BRIEFING TO THE STANDING COMMITTEE ON APPROPRIATIONS ON THE APPROPRIATION BILL [B4-2014]

"For an Equitable Sharing of National Revenue"

9 July 2014

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LIST OF ACRONYMS

DHET	Department of Higher Education and Training
DPSA	Department of Public Service and Administration
EPWP	Expanded Public Works Programme
CWP	Community Work Programme
FFC	Financial and Fiscal Commission
HPV	Human Papilloma Virus
ICT	Information and Communication Technology
LES	Local Equitable Share
MDG	Millennium Development Goal
MISA	Municipal Infrastructure Support Agency
MoU	Memorandum of Understanding
MTEF	Medium Term Expenditure Framework
NDP	National Development Plan
NSG	National School of Government
PALAMA	Public Administration Leadership and Management Academy
PAM	Public Administration Management
PICC	Presidential Infrastructure Coordinating Commission
PSC	Public Service Commission
R&D	Research and Development
SALGA	South African Local Government Association
SIP	Strategic Integrated Project

1. THE CONTEXT

1.1 The submission is made in terms of Section 4 (4) (2) of the Money Bills Amendment Procedure and Related Matters Act (Act 9 of 2009) which requires Parliamentary Committees to consider any recommendations of the Financial and Fiscal Commission (the Commission) when processing the Appropriations Bill[1]. It is also made in terms of Section 3 of the Financial and Fiscal Commission Act (1997), as amended, which requires the Commission to respond to any requests for recommendations by any organ of state on any financial and fiscal matter.

1.2 When the Commission made its submission to Parliament on the 2014 Division of Revenue Bill and Fiscal Frameworks and Revenue Proposals in February, it welcomed the strong emphasis that Budget 2014 placed on resource allocations that underpin the achievement of goals outlined in the National Development Plan (NDP). Given government's adoption of the NDP as the key driver for policy-making in South Africa, this approach to budgeting and spending should enable greater progress towards the social and developmental goals outlined in South Africa's long-term vision.

1.3 The fiscal reforms contained in the 2014 Budget Review[2] had begun to achieve a delicate balance between pursuing fiscal discipline whilst balancing priorities and investment in constitutionally mandated basic services like education, health, water and sanitation. However, the impact of the recently ended protracted strike in the mining sector, and concerns about the possibility of a similar occurrence in the manufacturing sector, have contributed to a downward revision to South Africa's growth prospects in 2014. The slowdown in economic growth coupled with structural factors leading to high unemployment and poverty pose the most significant risk to the fiscus.

1.4 In line with the request from the Standing Committee on Appropriations, this submission is focused on the following four areas:

- Assessment of the composition of appropriated funds as per the 2014 Appropriation Bill
- Assessment of the 2014 Appropriation Bill with regards to effecting government's five priority areas

[1]The Appropriation Bill is a piece of legislation that serves to appropriate money from the National Revenue Fund for the requirements of national government in order to provide for subordinate matters incidental thereto.
[2] See in particular Chapter 1, 2 and 3 of the 2014 Budget Review document which outline the key reforms proposed for the 2014 MTEF period. This document is available online at: www.treasury.gov.za

- Assessment of infrastructure investment in national government, and
- Assessment of possible or existing institutional arrangements or mechanisms that can stimulate cost efficiencies.

2. An Assessment of the Composition of the Appropriated Funds as per the 2014 Appropriation Bill

2.1 The most important administrative issue regarding the 2014 Appropriations Bill is that it is being considered subsequent to the 2014 elections. Additional national departments have been established (for example the Department of Small Business Development) while structures of certain votes have been changed[3]. To deal with this situation from an administrative perspective, the procedures has been revive the Appropriation Bill tabled with previous Parliament, change the structure of the votes where necessary but keep the allocations to the various votes as previously set. The allocations can then be revised when we come to 2014 Adjustments Budget.

2.2 The Commission's view is that the process recommended above, is reasonable in that it is not introducing any new money at this stage. This approach of not altering allocations serve to entrench the ethos of fiscal consolidation. Postponing alterations to the Adjustment Budget is also reasonable with the proviso that the size of expenditure remains consistent with South Africa's MTEF budget deficit target.

2.3 Table 1 shows the percentage of the total budget spent for the period 2011/12 to 2013/14 for selected key national government programmes that drive government priorities (such as education, health, justice and policing), and key built environment programmes (such as energy, human settlements and rural development). While most programmes have spent on par with the national average over the period (99 percent), uneven spending patterns are nevertheless noticeable.

2.4 Programmes that are important drivers of job creation and economic development such as Public Works (92.5 percent), Basic Education (92.63 percent) and Human Settlements

[3] New ministries include: Telecommunications and Postal Services, Small Business Development, Communications. Reconfigurations include: consolidation of the National Planning Commission and the Performance Monitoring and Evaluation ministries in the Presidency, support for people with disabilities and children transferred to the Department of Social Development, consolidation of the Department of Justice and Constitutional Development and Correctional Services, Department of Water now the Department of Water and Sanitation

(97.4 percent) have spent below the national average (92 percent). While no additions are added to the Public Works for the 2014/15 financial year, it is noticeable that Human Settlements is receiving an extra R365 million in the Appropriations Bill mainly to fund the housing function being devolved to municipalities and to repair housing infrastructure damaged by disasters.

