policy responses in Europe and the US (and to a lesser extent in emerging economies). It now seems clear that the structural and balance-sheet impediments to growth have been persistently underestimated, but it is far less clear whether officials have the capacity to identify the critical issues and the political will to address them”. (Spence)
- “The debate focuses on how budget deficits should be controlled, with the dominant view saying that they need to be cut quickly and mainly through reduction in welfare spending, while its critics argue for further short-term fiscal stimuli and longer-term deficit reduction relying more on tax increases.” (Ha Joon Chang)
- The diagnoses are many, but there seems to be growing consensus that global

growth must be restored; that the growth must lead to greater numbers of jobs being created; that social and economic inequalities are growing and must be reduced; that debt in certain countries must be reduced but not in a manner that undermines growth and services particularly to the poor; that the big economies need

a “grand bargain” which will initiate rebalancing of economies to promote greater equilibrium.

The shifting pattern of global growth

Against this backdrop, emerging economies have continued to grow strongly and are increasingly becoming the engine for global growth. Emerging markets do not have the same fiscal problems; deficits are much lower, public debt much lower and rates of growth faster. The traditional perception of emerging markets as a risky investment destination is changing, meaning that we are likely to see investment flowing South over the coming years and decades.

- Emerging markets are expected to contribute 3.2 percentage points to total global GDP growth of 4.3 percent in 2011, and by 2015 the BRICS group, which includes Brazil, Russia, India, China and South Africa is expected to account for almost a quarter of global GDP, up from just 8 per cent in 2000.
- In this economic climate, some of the fastest growing economies are from Sub-Saharan Africa. High commodity prices and rapid industrialisation have contributed much faster growth in the region. The IMF expects the DRC to grow by 6.5% in 2011, Zambia by 6.8%, Nigeria by 6.8%, Mozambique by 7.5%, Ethiopia by 8.5%, and Ghana by 13.7% and this region will provide seven of the ten fastest growing economies over the next five years.

As an emerging economy, this places South Africa on the brink of economic opportunity that can be grasped if we put in place the correct partnerships among all players in society. South Africa’s fundamental socio-economic challenges remain at the forefront of such a partnership. A strong capable developmental state is needed to combat poverty and implement the developmental agenda. But a capable and developmental state is also one that has access to resources without incurring excessive debt.

We should be proud of the fiscal capability and sovereignty that South Africa has been able to attain. We do not depend on the IMF to sustain ourselves in respect of what we want to do in South Africa. This has stood us in good stead in weathering

recent turmoil in the global economy. As we look now to the period ahead, it is important to recognise that, without a determined effort by all stakeholders to create a credible and sustainable tax compliance culture and a broad tax base with effective administration, this fiscal capability will be at risk. Equally important is ensuring that public resources are well spent and that we get better value for that spending. And this is where good corporate governance can add value to the growth of our economy and an improvement in our economic outlook.

The New growth Path

The New Growth Path of government provides a framework within which we can address some of the critical challenges and opportunities facing SA. South Africa's fundamental socio-economic challenges – unemployment, poverty, and inequality – remain at the forefront of our programs.

As highlighted by President Jacob Zuma in his State of the Nation Address, creating employment is the highest priority of government. According to official statistics just over a quarter of all working age South African's are employed with youth unemployment at 50 per cent and three quarters of the unemployed between the ages of 15 and 34.

Given our current growth trajectory, South Africa may only generate 4 million jobs by 2025 – not enough to make a significant dent in unemployment. In order to create enough jobs to address the unemployment challenge, the economy must achieve and sustain growth of about 7 per cent per year, twice as fast as we forecast for 2011. To make this possible we need to assess where the obstacles to growth exist, what reforms will release these constraints, and how to better translate growth into job creation.

Over the next few years we need to energetically reposition, restructure and reform our economy. This is a formidable task which will require South Africans from all backgrounds to unite around a single vision and develop a common purpose and passion to effect the changes we need. Some of these are:

- Maintaining macroeconomic stability but recognizing that while sound macroeconomic management provides the foundation for faster, sustained economic growth, much more needs to be done
- Increase economic growth and increase labour participation rates
- Increased savings and investment are essential for the economy to reach a higher growth trajectory.
- Lower the cost of young, inexperienced low-skilled workers for firms to stimulate the demand for labour,
- Improving the efficiency of the job search, job readiness and job matching process,
- Releasing the skills constraint through improving education and skills levels,
- Removing the regulatory constraints to firm growth and job creation in SMMEs.
- The economy needs to implement a myriad of micro-economic reforms to evolve onto a higher growth trajectory e.g. lowering the cost of doing business: logistics and communications
- Increasing competition: many major industries are characterised by high levels of concentration. Weak competition translates into higher prices for consumer and reduces the competitiveness of downstream industries.
- Enhancing regional integration
- Getting more for our money – improving the efficiency of government

Role of internal auditors

It is in the abovementioned context that the pivotal role of the internal audit community comes into focus. Now, more than ever, your role is critical in ensuring a paradigm shift in how businesses and government agencies conduct themselves and construct their understanding of the South African imperatives.

