MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA

Budget Vote Speech

Vote 10: National Treasury

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Minister of Finance

7 June 2011

Check against delivery

Mister Chairperson
Honourable Members,

Since the middle of last year our economy has grown strongly – driven by buoyant consumer spending, continuing high commodity prices and a recovery in the motor industry. The latest GDP data for the first quarter of this year indicates growth of 4.8 per cent on an annualised basis, with the manufacturing sector leading the recovery despite difficulties associated with the relative strength of the rand.

This is good news: we have moved out of recession, and the South African economy has responded well to the global economic recovery over the past year.

Employment growth is far too slow, however. We face a very serious unemployment challenge, particularly amongst our young people. This is the most important reason why we have adopted a New Growth Path – a set of policy measures and practical reforms that accelerates the creation of job opportunities and achieves an inclusive and durable transformation of our development trajectory.

I have had the privilege over the past few months, during the Local Government Elections, of meeting and speaking with many South Africans of all walks of life about the progress we have made since 1994 and the problems that remain to be addressed. It has been an invigorating and humbling reminder of what we are here for.

I have spoken to hostel dwellers about why their toilets and cooking facilities are not maintained. I have spoken to street traders and young township entrepreneurs about the opportunities and uncertainties they face in making a living outside of the security of paid employment. I have talked to businessmen and women about adapting to the volatility and strength of the rand, and about their frustrations in dealing with bureaucratic procedures that are often too slow.

We have all been reminded during this election process that service delivery is not a political slogan, that even a budget and a long term plan are not enough. Service delivery is the daily practical experience of 50 million South Africans, who either have running water or they don't, who either have electricity for cooking and warmth or they don't, who either have a bus or train service that works or they don't, who live in a house or do not, who may have food for their children or may not, who may have a job or may not.

The local elections have provided a reminder of what we are here for: not just to talk and hear reports, but to serve our people. To ensure that there is action, and that what we do is disciplined, is practical, and is implemented with urgency and determination. No doubt others in this House have had similar experiences.

At the same time, we are mindful of a global economic context that brings both opportunities and considerable risks. Last year saw a broad-based global recovery from the 2009 Recession, fuelled in part by an enormous infusion of financial support by the central banks and governments of the world's major economies. But the recovery is now stalling in the United States, where home prices are still 30 per cent below 2008 levels. In Europe, governments are being swept from office in countries that still face immense debt problems, rising unemployment and highly unpopular austerity measures. In China and other emerging economies, higher food prices and rising inflation are creating difficulties.

There are new forces driving democratic change in the Middle East, and economic and financial trends are contributing to a rebalancing of power, influence and alliances. These are complex times, in which South Africa plays a special role – not by virtue of our power or wealth, but because there are principles of partnership, fair play, democratic participation, regional development and global solidarity that underpin our commitment to a better Africa and a better World.

The National Treasury's strategic plan for the period ahead, based on Government's twelve outcomes, and under the leadership of Director-General Lungisa Fuzile, takes forward our particular responsibilities related to macroeconomic and fiscal management, supporting investment in infrastructure, encouraging job creation and improving financial management and accountability across all three spheres of government. Social security and health financing reforms are key priorities this year. The strategic plans and budgets of the National Treasury and the "finance family" cover a wide range of activities, Mister Chairperson. The detailed strategic plans have been tabled and we have benefited from constructive and very helpful discussion during hearings conducted by the Select Committee and the Standing Committee on Finance.

Multilateral and Regional Financial Cooperation

I particularly welcome, Mister Chair, the support that has been expressed by so many members of the House on the stance we have taken on the governance of multilateral financial institutions, drawing on the Pittsburgh Communiqué of the G20 leaders. We want to see open, merit-based appointments to the senior management positions of the IMF, the World Bank and other multilateral institutions. I should emphasise though that reform of the governance of global financial institutions needs to go much further than this – it is also about the ways in which consultation and joint decision-making are structured, and it is about rules of access to collective financial resources and how the interests of debtors and creditors are appropriately balanced.

These issues are complex partly because they involve difficult trade-offs between national sovereignty and international cooperation. We are well aware, for example, of the difficulties we face because of the persistent strength and volatility of the rand – but improving the transparency and stability of global currency and capital markets has to be a multilateral project, involving clear guidelines for both "sending" and "receiving" countries.

