Briefing by the Financial and Fiscal Commission on the 2014 Medium Term Budget Policy Statement

29 October 2014

For an Equitable Sharing of National Revenue

BACKGROUND

- Submission made in terms of:
  - Section 4 (4c) of the Money Bills Amendment Procedure and Related Matters Act (MBAPRMA) (2009)
    - Requires Committees of Parliament to consider FFC's recommendations when dealing with money bills and related matters
  - Part 1 (3) {1} of the FFC Act (2003) as amended
    - Provides for Commission to act as a consultative body and make recommendations to organs of state in all spheres on financial and fiscal matters

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BACKGROUND [CONT.]

- The Commission welcomes the main themes in the 2014 MTBPS which resonate very well with the Commission's Submission for the Division of Revenue 2015/16 that was tabled in Parliament in May 2014
- The FFC's recommendations for 2015/16 division of revenue were divided into 11 chapters covering four main themes:
  - Macroeconomic and Fiscal Frameworks for Inclusive Growth
  - Improving Investments in Education and Health
  - Investment in Infrastructure
  - Demarcations and Beyond
- The submission ran under the theme of "balancing fiscal sustainability with socio-economic impact"
  - The Submission agrees in most aspects with the 2014 MTBPS that has been crafted in a constrained environment characterised by downward economic growth forecasts
  - Government has done a good job that promises a deficit reduction programme for the next three years and thereby prevents public debt from spiralling out of control

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BACKGROUND [CONT.]

- Key recommendations
  - Avoid across the board cuts when implementing expenditure ceiling to control debt
  - Maintain (if not expand) effective and efficient use of social expenditure
  - Encourage participation in the economy and improve equity
  - Investment in physical infrastructure and innovation

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BACKGROUND [CONT.]

- Key recommendations
  - Distribute resources to schools more equitably to improve outcomes
  - Improve allocations to Primary Health Care
  - Improve the financing of municipal capital investments
  - Implement a transport subsidy framework that incorporates social welfare
  - Introduce a transitional demarcation grant to deal with the fiscal effects of municipal boundary changes

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2014 MTBPS: Overall Assessment

- The Commission welcomes efforts geared towards fiscal consolidation
- From previous recommendations, a successful fiscal consolidation requires
  - Deciding on which components of the budget need to be consolidated, and the pace at which to achieve fiscal consolidation.
  - Credible commitment to fiscal targets to ease frequency of sovereign debt downgrades
  - Actual implementation of planned measures to remove waste, inefficiency and corruption in utilization of public resources across the three spheres of government
- Commission notes that a key component is containing public sector wage bill across the three spheres in line with its past work
  - Emphasis of cuts fall on a lower rate of increase in public sector remuneration and on Government needing to improve its efficiency to generate more productivity out of less spending
  - Cumulatively, whereas compensation of employees rose by 27.4% over the former three-year period, it is budgeted to grow by just 21.1% over the coming three-year period.
  - Commission wishes to emphasise that whatever bargaining deal is struck should be a multi-year agreement so as to encourage certainty and stability
- There is a need to rebuild some of the fiscal buffers that provided the fiscal space for countercyclical measures

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CONSOLIDATED FISCAL FRAMEWORK

R billion/Percentage of GDP	2011/12	2012/13	2013/14	2014/15		2015/16	2016/17	2017/18
	Outcome			Budget	Revised	Medium-term estimates		
Main budget								
Revenue	**745.3**	**799.2**	**886.1**	**962.8**	**956.6**	**1 055.1**	**1 169.4**	**1 272.9**
Expenditure	**889.9**	**965.5**	**1 047.8**	**1 142.6**	**1 136.3**	**1 222.3**	**1 308.4**	**1 416.7**
of which:								
Non-interest allocations	813.5	877.4	946.6	1 024.7	1 021.9	1 090.8	1 153.9	1 222.0
Debt-service costs	76.5	88.1	101.2	114.9	114.5	126.5	139.4	149.7
Unallocated reserves	–	–	–	3.0	–	5.0	15.0	45.0
Main budget balance	**-144.6**	**-166.3**	**-161.7**	**-179.8**	**-179.7**	**-167.2**	**-139.0**	**-143.8**
	-4.9%	**-5.2%**	**-4.7%**	**-4.7%**	**-4.8%**	**-4.1%**	**-3.2%**	**-3.0%**
Cash balances of social security funds, public entities and provinces	33.8	30.1	27.0	26.7	26.5	22.7	25.0	25.0
Consolidated budget balance	**-110.8**	**-136.2**	**-134.7**	**-153.1**	**-153.2**	**-144.5**	**-114.1**	**-118.7**
	-3.7%	**-4.3%**	**-3.9%**	**-4.0%**	**-4.1%**	**-3.6%**	**-2.6%**	**-2.5%**

CONSOLIDATED FISCAL FRAMEWORK [CONT.]

