FINANCIAL AND FISCAL COMMISSION

BRIEFING ON THE 2013/14 APPROPRIATION BILL

17 May, 2013

For an Equitable Sharing of National Revenue

1. CONTEXT

- Submission made in terms of:
  - Section 4(4)(2) of MBAPRMA (Act 9 of 2009)
  - Section 3 of the FFC Act (1997) as amended
- Underlying message from analysis of Bill = address root causes of poor performance
  - Increasingly negative sentiments expressed about standard of SA's fiscal governance and fiscal prospects
  - Views may not be unfounded given AG's findings for 2011/12 that show stagnant audit outcomes for provincial departments and persistent deficits in financial management practice and capability and the s100 interventions last year

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1. Context [cont.]

- Commission believes that challenges lie not in technical financial management interventions but in the political-administration interface, HR management, organisational systems and capacity
- Presently there is a tightening of regulations at LG level
  - These include amendments to Municipal Systems Act prescribing competency criteria and other regulations relating to conditions of employment of S57 managers
- No parallel process at provincial level, yet there are definite areas of performance and governance that require improvement
  - Has framework enabling legislation such as PFMA achieved what it intended to?

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2. Macroeconomic and Fiscal Outlook

- Views on fiscal policy have changed significantly over the years
  - recently focus has centred on sustainability
    - Macroeconomic stability, budgetary stability, affordability
- SA economy vulnerable to slow global recovery and domestic factors (e.g. recent violent labour conflicts and service delivery protests)
- Government tabled a total budget of R1.2 trillion
  - National receives 47.6%, provinces 43.5% and local government (LG) receives 8.9%
  - 2013/14 baseline revised ↑ by R10 billion
    - Revision to baseline composed of reprioritised funds and savings (amounting to R7.2 billion) and new additions totalling R2.8 billion

