T T Mboweni: The foundation has been laid[1]

Speech by Mr T T Mboweni, Governor of the South African Reserve Bank, at the BMF Corporate Update Gala Dinner, Gallagher Estate, 18 June 2004.

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One of the institutional arrangements arising out of the political negotiations process at the World Trade Centre in Kempton Park was the creation of the Transitional Executive Council (TEC), a sort of "provisional government". The TEC as many will recall, established a number of sub-councils. I served on the sub-council on finance. Effectively, the then government could not take any major economic decisions without the concurrence of the TEC sub-council on finance. Those were nice days when we had power without the stress of responsibility!

One of the problems/constraints facing the economy at that time, was that the country only had foreign reserves to cover for plus/minus three weeks of imports. This was indeed a crisis for an economy as big as ours. At that time, South Africa's gross domestic product at market prices was around R480 billion. For the sake of perspective, today's GDP at market prices is R1.2 trillion. The then Minister of Finance, Mr Derick Keys, approached the TEC to negotiate an agreement with us for a joint approach to the International Monetary Fund (IMF) for assistance. This was a difficult request since there were so many strategic and tactical questions to consider. An example in this regard was the question of whether the apartheid government was trying to lock us into an IMF structural adjustment programme via the back door, thereby tying the hands of the future democratic government.

The end result was that we agreed to that request by the then government to approach the IMF for the required balance of payments support called the Compensatory and Contingency Financing Facility (CCFF). There were no conditionalities attached since this was a soft loan as it were. However, we had to provide the IMF with a "Statement on Economic Policy". The statement was fairly simple: assure the IMF that the future government will pursue prudent macroeconomic policies. This was something that the ANC in particular had adopted as an approach as early as 1992 in a document entitled - ***Ready to Govern****.* We did not sell out!

However, this "Statement on Economic Policy" has been described by some as the beginning of neo-liberal economic policies that were to be pursued by the future government. Recently, Prof Sampie Terreblanche, of the University of Stellenbosch has said in a book entitled: ***A history of Inequality in South Africa, 1652 - 2002***, that "in 1993 the corporate sector and some ANC leaders reached a hugely important elite compromise. This happened before the Transitional Executive Council (TEC) accepted a secret $850 million loan from the IMF to help tide the country over balance of payments difficulties in November 1993" (p96). He continues to say that "before the TEC signed the loan agreement, the corporate sector and the NP government on the one hand and ANC leaders on the other signed a secret protocol on economic policy … (they) agreed with the IMF, the TEC committed itself to a neo-liberal, export-oriented economic policy and a 'redistribution through growth' strategy".

I was one of the people involved and I can say with confidence that Prof Sampie Terreblanche is totally and completely wrong. There was no secret meeting of the corporate sector and the core leaders of the ANC that I am aware of to agree on a secret document. This was a TEC matter handled through the sub-council on finance. Naturally, the delegates to the subcouncil consulted their principals. But I emphasize that any careful reading of the statement will find no contradiction with ***Ready to Govern****.*

But that is a matter for political economists to sort out in due course.

It is fair to say that the balance of payments constraint that we grappled with at the TEC was only the tip of a large iceberg. Here are some of the indicators of an economic crisis that we went through. The pre-1994 period is contrasted below with what has happened in ten years. Firstly, in 1985, on the back of the sanctions campaign, the government of the day declared a partial debt standstill. The affected debt was $13,6 billion and the total debt was $23,7 billion. From 1985 to 1993, the net financial outflow

[1] Adapted from the chapter appearing under my name in a book by the World Economic Forum entitled *South Africa: The Miracle Continues*. June 2004.

from South Africa was some R45 billion or 11 per cent of gross domestic fixed investment. That forced the authorities at the time to implement stringent policies to generate current account surpluses. The cost to the economy was immense. In August 2001 the final repayment was made. The international capital markets were opened to South Africa effectively in 1995 when the first post-apartheid sovereign bond issues of $750 million was launched.