- The depressed macroeconomic outlook with projected weaker revenue and higher debt services costs imposes constraints on the broader fiscal framework
- In total, Government is expected to spend R3.947 trillion over the three years relative to a revenue envelope of R3.497 trillion
  - Over the 2015 MTEF period, real annual average growth in expenditure is projected at 4.7%. A relatively stronger 6.8% growth is projected for revenue
  - The bulk of resources are allocated in respect of non-interest allocations in the form of equitable share and conditional grant funding to the provincial and local spheres

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NON-INTEREST ALLOCATIONS: DIVISION OF REVENUE

- After accounting for national debt, there are estimated receipts of R1, 02 trillion to share amongst the three spheres in 2014/15 financial year
  - The budget available for sharing between the three spheres is projected to increase to R1.09 trillion in the 2015/16 financial year and R1.2 trillion in the outer year
- Over the 2015 MTEF period, the division of revenue amongst the three spheres is projected to grow by a real annual average of 2.9%

	2014 Budget	2014 MTBPS	2014 MTBPS			Real Annual Average Growth Rate (2015/16-2017/18)
Division of Revenue	***2014 M/term Estimate***	***2014/15 Revised***	***2015/16***	***2016/17***	***2017/18***	
National allocations	489.4	494.7	523.1	553.2	585.0	2.8%
Provincial allocations	***444.4***	***440.2***	***468.5***	***496.8***	***527.0***	***3.1%***
Equitable share	362.5	360.2	383.0	405.6	429.3	2.9%
Conditional grants	***82.0***	***80.0***	***85.4***	***91.2***	***97.7***	***4.0%***
Local government allocations	90.8	91.1	99.2	103.9	110.0	2.4%
Total allocations	***1024.6***	***1 026.0***	***1 090.8***	***1 153.9***	***1 222.0***	***2.9%***

MTEF Division of Revenue [cont.]

- Government has proposed to lower the expenditure ceilings for the first two years of the 2015 MTEF by R10 billion and R15 billion respectively
  - With respect to the national sphere, staying within the confines of the expenditure ceilings will be achieved through the freezing of posts, withdrawing posts where vacancies have been persistent and reducing the growth in transfers to entities
  - The baseline allocations for provinces is revised downwards by R11 billion, while local government is reduced by R2.4 billion within the two years
  - Government's current position on fiscal consolidation is in line with the Commission's submission for the 2014/15 Division of Revenue which emphasised the need for South Africa to accelerate the pace of fiscal consolidation

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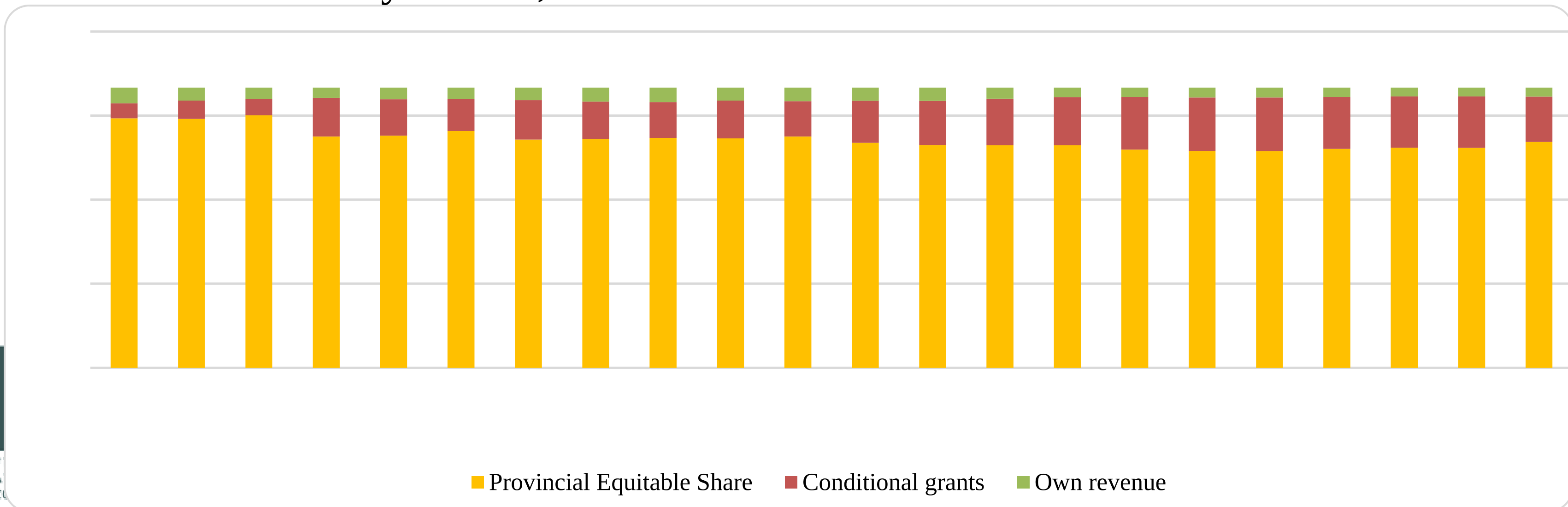
DIVISION OF REVENUE: PROVINCIAL SPHERE

