BRIEFING ON THE FINANCIAL AND FISCAL COMMISSION'S SUBMISSION ON THE 2013 MEDIUM TERM BUDGET POLICY STATEMENT

29 October 2013

For an Equitable Sharing of National Revenue

BACKGROUND

- Main theme to draw from 2013 MTBPS and 3-year expenditure framework:
  - Government has done a commendable job in beginning to implement National Development Plan (NDP)
  - Ambitious policy strategy for growth a pre-requisite if SA is to move further on its transition to attaining 2030 Vision
  - Government is looking towards infrastructural investment as principal driver of whatever upturn in economic growth is anticipated
  - Corollary to relatively high growth in gross fixed capital formation forecast is that the current account deficit is projected to remain at levels above 6% of Gross Domestic Product (GDP)

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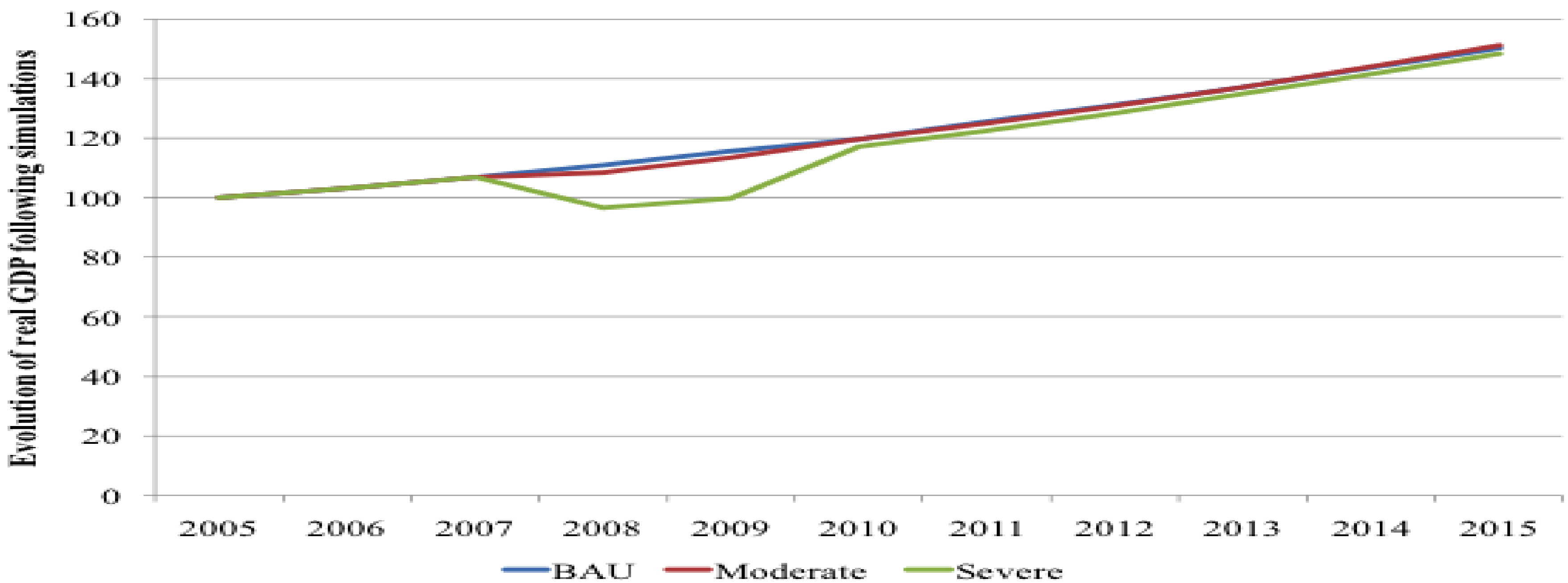
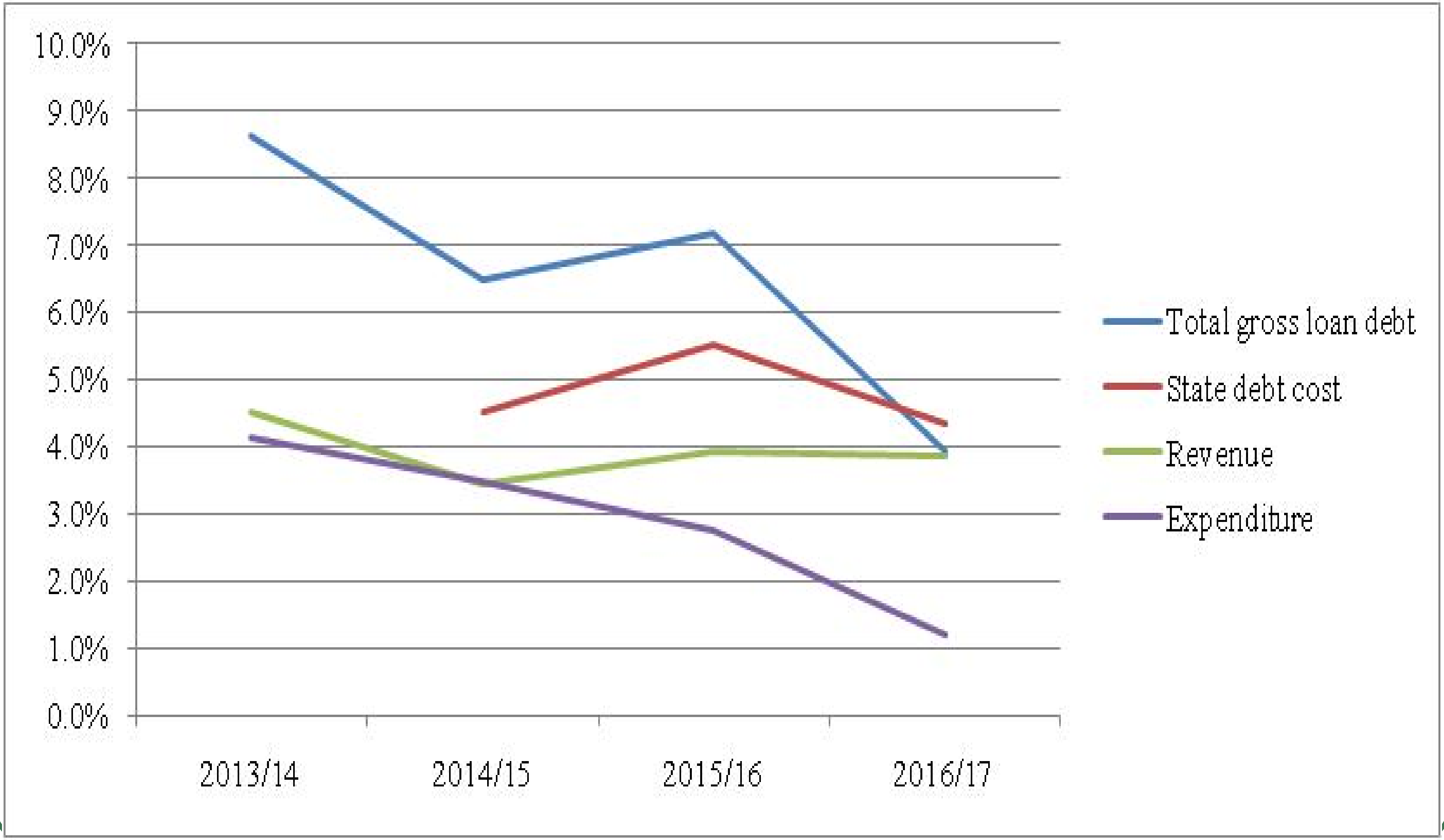
GENERAL ECONOMIC OUTLOOK

