FOREWORD

The roles and responsibilities of the Ministry of Finance are distinctly different from all others. Firstly, the functions are performed through a number of discrete departments and a series of agencies. Secondly, there is the reality that even the tasks of the National Treasury alone are sufficiently diverse for the department to be considered an amalgam of different, but interrelated functions. Unfortunately, the official handover report follows a set template for all departments that does not adequately capture the complexity of the tasks. The alternative therefore is to provide a political handover report – this is not that report. I operate from the premise that the person appointed as Finance Minister will have sufficient political experience and, because the tasks require the frequent exercise of political judgement, it would be highly presumptuous to try and prejudge the situation or believe that my successor would be required to exercise the same judgement as I have in past situations.

This report is a narrative, designed to provide texture to the functions of the Ministry. Yet, in drafting this, we have found that the tasks are too multi-layered to even do justice to that. This narrative will, I am sure, be found to be exceedingly useful. The style of drafting is intentionally discursive. I opted to bring in a writer with some experience of government, but who has no axes to grind or positions in any of the departments to defend. His remit was to read up on the departments, to discuss his observations, to prod the Deputy Minister, senior management and I, and to feel comfortable about writing up his observations. This approach affords this narrative a freshness that I hope you will find useful.

I leave, believing that we have a cluster of sound institutions and a reasonably developed practise. These become your responsibility to live with, alter and refocus. I said earlier that I do not wish to write reams of my political observations. Whilst offering you the freedom to arrive at your own conclusion, I hope that I do not leave here as "the enemy" with whom engagement is ill-advised. I have had the distinct privilege of having been part of the evolution of this cluster over the past 13 years – I have no intention to rule from the grave, yet I will offer my friendship, collegiality and comradeship available as and when this is required.

I invite you to enjoy this wonderful opportunity to work with some of the nation's finest minds, who are also exceedingly committed public servants focussed on the task of improving the quality of life of the majority of South Africans. I advise that they are often strong-willed and opinionated – it is this which makes the assignment so wonderfully challenging.

Enjoy

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ONE

INTRODUCTION

The transition from one government administration to another is a critical moment for both reflection and renewal. It is an opportunity to weigh the achievements of the past and assess its failures, an opportunity to rethink established approaches and revisit entrenched dogmas. It is, in short, an opportunity to recommit the state to its fundamental purposes.

As important are also a number of risks: that established patterns of decision-making and review will break down; that skills and experience and institutional memory will be lost; that the processes of renewal to which any new administration is committed will take longer to implement and will deliver less than is hoped.

Given these opportunities and risks, it is one of the fundamental responsibilities of those whose tenure is coming to an end to lay as firm a basis as possible for the success of those who will follow them.

These are the opportunities and risks inherent in the handover process, and it is with these firmly in mind that this report has been drafted. It is also with these in mind that the report should be read.

As a practical matter, this report should also be read along with the 'official' handover file that was prepared for the Presidency, and which sets out the key official duties and responsibilities of the Minister of Finance. This report seeks to complement the official file in two different ways. Firstly, to provide a more detailed account of the job description of the Minister of Finance. This section – which accounts for the first 70-odd pages – goes beyond the standard bullet-point lists of agencies and tries to identify some of the critical policy and operational issues facing these entities. These issues are dealt with in a highly summarised form, so this report will not provide sufficient information and analysis for responsible decision-making. More detail is also provided in a series of annexures which

have been drafted by the National Treasury, SARS and StatsSA. These are appended to the end of this report.

Secondly this document seeks to provide a more 'conceptual' account of the role of the Minister of Finance. Chapter three tries to explain how the exercise of the Minister's functions is related to the process of addressing the socio-economic development of the country, while chapter four sets out some of the development issues that arise from the Minister's role in regulating and overseeing the financial services sector. Chapter five looks at the role the Minister plays in representing South Africa in international and multi-national forums, while chapters six and seven look at the role of the Minister in the budget process.

The intention of these chapters is not to defend existing practices and policies. Nor is it to try to influence future decisions that the Minister of Finance might make. It is, instead, an attempt to set out some of the challenges that confront the Minister of Finance, both in the shaping of policy and in its execution. The intention is to offer insight rather than explicit guidance, food for thought rather than prescriptions about what to do.

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TWO

THE JOB DESCRIPTION OF THE MINISTER OF FINANCE

Introduction

The Ministry of Finance is undoubtedly a tough assignment.

Even in the best of economic times – and these are not the best of times – being the Minister of Finance means playing a role in government that will not always lead to unqualified popularity. This is partly a result of the role of the Minister of Finance in the budget process and all the expenditure management tasks that go with that. In this role, the Minister of Finance must advise Cabinet about what is affordable, and just as controversially, must recommend which of the contending priorities needs immediate resourcing and which might have to wait. Inevitably, this means that the Minister of Finance is sometimes cast in the role of an obstructionist or scrooge, and becomes the obvious target for blame if and when delivery agencies appear to fall short of their aims and objectives.

Another reason for the unpopularity has to do with the fact that the policy role of the Ministry abuts those of a number of other ministries. This means that there may sometimes be contestation between the Minister of Finance and other members of Cabinet about the appropriateness of particular policies which fall outside the formal domain of the Minister of Finance.

There are other kinds of policy issues which can become messier. What, if anything, is the Minister of Finance to do if a Cabinet minister proposes a policy change that may affect the competitiveness of the economy and, therefore, its long-term growth path? Or what if the issue of contention is 'merely' a question of the effectiveness of one or another department? In circumstances such as these, the basis on which the Minister of Finance engages with other Ministers is less clear. Nevertheless, this is unquestionably part of the responsibility of the office. This is partly because the Minister of Finance is a minister and

shares collective responsibility for the consequences of government policy. It is also however the consequence of the specific responsibilities of the Minister of Finance. The Minister of Finance has a mandate which one might characterise broadly as one of custodianship for the long-term prosperity of the country, and he or she cannot be indifferent to the effects of any policy that seems likely to impact negatively on its long-run growth potential. It is incumbent on the Minister of Finance to engage with Cabinet colleagues whose policies seem likely to reduce economic growth and job creation.

It is also necessary to spend some time setting out the key elements of the role as defined in the Constitution and various pieces of legislation. One needs to distinguish between first tier domestic responsibilities (associated with the political and policy management of the core institutions for which the Minister of Finance is responsible) and second tier domestic responsibilities (associated with an array of other institutions which fall within the domain of the Minister of Finance). It is also necessary to address those responsibilities regarding the Minister of Finance's role in a range of international institutions.

Core responsibilities of the Minister of Finance

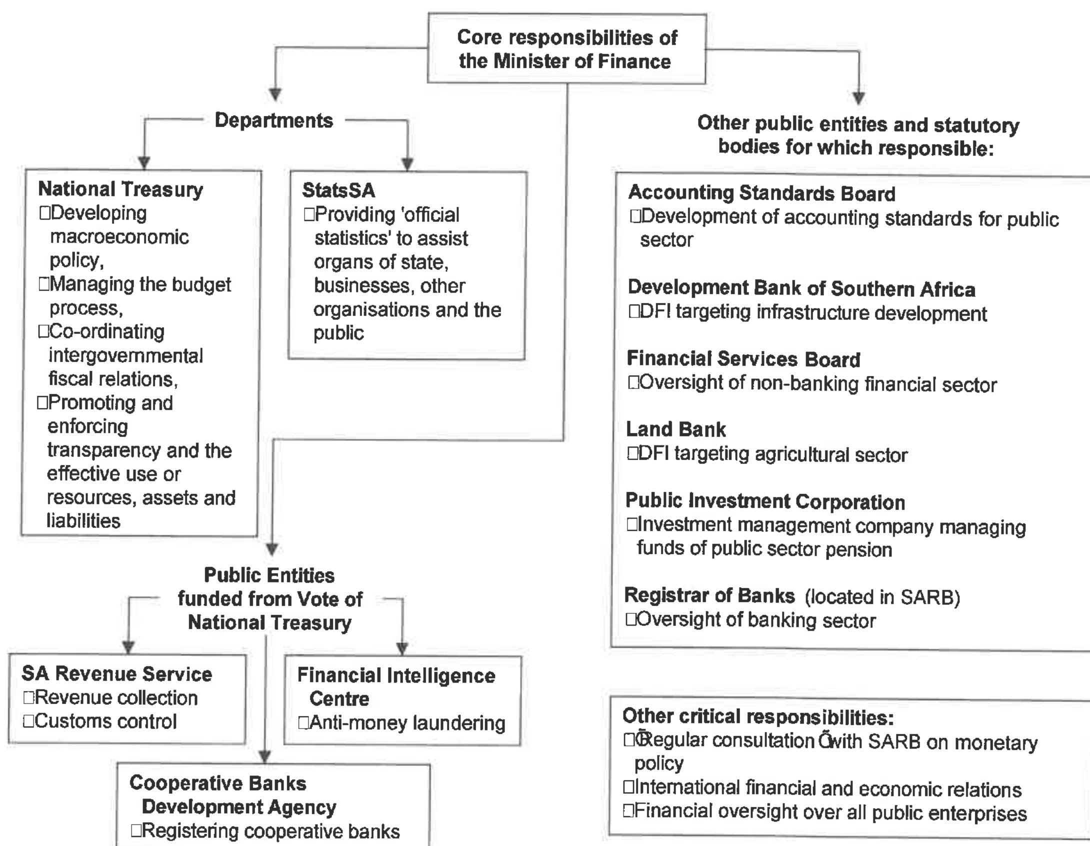
The most significant entities for which the Minister of Finance is politically responsible are the two national departments for which the Minister is the executive authority (the National Treasury and the South African Revenue Services), and three regulatory entities (the Financial Services Board, the Financial Intelligence Centre and, most recently established, the Cooperative Banks Development Agency). He or she is also responsible for two state-owned entities: the Development Bank of Southern Africa, and the Land Bank. The Minister is also responsible for StatsSA.

Between them, these institutions are responsible for forecasting macroeconomic variables and developing macroeconomic policies for consideration by Cabinet, collecting revenue and enforcing tax laws, raising new loans (in both domestic and international capital markets), managing the stock of public debt, advising Cabinet on the allocation of resources between contending policy priorities, allocating resources from the National Revenue Fund to government, implementing public finance management reforms to ensure greater transparency and accountability, regulating and overseeing the financial sector of

the economy, playing a quasi-law enforcement function in relation to flows of money through financial institutions, collecting data about South African society and the economy so that policy-makers can make informed decisions, and investing in or making loans to the providers of public infrastructure. In addition to these roles, the Minister also consults regularly with the Governor of the Reserve Bank about the co-ordination between fiscal and monetary policy, and about banking supervision, exchange controls, and management of reserves.

In addition to all of this, the Minister of Finance is also the 'face' of the South African economy, and it is his or her responsibility often to 'sell' the viability and attractiveness of the economy to ratings agencies, investors and other constituencies. Some of these audiences are tough and well-informed, and it is critical that the Minister of Finance has a high degree of credibility in order to deliver on this responsibility. He or she must also represent the country (and, sometimes other countries in the region of in the developing world) in international and multilateral policy processes.

As the present summary suggests, the responsibilities of the Minister of Finance are wide-ranging and complex. Graphically, a summary of the responsibilities of the Minister of Finance might be depicted like this:



The Ministry of Finance

The complexity of the responsibilities of the Minister of Finance raises a question about the structure and location of the Ministry of Finance. This is not an issue which is prescribed in legislation, but present practice is informed by a number of considerations.

Firstly, there is a sense in which the responsibilities of the Minister of Finance do all speak to each other, and need to be managed holistically. While the Minister of Finance's time and energy is not consumed equally by all official responsibilities, he or she is not just the 'Minister of the National Treasury'. In practical terms, this means that current practice has the Minister holding bi-weekly meetings with the management of the National Treasury, SARS, StatsSA and the FIC. There are also regular but less frequent meetings with the management of the other entities, such as the FSB. In addition, if and when circumstances dictate that more frequent meetings with one or other entity is required – as is the case during the present financial crisis, with issues relating to the regulation of the financial services sector being a central issue – these are arranged.

The second point to make is in relation to the role of the Deputy Minister. Present practice has it that the Minister and the Deputy divide the labour between them and then seek the consent of the President for the resulting allocation of responsibilities. The present division of responsibilities is set out in the following table. It is important to note, however, that because the roles, powers and functions of the Deputy Minister are not clearly defined in law, it is generally the Minister who is accountable for the function in question. It is the Minister's signature that is usually required before any decision can be made official. The one exception to this rule is that the President has granted the Deputy Minister the authority to sign off on tariff changes. It is, therefore, essential that the Minister and Deputy Minister seek to establish a working relationship in which it is possible for the Minister to sign off on decisions without having to review them. This requires working together closely and, in organisational terms, demands a reasonably high level of integration of the Minister and Deputy Minister's offices.

Responsibility of the Minister	Responsibility of the Deputy Minister
National Treasury Budget Process • Budget Office • Public Finance • Intergovernmental Fiscal Relations International Economics • IMF / World Bank • SADC / SACU • G20 • Commission for Africa • United Nations Economic Commission for Africa Economic Policy • Macro Tax, Finance and international relations • Tax Asset & Liability Management Specialist Functions Office of the Accountant General	**National Treasury** Financial Sector Policy • Financial Services Board International Economics • IMF / World Bank • SADC / SACU • Commonwealth Finance Ministers • United Nations Economic Commission for Africa Specialist Functions Office of the Accountant General Fifa 2010 World Cup Bilateral Aid
SA Revenue Service	**SA Revenue Service** • Tariff approvals
Statistics South Africa	**Statistics South Africa**
Government Employees Pension Fund • Trustee	**Special Pensions Board**
Development Bank of Southern Africa	**Public Investment Corporation** • Chair
South African Reserve Bank	**South African Reserve Bank** • Banking supervision

Finally, present institutional practice in the Finance Ministry has sought to minimise the gap that can emerge between the Minister and the departments over which he or she exercises executive authority. While this is not altogether avoidable (or altogether unhealthy), the present system is premised on expectation that the Minister can rely as far as possible on the technical competence of the officials in the various departments and public entities, rather than on a squad of advisors. In addition, the Ministry shares the communications facilities of the National Treasury rather than appointing additional personnel.

The National Treasury

Section 216 of the Constitution establishes the National Treasury. Section 216 provides that the National Treasury should be created by legislation and that it 'must prescribe measures that ensure both transparency and expenditure control in each sphere of government, introducing (a) generally recognised accounting practices, (b) uniform expenditure classifications, and (c) uniform treasury norms and standards.' S213 also creates the National Revenue Fund, into which virtually all money received by the national government is paid. It is the Public Finance Management Act (PFMA) that defines the role of the National Treasury and which provides that the Minister of Finance is the 'Head' of the National Treasury and must make policy decisions for it. It lists as the Treasury's principal functions:

- Promoting government's fiscal policy framework and coordinating macroeconomic policy,
- Managing the budget process,
- Coordinating intergovernmental financial and fiscal relations (meaning the flow of national funds to the provinces and local government, and the flow of information about resource needs from those spheres to national government), as well as monitoring the implementation of provincial budgets,
- Controlling the implementation of the annual budget (i.e. ensuring the passage of the relevant legislation through Parliament, including the Division of Revenue and Appropriation Acts and any adjustment budgets), and
- Promoting and enforcing transparency and effective management of revenue, expenditure, and assets and liabilities of departments, public entities and constitutional institutions.

It should be noted that many of the reforms on budgeting and public management (as enacted in the Public Finance Management Act), together with greater transparency and accountability, were introduced during the first five years of the new democratic government, under President Mandela. These reforms remain a legacy of both the Constitution and the presidency of Nelson Mandela.

While these are all, broadly speaking, financial responsibilities, there are also important distinctions between them: some are pure policy questions (such as those relating to the fiscal framework), some relatively bureaucratic functions (such as the drafting of the Division of Revenue and Appropriation Acts), and some lie somewhere in between the purely policy and the purely administrative (such as the management of the budget process and the promotion and enforcement of transparency and effectiveness).

Another critical point to note about the statutory functions of the National Treasury is the language in which they are framed: the National Treasury does not *write* or *produce* the budget, it *manages* the budget *process*; the National Treasury does not *decide* or *determine* government's fiscal policy, it *promotes* the fiscal framework. In other words, apart from the Treasury's having a role in *enforcing* transparency and effectiveness in the use of state resources, its functions are defined using verbs that tend to come from the more facilitative end of the spectrum.

So despite its reputation for appropriating excessive powers, the truth is that in relation to most of the policy questions in which the Treasury plays a role, it does not have a free hand. Indeed, as a matter of legal, political and practical reality, the role they play is facilitative rather than purely executive.

In truth some of the most critical decisions for which the Minister of Finance is responsible are really collective decisions of government (made by Cabinet as proposed by a committee of Ministers called the Ministers Committee on the Budget [MINCOMBUD]). The Minister of Finance has the political responsibility (as well as the staff and resources) for thinking about the critical policy issues involved in the crafting of a budget. For this reason, it is the Minister who must assume a leadership role in these processes. That doesn't mean he or she must dictate terms to his colleagues but rather that the Minister must be informed about the critical policy questions and must seek to provide the highest quality advice and analysis to the Cabinet. As already noted, the issues for which the Minister of Finance might require the National Treasury's assistance in advising Cabinet are not confined to questions of fiscal policy and the allocation of resources between the spheres and functions of government. There are also policy questions associated with promoting the effective and transparent use of resources (in pursuit of a value-for-money

agenda in government), and questions relating to the management of the state's assets and liabilities (especially cash balances, debt stock, and the financial assets of the various parastatals) so that returns are maximised and/or losses are minimised.

Critically, there are also questions relating to policies pursued by other departments which affect the efficiency with which the country's resources are used (and therefore the cost structure of production and the growth rate). There is no question that South Africa needs to make significant progress in some of these areas. It will often fall to the Minister of Finance and officials in the National Treasury to engage with policy development and implementation issues which affect the overall performance of the economy. Which battles are fought and how vigorously is something which the Minister of Finance has to give very clear direction about. It must also be noted that the National Treasury is not just a glorified policy shop with no executive responsibilities. It fulfils a range of technical functions which government depends on for some of its day-to-day functioning. Reference has already been made to one of those functions: the duty to draft legislation which allocates funds to spending agencies in government, without which it would be illegal for those agencies to sign any cheques. Thus the budget must be translated into various pieces of legislation. In addition, on the revenue side, every change in tax policy and tax rates must also be legislated, as must the less regular changes to other pieces of legislation for which the National Treasury is responsible (such as the regulation of the financial services sector). All of this legislating requires time and attention to ensure it is properly drafted and brought to parliament timeously.

