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## Africa Meeting Summary

# South Africa's Growth and Development: Implications for Regional and International Engagement

Hon. Pravin Gordhan

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Chair: Ann Grant

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## INTRODUCTION

The following document provides a summary of a meeting held at Chatham House on 2 May 2013. The meeting focused on South Africa's growth and development and the resulting implications for regional and international engagement.

This year South Africa hosted the fifth BRICS summit. While its economy may not compare in size to the original BRIC countries, membership illustrates the increasing role played by South Africa in South-South relations. Yet the national economy is still blighted by structural inequality and poor labour relations.

Finance Minister Pravin Gordhan discussed South Africa's National Development Plan and efforts to overcome outstanding challenges and maintain South Africa's position as sub-Saharan Africa's largest economy. He discussed the role of South Africa in enhancing regional development and the importance of developing stronger links with emerging economies globally.

The meeting was held on the record and consisted of a presentation followed by question-and-answer session. The following summary is intended to serve as an *aide-mémoire* for those who took part and to provide a general summary of discussions for those who did not.

## **HON. PRAVIN GORDHAN**

Hon. Gordhan began his presentation with an overview of the achievements in growth and development South Africa has made since in 1994. The nation, due to celebrate its nineteenth birthday this year, faced immense challenges owing to the legacy of apartheid, including a deficit of 9.4 per cent and national debt of 40 per cent as well as a hugely divided society with four independent Bantustans and a further eight self-governing territories.

When the ANC took over after the 1994 elections, it had to put together a single government administration in accordance with the interim constitution negotiated in 1993. This included setting up national departments for health and education and consolidating provincial departments, creating nine new provinces and provincial legislatures. The ANC began the process of the growth and development of South Africa.

South African GDP has expanded by 83 per cent over the past 19 years. National income per capita, which stood at 27,000 rand in 1993, reached 38,500 rand in 2012, and disposable income per capita increased by 43 per cent. Total employment increased by 3.5 million people and average real wages in mining and industry increased by 150 per cent. An expanded public works programme has created 1.6 million work opportunities.

Three million houses have been built in South Africa since 1994, and the number of recipients of social assistance rose from 2.5 million to 15 million by 2012, with child support grants accounting for a large proportion of this increase. Access to water has increased from 60 per cent to 90 per cent, and electricity connectivity is now over 80 per cent.

Before the global recession in 2009, South Africa enjoyed a 1.5 per cent surplus on the budget, growth at almost 5 per cent and employment increasing at a reasonable rate, although not sufficiently to cover unemployment deficits.

The implementation of a new tax administration system changed tax compliance culture in South Africa and increased tax revenues from 100 billion rand in 1993 to around 810 billion rand in 2012. In the last few years South Africa has come top in global rankings in terms of budget transparency and sound financial regulations. However, the country has lingered at the bottom of global rankings in education, despite the fact that it allocates one of the highest proportions of the budget to education globally.

There has been significant progress in infrastructure building. Over the past few three-year terms, the government has invested 800 billion rand into

infrastructure development, with the installation of the Gautrain as one example of a successful public–private partnership. There is a long-term plan for infrastructure development as part of the National Development Plan (NDP) which will include up to ZAR 4 billion of infrastructure investment.

There are multiple challenges in implementing the NDP, a 20-year vision until 2030. The finance ministry is in the process of aligning the Plan with the national budget and embedding the project within government departments. Various initiatives in industry, agriculture and skills development are planned to raise potential growth and employment, and to improve education and training to create a much more skilled workforce in South Africa. Access to education has improved owing to increased spending, but there is a need to improve the quality of education.

Investment in infrastructure is needed to increase growth from an anticipated 2.7 per cent to 5 per cent, which must be sustainable over at least 20 years in order to overcome current unemployment levels. The government's ambition is to halve unemployment levels by 2030, and again by 2040.

On the regional front, South Africa is a member of the oldest customs union in Southern Africa, the Southern Africa Customs Union (SACU). The country contributes over 90 per cent of funds to this revenue-sharing regional body and receives less than 50 per cent. South Africa supports several million people from neighbouring regions through its social services. SACU member states are encouraged to create transnational value chains to develop a larger tax base and improve employment rates.

Regional integration through infrastructure development is supported by the Development Bank of Southern Africa and the Industrial Development Corporation. African leaders have endorsed a NEPAD infrastructure plan to increase intra-regional trade in Africa from around the current 11 per cent. A triple free trade agreement deal between SADC, the East African Community and the Common Market for Eastern and Southern Africa has been planned to create a free trade area comprising more than 500 million people.

South Africa works regionally in the Collaborative Africa Budget Reform Initiative (CABRI), a transnational scheme which advises members on financial budgeting. South Africa helped create the African Tax Administrative Forum (ATAF), entailing collaboration between 36 countries to build tax administrative capacity. South Africa also works with the OECD and runs a training programme once a year on debt management.