Table 1. Aggregate Spending and Deviation from Final Budget, 2011/12 – 2013/14

Percentage	**% expenditure (2011/12)**	**% expenditure (2012/13)**	**% expenditure (2013/14)**	**Average % Spending (2011/12 - 2013/14)**
National Sphere	**98%**	**98%**	**99%**	**98%**
Selected key budget votes				
7. Public Works	90.2	90.1	97.19	92.50
15. Basic education	91.6	91.1	95.20	92.63
16. Health	99.0	101.2	98.08	99.45
17. Higher Education and Training	99.9	100.3	100.00	100.06
21. Correctional Services	97.5	97.6	99.74	98.31
24. Justice and Constitutional Development	99.0	98.7	96.87	98.21
25. Police	98.9	101.1	100.00	100.01
25. Agriculture, Forestry and Fisheries	98.8	100.2	98.85	99.30
28. Economic Development	96.5	100.1	99.51	98.72
29. Energy	99.6	97.8	100.00	99.14
31. Human Settlements	99.0	96.8	96.38	97.41
33. Rural Development and Land Reform	98.3	100.5	100.00	99.59

SOURCE: NATIONAL TREASURY SECTION 32 REPORTS (2011-2014).

2.5 Table 2 illustrates historical growth in selected key national departments for the period 2009/10 to 2014/15. Basic Education, Economic Development and Energy all grew above 10 percent in real terms on average per annum and are in line with the priorities identified in the 2014 State of the Nation Address. The Commission notes all other votes grew at a positive annual average growth rate although Correctional Services (2.8 percent) and Rural Development and Land Reform (2.8 percent) registered the lowest growth figures.

2.6 Except for Correctional Services, the growth rate of all selected votes in the 2014/15 Appropriation Bill has declined when compared to the average annual growth rate for the period 2009/10 to 2014/15. This evident decline in growth for 2014/15 reflects the tight fiscal environment that is likely to continue over the medium term, especially in light of

depressed growth forecasts. If the macroeconomic environment remains volatile, trade-offs between key votes are likely in order to ensure a balance between fiscal sustainability and protecting existing socio-economic gains.

2.7 The largest reduction in growth rate for the 2014/15 financial year are recorded for Agriculture, Forestry and Fisheries (-15.9 percent), Human Settlements (-6.2 percent) and Public Works (-4.6 percent) votes. Despite the Agriculture, Forestry and Fisheries spending 99 percent of its allocation, the likely reason for the decline in the growth for all three votes is as a result of poor spending performance. In terms of Agriculture, Forestry and Fisheries, grant allocations have declined due to under-performance of these grants mainly as a result of planning, procurement challenges and skills deficit in some of the provinces.

(a) In its submission on the 2015/16 Division of Revenue Act, the Commission made a recommendation that the agriculture sector, led by the national department, should assess the entire value chain of all three agriculture conditional grants and unlock operational constraints, especially in relation to planning, procurement, comprehensive smallholder support, cash flow and monitoring and evaluation among others.

Table 2. Real Growth Rates of Key National Votes, 2009/10 to 2014/15

	2009/ 10	**2010/ 11**	**2011/ 12**	**2012/13**	**2013/ 14**	**2014/ 15 Appro-priation (A)**	**Ann. Avg. Real Growth (B)**	**Difference between (A) and (B)**
Selected Key National Votes								
7. Public Works	25.1%	15.4%	2.0%	3.9%	-22.4%	-4.6%	3.2%	-7.9%
15. Basic Education	16.3%	6.4%	44.0 %	10.9%	2.2%	15.9%	16.0%	-0.1%
16. Health	10.0%	13.4%	9.5%	3.1%	1.9%	6.5%	7.4%	-0.9%
17. Higher Education and Training	3.5%	10.7%	14.4 %	6.0%	2.6%	1.2%	6.4%	-5.2%
19. Social Development	5.4%	6.1%	5.0%	2.5%	2.2%	-1.0%	3.4%	-4.4%
21. Correctional Services	0.0%	3.3%	6.0%	2.0%	1.3%	3.2%	2.6%	0.6%
24. Justice and Constitutional Development	9.3%	6.6%	3.6%	7.0%	2.9%	-0.8%	4.8%	-5.6%
25. Police	7.8%	8.2%	3.5%	3.8%	0.3%	2.1%	4.3%	-2.2%

26. Agriculture, Forestry and Fisheries	4.4%	-6.9%	23.3 %	10.6%	8.5%	-15.9%	4.0%	-19.9%
28. Economic Development	36.1%	23.2%	39.5 %	6.9%	-8.6%	8.1%	17.5%	-9.4%
29. Energy	17.9%	45.1%	7.4%	3.5%	9.2%	2.0%	14.2%	-12.2%
31. Human Settlements	16.9%	11.2%	14.8 %	4.5%	0.0%	-6.2%	6.9%	-13.1%
33. Rural Development and Land Reform	-18.8%	17.4%	7.6%	6.6%	1.9%	2.0%	2.8%	-0.8%

SOURCE: ESTIMATES OF NATIONAL EXPENDITURE (2014) AND APPROPRIATION BILL (2014).