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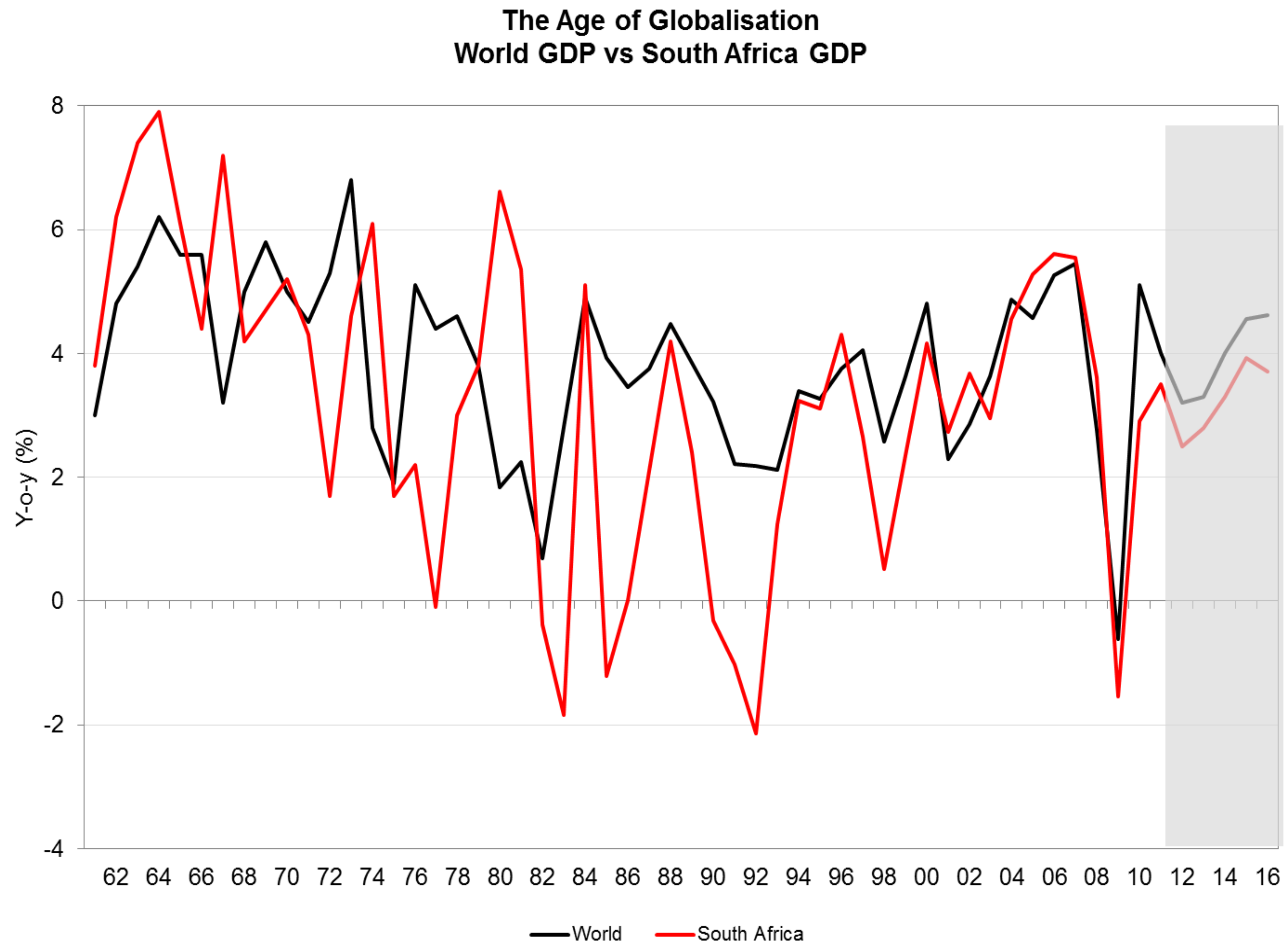
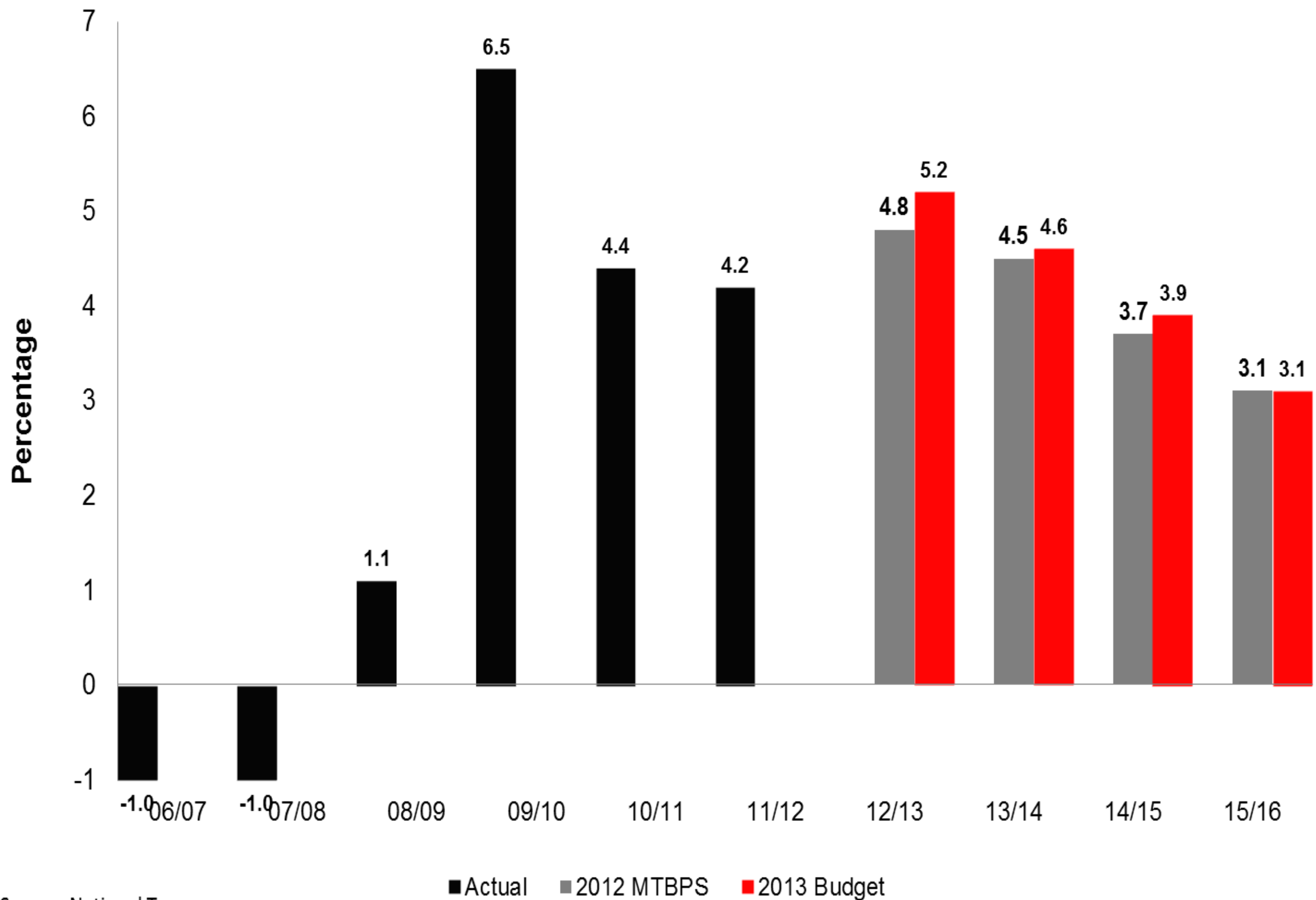