- Economy remains vulnerable to slow global recovery and domestic challenges
- ↓ revisions to economic growth
  - Confirms Commission's GDP projections



GROWTH IN CONSOLIDATED BUDGET



Risks to Economic and Fiscal Outlook

- Public sector wage bill pressures
  - Supports general discipline in hiring additional government workers
  - Remains important that government productivity and service delivery remains the core of recruitment
  - Frontline staff core to service delivery are prioritised over general administrative positions
- Persistent underspending
  - R3.14 billion underspent by all levels of government
  - Undermines impact of fiscal policy and long term economic growth (under spending usually on capital expenditure)
- Negative external balance
  - Current account deficit is projected at 6.5% of GDP in 2013
  - Diversification of exports remains important
- Robustness of global growth and domestic responses

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DOMESTIC CHALLENGES

- Infrastructure
  - Investment pivotal in fostering and attracting private investment
  - inadequacy of existing infrastructure, particularly with respect to port facilities, roads, rail, energy, water and sanitation acts hampers the country's long run growth potential
  - Role of President's Infrastructure Coordinating Committee (PICC)
- Mobilising Finance
  - Tax revenue bouyancy is a concern
  - Tax revenues to GDP ratio indicates a progressive decline in the buoyancy ratio
  - Commission to continue engagement with Tax Committee

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DOMESTIC CHALLENGES [CONT.]