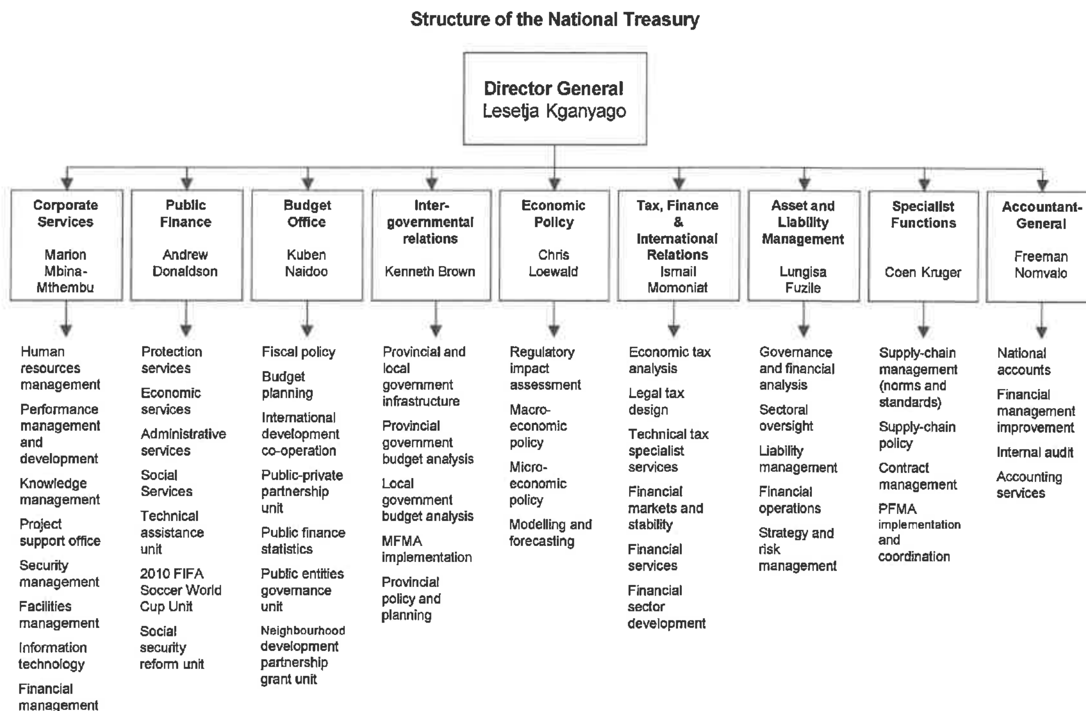
In addition to ensuring the passing of legislation enabling the spending of money by government departments, the National Treasury also administers a range of conditional grants to provincial and local governments for the delivery of particular goods and services, and the improvement of some financial, management and information systems.

There are also other areas of activity within the National Treasury which have a material impact on the day-to-day workings of government. The Treasury plays a critical role in maintaining some of the transversal IT systems in government, including the Basic Accounting System, Persal and the logistics management systems. The division responsible for that, Specialist Functions, also contains units responsible for some of

government's strategic procurement contracts, including those for motor vehicles, medicines and uniforms.

A different set of practical functions relate to the role the Asset and Liability Management division in managing government's debt stock and raising new debt through the auctioning of government bonds. Many improvements in the performance of this function have been instituted in the past 15 years, all of which have helped to dramatically reduce the cost of servicing state debt, by improving cash management and adopting more efficient management strategies. The performance of this function is essential if government is to have the funds available to pay salaries and suppliers timeously.

These are some of the practical tasks that the Treasury fulfils, in the absence of which government would not function smoothly. The delivery of these functions, together with its various policy roles in government, is pursued through a structure presently composed of nine divisions, reflected below:



The next few sections examine each of these divisions in a little more detail. In addition to this summary, each division has also compiled a brief report on the key issues with which it is presently engaged. These are attached to this report as annexures.

Economic Policy

The principal role of the Economic Policy division is to provide the best possible macro- and microeconomic policy analysis. This is done on the basis of the economic models which they build and maintain, their analysis of economic data from various sources, and their liaison with the South African Reserve Bank through three Standing Committees. These seek to improve policy coordination in areas of overall fiscal and monetary policy, inflation targeting, reserve management, financial-sector regulation and cash management The division plays an important role in keeping track of and assessing what is happening in the global and national economies; in forecasting the key macroeconomic variables; and in providing advice on how these affect (and are affected by) policy choices government might make in the budget. This division is primarily responsible for drafting the 'economic policy and outlook' chapters of the *Budget Review* and the *Medium Term Budget Policy Statement*. In addition, it helps prepare presentations and papers for MinComBud, for Cabinet makgotla on the state of the economy, and for a variety of forums.

In the context of the present economic crisis, the role of Economic Policy has been to provide information and analysis about global and domestic developments. In addition to this, however, it also plays a role in representing the National Treasury in a variety of local policy processes such as those devoted to the development of trade policy. It is, for example, presently sitting on the Economic Impact Committee of the National Electricity Response Team, it is assessing the appropriateness of Zimbabwe's joining the common monetary area, and it is assessing the impact of the possible implementation of a wage subsidy, together with external researchers. Economic Policy was also the principal host for the international team of researchers that government put together in 2007, which produced 19 papers on questions relating to the acceleration of growth in the South African economy.

In addition, a relatively new function of the division is that of regulatory impact assessment. This was established after Cabinet took the view that too little work was being done to assess the economic effects of the regulations being instituted across government departments.

Among the critical questions that this division must help government think through are the nature, causes and depth of the present economic downturn, as well as the impact of possible policy responses to it, and how to drive labour-absorbing growth in South Africa.

The Budget Office

The principal functions of the Budget Office relate to the budget, the compilation of which is coordinated through this division. To facilitate this, the division plays a secretarial role for MinComBud to ensure that Cabinet's directives feed directly into the budget process. The Budget Office does not play an administrative or secretarial role. Its coordinating and facilitating role demands a degree of intimacy with the policy priorities of government, the spending needs of departments, and the practical consequences of different choices. Without these competencies, this division would not be able to play its advisory role in relation to the fiscal policy issues that drive questions of how much government should spend and how it should be financed.

The Budget Office also houses a number of other units, including a unit responsible for compiling government's financial statistics, the Public-Private Partnerships unit (which advises government departments during the tendering for or negotiating of PPPs), the Neighbourhood Development Partnership Grant unit (which allocates funds to projects aimed at improving urban environments and monitors their implementation), a international donor assistance coordination unit, and a unit dedicated to improving governance at public entities.

In very broad terms, however, it is the annual budget cycle which sets the rhythm of work in this division. This process was one of the most significant reforms introduced by the new democratic government under President Mandela, as it broke away from the bean-counting approach to budgeting, and recognised the need for a more participative approach

which was more closely aligned to the policy-making process. As a result, the budgeting process now begins with the compilation of Treasury's submission to the July Cabinet lekgotla, at which government frames its medium-term strategic priorities. These priorities guide the decisions to be taken in the course of the budget process.

The next step in that process is the compilation of departmental budget submissions. These are drafted by the departments themselves on the basis of frameworks put together by the Treasury, which are returned to the Treasury to be considered by the Medium-Term Expenditure Committee (MTEC) in August/September.

MTEC is composed of officials from Treasury and the Presidency, and it compiles and analyses the budget requests from the departments, to inform Cabinet of the needs expressed by departments, and advise Cabinet on their appropriateness and affordability.
In the last week of October, after thorough consultations with MinComBud and Cabinet, the *Medium Term Budget Policy Statement* (which the Budget Office plays a critical role in drafting) is presented to parliament. It sets out government's forecast of trends in the economy, and provides some detail about fiscal policy choices and the allocation of funds to government functions. At the same time, an Adjustments Budget is tabled to accommodate and authorise (sometimes retrospectively) any unforeseen and unavoidable expenditure incurred by government departments. These authorisations would have been approved by the Treasury Committee in September/October.

The Treasury Committee process is also facilitated by the Budget Office, but the committee itself is somewhat different from other Cabinet sub-committees in that, while it is presently chaired by the Minister of Finance, the President and Deputy President sit on it, as does the Director-General of the National Treasury. It is also the one Cabinet sub-committee with direct decision-making authority.

Departments are formally informed of Cabinet's decisions with respect to their budgets for the following financial year through letters of allocation sent out in November and. Departments are then legally in a position to plan their expenditures even before the passing of the relevant budget legislation.

The final budget is completed in January and tabled in Parliament in mid- to late-February. It is accompanied by the requisite draft legislation as well as the *Budget Review* and the *Estimates of National Expenditure*.

The Minister of Finance doesn't have to know every number and every sentence in these documents, but he must be familiar and satisfied them before they can be released.

Public Finance

The Public Finance division is the principal point of interaction between the National Treasury and other national departments, and its staff are organised in functional groups in much the same way as the cluster system works in Cabinet. There is a team dedicated to the departments making up the administrative services cluster, as well as one each for urban development and infrastructure, economic services, and protection services, as well as teams for education and health services. It is within these teams that financial and budgetary analyses are compiled in relation to government functions, and it is here that the National Treasury's understanding of the operational performance and service delivery challenges across government is developed. This is required to make proper evaluations of the operational and policy needs of departments, public entities, and the three spheres of government. Because Public Finance is the unit most directly involved in assessing all the policy proposals that come to Cabinet, its engagements with the funding requests of spending agencies is often the site of many of the National Treasury's disagreements and disputes with other departments.

Public Finance also plays a more administrative role as it is also the division responsible for processing and resolving requests by departments to depart from their budgets in ways that they are not authorised to do on their own. With the empowerment of departments' management of their budgets, and the move away from the heavy-handed role of the old Department of State Expenditure, Public Finance now plays less of a role in authorising expenditure than in the past, and spends more time ensuring that policies are both appropriate and are appropriately financed. Still, the workload arising from this administrative role is significant. It requires that Public Finance liaise regularly with departmental CFOs, compile monthly and quarterly analyses of expenditure in national

departments, review annual reports, approve shifts in spending to and from capital projects and between budget items, and approve any changes to tariffs, user charges and other administered prices.

Public Finance is also responsible for compiling the *Estimates of National Expenditure*, though it is not responsible for drafting individual chapters, or determining the performance indicators and targets with which individual departments are to be held accountable for delivery.

The division houses a unit dedicated to issues relating to the Fifa 2010 World Cup. This unit works closely with a variety of technical and Ministerial committees, as well as with municipalities and provincial governments, and seeks to assist with financial aspects of preparations for the Fifa 2010 World Cup and associated activities. Other technical matters, including the tax treatment of 2010 World Cup activities, transportation issues and the development of a 60-year maintenance programme for the stadiums, are also receiving attention.

Public Finance is also the home to the Technical Assistance Unit, which provides professional support and services to a wide variety of government departments. It currently has nearly forty projects, ranging from assisting with the establishment of DNA laboratories in the SAPS, to providing technical support to a range of departments that are implementing performance management systems.

Finally, a newly-formed unit has been established to coordinate interdepartmental work on the reform of the social security system. Using research undertaken on behalf of the Department of Social Development, National Treasury and other participating departments are designing options for a contributory social security system for wider consideration in government. Key elements of this process include:

- The design of a basic contributory pension benefit that would build on the existing social old age grant as a minimum benefit, funded through a standard payroll-based savings contribution, which would provide an affordable inflation-protected post-retirement annuity;
- Extending and improving unemployment benefits; and

- Providing survivor and disability benefits consistent with a sustainable, well-targeted assurance of family income in the event of death or disability of a breadwinner

In summary, Public Finance's work revolves around three kinds of process. The first is the budget process, with the division playing a critical role in helping Treasury develop an assessment of the submissions for additional funding made by spending departments to MTEC. Public Finance also engages government departments through a series of technical committees in which policies and performance are assessed and analysed, to assess the wider needs of the departments concerned. Officials from Public Finance represent the National Treasury in a variety of policy processes and on the boards of a large number of public entities. This is the second broad process of the Public Finance division.

The third process in which Public Finance is engaged is preparing analyses of Cabinet Memos submitted to Cabinet by other Ministers. In this role, Public Finance assists the Minister of Finance in dealing with any issues which may require intervention at Cabinet level.

Since all legislation and policy documents come to Cabinet before they are presented to parliament and the public, and since Cabinet also receives numerous other submissions, this generates a lot of work for the National Treasury. The demands that Cabinet Memos place on the National Treasury are somewhat different to the demands they create elsewhere in government. One reason is that every Cabinet Memo must contain a section dealing with any financial implications of any decision taken. Obviously, this is something in which the National Treasury has an interest, and it is expected that the Minister of Finance take a view on what is presented in that section. Often, however, the information and analysis in this section is poor or entirely absent, so it is not always possible for the Minister of Finance simply to rubberstamp the memorandum. Even in the absence of this, the Minister of Finance would have to work through Cabinet Memos more rigorously than other Ministers, to assess what the consequences of the proposals might be on the sustainability of government policies and on the long-term growth of the economy. On occasion, this may mean that the Minister of Finance will have to engage other members of the Cabinet about policies, even when these do not have significant budgetary implications.

There is clearly a great deal of potential for contestation with other departments and their executive authorities on issues in Public Finance's inbox. These contests are part of the reason why some regard the role played by Treasury and the Minister of Finance in government as controversial.

Intergovernmental Relations

Intergovernmental Relations manages financial and policy relations between national government, and the provincial and local spheres of government.

Some of the policy and analytical work done by Intergovernmental Relations overlaps with Public Finance, because the vast bulk of provincial funding comes from national government, and because of shared competencies between national and provincial government in a range of functional areas,.

In addition to this kind of policy-related work, Intergovernmental Relations is responsible for drafting the Division of Revenue Bill, and for administering a range of conditional grants which go to provincial and/or local government for specific purposes. This process has meant that IGR has also become involved in coordinating and implementing capacity-building initiatives in provincial and local government, because of the problems many local governments have with delivery.

Amongst the division's most important functions, however, is its role in giving effect to the constitutional requirement that revenues raised through national taxes are distributed equitably to the provinces and (where necessary) to local governments. This is a delicate business because the equitable distribution of funds must be on the basis of a range of objective factors. The precise basis for these decisions and the structure of the resulting formulas must be carefully calculated.

IGR's policy-related functions revolve around ensuring that policies and procedures exist so that provincial and local governments receive the funds they need, and spend them appropriately and effectively. It also monitors provincial and local government budgets,

and publishes a range of financial data pertaining to the activities of these two spheres of government. IGR is also responsible for ensuring that reporting frameworks for financial information are appropriate, that Provincial Treasuries function well, and that the MFMA is properly implemented.

IGR also organises at least four Budget Council meetings (involving the Minister of Finance and nine MECs) every year, as well as an additional two or three day lekgotla. It also arranges one Budget Forum (which includes, along with the Budget Council's role-players, the Minister of Provincial and Local Government and representatives of local governments). The Minister of Finance chairs all these meetings, the agendas of which revolve around spending trends in the provinces and questions about financing changes to policies in areas in which there are concurrent responsibilities. One historical example of this is the implementation of free basic services, which imposed new costs on local authorities. A more current example is the implementation and roll-out off a much larger number of no-fee schools, which has cost implications for provincial Departments of Education.

A consequence of the role played by IGR in the system of cooperative governance is that it is frequently cast as a role-player, judge or participant in policy debates between departments of the national government (which tend to want to see more centralised decision-making on issues of policy and expenditure) and provincial governments (which tend to resist these pressures). Whatever the final outcome of these processes, it usually requires some adjustment to the way in which funds flow between the spheres of government.

Another issue that that can cause contention is the role IGR plays in assessing requests from municipal and (less frequently) provincial governments to implement new rates or taxes.

IGR also plays a role in compiling financial data of provinces and local governments, in assessing whether provincial budgets meet the priorities determined at a national level engaging with provinces where this is not the case, and in the regular publication of revenue and expenditure numbers for provincial and local governments. The division

produces – in alternating years – the *Intergovernmental Fiscal Review* and the *Local Government Budget and Expenditure Review*. It also monitors provincial and local government treasuries to assess their capabilities and performance.

Asset and Liability Management

Asset and Liability Management plays the function that a corporate treasury might play in a large company: it manages the financial assets and liabilities of government. It also raises money on local and international capital markets, primarily through the auctioning of bonds. Inevitably, this means that this division must play a role in marketing South African bonds, especially to international investors.
Much of the division's work is precise and highly technical, and relates to the most efficient and effective management of cash and debt stocks so as to minimise the financing costs that government must incur, while also ensuring that government always has available the cash it needs to meet its liabilities as they become due. At the same time, policy questions emerge all the time: should the country borrow locally or internationally to finance the deficit, and at what costs? What is the appropriate term structure of debt? Should National Treasury assist the Reserve Bank in building up foreign currency reserves? What is the appropriate capital structure for public entities such as Eskom, Transnet and SAA? If public entities need to raise money, should the state guarantee the loans of public entities or should it inject capital directly into those entities? If guarantees are to be issued, under what terms should this happen?

The answers to some of these questions have the potential to create friction with the executive authorities responsible for the public entities in question, so there are times when ALM's work ceases to be technical, and instead becomes the source of significant political contestation. Given the parlous state of the balance sheets of many public entities and their large and growing need for money to fund infrastructure investment, critical questions of this kind are likely to arise in the short- and medium-term, revolving around recapitalising these entities, reconfiguring their mandates and instituting a dividends policy. These include requests or anticipated requests for capital, including:

- R2 billion for the Land Bank;
- R15 billion in callable capital for the DBSA;

- Possibly changing the structure and timing of the loans and guarantees extended to Eskom in light of Nersa's decisions on electricity pricing;
- About R3.1 billion to help fund the new multi-product petroleum pipeline under construction by Transnet Pipelines; and
- Possibly extending further loans or guarantees to SAA, Denel, and the Pebble Bed Modular Reactor.

Apart from upgrading back-office systems, other issues that may arise is the decision to fund part of the budget deficit on international markets later in the year (depending on the costs of doing so), appointing board members to the DBSA, SASRIA and the Land Bank, and engaging with the Presidency and the Department of Public Enterprises on policies affecting the governance structures of state-owned entities and their dividend policies.

Tax, Finance and International Economics

This division houses three quite distinct functions: the unit responsible for developing tax policy and translating the results into draft legislation; the unit responsible for developing policies and legislation regulating the financial services industry; and the unit responsible for managing South Africa's involvement in multilateral financial and economic organisations, both in Africa (the Southern African Currency Union, SADC, the Common Monetary Area and the African Development Bank) and globally (the World Bank, the IMF, and the G20).

This division is currently being split into two, with international economics being separated from tax and finance. The post of head of international economics has already been advertised.

Tax Policy

Taxation-related policy questions cannot be divorced from questions of fiscal policy, and this unit participates in the process of deciding on changes to tax policy warranted by fiscal conditions. It analyses tax data in order to forecast collections and help determine how taxes can be raised most efficiently, while also reinforcing government's social objectives.

This unit therefore works closely with SARS and other units in the National Treasury. There is also some degree of consultation with role-players outside of government, but engaging in full public consultation is not straightforward because floating tax proposals can have economic implications.

The unit brings one or two pieces of legislation to Parliament every year in order to implement new tax policies and tax rates, and to close any loopholes that might have been identified. This legislation is generally highly complex and specialised, as well as market-sensitive, and is generally not taken through the normal Cabinet processes before going to Parliament. Given the newly-crafted procedure for money bills, existing processes may have to be reviewed.

Because only the Minister of Finance has the authority to introduce money bills to Parliament, the tax policy unit also works with other departments whose policy initiatives require them to raise revenues. This was the case with the Department of Labour's introduction of the skills development levy.