- Share of own revenue has declined from 6% in 1995/6 to 3% in 2013/14
- The largest share of provincial funding is in the form of intergovernmental transfers, which comprises the provincial equitable share and conditional grants
  - The inability of provinces to maximise own revenue collection has created a heavy reliance on intergovernmental transfers and a mismatch between provincial own revenues and expenditure needs which widens the vertical fiscal imbalance

Provincial Revenue by Source, 1995/96 – 2016/17



Division of Revenue: Provincial Sphere [cont.]

- It is the Commission’s view that following the recent review of the Local Government Fiscal Framework (on-going) it is now time to review the provincial fiscal framework so that provinces’ role in economic development can be better appreciated
- Current practice has had the unintended consequence of characterising provinces as implementation agents for government’s social programs, namely education, health and social development
  - As a result, resources for other provincial functions become a residual (particularly economic development) resulting in inherited disparities being perpetuated

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DIVISION OF REVENUE: LOCAL SPHERE

- Commission notes the growth in local government equitable share (LES) and conditional grants to municipalities
  - LES grows by 8% and grants by 5% annually between 2014/15 to 2017/18, respectively
- LES in the 2014 MTBPS has risen faster (14%) than in the 2014 budget (11.8%), indicating that more resources have been channeled to the local government sector since February 2014
  - In outer years the rate of growth of the LES allocations would progressively decline
- Of concern for local government fiscal frameworks is not only that fiscal capacity varies substantially across various municipalities, but also that fiscal capacity appears to have declined over time
  - In 2004/5, aggregate municipal own revenues amounted to 90% of aggregate expenditure and this has has declined to about 75% of aggregate municipal expenditure in 2014

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ADJUSTMENTS TO CONDITIONAL GRANTS

- In 2011, the Commission initiated a comprehensive review of the LGFF – the conclusions and recommendations of which were tabled in Parliament in April 2013
  - The Commission raised concerns on the performance of infrastructure grants (e.g., on recurrent under-spending, proliferation, perverse incentives, and whether they reflect priorities of the NDP or government policy in general)
  - To this end, the Commission welcomes the ongoing review of infrastructure grants by Government that the Commission is a member of, whose key objective is to make evidence-based recommendations on how the current system of funding municipal infrastructure can be enhanced

ADJUSTMENTS TO CONDITIONAL GRANTS [CONT.]

- The Commission also welcomes the timely implementation of two recommendations emanating from the review process alluded to above, namely:
  - (a) the rationalisation of four grants administered by Department of Water Services (the municipal water infrastructure grant, water services operating subsidy grant, rural households infrastructure grant and the regional bulk infrastructure grant) and
  - (b) the merging of the public transport infrastructure grant and the public transport network operations grant into a single grant
- The rationalisation of grants and merging of two transport grants has potential to minimise inefficiencies associated with overlap of grant mandates, and also helps improve grant management
  - However, rationalisation and merging of grants should not be seen as substitute to efforts at uncovering the root cause of underperformance and decisively dealing with them

