MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA

Budget vote speech

Minister of Finance Pravin Gordhan

1 July 2009

Votes 7 and 11

CHECK AGAINST DELIVERY

Honourable Chairperson

This is either a very difficult moment to become a finance minister or a very opportune one, depending on one's perspective. It is a testing time because the world is facing its deepest economic crisis in decades. South Africa is in its first recession in 17 years. Our revenue collection has weakened significantly and spending pressures are mounting.

On the other hand, a new administration has just taken office, full of enthusiasm and the will to do more and better. New structures and ministries in government have been set up to enhance the performance of government. It is also important to point out the strengths that I have been fortunate enough to inherit. With a low debt to GDP ratio, the fiscal position is in a much better shape than at any point in our history. My predecessor has built a solid foundation for the public finances and the institutions that report to the Ministry of Finance enjoy respect amongst their peers throughout the world.

And so Honourable Chairperson, even though we find ourselves in very trying circumstances, we can take comfort in both our track record in fiscal and economic management, and the strong institutional base with which we have to find solutions to our critical challenges. Our task today is to outline the economic context in which we find ourselves and to set out the role that will be played by each of the key institutions that report to the Ministry over the course of this fiscal year. These include the National Treasury, the South African Revenue Service, the Financial Intelligence Centre, the Public Investment Corporation, the Financial Services Board, the Development Bank of Southern Africa and the Land Bank. During this interim period, Statistics South Africa also falls under the ambit of the Ministry of Finance and so I will also deal with their key strategic challenges here.

Honourable members, the global economy has deteriorated at a much faster pace than anyone had anticipated. In the six month period from October last year, industrial production declined by almost a quarter. Falling industrial production globally sent commodity prices plummeting and as a result, our mining production is down sharply on a year ago. Driven by lower mining and industrial production, South Africa's economy contracted in the last quarter of 2008, and in the first quarter of 2009 experienced an annualised 6.4 per cent contraction, the worst quarterly performance since the early 1980s. Last week, Statistics South African announced that 179 000 South Africans in the formal sector lost their jobs in the first quarter of 2009, again the worst quarterly performance in the labour market for over a decade. GDP growth forecasts by the World Bank, OECD and IMF for South Africa for this year range from -1.5 per cent to -2 per cent, far off the 1.2 per cent growth we projected at the time of the budget.

The consensus amongst governments at the G20 meeting in Switzerland last week is that the global economy will begin a slow recovery towards the end of the year; slow because governments will have to take steps to reduce their deficits and because households and corporates are still repairing their balance sheets. Given the information base today, it is highly unlikely that the world economy will return to growth rates of 4 or

5 per cent in the next few years. Given the close relationship between our own growth and global growth, this outlook is worrying for our own growth prospects.

Our economic response in the form of fiscal expansion, monetary easing, infrastructure expansion and public employment programmes is making a positive contribution to our economic performance, but cannot offset the loss of demand from the global economy and hence cannot prevent some jobs from being lost.

After holding up reasonably well in the last year, our revenue collection has deteriorated in the first three months of this fiscal year. At the moment, we are about R19 billion below our benchmark target for revenue. If the present trend continues, we could be as much as R50 to R60 billion below our target by the end of the year. Assuming that spending stays as budgeted, our deficit will be higher than we estimated in February. Honourable Chairperson, it is too early in the fiscal year to make a reliable prediction of the fiscal outcome but it is already clear that spending will substantially exceed our revenue this year. We should remind ourselves that our fiscal position would have been far worse had we not had a surplus in 2007/08.

Honourable members, when a country faces a reduction in its revenue, it has limited options. It can either reduce public spending, or it can borrow more to maintain its spending growth. In many countries, even countries such as the US and the UK with budget deficits over 10 per cent of GDP, deep cuts in spending have had to be effected.