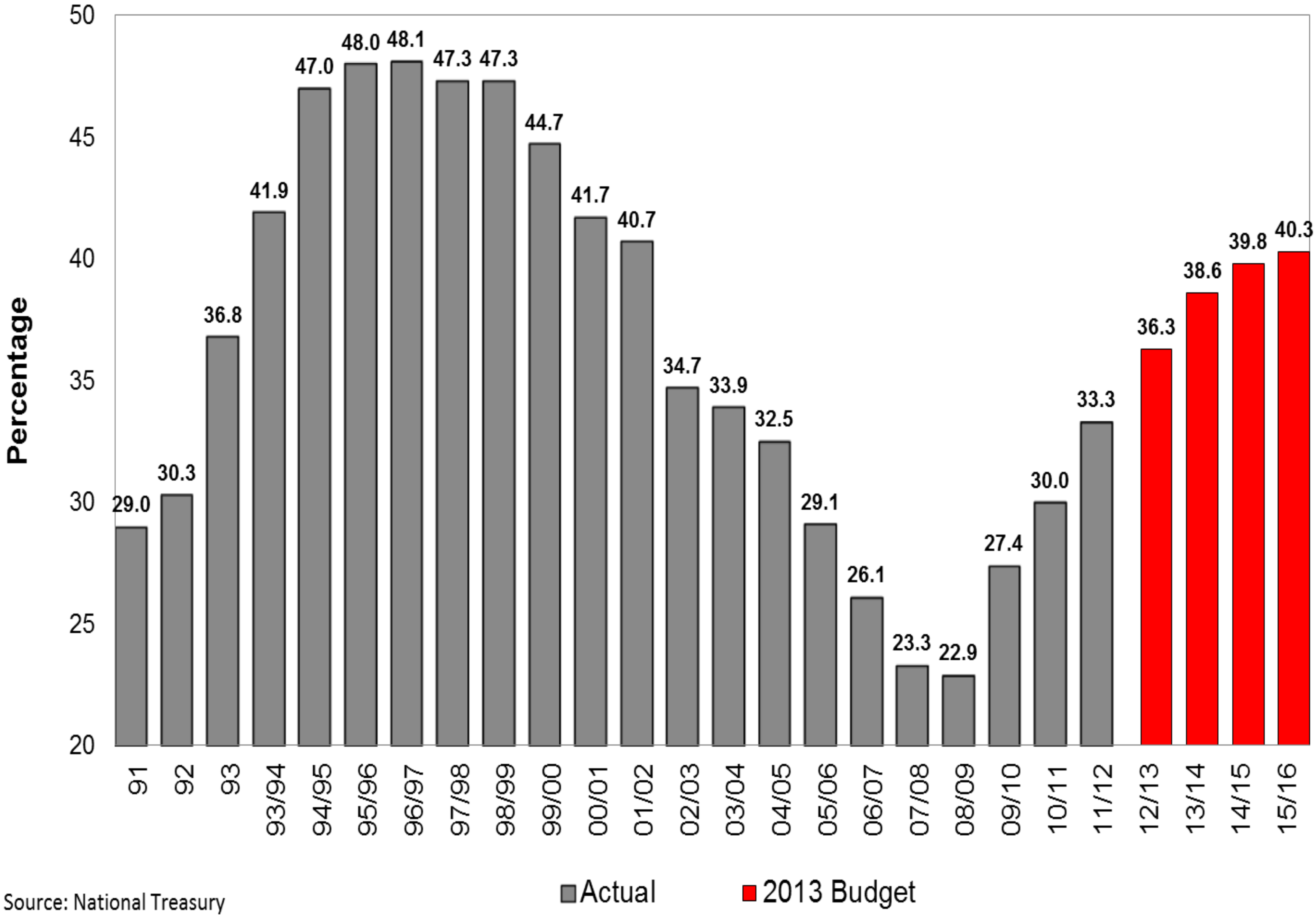
IMF, World Economic Outlook Database, Apr13