Secondly, the trade regime at the beginning of the 1990s was characterised by three interrelated strategies, namely the promotion of domestic industries through import substitution, the development of specific industries to attain self-sufficiency and the promotion of mineral beneficiation. South Africa's industries therefore became heavily protected by formulae, specific and *ad valorem* duties and surcharges. High tariff levels were complemented by quotas that limited the quantity of imports. The tariff structure was extremely complicated. Overall the strategies pursued by the authorities resulted in a complex discretionary regime fraught with corruption and bureaucratic mismanagement.

As a result changes to the tariff regime became a fundamental imperative for the new government in 1994. The number of tariff categories was reduced from over 100 to only six and the average weighted import duties on manufactured goods to the total value of manufacturing imports decreased from 14,0 per cent in 1994 to 4,7 per cent in 2002. Several free trade agreements were also signed to dismantle trade barriers and to gain increased market access. The process continues today and many global trade doors have been opened.

In addition to these, measures were undertaken to promote competition, industrial policy was adjusted to enhance the competitiveness of manufacturing enterprises in export markets. In particular more emphasis was placed on supply-side measures, rather than demand-side measures such as expensive export support programmes. These measures included investment incentives for large investments of a strategic nature and for small and medium enterprise development; training grants to firms investing in the promotion of skills; the development of industrial development zones; improved access to finance; and support for investments in economic infrastructure.

A new Competition Act was passed in Parliament in 1998 to, among other things, create a greater spread of ownership in enterprises, to expand opportunities for South African participation in world markets and to provide consumers with competitive prices and product choices.

Thirdly, at the beginning of the 1990s an unsustainable fiscal situation had started to develop, and the deficit before borrowing and debt repayment of the government reached 7,3 per cent of gross domestic product in the fiscal year 1992/93. The internationally acceptable rule of thumb is that the fiscal deficit should ideally not be more that 3% of the GDP. Government expenditure continued to rise relative to domestic production, the tax burden increased, the public sector made increasing demands on the domestic capital market, the ratio of government's interest payments to gross domestic product rose steeply and government dissaving increased to unacceptably high levels.

The post-apartheid South African government therefore placed considerable emphasis on restoring fiscal consolidation and stability. The economic strategy at first was to create stable macroeconomic conditions as a necessary precondition for economic growth and employment creation. The basic logic of the approach followed was that by improving fiscal sustainability, poverty reduction and income redistribution would become attainable objectives over the medium term. The expenditure restraint applied by the national and provincial governments reduced the fiscal deficit before borrowing and debt repayment to 1,5 per cent of gross domestic product in fiscal 2001/02. This by any measure represented a major milestone by a government which was suspected of being macroeconomic populist.

This successful fiscal consolidation allowed the government to adopt a more expansionary fiscal policy stance from fiscal 2001/02. More emphasis is now placed on infrastructural development and social upliftment. The government, however, continues to apply fiscal prudence and despite a decline in the growth of tax revenue, was able to contain the main budget deficit to an estimated 2,4 per cent of gross domestic product in fiscal 2003/04.

An important aspect of the budget reform was the adoption of the Medium-Term Expenditure Framework in the fiscal year 1998/99 and the Public Finance Management Act of 1999. The Medium-Term Expenditure Framework consists of three-year rolling expenditure and revenue projections for the national and the provincial governments. This creates greater certainty and transparency to the budgetary process. The Public Finance Management Act has enhanced the accountability of public sector managers by emphasising disciplines such as regular financial reporting, sound internal expenditure controls, improved accounting standards, performance monitoring and independent audit and supervision systems.

The government has reduced its net loan debt from a peak of 48,1 per cent of gross domestic product in fiscal 1996/97 to 36,8 per cent in 2003/04. This not only contributed to lower interest payments on total public debt, but also to generally lower long-term yields in the South African capital market. The prudent measures applied by government have brought about a decline in government net dissaving from the high level of 7,3 per cent of gross domestic product in 1992 to 1,1 per cent in 2003. This is absolutely superb and provides an excellent support pillar for lower inflation.

Fourthly, monetary policy has also seen many changes. The objectives of monetary policy at the beginning of the 1990s were to reduce the rate of inflation to the average rate of inflation in trading partner and competitor countries; to manage the money creation process in such a way that an adequate, but not an excessive amount of new money would be supplied to the system; to maintain positive real interest rates; to increase the gold and other foreign reserves to a comfortable level and to develop a sound financial infrastructure consisting of healthy financial institutions and financial markets. This was a reasonable approach in the circumstances, but the achievement of these goals was hampered by the overall political and economic environment.