Globally, South Africa holds a representative role as the largest economy of sub-Saharan Africa. The country works closely with the BRICS members,

having hosted the fifth BRICS summit in Durban this year. The summit looked at creating a business council and BRICS bank, as well as formulating a contingency reserve arrangement and cooperation in the taxation and customs area.

The G20 is another forum in which South Africa participates, although the success of the group has so far been limited. There have been disagreements on how to drive global growth, how to solve the European crisis and the 'too big to fail' bank rules. The focus on development and infrastructure that South Korea brought when it joined the G20 is being lost, although it may be regained through the Russian chair's long-term focus on infrastructure financing.

South Africa is an active member of the World Bank although issues of representation and quotas remain. A new chair was created for Africa in the World Bank; however there should be a third chair for Africa in the IMF.

Hon. Gordhan concluded that there needs to be a shift in focus in the economy to job creation, increasing growth and reducing inequality, and to the institutional and policy changes needed in order to achieve this.

## QUESTIONS & ANSWERS

### Questions

How did you create the social shift in tax compliance culture in South Africa from that of avoidance being communally acceptable to inherently criminal?

How will the government try to create new jobs in order to deal with the social issue of youth unemployment?

Could you comment on the recent row between Britain and South Africa over the termination of aid? How does international aid play into the South African economy?

### Hon. Pravin Gordhan

Hon. Gordhan said that as an ANC activist he had learnt how to organize and persuade people to commit to building a new society and new democracy after 1994. He remarked on his 10-year experience working with around 14 or 15 million people institutionalizing and creating a modern tax administration and customs union that is probably in the top 10 globally today.

The key to better tax compliance is obtaining a balance between three key elements. The first is education: informing people why taxes are crucial, and how their money is used. The next is service: making it easy for honest people to comply. The last is credible enforcement: prosecuting tax avoidance publicly and in court. The Minister spoke with the business community and financial institutions, and said that the average contribution in tax from these institutions had risen from nothing to around 22 per cent.

There are a number of ways to tackle the challenge of unemployment. One method is to invest in infrastructure and increase incremental growth in the economy, allowing for a ripple effect in the production areas of the economy. Another is investing in the agriculture sector, as smaller farmers are not becoming part of the economic value chain. There are the public works programmes which have made a significant contribution. Increasing the capacity of skills development and training institutions can help to increase skills levels. Another is a renewed focus on key sectors such as mining, agriculture and the green economy which is a potential area for employment and training.

Each of these needs to be leveraged to a higher extent to give young people their first opportunity to work. There has been a recent agreement between business, labour and government on a number of projects and programmes such as the possibility of incentives for the private sector to employ young people.

Regarding the termination of UK aid, Hon. Gordhan commented that in about July 2012, he had had a meeting with Andrew Mitchell, the then Secretary of State for International Development. The Minister said he was informed that the existing DFID aid programme would remain in place until 2015, but after that date a change would be made that would imply less direct aid for areas such as education and health; however, there could perhaps be a trilateral programme between Britain, South Africa and Lesotho or Swaziland on issues such as tax administration.

Britain considered South Africa to be in a different development category, given where it was as a middle-income country. Hon. Gordhan pointed out that while he understood the new policy the British government wanted to work on, South Africa is two societies in one: a developed part that does not need aid, and a developing part in which the British government, through DFID, could make a difference. He said that South Africa could manage without the existing aid of £19 million per year; such a reduction in income would be covered fiscally. Hon. Gordhan said that South Africa is funding its own development and as a result of tax compliance, over 90 per cent of what is spent is taxpayers' money. The rest South Africa borrows, and it repays what is borrowed. Where the UK could add value in the future was in specialist technology and expertise.

Hon. Gordhan said that six weeks before the Chatham House event he had had a telephone conversation with the Secretary of State for International Development Justine Greening MP, , who had recounted what Andrew Mitchell had already said. The South African government noted that there had been a change in approach. The UK and South Africa agreed that they could work on projects, that there could be a joint assessment at the World Economic Forum that took place in Cape Town in early May and that officials would take this matter further.

The Minister said there were some suggestions on the wording of a statement, but the South African side did not agree on anything. He said he was surprised when it was brought to his attention that a statement had been issued by the Secretary of State's office, which in the first few paragraphs indicated a change in approach and a cut in aid. The second-to-

last paragraph said that there had been a discussion with her South African counterparts and an agreement that South Africa could fund its own development.

The Minister said that no such discussion took place, and no such agreement was arrived at. The Secretary of State said something had been sent to his office, which he had not seen. Then he looked at the statement on which the Secretary of State was going to base her press conference, which initially had been supposed to be a joint one; but South Africa did not agree to a joint one. The statement made reference to this discussion with South African counterparts who had agreed that they could fund their own development.

The Minister said that the Government of South Africa objected to these lines of the statement, on the grounds that they were not true. Hon. Gordhan said that the Secretary of State agreed to omit them, and they were omitted. Hon. Gordhan's colleagues in South Africa issued a statement commenting on this matter. In a report in *The Times* newspaper, reference was made to local UK council elections on 3 May 2013. The Minister was not aware that such a link could be made. He said it seemed there was an intention to demonstrate some kind of fiscal probity using South African assistance as a political tool. The Minister stated that he considered this extremely improper and highly regrettable because South Africa enjoyed a very good relationship with the British people.