There are presently a variety of issues on the table, including:

- the more or less routine updating of tax legislation and forecasts;
- managing processes related to the negotiation or renegotiation of tax treaties;
- working on the tax components of industrial policies and other possible responses to the economic downturn;
- the taxation of the financial sector in general and financial instruments in particular, an issue that affects the level of savings;
- the publication, in collaboration with SARS, of tax statistics as well as the possible publication of a tax expenditure report;
- designing of taxes that might be needed because of new policy developments such as the proposed introduction of national health insurance and social security reform; and
- the possible future introduction of carbon taxes.

Financial Sector Policy Unit

The Financial Sector Policy unit works with regulators of the financial sector – especially the Registrar of Banks, the Financial Intelligence Centre and the Financial Service Board – to ensure that the sector is stable, its institutions are sound, and that the market conduct of individual companies does not violate the law or legitimate expectations of consumers. This unit also ensures the vibrancy of the industry and the accessibility of its products. This is an area of work that is likely to grow, given the nature of the industry, the nature of the present global crisis, the development needs of the South African economy, and the fact that events like the collapse of Saambou Bank and the Fidentia fraud have occurred in the relative recent past.

One of the biggest challenges facing this unit is co-ordinating the work of the various regulatory agencies, and improving the design of the system in order to make it more effective. A further challenge is the implementation of the Financial Sector Charter, which differs from other empowerment charters as it focuses on access targets. This charter awaits gazetting as a sector charter, and is in danger of being replaced by a less transformative generic charter should government fail to gazette it as a sector charter.

Present work being done in this unit revolves around:

- the on-going monitoring of global and domestic financial stability;
- contributing to global and domestic debates about the future regulation of the financial sector (including assessing whether the present institutional architecture is optimal);
- finalising a position paper on financial inclusion policy;
- establishing the Cooperative Banks Development Agency;
- drafting legislation relating to deposit insurance in South Africa; and
- the finalisation of the competition commission's enquiry into the pricing of certain banking services.

International Financial Relations

Finally, this division also houses the units most heavily involved in the engagement of the National Treasury and the Minister of Finance with multilateral institutions. Because there are many of these institutions, and because each has a different mandate and a unique organisational and political culture, it is not easy to summarise neatly what this work entails. Suffice it to say that in a globalised world, and one that is currently suffering a crisis, international financial relations have become an enormously important area of work for the Minister of Finance.

There is a good deal more to say about the international dimension of the Minister of Finance's work, especially as it relates to the current crisis. For the moment, it is sufficient merely to list the kinds of issues that need to be worked through:

- Promoting regional integration, including increasing intra-African trade;
- Harmonising regional economic policies;
- Negotiating the SACU revenue-sharing formula;
- Increasing the volume and quality of aid flows;
- Restructuring sovereign debt;
- Governance questions relating to the management of the World Bank and the IMF; and
- Responding to the present crisis in a way that (a) resolves the financial crisis, (b) stimulates economic growth, (c) ensures the construction of appropriate regulatory architecture, and (d) addresses the deep imbalances in trade and capital flows that are the root of the crisis.

In dealing with these issues, obviously the premium is on having the analytical skills to ensure that South Africa's analysis of these problems and proposed responses are correct. A great deal also turns on the ability to play the politics of these multilateral institutions well. This work thus demands a broad set of analytical, policy and interpersonal skills.

Specialist Functions

Among other functions, Specialist Functions and the Office of the Accountant General regulate the manner in which departments and other entities conduct financial transactions and record the results of these.

Specialist Functions is primarily responsible for the design systems, procedures and regulations governing procurement practices across government; monitor and evaluate the implementation of the PFMA; and provide the financial systems required.

The division continuously engages with a range of role-players such as end-user departments, SITA and external service providers, as well as training institutions (especially the Public Administration Leadership and Management Academy).

Given the real challenges that exist across government in maintaining the integrity of procurement processes, the work Specialist Functions does in regulating these matters remains important. As its role grows in the investigation and policing of tender-related grievances lodged by suppliers, it is also likely to become increasingly controversial.

The division is currently busy aligning procurement policies and the requirements of the Broad-Based Black Economic Empowerment Act. There are challenges with regard to BEE verification as there is not enough agencies accredited to verify the BEE status of companies seeking to supply goods and services to government.

Specialist Functions is also responsible to ensure the implementation of the PFMA across and for reporting on progress to Cabinet and Parliament. The division therefore continuously updates the PFMA and Treasury Regulations. I t is expected that the Minister of Finance will send through amendments to the PFMA and MFMA through Cabinet and Parliament this year.

Office of the Accountant-General

Since 1994 government has embarked on a programme of updating accounting standards because the old standards did not match general practice in the rest of the world. Also, South Africa's new system of public finance management necessitated a new system that ensures that public funds are used and accounted for accurately.

The Accountant General's office, together with the Accounting Standards Board (ASB), is developing a framework for instituting Generally Recognised Accounting Practices (GRAP) for the public sector. This will ensure that accounting standards change from a cash basis to an accrual system of accounting. In addition, the Accountant General also seeks to develop and roll out enhanced risk management policies and systems across government, as well as ensuring that internal audit capabilities are adequate.

One of the divisions functions is to produce government's consolidated financial statements. This is essential both for accountability and transparency, but also for ensuring that government knows and understands the pattern of its revenue and expenditure flows so that the impact of these on the macro-economy can be understood.

Corporate Services

As in other departments, the Corporate Services division is a strategic enabler, and ensures that the department has the staff, equipment and facilities it needs. It also ensures that physical and information security is adequate, that the intellectual and organisational capital of the National Treasury is protected, that it has access to the legal services it needs, and that it manages its finances effectively.

Some issues that require review include the communications capacity of the department, the quality of the coordination of interaction with Parliament, the extent to which the National Treasury has adequate access to legal advice, and the question of whether its security and accommodation needs are properly met.

Most critical of all, however, is the awareness that the department functions because of the dedication of its employees.

National Treasury: Conclusion

National Treasury officials also sit on interdepartmental technical committees and the boards of public entities. These are often difficult assignments such as negotiating salaries and benefits of political office bearers, civil service salaries and benefits as well as sitting on the board of the Government Employees Pension Fund and the other pension funds in government. These roles are partly technical; however the Minister's intervention may be required at times.

The National Treasury also interfaces with a range of public entities whose financing can and does have an impact on the fiscal position of government. Thus, when a public entity asks for a government guarantee when trying to raise funds on local and international domestic markets, there may be implications for the conduct of economic. The answer to the request for a guarantee, in other words, cannot be given without a least some consideration about the impact that a positive response will have on other areas of government policy and spending.
Some challenges relate to the management of financial sector which may have macroeconomic consequences. So the department spends a lot of time ensuring that there is coordination of policies and that impact on the economy is well calculated.

At times there are disagreements about pertinent policy questions and the direction the country should take. However, these often add to the richness of the debate as officials often disagree about the issues as they have to weigh different aspects of policy questions differently and come to different conclusions about the appropriateness and affordability of those policies.

Other domestic responsibilities

The Minister of Finance is also responsible for institutions such as the Development Bank of Southern Africa (DBSA), The Land Bank, The Financial Services Board (FSB), the Accounting Standards Board, and the Public Investment Corporation (PIC). While each of

these plays an important role in the economy, SARS, the Financial Intelligence Centre (FIC) and StasSA take up a greater proportion of the Minister's time than the others. Before returning to the other entities the next sections focus on these three.

While the PFMA provides that the Minister is the 'head' of the National Treasury, and while this means that there are almost no areas in which the Minister may not intervene in the decision-making processes within the National Treasury. There are good reasons why the Minister of Finance has less authority over the operational activities in the other three agencies. The Minister cannot order that the tax affairs of an individual or company be investigated (or that an investigation be terminated). Nor can the Minister insist that SARS treat some or other class of tax-payer differently from the others. Similarly, the Minister cannot intervene on behalf of a person or institution alleged to have been involved in the laundering of funds and into whose activities the FIC is looking. The Minister also cannot determine how StatsSA should conduct its surveys or report its findings.

There are reasons for all these limitations including limiting the scope for political interference in decisions which might jeopardise constitutional order. Thus this means that these institutions enjoy a measure of formal, statutory independence from the executive authority.

StatsSA

It is important that the institution produces reliable, timely and credible statistics government can take well informed decisions. If data on employment and poverty and living conditions were unavailable or unreliable, it would be impossible to assess the impact of government's programmes. If inflation data is unreliable the Reserve Bank cannot make sound decisions about interest rates. If data on economic activity and price trends and production levels in various sectors was inadequate or misleading, banks and financial institutions would be unable to assess economic conditions adequately and would have to be that much more conservative in their lending decisions.

In 2006/07, StatsSA worked with the Presidency to compile a compendium of statistics (not all of which are based on StatsSA's surveys) reflecting the quality of life of the

country's people. Without this it would be difficult to assess what progress has been made in delivering 'a better life for all'.

The institution also produces population estimates and various other infrastructural and social data which is used to determine the equitable share formula in distributing national revenue.

The data that StatsSA does produce (and there are something like 300 releases every year, with 7,000 individual data items), are among the most important data collections in the country. These include data on:

- The number of people in South Africa, their distribution across the country, as well as various aspects of the population's profile such as its age and gender distribution, the size of households, their access to basic services, etc.;
- The state of the labour market, with regular surveys both of households and of businesses in the formal sector seeking to chart employment and wage trends;
- The performance of individual sectors of the economy, such as tourism, mining, construction and international trade;
- Official registrations of births, deaths, marriages, and insolvencies; and
- Monthly data on consumer and production prices.

Producing these statistics is not easy: in order to survey an industry, one must have a register of all the entities in that industry so that one can draw samples that are representative. The same is true for household surveys and labour force surveys and all the rest. The difficulties are - a significant proportion of South African life is not as carefully recorded and social and economic forces are in constant flux, making it difficult to ensure that yesterday's registers reflect today's reality. Problems of a similar kind arise with inflation (and, for that matter, with valuing GDP), when changes in patterns of consumption (and production) mean that the collection of data on the basis of the historical their profiles can lead to a misrepresentation of present reality.

These are technical matters which challenge all statistics agencies (including, most recently, Statistics Canada), and, on occasion, they have led to credibility-damaging challenges. One of these was the discovery in 2003 that methodological problems relating

to the collection of data on residential rents had led to the overstating of inflation. This mistake had significant economic consequences because it impacted on the implementation of the Reserve Bank's monetary policies. Another challenge happened during Census 2001 with a substantial undercount of the population.

These challenges are being raised not to criticise StatsSA, but to suggest the critical importance of seeking to enhance the quality of work done by StatsSA. This is an area of precise technical skills where even seemingly small errors can have very serious consequences. As a result, the executive authority needs to work hard with the Statistician-General to make sure that everything is being done to ensure that StatsSA's work is of the highest quality of work. While StatsSA is tasked with producing a range of official statistics, precisely because of the difficulties of constructing and maintaining frames from which to draw representative samples, there is plenty of room for debate about how to interpret the figures. The Statistics Advisory Council therefore becomes important in providing guidance about some of these issues. The Council is appointed by the Minister of Finance and can source skills from outside of StatsSA in as a way of assisting both the Statistician-General and the Minister of Finance about the quality and reliability StatsSA's work.

One critical issue that cannot be addressed by StatsSA alone, is the fact that the social and political environment within which the organisation conducts its work is not especially literate when it comes to the interpretation of data. This means that data is sometimes deliberately misused, misunderstood or misinterpreted. The challenge for StatsSA is to ensure that it crafts its products and its messages as carefully and comprehensibly as possible, and works closely with other stake-holders to raise the level of statistics-literacy.

There are limitations stipulated in legislation that restrict what the Minister of Finance's involvement in StatSA can be. These limitations are appropriate in that they seek to prevent political interference in gathering, analysing and disseminating statistics. Thus, the Statistics Act says that the Minister must 'prioritise the work programme' of StatsSA and monitor the performance of the Statistician-General in his functions as accounting officer. The Minister may even direct the Statistician-General to undertake some or other statistical collection. What the Minister is not allowed to do, however, is 'interfere with the

power of the Statistician-General to decide… on (a) the manner in which, and the time when, a statistical collection is to be undertaken; (b) the form, extent and timing of the release of statistical information; or (c) whether a statistical collection should be discontinued.'

In very broad terms this entails a focus on three critical developments:

- Implementing the Statistical Quality Assessment Framework in order to ensure that every aspect of the production of statistics can be assessed and processes can be improved;
- Building human and institutional capacity, especially its high-level analytical capabilities; and
- Improving critical statistics infrastructure, which involves constructing out dwelling frame as well as working with other departments, such as Home Affairs (which manages the population register), SARS and the DTI (which manage the business register).

In practical terms, StatsSA's mandate is undertaken through a structure composing of six divisions. These manage StatsSA's interface with the users (and some providers) of its statistics, ensure that the relevant databases are as up-to-date and comprehensive as possible, manage the quality of work done by the department, and conduct the numerous surveys which the institution produces.

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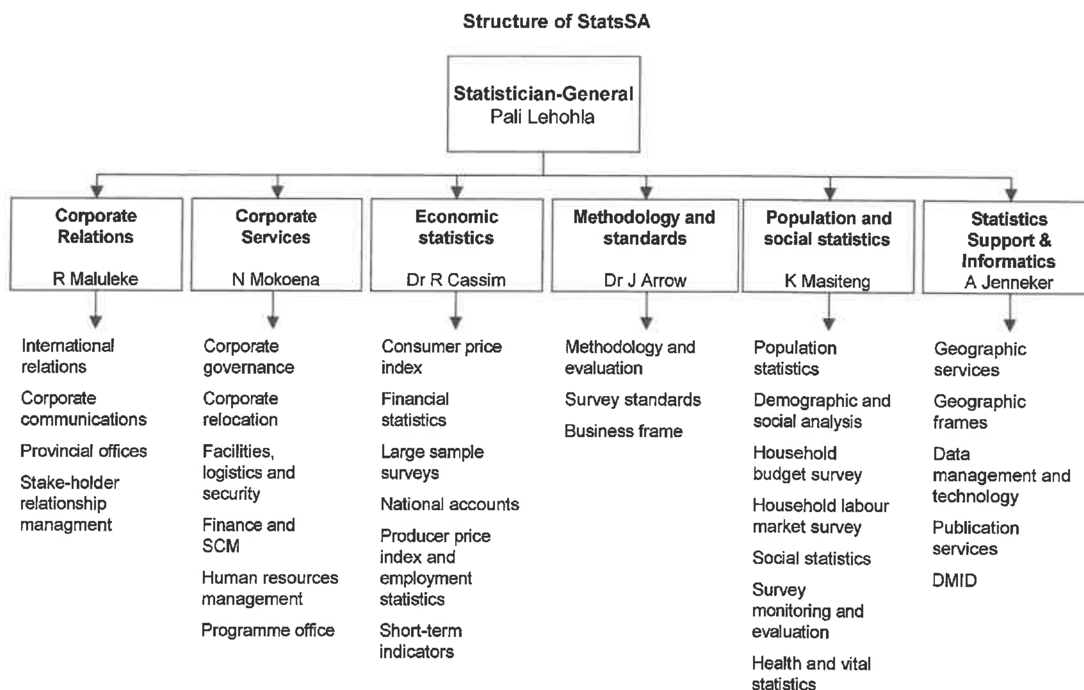


Economic statistics

The Economic Statistics cluster is responsible for data relating to the economic activity and prices, including data on GDP and employment, on the value of turnover in a number of sectors of the economy, on inflation rates (consumer and producer) and on government's spending. The data is produced through tracking data surveys or as in the case of inflation, by capturing around 1,000 unique prices every month.

The complex task of weighting prices in order accurately reflect the baskets of goods and services purchased by consumers and producers was recently completed. The latest income and expenditure survey (for 2005/06) was released in March.

Some of the priorities for the short- and medium-term are to:

- Continue to produce timely, accurate and comprehensive economic data;
- Improve the coverage of quarterly surveys of the ten largest sectors of the economy, by ensuring that the business register is comprehensive and that the response rates to surveys are as high as possible;

- Developing tools – such as instruments measuring the expenditure side of the economy – that will facilitate the cross-checking and appropriate weighting of production data; and
- Managing and bedding down the new processes being used to produce inflation data.

Population and social statistics

This cluster is responsible for a range of statistical products. These include those related to births, deaths, marriages and divorces, as well as those relating to living conditions and demographic trends (including annual population estimates). In addition it produces data on labour market activity, through the household labour market survey.

Over the short- and medium-term, work needs to focus on:

- Ensuring that Census 2011 (and this year's pilot) is executed flawlessly;
- Managing and popularising the use of indices developed by StatsSA and the National Treasury to measure and track poverty; and
- The first deployment, in September, of the Living Conditions Survey, which will provide data on most aspects household welfare including poverty, employment patterns, household enterprises, and so school enrolment.

Methodology and standards

This cluster ensures that the methodologies deployed by StatsSA are of the highest technical quality possible, and provides guidance to the rest of StatsSA in this regard. Over the short- and medium-term, efforts need to focus on:

- Ensuring the continuous improvement of methodologies throughout StatsSA, through standards-development and the regular auditing of individual surveys;
- Continuing to improve the business frame, though developing relatively absent analytical skills that would help ensure improved profiling of businesses, where complex corporate structures make accurate classification difficult;
- Continuing to work with the rest of the Governance and Administration Cluster to ensure that the National Statistics Committee delivers on its mandate – to ensure that

the collection, compilation and analysis of statistics across government is improved, that duplication is eliminated and that gaps are closed;

- Continuing to help the process of reforming business registration procedures in South Africa, to improve the coverage and accuracy of the relevant databases; and
- Continuing to help ensure that skills are developed in this area.

Statistical support and informatics

For accurate household statistics to be gathered, it is essential that there is a comprehensive database on dwellings and other structures. This is true for every kind of household survey, but it is especially true of the census, which involves sending interviewers to every home in the country. Building and maintaining this database is a long-term priority for this cluster, and for StatsSA.

This cluster also hosts StatsSA's in-house publication service and its IT and data management capabilities.

Corporate relations

It is critical that StatsSA maintain good relations with key role-players, especially respondents to questionnaires, suppliers of administrative data and users of statistical products. This is a prerequisite to the sound functioning of the statistical system and the deepening of statistical literacy.

In the short- and medium-term, efforts need to be directed at:

- Ensuring that the appropriate infrastructure is in place for the collection and dissemination of official statistics;
- Ensuring that the requirements of the National Statistics System are met, especially at provincial and local levels; and
- Hosting a variety of regional and international initiatives, including the 2009 conference of the International Statistics Institute.

Conclusion: StatsSA

Over the past five years, StatsSA has become an increasingly professional and effective agency, and has executed initiatives aimed at addressing the root causes of the problems with the compilation of the CPI and similar problems. There remain issues that need to be dealt with, such as building statistical infrastructure and issues of governance and skill; for the most part, however, StatsSA seems on an upward path of institutional improvement.