This, of course, means that as a profession you need a deeper engagement with some of the national challenges raised above. Your profession can make an

invaluable contribution to changing the outlook of both business and government managers in respect of the key economic and social goals we aspire to reach in SA.

You can help to redefine corporate citizenship – from how they view tax compliance, to fraud and corruption, profit margins and the cost to society and government. It might even be appropriate to ask your organisations how they are contributing to resolving some of the challenges outlined above. How are we contributing to implementing the New Growth path? What are we doing to give unemployed youth work and training opportunities? How are we contributing to increasing productivity and competitiveness of the SA economy? What can we do about poverty? How do we create opportunities for small black businesses? How do you play a proactive role in enhancing value for money for both business and government?

You also have a creative and catalytic role to improve the efficiency and strategic orientation of both private and public sector organisations. You can help contribute to new, innovative ways of working.

Government institutions must also be challenged. Now is the time to play your part in ensuring the prudent use of resources; ensuring that organisational policies are followed, and that operations are efficient. It is your responsibility to ask the tough questions to ensure that inefficiency, reckless use of resources and corruption is exposed.

I say this in the context of the “cancer” of corruption we are trying to tackle in South Africa. As Government, we want to intensify our efforts against corruption, particularly in the procurement processes. No South African with a clean conscience and a commitment to building a democratic state and eradicating poverty and joblessness can countenance what we read in our newspapers daily. Internal auditors have a crucial role to play in this regard. You have to build your resilience and integrity. You have to be at the frontline to expose unethical management practices.

However, corruption in the private sector too must be addressed. This not only kills investor confidence, but also fuels the corruption in the public sector. For example,

the fraud and corruption that occurs in the public procurement of goods and services is directly linked to the private sector. In other words, we must come down hard on the corrupted and the corrupters.

It is taxpayers money which is being pilfered, and sadly the poor are poorer for it. It cannot be right that key government functions are outsourced at exorbitant rates. Nor can it be right that millions of rands change hands for poor or no services being delivered. The time has come to expose and challenge the newly developed networks of connected parties that undermine state procurement policies.

The question which arises is where are the internal controls? Why are internal auditors so silent? Why are they not raising serious and uncomfortable questions? Why are we not exposing those that are abusing state resources? You are the guardians of our democracy and our intellectual and moral integrity. You have to act, and act boldly if you are to live up to this expectation.

Please tell us what we could do to strengthen your position and increase your ability to play your rightful professional role. You have a critical role in enhancing, in practical terms, corporate governance, business ethics and a developmental approach to management both in the private sector and in government.

What are the prospects ahead?

The world of economists, political leaders and civil society all over the world is energetically and excruciatingly engaged in debates about what is the right “solution” to the myriad of challenges facing different countries, regions and the globe. Some areas of consensus, reflected in some respects in our growth path as well, are emerging:

- creating jobs, partly via more fiscal stimulus on productive government spending, i.e. infrastructure;
- introducing more and different policies to reduce inequality;
- a sustainable and growth-inducing fiscal trajectory

- develop growth policies that lead to investment in skills and productivity; new emerging sectors; sound energy and environmental policies;
- tighter supervision and regulation of the financial system;
- investing in human capital and skills to increase productivity

As Michael Spence indicates: “This somewhat bleak picture could change, though probably not in the short run. Stability can return, but not until domestic policy in the advanced countries, together with international policy coordination, credibly shifts to restoring a pattern of inclusive growth, with fiscal stabilization carried out in a way that supports growth and employment.”

The alternative, according to Roubini, is more double-dip recessions, stagnation, depression, currency and trade wars, capital controls, financial crises, sovereign insolvencies and massive social and political instability

South Africa needs to do more than just steer its way through this crisis. We need to focus our energies on implementing our policies with a greater sense of urgency. The test of the validity of our policies lies not in the debate but in the actual practice of changing the economic and social fortunes of all South Africans.

We will have to take risks; try out new ideas; emulate good practice elsewhere and create our own examples of excellence. We must be humble enough to admit that many of our institutions are weak – but we do have skills that we could mobilise to assist us.

Everyone must sacrifice to achieve the goals we have set. This is a time for a unique solidarity among all our people. This challenging conjuncture requires bold leadership from all sectors of our society. Now is the time to put our heads together to find creative solutions and chart a new decade of hope and real change for all South Africans. It can be done. We have done it before in the lead up to our first democratic elections in 1994 and we can do it again.

Conclusion

I also urge you to retain and strengthen your integrity. Become a trusted partner to the good people in all parts of our country who are genuinely interested in urgent change that will help us overcome our legacies and fulfil our potential. Let us work together in the interest of clean business and clean government.

Ladies and gentlemen, I hope your deliberations will help you to embrace a developmental paradigm which enables you to acknowledge both the challenges and the exciting possibilities we have as a country. All of us have a valuable contribution to make to ensuring that our country affords a better life for all who live in it.

Thank you.