We have several specific international financial coordination issues to address in our own regional environment, which may lead to legislative and regulatory reforms in the near future. Reform of the Southern African Customs Union has been under discussion for several years. The issue has become more pressing because the sharp deterioration in global trade impacted so severely on the revenue shares of SACU partners. This is an opportunity to take a longer term view on regional cooperation in both trade and financial arrangements, and joint investment in infrastructure across regional borders. There is potential here for changes that will benefit the regional economy as a whole, and contribute to competitiveness of Southern African business and industry in the wider global economy. Our development finance institutions, including the Development Bank of Southern Africa, have a special role to play in constructing the partnerships across national boundaries that are required if we are to make expanded trade and investment a reality.

Fiscal Sustainability and the Budget Framework

Accelerated growth and development of our business sector is not only important for the jobs and income it delivers, Mister Chairperson, but it is also a precondition for revenue growth and the expansion and improvement in public services that rely on government revenue.

Preliminary revenue and spending estimates suggest that the consolidated budget deficit for last year was 5 per cent of GDP. This is a pleasing outcome by comparison with the original budget estimate of 6.2 per cent tabled in February last year, which mainly reflects the recovery in revenue associated with an improved economic growth performance. But while government personnel expenditure exceeded the original budget estimate by nearly R20 billion last year, spending on maintenance of infrastructure and capital works fell short of the budget projection by about the same amount. This is not a satisfactory result. As several Cabinet colleagues have emphasised in recent weeks, we face immense backlogs in public infrastructure maintenance. Investment in infrastructure is central to improving household service delivery and overcoming the spatial imbalances of both our urban and rural landscapes. It is vital that we should make better progress in infrastructure maintenance and investment, and we need to take care that this is not crowded out by an unsustainable rise in personnel spending.

The 2011 Budget provides for consolidated personnel expenditure to rise from R314 billion last year to R339 billion this year, which is an increase of just under 8 per cent, including a moderate expansion in public service employment and improvements in conditions of service. Under Minister Baloyi's guidance, negotiations are in progress aimed at a fair and balanced wage settlement this year, taking into account also the salary progression provided for in occupational service dispensations and notch adjustments.

As requested by Parliament last year, the National Treasury has proposed broad proposals for fiscal guidelines aimed at long-term sustainability in our public finances. The proposed principles are

- Counter-cyclicality
- Long-term debt sustainability, and
- Inter-generational equity.

As economic growth improves this year and over the period ahead, we aim to lower the budget deficit to between 3 and 4 per cent of GDP, thereby rebuilding fiscal space and allowing for the substantial borrowing requirements of Eskom, Transnet and our municipalities.

The Treasury will develop the fiscal guidelines further this year. Reporting on this framework will strengthen the ability of Parliament and the public to assess the long-term soundness of our fiscal stance.

Ensuring that expenditure is well-managed, and targeted at our social and development priorities, is clearly also a fundamental fiscal policy objective. Once again, in this year's budget process, we will seek to improve the efficiency of public service delivery through savings and targeted cost-effectiveness measures. Now that performance targets and measures associated with Government's outcome priorities have been finalised, these will play an enhanced role in the assessment of spending plans and reprioritisation of resources.

Financial Management and Procurement Reform

Alongside these performance-related measures, several steps are being taken to tighten up financial management and improve government procurement processes.

Following an extensive consultation process, revised regulations will be promulgated this week to align the preferential procurement system with the Broad-based Black Economic Empowerment Act and its associated Codes of Good Practice. This reform will further encourage the development of small enterprises and takes into account local content objectives associated with Government's Industrial Policy Action Plan. In order to provide time for suppliers to be BEE-rated, a grace period of six months will be allowed and the current regulations will remain applicable until 7 December 2011.

To promote uniformity throughout the public sector procurement system, the revised regulations will also be applicable to schedule 2, 3B and 3D public entities, which are exempt from the current rules.