Because of our low debt to GDP ratio and our strong fiscal position, we can afford to maintain our present spending level and increase our borrowings to offset the revenue loss. We can maintain our spending level but we have to spend differently. We choose to do this because reducing our spending level now will add to the weakness in the economy and will impact to a greater degree on the poor and vulnerable. We have the fiscal space to maintain our spending by borrowing more today, but this space is not limitless and it has implications for how much room we have in the future.

There are several areas where government would like to maintain strong growth in spending. The key budget priorities outlined by the President in the medium term strategic framework include the creation of jobs, fighting crime, improving the quality of education and health and investing in rural development. We have also committed ourselves to finding more money for the occupation-specific dispensation for doctors. We are committed to increasing spending on public employment programmes to ensure that resources are not a constraint to reaching our targets for public works programmes. We will continue to provide adequate resources for our anti-retroviral programmes and to improve the capacity of our health system.

Honourable members, because we choose to protect spending on these key priority areas, it implies that we will have to find savings in other parts of the budget. Following a briefing to Cabinet this morning on the fiscal outlook, my Cabinet colleagues are determined to work collectively to review spending plans, to reprioritise the budget, to reduce wastage and inefficiency and to get greater value for each rand spent. Deputy Minister Nhlanhla Nene will deal in greater detail with our value for money agenda when he speaks later this afternoon.

Finding savings is not only about reducing budgets, it is also about combating corruption, wastage and leakage in government. In particular, corruption in our procurement system is of grave concern to us. Work is currently underway to establish a Supply Chain Management Compliance Monitoring Unit in the National Treasury. We call on all honest public servants and the South African public to join us in identifying and rooting out corruption.

Public sector employment is rising at a healthy pace with over 45 000 additional people employed in the past two years, mainly in health and police. Designing and implementing occupation specific salary dispensations for specific categories of public servants has been a challenge and has cost us more than originally budgeted. Government, led by my colleague Minister Richard Baloyi, will endeavour to find the right balance between creating new jobs in the public service, appropriately remunerating skilled professionals, and general salary increases. Honourable members, we cannot borrow money to pay salaries and we cannot raise taxes in the present economic environment.

Increasing our deficit today as a result of falling revenue is a sensible economic strategy to cushion our economy from the effects of the downturn. Increasing spending further when revenue is falling, especially spending that cannot easily be reversed, cannot be justified.

Honourable members, our fiscal response to the crisis constitutes a significant contribution to sustaining growth and investment in the economy. We have also had a significant degree of monetary easing with lower interest rates helping households to repair their stressed finances. Our infrastructure programme is well under way and we are actively engaged with our state owned enterprises to ensure that they have access to the finances required to carry out their plans. Both the Department of Public Enterprises and the Department of Trade and Industry are taking steps to ensure that over time, we can increase the local content of the purchases made by our state owned enterprises. The second phase of the expanded public works programme is being implemented and in the case of the community works programme, some plans are being brought forward from next year so that we can absorb more people into public employment programmes.

Honourable chairperson today is the start of the 2009 Tax Season for individual taxpayers and trusts. The deadline for the submission of manual tax returns is 18 September 2009 and for electronic submission, 20 November 2009.

SARS has a highly capable team of professionals who will increase its focus on tax compliance by intensifying risk management and increasing its audit capacity. SARS will over this financial year:

- Employ an additional 1000 auditors and specialists in finance and banking
- Intensify its focus on high-net worth individuals and their tax behaviour, and

- Focus on unravelling tax schemes aimed at aggressive tax avoidance

Already last week, SARS issued over 7 000 letters of penalties to businesses who failed to comply with the PAYE filing requirements. This includes those companies who filed late. At the same time a further 4 000 cases where employers have failed to submit the tax have been referred for criminal investigation and prosecution.

This year, SARS will introduce a range of enhancements to the filing process to improve its service to taxpayers. These include:

- Taxpayers will receive a tax return with a high level of accuracy of information which SARS would have pre-populated onto their returns
- SARS will for the first time this year be validating bank accounts of taxpayers to avoid delays in refunds which affected 400 000 taxpayers last year
- SARS will provide taxpayers with a Statement of Account - a history of the taxes they've paid and the returns they've submitted as far back as 1999

Honourable chairperson, I trust that members of this House will lead from the front by filing their returns correctly and on time.