In the 1990s the SA Reserve Bank also intervened heavily on its own initiative in the spot and forward market to influence supply and demand in the foreign exchange market. These operations were undertaken supposedly with the intention of smoothing out large short-term fluctuations in the exchange rate. An impression was created that the SA Reserve Bank had some preferred exchange rate level. This naturally was an open invitation to speculators.

Despite this active intervention, large fluctuations occurred in the weighted average external value of the rand, particularly during the second half of the 1990s. The monetary policy measures, however, achieved considerable success in bringing the rate of inflation down. After inflation in the consumer price index had generally fluctuated around a level of about 15 per cent in the late 1980s and the beginning of the 1990s it moved below double digits in 1993 and declined to 5,2 per cent in 1999.

In February 2000 the government announced that South Africa had formally adopted an inflation-targeting monetary policy framework to make monetary policy more transparent and accountable and to promote an ex ante co-ordination of economic policy.

Fluctuations in the exchange rate of the rand have nevertheless complicated the implementation of monetary policy even under inflation targeting. For example in 2002 monetary policy was dominated by inflationary pressures arising from the substantial depreciation in the external value of the rand in late 2001, combined with a sharp rise in international oil prices as well as in domestic food prices. These external shocks were responsible for a surge in the twelve-month rate of increase in the CPIX from a low of 5,8 per cent in September 2001 to a peak of 11,3 per cent in October 2002. Restrictive monetary policy measures undertaken and the subsequent recovery in the exchange rate of the rand then brought the rate of increase over twelve months in the CPIX down to 4,4 per cent in April 2004.

Fifthly, a large forward book was built over the years as the country faced sanctions and could not access the international capital markets. The SA Reserve Bank entered into forward forex contracts in order to gain access to foreign currency. It was a very expensive exercise. In 1994, the forward book stood at $26,9 billion. Unfortunately, in the post-1994 environment, the central bank continued to intervene heavily in the forex market. In September 1998, the forward book stood at $24,9 billion and the Net Open Foreign Currency Position was $23,2 billion. In mid February 2004, the forward book was expunged and the foreign reserves position improved impressively. The country now has gross gold and foreign reserves of some $26 billion, with plus/minus $10 billion of the international liquidity position currently in ‘the bag’.

Sixthly, clearly, the financial sector suffered tremendously before 1994. Efforts to maintain an effective and efficient financial sector were hampered by the lack of co-operation with international regulators due to the political circumstances at that time. As a consequence, some regulations and practices deviated from international best practices. With the reestablishment of normal relations with the rest of the world in the 1990s, great efforts were made to bring the rules and regulations on the activities of financial institutions in line with international best practices.

From 1994 South African financial institutions started operating on an increasing scale in major international financial centres such as London New York and Hong Kong as well as opening branches or subsidiaries on the African continent. As part of the globalisation process, five large domestic companies transferred their primary listings to international bourses. This change gave them greater access to capital at lower cost and provided them with opportunities to become truly global South African giants. But more significantly, all these companies maintained their secondary listings on the JSE Securities Exchange South Africa, and their market capitalisation on the JSE actually increased from R126 billion in 1997 to R471 billion in 2003. So they have kept the home fires burning too!

Over this same period international financial institutions began to conduct business in South Africa. The creation of a level playing field between local and foreign service providers was entirely pursued by the authorities. The regulatory authorities also actively encouraged the development of appropriate clearing, settlement, ownership-transfer and market information systems and insisted on proper intra-market and cross-market risk management systems, including capital adequacy requirements for market participants.

The operations of the financial markets in South Africa were improved considerably to bring them in line with international best practice. In 1996 bond trading was shifted from the JSE to the Bond Exchange of South Africa. This led to a substantial rise in the turnover in the secondary bond market from R2 trillion in 1995 to nearly R12 trillion in 2003. Improvements to the JSE included the electronic clearing and rolling contractual settlement, the dematerialisation of equity scrip and the implementation of an electronic trading system. The value of shares traded on the JSE increased from R62 billion in 1994 to R752 billion in 2003.

