FINANCIAL AND FISCAL COMMISSION

SUBMISSION ON NEW DEVELOPMENT BANK SPECIAL APPROPRIATIONS BILL (B32-2015) AND FINANCE BILL (B31 - 2015)

For the Standing Committee on Appropriations

6 November 2015

For an Equitable Sharing of National Revenue

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NEW DEVELOPMENT BANK SPECIAL APPROPRIATIONS BILL

Summary of the New Development Bank Bill

- The Bill gives effect to the BRICS Bank agreement and appropriates $150 million (approx. R2.09 billion) out of the National Revenue Fund (NRF) for the 1st capital instalment to the New Development Bank (NDB)
  - The amount appropriated for the 1st instalment was not included in the current 2015/16 budget as the ratification of the agreement was only finalised in July 2015
- Clause 1(3) enable Minister of Finance to impose conditions on the appropriation to enable transparency and effective management of funds and to stop appropriation until any conditions imposed are met
- Clause 1(4) provides for the reporting of the stoppage of the appropriation to the relevant Parliamentary Committees

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BACKGROUND TO THE BRICS BANK AGREEMENT

- At the fifth BRICS summit in 2013 decision to establish the BRICS bank was announced.
- The Financial and Fiscal Commission briefed the Standing Committee on Finance on arguments for and against NDB on 27 May 2015:
  - Funding and Budget Process
  - Cost Benefit Analysis
  - Intergovernmental Fiscal Relations
  - Other Dimensions – South African Reserve Bank
- The NDB has its headquarters in Shanghai and a regional office in Johannesburg, no loan has been disbursed yet
- Parliament ratified the BRICS agreement on 18 June 2015
- UWC, FFC and HSRC held an international BRICS conference in October 2015

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FUNDING CONSIDERATIONS

- Initial authorised capital of NDB is $100 billion and subscribed capital of US$50 billion to be equally distributed amongst founding members (Article 7, paragraphs a and c)
  - Will be divided into paid-in shares (US$10 billion) and callable shares (US$40 billion) (Article 7, paragraph c). Given the aforementioned:
    - South Africa is liable for US$2 billion in respect of paid-in shares
      - Amount is a direct charge on the National Revenue Fund and forms part of a national budget vote of the National Treasury
      - South Africa is liable for US$8 billion in callable shares
      - The callable shares won't be part of budget - similar Government commitments are reflected as 'Provisions'. Provisions are defined as liabilities for which the payment date/amount is uncertain and are reflected in the statistical tables section of the annually published Budget Review
      - Voting power of each member equal to the subscribed shares in capital stock of the Bank [article 6, para a]. South Africa therefore has the same voting power to other member countries.

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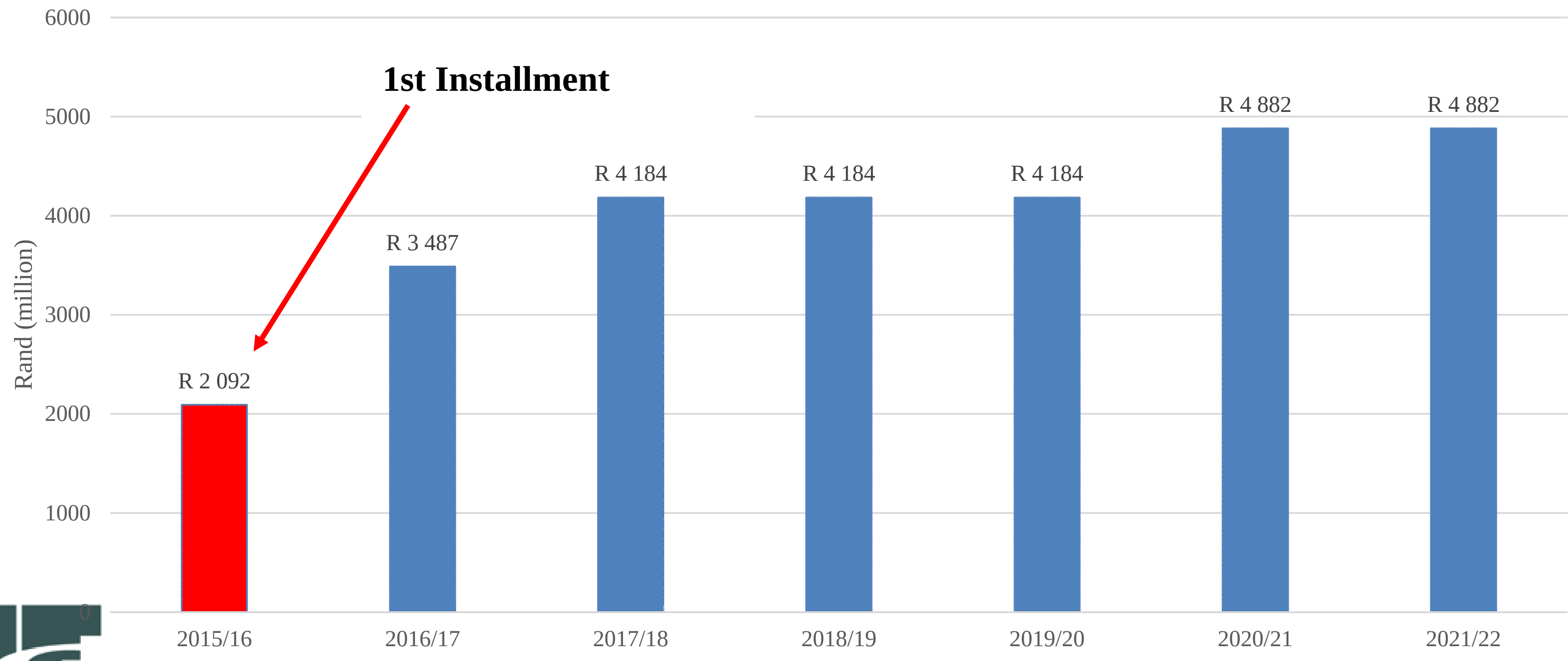
FUNDING CONSIDERATIONS [CONT.]