3. GENERAL ASSESSMENT OF 2014 APPROPRIATION BILL WITH REGARDS TO EFFECTING GOVERNMENT'S FIVE PRIORITY AREAS

3.1 Government has identified five specific objectives as areas of priority within the DoR, namely:

- Promoting economic growth
- Education
- Health
- Job creation and economic transformation; and
- Improving the public service

3.2 PROMOTING ECONOMIC GROWTH

(a) Government controls various economic policy leavers that affect economic growth as well as long-term competitiveness. In addition to education and infrastructure policies, other important economic policy levers with a bearing on the economic growth rate include: (a) energy policy, (b) competition policy, (c) trade policy, (d) economic regulation of utilities (e.g. telecommunications, broadcasting and energy), (e) financial services and regulation of financial markets, (f) consumer protection and product and trading standards; and (g) policies affecting the labour market, including employment law and immigration. These are significant responsibilities which have a considerable bearing on the performance and the growth potential of the economy. Decisions in these areas by Government can also have important consequences for fiscal policy, at both the national level and in the provinces and municipalities. For example, decisions on labour market policy, and particularly on immigration, can have an important influence on demand for public services and the size of the tax base. The challenge across the board is in the

implementation of the policies in order to achieve the relevant objectives and address priorities of government.

(b) Table 3 reports changes to the 2014/15 financial year, comparing MTBPS 2013 and Budget 2014.Welcome developments include significant upward revisions of science and technology by 3.3 percent. Greater investment in research and development can facilitate greater innovation, productivity and economic growth[4]. Despite limited fiscal space, it is noteworthy that education and health and social protection show increases. The significant downward revision of the allocation to employment and social security is of concern since expenditure in this area, especially for social security, provides an important buffer during cyclical downturns. A similar sentiment is expressed with respect to the downward revision to economic infrastructure, which is meant to drive growth.

Table 3. Expenditure Component Revisions (Functional Classification)

R' Billion	2013 MTBPS	Budget 2014	% Change
General public services	65.3	65.1	-0.3%
Defence, public order and safety and state security	163.5	163.6	0.1%
Economic infrastructure	94.1	92.8	-1.4%
Economic services	48.7	50.00	2.7%
Local government, housing and community amenities	141.2	142.9	1.2%
Health and social protection	289.2	290.17	0.3%
Education and related functions	250.2	253.9	1.5%
Employment and social security	60.0	57.3	-4.5%
Science and technology	18.1	18.7	3.3%

SOURCE: MTBPS (2013); BUDGET REVIEW (2014); COMMISSION CALCULATIONS.

(c) Overall, the Commission is of the view that given the prevailing economic climate, growth and employment targets in South Africa can only be achieved through a combination of fiscal consolidation and investment in future growth. Already a number of policies have been put in place such as manufacturing development incentives (allocated R10.3 billion over the next three years), the Economic

[4]For more on the role of innovation and the knowledge economy in stimulating inclusive development and growth, the interested reader is directed to the Commission's Submission for the 2013/14 Division of Revenue. The research contained in this submission is geared at investigating how the different elements of the IGFR system, as well as the different spheres of government, can be used efficiently to address inclusive growth and stimulate innovation. This document can be accessed from the FFC website: www.ffc.co.za

Competitiveness and Support programme (R15.2 billion allocated over the MTEF), Special Economic Zones (allocated R3.6 million) and the cushioning of social services. Aspects contained in the NDP that can serve to enhance growth and should be pursued more strongly, include improvements to human capital, the fostering a social compact and less adversarial relationship between business and organised labour and government, more focus on improving small business development of entrepreneurship, increased infrastructural investment, greater cooperation between public and private sectors and improved capacity of the public sector to implement projects and strategies to reduce corruption.

(d) In terms of the role that subnational governments play in facilitating economic growth and more efficient service delivery, the Commission calls for national departments to establish precise cost estimates of norms and standards for concurrent functions for provinces and municipalities to implement. This implies accurately costing a standard basket of social/economic services across all spheres of government. This will serve to minimise the unevenness in access to and quality of services enjoyed by beneficiaries from different provinces.

(e) In accordance with Section 153 of the Constitution, municipalities promote and provide economic support and development through the delivery of basic services such as water, sanitation, electricity and refuse removal. The provision of these services is funded through the local government equitable share (LES)[5]allocation and municipal own[6] revenue. Similar to the national sphere, the availability of accurate cost estimates to inform the funding of basic municipal services is a cause for concern. However the Commission, together with the South African Local Government Association (SALGA) is undertaking a comprehensive study to produce more accurate cost estimates for local government services such as water, sanitation, refuse removal and other basic services.