Perhaps the biggest problem that StatsSA faces – and it is not of their making – is that South Africa is not an especially fertile ground in which to fulfil these kinds of responsibilities. This is because, as already mentioned, statistical literacy is lacking across government and civil society. Consequently, StatsSA struggles to find and retain the high-level technical skills an agency of this sort needs, and its products are routinely misunderstood and misinterpreted. It reflects well on the organisation that it has made steady progress in spite of these obstacles. At the same time, over the medium- and long-term, it is this that most needs to change to put the management of policy-development and assessment of the impact of government programmes on a better footing. The organisation's key medium-term priorities therefore relate to:

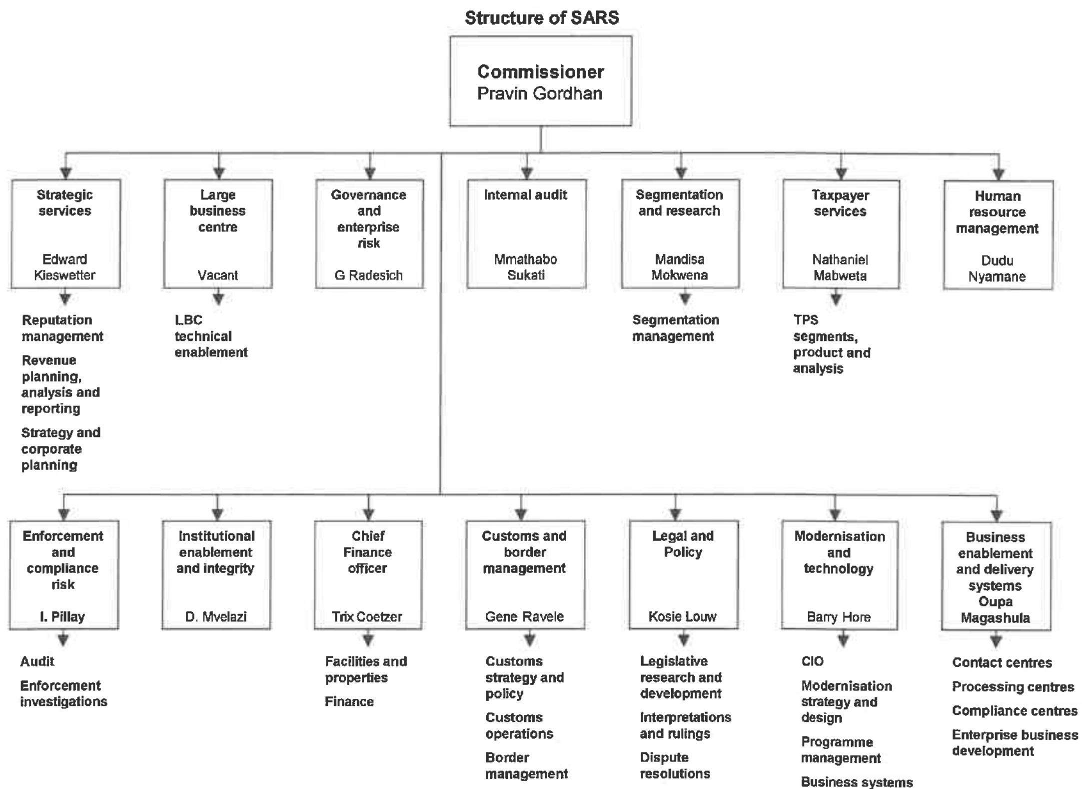
- Conducting capacity-building programmes internally;
- Improving statistical literacy across the rest of government to improve decision- and policy-making, and improve government's ability to assess its achievements and those of its staff; and
- Building statistics literacy at school

SARS

The statutory mandate of SARS is pleasingly clear compared to those given to most government agencies: according to s3 of the South African Revenue Services Act, which establishes the institution as a public entity funded from the National Treasury's Vote, SARS's objective is 'the efficient and effective collection of revenue.' Achieving this is, of course, more complicated than the objective suggests. SARS is a large enterprise, employing nearly 15,000 people who are tasked with, amongst others, maintaining SARS's databases of tax-payers and traders, engaging with tax-payers (through electronic

platforms, offices, call centres and various special units such as the Large Business Centres), auditing returns and other declarations, managing customs operations at border posts, managing the processes of collecting revenues and refunding tax-payers, investigating tax offences, and policing the integrity and honesty within SARS itself. In addition to making itself as accessible as possible and enforcing the law against those who evade taxes, SARS also tries to find other ways to impact positively on the culture of tax compliance.

As SARS plays a role in collecting customs duties on imported goods, it also has a responsibility toward the management and implementation of trade policies and trade agreements, including incentive schemes such as MIDP. For this reason, it advises both the Minister of Finance and the Minister of Trade and Industry on the design, administration and enforcement of trade and tax policies. SARS also plays a role in protecting South African producers and consumers from illegal imports.



While the functions of SARS officials may be complex, they all proceed from the most straightforward of organisational mandates: the efficient and effective collection of revenue. As a result, SARS's role is less that of policy-making and more one of administering tax and trade policies. The Act thus provides that most of the key decisions giving effect to the SARS mandate are to be made by the Commissioner, to whom the Act gives wide authority for running the organisation. It is, however, the Minister of Finance who appoints the Commissioner after consulting Cabinet. The Minister also appoints an Advisory Board to advise him or her on a range of matters relating to the management of SARS.

While SARS and the Commissioner are reasonably independent of the Minister on operational matters, the Act also provides that SARS is 'under the policy control of the Minister' and 'subject to any directives and guidelines on policy matters issued by the Minister.' Therefore, although SARS collects and analyses tax data essential for drafting tax policy, it is an implementation and enforcement agency. Policy processes relating to taxation are driven by the Minister, who typically tasks analysts in the National Treasury and SARS with assessing policy options.

This is not to undermine SARS. It is doubtful that there is any single agency in government whose operational performance is more critical to the work of government than SARS's. The rigorous focus on improving administrative efficiency is the most important policy process in SARS, and its performance in gathering revenues is the most important issue likely to exercise the Minister of Finance's mind in relation to this entity. In practice, that means continuous engagement with SARS about its performance and ways to overcome problems in enforcing relevant laws, developing appropriate outreach activities, and improving levels of service received by tax-payers.

This is not an absolutely straightforward task: despite the fact that people complain about the quality of public services, no tax-payer anywhere in the world relishes paying their taxes. Even before one thinks about the challenges presented by those seeking to profit by gaming the tax system, the free-rider problem among tax-payers is immense. Everywhere in the world, people attempt to minimise, defer, avoid and evade their tax obligations.

In South Africa, these problems are potentially more severe. One reason for this is the extent to which economic activity in the country is undocumented. Most undocumented activity is survivalist, and incomes, as a consequence, usually fall below the relevant tax thresholds. However, the ability to avoid leaving paper trails is not confined to the poor but extends to the very highest reaches of the income pyramid.

A second problem is that the system of revenue collection inherited from the old regime was ludicrously inefficient and ineffective, with human and technological systems that could not possibly serve a large, complex and modern economy. In such circumstances, tax-payers were either able to evade their responsibilities with impunity or, just as importantly, experienced such poor service from the Revenue Service that they would feel little compunction about failing to declare income.

A third problem is that the fiscus relies disproportionately on a relatively small number of individual and corporate tax-payers. These are not usually the principal beneficiaries of the national democratic project and government programmes flowing from it, and many are historically, socially and politically at odds with that project. Government thus cannot rely on any underlying public-spiritedness among the highest-paying tax-payers to raise levels of compliance. There has always been some danger that levels of tax morality among the group of people on whom the fiscus relies most will be less than optimal.

Given the historical challenges, revenue performance and the performance of the Revenue Service over the past decade has been pleasing. For example, tax revenues grew by more than 13 per cent per year between 1997/98 and 2007/08. That is almost 20 per cent faster than the rate of growth of nominal GDP. Registered tax-payers have grown by more than 50 per cent in the past six years across all categories, and SARS now has over 8 million separate registrations of individuals, companies, trusts, VAT vendors, now on its books. Indeed, in the case of companies, the number of registered tax-payers has all but doubled over that period.

There is also the improvement in the efficiency with which SARS deal with tax-payers. Indicators of this include the rapid take-off of e-filing (with 2 million registered users), the high proportion of calls to call-centres answered within 20 seconds, the even higher

proportion of calls resolved immediately, and the dramatic improvements in turnaround times for tax assessments and payment of refunds.

Another element in improving compliance is the work done by SARS to pursue tax cheats. Almost 70,000 audits were completed in 2007/08, and there have been about 2,000 criminal investigations and 500 successful criminal prosecutions, resulting in the assessment of about R4.7 billion in unpaid taxes and over R10 million paid in fines.

However, there is the view that revenue performance will not be as robust as it has been in the past ten, because of the much lower rate of growth that the economy is likely to enjoy in the short-term. There are also other factors which contributed to successful revenue performance in the past. Unfortunately, some of these also suggest that continued success on the scale achieved over the last decade and a half is unlikely. These factors include:

- The improvement in the legitimacy of the Revenue Service was a consequence not only of its own endeavours, but also of the transition to democracy which boosted the legitimacy of government as a whole;
- The rapid economic growth achieved between 2000 and 2007, which was heavily concentrated in the commodities sector and meant that the quantum of taxes owed by the corporate sector was easier to track than it might otherwise have been; and
- A variety of interventions and policy changes which might not be replicable. These include tax amnesties for irregular off-shore funds and previously-unregistered or non-compliant small businesses, and the introduction of capital gains taxes.

As some of the reasons for SARS's success appear to be specific to the circumstances of the past decade or so, it would be reasonable to think that even in the absence in the decline in growth, revenue performance would not have continued to hold up as well as it has. Nor, in fact, would that be particularly desirable in the context of a severe downturn, since the decline in tax revenues that results from a downturn is one of the automatic stabilisers of the economy. Still, the likely drop off in revenue performance is something that needs to be monitored carefully if it is not to impact on the medium- and long-run sustainability of government's policies.

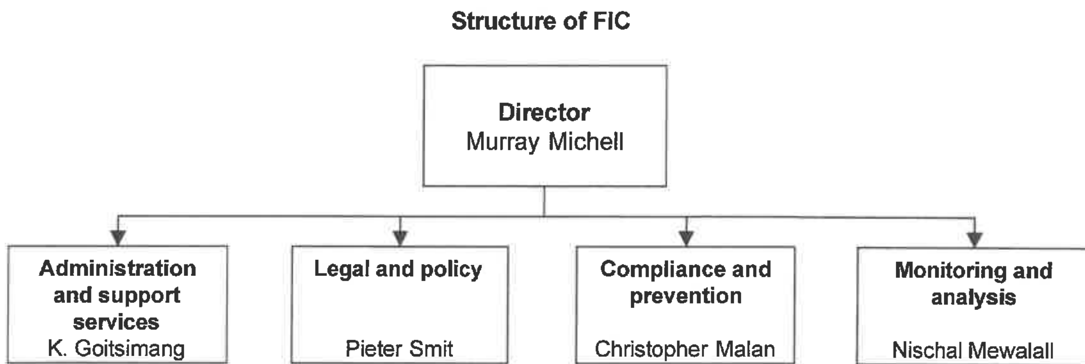
This is the medium- and long-term challenge facing SARS and, by extension the entity's executive authority, the Minister of Finance. In the short- and medium-term, a variety of operational matters need to be implemented. These include the continued rolling out of the modernisation programme and the implementation of a variety of reforms to the tax code, including:

- Administrative reforms such as:
  - Developing an approach to segmenting the tax-base so that SARS's handling of each is tailored to its specific characteristics (which has already led to the establishment of the Large Business Centre);
  - Implementing the modernisation programme to automate low-value processes; and
  - Extending SARS's service footprint in order to improve accessibility.
- Policy reforms, such as:
  - The streamlining of tax procedures, especially for individuals and small and medium-sized businesses;
  - Developing a system for ensuring that taxation agreements with Fifa relating to the 2010 Fifa World Cup are in place and properly implemented;
  - Delaying implementation of new mineral and petroleum royalties until 2010;
  - Switching from the Secondary Tax on Companies to a Dividends Withholding Tax;
  - Implementing tax incentives to encourage investment in and use of energy efficient and green technologies;
  - Developing tax-sharing arrangements with municipalities;
  - Developing plans for a social security system, with associated social security contributions collections;
  - Planning for a possible wage subsidy;
  - Rewriting the Customs and Excise Act to support modern administration and international developments; and
  - Rewriting of the Income Tax Act, beginning with a separate Tax Administration Bill and redrafting the rules governing the taxation of employment income.

The Financial Intelligence Centre

The FIC, a public entity, is the youngest of the four institutions whose functions demand careful attention by the Minister of Finance. Because its character and mandate combine those of regulation, law enforcement and intelligence, it is also quite different from the other institutions for which the Minister is responsible.

Structure of FIC



The Centre was established by the FIC Act (FICA) in 2001, and its essential purpose is to create the systems and processes needed (a) to prevent the abuse of the financial system by criminals seeking to launder the proceeds of their crimes or by those seeking to channel funds to international terrorist groups, (b) to ensure that criminals who do seek to launder those funds are identifiable, and (c) to use the data generated in the process of fulfilling the first two tasks to help policing agencies identify people whose incomes appear to be suspicious, and who may be assessed to see if they are involved in crime. These functions arise, in part, from the creation of money laundering as an offence though the Prevention of Organised Crime Act. The responsible department is the Department of Justice, and the Act is implemented by the National Prosecuting Authority. The introduction of the Protection of Constitutional Democracy against Terrorist and Related Activities Act extended the role of the Centre to performing these functions, in addition to money laundering, to those who would attempt to channel funds to international terrorist groups.

In order to do all this, FICA established a series of obligations on 'accountable institutions' (all financial services companies and a variety of other entities such as car dealers and real estate agents) to ensure that they could properly identify everyone with whom they did business, and that they would report to the FIC any transactions that appeared to be

suspicious. The Act provides that the FIC can request further information about people engaged in transactions that appear suspicious, but it requires that the FIC treat all of this information with utmost confidentiality. It provides, however, that if and when the FIC's analysis suggests that a transaction or series of transactions appears suspicious, it must hand that information over to appropriate investigating authorities.

Therefore, part of the rationale for the existence of the FIC is regulatory (it helps to keep the financial system clean and prevents its use by criminals and terrorists) and part relates to providing new tools and techniques to pursue criminals.

The Centre also formulates policies where these are needed to ensure that government can combat money laundering effectively. The Centre, and by extension the Minister of Finance, are therefore responsible for ensuring that South Africa has the institutional and regulatory capacity to combat money laundering and prevent the financing of terrorism. Achieving this in a manner that meets international norms and standards raises a range of practical and policy questions, and necessitates collaboration across many public sector institutions and law enforcement agencies, each of which answers to its own executive authority and has its own set of institutional and operational priorities.

The legal machinery available to the Centre to assess and enforce compliance with the requirements of the FIC Act has been recently enhanced. Amendments to the Centre's governing legislation will allow it to impose administrative fines on non-compliant institutions, widening its toolbox beyond the criminal sanctions that were made available in the original Act. The Centre will perform this new oversight function in conjunction with existing supervisors of financial and non-financial institutions, including the Registrar of Banks and the Financial Services Board to the Estate Agency Affairs Board, and the National Gambling Board, as well as the supervisors of legal practitioners. It is therefore important that the Centre maintain good working relations with these institutions and the executive authorities to which they answer.

As indicated above, South Africa uses international standards and best practise as the benchmark in the development and implementation of its anti-money laundering regime. To this end, it is a member of the Financial Action Task Force (FATF), which sets

international norms and standards. The FATF consists of 34 members and meets in Plenary three times a year, with the Centre coordinating South Africa's representation at these events. The FATF also has regional bodies throughout the world, including the Eastern and Southern Africa Anti Money Laundering Group which consists of 14 member countries, all of which subscribe to the FATF standards and principles.

An implication of FATF membership is its peer review system. The FATF recently conducted the peer review of South Africa's measures to combat money laundering and terror financing. The Centre was responsible for coordinating the participation of the South African government in this process. While the outcome of this review was generally favourable, the review also identified a number of areas where various government agencies ought to take action to improve the overall system efficacy. The Centre will be centrally responsible in coordinating this process of remedial action and reporting back to the FATF.

Another implication of membership of the FATF is that its activities and processes sometimes have implications for the conduct of foreign policy. One way in which this might occur for example, is when the work of the FATF is directed at countries partly on the basis of the foreign policy objectives of other countries, rather than on the need to ensure that their money laundering policies comply with international norms. Because South Africa does not always share the foreign policy concerns that motivate these engagements, but does share the concern about the efficacy of global strategies against money laundering, negotiating an appropriate stance can sometimes be quite delicate.

A final implication of South Africa's seeking to comply with global norms is that a handful of South Africans have been identified for possible listing by the relevant structures of the United Nations as financiers of terrorism. The consequence of the listing of these individuals would be that South Africa may be required to institute some remarkably punitive steps against them, including the freezing of all of their assets. So far, South Africa has been able to delay the process, through the intervention of the Department of Foreign Affairs at the level of the United Nations. It is likely, however, that at some point these names will be added to the list. When that happens, there are bound to be some fairly

complex legal consequences because the UN processes do not provide for these individuals to make representations.

As a note, the FATF has been called upon by the G20 countries to assist in monitoring non-cooperation by countries within the framework of dealing with the global financial crisis.

Some of the key issues for the FIC over the short- and medium-term include:

- Ensuring that the relevant agencies (especially SAPS, the NPA and the SARS, as well as supervisors of financial and non-financial institutions) take the crime of money laundering seriously, and work together to pursue cases of commercial crime and fraud;
- Monitoring compliance levels of accountable institutions and ensuring that the Centre's strategies in this regard are appropriate; and
- Dealing with issues arising from South Africa's membership of international organisations relating to money laundering and terror financing, such as the peer review of South Africa's system against money laundering and terror financing.

Other public entities

In addition to the National Treasury, StatsSA, SARS and the FIC, there are a number of other public entities for which the Minister of Finance is the executive authority. Two of these are development finance institutions (DFIs) – the DBSA and the Land Bank. Three others are regulatory/supervisory bodies – the FSB, the Registrar of Banks (which is a unit within the Reserve Bank, but can fulfil many of its functions only after consultation with the Minister of Finance), and the Accounting Standards Board (ASB). The last is an investment company – the PIC.

As with all the other agencies, the Minister of Finance is responsible for appointing the chairperson and/or CEO of these organisations, as well as for appointing members to boards and advisory boards where these exist. Beyond that, ministerial interest in these entities is largely that they fulfil their mandates as effectively and efficiently as possible. In some cases, however, that might require some degree of restructuring and recapitalisation.

The Development Finance Institutions

Though DFIs sometimes provide grant funding to specific projects (which the 2008 review of DFIs suggests should be limited to projects building the capacity of recipients to obtain private sector credit), their principal role is to provide risk-based financial services. These services – principally loans, equity investments and guarantees – are extended to a variety of institutions, both public and private. They are intended to support economic activities deemed likely to generate a reasonable return on investment, but which for some reason cannot be financed from private sector sources.

The DBSA

Within the broad mandate of DFIs, the specific mandate of the DBSA is to fund social infrastructure investments in South and Southern Africa. It plays four roles: advising institutions on improving their capacity; assisting institutions leverage private sector involvement into development projects; driving and implementing key interventions; and integrating the work of diverse role-players. These roles are focussed on three key strategic priorities: driving social transformation, enhancing economic potential and growth, and developing capacity (especially in weaker institutions).

Given its mandate, a large proportion of its loans and investments have been extended to local governments and public utilities. These are currently worth about R35 billion, with annual disbursements projected to be in the order of R6 billion over the medium-term. Three quarters of this is disbursed to South African institutions and entities. The DBSA is also used to direct some funds to municipalities whose capacity problems are so great that they are struggling to access even public finance sources, such as the Municipal Infrastructure Grant.

