Financial and Fiscal Commission: Submission on the 2012 Medium Term Budget Policy Statement

For an Equitable Sharing of National Revenue

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List of Acronyms

AFCON	Africa Cup of Nations
BAU	Business as usual
CPI	Consumer Price Index
ECD	Early Childhood Development
EMS	Emergency Medical Services
EU	European Union
FET	Further Education and Training
GDP	Gross domestic product
GFIP	Gauteng Freeway Improvement Project
HSDG	Human Settlements Conditional Grant
ICS	Improvement of Conditions of Service
LES	Local Government Equitable Share
MBAPRMA	Money Bills Amendment Procedure and Related Matters Act of 2009
MDG	Millennium Development Goals
MFMA	Municipal Finance Management Act
MIG	Municipal Infrastructure Grant
MISA	Municipal Infrastructure Support Agency
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
MYPD	Multiyear price determination period
NDP	National Development Plan
NHI	National Health Insurance
NGP	New Growth Path
NGOs	Non-governmental Organisations
OSD	Occupation Specific Dispensation
PES	Provincial Equitable Share
PFMA	Public Finance Management Act
PSC	Public Service Commission
RHIG	Rural Households Infrastructure Grant
SMEs	Small- and medium-sized enterprises
SADC	Southern African Development Community
SANRAL	South African National Roads Agency Limited
SARB	South African Reserve Bank
SIP	Strategic Integrated Project
USDG	Urban Settlements Development Grant

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1. Background

1.1. This submission on the 2012 Medium Term Budget Policy Statement (MTBPS) is made in terms of Section 4 (4c) of the Money Bills Amendment Procedure and Related Matters Act (MBAPRMA)(2009), which requires Committees of Parliament to consider the Financial and Fiscal Commission (the Commission)'s recommendations when dealing with money bills and related matters. The Submission is also made in terms of Part 1 (3) {1} of the Financial and Fiscal Commission Act (2003) as amended, which provides for the Commission to act as a consultative body for and to make recommendations to organs of state in the national, provincial and local spheres of government on financial and fiscal matters.

1.2. The 2012 MTBPS is divided into four chapters which cover the following areas:

- Chapter 1: Levers of Development: Opportunities and Challenges
- Chapter 2: Economic Outlook
- Chapter 3: Fiscal Policy and Trends
- Chapter 4: Medium Term Expenditure Framework and Division of Revenue

1.3. This Submission presents responses by the Commission to the 2012 MTBPS. These responses are made taking into account the major macroeconomic developments and also address in more specific terms the following areas: (i) the spending priories of government for the next three years; (ii) the proposed division of revenue among the spheres of government and among arms of government within a sphere for the next three years; (iii) the proposed substantial adjustments to conditional grants allocations to provinces and local government if any; and (iv) a review of actual spending by each national department and each provincial government between 1 April and 30 September of the current financial year.

1.4. Overall the Commission supports the main themes in the 2012 MTBPS. The Commission is also of the view that growth and employment in South Africa can only be achieved through a combination of fiscal consolidation and investment into future growth given the prevailing economic climate. The poor and vulnerable must be cushioned through effective and expanded use of social expenditure, while at the same time taking into account the difficult economic context and pressure on national budgets, i.e. the sustainability of the programmes. This can contribute directly to growth and jobs especially when taken in tandem with interventions devoted to job-friendly growth. Programmes aimed at research, competitiveness and innovation have been given particular emphasis. The Commission also fully endorses Government's intention to intensify initiatives to combat waste, inefficiency and corruption and welcomes Government's continued effort at developing a long-term fiscal report that assesses the sustainability of spending options in light of demographic and economic projections. It should be noted that the Government has already published some fiscal guidelines (countercyclicality, debt sustainability and intergenerational equity) as well

as agreed with the Commission that given the uncertainty of economic projections a low, medium and a high-economic growth scenario should be reported. This will be helpful for preparers and users of these important reports.

2. Macroeconomic and Fiscal Outlook

2.1. **General economic outlook:** South Africa's economy remains vulnerable to slow global recovery as well as to domestic factors such as the recent labour unrest. The announcement of a downward revision of the economic growth figure from 2.7% to 2.5% by the Minister of Finance presents a further challenge to the achievement of the targets set out in the New Growth Path (NGP) document, most notably a decrease in the unemployment rate by 14% by 2030. The average economic growth rate of 7% cited by the NGP as necessary to achieve this target grows with each year that South Africa records sluggish economic growth rates, so that the future economic growth trajectory for South Africa necessitates considerable back-loading (which may be unrealistic).

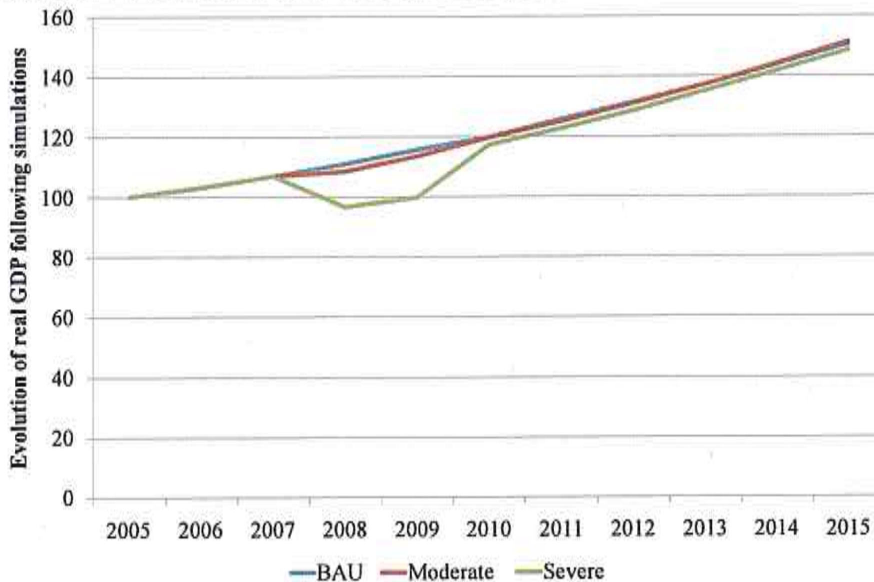
1. In its 2011 response to the MTBPS, the Commission reported its GDP simulations under three scenarios: business as usual (BAU)[1], moderate[2] and severe[3] scenarios (see Figure 1 below). The Commission noted that without positive shocks as well as deliberate interventions to counteract the negative impacts of the world economic crisis, South African gross domestic product (GDP) will not recover to the BAU levels. It now seems that South Africa is tracking the then pessimistic scenario, further exacerbated by severe industrial action as well as the global economic growth that is lower than expected.