3.3 EDUCATION

(a) The Department of Basic Education receives R19.7 billion and the Department of Higher Education and Training (DHET), R36.7 billion in the 2014/15 Appropriation Bill. Additions of R213 million in Basic Education for 2014/15 is

[5] The LES is an unconditional transfer to municipalities via the annual Division of Revenue process

[6] This refers to revenue that a municipality raises and has discretion over. Revenue derived from property rates represents an example of own revenue.

being funded by significant reductions in the School Infrastructure Backlogs grant (R231 million) and the Education Infrastructure Grant (R284 million). An amount of R31 million is also added to Higher Education in respect of salary adjustments related to conditions of service. While the Commission supports alignment of grant allocations with the capacity of a department to spend, addressing significant backlogs in school infrastructure must not be compromised in the process. The Commission notes the average annual growth of 14.8 percent in the school infrastructure grant over the medium term. The Commission calls on the national Department of Basic Education to provide provinces with adequate support to ensure funds are spent appropriately. The Commission welcomes the infrastructure spending on two new universities in Mpumalanga and Northern Cape and also expanding the access of broadband connectivity by the DHET as this is in line with the NDP goal of developing human capital.

(b) The Commission notes the R31 million increase in the Further Education and Training (FET) grant in respect of salary adjustments in the 2014/15 Appropriations Bill. To create an integrated post-school education and training system, FET colleges are migrating from provincial to the national sphere. The Commission would like to reiterate the recommendation made in its submission for the 2014/15 Division of Revenue that the transfer of the FET function to DHET should include the development of sound systems and uniform templates for financial reporting, designed in a manner that ensures that DHET can proactively monitor the financial health of FET colleges. This should be complemented by holistic interventions to improve fiscal governance in FET colleges including recruitment of appropriate skills, ongoing training, and credible financial systems and processes

(c) South Africa has an inadequate education and skills base. While access has increased, quality of educational outcomes have been poor. Most students leaving the post-schooling education system is unable to find jobs. According to the NDP, improved education, will lead to higher employment and earnings. Commission has in its 2013/2014 and 2014/2015 submissions made recommendations for promoting excellence in higher education and innovation, as well as dealing with other longstanding problems in pre-school education, e-learning and adult skills. The Commission is of the view where schools under-perform; emphasis should continue to be placed on the professional development of teachers, improving

school management as well as greater accountability of school principals and strengthening district level management capacity.

3.4 Increasing Access to High Quality Health Care Services

(a) The Department of Health received an appropriation of R34 billion in the 2014/15 financial year of which roughly R30 billion are conditional grants to provinces. An amount of R286 million is added to the department for 2014/15, largely to fund the rollout of the vaccine for the Human Papilloma Virus (HPV). The R286 million addition is largely funded by the reduction of R225 million in the national health grant. The Commission welcomes the introduction and the roll out of the HPV vaccine as HPV is the root cause for cervical cancer amongst women. In its 2014 submission on the Division of Revenue Bill, the Commission raised concern that the grant has too many objectives that may hamper effective attainment of intended outcomes.

(b) The National health grant, which declines by R225 million in 2014/15, was introduced in 2013/14 and complements the National health insurance (NHI) grant. The Commission notes the challenges with respect to implementing the NHI case studies such as underspending on infrastructure, doctors not willing to work in certain hospitals, affordability and potential skills shortages. While these factors may delay the successful implementation of the NHI, the Commission commends the steps being taken by DOH to address some of these challenge such as putting together a human resource strategy to inform staffing norms, establishing a commission of enquiry to investigate private health care costs and the intention to establish more medical schools.

(c) Of concern in relation to long term economic growth potential is the weakness in the health system as reflected by high infant and mortality rates[7]. According to the 2013/14 Global Competitiveness Report, the health of South Africa's workforce is ranked 133rd out of a total 148 economies included in the report. This poor ranking is directly attributed to the high level of communicable diseases but also due to

[7]UNAIDS data indicates South Africa has a maternal mortality ratio of 310 deaths per 100 000 live births and an under-five mortality rate of 56 deaths per 1000 live births – 50% maternal deaths and 40% under –five deaths are as a result of HIV infection.

poor health indicators of South Africa and the likely shortfall in achieving the Millennium Development Goals (MDG)[8].

(d) The National Development Plan envisions a health system that increases life expectancy, reduces infant mortality, HIV/AIDS and lowers the burden of disease. The Commission notes the progress being made to address some of these challenges and also concerns raised by the Commission previously, especially related to health procurement irregularities and the quality of health care in the wake of fiscal consolidation. In this regard, the Commission welcomes the cost savings achieved through centralizing medicine tenders and the establishment of the Office of Health Standards Compliance to monitor health care service delivery.

(e) The achievement of improved health outcomes, whilst a national priority area, is implemented at the provincial level. As such the ability of provinces to improve effectiveness of service delivery in accordance with NDP goals is critical.

3.5 Jobs Creation and Economic Transformation

(a) While post-apartheid South Africa has witnessed many positive developments, unemployment and poverty remain serious challenges. The slow recovery from the historical structural weaknesses in the South African economy has contributed to unemployment figures remaining stubbornly above the 20 percent mark over the past 20 years. Youth unemployment is also a critical challenge. Unemployment places budgetary pressures on the Appropriations Bill as tax revenues decline and expenditures increase. In the long term, unemployment erodes skills thereby reducing future national productivity and income.