- Human Capacity
  - Structural unemployment, skills constraints and health issues continue to be a problem
  - SA fares poorly on many human capital indicators
  - Undermines NDP goals
- Governance Issues
  - SA fares poorly relative to numerous other countries on the issue of corruption and general inefficient or unproductive government expenditures
  - Commission notes establishment of Chief Procurement Officer
  - Commission notes the persisting need to strengthen accountability and create consequences for corruption

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APPROPRIATE FINANCING OF SOCS

- SOCs are expected to borrow on the strength of their balance sheet, rather than being funded from the fiscus
- In addition to contingent liabilities there are also risks in terms of greater use of user fees
  - Run up to implementing e-toll fees for Gauteng Freeway Improvement Project is an example
- Some of the SOCs are making losses which are not to the benefit of South Africa in terms of infrastructure
  - Commission notes the potential benefits of intensified use of PPPs
  - Commission is of the view that PICC should assume leadership role in determining appropriate implementation mechanisms to ensure rapid roll out of infrastructure

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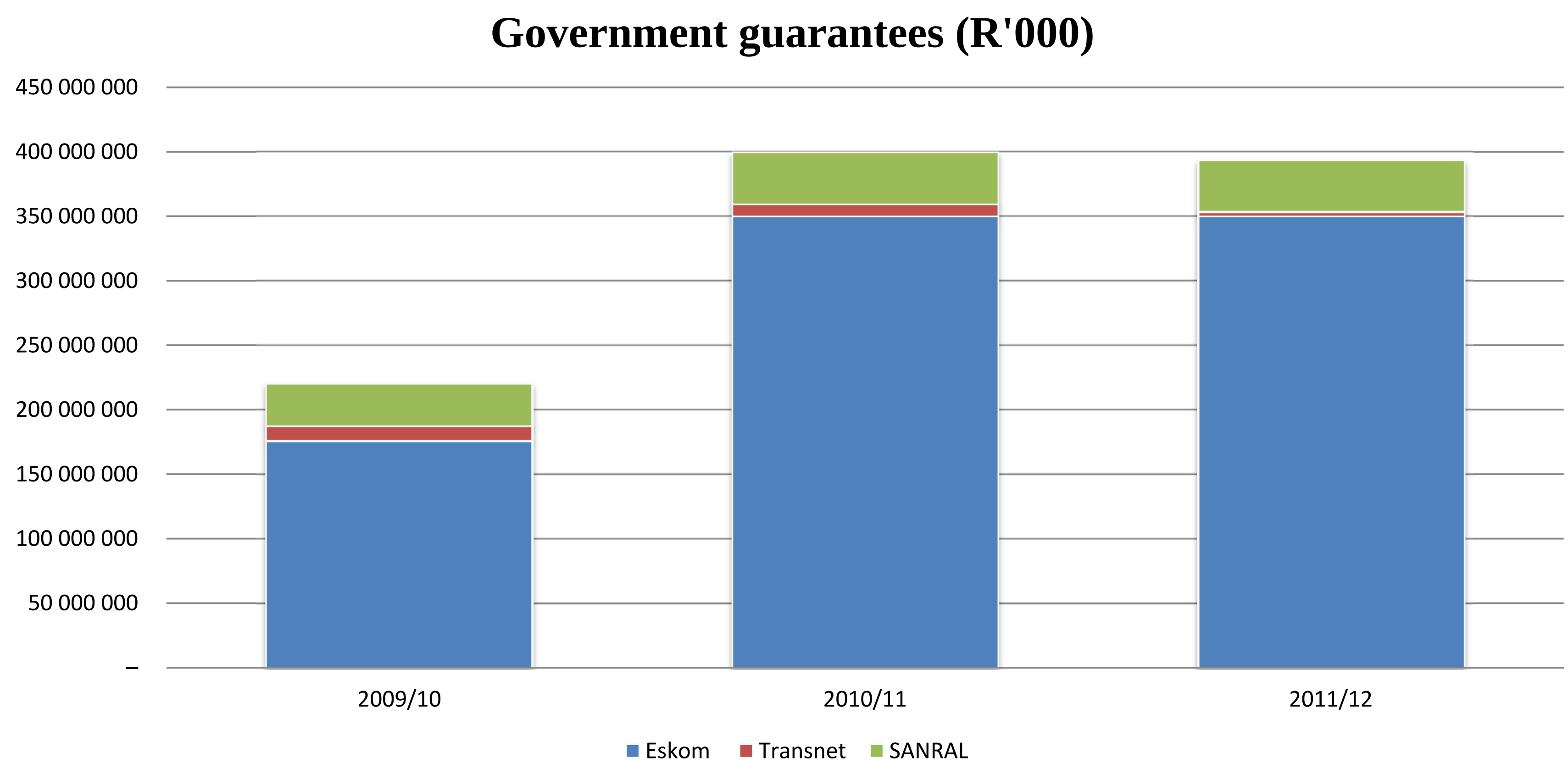
Extent of Government Guarantees