[1] Business as usual, in macroeconomic terms, in the context of this submission, is the natural trend of the economy and economic policy.

[2] The moderate scenario is consistent with the view that growth begins to pick up, albeit moderately, from the end of 2009 onwards.

[3] A severe scenario reflects a protracted slow global growth era and implies tight public budgets for some time to come.

Figure 1: Evolution of real GDP in BAU, moderate and severe scenarios



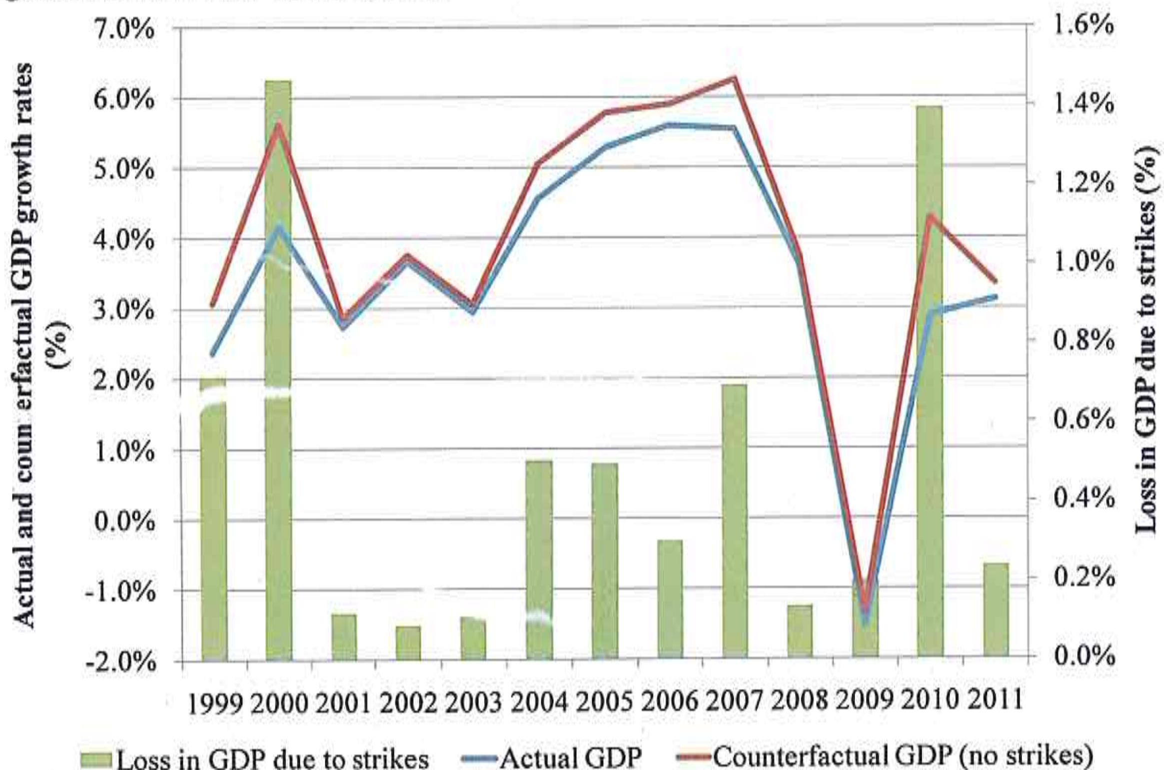
Source: Commission's calculations.

2.2. **Sectoral contribution to GDP**: The largest average contributions to real GDP growth over the period 2009Q1-2012Q2 have been; (i) general government services, (ii) finance, real estate and business services, as well as (iii) wholesale, retail and motor trade, catering and accommodation (Statistics South Africa, 2012). Most volatile contributions to real GDP growth over the 2009Q1-2012Q2 period (i.e. since the global economic crisis) have come from the mining and quarrying and manufacturing sectors (Statistics South Africa, 2012[4]). Historically, these have been the sectors most affected by strikes (when considering the data on work days lost and the number of workers involved in strikes provided by the Department of Labour). The recent strikes in the mining industry are also expected to have a negative impact in the mining sector's contribution to GDP growth for 2012Q3. It should be noted that mining and quarrying as well as the manufacturing sector have been shrinking for much of the past decade. Given that they constitute important contributions to South Africa's export sector and labour absorption, developments in these sectors should be closely monitored by the Government, particularly over the medium term. In addition, given that performance of South African exports to the European Union (EU) has been declining considerably since 2010 while exports to Southern African Development Community (SADC) and China have been steadily increasing over the same period (2012 MTBPS), more aggressive export promotion and/or targeting strategies may be appropriate in order for Government to capitalise on the positive growth prospects of these regions.