In the short- and medium-term, issues that may need attention include:

- Deepening the developmental impact of spending by:
    - Mobilising co-funding from other sources;

  - Ensuring that an ever-greater proportion of disbursements are to the poorest municipalities; and
  - Ensuring that job-creation and the use of small businesses are at the centre of project planning;
- Continuing to roll out the Siyenza Manje project and other initiatives aimed at improving capacity in local government (often by deploying experts directly to those institutions), so that they become better credit risks and are able to access conditional grants;
- Diversifying the Bank's client base and widening its sectoral scope to include under-served parts of the public sector;
- Ensuring improved public-private cooperation in the delivery of development funding;
- Continuing to improve cooperation with other development funders and aid agencies; and
- Ensuring that the DBSA and National Treasury's Asset and Liability Management division work through the costs and benefits of the DBSA's proposal to increase its callable capital from R4.8 billion to R20 billion.

The Land and Agricultural Bank of Southern Africa

The Land Bank is an agricultural development finance institution that supports economic growth through the provision of retail, wholesale, project and micro-financial services to agriculture and related rural sectors. It offers its services to both the commercial and the emerging agricultural sectors and has assets worth about R16 billion.

The critical challenge facing the Land Bank is finding a balance between playing a more robust developmental role and maintaining financial and institutional stability. Striking this balance has been made difficult by the fact that loans to emerging farmers are more risky and expensive than loans to established, commercial enterprises. A number of commercial banks have also recently entered or re-entered the agricultural space, which has been seen as more viable, given the rapid rise in food prices. This has had negative implications for the extent to which potential investors see the Land Bank as the most efficient platform for accessing this market, making it harder for the Land Bank to source capital. The Land

Bank's balance sheet has already weakened significantly because of the poor and declining quality of its loan book.

Given the rather risky state of the institution, its high cost structure and the weaknesses of some of its systems, the changing competitive environment created a real danger of institutional failure and loan defaults. This has led to the development of a turnaround strategy which focuses on:

- Streamlining systems and improving processes;
- Properly aligning resources to strengthen skills and capacity;
- Enhancing management of systems, risks, revenues and costs;
- Improving the image of the Bank;
- Adopting an enterprise-wide risk management framework; and
- Implementing a fraud and corruption prevention plan.

Regarding its role in the development of the emerging agricultural sector, the Land Bank has recognised that the source of high levels of loan default is the lack of post-approval assistance. It is now seeking to develop mechanisms to continue to support recipients of loans. These include:

- Structuring funding so that farmers have access to supplementary resources, such as grants, to augment financial resources;
- Actively facilitating the linkage between farmers and institutions that provide support, such as the National Agriculture Marketing Council and the Agriculture Research Council; and
- Creating an enabling environment for farmers to effectively benefit from skills transfer to access markets and become part of strategic networks.

Over the medium- and long-term, the most important question is whether the Land Bank can be turned into a viable DFI with a proud record of funding rural development. In the short- and medium-term, however, the critical question is how quickly and effectively the turnaround strategy can be implemented.

The regulatory bodies

The Minister of Finance plays a critical role in overseeing, regulating and managing the policy processes in the financial. The two bodies through which much of this work is done are the Registrar of Banks (which oversees the banking industry) and the Financial Services Board (which oversees non-banking financial services.).

In addition to these two institutions, a third, the Cooperative Banks Development Agency (CBDA), has recently been established by an Act of parliament. It will regulate the cooperative banks sector, which will include deposit-taking financial services cooperatives, savings and credit cooperatives, as well as community and village banks. The Agency will be funded by a transfer from the National Treasury's Vote and was established primarily to counter challenges in many cooperative banks. The agency has begun to receive funds and will in the short- to medium-term begin licensing and regulating entities.

Finally, a fourth regulatory entity is the Accounting Standards Board. It is responsible for maintaining and developing accounting standards used in the public service, and to recommend to the Minister the dates on which new standards are to become effective. It is funded through a transfer from Parliament of around R3 million per year. The Board has published a variety of policies and practice notes, which guide institutions in the public service on how to report income and expenditure, and assets and liabilities.

Its accounting standards development role is a critical element in the process of moving accounting standards in government closer to an accrual-based approach. It is also central to the development of the IT systems on which financial management in government is done. It however, has no operational responsibilities other than drafting these standards, with the National Treasury, SARS and the Auditor-General.

The FSB

The FSB is responsible for regulating activities of a range of (non-banking) commercial institutions in the financial sector. It is funded through levies on institutions in the industries they regulate. The industries account for hundreds of billions of rands worth of

turnover every year, with entities being supervised including 2 capital markets, 2,100 authorised users of those markets, 14,500 authorised financial services providers, nearly 200 insurance companies, 12,500 retirement funds and friendly societies, and 1,400 collective investment schemes. All of these must comply with the relevant legislation in terms of which they conduct their business (such as the Pension Funds Act, the Financial Supervision of the Road Accident Fund Act, the Long- and Short- term Insurance Acts, and the Collective Investment Schemes Control Act) and with the various pieces legislation such as FICA and the Financial Advisory and Intermediary Act.

Also, the FSB is responsible for maintaining the capital adequacy ratios required to ensure the soundness of the entities and the stability of the system. This is a critical role which ensures that the financial sector functions adequately. The importance of this function has been reaffirmed by the recent crisis in global financial markets. The FSB also ensures that capital markets work efficiently and that market players abide by the rules against insider trading and other forms of market abuse.

The FSB registers and licences insurance companies and retirement funds and ensures their financial soundness. However, it does not regulate new product offerings, something that may be a gap, given the pace of innovation in the industry. Finally, it is responsible for ensuring that insurers comply with the terms of their agreements with policy-holders.

The FSB also registers and monitors the market conduct of financial advisors and also helps build an informed and critical public and investing community.

Its short-term objectives are to:

- Address issues relating to the lack of compliance with s14 of the Pensions Fund Act (which provides for the transfer of funds from one pension fund to another);
- Encourage the industry to finalise the submission of all surplus schemes;
- Assist the National Treasury with the process of retirement reform, especially in relation to the implementation of a social security system;
- Assist the National Treasury with the development of a regulatory framework for micro-insurance;

- Continue developing proposals with industry to introduce Financial Condition Reporting for short-term insurers;
- Continue with an investigation regarding the role of the statutory actuary in a life insurer;
- Start a process for new solvency requirements of long-term insurers; and
- Assist with legislative changes to the Long-term and Short-term Insurance Acts.

Registrar of Banks

The South African Reserve Bank (SARB) performs its functions independently but with regular consultation with the Minister of Finance. Within SARB is a unit called the Registrar of Banks licenses bank which is independent of government and mostly owned by private shareholders. The Registrar of Banks licenses banks and regulates the banking industry. It also has powers of inspection, though it tends to use a risk-based approach to supervision. Most of the regulatory functions of the Registrar are conducted on the basis of policies regulated by the Minister, and many of its decisions are done in or after consultation with the Minister.

South Africa's banks were not directly exposed to the financial products at the heart of the crisis. This is the result of a cautious approach in the banking system. However, the economic crisis may impact on South African banks in the short- and medium-term. Since 2001, the Registrar has been working with the banking sector on the implementation of the Basel II accords. Basel II sets out new methods for assessing and regulating bank governance and the adequacy of their reserves. This process culminated in the implementation of Basel II on 1 January 2008.

Because Basel II protocols require banks to model the riskiness of their assets and to accord reserves on the basis of the results of these models, it requires a modification of the approach to supervisions. This has been designed and is being implemented with continuous improvements. Also, there is ongoing international debate about whether Basel II protocols have played a role in the recent crisis or have helped amplify it.

Apart from supervising the adequacy of capital reserves, the Registrar plays a number of other roles in regulating the industry including:

- Licensing and registering banks, including branches of international banks, so that they may take deposits and do banking;
- Approving or disapproving certain transactions involving the purchase or sale of banks;
- Regulating certain forms of market conduct, including in such areas as credit extension; and
- Involving itself in consumer education.

The GEPF and the PIC

The Minister of Finance is the executive authority responsible for the Government Employees Pension Fund. The Fund currently has over 1.1 million members and is the largest pension fund in the country and the 21st largest in the world. It is run by a board representing its members and is a defined benefit fund, the surplus funds of which are managed by the Public Investment Corporation.

In addition to the GEPF a separate system of special pensions applies to people who 'made sacrifices or served the public interest in establishing a non-racial, democratic and constitutional South Africa'. There are some administrative challenges needing urgent attention at special pension. Also, the unit has been very slow to process applications, leading to frustration for many applicants.

The PIC currently manages R800 billion from GEPF's funds. The PIC is wholly owned by government, with the Minister of Finance acting as share-holder. In is managed by an independent board which is appointed by the Minister of Finance, who must take into account the nominations submitted by depositors when he or she does so.

The Minister of Finance and the conduct of monetary policy

The Minister is not directly responsible for the conduct of monetary policy. However, the country's macroeconomic policies provide a less effective set of tools with which to drive

economic growth and job creation. Fiscal policy, while not the exclusive preserve of the Minister of Finance is a matter over which the Minister plays a reasonably decisive role. However, the conduct of monetary policy is the responsibility of the Governor of the South African Reserve Bank.

The independence of the Reserve Bank

The SARB is primarily responsible to protect the value of the currency in the interest of balanced and sustainable economic growth in the Republic. This means to combat inflation. The Bank's inflation targeting has been a subject of controversy for a number of years. Some people say that the SARB should also be conscious of the impact that its efforts to contain inflation may have on economic growth and job creation.

The Governor of the Bank is appointed by the President after consultation with the Minister of Finance. The Bank is protected by the Constitution which states that the Bank must pursue its mandate independently and without fear, favour or prejudice. The Minister of Finance determines the band within with annual inflation rates are expected to fall. This has been the practise since inflation targeting was introduced in 2000.

Central bank's independence ensures that its decisions are not influenced by the political in government and allows it to maintain stability in the value of the currency. However, this does mean that there should never be communication between the Reserve Bank and government. There should be synergy in monetary and fiscal policy choices undertaken thus coordination is important. Coordination does not mean that decisions of the Reserve Bank must be subordinated to government's decisions relating to fiscal policy.

International responsibilities of the Minister of Finance

The Minister of Finance also represents South Africa in international fora and institutions. In this role the Minister is ably assisted by official within National Treasury.

Some of the Minister's interactions and on-going work includes:

- Financing African development, including questions of the volume and effectiveness of aid, access to capital markets and the deployment of resources like those under the management of the African Development Bank;
- Improving intra-African trade, an issue that involves both questions of regulatory policy and questions of infrastructural development;
- Assisting other developing countries, especially in Africa, establish sound budgeting and financial management systems, as well as policies relating to intergovernmental fiscal relations;
- Dealing with the legacy of debt with which many poor countries – not just in Africa – are saddled;
- Addressing a range of questions relating to global trade, to the flow of capital and to the links between the two;
- Playing a role in the deliberations and decision-making of multilateral institutions such as the World Bank and the IMF, while also dealing with questions arising about their institutional structure and governance;
- Managing economic and financial aspects of South Africa's treaty obligations, including tax agreements, the implementation of anti-money laundering regimes, as well as the adoption of international codes of practice in taxation and customs and government accounting and in the regulation of the financial sector of the economy;
- Participating in global processes assessing the economic impact of, and responses to, climate change; and
- 'Marketing' South Africa and the South African economy to private international investors, including potential purchasers of government debt.

In the short to medium term, the key issues with which the Minister of Finance will have to deal include:

- Dealing with the economic and policy challenges arising from the global slowdown and its causes;
- The reform of the Bretton Woods institutions;
- Strengthening of cooperation between South Africa and the Organisation for Economic Cooperation and Development (a partnership for which the lead South African department is the National Treasury);

- Recruiting new Senior Advisors to the World Bank and IMF for South Africa as the incumbents' appointments are beginning to draw to a close;
- Negotiating the constituency structure that will provide the third Chair for Africa in the World Bank board, while seeking to ensure that South Africa retains its leadership position;
- Coordinating of World Bank's programme in South Africa in order to maximise the country's access to financing for its infrastructure programme; and
- Continuing South Africa's leadership and advocacy roles in debates about development finance.

Conclusion: the role of the Minister of Finance

This section sought to outline the principle roles of the Minister of Finance. These roles include various policy-making functions and some regulatory functions. The Minister of Finance is not just the state's book-keeper. He or she is an active participant in the development of policies which must collectively address the development challenges of the country and improve the lives of South Africans. The Minister of Finance therefore needs to carefully consider long-term impact of policies.

THREE

THE MINISTER OF FINANCE AND DEVELOPMENT (I): MACROECONOMIC POLICY

Introduction

The budget reveals the real character of the state and not what the state says about itself. The budget is not entirely divorced from the ideas of the ruling party and the country's citizens. To be relevant a budget needs to be clear about its objectives. The Minister of Finance however, is not just the state's bookkeeper-in-chief and ensure the country's long term prosperity.

The Minister of Finance as a custodian of economic prosperity and development

In broad terms, the Minister of Finance is a custodian of the country's economic resources. He or she has responsibility to ensure that the economy grows quickly, that wealth is shared equitably, and that these objectives are achieved without imposing unsustainable costs on future generations. Therefore, the Minister of Finance is not always going popular with his colleagues. It is the Minister of Finance who advises Cabinet on what is and is not affordable, an analysis that is not always going to be greeted with universal acclaim. All Cabinet Ministers strive to deliver 'a better life for all' and thus pressure to drive faster levels of delivery may be financially unsustainable.

At times the Minister might be at odds with his colleagues when some of his/her colleagues want to pursue policies that might compromise the prospects of long-term economic growth. Because, in that role, he or she cannot be indifferent to policies that increase the costs of doing business in South Africa or increase the perceived risks of investing in the economy.

As a consequence, the Minister of Finance needs to worry about whether the policies being pursued across government help or hinder the pursuit of faster growth. The implications of

any policy however, must always be considered fully and the Minister must be prepared to argue the point in Cabinet.

The focus on the long-term and, in particular, on the drive for rapid and sustained economic growth should not be discarded as a symptom of a kind of Thatcherite faith in 'trickle-down economics'. It is imperative to note that higher long-term growth rates are the key to South Africa's social and economic development. South Africa cannot break the poverty trap and address the challenges of development without sustained growth. That is not all there is to development, of course, but it is one of the principle developmental challenges South Africa faces.

The Minister of Finance and the challenges of development

For the past fifteen years, government has been committed to the broadest possible goal: 'a better life for all'. Within that, however, the conscious bias of its policies has been to improve the standards of living of the country's poor.

Despite the achievements that have been made South Africa's development challenges remain. More than 70 per cent of households (accounting for about 35 million people) have an income of less than R50, 000 per year (or about R1, 000 per person per month), while more than 10 million of people live on less than R250 per month; about 30 per cent of households do not live in a formal structure, with similar numbers of households lacking access to sanitation and electricity; 25 per cent of adults are illiterate; and life expectancy is in the forties. And this is despite the fact that millions of houses that have been built, that hundreds of thousands of jobs that have been created, and increases on grants, and healthcare and education have been effected.

If the country is to succeed in all the tasks at hand – if habitable homes are to be built, if quality education and health care are to be provided, if households are to have access to electricity and water, and if communities are to be made safe – then a large number of profound challenges must be overcome. It is, after all, not enough to build lots of houses, but the resulting communities must be economically and socially viable; it is not enough to erect schools and clinics, but they must be staffed with committed professionals and

stocked with appropriate medication; it is not enough to employ police officers, but they must be effectively managed.

Such is the nature of the challenge. And it demands hard work, clear thinking and bold action from government.

The poverty trap

Millions of people live without access to decent education and housing and healthcare and that is a *symptom* or effect of poverty. The same deficiencies are also a *cause* of poverty: those who have been denied a good education struggle harder to find jobs; those who live in unsanitary conditions or who lack access to quality healthcare are more susceptible illness and are more likely to become burdens on their families.

The poor, then, are stuck in a poverty trap and become unable to pull themselves out of poverty.

A classic example of this arises in the manner in which the poor are doubly excluded from the spatial economy: being poor, they cannot live in areas which are close to employment opportunities because these are relatively expensive. Also because they live where employment opportunities are scarce, they cannot work and earn the income they need to move to areas closer to realistic employment opportunities. Education is another example of this kind: for the poor, the inequalities in education tend to reproduce themselves across the generations.

Fundamentally, South Africa's development challenge involves breaking the vicious cycle of poverty. Because the poor are trapped in their poverty they cannot break out of it themselves government that must intervene to help them. Government can intervene *directly* by providing incomes (through grants and welfare payment or by subsidising the cost of goods and services used by the poor) or by employing more people or by providing goods and services which the poor could not afford on their own; alternatively. Government could pursue an *indirect* strategy by adopting policies that promote economic growth and job creation and thus improve the people's quality of life.

These choices are not mutually exclusive. However, because all direct interventions cost money, each needs to be assessed for the likely impact. The difficulty here is that because their impacts differ fundamentally, rigorous comparison across alternative interventions is usually difficult and sometimes impossible. Policy-makers seldom about what kinds of interventions work best at breaking the poverty trap. Further, because each intervention will typically benefit a different constituency government would still face the delicate task of choosing between equally deserving constituencies.

This demonstrates that careful analysis must precede the allocation of funds and that careful evaluation of its impact must follow spending. Government must always understand what the public funds buy.

Government also needs to address the issue of affordability which limits how much can be done. Even if taxes on the wealthy were dramatically and spent on the poor this would not impair the economy's long-term capacity to grow. It would also be insufficient to lift the poor out of poverty. If even a radical increase in taxation would not generate sufficient resources to alleviate poverty, then robust economic growth is a precondition for addressing South Africa's socio-economic challenges. Obviously, economic growth alone will not ensure the full and equitable development of South Africa and its people.

Interestingly, at 4 per cent average annual growth per capita income doubles every 18 years. At 2.2 per cent average annual per capita growth per capita income doubles every 32 years. At 0.2 per cent per year (which is all that South Africa achieved), per capita income doubles every 3.5 *centuries.* [1] That is partly why South Africa continues to lack poverty reducing resources. As important as the effect of growth on facilitating poverty alleviation through increased state spending, its contribution is felt most directly through job creation.

Job creation in the South African economy

The South African economy has not created the number of jobs it needs to break the poverty trap. Since unemployment is the single biggest cause of poverty, government's

[1] Figures come from the OECD assessment of the SA economy.

priority continues to be job creation. There is no one particular reason why the country has failed to create more jobs and this remains a subject of debate.

While significant changes in the economy have taken place since 1994, historic elements rooted in the apartheid era unfortunately continue to dominate the economy. The inherent growth strategy therefore has shaped habits of thinking and investing. As a result some sectors of the economy found ways to increase revenues and profits through improving productivity rather than expanding employment. This, certainly, seems to be true of the mining sector which has seen a large decline in employment in the past few decades driven by declining yields and increased mechanisation.

Changes in the global economy over the past few decades have meant that pursuing an alternative strategy based on low-skill economic activity has become increasingly difficult.