(b) The NDP target around job creation is 5 million jobs within the next decade and an additional 11 million jobs created by 2030. Whilst the Commission acknowledges that the public sector cannot be solely responsible for employment, government expenditure policies will need to be sensitive to the job creation possibilities associated with the realization of the government's expenditure programme. The government has maintained focus on job creation as a priority in the 2014/15 Appropriation Bill. The Commission welcomes the proposals to introduce

[8] As part of its Submission for the Division of Revenue 2012/13, the Commission made recommendations regarding specific gaps that need to be attended to if we are to move towards achievement of the MDGs. The interested reader is directed to Chapter 2 (titled: Inclusive Growth, Development and Fiscal Policy) of the Submission document which can be accessed at: www.ffc.co.za

employment tax incentives to improve employment in the medium term while acknowledging the need for continued investment and improved outcomes in the education. Its success however will depend ultimately on the ability and willingness to substitute labour for capital in the production process as well as the amounts dedicated to the subsidy. Government also makes provision for other job creation initiatives such as expanded works programme (EPWP) and community work programme (CWP). Through its coordination of the EPWP, the Department of Public Works aims to create 3.7 million work opportunities by the end of 2016. These programmes create job opportunities for the unemployed and reflect an acknowledgement by government that expanding permanent employment in the economy will take some time to achieve.

(c) Government has increased funding and incentives for special economic zones and increased support and tax relief for entrepreneurs and small businesses. There is also a focus by government on labour absorption, and export competitiveness, with efforts in mineral beneficiation achieving some success.

(d) The Department of Performance Monitoring and Evaluation (2012) notes in its midterm assessment report (2012) that government is still struggling with coordinating job creation efforts across departments, resulting in slow implementation of decisions. There is also the policy question of how to improve labour market recovery while protecting the vulnerable from its adverse impacts. Should output recovery be weak and job content low, South Africa could be in for a slower recovery of its labour market. However, if policies aim to stimulate growth and also labour absorption as intended, then the distress could be alleviated sooner.

3.6 Improved Public Service

(a) Building a capable state, that is able to assume centre stage in driving implementation of Vision 2030, is a key pillar of the NDP. Building a capable state requires sound institutions, underpinned by a competent civil service.

(b) Measures aimed at combating corruption, cutting waste and increasing accountability amongst public servants are particularly pronounced in Budget 2014. To this end, the Commission welcomes the recent establishment of the Chief Procurement Officer which will play a key role in detecting procurement-related corruption, the spending reviews that are currently underway and which will place particular emphasis on value for taxpayers' money as well as the cost containment

instructions that were issued by National Treasury in January 2014. It is also envisaged that stricter enforcement of the minimum competency standards, as prescribed in the Municipal Systems Act – particularly with respect to the strategic posts of municipal manager, chief finance officer and other senior managers – will go a long way in ensuring that posts are held by individuals with the appropriate skills mix.

(c) Limited capacity is often cited as a hindrance to good performance, particularly at the local level. An array of capacity building conditional grants exist to strengthen the capacity of civil servants. The 2014 Appropriation Bill allocates R805.7 million in respect of capacity building at the local level. This includes the Municipal Systems Improvement Grant (R252.1 million), the Local Government Financial Management Grant (R449.1 million) and the Infrastructure Skills Development Grant (R104.4 million). The impact and outcomes attached to these initiatives (in terms of producing a more skilled and efficient civil service) are critical if the public sector is to achieve more within the constraints of limited resources. The ability of the civil service to do more with fewer resources is particularly important if South Africa's economic growth remains subdued. Going forward it will be important to ensure that municipalities are able to absorb and utilize the funding available through these conditional grants, particularly the Infrastructure Skills Development Grant which is projected to increase by 23.8 percent between 2014/015 and 2015/16 (see Table 4).

Table 4: Key Local Government Capacity Interventions

Capacity Building Grant (R'000)	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**
Municipal Systems Improvement Grant	230 096	240 307	252 152	261 060	274 896
Local Government Financial Management Grant	402 753	424 798	449 138	469 799	494 698
Infrastructure Skills Development Grant	75 460	98 500	104 425	129 226	138 725
TOTAL	**708 309**	**763 605**	**805 715**	**860 085**	**908 319**
Annual Growth (%)					
Municipal Systems Improvement Grant		4.4%	4.9%	3.5%	5.3%
Local Government Financial Management Grant		5.5%	5.7%	4.6%	5.3%
Infrastructure Skills Development Grant		30.5%	6.0%	23.8%	7.4%
TOTAL		**7.8%**	**5.5%**	**6.7%**	**5.6%**

SOURCE: ADAPTED FROM APPROPRIATIONS BILL (2012, 2013, AND 2014).

(d) In addition to conditional grant funding, which to date, has shown limited improvements in capacity, the Municipal Infrastructure Support Agency (MISA) was established in 2012, to provide technical support to municipalities struggling with provisioning, refurbishment and maintenance of infrastructure. According to the 2014 Appropriation Bill, MISA is allocated R294.1 million.

(e) On aggregate national government has budgeted to spend just over R2 billion on training for 2014/15. The Commission is of the view that there should be more integration between capacity building grants and the numerous other interventions (such as MISA) and spending programmes that aim to achieve the same goal of improving the technical skills that a municipality can draw on.