[4] Statistical Publications, online at www.statssa.gov.za.

2.3. **The impact of strikes on GDP**: Calculations by the Commission[5] indicate that since 1998, the average loss in GDP due to strikes has been about 0.5%. Figure 2 illustrates how the scale of strikes is damaging to economic growth in South Africa and that perhaps Government should consider a greater level of (or quicker) intervention and/or an objective review of the labour laws and other elements pertaining to the effective operation of the collective bargaining system. In support of this recommendation, it should be noted that 2012 MTBPS reports that the total value of production lost to platinum and gold mining strikes and stoppages since the beginning of this year has been around R10.1 billion, which is already about 0.3% of projected GDP for 2012.

Figure 2: Loss in GDP due to strikes



Source: Commission's calculations.

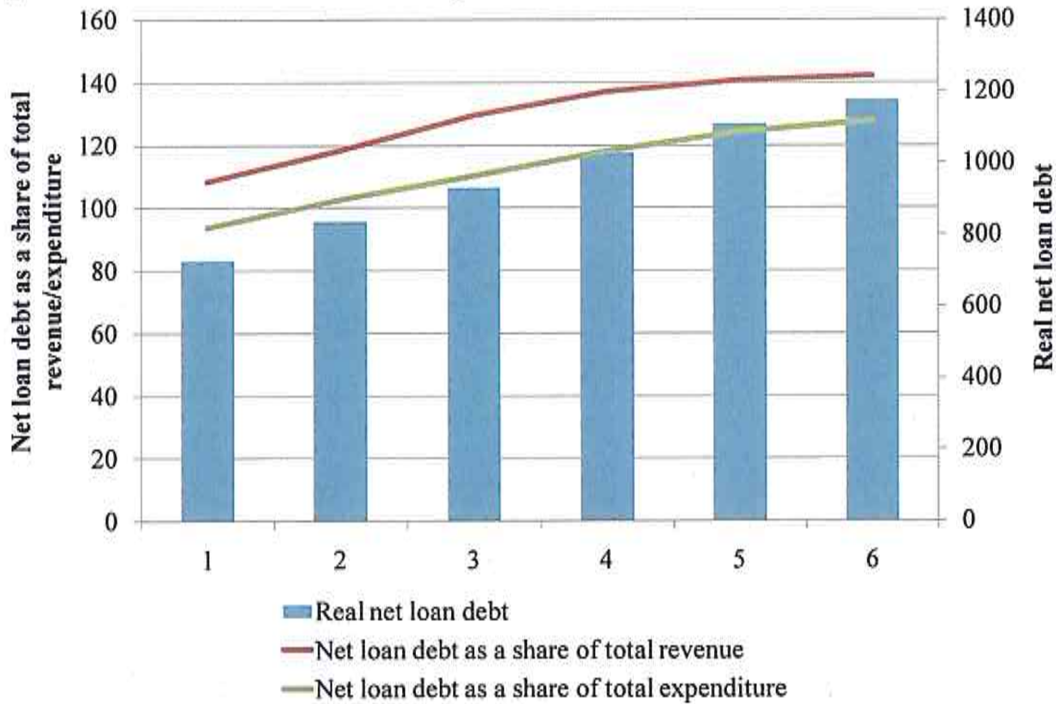
2.4. **State debt**: In terms of all relevant measures, state debt (adjusted for inflation) in South Africa is increasing – that is, in absolute real terms, as a percentage of total expenditure, or as a percentage of total revenue (see Figure 3). Increases in the state debt as a percentage of total revenue (which can loosely be interpreted as the debt

[5] Annual data from Department of Labour on average work days lost and the number of workers involved in strikes was used. Actual GDP growth rate was calculated using historical GDP data obtained from the South African Reserve Bank (SARB). The counterfactual GDP was calculated using a simple production function using capital and labour data also obtained from SARB (the labour data in the counterfactual GDP calculation assumes that no strikes took place during that particular year). The loss in GDP due to strikes is calculated as the difference between the actual and the counterfactual GDP growth rates.

service ratio), generally imply that expenditure increases are being financed by debt. Figure 4 compares the real gross loan debt with the growth in real state debt costs. The former is increasing while the latter is decreasing, thus indicating the debt restructuring efforts of Government through the switch programme[6] which was announced during the 2012 budget. The Commission notes that while such actions reduce the current debt burden and limit the consolidation measures that are imposed on South African citizens, slowing economic growth may put pressure on Government to extend its switching programme. Refinancing near-dated debt with longer term maturity bonds is likely to put pressure on bond yields as investors will likely seek to be compensated for increased risks associated with deteriorating economic conditions and a wide budget deficit. Hence, although South African bonds are currently still over-subscribed, extending the duration of public debt combined with higher yields could result in increased costs for Government in the future. This is further exacerbated by the recent downgrading of South Africa's sovereign credit rating which may also negatively affect the longer term prospects of debt sustainability in South Africa as it is likely to result in higher costs of borrowing due to negative investor perception.