The revised preferential procurement regulations will assist in curtailing fronting. Further preventative measures to counter supply chain management fraud and corruption, are detailed in a Treasury Instruction issued on 31 May 2011. These include

- requirements for tender programmes to be submitted to treasuries at the beginning of the financial year,
- publication of the names, preferences claimed and bid prices within 10 working days of the closure of a tender,
- prior approval by treasuries for the award of tenders in excess of R10 million, and
- prescribed limits on the expansion or variation of contracts.

These measures will also be extended to municipalities and municipal entities. We will continue to work with other government agencies and the private sector to combat corruption vigorously.

I am also pleased to report that the first three modules of the Integrated Financial Management System are being implemented this year, representing the outcome of several years of research and development in the modernisation of our systems. Further modules are scheduled for implementation next year.

Transparent and cost-effective procurement of goods and services is central to the challenge of good governance and improved service delivery. Fighting corrupt tendencies is never easy, but we have invested in the tools required and have established strong partnerships with the surveillance and justice sector agencies which play critical complementary roles in cleaning up public procurement.

Revenue Collection and SARS Administrative Modernisation

Improved tax administration also contributes to sound financial management and good governance. Under Commissioner Magashula's leadership, we can again report on excellent progress in revenue systems development, and several initiatives to take this further over the period ahead.

Mister Chairperson, revenue performance is an instructive barometer of the broader economic trend and the uncertainty we confront. As a result of the recession, tax collections declined from a peak of 27.6% of GDP in 2007/08 to the trough of 24.5% over the past two fiscal years. Despite the year-on-year improvement of 12% in revenue collections, the tax to GDP ratio has yet to recover to the levels before the recession. The tax-to-GDP ratio is expected to remain below 25% for this year, though we expect to see growth of about 10 per cent, including a strong recovery in company tax receipts.

SARS will continue its focus to improve the levels of tax compliance in the country. Last year a record of more than 4 million individuals submitted their tax returns on time. We must thank the growing number of compliant taxpayers in the country, and I am happy to share with you advance notice that the 2011 Tax Season for individuals will start on 1 July this year.

The 2011 Tax Season for employers closed this past week with another record number of employers filing their annual payroll reconciliation timeously. So far 229 115 employers in the country have filed their reconciliations compared with 195 856 last year. These declarations have been accompanied by over 13 million IRP5 certificates issued to employees.

Again, we would like to thank those employers that have made every effort to submit their payroll data on time. This will now enable SARS to prepare a unique income tax return for most working individuals in the country who will be required to submit a tax return after 1 July 2011.

Employers who have not yet submitted their payroll information to SARS are encouraged to do so as soon as possible in order to avoid penalties.

Good progress has also been made in pursuing non-compliant taxpayers who have outstanding income tax obligations. Following the despatch of over 230 000 penalty notices in January last year, 81 866 individual taxpayers have submitted returns and over 50 000 have paid penalties amounting to R189 million. The new penalty regime, in which penalties range between R250 and R16 000 in proportion to the severity of the transgression, has proved to be effective in encouraging better compliance.

Parliament will have a change from the usual consideration of amendment Bills in the tax arena this year. The Tax Administration Bill will be introduced later this month. The Bill will consolidate generic administrative provisions in different tax Acts, update them in line with modern thinking and SARS's modernisation agenda and serve as a preliminary step to the re-write of the Income Tax Act, 1962.

In the arena of revenue administration we are already able to take advantage of South Africa's inclusion in the so-called BRICS grouping of emerging economies. Building on work of the India, Brazil and South Africa (IBSA) grouping, progress has been made in sharing tax and customs information and bringing greater pressure to bear on nearby offshore financial centres such as Mauritius. The visit last month of the Chinese Vice-Minister responsible for Customs provided an opportunity to engage on the possibility of closer cooperation between SARS and China Customs on issues such as the under-valuation of goods and measures to combat counterfeit and illicit trade.

Members of the House will have noted that the Tax Laws Amendment Bills to give effect to this year's revenue proposals were published last week. These include new anti-avoidance measures, including revision of the section 45 provisions to treat dividend cessions as ordinary revenue, where tax-free treatment is inappropriate because the holder lacks meaningful economic interest in the underlying shares.

Financial Regulation

Turning to financial sector regulatory issues, Mister Chairperson, I am pleased to report that preliminary comment on the Government's proposals set out in the policy document published at the time of the Budget, titled *A Safer Financial Sector to Serve South Africa Better*, has been positive and encouraging.