- A time schedule of when paid-in shares are due is provided in section 1.6 of the Memorandum to the Bill. Between 2015/16 and 2021/22 commitment of financing paid-in shares will amount to R27.9 billion – to be spread over seven years



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The role of NDB

- Pros and Cons
  - Pros:
    - NDB Articles of Agreement allow the option of financing certain projects in local currencies
      - Reduces systemic risks associated with FX lending to unhedged borrowers
      - To this end, debt issuance in local capital markets can help avoid currency mismatch arising out of such project funding, and help to develop nascent capital markets of municipal debt
      - Modalities of local bond issues must be developed in conjunction with retail investor awareness and education programmes
    - Modernization of risk management and monitoring techniques, improving the mobilization of savings and the allocation of resources
    - Increase stability: Large, internationally diversified bank safer, has a lower probability of failure, leading to less flighty depositors.

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The role of NDB

- Pros and Cons:
  - Cons:
    - May increase volatility: Import shocks from home (or other BRIC) countries; reduce exposure when the going gets tough in the host; in the limit, simply pack up and leave!
    - Stability of exchange rate and inflation rate - In the past five months, value of paid-in amount has escalated by R3.9 billion.
    - Large presence of NDB financial products may crowd out domestic banks that may not be able to compete for deposits with NDB. This could reduce lending to SMEs and marginal sectors and reduce the effectiveness of monetary policy.

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BUDGETARY IMPLICATIONS OF THE SPECIAL APPROPRIATIONS BILL

- The amount appropriated from the NRF for the 1st instalment to the NDB will come from the sale of state assets and is due in January 2016
  - While likely to be budget neutral, Government's balance sheet may still be negatively affected if the return from the investment does not eventually exceed the dividend Government was receiving from the sold asset
  - The sale of state assets is a once off cash injection and cannot be called upon again to balance off future expenditure needs
  - The decision to sell state assets could be signalling that Government is cautious about the impact of the instalment on the fiscal framework and may have reached its debt to GDP tolerance level

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OVERALL ASSESSMENT

- Selling state assets to obtain appropriated amount can be viewed as a mechanism that forces Government at political level to internalise the cost of financing new projects that were not included in a current budget
  - Fosters robust debate on budget neutrality of financing projects through sale of assets which otherwise would not have taken place where the project to be financed from tax money which is perceived to be free – i.e., there are consequences to state sell of assets
  - This cost internalisation is crucial for strengthening future fiscal sustainability
- The Committee should request Government has measures in place to ensure country’s ability to secure funding.
  - Dependent on country's ability to "package" projects in a way which would be attractive
  - Government should be required to demonstrate measures taken to ensure that projects are ready for financing on routine basis to parliament

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FINANCE BILL [31-2015]

SUMMARY OF THE FINANCE BILL

- The purpose of the Bill is to implement recommendations in the reports of the Committee on Public Accounts on authorising national government unauthorised expenditure
- The recommendations were adopted by Parliament on 23rd June 2015
- A total amount of R110.22 million in unauthorised expenditure was incurred by the Presidency, Department of Women, Children and people with Disabilities, Social Development and Trade and Industry in different years
- Of the total unauthorised expenditure incurred, R46.67 million refers to overspending that will result in additional allocations to votes while the remaining R63.55 million is a reimbursement to votes that previously surrendered funds to the NRF

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Department	Amount	Reasons for Unauthorised Expenditure	Impact on National Revenue Fund
Presidency (2008/09)	R14.51 million	The overspending was due to National orders ceremony; legal fees; travel and subsistence costs and leave gratuity.	Additional appropriation
Presidency (2010/11)	R28.43 million	The overspending was as a result of creation of additional Ministries for National Planning, and Performance, Monitoring and Evaluation; legal fees; travel and subsistence; Presidential hotline and leave gratuities.	Additional appropriation
Women, Children and People with Disabilities (2010/11)	R3.73 million	The overspending was due to operational expenditure not initially provided for such as the hosting national days and travel and subsistence.	Additional appropriation
Trade and Industry (2004/05)	R37.38 million	The overspending was due to irrecoverable general export incentive scheme debt of R31.1 million and legal award of R6.2 million for non-detection and non-prevention of the destruction of the property at Pumlani Lodge	Previously surrendered funds being refunded to vote
Social Development (2007/08)	R26.17 million	The overspending was due to an increase expenditure on social assistance grants, which was driven by an increase in the number of child support grant beneficiaries.	Previously surrendered funds being refunded to vote

Overall Assessment and Next Steps

- NDB Bill
  - The Commission supports the NDB Bill and its financing through sale of *non strategic* state assets
  - While the NDB Bank will likely have benefits beyond existing opportunities and compensate for loss of dividends, for this benefit to materialise will require strong oversight and scrutiny to ensure ongoing relevance, project readiness, constitutional values are upheld and fiscal risks are minimised (through trade-offs at high political level)
- Finance Bill
  - The Commission supports the condonement of unauthorised expenditure as provided for in the Finance Bill
  - However, for public financial management to remain credible, the Commission would like to emphasize that dealing with unauthorised expenditure should not be dragged out unnecessarily as executing consequences for authorised expenditure may be more difficult

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