Our development finance institutions in general are playing an enhanced role during the present economic crisis through financing public investments and drawing private finance into public investment programmes. Most of our DFIs are in a sound financial position, and are well-placed to play a greater role in providing loans or liquidity in support of government's economic objectives.

We also acknowledge that in the context of enhanced mandates, some DFIs might need support. In this regard, we are close to concluding the process of expanding the callable capital of the DBSA from R4.8 billion to R20 billion. This will enable the DBSA to expand its loan book with a further R108 billion over the next five years, focused mainly on poor municipalities that cannot access capital markets. In addition, the DBSA continues to provide technical and managerial support to municipalities through the Siyenza Manje programme.

The Land Bank is in a better position now than the state in which we found it over a year ago, and has provided me with a comprehensive turnaround strategy and corporate plan. Various steps have been taken to improve governance and internal administrative and financial processes. Evidence of success is the fact that a total of R560 million in previously non-performing loans have been recovered. In addition, the turnaround strategy allows the Land Bank to focus on lending to the developmental segment of the agricultural sector. We are in the final stages of concluding a support package for the Land Bank that will go a long way in enhancing the financial sustainability of the Bank, and will give greater effect to the rural development agenda of our government.

The Government Employees Pension Fund is the custodian of the savings of public servants. In addition to providing fiduciary oversight over the savings of public servants, the GEPF administration will focus its efforts on improving its service towards its members and pensioners.

Honourable members, since the establishment of the Public Investment Corporation as a registered financial services provider, the PIC has substantially improved its operations, has deployed world-class asset management IT infrastructure, and has been on a drive to recruit the best people from the financial sector. We are happy to report that over the last three years the PIC has outperformed the benchmarks set for it by its clients.

The corporation also spearheaded the establishment of Pan African Infrastructure Development Fund, through which the trustees of the GEPF have agreed to support infrastructure development on the African continent. We are pleased to report that the fund has $625 million under management. Going forward, the PIC will continue to contribute to the development of financial markets on the African continent.

Our financial institutions have not had to endure the same kind of corrective process that banks in the other countries have had to undertake. The combination of prudential regulations, banking regulations and the introduction of the National Credit Act served to moderate the desire to indulge in risky business practices. Our key regulators, the Registrar of Banks, the Financial Services Board, the National Credit Regulator and the Bank Supervision Department in the South African Reserve Bank, have served us well. We will continue to ensure that they work together more closely through a Financial Regulators Forum. We are watching closely what is happening in the rest of the world so that we can continue to refine our regulatory regime, ensuring it remains at the cutting edge. We will also review the current regulatory architecture to ensure that it remains robust and responsive.

That we have not had major difficulties in the financial sector is not cause for complacency, however. News of the latest Ponzi scheme to defraud our citizens is a reminder that there remain risks in the financial sector. I have called regulators into a task team together with the law enforcement authorities to make sense of the media stories and to separate fact from fiction related to this matter. While the losses have been severe, various media estimations of the extent of the scheme have alleged amounts of between R5 and R18 billion. Current indications are that the scheme amounts to approximately R2 billion.

The Financial Intelligence Centre has coordinated the overall functioning of a legal and administrative framework for anti-money laundering and terror financing in South Africa. This system was subject to a rigorous audit last year by the Financial Action Task Force, the international standards-setting body, with a very positive result. The report reinforces the integrity of our financial system and it will have a positive impact on the credit ratings for our financial sector institutions.