(f) As part of improving and streamlining pubic services, the Commission welcomes government efforts to delay assignment of the housing function to the six metropolitan municipalities while building the requisite capacity. Government has revised the initial set date of shifting the function from July 2014 to beginning of the 2015 municipal financial year due to planning and capacity considerations. A total amount R900 million has been set aside for the 2014 MTEF through the newly created Human Settlement Capacity Grant to build the capacity of the metros and cover the cost of administering the national housing program. The Commission maintains its support for the shifting of the housing function to metropolitan municipalities and the rest of other municipalities in order to promote integrated planning and delivery. However, in the case of transport, to improve service delivery, assignment of some transport functions to municipalities are envisaged in terms of the National Land Transport Act (2009). The Commission would like to reiterate a recommendation made for the 2014/15 Division of Revenue that the full costs of assignment must be properly understood before assignment takes place. Should this not be done, assignment could pose a significant fiscal risk to municipalities and also create the likelihood that municipalities could sit with an unfunded mandate.

(g) The recent establishment of the National School of Government (NSG), which replaces the former Public Administration Leadership and Management Academy (PALAMA), is poised to take further Government's attempts to professionalise the public service further. The NSG, which will run mandatory training programmes for civil servants will receive an allocation of R138 million for the 2014/15 financial year. To ensure value for taxpayers' money, public servants receiving

training need to be held accountable in terms of transferring and implementing skills acquired during training in the everyday work activities. In this way, real value from training interventions can be better assessed.

(h) A key enabler with respect to building a single public service is the Public Administration Management (PAM) Bill, which will effectively criminalise the non-disclosure of interests by civil servants (previously non-disclosure was merely seen as misconduct). It will be important for the newly appointed Parliament to fully interrogate the intentions of this proposed legislation both in terms of its benefits (in terms of building an ethical, efficient and more effective public service) but also the intended and unintended costs that it may give rise to (for example, moving to a seamless public service where interoperability between departmental systems is possible, will require will give rise to costs for those departments that will have to migrate to a new system).

4. Assessment of Infrastructure Investment in National Government

4.1 Infrastructure is critical to the generation of growth and jobs. Over the next three years, R847 billion is allocated in respect of targeted public infrastructure investment. More specifically, government is pinning advances in the level of economic growth on targeted investment in transport and electricity.

4.2 In 2011, the Presidential Infrastructure Coordinating Commission (PICC) was established. The PICC is composed of ministers, premiers and metropolitan municipality mayors. Its main function is to identify, prioritize and coordinate infrastructure development. Thus far it has prioritized 17 strategic infrastructure projects (referred to as Strategic Integrated Projects (SIPs)). Most of these projects focus specifically on infrastructure falling within the ambit of local government. Given the impact of urbanisation (which is being exacerbated by continued migration), particularly on metropolitan municipalities and other major cities, as well as the existence of significant backlogs at the local level, the focus of the SIPs are welcomed. The SIPs include plans to:

- Expand the electricity distribution network and provide access to electricity

- Develop national capacity to assist the 23 least resourced districts in addressing their maintenance backlogs and upgrading water, electricity and sanitation bulk infrastructure
- Coordinate planning and implementation of public transport, human settlement, economic and social infrastructure so as to create sustainable urban settlements[9]

4.3 Table 5 indicates that the bulk of infrastructure investment over the 2014 MTEF period, will be in the areas of transport, energy and water and sanitation.

Table 5: Public Sector Infrastructure Expenditure by Area of Responsibility, 2014/15-2016/17

R' billion	**2014/15**	**2015/16**	**2016/17**
Energy	72.3	65.5	50.6
Water and Sanitation	36.5	36.9	38.5
Transport and logistics	99.6	120.0	127.5
Other economic services	15.2	14.2	12.8
Health	10.5	11.3	11.6
Education	13.5	13.6	14.0
Other social services	12.5	13.0	15.9
Justice and protection services	4.9	5.0	6.5
Central government services	7.9	8.4	9.3
Total	**272.9**	**287.9**	**286.7**
National departments	14.1	14.3	16.7
Provincial departments	42.6	45.5	46.6
Local government	58.3	61.8	63.5
Public entities	21.5	23.7	24.4
Public private partnerships	3.1	3.3	3.5
Public enterprises	133.4	139.1	132.0
Total	**272.9**	**287.9**	**286.7**

SOURCE: BUDGET REVIEW (2014).

4.4 As per South Africa's intergovernmental fiscal system, investment in new and existing infrastructure lies with all three spheres of government. With respect to new infrastructure, state owned companies and municipalities in particular, will be the key implementers of economic infrastructure.

(a) As noted in the Commission's Submission on the Fiscal Frameworks and Revenue Proposals for 2014, the concern with Government's infrastructure investment plan

[9] For further details, see the PICC Report for 2012.

is the capacity of state owned enterprises (SOEs) and municipalities to deliver effectively. Specifically with respect to the targeted areas of electricity and transport, SOEs such as Eskom and municipalities in general, continue to experience financial and capacity challenges that brings into question their ability to drive Government's ambitious infrastructure investment plan.

