Midrand Office
Montrose Place
2nd floor
Waterfall Park
Bekker Street
Vorna Valley, 1685

Cape Town Office
Constitution House
12th floor
124 Adderly Street
Cape Town
8000

30 October 2013

Dear Honourable Sogoni

RE: RESPONSE TO QUESTIONS POSED DURING THE FINANCIAL AND FISCAL COMMISSION BRIEFING TO THE STANDING COMMITTEE ON APPROPRIATIONS ON THE 2013 MEDIUM TERM BUDGET POLICY STATEMENT (MTBPS)

Thank you for allowing the Financial and Fiscal Commission (FFC) to respond in writing to questions that were posed when we made our submission to the Standing Committee on Appropriations (SCoA) on the 2013 Medium Term Budget Policy Statement on 29 October 2013. My letter summarizes the Commission's views on the questions posed by Committee members on the presentation provided.

Question 1**:** The FFC notes a declining/slower growth trend. What is the impact on social programmes?

With slower expected growth over the MTEF period, moderate real growth in social sector departments is expected. The Commission does not expect any new spending programmes which will qualify for additional funding (unless national priority), with the likelihood that resources will most likely be reallocated within the existing baselines to take account of reprioritization by social sector departments. The emphasis within a constrained fiscal environment is to ensure improved quality of spending and enhanced work process efficiencies that will lead to doing more with less.

Question 2**:** In its presentation, the FFC identified a number of risks but posed no solutions or ideas on how government can overcome these risks.

In relation to the risks identified, the Commission recommends the following solutions:

- ***Public Sector Wage Bill Pressures**: Government should consider freezing all posts that are non-core and cleaning the system of ghost employees. The Commission would also refer the Committee to Chapter 7 of the FFC's 2014/15 Submission for the Division of Revenue which looks at the issue of the public wage bill and how it can be managed so as to contain fiscal stress and build a capable state.*
- ***Persistent Underspending**: There are a range of actions government can undertake to counter this risk. For example Government can ensure that stricter accountability is enforced, that competent individuals are employed and capacity building can be stepped up*

- ***Negative external balance****: Broadly speaking, there are three possible solutions that the FFC can propose to correct external imbalances available to South Africa. These solutions are measures aimed at facilitating adjustments of exchange rates, adjustment of internal prices along with levels of demand; and entering into bilateral arrangements (e.g. as a part of BRICS or SADC) to use financial instruments that allow importers to pay with their domestic currency, and the reserve asset will often play an intermediary role, but ultimately exporters require paying in their own currency. Improving productivity and hence competitiveness can also help, as can increasing the desirability of exports through other means and promotions (e.g., Proudly South African, Buy South Africa campaigns etc).*
- ***Export Diversification****: The motive for diversification for South Africa would be that export diversification is associated with higher long-run growth. The socio economic status and developmental state objectives of the country will shape diversification priorities and policies. Productive employment is a major goal, for example. Strategies for South Africa would include sustaining a high and relatively stable savings rate, massive investments in technology and infrastructure, especially in the areas of energy, communications and transport and agriculture. Measures to hold down costs can include policies to reduce the costs of labour and manage industrial relations, gradually shifting towards higher-technology products and skills upgrading. Policies included liberalizing skilled immigration, a dramatic expansion in enrolment in polytechnics, exchange relations with leading universities and skills development programs jointly sponsored by Government and Federations/Unions. Investments and targeted support can be provided through a variety of programs including free zones, export financing facilities, assistance with research, product development and marketing, aimed at reducing production costs and increasing competitiveness. Exporting can be clearly stressed strongly as a condition for support so that export performance becomes an important goal of diversification efforts.*
- ***Infrastructure****: The Commission recommends a stronger role for the President's Coordinating Committee (PICC) which has been established to fast track roll out of infrastructure*
- ***Mobilising finance****: Here the Commission is aware of the work being undertaken by the Davis Tax Commission. The FFC is also represented on the Tax Committee. As a result the Commission would not want to pre-empt changes this Committee will recommend in terms of reforming the tax system.*
- ***Human Capacity****: The Commission has done extensive work on this issue. In terms of strengthening human capacity the Commission would refer the Committee to its Submission on the Division of Revenue, 2014/15 in particular chapters three and four which relate to improvements that can be made in respect of the further education and training (FET) and higher education financing respectively.*
- ***Governance Issues****: With respect to this issue the Commission believes that a tightening of the accountability framework is needed – again the responsibility of accounting officers and provincial treasuries in ensuring good governance cannot*

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be underplayed. In addition, there need to be consequences/repercussions for acts of corruption.