Budget deficit as a percentage of GDP



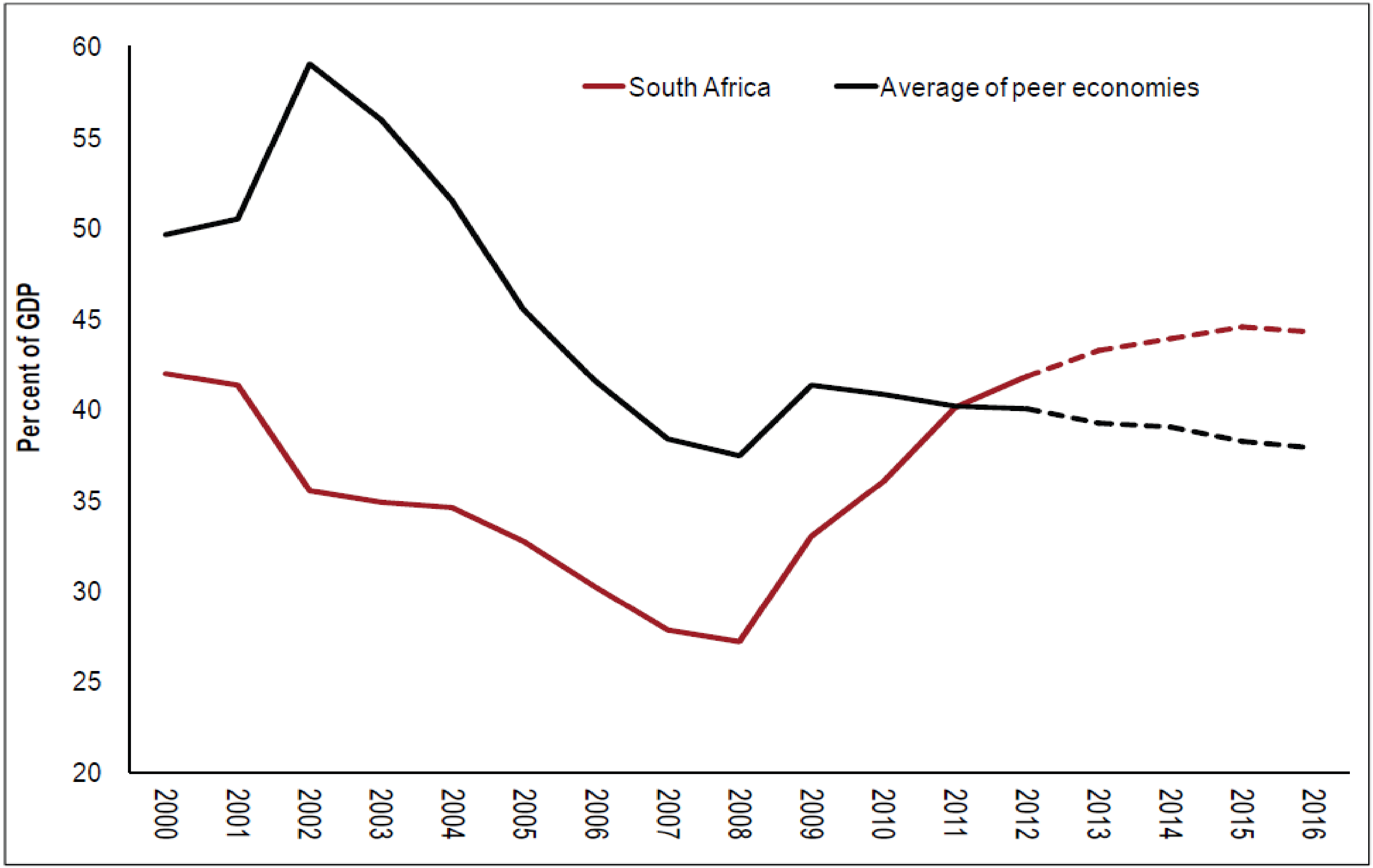
Source: National Treasury

Public debt as a percentage of GDP



Source: National Treasury

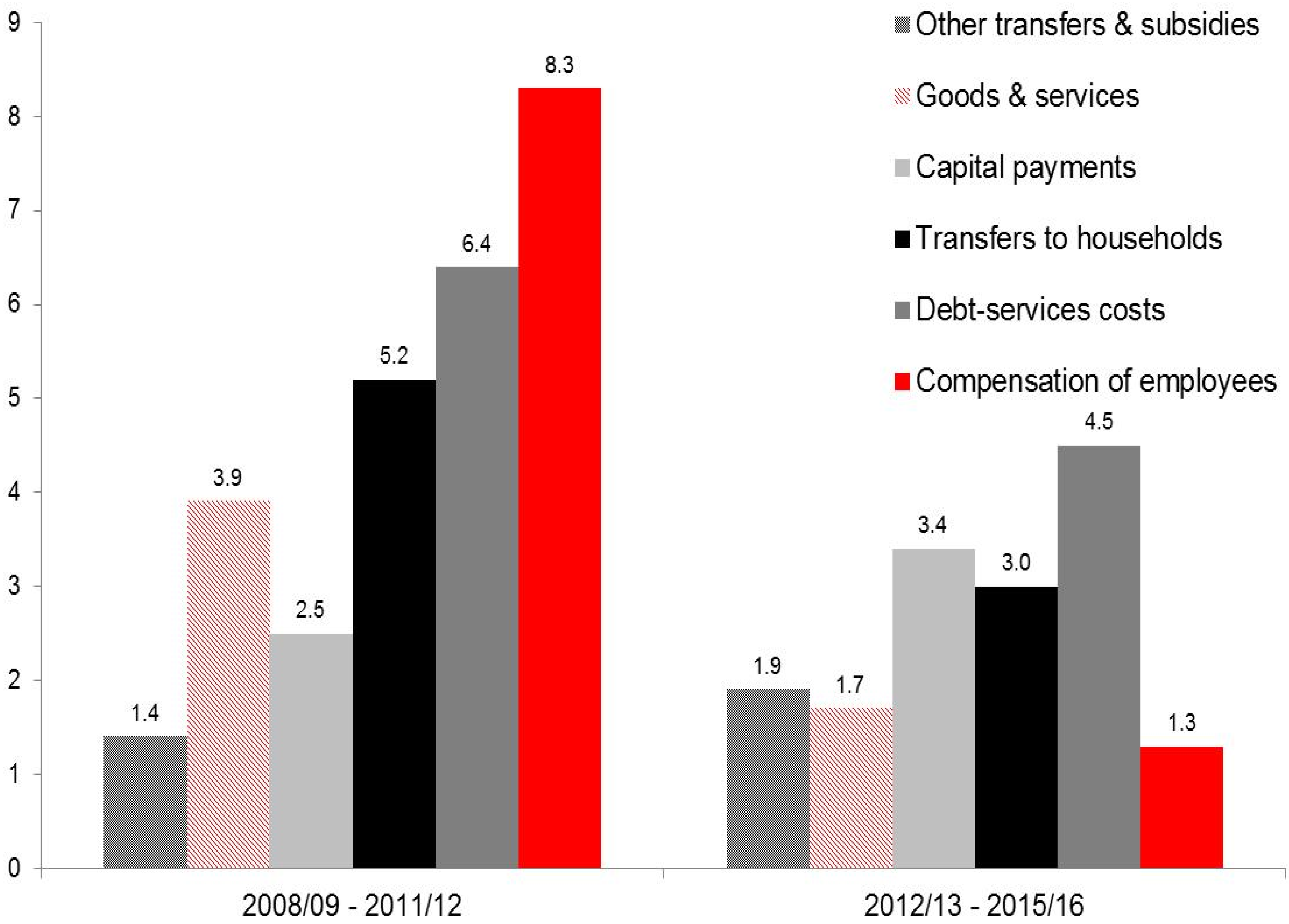
Figure 3.3 South Africa's gross debt-to-GDP ratio compared with peer economies,[1] 2000 – 2016



1. Average of Argentina, Brazil, Bulgaria, Chile, Colombia, India, Indonesia, Kenya, Latvia, Lithuania, Malaysia, Mexico, Morocco, Peru, Poland, Russia, Thailand, Turkey and Uruguay

Source: International Monetary Fund, National Treasury; South African data is for fiscal years

Real growth of expenditure components



Source: National Treasury; Budget 2013

2.2. Macroeconomic and Fiscal Outlook – Sustainability

- Fiscal sustainability analysis ignores key channel for fiscal policy to influence growth, i.e. effect of composition of expenditure and taxation
  - Result = fiscal policy often achieved in ways that sometimes undermine long term growth
- Challenges of SA's fiscal stance
  - If GDP growth lower than forecasts, tax revenues will fall short of budget causing fiscal situation to deteriorate, leading to lower economic growth
  - Healthy GDP growth = easier to meet deficit reduction programme
    - If deficit reduction premised on containing public sector wage bill, then pillar for growth (i.e. consumer spending) is removed
    - Planned reduction in real growth of remuneration within public sector will slow consumer spending
    - Infrastructure investment, improvement in exports to counterbalance slowdown in growth of consumer spending

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3. Assessment: Giving Effect to Government's Priorities

- Four overarching Government priorities that inform the submission:
  - Promoting economic support and development
  - Investment in infrastructure
  - Job creation
  - Enhancing LG capacity

3.1. Assessment: Promoting Economic Support and Development

Table 1: Expenditure Component Revisions (Functional Classification)

	2013/14 Figures		
R'billions	2012 MTBPS	Budget 2013	% Change
General public services	56.0	56.7	1.3%
Defence, public order and safety and state security	151.7	153.7	1.3%
Transport, energy and communication	91.5	88.6	-3.2%
Economic services	48.1	48.0	-0.3%
Local government, housing and community amenities	132.5	132.1	-0.3%
Health and social protection	267.8	268.5	0.3%
Education and related functions	234.0	232.5	-0.6%
Employment and social security	48.6	49.2	1.2%
Science and technology	14.5	16.3	12.4%