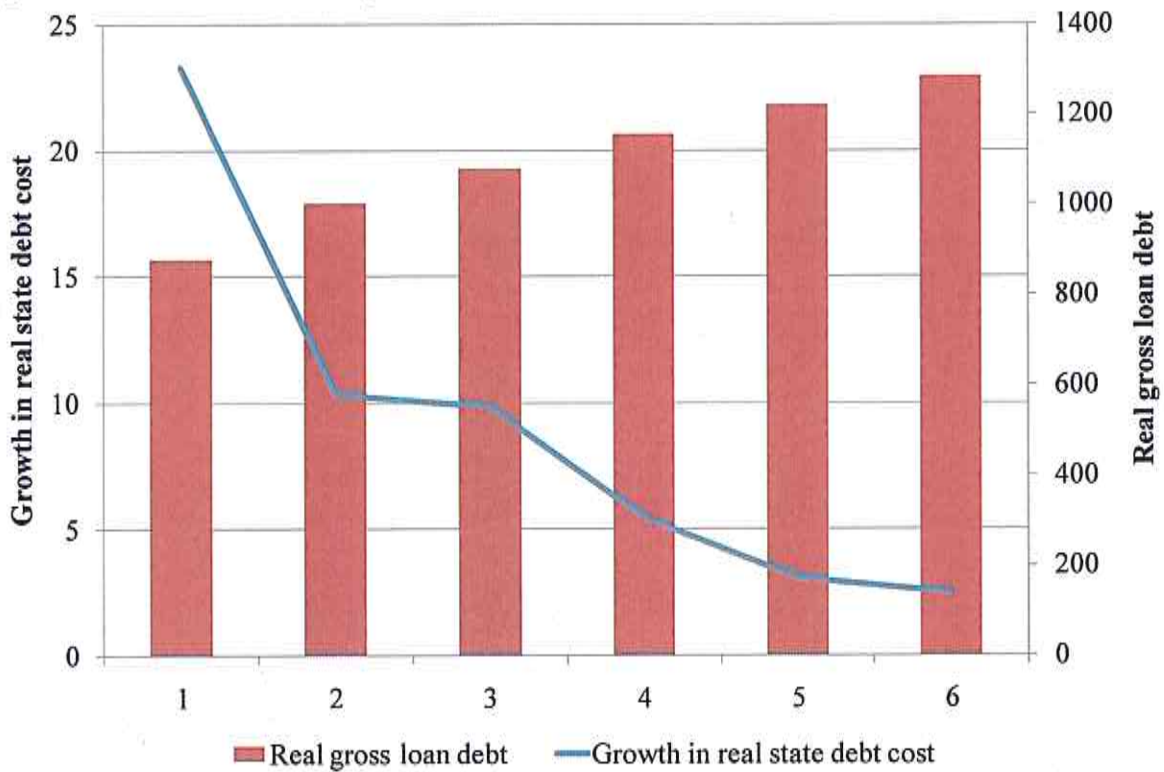
[6] Switch programme entails the exchange of near-maturing bonds for longer dated debt in order for Government to manage redemptions.

Figure 3: State debt: share of total expenditure and revenue



Source: Commission's calculations.

Figure 4: Gross loan debt and growth in real state debt cost



Source: Commission's calculations.

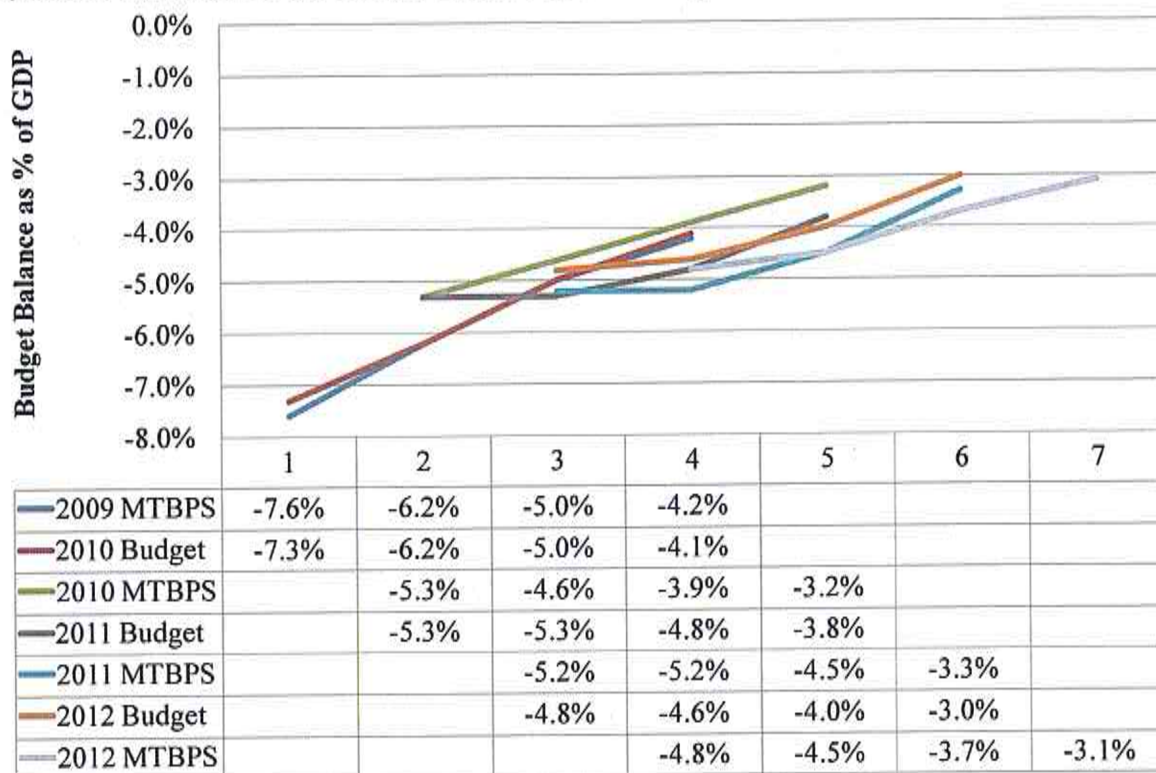
2.5. **Fiscal consolidation**: The Commission believes that South Africa should continue on the path of gradual fiscal consolidation. Renewed deceleration in global economic growth presents substantial uncertainties and downside risks to South African economy. This, combined with the narrowing fiscal space, further indicates the need to rebuild fiscal buffers which helped to moderate the effects of the 2008/09 recession through Government having the necessary fiscal space to act in a countercyclical manner. The Commission also notes that the demands on the South African budget are already significant (for example, spending on the public sector wage bill and on the social wage) and some are unpredictable (for example, financial support to the state-owned enterprises), so that the achievement of a growth-friendly fiscal consolidation will involve some difficult choices in the future. As noted in the Commission's past recommendations, a successful fiscal consolidation requires decisions on what components of the budget need to be consolidated as well as the pace in which to achieve fiscal consolidation. In this regard, the Commission welcomes the proposed expenditure reprioritisation and also supports Government efforts at imposing hard budget constraints aimed at obtaining maximum impact and quality of expenditure.