***Question 3*: In terms of global versus domestic growth, what can we do to promote domestic growth?**

It's about economic management, ensuring certainty within the labour market (managing the negative perception caused by persistent labour unrest), improved roll out of infrastructure and improved governance. The issue of governance requires accounting officers to be held more accountable where no or underperformance occurs.

***Question 4*:** Has the Commission looked at the issue of contingent liabilities as it relates to the land reform issue?

The Commission has not done any work to date in this area.

***Question 5*:** Are rollovers an indication of tighter monitoring or rather a case of if you don't use funds, you lose them?

Whether decreased rollovers represent better monitoring and stricter enforcement of controls or whether it's about reducing allocations due to underspending, the Commission is of the view that underspending is indicative of inefficiency and contributes to unproductive allocations and poor service delivery outcomes.

***Question 6*:** How can we ensure alignment of NDP at all across all spheres of government?

It starts with the NDP sentiments being translated into the Medium Term Strategic Framework (MTSF) (which outlines government priorities over the electoral period). This should then trickle down into provincial growth and development strategies (PGDS) and various departments' strategic plans and then finally it should be incorporated at the local level in relation to municipalities' integrated development plans (IDPs).

***Question 7*:** What influenced government to move the Rural Household Infrastructure Grant (RHIG) to municipalities?

The RHIG was first sitting with the Department of Water Affairs before being placed under one umbrella containing all built environment grants administered by the Department of

Human Settlements (DHS). National Treasury expressed concern that the DHS is unable to effectively manage the grant and a proposal was put forward to move the grant to Department of Cooperative Governance (DCOG). The Commission and the Portfolio Committee on Human Settlements apposed this proposal on the grounds that there is no guarantee that grant performance will improve if it is moved to DCOG. The grant was then changed from an indirect to a direct grant so that municipalities can better align their plans with the grant funding available. The reason for the current underspending on the RHIG grant is as a result of inadequate preparatory work to spend the funds when the grant was changed from an indirect to direct grant.

Question 8**:** What is driving poor performance with respect to NHI pilot projects – is it s HR issue?

Doctors are reluctant to take up contracts with the NHI pilots because the proposed consultation fees proposed by the Department are relatively small. A further issue is doctors are not being reimbursed for transport costs to the hospital where they are going to provide a service. Further challenges are poor planning and inability of NHI pilots to absorb the funds.

Question 9**:** Please provide clarity on direct and indirect grants and if indirect grants open up room for abuse?

There is no evidence to suggest that there is abuse of indirect grants. The desire for national government to take over responsibility for some local and provincial functions are as a result of the view that national government is better placed to implement national priorities. What we are seeing is national government underspending on indirect grants which indicate they are failing to coordinate their spending plans and consultation processes that must take place before one is able to spend this grant. Over the MTEF period, indirect grants are declining at a faster rate than direct grants largely because of reductions to under-performing grants. The potential for abuse is small because of the requirement in the Division of Revenue Act for transferring departments to publish indirect allocations to provinces or local government.

Question 10**:** Greater elaboration of the Municipal Infrastructure Support Agency (MISA) and Approach to Distribution Asset Management (ADAM).

MISA represents a local government-wide intervention aimed at assisting municipalities with the roll out of infrastructure. ADAM is a sector-specific intervention aimed at assisting municipalities with asset care (maintenance and refurbishment) specifically in the electricity sector. The Commission is of the view that in order to unlock the challenge

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of poor capacity, there should be greater integration between capacity building grants, sphere-level intervention (MISA) and sector-specific intervention (ADAM). These interventions all aim to achieve the same goal and as such we need some level of integration between them to ensure effectiveness.

Yours sincerely

Bongani Khumalo

Acting Chairperson and CEO

Financial and Fiscal Commission

Telephone: +27 11 207 2300; Facsimile: +27 11 207 2345; Web: www.ffc.co.za