Source: National Treasury, 2013.

MTEF Division of Revenue

- 2013 DoR revised ↑ by R1.7 billion – mainly due to R1.3 billion injection to Provincial Equitable Share (PES) for inflation-related salary adjustments
- 2014 MTEF will be characterised by moderate growth – real annual average growth of 1.02% projected

Division of Revenue	**2013 Budget**	**2013 MTBPS**	**2013 MTBPS**			**Real Annual Average Growth Rate (2014/15 - 2016/17)**
	2013 M/Term Estimate	**2013/14 Revised**	**2014/15**	**2015/16**	**2016/17**	
National Allocations	452.5	452.5	487.9	520.4	550.1	0.60%
Provincial Allocation	414.2	415.8	444.7	478.2	507.8	1.25%
Equitable Share	*337.6*	*338.9*	*362.5*	*388.0*	*412.0*	*1.01%*
Conditional Grants	*76.6*	*76.9*	*82.3*	*90.2*	*95.8*	*2.22%*
Local Allocations	84.7	84.8	91.9	101.4	106.7	2.09%
TOTAL	**951.4**	**953.1**	**1 024.5**	**1 100.0**	**1 164.6**	**1.02%**

Source: 2013 MTBPS, Commission's calculations.

MEDIUM TERM SPENDING PRIORITIES

- Employment and social security, local government, housing and community amenities, water and science and technology record average real growth rates above 3%
  - Key focus areas are job creation and infrastructure (E.g. Water infrastructure projects)
- The need to make important trade off reflected in negative growth of economic service (-0.64%) and general public services (-0.55%)
- Social sector departments (i.e. Education, health and social security) comprise nearly half of the total allocated budget for 2013/14 (i.e. 47.9%)
  - All social sector functions reflecting declining share of total budget over MTEF, even though by marginal amounts

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Job Creation and Education

- Job Creation
  - Short–term initiatives include EPWP, CWP, job fund and creating special economic zones
  - Long-term structural reforms include improving educational outcomes, boosting productivity of workforce and enhancing competitiveness of local firms
- Education
  - ↑ by R34 billion over MTEF period, largely to fund increased cost of living adjustments
  - Focus should be on improving educational outcomes in line with NDP (E.g. Teacher training, improved school management and greater accountability of school principles)

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HEALTH AND SOCIAL DEVELOPMENT

- Health
  - Allocation ↑ by R31 billion over MTEF period, largely to fund increased cost of living adjustments, anti-retrovirals, new vaccine for cervical cancer and building forensic chemistry laboratory
  - Commission awaits:
    - Funding arrangements for the new reform and
    - Associated long term fiscal report
    - Notes the challenges with implementation of the NHI pilot studies
- Social Development
  - Allocation ↑ by R31 billion over MTEF period, largely because of the increase in beneficiaries of grants, which is aligned with Commission recommendation for 2014/15 DOR submission

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Adjustments To Provincial Government Conditional Grants

- Commission welcomes proposed adjustment to provincial conditional grants
  - Baseline adjusted upwards, reflecting ↑ of 0.6% from the 2013/14 baseline
- Commission notes proposed ↓ over the 2013 MTEF to allocations of under performing grants
  - Concerned that reductions have been carried out without proper assessment and that may undermine objectives of grants

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ADJUSTMENTS TO PROVINCIAL GOVERNMENT CONDITIONAL GRANTS[CONT.]