1. A credible commitment to fiscal consolidation (within the framework of fiscal guidelines) is also necessary to ease the frequency of sovereign debt downgrades as Government demonstrates its ability to control spending pressures.

2. The Commission would like to note that fiscal consolidation is not the only factor to consider in South Africa's public finance management. Public governance and accountability measures are of paramount importance to achieving the outcomes outlined in national policies such as the NGP and the National Development Plan (NDP). In this regard, the Commission welcomes Government's intent to combat waste, inefficiency and corruption and notes that the Public Finance Management Act (PFMA) and the Municipal Finance Management Act (MFMA) make special provisions to deal with issues related to waste, inefficiency as well as corruption, and that these provisions should be enforced where applicable. The Commission also supports efforts at strengthening the role of the Public Service Commission (PSC) in this regard.

3. What Figure 5 shows is the slowing-down of fiscal consolidation since 2009 and how South Africa is unlikely to achieve -3% budget balance as percentage of GDP over the medium term (it should be noted that -3% budget balance as a percentage of GDP was a medium-term goal reported in the 2010 MTBPS as indicated by the green line in Figure 5). Hence, while Government reiterates its commitment to fiscal consolidation in the 2012 MTBPS, the pace of South African fiscal consolidation may be too slow, thus potentially undermining the credibility of Government's plans, particularly in the eyes of the international community.

Figure 5: Projections of the Budget Balance as Percentage of GDP Since 2009



	1	2	3	4	5	6	7
2009 MTBPS	-7.6%	-6.2%	-5.0%	-4.2%			
2010 Budget	-7.3%	-6.2%	-5.0%	-4.1%			
2010 MTBPS		-5.3%	-4.6%	-3.9%	-3.2%		
2011 Budget		-5.3%	-5.3%	-4.8%	-3.8%		
2011 MTBPS			-5.2%	-5.2%	-4.5%	-3.3%	
2012 Budget			-4.8%	-4.6%	-4.0%	-3.0%	
2012 MTBPS				-4.8%	-4.5%	-3.7%	-3.1%

Source: National Treasury.

2.6. **Energy prices:** Eskom has submitted its third multiyear price determination period (MYPD) application to the energy regulator, in which it is requesting average yearly tariff increases of 16% for the five-year period from April 1, 2013, to March 31, 2018. While Eskom has not received the price increases initially requested, there are fears that if such enormous price requests are granted, they may destabilise the macroeconomic forecasts. How does one make sense of this, in a context where the MTBPS and indeed Government policy points out correctly that there is an urgent need to address the challenges of a recessionary economy, unemployment and poverty?

1. Most of the discourse on electricity price application views it in negative light because the focus is exclusively on one aspect, namely pricing and consequences on consumption. On the face of it, Eskom's plan to increase electricity prices seems unreasonable, particularly given the economic pressures felt by households and businesses (for example, increasing food prices, continuous petrol price hikes and the already high level of indebtedness by households) as well as the knock-on effects to other administered prices such as transport and health costs.

2. However, there is also another equally important aspect linked to the application, namely the investment aspect that the resultant revenues from the price increase would be used for. Taking both the investment and pricing aspects simultaneously, the Commission considered the pricing of electricity and its generation, as well as investment in light of the current reforms in electricity pricing and infrastructure expansion. The Commission model considers the impact that these changes (pricing and infrastructure expansion) will have on the economy. The impact on economic growth is minimal. When it comes to employment, the results indicate that this will result in both a positive change in employment of 0.2 percentage, and a decrease in unemployment of 0.17 percentage points. The most important channel through which this expansion in infrastructure translates into employment growth is through increased demand in investment products. Although the results show that overall employment is likely to increase as a result of the infrastructure expansions, the employment prospects of the poor (low skilled workers) are unfavourably affected.

3. The need to develop much needed new generation capacity and effective distribution of electricity is a costly reality necessary to lower the cost of doing business and to attract foreign direct investment, both of which are likely to positively impact job creation, thus benefitting the poor. But sharply rising electricity costs and prices will have a significant impact on the welfare of poor households. It is important to re-emphasise that there is still no agreed upon tariff application as yet. The final number may end up lower than 16%, with less negative impacts on poor households. At the same time, the increase applied for might have to be revised upwards in the event that government agrees to build a nuclear power station and pursue the long-term Integrated Resource Plan (IRP) incorporating widespread introduction of renewable energy. The Commission thus calls for a balanced approach to the proposal. The Commission also calls for strengthening of existing interventions such as (a) the electrification grant (by increasing pace of new connections and spending effectiveness), (b) Free Basic Electricity grant (widening reach of the benefit) to cushion the poor and (c) demand side management.