Changes in the structure of the local and the global economy have seen the rise in demand for the goods and services produced by highly-skilled workers. Another, even more important factor, however, is that the fall in transportation costs and other barriers to trade has meant that millions of low-skilled workers (mainly in East and South Asia) have entered the global production system. Inevitably, as the demand for less skill-intensive goods has fallen relative to the demand for more skill-intensive goods, and as the supply of low-skilled workers has risen relative to the supply of high-skilled workers, so the price of low-skilled labour has fallen. As a result global wages for low skill work have been driven down, making it possible for South Africa to import some manufactured goods that do not require high levels of skill cheaply.

Even if it were desirable to pursue a low-skill strategy successfully implementing one would be difficult: what demand exists for low-skill products is more than adequately met by the economies of East and South Asia. The result is that either import barriers would have to be thrown up with negative implications for South Africa's inflation and for the quality of goods available to consumers or wage rates would have to fall dramatically.

Still, pursuing a high-skill strategy has not been easy either. This is largely because of the on-going challenge in the education system. It is not easy to change the education system

inherited from apartheid. One estimate suggests that in 2006, only 30 per cent of matric passes come from the 89 per cent of schools formerly classified as serving African learners. This is worsened by the difficulties experienced in implementing new training regimes for those who are already working. Consequently, South African continues to have a relatively unskilled labour force.

Even if South Africa had a much more highly-skilled workforce than it does, it is worth asking whether the country would have access to the capital required to put them to work effectively. In addition to lacking the requisite skills, the country also lacks the necessary capital, equipment, buildings, electricity, roads and logistics infrastructure needed to increase the number of people employed. This is the result of decades of under-investment, by both public and private sectors. Also, because the level of investment in a country is determined by the sum of domestic savings plus the import of foreign savings and less any government dissaving, the lack of investment is also a reflection of the lack of savings and the relatively low level of foreign direct investment flows.

The country's challenges are both complicated and self-reinforcing. The question to ask then is – what can economic policy do to address these over a reasonably short periods?

Growth and the limitations of macroeconomic policy

While the structural causes of unemployment are widely recognised, it is less understood that they are not very amenable to correction through macroeconomic policies. One way to see this is to think about the rate of growth of an economy at any given time as being composed of two relatively distinct components. The one is a long-run trend. The other is made up of short-run fluctuations around that trend.

The pace of the long-term trend rate of growth is driven by factors such as the mobilisation of previously untapped resources, rising levels of education and skill, the level of investment in capital deepening, and the pace of technological change. In South Africa's case, in per capita terms, this trend, despite having risen in recent years, has averaged close to zero over the past 30 years. Policies aimed at changing this for the better need to focus on unlocking the supply side of the economy. In essence, this means raising the level of

investment in physical and human capital, and in research and development. In addition, it involves addressing any factors that might be inhibiting the more efficient use of resources (or, to put this another way, in addressing factors that raise the cost of doing business in South Africa, which might include such things as the high level of crime, high transport costs, high communications costs, limited competition in key industries, and many other issues).

If long-term growth trends are driven by factors affecting the supply-side of the economy, short-term fluctuations around that trend are driven primarily by changes in demand. Inevitably, these ebbs and flows are driven by changes in the consumption patterns of households, the investment decisions of businesses, the spending decisions of government, and/or the choices made by consumers of a country's exports. These changes might be driven by any of a range of different factors, but the crucial point is that a rise or fall in demand doesn't change the capacity of an economy to produce goods and services – that is determined on the supply side of the economy.

Precisely what drives particular changes in aggregate demand is not always clear. What is clear, however, is that these changes can move the economy away from its long-run growth trend. This can result in consumption-fuelled booms and, often, 'overheating' which manifests in a widening deficit on the current account and/or in accelerating inflation. Changes in aggregate demand can also lead to recessions, when demand fails to match the economy's ability to produce goods. In either case, the policy responses are reasonably clear: when the economy overheats, demand must be reduced, either by raising interest rates or tightening fiscal policy; when the economy is in recession, demand must be pumped up by lowering interest rates or loosening fiscal policy.

The Finance Minister may be able to ease recessions, but, when the causes of unemployment are structural, rather than being reflective of a deficiency of aggregate demand, these policy responses might not work.

To put the same point slightly differently, it might be said that, though South Africa's unemployment problem is quantitatively similar to the level of unemployment in the United States in the midst of the Great Depression, its source is not the same.

Unemployment during the Depression was the result of a collapse in demand aggravated by bad economic policy responses. In South Africa, by contrast, the problem is not a cyclical fall in aggregate demand, but that a range of structural (i.e. supply-side) problems which have combined to prevent increased employment. That kind of problem cannot be fixed by pumping up demand through increased government spending or by loosening of monetary policy.

Framing the issues in this way doesn't imply that fiscal policy is completely irrelevant to long-term economic growth. It just means that, on its own, neither the quantum of public spending nor the interest rate can raise a country's long-run growth prospect. Although macroeconomic policies cannot induce rapid economic growth over the medium-term, poor policies can cause economic crisis if spending policies are unsustainable and public debt mounts up too quickly.

Why more spending will not raise growth rates

Consider a hypothetical scenario in which government spent an additional 5 per cent of GDP every year after 1994. What would be the impact on jobs?

Part of the answer depends on how that extra spending would have been financed. If it had been financed by increased taxes, then the impact on employment would have been negligible. By increasing taxes on households and using that to increase public spending that would have caused displacement of aggregate demand from one component of the economy (household consumption) to another (government spending). What it would not have done is raised growth by 5 per cent. Indeed, depending on how tax-payers reacted, it might have reduced consumption spending by more than the rise in public spending. So, in this hypothetical example, if public spending were boosted by 5 per cent of GDP every year for 15 years, the only way that could possibly have a significant impact on employment would be if that were financed by public sector borrowing.

But one must ask whether it is remotely plausible that government could have borrowed this kind of money over this kind of period. The basic issue is that investors would have wondered about the likelihood being repaid any loans they might make, especially since

such expenditure would have directed at redistribution. Even all the money borrowing were invested in projects that were aimed at boosting economic growth, investors would remain sceptical because the returns on those investments would have to be unrealistically large if they were to generate tax flows enough to pay back the investment.

In addition, investors know that a government whose spending is persistently greater than its revenues is very likely one day have to monetise some or its entire deficit. That may not happen at once but monetisation would have to occur and that would lead to inflation. Domestic investors would, therefore, balk at lending to government (since they will fear being repaid in rands whose real value has fallen) while foreign investors would suspect that the currency would depreciate and would demand hefty premiums to cover their exposure to this.

Expansionary fiscal policy cannot eliminate an unemployment problem such as South Africa's because most of the key problems are structural and relate to long-term, supply-side trends in the economy. Fiscal policy, however, is much better suited to dealing with short-term, cyclical fluctuations in aggregate demand. In addition, if the financing of a much more expansionary policy were sourced locally (through taxes or borrowing), it would tend to crowd out other domestic spending, while it is hard to see why foreign investors would take the risk off a serious depreciation in the currency.

That does not mean that either government policies or the manner in which government spends its money is irrelevant for addressing our structural problems, driving increased growth and raising employment levels. What it does mean is that a nation – like all other economic agents – cannot simply borrow its way to prosperity.

So what options are left?

Public spending and economic growth

There are only two factors that govern the long-run rate of growth: (i) the mobilisation of previously unused resources (whether these are natural resources, existing capital equipment or unemployed people) and (ii) the rate of growth of productivity. Of the two

options, it would be preferable for South Africa to find ways to find work for the millions of people who are unemployed or under-employed. The two most important ways of achieving this are by investing in human capital and, given the gross inefficiencies and lack of capacity in the economy, by investing in the infrastructure and services that will have the effect of lowering the cost of doing business. This would stimulate employment because it is only by lowering the cost of production – which amounts to making labour more productive that employers might be encouraged to employ more people.

The only alternative to this approach would be to reduce wages. This would mean that businesses would need to squeeze less production out of their employees in order to justify their employment, and would, as a consequence, increase employment levels.

The very obvious challenge with this account is that South Africa has been losing jobs in low-wage sectors for a long time. In that the agricultural sector, where daily wages run as low as R30 or R40, employment fell by nearly 30 per cent between 1993 and 2007. Similar stories can be told of forestry and textiles and mining. And, with the exception of mining where the fall in employment over the next few decades is probably inevitable, employment in all of these sectors has fallen not because wages are high, but because of the extraordinary gains in productivity that can be obtained through trade or mechanisation. Thus, by way of example, the mechanisation of forestry operations can mean a 90 per cent reduction in the number of employees needed. Even if wages for the skilled and semi-skilled workers are ten times higher than those of unskilled, manual workers, then, employers would still increase profits if they mechanised. There are costs associated with mechanisation – the cost of capital and the running costs of the machines but there are also substantial administrative savings to be gained from having a much smaller workforce.

Against this kind of productivity gain reducing wages offers almost no protection for employment levels.

Given all of this, the principal task for public policy must be to help create an economy in which the rising level of overall productivity justifies the employment of more people. To do this means that South Africa must pursue four strategies, and must seek to:

- Increase private sector investment, particularly in areas in which increased investment leads to a net increase in employment;
- Increase public sector investment so that the deficiencies in public infrastructure do not create unnecessary costs for business or bottlenecks in the value chain;
- Invest heavily in human capital creation; and
- Ensure that the economy becomes more competitive by driving down those costs of doing business that help to make us uncompetitive, including such things as non-competitive behaviour, the inefficient spatial structure of our cities, inefficient public administration, high levels of crime, and the low level of public health.

Spending on infrastructure

Since 1994, public spending on economic infrastructure has not been adequate to provide the foundations for faster economic growth. The most obvious example of this is the inadequate capacity for generating electricity, but there are plenty of other areas in which similar gaps have emerged. These include the country's roads and rail infrastructure, its public transportation, its ports and harbours, and its pipelines. The problem is not limited to the failure to invest sufficiently in new infrastructure, spending on maintenance of existing infrastructure has also been inadequate.

There are a number of reasons for this.

- One is that in the mid- and late-1990s, when economic growth was slow and when government was trying to unwind some of the unsustainable trends in public sector spending, the fiscus lacked the resources to spend adequately on public infrastructure. Also, the increase in the wage bill when public sector salaries were equalised across the newly-integrated public service in 1995 and 1996, the constraints in planning and executing capital projects and the squeeze on public sector investment was enormous.

- Much of the past 15 years, government has been rapidly expanding spending aimed at increasing the quality of life of the poor. Thus, spending on social grants nearly trebled in real terms between 1996 and 2008/09. In addition government has spent

billions of rands on providing housing subsidies to poor households, and has rapidly increased spending on healthcare, education, and safety and security. The result is that it has not always been possible to prioritise infrastructure spending over everything else.

- In its most recent budgets, government has begun to devote rapidly-growing share of the budget to spending on public infrastructure. At the same time, parastatals have also begun to roll-out large-scale investment programmes in electricity, water, roads and the country's logistics infrastructure. Thus, over the next three years, combined public sector investment spending will amount to R787 billion, or a fraction less than 10 per cent of GDP. That is a huge programme by any standards, and it is worth noting that it will make huge demands on managerial capacity across government. Given the relative scarcity of domestic savings, it is likely to put additional pressure on the current account.

Investing in human resources

In relation to investing in our human resources, government has devoted resources to basic education. Government has also sought to construct a system for the development of workplace skills that incentivises training through reclaimable payroll levies. However, producing a more skilled workforce has proved to be extremely challenging despite the relatively high levels of spending, and the performance of our learners on standardised international tests remains a concern.

A less obvious strategy for improving productivity by investing in human resources has been the increased expenditure on public health. The reason for this kind of expenditure is not to increase productivity, but to provide decent healthcare to the people. And yet, if one invests in the health of a nation, one is also raising its productivity since the sick are less productive than the healthy, and, in the context of HIV and Aids, better healthcare has the potential to prevent unnecessary deaths among the economically active population.

Given the less than stellar performance of our mortality and morbidity statistics over the past 15 years one can question the effectiveness of spending.

The bottom-line, then, is that government has not always spent as much as would have been desirable on public infrastructure (though that has improved) and that much of its spending on human capital has not been as effective as it might have been. These factors, together with a range of others, explain why growth has not been as strong as government would have liked. But even if government had been able to spend significantly more on enhancing the productivity of the economy, and even if spending on improving human capital had been more effective, South Africa would still have a large population of unskilled and unemployed people. Millions of people, in other words, would have been dependent on the state for many of their needs. How has government performed in relation to their needs?

How pro-poor is government spending?

In the most authoritative review South Africa's inequality data, Seekings and Nattrass note that in most of the developing world, public spending is almost always captured by the 'non-poor'. This is because in most poor countries, a large proportion of the budget is spent in ways that does not address the needs of the poorest. The poorest people, for example, typically live in rural areas, while public spending is often concentrated in urban areas. Or, to cite another kind of example, spending on fuel subsidies often has regressive welfare consequences. In comparison to what is usual in the developing world, Seekings and Nattrass write, South Africa's redistributive public spending patterns are a 'glaring exception'.[2]

More recently, this conclusion was confirmed by Servaas Van den Berg's assessment of the degree to which social services spending in South Africa is pro-poor in orientation. After documenting the increasing share of social spending that is being spent on the poorest 20 per cent of the population, he points out that a 1999 World Bank study of thirty developing countries found that South African spent the most on health and education for the poor.

In relation to redistribution, government has been doing relatively despite high levels of poverty and inequality and the proportion of people living below the poverty line has been

[2] Seekings and Nattrass, 2006, *Race Class and Inequality in South Africa*, UKZN Press, South Africa, p11.

falling in the last decade. This is because nearly 25 per cent of South Africans receive income support from government, that about 2.5 million homes have been built for low-income households using state-provided subsidies, that public transport, though still inadequate to the country's needs, is heavily subsidised, and that nearly R100 billion a year is spent on public education. Also, tax policies are highly progressive, and the result is a large difference between inequality measured *before* the inclusion of taxes and benefits and inequality measured *after* these are taken into account. Van den Berg's assessment of this is that, while the pre-tax-and-benefits Gini coefficient, at 0.69, is one of the highest in the world, the post-tax-and-benefits measurement of inequality is a much less abnormal 0.47.

Consequently, besides a few oil-producing countries, the extent of redistribution through South Africa's budget may be unique in the developing world.

However, while patterns of public spending may create the basis for more equality, there are differences in the *quality* of services provided. For instance, one study suggests that learners at the best public schools (which are almost invariably in the wealthier suburbs) will receive about three times as many teaching hours as learners in weaker public schools. Also the services that people in poorer communities receive are often of a much lower quality than the people staying suburbs.

While government spends money on providing services to the poor, a lot of money is spent paying public service salaries. There is no consensus as to whether the salaries deliver value for money or benefits the poor.

If not through fiscal policy, how does the Minister of Finance drive growth?

One of the crucial roles of the Minister of Finance is to ensure that government effectively manage tax, borrowing and spending. This helps to minimise the risk of the kind of serious economic crisis that have battered emerging economies over the past two decades.

However, not every economic crisis can be blamed on its victims.

Government, like any economic agent, must live within its means. Similarly, like any other economic agent, the consequences of government's failing to stay within its means can be dire. A country whose debt levels are unsustainable will be unable to refinance its outstanding debts and could end up defaulting on its loans. That may be unavoidable in some circumstances but the consequences are enormous such that some lenders might that public finances are unsustainable, and demand increasing risk premiums when the chance of default is rising. In addition, when defaulting seems likely, there is every likelihood that private capital will begin to flee the country (or simply stop flowing into it) and the value of the currency may begin falling. Trying to reverse these processes may require significant increases in the interest rate and a severe recession.

It was the decision to avoid taking on excessive debt that led to some controversy about government's economic policy in the past 15 years; the fiscal stabilisation programme launched in 1996.

GEAR did not achieve much of its intended purposes in the first five years. In particular the economy did not grow as fast and the country did not experience the rapid job creation that was expected. However, it must be remembered that economic growth in that period was severely affected by the Asian meltdown and the Russian debt default in 1997 and 1998. Both reduced global growth and dramatically reduced the flow of capital to emerging markets. Still, even without those shocks it is plausible that GEAR would not have generated as much growth as had been predicted.

The democratic government inherited a dire situation in 1994 - public sector debt was fast approaching 50 per cent of GDP and the deficit, including the Bantustans, was in the order of 8 or 9 per cent of GDP. Indeed, even in 1996, after some minimal order had been imposed on public finances, and the deficit had been reduced to about 5 per cent of GDP, the ratio of debt to GDP was still worsening. Even if it were possible to finance a deficit of this size sustainably, the resulting debt service costs would quickly have become greater than the value of new borrowing and South Africa would have fallen into a debt trap. Investors would not have financed a persistent deficit in because they would have regarded the risks of default as too great. So, even if GEAR had not been introduced, there is a

chance that South Africa would have had to embark on a strict programme, the only alternative to which would have been the printing of money.
GEAR helped unwind this position and South Africa managed to halve the ratio of public sector debt to GDP from just less than 50 per cent in 1996 to about 23 per cent in 2008.

Apart from avoiding a crisis there are also important benefits from fiscal stabilisation. One is that the proportion of the budget (and of GDP) that is now devoted to servicing debt is smaller than it would have been had the ratio of debt to GDP not been reduced. So, had public debt levels remained around 50 per cent of GDP, government would now be paying around R125 billion a year on servicing debt instead of the R52 billion. These lower debt service costs mean that more funds are now available for service delivery than would otherwise have been.

One way of expressing what GEAR achieved is to say that it created 'fiscal space'. This can be defined as the extent to which a government has the capacity to increase spending on desirable programmes and projects while maintaining the sustainability of its financial position. The relative narrowness of the tax-base and the pro-cyclicality of fiscal policy continue to limit the creation of fiscal space.

The narrowness of the tax base

Since 1995/96 the value of taxes received by government has generally grown faster than the economy as a whole. The result is that from a low of less than 23 per cent of GDP, tax revenues accounted for nearly 28 per cent of GDP in 2007/08. It is not conclusive what accounts for the high level of fiscal buoyancy that has been experienced, but it might the tax base has widened and tax compliance has improved.

South Africa relies heavily on a relatively small number of tax-payers. This reliance of the fiscus on the taxes paid by a relatively small number of individual tax-payers and companies is a reflection of the structure of the economy, especially the high level of income inequality. This means that it is neither unreasonable nor undesirable for the source of government's revenues to be highly concentrated. At the same time, however, it must be

recognised that it is not possible for a state to service the needs of nearly 50 million people on the basis of taxes paid by only 400,000 of them.

Another consequence of the narrowness of the tax base is that the tax-take is heavily dependent on the compliance of a small number of people and companies.

The pro-cyclicality of fiscal policy

Broadly, post-1994 fiscal policy can be divided into two phases. In the first, which ran between 1994 and 2000, the overall emphasis was on stabilising public finances by holding back the growth of public spending. Since 2000 the emphasis has been on the rapid expansion of public spending. In the second, more expansionary period average annual growth of non-interest spending was five times higher that the1.6 per cent per year between 1995/96 and 2000/01.

There is an important link between these two periods, in that the careful management of expenditures in the late-1990s helped open the fiscal space needed for the increased spending that followed. As already noted, had government failed to assert more control over spending trends, it is quite possible that we would have fallen into a debt trap. Still, it is important to acknowledge that there is something to the fears of those analysts who feel that fiscal policy has been excessively pro-cyclical since 1994.