Seventhly, the normalisation of relations with the rest of the world made it unnecessary to follow restrictive fiscal and monetary policies to maintain a surplus on the current account of South Africa's balance of payments and created a leeway for the promotion of economic growth. In the past ten years a deficit was therefore recorded on the current account, but this deficit as a ratio of gross domestic product remained low and averaged only 1 per cent per year. Over the same period there was a net financial inflow recorded from the rest of the world amounting to nearly R204 billion, compared with the net financial outflow of about R45 billion from 1985 to 1993. As a result, the level of foreign investment in South Africa amounted to R736 billion at the end of 2002. This is a very significant post-apartheid dividend for country.

South Africa's real economic growth doubled from an average annual rate of 1½ per cent during the 1980s to about 3 per cent between 1994 and 2003. In addition, the average growth in real gross national income per capita, an indicator of living standards, improved from a negative figure of 1,1 per cent per annum during the 1980s to a positive figure of 0,8 per cent between 1994 and 2003. Moreover, between 2000 and 2003 the average growth in real gross national income per capita amounted to about 1,5 per cent. The big challenge is to further increase the growth performance of the domestic economy. The foundation has been laid over the past ten years to make this achievable. To make life better for all our people.

So we can indeed claim, without fear of contradiction that the post-1994 period has seen some remarkable improvements in the macroeconomic and financial position of our country. A good foundation has been laid. Greater efforts have now to be directed at micro-economic reforms and job creation as the President has directed.

My own personal journey has been a momentous one. In 1980, as a twenty one- year-old kid, I adventurously and illegally crossed the South Africa/Lesotho border at Ladybrand into Lesotho whilst the border guarding soldiers were changing guard. A long story on its own in an autobiography perhaps. My parents were utterly shocked when I skipped the country. They could not comprehend it at all. My father died whilst I was in exile and I could not attend his funeral. So traumatic. His younger brother died last month at the age of sixty-nine (69) and we buried him next to my Dad at our family burial grounds. I gave the funeral oration. It was like burying my own father. I cried so badly. I grew up in foreign lands, in exile I received good university education abroad, learnt how to shoot using all sorts of guns and make bombs, studied military combat work (mcw), learned how to speak some Portuguese and Sesotho sa Moshoeshoe, drafted and edited radical economic policies. And now after being a minister of labour between 1994 and 1998, I hold one of the most coverted jobs in the world, Governor of a central bank. The greatest honour a country can bestow on any of it's children, is to make them Governor of their central bank. The journeys of so many South Africans have been remarkable too. From having no electricity and pipe water, schooling under a tree, to what we have today. This country of ours has moved on. So much still needs to be done. So little time. Life is not about economic statistics, it is about people. Myself, yourself, all of us, we have made progress. We have moved on.

I suppose that you can call me an exile kid, an international kid born in South Africa, but my home is in South Africa, Lesotho, Mozambique, the United Kingdom, Zambia, Angola, Tanzania, Swaziland, the

USA, Switzerland and everywhere I stayed in my youth. I hate narrow nationalism, cannot stand it. I hate xenophobia. But now my country is free and ten years old. Only ten years! Still too young.

It has been a long walk from the beautiful and dusty village of Bordeaux in Tzaneen. But as President Manadela says "I have walked that long road to freedom. I have tried not to falter, I have made missteps along the way. But I have discovered the secret that after climbing a great hill, one only finds that there are many more hills to climb. I have taken a moment here to rest, to steal a view of the glorious vista that surrounds me, to look back on the distance I have come. But I can rest only for a moment, for with freedom come responsibilities, and I dare not linger, for my long walk is not yet ended."

I love Freedom!!!!! Even central bank governors love freedom!!!!

Tonight, I salute our country! I salute our people! Poor as they might be, they have political power in their hands. Hold on to that dear people, don't let that slip away no matter how hard things might be. You are my boss, for which I am eternally grateful.

And so, here is to TEN YEARS OF FREEDOM!!! May we have many, many more years of FREEDOM!!!

Thank you very much BMF for what you are doing for us all.

Thank you.