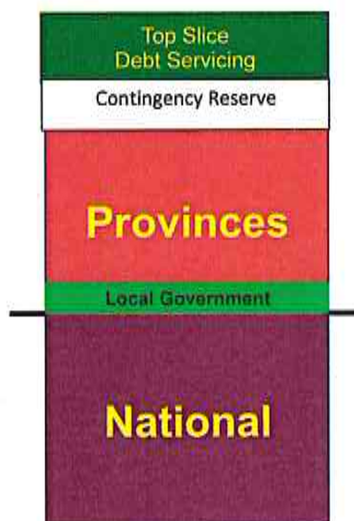
4. It is important to note that the Eskom tariff increases on electricity generation will have an impact as a cost pressure on the distribution of electricity. In this regard, local government is mandated for the distribution of electricity, which also constitutes a significant revenue source for municipalities. Electricity bulk purchases (through the generation and transmission of electricity) constitute approximately 67% of the total cost of distributing electricity. Therefore, Eskom's proposed increases are likely to put a pressure on the cost of providing electricity for municipalities. Consequently, the division of revenue would need to be sensitive to this additional cost pressure for municipalities, especially in the provision of Free Basic Electricity to poor households. In addition, municipalities generate a substantial revenue surplus from providing

electricity through the imposition of municipal surcharges. Such surcharges are important for cross-subsidising electricity provision to poor households as well as other, less revenue-buoyant, services. Although such surpluses allow for municipalities to partially cushion the large Eskom increases on the bulk tariff, they also result in pressure on municipal own revenues in supporting the provision of other services.

3. Fiscal Frameworks and Proposed Division of Revenue

3.1. The total appropriated expenditure for a given financial year comprises all government revenues, including revenues generated from taxation and debt incurred. This revenue supports all government expenditure and ultimately informs the division of revenue among the three spheres of government. However, prior to the division of revenue process, funds are "top sliced" from total government revenues to pay for the costs of government debt and to support a contingency reserve. The contingency reserve aims to protect the country in instances of unforeseen or unavoidable expenditures that may arise during the financial year as well as to support pivotal Government policy decisions that may also arise. Once these two expenditure items are accounted for, the remaining funds are available to inform the division of revenue process.

Figure 6: Vertical division of revenue



Source: Commission.

3.2. Deteriorating external economic conditions exacerbated by internal strife in the labour markets resulted in a downward revision of revenue by R5 billion and a higher than projected budget deficit. Table 1 below compares the medium term expenditure

framework (MTEF) estimates in the 2012 Budget with estimates in the 2012 MTBPS. The fiscal framework for the whole of government is revised upwards by R27 billion over the MTEF. Average annual real growth in total allocations increases from 1.94% in the 2012 budget to 2.44% in the 2012 MTBPS. Government is expected to spend R2.8 trillion over the MTEF period, with the national sphere making up 47% of total allocations followed by provincial government at 44%. Local allocations remain the lowest at R254 billion, but are expected to grow faster than the other spheres at 5% in real terms per annum over the MTEF period. Government should be commended for exercising fiscal prudence and managing the sustainability of the fiscal framework, despite pressures from higher unanticipated wage bargaining agreements, carry through costs of Occupation Specific Dispensation (OSD) and constrained resource envelope due to worsening economic conditions. The Commission agrees with Government's planned efforts to restrict real growth in public spending below the rate of GDP growth by 2014/15 but emphasizes the need to simultaneously improve the quality and developmental impact of public spending. Furthermore, cuts should be made such that core services as well as repairs and maintenance expenditure are protected and not compromised.

Table 1: Medium Term Expenditure Framework Division of Revenue

Division of Revenue	**Total (2012/13 - 2014/15)**		**Av. Annual Real Growth Rate**	
	2012 Budget	2012 MTBPS	2012 Budget	2012 MTBPS
National Allocations	1337.4	1340.0	2.29%	2.49%
Provincial Allocations	1232.6	1254.0	1.05%	1.90%
Equitable Share	987.4	1006.0	0.83%	1.63%
Conditional Grant	245.3	249.0	1.99%	2.99%
Local Allocations	251.9	254.0	4.63%	4.99%
TOTAL	2821.9	2848.2	1.94%	2.44%

Source: 2012 MTBPS, Commission's calculations.

3.3. The 2013/14 provincial fiscal framework is revised upwards by R26.1 billion to mainly cater for inflation amounts related to Improvement of Conditions of Service (ICS) and continued support to the carry through cost of OSD. The provincial equitable share (PES) adjustment is revised slightly from the allocations received through a re-prioritisation exercise by an additional R21.3 billion. This revision brings the PES to a proposed R335.3 billion in 2013/2014. The provincial conditional grant framework is revised for inflation and a few policy adjustments resulting in an increase of 6.8 per cent, bringing its baseline to R82.7 billion in 2013/14.

3.4. A total of R276.8 billion is allocated to the local government fiscal framework over the 2013 MTEF (R84.5 in 2013/14, R91.6 in 2014/15 and R100.7 in 2015/16). This constitutes an average growth rate of 9% over the MTEF in nominal terms and a 4%

average growth in real terms. Revisions to baseline amount to R7.4 billion in total over the MTEF, with a R100 million adjustment for the current financial year. The local government equitable share (LES) is expected to increase by 4% in real terms over the period from an average 12% real increase in the three previous financial years. The sharing of the general fuel levy with metropolitan municipalities is expected to increase by 1% in real terms over the MTEF, with no real increase in 2015/16. The Commission commends Government for managing to increase allocations to local government given the current negative economic outlook and fiscal tightening measures in place. Municipalities must use such additions effectively and efficiently. The Commission has previously raised concerns over the nature and size of the vertical municipal fiscal gap. To this end, recent Commission research, through its public hearings on the review of the local government fiscal framework, indicates a significant fiscal gap on the capital budget of local government. In other words, the current funding framework intended to support the capital expenditure needs of municipalities, given the demand for local social and economic infrastructure, may not be sufficient. However, similar estimations suggest a minimal (negligible) fiscal gap on aggregate municipal operating budgets. The Commission is finalising the report on the public hearings and the results will be published shortly.