Honourable members, allow me to turn to the post-recession environment. Just as responding to the crisis is important, it is equally important to start planning for the post-crisis period. Our view is that the economic recovery will start later this year, but it will be a slow, gradual recovery with employment growth lagging the economic recovery. Global growth of about 2 to 3 per cent a year is projected for two to three years following the recession. Given our close correlation with global growth, this probably implies that we are likely to grow by about 2.5 to 3.5 per cent a year for several years following the recession. Growth is likely to come from a recovery in global industrial production and higher demand for commodities as fixed investment rises in China and India. Households are likely to gradually increase spending again next year, but consumption growth is likely to lag GDP growth for a period as household savings rise.

The past year has shown us that capitalism is prone to periods of excess and exuberance. Going forward, one of the roles of public policy is that we have to protect the poor and vulnerable from the effect of these boom-bust cycles, and economists are increasingly of the view that public policy has a greater role to play in the regulation of markets to prevent such excesses and exuberance.

Reducing unemployment and poverty is likely to be much harder in the period ahead. The pro-poor nature of the budget will have to be enhanced further to ensure that we continue to expand the social wage that goes to poor households. We will have to continue to act to reduce inflation as this undermines our competitiveness, making it harder to grow employment. We will also have to take further steps to improve our competitiveness through reducing the burden on small business, enhancing competition in our economy and improving the performance of the public sector. The Treasury will work closely with other economic departments and the Presidency to deliver on these key objectives.

As the economy recovers, revenues are likely to rise, providing the space to reduce our deficit. However, because of our higher borrowings now, our interest costs will be much higher and so the post-recession period will have to be characterised by a period of fiscal consolidation. This does not mean that budgets will have to be cut. It does mean that spending growth will be more moderate than during the previous seven years. This is the price we will have to pay so that we can maintain our spending levels now during the crisis.

Honourable Chairperson, the President has announced significant changes to the structure of government. The intention is for government to operate differently, and to re-orientate government towards delivering better services in a more integrated way. This is to be driven by a planning process that is more coherent and a centre of government more adept at intervening to resolve delivery pitfalls. In addition, Parliament has passed legislation that has implications for the budget process. We look forward to interacting with both the Presidency and Parliament to explore what needs to change in the budget process and how the Treasury can support better oversight and governance.

One of the changes made to the workings of government is that Statistics South Africa will shift from the Finance Ministry to report to Parliament through the new Minister in the Presidency responsible for planning. Because these changes are still underway, it remains my task to introduce the budget vote for Vote 11: Statistics South Africa.

Honourable members, in the year ahead Stats SA will report on economic growth as is usual. Additionally, the Gross Domestic Product will be benchmarked and rebased to a reference year of 2005, drawing on the results of the 2005 Income and Expenditure Survey.

To contribute to a greater understanding of poverty, Stats SA will conclude the Living Conditions Survey by October this year and release the results by April next year. The next five yearly Survey of Income and Expenditure is due in 2010 and a pilot will be conducted in this fiscal year. After a number of false starts on the Producer Price Index, the organisation has decided to give as much attention to the PPI as it did the CPI. Starting in this year, Stats SA will initiate a fully fledged revamp of the PPI.

In October 2010, Stats SA will pilot Census 2011, surveying a sample of 480 enumeration areas covering approximately 60 000 households.

Honourable members, the departments and agencies that report to the Ministry of Finance are geared up to contribute towards government's objectives and in particular to respond appropriately to the present global economic crisis. In spite of a worrying fiscal outlook, our strong public finance track record will enable us to continue to spend on those services that create jobs and impact positively on the poor and the vulnerable. Significant reprioritisation of the budget is required and government collectively will work with Parliament and civil society to ensure that we are spending more on our priorities. We want to encourage greater oversight by Parliament and we are looking forward to robust engagement with the legislature. These are difficult times that will require a unity of purpose in all of government to meet our objectives. We are prepared for this challenge.

I would like to take this opportunity to thank
Mr Thaba Mufamadi, Chair of the Standing Committee on Finance
Ms Mmathulare Coleman, Chair of the Portfolio Committee on Economic Development
Mr Elliot Sogoni, Chair of the Standing Committee on Appropriation