Source: MTBPS (2012); Budget Review (2013); Commission Calculations

Key elements to support supply side in place = education, infrastructure, energy, competition and regulation policy. These are key pillars of future growth

3.1. Assessment: Promoting Economic Support and Development [cont.]

- Provinces have significant instruments to shape spending programmes (education + skills), but there is need to enhance abilities to shape establishment of clusters and key sectors – these are vital to sustainable economic growth
  - Enhances economies of scale, creating spillovers capable of ↑ growth
- Concern – national departments do not have norms/standards for concurrent functions
  - Result = funding a standards basket of social/economic services across provinces not possible, so varying quality across provinces
  - Municipalities promote economic development through provision of basic services
    - LES funds provision of basic services
    - Revisions to LES will result in greater funding to poor, rural municipalities

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3.2. Assessment: Investment in Infrastructure

- Presidential Infrastructure Coordinating Commission (PICC)
  - Established in 2011 and responsible for identifying, prioritising and coordinating infrastructure development
  - To date, 18 strategic integrated projects prioritised
  - Majority of projects fall within ambit of LG and focus on electricity distribution, addressing maintenance backlogs, upgrading water and creation of sustainable urban settlements
- Increased spending on infrastructure = vital component of Government policy
- Raises important questions: How should the money be spent? How should expanded spending be financed?
  - Investment in infrastructure declines from R844.5 billion over the 2012 MTEF to R827.1 billion over the 2013 MTEF

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3.2. Assessment: Investment in Infrastructure [cont.]

- R8.2 billion allocated to provincial conditional grants
  - ↑ in grants to provinces to fund infrastructure in health and education
  - Provinces historically underspend on infrastructure budgets
    - FFC concerned over poor planning and critical skills shortages in provincial infrastructure delivery
    - Close scrutiny on spending of these grants will be important to ensure policy priorities are adequately provided
- At LG level, infrastructure funded through conditional grant funding
  - Water through newly created Municipal Water Infrastructure Grant
  - Electricity, through Integrated National Electrification Programme (INEP)
    - In 2013/14, INEP to receive an addition of R511 million to its baseline. FFC pleased to note that a proportion of the addition to INEP is for asset management

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3.2. Assessment: Investment in Infrastructure [cont.]

- Commission study looks at how sustainable is ↑ public expenditure to fund infrastructure?
  - In short-term impact on real GDP is negligible if Government ↑ investment spending
  - In medium to long term, GDP grows as spending increases output
    - Greatest improvement is with debt-financed scenario
    - If tax rates kept constant, government revenues will ↑ in longer term, allowing for smaller deficit.
  - Without positive impact of infrastructure on total factor productivity, ↑ public investment would have almost no impact on SA economy

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3.3. Assessment: Job Creation

- Unemployment consistently high in last two decades
  - Places strain on government as tax revenues ↓ and expenditures ↑
  - Over 2013 MTEF, Government has maintained job creation as key priority
    - Key initiatives include: Community Work Programme, Social Sector EPWP Grant for Provinces, EPWP Integrated Grant for Provinces, EPWP Integrated Grant for Municipalities
- View of SA economic policy (New Growth Path, Industrial Policy Action Plan and NDP) = ↑ capex by Government will help to meet job creation target
  - FFC analysis indicates that ↑ expenditure on infrastructure alone has **negligible** impact on employment growth
  - Also focus on shifting skills mix, regulatory constraints, SMME sector