(b) Delays in the delivery of key, large-scale infrastructure projects constitute additional risks that may constrain South Africa's economic growth. Such delays coupled with cost overruns (such as those experienced in the current construction of the Medupi Power Plant), have exacerbated concerns around key infrastructure problems such as shortages in the electricity sector or capacity issues related to road and rail network infrastructure. In addition, the delays and cost overruns are bound to create credit concerns among investors, and impact the extent to which state owned enterprises (such as Eskom) can use their credit ratings as a leverage to raise additional financing in the capital market. Addressing investor concerns over long-term viability of expenditure programs will require policy certainty regarding the construction, implementation and financing of the anticipated roll-out of public infrastructure programs.

4.5 Investment in new infrastructure is critical. However, management of existing infrastructure stock is equally important. Table 6 disaggregates the infrastructure transfers from the national sphere to subnational government, entities and agencies over the 2014 MTEF period. It is clear that there is much emphasis on funding of new infrastructure projects. With respect to transfers to subnational government, this funding mainly takes the form of conditional grant funding. The concern is that whilst new infrastructure is funded via intergovernmental grants, the responsibility for maintenance and rehabilitation lies with the subnational government where the infrastructure is developed. Poor performance with respect to asset care is a challenge that cuts across all three spheres of government and can jeopardise the potential benefits of infrastructure development and compromise the long run growth potential of the economy. Previous research conducted as part of the Commission's Submission for the 2014/15 Division of Revenue, emphasised the poor state of municipal asset care particularly with respect to the key basic services of electricity and water. This approach runs contrary to the goal of establishing a well-functioning infrastructure network, capable of facilitating improvements in productivity and growth.

Table 6. Nature of Infrastructure Transfers to Other Spheres, Agencies and Entities, 2014/15-2016/17

Infrastructure Transfers R'million	2014/15	2015/16	2016/17	Annual average growth 2014/15-2016/17
Current	614	445	449	-14.5%
Capital	101 016	115 000	121 633	9.7%

SOURCE: ADAPTED FROM ESTIMATES OF NATIONAL EXPENDITURE (2014).

4.6 Previous Commission research on the relationship between decentralisation and economic growth shows that fiscal decentralisation has a positive but weak relationship with economic growth[10]. This is due to the heavy skewness of resource allocations at the provincial level towards operating current expenditure as opposed to growth inducing capital expenditure (investment). Constraints on revenue mobilisation and lack of capacity at the lower spheres of Government are also additional factors that account for the weak relationship between fiscal decentralisation and economic growth. The key question is how the PICC and the interface with fiscal decentralisation can be targeted at investment expenditure to ultimately enhance economic growth.

- Previous Commission research has recommended that further decentralisation, especially with respect to revenue powers to local government, has to be accompanied by measures to ensure accountability and effective spending allocation according to the needs of the local citizens. The Commission's view is that the value add of the PICC lies in its interface with the IGFR system and how the IGFR can contribute to infrastructure and growth. The underlying point is that for PICC to work in our IGFR setting there is definite scope for improvement that can enhance the positive virtues of decentralisation, thus ultimately leading to stronger growth.

5. MEASURES TO STIMULATE COST EFFICIENCIES

5.1 DEFINITION AND APPROACH

[10] For more detail on this research, please refer to Chapter 7 (titled: The Impact of Aggregate Revenue and Expenditure Assignments on Economic Growth) of the 2013/14 Submission on the Division of Revenue. This document can be accessed on the FFC website at: www.ffc.co.za.

(a) Using a cost-efficient instrument involves allocating the smallest amount of resources to reaching a priority, conditional on a given target being achieved. As such, achieving cost-efficiency in a fiscally constrained environment, is a desirable attribute. It has the minimum opportunity cost. Hence, the use of cost-efficient instruments is a prerequisite for achieving an economically efficient allocation of resources.

(b) As noted in the Commission's Submission on the Appropriation Bill for 2013, three policy issues emerge as important in intergovernmental relations from this. The first one is how to balance the need to provide constitutionally mandated basic services (CMBS) with macroeconomic constraints that limit the available resources. The second policy concern is how to objectively determine the equitable sharing of available revenue amongst the national, provincial and local spheres of governments. The final one is what resources need to be allocated to capital spending in a way that is consistent with the answers to the first two questions. Despite the centrality of cost efficiencies to this and considerable amounts of work and interest that have been devoted to it, providing a comprehensive and directly available measurement of public sector costs, for a large number of countries and time periods, remains an incredibly difficult challenge.

(c) There are at least two conceptual approaches to deriving the cost of providing provincial, local government and national government services: the so-called costed norms method proposed by the Commission in 2001 which entails estimating the average cost of providing a particular service. A second approach is to estimate a 'cost function' for each nationally, provincially and local government provided service. Cost functions are widely used in economic analysis and for given costs of inputs define the minimum cost of producing various levels of output.