He commented on South Africa's emotional link with the British people through the latter's anti-apartheid stance. The Minister noted that the quantum of aid was not the issue; but for him this incident was breaking that spirit of solidarity.

### **Question**

You mentioned that South Africa devotes the highest budget in Southern Africa to education, but why are there still young people unable to go to university?

### **Hon. Pravin Gordhan**

In the past few years, the fiscal situation has improved and the government has been able to channel a lot into higher education as part of the education budget, including the National Student Financial Aid Scheme. Billions of rand are spent every year on this scheme to support students through grants and loans, but unfortunately there is not enough money to support everyone.



South Africa is building two new universities to increase capacity. The University of Johannesburg has expanded its student intake and is trying to assist more students financially, but at this stage the state cannot support everyone.

## Questions

How can UK businesses best support education in South Africa?

What is South Africa's response to the recent US initiative to introduce withholdings on payments on a global scale, in relation to the growing web of international, intergovernmental agreements on tax-related information?

What do you see for the future solidarity between Britain and South Africa, and between South Africa and the other BRICS countries?

Are there any initiatives that the South African government is taking to foster better relations with the unions and labour market after the unfortunate events in Marikana?

In your remarks you were very optimistic about the growth of some of South Africa's biggest firms, but could you focus on some of the specific challenges facing emerging small and medium-sized enterprise (SME) growth in the South African economy?

## Hon. Pravin Gordhan

Medium-sized firms have demonstrated a fascinating resilience. In terms of corporate income tax take at the end of the last fiscal year, medium-sized companies made a significantly higher contribution to corporate income taxes compared with some of the bigger companies.

Part of the overall apartheid tragedy is that smaller and micro businesses were not allowed the space to operate, and South Africa still does not have enough money moving into small businesses. There is still a lot of hesitancy in financial institutions, although the government has set up various institutions and funds to support SMEs, including the consolidation of various small business agencies into a single agency.

In the township areas of South Africa there is huge potential for municipalities to put some very simple infrastructure in place to support micro businesses. More should be done as a state to ensure SMEs hold ownership and security of land, and get the necessary support.

Marikana was a shock to all parties concerned: mining firms, labour unions and the government, particularly municipal government. The government had made considerable efforts to get the three major players around the table: namely government, business and labour. There has been some hard talking between the ministers of mineral resources, trade and industry, and labour and the unions to work out how to clear the difficult climate in the mining industry. An agreement has been reached and signed by all parties committing themselves to peaceful processes within the mining sector, to restoring production and to finding win-win solutions that will enhance the position of the industry.

The government will continue to do what it can to bring players together, particularly in view of the migrant labour system that underpins the mining industry, and a lot more needs to be done by some businesses. At the height of the crisis, the response of some businesses was to set up health services, contribute to the housing of workers and enable workers to return home on a regular basis. Businesses are aware of how things need to improve, and if this can be converted into concrete action there will still be a positive picture for the mining sector.

On the point about the extra-territorial impact of decisions that are made in one part of the world: South Africa has co-signed a letter with the British Chancellor George Osborne and about eight or nine other finance ministers indicating to the US that for some of its more recent initiatives, they should take into account the impact they might have on other environments and jurisdictions. It is hoped the parties can have a constructive discussion on that.

The Minister also discussed tax information with the Chancellor: there has been a G7 initiative to target profit-shifting and tax-based erosions. This is an important initiative from a developing country's point of view. NGOs working in this area point to an interesting trend that needs to be stopped: that of capital extraction from the African continent. A change in the limited growth of the tax base will give countries immense resources to invest in their own environment and create a more developmental climate. If stable government and fiscal sustainability are sought, then surely a fair share of tax must be contributed by those who are able to do so.

About the relationship between the UK and South Africa and between South Africa and the BRICS countries: it is a hyper-connected or hyper-dependent environment where what happens in one part of the world impacts on another. Solidarity in this environment will require understanding that all are

interconnected, and that none can live in an unequal world where three-fifths of people who live on below \$1.5 per day live in middle-income countries.

There are times when national interest must be balanced with global interests, and this is one of the shortcomings of the G20. It started on the basis of global interest, but slipped into national interest mode and this is incompatible with what global governance requires. The challenges of growth, jobs and inequality are common challenges for most of the world. It would be unsustainable to maintain current levels of consumption with a larger middle class, so new levels of modesty need to be introduced in the world. All-round development is mutually beneficial, and building solid and inclusive economic and political institutions will be a key task for all.

Cyril Ramaphosa has launched a broader version of the 'Adopt-A-School' Foundation. It is very easy for anyone with sufficient capital to adopt a school and help to create better management capabilities. An executive can be sent for six months to set up systems in the school, and to teach a principal how to manage better and how to inspire the teachers and community. In some of the poorest sections of South Africa brilliant leadership on the part of principals and teachers can produce phenomenal results.