One of our key announcements was the gradual shift to a "twin peaks" model of financial regulation. This approach envisages the separation of prudential regulation of financial institutions and locates it within the South African Reserve Bank; while locating responsibility for market conduct regulation at the Financial Services Board. National Treasury has met with the Reserve Bank and a joint task team has been established with the Financial Services Board to guide the implementation of these reforms.

Since the Budget, the new Consumer Protection Act has also come into effect and care will need to be taken to ensure that there is alignment of objectives and that we minimise duplication. The financial sector must be held to the highest standards of market conduct and consumer protection, and for this reason requires unique legislation and associated support initiatives.

The policy document also emphasises the importance of safeguarding the interests of pensioners through proper regulation of the pension funds industry and strengthening of governance mechanisms. Mindful of the poor investments made by some pension funds, I need to remind trustees of pension funds to focus on their core fiduciary responsibilities in acting at all times in the interest of the members of the pension fund. The philosophy behind Regulation 28 is to create an investment framework that not only safeguards the savings of fund members, but also encourages prudent long-term and sustainable participation of retirement funds in broad-based development of the South African economy.

Provincial and Local Service Delivery

Although not codified in quite the same regulatory framework, these principles of financial trusteeship also apply to public service delivery and financial management across the national, provincial and local government spheres.

There is still more to be done, but I wish to record my appreciation for the efforts of the provincial Finance MECs and their treasury departments in supporting financial management improvements in provincial departments over the past year. Of the 122 provincial departments, only eleven departments overspent their budgets for the 2010/11 financial year, compared with 31 departments in 2008/09. Active steps have been taken to improve resource allocation efficiencies and there is better alignment between national identified priorities and funding at the provincial level.

However, the slow pace of capital spending as a result of poor planning, weak supply chain management and poor contract management must be dealt with. Further work is in progress, drawing on capacity of the Development Bank of Southern Africa, to dramatically change the pace of delivery of infrastructure.

At the local government level, we have also seen progress in stabilising finances. However, the composition of spending needs further refinement. Capital spending and infrastructure maintenance have slowed significantly while operational spending, including personnel costs, is growing rapidly.

We have noted that Parliament has requested that the provincial and local equitable share allocations should be put under scrutiny over the year ahead. The local government equitable share is designed to assist municipalities in meeting the national government policy imperative of providing free basic services. On average, municipalities receive over R500 per month per poor household to provide for free basic services. Future years will see the share for poorer more rural municipalities growing. This is accompanied by rapid increases in Municipal Infrastructure Grant allocations to poorly resourced municipalities. These arrangements will be re-examined this year, in consultation with all stakeholders, with a view to phasing in reforms from 2012 onwards.

It has to be noted, though, that funding constraints do not appear to be the main difficulty in municipalities. Limited service delivery and infrastructure management capacity is evident in many municipalities, exacerbated by poor political stewardship. National Treasury is therefore reinforcing its capacity building interventions, in cooperation with provincial treasuries and other departments and agencies.

The Jobs Fund

Mister Chairperson, you will recall that President Zuma announced the establishment of a new Jobs Fund in the State-of-the-Nation Address this year, and a total of R9 billion was set aside over the MTEF period for this initiative in the February Budget.

Drawing in part on experience of the Business Trust in supporting innovative enterprise development projects in recent years, the Jobs Fund will operate as a competitive "challenge fund", supported by a technical appraisal and project management team based at the Development Bank of Southern Africa. Mr Frans Baleni, Deputy Chairperson of the DBSA Board, and Mr Brian Whittaker, CEO of the Business Trust, have agreed to serve as the chair and deputy chair of the Fund's Investment Committee. An Advisory Committee will also be appointed, drawing on appropriate expertise in both the public and the private sectors. The Jobs Fund will initially seek project proposals in four broad areas:

- Enterprise Development
- Infrastructure Investment
- Support for Work Seekers, and
- Overcoming institutional barriers to job creation.