Expenditure Prioritisation: Housing Development and Social Infrastructure

- The Commission welcomes the priority being placed on housing and basic infrastructure in the MTBPS
  – Over the 2015 MTEF period, R569.4 billion allocated to housing and social infrastructure
  – For the 2015/16 financial year, budget with respect to housing and social infrastructure expected to grow by 2.9% p.a in real terms
- The Commission is of the view that allocating additional resources in the absence of technical capacity support would not achieve the full benefits of infrastructure investment
- The Commission has previously raised the issue of the rollout of infrastructure at local government level
  – In its 2014/15 Division of Revenue Submission, the Commission recommended how asset care at local government can be improved.
  – For example, the need for legislation similar to the 2008 Government Immovable Asset Management Act that regulates asset care at national and provincial sphere

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EXPENDITURE PRIORITISATION: EDUCATION

- Generally, education is a priority over the 2015 MTEF, especially post-school education
  - Post school education expected to receive R300 billion over 2015 MTEF; just over half of this allocation is in respect of subsidies to universities and contributions to the National Students Financial Aid Scheme (NSFAS)
- The Commission notes the transfer of the Further Education and Training (FET) and adult education and training functions from provincial to national sphere from the 2015/16 financial year
- The Commission also notes funding from the provincial equitable share and FET colleges grant will shift with the function
  - In its submission on FET function shift in 2013, the Commission recommended that once the FET function is shifted to national, baseline funding should not perpetuate past underfunding in some provinces and that additional resources should be allocated to ensure equitable distribution of resources across provinces
  - The Commission assisted Government in technical work on implementing the FET migration

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EXPENDITURE PRIORITISATION: HEALTH

- Approximately 13% of the non-interest budget is allocated to health in 2015/16
  - Real growth slows from 4.7% in 2014 to 2.9% in 2016
- Priority spending is related to expanding provision of antiretroviral drugs
  - Prioritization of antiretroviral drugs in line with recommendation Commission made in 2011, as is Government's increased focus on efficiency and cost savings in health
- At provincial level, spending is largely driven by employee costs, which has seen the cost of employment growing by 10% in the past 3 years
- Commission notes the high level working group being established to look into impact of National Health Insurance (NHI) on the intergovernmental fiscal relations system
  - While NHI may lead to significant reconfiguration of health functions, it is important for the working group to consult broadly so that ramifications of any recommendations proposed are well understood

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Expenditure Prioritisation: Job Creation and Social Protection

- The 2015 MTEF sees efforts to enhance job creation and protect social security
  - Employment, labour and social protection grow by 7.7% per annum in real terms while social protection increase by 4.4% per annum
- Government's strategy to create jobs multi-pronged (e.g. Public employment programmes, employment tax incentive and jobs fund)
  - The Government Technical Advisory Committee (GTAC) within National Treasury has taken over the responsibility of managing the Jobs Fund from the Development Bank of South Africa
  - The Commission welcomes the new strategy of seeking partnerships with larger intermediaries with the aim to scale up activities
- While Commission welcomes the positive uptake on the employment tax incentive since the beginning of the financial year, the tax incentive should be aimed at creating new jobs instead of jobs that would have been created irrespective of whether the tax incentive was available or not
- Efforts must continue that encourage reducing the capital intensity of production

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Review of Actual Spending

R million	2014/15		
	Main budget	Actual spending April to September	% Expenditure
Selected Key Budget Votes	306 007	153 638	50.2%
7 Public Works	6 121	3 014	49.2%
15 Basic Education	19 680	10 768	54.7%
16 Health	33 955	16 212	47.7%
17 Higher Education and Training	36 867	27 374	74.3%
21 Correctional Services	19 721	9 291	47.1%
25 Police	72 507	34 320	47.3%
26 Agriculture, Forestry and Fisheries	6 692	3 441	51.4%
28 Economic Development	697	318	45.7%
29 Energy	7 416	3 514	47.4%
31 Human Settlements	30 521	11 423	37.4%
33 Rural Development and Land Reform	9 455	4 459	47.2%
37 Transport	48 727	25 938	53.2%
42 Water and Sanitation	13 647	3 566	26.1%
Provincial Level	454 511	220 195	48.4%
Education	186 147	92 720	49.8%
Health	140 684	69 254	49.2%
Social Development	15 505	7 161	46.2%
Other	112 175	51 060	45.5%

REVIEW OF ACTUAL SPENDING [CONT.]