4. Medium Term Spending Priorities

4.1. Table 2 reports the average real growth rates of expenditure components. The average real growth rates for most expenditure components are fairly modest and close to or below 3% (which is the real annual growth rate required to achieve a balanced budget by 2015/16 according to the Commission's calculations). The exceptions include: (i) general public services, fuel and energy as well as communication which record average negative growth rates; and (ii) water supply, employment and social services as well as local government, housing and community amenities which record average growth rates of above 3% over the MTEF. In line with Government's reprioritisation strategy, categories with the highest growth rates are water supply, local government, housing and community amenities as well as employment and social security. The Commission welcomes these developments as well as Government's commitment to reprioritise expenditure in line with its commitment to fiscal consolidation

Table 2: Average real growth of expenditure components (functional classification)

	2012/13	2013/14	2014/15	2015/16	Average
General public services	-2.5%	-0.2%	1.3%	-0.7%	-0.5%
Defence, public order and safety	4.4%	1.7%	0.7%	0.8%	1.9%
Defence and state security	3.5%	1.1%	0.9%	1.0%	1.6%
Police services	4.0%	1.7%	0.8%	0.9%	1.9%
Law courts	6.9%	4.1%	1.3%	1.1%	3.4%
Prisons	5.8%	0.8%	-0.3%	0.1%	1.6%
Transport, energy and communication	1.0%	4.1%	2.7%	1.4%	2.3%
Fuel and energy	-15.4%	7.3%	6.0%	-8.2%	-2.6%
Transport	3.3%	4.4%	2.8%	2.4%	3.2%
Communication	2.8%	-16.4%	-13.5%	9.6%	-4.4%
Economic services	10.7%	2.4%	-0.3%	-0.5%	3.1%
Local government, housing and community amenities	5.6%	3.4%	3.8%	3.9%	4.2%
Housing development	6.1%	5.9%	0.5%	2.4%	3.7%
Local government and community development	5.6%	2.2%	2.4%	3.5%	3.4%
Water supply	4.3%	4.2%	11.3%	6.0%	6.4%
Health	0.9%	3.2%	2.0%	1.6%	1.9%
Social protection	2.2%	3.4%	2.2%	1.6%	2.4%
Education and related functions	1.9%	1.0%	1.9%	2.3%	1.8%
Employment and social security	13.3%	7.3%	5.5%	-1.1%	6.3%
Science and technology	2.6%	-2.3%	1.1%	-1.0%	0.1%

Source: 2012 MTBPS, Commission's calculations.

4.2. Table 3 below indicates that expenditure components' share in total expenditure is expected to stay fairly constant over the medium term. The three categories with the decreased shares over the medium term are: general public services, defence, public order and safety, as well as education and related functions. The latter is perhaps the greatest cause for concern as spending on education is one of Government's priority areas.

Table 3: Selected expenditure components (functional classification) share in total expenditure

	2011/12	2012/13	2013/14	2014/15	2015/16
General public services	5.4%	5.0%	4.9%	4.8%	4.6%
Defence, public order and safety	13.3%	13.4%	13.2%	13.0%	12.7%
Transport, energy and communication	8.1%	7.9%	8.0%	8.0%	7.8%
Economic services	4.0%	4.2%	4.2%	4.1%	3.9%
Local government, housing and community amenities	11.3%	11.5%	11.5%	11.7%	11.8%
Health	11.8%	11.5%	11.5%	11.5%	11.3%
Social protection	11.9%	11.8%	11.8%	11.8%	11.6%
Education and related functions	21.2%	20.8%	20.4%	20.2%	20.1%
Employment and social security	3.7%	4.1%	4.2%	4.4%	4.2%
Science and technology	1.3%	1.3%	1.3%	1.2%	1.2%

Source: 2012 MTBPS, Commission's calculations.

4.3. **Job Creation:** Similar to last year, much of the MTBPS this year has been about the need to ignite job creation. Government acknowledges in the 2012 MTBPS that active labour market policies are central to improving employment potential. There are proposals made to accommodate the amended labour legislation. Government also proposes supplementary funding for maintaining factories providing jobs for disabled workers, expansion of employment opportunities through public works and special employment programmes (including expanded public works projects and community work programmes). The Jobs Fund will receive over R5.5 billion over the MTEF period although initial allocations made to it have been reduced, with Government citing slow progress in establishing administrative capacity as the reason. Hence R1 billion has been shifted from the Jobs Fund allocation towards other labour-market priorities. Government has now made many proposals to stimulate job creation that include promoting education and skills development, the Manufacturing Competitiveness Enhancement Programme, the Jobs Fund, a Youth Subsidy, the Community Works and Expanded Public Works Programmes and the investment infrastructure programme. With respect to the expanded infrastructure expenditure plan, the Presidential Infrastructure Coordinating Commission has identified 17 Strategic Integrated Projects (SIPs) and these provide an overarching set of infrastructure priorities for South Africa. The SIPs combine investments in economic and social infrastructure aimed at unlocking economic potential, improving the competitiveness of the country and addressing backlogs in access to basic services. The SIPs cover all nine provinces with emphasis on poorer provinces. Despite this raft of proposals, the response to date has been muted from business and labour. Unions on the one hand often simply champion high wage demands and business on the other hand often simply champion small businesses as the key to job creation without responding directly to these proposals. The Commission's recommendations for 2013 call for interventions to address this 'prisoner's dilemma' scenario, which is currently

preventing realization of a coordinated social compact among the role players who can influence employment. It calls for accounting officers to take responsibility for their supply chain management processes and use these systems to maximise efficiencies in procurement to create jobs and the Department of Performance Monitoring and Evaluation to assist in monitoring government performance in this regard.