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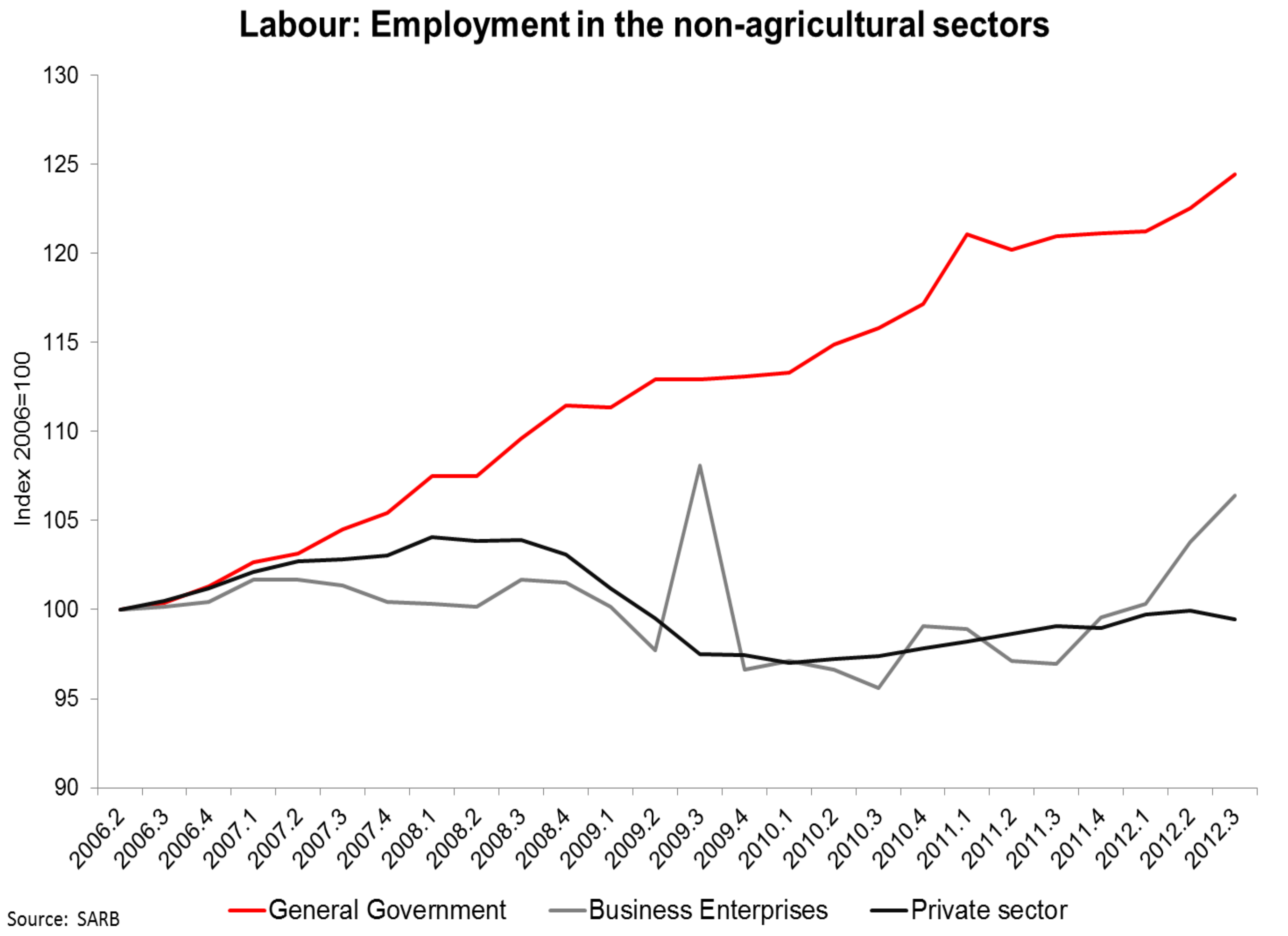
Labour: Employment in the non-agricultural sectors
Index 2006=100
130
125
120
115
110
105
100
95
90
2006.2
2006.3
2006.4
2007.1
2007.2
2007.3
2007.4
2008.1
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2010.3
2010.4
2011.1
2011.2
2011.3
2011.4
2012.1
2012.2
2012.3
General Government
Business Enterprises
Private sector

Source: SARB

3.4. Assessment: Enhancing LG Capacity

- Constitutional and legislative responsibility for provinces to monitor and support LG
- 2013 Appropriation Bill allocates R763.6 million for capacity building at LG level
  - Impact and outcomes of initiatives are critical if public sector is to achieve more within constraints of limited resources
  - Particularly important if SA's economic growth remains subdued
  - Are municipalities able to absorb and utilize funding from capacity conditional grants?
- Reiterate two past FFC capacity-related recommendations
  - Strictly enforce minimum competencies as per MFMA to ensure that appropriate technical skills are in place
  - Attach conditions to capacity grants to commit municipalities to specific, independently verifiable capacity and performance improvements

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4.1. Measures to Stimulate Cost Efficiencies

- Defining and measuring cost efficiencies
  - Involves allocating smallest amount of resources to reaching a priority, conditional on given target being reached
    - Comprehensive measurement of public sector costs = difficult
  - Two conceptual approaches to deriving cost of providing government services
    - Costed norms method proposed by FFC in 2001, entails estimating average cost of providing a particular service based on historical estimates of capital, labour and variable input costs per unit of service provided
    - Estimating a cost function capable of yielding the minimum cost of providing a service in a particular province/municipality

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4.1. Measures to Stimulate Cost Efficiencies [cont.]