5.2 Practical Examples of Where Greater Cost Efficiencies can be Achieved

(a) Public sector wage bill and productivity: One of the avenues to contain expenditure growth without compromising growth is the public sector wage bill. Public sector wages continue to grow above inflation over the medium term, albeit at a slower rate. In general, the Commission welcomes the firmer stance taken by government in enforcing discipline in the hiring of new employees and to maintain staff levels over the medium term, as they are in line with the Commission's recommendations

for the 2014/15 Division of Revenue. However, it remains important that government productivity and service delivery remains the core of its recruitment policy such that frontline staff core to service delivery are prioritised over general administrative positions. The size and sustainability of the public sector wage bill would continue to be a concern if core service delivery employment were not prioritised during this period. The Commission is of the view that norms for frontline versus administrative staff to total expenditure per sector and/or by specific occupational categories are of critical importance. The treasuries and sector departments as well as the Department of Public Service and Administration should collaboratively establish mandatory norms and standards relating to the functions of the public service, the organisational structures and establishments of department and other organisational and governance arrangements in the public service as required by Public Service Act (1994). In addition, there should be consequences for accounting officers who recruit outside of their approved establishment. Further to this, the Commission, in collaboration with the Public Service Commission (PSC), is currently undertaking research focused on the issue of public sector productivity. It is intended that recommendations emanating from this research will be tabled as part of the Commission's annual submission in May 2015.

(b) Reducing waste and duplication: Elimination of waste will require stronger governance practices. Reducing fruitless and wasteful expenditures, which contribute to rising inefficiency and unproductive expenditure, is critical in this regard. As noted in the Commission's Submission on the 2013 MTBPS, over the period 2008/09 to 2011/12, over R5 billion worth of fruitless and wasteful expenditure was recorded across the three spheres of government. This gives a slight indication of the level of inefficiencies currently inherent in the public sector. Elimination of unnecessary duplication is required to ensure that scarce financial and human capital resources are efficiently utilised to achieve social and development goals. With respect to this issue, vigilant oversight is required to ensure minimal duplication between existing and newly created departments. In this regard, the Commission welcomes the public expenditure reviews that is currently being undertaken jointly between National Treasury and Presidency and awaits the findings of these reviews. The Commission is undertaking a joint project with the Public Service Commission on Corruption in the public sector. The

Commission is intending to finalize this project in 2015 and will likely make recommendations in respect of this project as part of its submission for the 2016/17 Division of Revenue.

(c) Accurate cost estimates: In order to ensure greater efficiency in the use of scarce public resources requires more accurate cost estimates for services being delivered. In the case of local government for example, cost estimates are notoriously weak. Commission research has indicated that municipalities are essentially overspending on new capital formation and underspending on maintenance and renewal of existing infrastructure. The value add of Commission research in this area is the development of a model to cost basic services. The use of this tool can be advantageous to and enhance the oversight function in determining whether public resources are being used efficiently.

5.3 A Diagnostic Tool To Assist Identifying Cost Efficiencies

(a) The aim of this section is not to tell legislators *what* they should target as a priority, but rather *how they* should think of the concept of cost-efficiency in relation to fiscal policy and what questions they should ponder in order to build the appropriate policy and oversight agenda and, ultimately, reduce costs in a cost-effective manner.

(b) As expressed in the Commission's Submission on the 2013 Appropriation Bill, appropriate policies are almost always context specific. The prioritisation and sequencing of reforms should be designed in order to accommodate each jurisdiction's specificities. The prime determinants of fiscal costs matter, and a diagnostics framework could help legislators identify them in the specific circumstances of their oversight work.

- The conceptual advantage of a diagnostics approach is that it gives priority to identifying the most *binding* constraints, or, more precisely, the ones binding disproportionately, the ones whose relaxation will bring the biggest returns. At their core is the identification of what we called the "primary" or "underlying" causes of costs.

(c) The "costs diagnostics" approach can be summarised in the following sequential quest*ions:*

- *What* is the underlying source of costs?

- *Where* it is *primarily* and most heavily located in the fiscal system 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 downstream/upstream links?
- *How* much is the cost factor dependent on other policies?

(d) This diagnostics approach proposes a pragmatic tool that the Committee can use to identify the most binding barriers to service deliv*ery and* prioritise policy reforms meant to reduce costs. Such prioritisation needs to account for the inter-dependences between all cost factors and between jurisdictions policies in a context of fragmented supply chains, and should be revised according to jurisdiction resources, institutions and implementation capacities. It is crucial that costs are not only measured but well managed. To this end, proper human resource management and development is important for ensuring quality and productivity improvement.

6. CONCLUSION

6.1 The underlying message from the Commission's analysis is that while resources are generally efficiently allocated to priority areas, in order to positively contribute to the lives of all South Africans, Government needs to improve the impact of spending programmes.

6.2 The most important administrative issue regarding the 2014 Appropriations Bill is that it is being considered subsequent to the 2014 elections. To ensure stability and alignment to what was proposed and developments subsequent to the elections, such as the establishment of additional national departments, the proposal to revive the Bill with allocations to Votes remaining unchanged is supported as an interim measure leading up to the next Adjustments Bill.

6.3 Within the confines of lower growth and measures to strictly contain costs, strategies included in the NDP to: improve sustainable economic growth, foster a less adversarial relationship between business and organised labour, place more focus on improving small business development, increasing infrastructural investment and building a capable state premised on adequately skilled capacity of the public sector to implement projects and strategies to reduce corruption, must be supported.

For and on behalf of the Financial and Fiscal Commission

Mr. Bongani Khumalo

Acting Chairperson/CE