This is an exciting and bold initiative, in which we will in some respects be treading new ground. The Jobs Fund is founded on the recognition that we don't yet know enough about how to address our unemployment challenge. We therefore need to encourage innovation and learn from the experience of our business sector, non-governmental and civil society organisations, in addition to public sector agencies and development finance institutions. But as Minister Nkwinti advised me last week, we are not looking for men in suits with briefcases here, but for partners with practical ideas and mud on their shoes. I am sure you will join me in wishing the

DBSA and the Fund's Investment Committee well in taking this initiative forward, recognising that we want to know, in a year's time, not just how the funds have been allocated, but more importantly what we have learnt about the process and dynamics of job creation.

The Development Bank of Southern Africa

In taking on this task, Mister Chairperson, the DBSA is building on an increasingly wide-ranging portfolio of investment and service delivery capabilities forged in the cauldron of local and regional infrastructure investment. Under its Chair and CEO, Mr Jabu Moleketi and Mr Paul Baloyi, the Development Bank has consolidated its activities into three broad areas, encompassing its financing, advisory and integrator services to all spheres of government. The DBSA also plays a leading role in identification, origination, implementation and management of municipal infrastructure projects.

The Bank's strategic plan accordingly allocates substantially increased funds over the next five years to public infrastructure investment, both in its lending activities and in the coordination and facilitation of critical projects and programmes. The following focus areas are prioritised:

- Hospital revitalisation
- Water and sanitation services
- Renewable energy programmes
- Education infrastructure, and
- Improved maintenance of roads and other facilities.

The DBSA will continue to play a key role in financing infrastructure and improving financial management in municipalities, in close cooperation with the Treasury's Intergovernmental Relations Division, the Department of Cooperative Governance and Traditional Affairs and other national and provincial departments. Our approach is to strengthen cooperation between between public sector institutions while also building partnerships with the private sector in financing and constructing social and economic infrastructure.

To support these initiatives, Government has agreed to raise the Bank's callable capital to R20 billion, thereby increasing its lending capacity to around R140 billion.

The Land Bank

Turning to the Land Bank, I am sure that Members of the House will already have noted the impressive turnaround that has been achieved in both the financial health of the institution and its effectiveness in supporting transformation in the farming sector. Capital adequacy is now well above the level set as a condition for the government guarantee, and liquidity levels have significantly improved.

The focus for the year in progress is on increasing the development impact of the Bank, working with government to find suitable financing solutions for emerging farmers, growing the loan book while reducing the cost of funding, and establishing a wholesale finance facility for strategic partners to on-lend to qualifying participants.

Government Employees Pension Fund and Public Investment Corporation

Mister Chairperson, allow me to add a few words about the Government Employees Pension Fund and the Public Investment Corporation, before concluding.

The GEPF is overseen by a Board on which the government as employer, and members or pensioners, are equally represented. It is the largest fund by membership in the country, and is comfortably the largest single investor in government bonds and the wider South African capital market.

The Government Pensions Administration Agency has been established as a "government component" in terms of the Public Service Act, with responsibility for administering pensions on behalf of GEPF and non-contributory pensions and related benefits on behalf of National Treasury. Thirteen regional offices are now operational and a system modernisation programme will be implemented over the period ahead. There has been progress in improving services to members:

- The backlog in benefit payments has been reduced from over 14 000 to 4 741 in the last financial year.
- The average days taken to pay following receipt of completed forms has been reduced from 36 days in 2009/10 to 22 days.

- The GPAA call centre has achieved a 92 per cent satisfaction rating amongst callers, while responding to some 848 000 calls during the course of 2010/11.

The funds of the GEPF are administered by the Public Investment Corporation, under an investment mandate that is jointly agreed between the GEPF Board and the Ministry of Finance. The PIC now plays a leading skills development role in the asset management industry and is a prominent voice in improving corporate governance and promoting developmental and socially responsible investment policies.

This year the PIC will commence an annual programme to measure the impact of its investments, focusing on job creation and other national priorities.

Conclusion

This commitment, Mister Chairperson – to objectively measure the impact of what we do, against goals we have agreed on – is the hallmark of our approach to management and accountability in the finance family of institutions. The appropriate measures and indicators are easier to identify in some areas than in others, but the basic principle is the same: we seek to account to Parliament, to taxpayers and to citizens on the basis of results achieved, transparently measured, against targets and outputs identified in our strategic and operational plans.