- Commission notes under spending on the NHI grant which has potential to undermine full implementation of the scheme
  - Reasons for under spending: lack of planning, unpreparedness of pilots to fully absorb funds
- Reduction in the EPWP grant has potential to undermine government objectives of ↓ employment to 14% and 6% by 2020 and 2030 respectively
- Commission notes under spending in indirect grants relative to direct grants
  - National sector departments need to build capacity to adequately perform their oversight and improve sub-national capacity building initiatives

ADJUSTMENTS TO PROVINCIAL GOVERNMENT CONDITIONAL GRANTS[CONT.]

- Commission welcomes additions to the Human Settlements Development Grant (HSDG)
  - Due to the anticipation of housing function shift to metros by 2014, Commission submission to the Minister recommended additional resources to support the shift
- Additional funding to cover costs of salaries in respect of Further Education and Training (FET) colleges is welcomed
  - Commission reiterates its previous recommendation regarding the need for baseline funding requirement to be established before completion of transfer

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ADJUSTMENTS TO PROVINCIAL GOVERNMENT CONDITIONAL GRANTS[CONT.]

- Commission notes the inconsistencies in the performance of the Urban Settlements Development Grant (USDG)
  - A need to align this grant with other municipal infrastructure-related grants
- Commission also notes under performance of the Rural Households Infrastructure Grant (RHIG)
  - Commission maintains its view that changing this grant from schedule 6B to 5A is unlikely to improve performance
- Commission supports in principle the funding of disaster relief and recovery through conditional grants
  - Commission notes that the process of immediate release of funds and declaration of disasters remains unresolved

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Local Government Equitable Share and Conditional Grants

- Local government equitable (LES) share allocation to ↑ by 9.2% over the period
- Commission welcomes greater distribution of funds to poorer/more rural municipalities as a result of revised LES formula
  - Re-emphasise point raised in response to 2013 DoR Bill regarding importance of spending capacity - in absence of this, targeting of additional funds may contribute to ↑ in unproductive/inefficient expenditure and poor service delivery outcomes
- Conditional grant funding to municipalities to ↑ by 23% over MTEF period
  - Commission notes deliberate reprioritisation of funds away from underperforming grants to fund ↑ to the regional bulk infrastructure grant and integrated city development grant

LOCAL INFRASTRUCTURE

- Commission is concerned with the potentially severe underinvestment in social and economic infrastructure at the local government level due to a combination of structural financing problems and municipal inefficiencies
  - Persistent under spending on infrastructure grants
  - Key finding emanating from Commission's review of the local government fiscal framework was possible under funding of capital
  - Not very helpful to address capital funding gap if existing resources are not being spent
    - In this regard, role of MISA to support infrastructure roll out and enhance capacity in municipalities is key
- Commission acutely aware of challenges around asset care (specifically maintenance, refurbishment and rehabilitation) at local level
  - Require integrated approach to unblocking this challenge
  - Capacity building grants to be linked to other capacity-related interventions (MISA) as well as sector-specific interventions (ADAM)

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FUNDING OF DISTRICT MUNICIPALITIES

- Existing uncertainties around powers and functions of district municipalities should receive urgent attention as this creates ambiguities around expenditure assignment and appropriate financing instruments of this category of municipalities
- The financial sustainability of these municipalities continues to be a concern if such expenditure assignments are not finalised
- The Commission advises that a lasting solution to this long-standing issue be implemented

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FUEL LEVY

- Since inception, the Commission has been critical of the sharing of the General Fuel Levy instrument with metros
- One of the concerns raised was around the buoyancy of the revenue instrument
- The projected revenue from the general fuel levy is revised to fall for 2013/14 and 2014/15 financial years relative to projected amounts in the 2013 Budget
  - As metros receive a fixed share of around 23% of the general fuel levy, the overall envelope afforded to these municipalities is likely to ↓. This is likely to put financial pressure on these municipalities
- Commission welcomes the review of the general fuel levy sharing along with all the own revenue funding sources of local government

Review of Actual Spending

- Total government spending as at September 2013 is below the assumed norm of 50% by 2% at R506.9 billion
  - Uneven spending pattern evident, with Higher Education and Training spending 70% of their budget compared to only 38.8% by Rural Development and Land Reform
- Health and Education both spent budget according to 50% norm but Social Development 5.5% below the norm
  - Underspending on goods and services (44%) and transfers to NPOs (40%)

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REVIEW OF ACTUAL SPENDING [CONT.]