- Highlights based on analysis of aggregate spending and percentage spent six months into the 2014/15 financial year indicate:
  - Total government spending is slightly below the assumed norm of 50%. Spending by all votes is about 3% under the norm (R302.3 billion of the main budget)
  - With respect to the PES, 50% of the total amount has been transferred to provinces
- Notwithstanding overall positive performance, an assessment of individual departmental performance shows some uneven spending patterns
  - Certain departments far exceed the norm (Higher Education and Training spent 74.3% of its budget) whereas others such as the Human Settlements and Water and Sanitation departments have recorded spending rates below 40%
  - Excessive deviations below or above the norm are undesirable from an expenditure smoothing perspective. Unless a department's annual performance or strategic plan explicitly identifies under or over spending as a chosen spending profile, departments should attempt to remain within the confines of spending performance guidelines

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ADJUSTMENT ESTIMATES

- Annually government makes adjustments to the main, approved budget passed in February. These are expenditures that cannot be planned for in the beginning of the financial year and are meant to cater for unforeseen and unavoidable expenditure
  - Generally expenditure requirements may be the result of an in-year rise in inflation, reimbursements to sub-national governments for the shortfalls in the agreed to salary adjustments for public servants or for refunding sub-nationals that experienced nationally declared natural disasters
- Adjustments made for 2014/15 amount to R1.3 billion. The adjustments are funded through the R3 billion unallocated reserves set aside in 2014.
  - The largest category of adjustments (R789.6 million) are with respect to unforeseeable and unavoidable expenditure

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ADJUSTMENT ESTIMATES [CONT.]

- Declared unspent funds amounted to R1 billion
  - The bulk refers to underspending on programmes aimed at job creation (R561 million unspent on Employment Creation Facility) and economic development (R79 million underspent on tourism incentive grant)
  - While it makes sense to reallocate funds where it is not spent, resources taken away from programmes aimed at stimulating economic growth undermines government's efforts to kick start the economy

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Rollovers

- The adjustments budget makes provision amounting to R157.7 million for roll-overs. The Commission welcomes the continued reduction in roll-overs that began with the 2013 MTBPS where the amount of roll-overs was reduced from R1.5 billion (2012) to R894 million
- In terms of the Public Finance Management Act (PFMA) Regulations, departments are only allowed to rollover 5% of non-personnel expenditure
  - Since 2012/13, there has been a steady improvement in complying with this provision in the PFMA. In 2014/15, the Department of Energy only case where rollovers exceed the 5% threshold. The rollovers relate to (a) providing electrification connections to users, (b) a study on energy savings in heavy industry and for fuel sampling and testing project. Parliament may need to authorize the rollover in light of rollover amount exceeding the 5% PFMA threshold limit

Rollovers as % of Non-Personnel Expenditure

Selected National Votes	2010/11	2011/12	2012/13	2013/14	2014/15
Cooperative Governance	105%	1%	10%	4%	3%
Public Works	6%	0%	5%	0%	0%
Basic Education	0%	8%	9%	1%	0%
Health	13%	53%	17%	3%	0%
Social Development	0%	0%	0%	0%	3%
Agriculture, Forestry and Fisheries	2%	5%	8%	0%	0%
Communication	12%	52%	0%	0%	0%
Energy	65%	55%	14%	14%	8%
Human Settlements	24%	14%	3%	26%	0%
Rural Development and Land Reform	26%	0%	6%	0%	0%
Water Affairs/Water and Sanitation	3%	4%	9%	4%	0%

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CONCLUSION

- In May 2014, the Commission tabled at Parliament its Annual Submission for the 2015/16 Division of Revenue under the theme of "balancing fiscal sustainability with socio-economic impact"
  - The Submission agrees in most aspects with the 2014 MTBPS that has been crafted in a constrained environment characterised by downward economic growth forecasts
  - Overall, the 2014 MTBPS re-affirms and reflects the major thrust and spirit of the recommendations that the Commission has been making since the onset of the global economic crisis
  - The Commission fully agrees with the position in the MTBPS of emphasising the need to get value for money from Government programmes
  - Given the current negative economic outlook, the Commission agrees with the government stance on fiscal consolidation and tightening measures to maintain expenditure sustainability

CONCLUSION [CONT.]

- The Commission is in agreement with the proposed adjustments estimates and draws attention to rollovers for Energy that exceed the PFMA threshold limit
- Government should review the Provincial Government Fiscal Framework with a view to ensuring its long term viability and emphasis on economic development
- It is very clear that the economy remains far below the economic growth rates required to make the dent on unemployment and inequality
  - Rebuilding state capabilities should be prioritised with efforts aimed at both social capabilities for citizens and infrastructure and how these will be managed within the context of current consolidation measures.
  - In this regard, much more still needs to be done to implement the NDP and the MTSF

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