This assessment draws attention to the role of fiscal policy in fine-tuning aggregate demand. Instead of moderating recessions when aggregate demand falls below the trend growth in the capacity of the economy, and cooling expansions when aggregate demand grows more quickly than productive forces grow, fiscal policy from 1994 to 2007 has tended to deepen recessions and to inflate booms.

However, given the state of the economy, fiscal policy might have been less contractionary (or more expansionary) in the late-1990s because the new government could have financed a more expansionary fiscal policy. Secondly, the Asian crisis in 1997 and 1998 forced the developing world to tighten fiscal policies or risk investor flight.

Thus, there are reasons why policy may have been pro-cyclical, but that doesn't mean that there are no consequences for this, and it appears that expenditure growth over the past seven or eight years has been financed by revenues whose rise was partly cyclical rather than structural. Since that spending will not come down in downturns, it has the potential to create fiscal stress and renders spending programmes built on the back of cyclical revenue growth more precarious than might be desired. This, in effect, is the implication of National Treasury's calculation that, despite running a small surplus in recent years once cyclical factors are discounted the budget has been in a structural deficit.

Government needs to try to avoid reinforcing the tendency towards pro-cyclicality which is one of the sources of the present difficulty.

Inflation and monetary policy

Like fiscal policy, much of the role of monetary policy is to fine-tune aggregate demand when this grows either more quickly or more slowly than the growth of the economy's productive potential. Controlling inflation is, in some ways, a proxy for fine-tuning aggregate demand.

Inflation since 1994

South Africa's experience with inflation since the mid-1990s has been somewhat erratic. Between 1994 and 2000, inflation moderated from around 10 per cent per year to around 7 or 8 per cent. Then, the exchange rate crisis at the end of 2001 precipitated a rise in the price of imported goods rose, sending inflation closer to 12 per cent. During the next four or five years, however, inflation fell again, this time to within the target range of 3 to 6 per cent that had been introduced in early 2000. Then in 2006, inflation began to as international food and commodity prices rose. These pressures have since moderated and even reversed and inflation has begun to fall, and is likely to continue to fall over the next few years.

There are a couple of issues worth thinking about in this context. The first relates to the reasons for the fluctuations. The second relates to the effects of those changes. Since it is

the effects (rather than the causes of inflation) that ought to drive medium- and long-run approaches to managing inflation, it is to this that this report turns first.

The effects of inflation

The textbook answer to the question, 'what is wrong with inflation?' is that, over the long-term, a relatively stable rate of inflation is irrelevant to economic growth as economic agents adjust their expectations about trends in prices and wages and begin to build expectations of future price rises into their plans. Once everyone does that, the effects of inflation on real rates of growth and on employment and wages, is negligible. *Anticipated* inflation, in other words, neither harms the economy nor helps it. That implies that the only way inflation can matter if there is an inflation surprise, which can stimulate economic activity, doing so, essentially, by increasing nominal profits and inducing employers to take on new staff.

Nevertheless, one plausible conclusion that can be drawn from the textbook tale of the effects of inflation is that, even if there is no positive effect of a relatively stable rate of inflation, there is also little negative damage done by it.

The pursuit of low and stable rates of inflation is desirable. However, getting there from a situation of high inflation can be costly because reducing inflation (most effectively done by tightening monetary policy) it reduces the rate of economic growth and as interest rates rise, borrowers suffer and investors retreat.

Consider, for instance, South Africa's post-apartheid tale of falling (1994 to 2001) then rising (2001 and 2002) then falling (2002 to 2006) then rising (2006 to 2008) then falling (2008 to 2009) inflation rates. While the country's relatively tight monetary policies played a role in reducing inflation, it is also true that some of the inflationary and disinflationary forces have their roots in factors over which the Reserve Bank has no control. These include international food prices, the price of oil and other commodities.

The dilemma is that, while the only way to moderate inflation is by clamping down on domestic spending levels, the impact of higher interest rates on *imported* inflation is eased

than its impact on inflation that has its roots in domestic factors. Imported inflation may, therefore, require the application of tighter monetary policies for longer periods, and in some cases it is arguably better just to allow the price changes to take effect.

The current account deficit and what it means

If inflation is often one sign of an economy's overheating, the same is true of a widening deficit on the current account. This occurs when domestic demand grows faster than the economy's capacity to produce, resulting in more imports. Because the current account deficit has widened during the recent boom, it is regarded by many as a reflection of weaknesses in the economy's ability to grow its productive forces. Because it implies that growth and investment depend on foreigners' willingness to invest in South Africa it is also regarded as a source of potential instability which requires policy attention.

So, when foreigners finance a country's current account deficit, they do so because they think that this is in their financial interests. This results in foreigners ceasing to do so if they believe that it is no longer in their interests. The implication of this is that no country can run a deficit forever and that, at some point, South Africa's external imbalances will have to be unwound. The question is whether that unwinding will be a managed issue, or whether it will be abrupt and costly. Ultimately, the ideal would be for South Africa to export as much as it imports while maintaining an exchange rate that does not make foreign goods too expensive, while maintaining price levels that are not so low as to require the paying of indecently low wages. This is the ideal, but the fact that we are presently running what appears to be a large and persistent deficit on the current account means that we are not there and adjustment is required.

In essence, the weight of the adjustment of a country's external balance must be borne by two variables: the relative price of a country's imports relative to its exports (which must rise) and the level of aggregate demand in the economy (which must fall). Because another name for the adjustment of aggregate demand is 'recession', it is obviously preferable that most of the adjustment is through changes in relative prices. The easiest way to achieve this is through a nominal depreciation of the exchange rate, but this works in the long-run only if, the decline in the value of the currency is not followed by rising inflation. Given

the country's reliance on imports, this is not easy to achieve, however, and so some fall in aggregate demand may be required if external balance is to be achieved.

Doing this in an orderly manner is not easy, but an adjustment that is driven by the drying up of international credit is not desirable since it would require either a steep decline in the rand as demand for the currency falls relative to demand for foreign currencies and/or the need to engineer a steep recession in order to reign in the demand for imports.

Crises of this kind have gripped developing economies a number of times in the past few decades, and it is important that reduce South Africa's vulnerability is reduced. Since many of the goods we import are essential to economic activity and growth, however, and because demand for many of our imports is relatively inelastic, it will be hard to cut back on these substantially in the short-term except by inducing a very deep (and undesirable) recession. That leaves only one viable response: growing the volume and value of exports as quickly as possible so that the current account can be put on a more sustainable path. In short, if South Africa continues to rely on imports, it will have to find ways to boost its exports.

The deficit in the current account necessitates responses such as increasing the capacity of the economy to produce goods and services that will either reduce its need for imports or increase its ability to export.

Conclusion

This section focused on the need to make spending plans affordable and sustainable.

Macroeconomic tools may be less effective at driving growth and development than some might imagine. One of the critical roles in achieving this is ensuring that government maximises the value created through public spending. This will be discussed in more detail later. Before that, however, two other areas of the Minister of Finance's developmental role need some explication: the regulation and oversight of the financial services sector, and the role of the minister in international and multinational policy processes and forums.

FOUR

THE MINISTER OF FINANCE AND DEVELOPMENT (II): THE FINANCIAL SECTOR

Introduction

The oversight and regulation of the financial sector is a huge function especially given that the source of the turmoil in the international markets has been in the banking and associated industries. Policy and oversight challenges are hugely complex because the financial sector is both one of the most globalised of all sectors in the economy.

However, the general practice around the world is for the Minister of Finance to be responsible for ensuring that the country's financial services industry is sound.

The Financial Services Charter (FSC) outlines some of the policy goals government has pursued in the industry. Still, a Minister of Finance's responsibilities would be disadvantaged if the policy agenda for financial services was constructed solely around the FSC and its implementation. This is because, as important as the transformation of the industry is the economy still needs to develop. As recent events show, without a properly functioning financial sector the rest of economy can tumble.

What the financial sector does and the risks associated with it

While the financial sector is broad, it consists of companies that do two different kinds of things: there are banks and there are insurance companies. While the services differ the entire sector links future economic activity with the present.

The principal way in which banks play this role is by intermediating between savers and borrowers. Banks pool savings from household and business and make those funds available to borrowers who pay for that privilege. Intermediation allows for two other benefits, both of which improve the efficiency of the economy. One is that loans to households for education or home-ownership or consumer credit allow recipients to some

of their future earnings before they actually earn them. The other is that, when they perform the functions well, banks play a rationing and screening function, advancing funds only to borrowers who are most likely to use them effectively. In so doing, they raise the average productivity of the economy.

Insurance and risk pooling is the second main function played by the financial services industry, and it allows households and businesses to avoid having to accumulate savings as a precaution against risks they cannot entirely avoid. The essence of the process is familiar, and allows economic agents to exchange a small risk of incurring a very large cost (a fire) for the certainty of a much smaller cost (the insurance premium).

There are important differences between banking and insurance, of course, but there are also similarities. One of these is that both are in the business of buying and selling financial products, and the balance sheets of both will be composed almost entirely of paper assets and liabilities. In the case of banks, their assets are made up largely of loans to households and business, while their liabilities are made up by the deposits of their clients. In the case of insurance companies, on the other hand, most of their assets are investments in other businesses, while their liabilities are their contractual obligations to their clients.

Another similarity is that in the case of both banks and insurance companies, assets are often very illiquid relative to their liabilities. So the transformation of liquid liabilities into illiquid assets is one of the most important functions of financial intermediation. The asymmetry of the liquidity of assets and liabilities however, is the principal source of risk which government must effectively regulate.

Liquidity, illiquidity and the need for regulation

Entities with liquid liabilities and illiquid assets face a number of challenges including the impossibility to liquidate an illiquid asset except at significant cost. Therefore a company with liquid liabilities and adequate but illiquid assets may be unable to meet its obligations. In a worst case scenario, this can lead to a self-fulfilling panic about the solvency of the institution. This may result in all depositors demanding their funds, not because they believe that the bank is insolvent, but because they fear that the demands of other

depositors will outstrip the ability of the institution to return deposits in the short-term. If that occurs, the bank may find its current assets quickly exhausted and that it must liquidate illiquid assets. When illiquid assets are sold the price may drop leading a solvent bank into insolvency.

In developed and well-regulated capital markets this should not happen often, but when it does the results can be explosive. Given this risk, governments have to regulate financial intermediaries in the interests of savers, investors, banks and the economy. Government must set the rules about the proportion of liabilities a bank or investment fund must hold in liquid reserves; it can supervise and regulate the investment decisions that banks and investment funds make; it can assure itself of the quality of its investments by inspecting balance sheets; it can regulate who is and is not able to run a bank or investment company using a host of licensing requirements.

In addition to these requirements, governments can undertake other measures to help mitigate risk by guaranteeing bank deposits. They can also help solvent banks faced with a mismatch between the demands of their depositors and their liquid assets, by acting as a lender of last resort (usually through the central bank) or, in more by pumping capital directly into the banks.

These measures have generally helped to maintain the stability of the financial sector in most parts of the world, including South Africa. However, handing out guarantees and thus the soundness of institutions or the safety of investors/depositors funds, governments may reduce the prudence of market participants.

It may seem ironic that guarantees can create instability, but one way in which this occurs is where guarantees exist investors tend to become less careful about making their investments. Investors may believe government will step in they make reckless investments. Another happens when the management of banks or investment companies believe that government will bail them out if their assets are insufficient to cover their liabilities. This is especially true if their profits and bonuses depend on the performance of their investments, in which case, they may pursue more rewarding (and, therefore more risky) investments.

A regulatory agenda for South Africa

The points above would apply to any financial sector in any economy in the world, and the policy-making and regulation of the financial sector in South Africa needs not be any different from that of the United States, England or Hong Kong. South Africa's challenges however are complex. For instance there are a number of inherent questions such as access to financial products, affordability, employment equity, transformation, the willingness and ability of the industry to underwrite both economic development generally and black economic empowerment, specifically. Because of the critical nature of these questions the FSC has been at the centre of government's policy agenda. The first order of business for South Africa's policy-makers therefore remains the need to maintain a financial system that is well-capitalised, stable and solvent.

These priorities require a careful development of policies relating to financial architecture. Issues unique to South Africa relate to:

Continuing to work on the expansion of access to financial services, a process that must also factor into, and be shaped by, developments in the reform of a social security system; and

Continuing to work on the regulatory architecture so that the quality of advice provided to consumers is improved.

Access to products and consumer protection

Another area of priority for policy makers relates to the conduct of institutions and how they provide services to millions of South Africans who need them.

Regarding questions of market conduct government has already sought to address competitiveness in the industry, the costs of its services and its conduct with consumers. These include issues such as the pricing of some bank services, the structure of commissions paid to sellers of retirement annuities, and the duties that financial advisors

owe to those who use their services. Also, through the National Credit Act, government has sought to improve the conduct of businesses that extend credit to consumers while also helping to build better consumer practices. Some progress has been made however; consumer-protection needs to be continuously monitored.

The affordability of financial products and services also requires urgent attention. The apparent inability of the country's banks' to provide business banking services or access to capital to emerging businesses is worrisome. Also, many banks are still unable to provide ATMs in townships.

Millions of South Africans still lack access to appropriately priced banking and insurance products which makes it harder for them to participate in the economy. Thus, millions of people who have jobs are unable to purchase appropriate retirement or insurance products. Equally damaging is that, even after the passage of the National Credit Act, many who have no access to loans from commercial banks must rely on credit provided by retailers. This raises a question about the role government should play in providing financial services to those who are not adequately served by the private sector?

Regarding banking, the need for basic transactional and savings products is being met to some extent through the use of the Mzansi products offered by the banks and Post Office. Risk and retirement products are different, however. Even if the FSC targets were met, about 50 per cent of the population would still lack access to these products, either because the products were unaffordable or because people could not physically access places where they are sold.

Issues to be addressed in finding a solution are how such a system would work, how much it would cost (both the state and its users), and what costs it would impose on the rest of the economy (including the existing financial services sector).

Social security reform remains one of the most important questions presently on the national policy agenda. There are gaps in the social safety net that must be closed, even while the state provides income support to poor households through the presence of a wide range of grants, job-creating programmes, and risk-related programmes such as the UIF,

the Road Accident Fund and various compensation schemes. These gaps include the absence of affordable savings, retirement and health insurance products for those who are employed but earn low incomes, which has negative welfare consequences.

A critical issue is whether government should create a national scheme compelling employees to save a portion of their salaries in provision for their retirement. This depends in part on whether society makes a principled commitment to such a scheme, but a great deal also turns on the modalities of such a system. It could be a pay-as-you-go system, with present contributions used to pay pensions to previous retirees (something that beneficiaries will desire, but which might be resisted by those who will have to begin making contributions now), or a system of individual accounts saved in the name of each person who makes contributions (questions then arise about those who have already retired or who are nearing retirement, and those who bear any market-related risks).

There are many potential advantages to such a scheme: apart from ensuring that people who have jobs will make some provision for their old age, it could also increase national savings. However, a concern is the implications it may have for the costs of employment and therefore the pace of job creation. This is because a savings scheme compelling workers to contribute to a fund that they will not be able to access until retirement is bound impact on salary negotiations across the economy.

Other questions also arise: should those who already save for their retirement using private sector products be compelled to save through public institutions established to manage funds of those who are not yet saving? If existing savers are compelled to contribute to a public fund, how will the disruption to existing businesses be managed? Given the well-known weaknesses of our identification documentation and the presence of acquisitive crime syndicates, how would the dangers of fraud be managed? Will the system provide decent service to people who have saved and are now owed their pensions?

Achieving this would also require reform of the rest of the retirement industry, and coordination with other changes in the social security system. Coordination is important because the changes all address some element of the risks that individuals and households face, and a holistic view is needed so that costs do not outrun affordability as a

consequence of piecemeal changes. Protecting the integrity and coherence of this process is also particularly difficult as policy issues in these areas are often under the control of different departments, including Social Development, Labour and Health. Without coordination, the net result will be reforms that are difficult to implement and unaffordable, and that fail to take advantage of potential economies of scale.

Work on this issue has already commenced, and an interdepartmental task team, supported by a newly-formed unit in the Public Finance division of Treasury is looking at the options.

Improving the regulatory architecture

The fact that the South African banking sector was not exposed to toxic assets that created a tailspin in the economies of developed countries is rooted in the character of the country's regulatory architecture. Critical factors include:

- The fact that that commercial banks do not generally have large in-house investment banking divisions, the risk-taking activities of which are the root of the problems in other countries;
- The conservative lending practices of the country's banks, which have meant that they were not as exposed to the 'sub-prime' mortgage market; and
- Exchange control regulations, which have limited domestic financial institutions' exposure to other sub-prime markets in the rest of the world.

It is true that the South African banking sector has managed to avoid this crisis. However, the economic downturn has implications for the country's banks and insurance companies. The most important implications, of course, relate to the business environment because there will be fewer transactions, more non-performing loans and weakened balance sheets resulting from the decline in the value of assets. Collectively this means that the soundness of banks and insurance companies is that much more in question now than it would have been 18 months ago. There is no immediate threat of a bank failure and South Africa looks set to weather the storm. Continued vigilance remains critically important, since a major banking or insurance failure would have implications for the economy.

Issues of financial sector regulation have also gone through something of a global renaissance since the deepening of the financial crisis. Countries and multilateral institutions are looking at ways to ensure that risks inherent to the sector can be better managed in the future. Issues being considered include the structure of remuneration in the industry; the regulation of new products and services, some of which escaped the regulatory net (particularly in the United States and United Kingdom); and the structure of the industry itself, particularly the relationship between commercial banking and riskier sub-sectors like investment banking. There are also questions about the structure of the regulatory architecture, which does not always coordinate the oversight of different sectors and allows for dangerous gaps to emerge. Finally, with the Fidentia collapse still relatively recent, improving the fitness assessments of management and owners of financial institutions remains a priority, together with the development of a robust law-enforcement capability.

There is an argument to be made that the vulnerabilities and risks arising from the financial sector cannot be properly regulated away – that product innovation is too rapid and the financial system too globalised for regulators to have sufficient reach, knowledge and power to prevent the next crisis and resulting contagion. This is not just a question of the legal powers and practical skills of regulators. These risks also arise in well-regulated financial systems, where the perception of sound regulation could lower the guards of investors, lenders and counter-parties to any transaction. Critical areas of interest regarding regulation are:

- the institutional relationship between commercial and investment banking;
- the management of ratings agencies and their conflicts of interest;
- the regulation of complex products such as derivatives;
- establishing the reserves a bank must maintain (Basel II sets out that this must be established using risk models developed by the banks themselves);
- the role (if any) of multilateral institutions in overseeing these industries; and
- the flow of capital between countries in the longer-term

The issues are complex, and South Africa will be expected to adjust some of its own rules and practices when new protocols and approaches finally emerge.

Conclusion

A modern economy needs a functioning financial sector: it needs banks and investment funds to pool savings and direct them to productive use; it needs channels through which individuals, households and businesses can protect themselves against unexpected costs, and to ensure that individuals can enjoy reasonable retirements. While these are necessities, it does not mean they are easily or cheaply provided, and it is important that providing these services does not consume a disproportionate amount of national income. They must be affordable to their clients and the economy as a whole. Together with affordability, another principle driving the oversight and regulation of financial services is ensuring that the architecture of the industry and of the state's social security system is sustainable over the long-term.