- Cost chain
  - Several dimensions of costs that recur along whole delivery chain – known as underlying/primary sources of costs
  - Identifying major underlying sources of costs can help prioritise policy reforms
    - First factor: un(certainty), un(predictability) and un(reliability) in delivery, transport delays etc,
    - Second factor: discrepancy between costs and prices that households/firms incur due to windows of opportunity for intermediaries to extract rent
    - Third factor: political economy of business policy whereby policymakers may opt for policies that depart from competitive regimes and which may favour certain groups

4.1. Measures to Stimulate Cost Efficiencies [cont.]

- Diagnostic tool to assist in identifying cost efficiencies
  - How to think about the delivery system chain and what questions to ask in order to build appropriate policy/oversight and reduce costs in a cost-effective manner
  - Keep in mind that appropriate policies are context-specific, designed to accommodate a particular jurisdiction's specificities
  - Determine the binding constraints by asking the following questions:
    - *What is the underlying source/driver of costs?*
    - *Where is it primarily and most heavily located in the delivery value chain?*
    - *What is the implementation cost of relaxing the constraint, given national capacities*
    - *What is the impact of remedial policies at this given point on upstream/downstream links?*
    - *How much is the cost factor dependent on other policies?*

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4.2. Other Related Matters: Provincial Budget Overview

- Commission welcomes the fact that provincial expenditure on personnel is within spending limits for 2012/13
  - Suggests stricter controls over provincial wage bill and productivity increases
  - Reassuring as it implies that resources allocated to other government priorities are protected from potential over expenditure on personnel
- Commission concerned over high under expenditure on capital assets (7.2%) – opportunity cost of this is high given backlogs in critical infrastructure persist

4.3. Other Related Matters: Water Affairs

- Departmental allocation R1.43 billion more in 2013/14 compared to expenditure in 2012/13
- 41% of total funds appropriated to Department is in respect of conditional grants – majority of funds in respect of regional bulk infrastructure projects in districts
  - Important to ensure adequate support to districts to enable funds to be spent efficiently and proper processes for timely disbursement of funds
- Spending performance has worsened: 96% of total budget spent in 2010/11 to 90% in 2011/12. Pre-audited figures for 2012/13 suggest 96% of budget spent
  - Most of funds spent in last quarter in respect of transfers, subsidies and capital assets
    - Suggests that Department may be experiencing challenges with in-year budget monitoring processes in place and broader problem of inadequate financial management systems in place

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4.3. Other Related Matters: Water Affairs [cont.]

- Working for Water project created 28 400 jobs in 2011/12 with a further 4505 jobs created through the regional bulk infrastructure programme
- Commission welcomes proactive approach of the Department:
  - Signing of Enhanced LG Support Concept Paper in 2011
  - Establishment of various initiatives to assist LG with provision of water supply
  - Establishment of rapid response unit to address LG emergencies (floods, pollution of water)

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4.4. Other Related Matters: Human Settlements

- Aim of Department of Human Settlements is to facilitate creation of sustainable human settlements and improve quality if lives of households
  - Aim implemented through use of conditional grants – Human Settlements Development Grant (HSDG), Rural Household Infrastructure Grant (RHIG), Urban Settlements Development Grant (USDG)
    - Overall spending on HSDG has been good
    - RHIG performance has been poor since introduction of grant. Has been changed to schedule 5B (direct) grant
    - USDG performing poorly since inception in 2011/12
    - These three programmes contribute to SA's priority on human settlements and it is important not only that baselines are increased but that spending improves

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4.4. Other Related Matters: Human Settlements [cont.]

Overview of performance of DoHS Grants

R'000		2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
HSDG	Allocation	10 819	13 032	15 121	15 725	16 983	17 918	19 667
	% Spent	99	98	98				
RHIG	Allocation		100	258	340	106	113	118
	% Spent		67.7*	72.8**	17.9***			
USDG	Allocation			6 266	7 392	9 076	10 334	10 699
	% Spent			44	45 ***			

Source: Commission’s calculations based on Estimates of National Expenditure (2013)

* March 2011; ** March 2012; *** January 2013

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5. Conclusion

- The Commission is of the view that in the context of the Appropriation Bill
  - Government has continued with its good fiscal track record which has allowed for sustained economic growth and set foundation for ambitious and expansive fiscal policy
  - Economic deficit =biggest strategic risk. Fiscal consolidation should be implemented such that:
    - Short run growth is least compromised
    - Potential for long run growth is increased
    - Gains in progressive realisation are extended
    - Impact of public spending is raised
    - Institutional capability, accountability and performance orientation is built in

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4. Conclusion [cont.]

- The underlying message from the Commission’s analysis is:
  - Resources are generally efficiently allocated to priority areas, the need remains for Government to improve spending
  - Within confines of lower growth in expenditure, strategies contained in NDP to improve sustainable economic growth are supported. This includes:
    - Less adversarial relationship between business and organised labour,
    - Greater focus on improving small business development of entrepreneurship
    - Increased infrastructural investment
    - Improved capacity of the public sector to implement projects
    - Strategies to reduce corruption

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THANK YOU.

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