- Public Works, Basic Education, Economic Development, Energy and Human Settlements all grew above 10% in real terms on average per annum
  - In line with Medium Term Strategic Framework
  - All other votes grew at a positive annual average growth rate
  - All provincial social sector departments grew at a steady pace, with health the largest growing at 7.8% annual average growth
    - Largely to fund the Occupational Specific Dispensation and health infrastructure

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ADJUSTMENT ESTIMATES

- Usually government makes provision for unforeseen /unavoidable expenditure in the annually budgeted contingency reserve
  - R5.7 billion downward adjustment in total estimated spending for 2013/14
- Department of Communication: shifted R374 million from transfers and subsidies to fund Schools Connectivity Project – reprioritisation in line with FFC recommendations on E-education
- Cooperative Governance and Traditional Affairs: shifted R130 million in 2012 and R149 million in 2013 from transfers and subsidies – reprioritised funding used for compensation of employees, skills development

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ADJUSTMENT ESTIMATES [CONT.]

- Trade and Industry: Budget substantially reduced in 2012 by R740 million and by R57 million in 2013/14
  - Reductions due to underspending on manufacturing development incentives programme, infrastructure programme and automotive production programme
  - Commission concerned about inadequate planning around incentive programmes
- Rural Development and Land Reform: R971 million deducted from comprehensive rural development plan
  - Commission reiterates the need to put in place adequate measures to ensure funds are spent

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ROLLOVERS

- ↓ of rollovers from R3.7 billion in 2010/11 to R894 million
  - Suggests stricter monitoring of expenditure and rollover requests
- DCOG (R647.9 million), Health (R390.5 million), Human Settlements (R.281.3 million) and Water Affairs (R829.4 million) consistently have large rollover amounts approved over the past four years.
  - Reasons cited are typically for existing commitments that must be finalized
  - Rollovers for Water Affairs are for infrastructure-related projects, likely as a result of project management and implementation-related challenges

R million	2010 MTBPS	2011 MTBPS	2012 MTBPS	2013 MTBPS	TOTAL
Total	3737	1789	1506	894	7 926.0
Selected Key budget Votes					
Cooperative Governance	430.8	5.6	139.5	72	647.9
Public Works	120	0	87.1	0	207.1
Basic Education	1	29.9	104.7	14.7	150.3
Health	49.8	231.3	87.2	22.2	390.5
Agriculture, Forestry and Fisheries	15.6	37.5	68.2	0	121.3
Communication	19.8	112.2	0	0	132.0
Energy	61	88.2	25.8	28.1	203.1
Human Settlements	82.7	64.6	13.5	120.5	281.3
Rural Development and Land Reform	495.7	0	96	0	591.7
Water Affairs	79	145.8	416.6	188	829.4

Source: Adjusted Estimates of National Expenditure (2010 – 2013).

Conclusion

- The Commission welcomes Government's fiscal stance highlighted in 2013 MTBPS
- The Commission emphasises that shifting organisational location of grants from sphere to sphere or department to department will not necessarily improve grant performance
- 2013 MTBPS begins to address key challenges facing SA and signals intent and purpose with respect to implementation of the NDP
  - Would like, in the 2014 budget and departmental strategic plans to see greater detail on what the next 3 years will contribute in terms of progress towards 2030 Vision
  - This should be in the form of specific output and outcomes milestones that will be achieved by the end of 2016/17 to gauge progress towards attaining the NDP Vision
- From an aggregate fiscal policy perspective Government has done enough to stave off downgrades from rating agencies
  - There is much work, however, on improving the value-for-money and impact of public spending
  - These micro fiscal goals lie in the domain of individual portfolios and accounting officers of departments
  - The capability of provincial treasuries and Offices of the Premier to drive improvements in financial management practice within provincial departments and municipalities is crucial

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