The Minister of Finance cannot however, be indifferent to the fact that many economic agents lack effective access to many products and services provided by the financial services sector. Nor does the sector always provide as much capital to developmental projects and priorities as would be desirable. These factors must all be borne in mind in developing and implementing policies, but in practice balancing these concerns is more easily said than done.

FIVE

THE MINISTER OF FINANCE AND DEVELOPMENT (III): THE INTERNATIONAL AGENDA

The international agenda: the issues

As noted, the international role of the Minister of Finance probably consumes as much time and energy as domestic work. The principal reason for this relates to the globalised character of economic activity, with trade and capital flows and cross-border commercial interactions accounting for an ever-growing proportion of the world's economic activity.

Globalisation has meant that events and decisions taken in other parts of the world can have a significant impact on the South African economy. Some of the effects of globalisation on South Africa are unquestionably positive – the rising demand for raw materials, for example. The effects of other consequences, together with the emergence of China and India, are more ambiguous. While the production of low cost textiles and other manufactures benefits South African consumers, some South African firms have been negatively affected, with serious consequences for employment creation.

The most important recent events globally have taken place in the United States and other developed countries. The financial crisis that began with the bursting of the housing bubble in the United States, and the subsequent rise in mortgage default rates, has transformed into a serious recession in both the developed and the developing world. The IMF estimates that the global economy will shrink this year, something that hasn't happened in three generations, with dire implications for unemployment and poverty across the world.

Both the emergence of East and South Asia and the present economic crisis are critical issues which will shape international economic and financial relations. There is also a diverse list of other issues on the international agenda of the Minister of Finance, even if they do not all attract as much on-going attention as they should. The policy list includes:

- Dealing with the economic crisis in Zimbabwe;
- Finding ways to increase access to development finance for poor countries, especially in Africa. This includes reducing debt, raising the quantity and quality of aid flows, and increasing access to international capital;
- The reform of multilateral institutions such as the IMF and World Bank;
- Developing a global response to climate change; and
- Raising levels of South-South trade, especially trade among African and Southern African economies, requiring the development of sound regulatory systems, institutional development and bricks-and-mortar investments in roads and train tracks.

Finally, South Africa also plays a bi-lateral, donor-like role in the development of other societies. Officials from the National Treasury, for example, sometimes assist finance ministries of other African countries in developing appropriate systems for budgeting and financial management.

The international agenda: the institutions

Dealing with these issues requires engagement with a wide variety of institutions, including regional forums such as SADC, SACU and the Common Monetary Area; development finance institutions such as the World Bank, IMF and African Development Bank; and a range of formal and informal forums of varying importance and impact, including the World Economic Forum, the G8, the G20, the G77 and the OECD.

The nature of these institutions and the issues they deal with vary enormously. In SACU, for instance, because policy questions governing the level of trade tariffs are driven primarily by the Department of Trade and Industry, debate revolves around the relatively narrow issue of the revenue sharing formula. Policy debates at the IMF, on the other hand, are much wider and include questions about the structure and governance of the institution itself. The differences in the breadth and depth of the policy questions and profiles of participants, and the varying leadership role South Africa can or should play, makes it difficult to succinctly summarise how South Africa, and the Minister of Finance, should participate in these institutions. The Minister of Finance can however be thought of as the 'face' of the South African economy in these forums and processes, representing its needs

and views and seeking to ensure decisions made take account of the country's needs. As other individuals, institutions and members of the executive sometimes also play a role, the Minister of Finance may not be the only face representing the country. Maintaining a consistent message is therefore not always straightforward.

Another factor to consider is that South Africa seldom represents only its own interests in these forums, but also those of the developing world or other African countries. In some cases – such as the Bretton Woods institutions – this is because, as a practical matter, South Africa's officials are expected to represent the views and needs of a 'constituency' of 22 Sub-Saharan countries. The positions adopted must therefore be pre-caucused with officials from other countries. In other cases, such as the G20, South Africa is the only African country in the group, and there is no other way for Africa's voice to be heard.

Apart from the number of processes the Minister of Finance plays a role in, the complexity of the individual processes themselves also makes the international dimension of the finance portfolio demanding. These include matters of substance (such as the right way to increase African countries' access to development finance, or how to respond to the financial crisis) as well as matters of structure and politics. The latter complexities arise because of such things as divergences in the agendas of participants (some of which arise from their own domestic policy debates), their analyses of the substantive issues, and their overall approach to international engagement.

The biggest challenge is that participation in international institutions is often regarded by member countries as a channel through which to advance their foreign policies. This can hinder debate and decision-making. Further, it is not just other countries who wish to use processes to advance their own agendas: entities like the World Bank and the IMF have their own institutional interests (such as obtaining more resources or securing greater independence from member countries), and will sometimes seek to use forums and policy processes to their own advantage.

As a result, participation in global policy processes demands very careful strategic and tactical management, particularly when the stakes are high. This is especially true because global issues can become entangled with each other: consider the issue of reforming the

governance structures at the IMF, one that long predates the economic crisis but with which it is now intertwined. China is one of the most obvious potential sources for the hundreds of billions of dollars the IMF needs in new resources needed to help countries affected by the crisis. However, China is under-represented in the governance of the IMF given its weight in world affairs and in the global economy and it regards decision-making in the institution as being too beholden to American interests. China is thus unwilling to provide new resources without increasing its representation. It is, however, no easy matter to resolve China's demands without dealing with comprehensive reform, something that cannot be achieved in the timeframes needed to secure the resources the IMF needs urgently.

Global issues have a habit of becoming log-jammed, partly because they are linked to each other and reaching decisions in one area without making complementary decisions on other issues is difficult. It is also, however, the result of parties with different agendas sometimes linking issues precisely because they know this will delay decision-making. Because the international agenda is so full, it often becomes difficult to ensure that processes continue to make progress in the face of determined resistance from significant role-players.

Critical issues: the global downturn

The slowing global economy has enormous implications for South Africa and the developing world in general. The most obvious of these relate to employment levels, government revenues and therefore socio-economic development.

Although no-one knows for certain what the duration and depth of the downturn will be, there is at least some clarity about its causes. It has become an interlocking crisis in developed world financial markets (which has resulted in a collapse in lending) and a recession in the 'real' economy (resulting from a collapse in household demand and investment spending), each of which has become both the cause and the effect of the other. Dealing with the recession thus requires simultaneously unfreezing financial markets (and therefore dealing with the shattered balance sheets of financial institutions) and pumping up aggregate demand. This is not easy to do because of the sheer scale of the crisis, and is

made more complicated by political pressures which make it difficult to 'bail out' the very institutions that are responsible for the crisis.

The globalisation of the crisis is largely the result of the weight of developed world economies in global trade. A steep recession in those countries has reduced economic activity around the world, lowering demand for and prices of developing world exports. Other reasons why the crisis has impacted so dramatically on developing world economies include:

- The 'flight to safety' that occurred when developed world governments offered guarantees on deposits and investments in some of their institutions, and international investors liquidated their positions in emerging markets where such guarantees were not or could not be made;
- The collapse in the flow of trade finance and other capital flows as a consequence of the freezing of global credit markets;
- Reduced trade finance and capital flows as perceived growth prospects in emerging markets are affected by:
    - Falling capital flows to developing economies as developed world investors avoid risks and continue to de-leverage,
    - Funding gaps that may lead to further depreciations in emerging market currencies,
    - Market access reductions for developing countries due to protectionist pressures in the developed world, and
    - Possible systemic crises from corporate failures, given the small size of some financial sectors.

Finally, a sometimes under-appreciated danger is that governments in the developing world may struggle to finance their own deficits because fiscal policies in the developed world have become aggressively expansionary, with countries like the United States and United Kingdom now running historically unprecedented deficits. These expansionary policies and the diminishing supply of capital available will result in first world countries crowding-out the developing world in global capital markets, with pro-cyclical consequences for the level of aggregate demand in emerging markets.

Given the complex and interlocking nature of the global crisis, the policy agenda must be equally broad and complex. While outlines of what must be done are reasonably clear, what is not clear is how quickly these initiatives would end the recession if implemented.

The most important economic goal must be stimulating aggregate demand in both the developed and the developing world, using monetary and fiscal policies. Here the biggest issues relate to scale (how much stimulus is needed) and sustainability (spending more without creating unsustainable financial commitments that make it harder to finance rising deficits). Other issues relate to the spending of stimulus packages. A critical issue is whether governments should prop up 'strategic' industries severely affected by the downturn or instead spend public monies in less interventionist ways, such as through income support for households or investing in infrastructure.

The policy agenda itself revolves around two critical issues: (a) getting lending flowing again in the short-term and (b) ensuring appropriate re-regulation of the industry in the medium- to long-term. These issues are linked, as the shape of future regulatory regimes may impact on the future profitability of the industry. This could impact on the considerations of investors regarding participation in schemes designed to recapitalise and restructure banks in the short-term.

The American government has found it difficult to either nationalise banks temporarily to cleanse their balance sheets of toxic assets (for fear of offending the right's political sensibilities) or find other ways of recapitalising banks (since these may appear to reward those institutions whose excessively risky activities are at the root of the crisis). Ensuring the recapitalisation of US banks is however critical and anxiety about the slow progress in achieving this is warranted, especially in light of the latest IMF estimate that banks in the developed world already need between $850 billion and $1.5 trillion in new capital.

Reforming the regulatory regime also requires intensive policy work. Some reforms will have to be adopted universally to avoid regulatory gaps and a future dominated by regulatory arbitrage, and a rise in the cost of cross-border transactions. Issues are:

- Improving oversight of the market conduct of mortgage originators and the products they develop;
- Ensuring that previously under-regulated but systemically important institutions (such as hedge funds and derivatives traders), are brought under regulatory umbrellas;
- Improving the rules and methodologies used to assess the regulatory capital requirements of financial institutions; and
- Finding ways to ensure that compensation schemes do not create incentives for excessively risky behaviour.

Other critical issues

Apart from the economic crisis, two of the most important other issues driving international work are (a) the reconstruction of the Zimbabwean economy, and (b) ensuring the acceleration of socio-economic development across Southern Africa. Both of these require sustained, long-term engagement, although the reconstruction of the Zimbabwean economy also requires urgent attention in the short-term

Zimbabwe

The Zimbabwean economy has already reached a state of serious crisis, with the collapse of the Zimbabwean dollar and subsequent dollarisation of the economy the most obvious symptom. Reconstruction must be pursued given the extent and duration of the crisis. The gap between the basic needs of the Zimbabwean people and the ability of the economy to provide them has become immense.

While some aspects of the crisis can be resolved, serious damage has been done to the productive capacity of the economy, and is one reason why the country needs a great deal of aid. Years of neglect has seen public and private infrastructure crumble. A priority for the Minister of Finance will be to continue to play a role in mobilising the international community to provide such aid. An important rider is that aid flows are carefully managed and monitored, since there is a real risk that they will be misappropriated or misused.

Financial aid alone will not resurrect the Zimbabwean economy, as one of the most significant causes and effects of the crisis is the deterioration of institutions critical to the functioning of an economy. Rebuilding these institutions is an absolute precondition for successfully attracting domestic and foreign investors, and creating a climate in which commerce and industry can restart. Along with political reconciliation and unity, institutional reconstruction is vital if Zimbabwe is to have any chance of standing on its own two feet again in the foreseeable future.

Southern African development

Although Zimbabwe presents the region with its most serious economic and development challenges, poverty is endemic to the region and demands attention from policy-makers. As in South Africa, the core of the problem in the region is on the supply side, with massive deficiencies in the stock of capital equipment, human capital and public infrastructure. These problems are deep and their scale means that they will not be quickly overcome.

Most of the development challenges in the region must be dealt with by domestic governments, of course, but there are two areas in which South Africa can help improve the prospects of these economies. The first is assisting in securing access to aid and other capital flows, including by providing technical assistance to countries. The second is the promotion of regional trade.

As a proportion of the region's GDP, levels of intra-regional trade in Southern Africa are extremely low. Reasons for this relate to the regulatory regime, as well as the lack of infrastructure, which makes to cost of trade prohibitively high.

The regional trade agenda is affected by serious concerns among some countries that such trade would allow for South African firms to penetrate their economies. Simultaneously, South Africa needs to ensure that rules of origin agreements and their enforcement do not allow regional trade to be used as a platform for cheap imports into the South African economy. While these are significant concerns, faster progress in regional trade integration has the potential to make a positive impact on regional economic prospects.

Conclusion

The international aspects of the Minister of Finance's work are substantial and may become more demanding because of the character of the present crisis and institutional context within which global policy making is conducted

In contemplating the international agenda, it is important to recognise that effectively promoting South Africa's views and interests (as well as those of developing countries and regions that may not be represented), cannot be based on South Africa's intrinsic importance to these debates.

South Africa is a small economy in global terms, and ensuring that its voice is heard depends heavily on the quality of preparatory work done, both on the substantive issues and in mobilising support for its views. It also depends on the ability of the country to build and maintain sufficient credibility for its views, something that is partly dependent on ensuring that its domestic policies are sound. This provides further motivation to the Minister of Finance for ensuring effective domestic policy processes. The budget process is particularly important in this regard.

SIX

THE MINISTER OF FINANCE AND THE BUDGET

Introduction

One of the most important features of government spending in South Africa is that it is exceptionally redistributive relative to its peers. The burden of taxation falls most heavily on the rich, and public spending is heavily concentrated on the poor. The progressive character of the budget reflects the hard work and difficult choices made by government over the past fifteen years. It has resulted in a 60 per cent rise in real, non-interest expenditure between 2001/02 and 2006/07, with growth concentrated in sectors such as social welfare (where spending has more than doubled in real terms) and community infrastructure (where spending has almost quadrupled). Along with the rapid growth of these budgets, spending patterns *within* some budgets in government (especially health and education) is remarkably redistributive, with service delivery concentrated on the poor.

Creating a budget of this kind is the result of relatively rapid growth and the rise of tax revenues, as well as the central objectives of the budget process itself. Driven by the National Treasury, these objectives ensure that government budgets are both pro-poor in character and deliver as much developmental value for money as possible.

Why the optimal budget is impossible

While the responsibilities of the National Treasury extend beyond the management of the budget, the annual process of producing a spending plan is at the heart of the department's work. This is a long, difficult and much-misunderstood process, often producing controversy and widely different assessments of the final product. The single most important reason for this is simply that there are not sufficient resources to meet all the demands placed on the fiscus.

The gap between government's policy objectives and the resources available means that two fundamental questions to be answered in the budget process are: (i) how many of the competing demands on the fiscus can be met (i.e.: how much money is to be spent), and, (ii) which demands will be prioritised over the others. These are not easy questions to answer.

There are different ways of answering the latter. One is to say that government should allocate its resources in ways that promote growth, create jobs, alleviate poverty, reduce inequality, and deliver services to all. These are important, but from the point of view of compiling the budget, are little more than statements of intent. A second way of answering the question is to say that government must maximise social returns on public spending.

To do so under conditions of scarcity, economic textbooks would prescribe that resources be allocated in such a way that the last rand spent on any good or service produces the same social return. The reasoning is that if spending a rand more on one good or service gives a greater return than spending on another, government would be better off reallocating money until the differential is eliminated.

However, it is not easy to determine the optimal allocation of resources. Government's challenge is to allocate resources across different departments, offering different services to different constituencies, and ensure that the last rand spent anywhere produces the same social return as the last rand spent anywhere else. This is difficult as you can almost never compare the social returns produced by different kinds of public spending, because there is no common metric to measure them. It is not possible to say definitively, for instance, that an million rand more spent on primary education will produce a greater social return than a million rand spent tertiary healthcare or any of the other services that government provides. Comparing the relative values of different spending patterns of government is not precise.

This problem is not the result of uncertainties about the quality of spending, management and staff in different government departments, or better processes of accountability in one sphere of government than another, and it cannot be resolved with better financial management. Rigorously comparing the impact of different services would be difficult even if it was known with certainty that every department would spend its money equally

well. There is simply no way to tell whether increasing spending in one department is better for South Africa than increasing it in another because, in this context, there is no way to define the word 'better'.

There are also important differences between the beneficiaries of different kinds of spending, making comparisons more elusive. Beneficiaries of old age pensions, for instance, are quite different from those of increased public education spending. Similar problems arise with the spatial distribution of spending across the country: spending on old age pensions tends to distribute resources into rural areas, while spending on housing subsidies and public infrastructure tends to benefit cities. They also arise in relation to the inter-temporal distribution of costs and benefits when government spends borrowed money that must later be repaid.

These problems are inherent in the production of a national budget, and one cannot reduce the budget process to a technical challenge of maximising output. Nevertheless, if the allocation of resources is to be sensible, it is essential that government try to surmount this problem. How it tries to do this has important consequences for the budget process.

The purposes of the budget process

As the allocation of resources cannot be decided based on technical decisions to maximise social returns, it must be decided on some other basis – that of a coherent budget process. The integrity of the process must be protected so that all spending options can be tabled at the same time, and compared and assessed simultaneously. The process must combine a rigorous, technical analysis of the costs and benefits of proposals with active political direction and oversight. The budget process should aim to produce a budget that:

- Can be financed in the short-term and avoids creating unsustainable long-term revenue or expenditure trends that undermine the stability of government's financial position and necessitate politically-difficult policy reversals later;
- Contributes towards macroeconomic stability by fine-tuning aggregate demand;
- Allocates available resources to government's priorities; and
- Allocates funds to achieve as much value-for-money as possible.

However rigorous the technical analysis brought to bear and however astute the political leadership, there are important rigidities inherent in any budget process which add to the difficulties of allocating resources optimally. Consider an example based on the budget of the Department of Safety and Security.

Government may conclude that crime would be more quickly reduced if the funds voted to the police were redirected towards job creation for the poor or other programmes aimed at the root causes of crime. Government might decide to halve the police budget in order to free up those resources and deploy them elsewhere. However, government would also have to take the decision to retrench half the members of the Police Service, as almost 75 per cent of the police budget is consumed by personnel expenditure. Labour laws however make this impossible, even if it were politically feasible.

If government were to come to the opposite view and conclude that the Police Service was functioning well, and dealing with crime demanded a dramatic increase in police personnel, it would encounter another kind of rigidity: police training facilities are already operating at full capacity, and in the short-term, personnel numbers cannot rise at a faster rate. Government might then want to spend more on non-personnel expenditure. But here, too, there are often issues of the absorptive capacity of a department, meaning that additional funds might have been better spent elsewhere.

Problems of this kind exist across government, and the result is that (i) cutting budgets is difficult because much of a department's expenditure is consumed by personnel budgets, while (ii) attempts to increase budgets are undermined by departments' limited absorptive capacity.

Other rigidities in the system include the repayment of public debt, which legally has first claim on the budget, so the larger the stock of debt, the less is available for other spending. Expenditure on large portions of the budget is also tied to commitments which cannot easily be downscaled, for example to welfare recipients or to civil servants. In addition, some big ticket items, such as Gautrain and the 2010 stadiums, are already contracted and must be delivered. These kinds of commitments spending decision must match prior