4.4. **Education**: The MTEF allocation for education increases from R666.5 billion to R704 billion (see Table 4 below). In real terms, average annual real growth rises from 1.13% to 3.21%. The increase in funding is largely to cover the cost of wage settlement but also to improve the delivery of school infrastructure and quality of education for learners from poor backgrounds. An important consideration going forward should also be the associated operational costs of school infrastructure such as the safeguarding, maintenance and operation of school infrastructure. The Commission calls for a proper funding model that will identify revenue streams to fund these operational expenses.

1. The Commission agrees with the sentiment that improving education outcomes is one of the main drivers to long-term economic growth. The Commission notes with concern though, most schools do not have conditions required for the effective attainment of learning outcomes. This is evidenced by the significant challenges in terms of literacy and numeracy attainment by learners which impacts learners from disadvantaged backgrounds disproportionately[7]. Further, a significantly high proportion of children who suffer from disabilities are not succeeding in accessing education. In its 2012/13 Division of Revenue submission, the Commission called for input-output norms to be established to give effect to inclusive education for intellectually disabled children.

2. Furthermore, the issue of fiscal consolidation in provinces such as Limpopo raises concerns about capability losses from indiscriminate cutting of education expenditure such as delayed or decreased funding to schools. The Commission calls for circumspection in the way cost cutting takes place in education and retrogressive spending to achieve fiscal discipline should not be done at the expense of targeting easy options (e.g. training and capacity building of educators) while having a negative impact on educational outcomes.

[7] The Annual National Assessment by the Department of Basic Education revealed that the most common score pupils achieved were below 20%.

Table 4: Medium Term Expenditure Framework Allocations to Social Sector

Social Sector	Total (2012/13 - 2014/15)		Av. Annual Real Growth Rate	
	Budget 2012	2012 MTBPS	Budget 2012	2012 MTBPS
Education	666.5	704.0	1.13%	3.21%
Health	381.8	395.0	1.85%	2.07%
Social Protection	513.8	396.0	3.22%	-4.28%
TOTAL	1562.1	1495.1	1.93%	0.45%

Source: National Treasury (2012), Commission's own calculations.

4.5. **Health**: The allocation for health increases marginally over the MTEF going from R381.8 billion to R395 billion, representing a 0.2% annual average real increase. Provinces received a revised allocation of R366 million for health infrastructure, with R180 million going to the health infrastructure grant and R188 million to the hospital revitalization grant. The increased allocation is also as a result of a new conditional grant for the National Health Insurance (NHI) and nursing colleges. With very little fiscal space to expand expenditure, the Commission commends Government for its intention to improve value for money spending on health-related activities over the MTEF period. The Commission, though, notes with concern the quality of health care in the wake of fiscal consolidation in provinces that puts salaries as a first claim on the fiscus above medicines and the maintenance and upkeep of medical equipment. The Commission also calls for the tightening of monitoring and oversight mechanisms on procurement practises in Health Departments to prevent irregular and fruitless and wasteful expenditure from taking place as evidenced in some provinces where hi-tech health equipment is purchased without any service plan which subsequently has to be replaced when it broke down. In other cases, operational procedures cannot take place because broken equipment which is needed for operations cannot be fixed because no funds are available as a result of fraudulent and corrupt procurement practises in some provincial Health Departments. The Commission reiterates the recommendation it made in the 2012/13 Division of Revenue submission that human resource, financial management and procurement should be devolved to hospital management to boost efficiencies and boost performance. The Commission also calls on Government to establish norms and standards that will define the level of service that should be expected at a well-functioning public hospital system.

1. Prioritisation of health Millennium Development Goals (MDGs) (tuberculosis and HIV and AIDS) proposed in this year's MTBPS is in line with the recommendations and findings of the Commission from 2011 as is the continued emphasis by Government on the need to achieve greater efficiencies and cost-savings for reprioritisation. With regard to NHI, the Commission awaits the results of the pilots that are currently under way. The Commission further welcomes Government announcement in the 2012 MTBPS that the long-term fiscal report will model the impact of the introduction of NHI

proposals as part of its work. The number of medical personnel is one of the major cost drivers on the health budget. Although the forecasted numbers are expected to fall, it is the Commission's view that infrastructure upgrades and development of health facilities, including the phased introduction of the NHI, will create a demand for medical personnel. The fiscal impact of a bourgeoning medical fraternity must be carefully considered against available resources, especially in the context of slow economic and revenue growth.

4.6. **Social development**: With respect to social development, the main proposal in the 2012 MTBPS is to reprioritise funds already in the baselines towards strengthening selected child welfare programmes, improve the South African Social Security Agency's infrastructure and systems, as well as to employ additional social workers. The budget will also provide for the recruitment of graduates from the social worker scholarship programme, support non-governmental organisations (NGOs) in social development and for facilitating a more equitable funding model for these organisations. The baseline allocation for social development decreased significantly going from R513 billion in the 2012 budget to R396 billion in the MTBPS. This represents a real drop in average annual growth from 3.2% to -4.3%. The Government has stated that it has identified savings of R450 million per year as a result of the new grants system. It is noted that some of these funds will be used to improve the infrastructure and systems employed at the South African Social Security Agency and to employ the 5000 graduates from the Social Worker Scholarship Programme. Whilst administration costs are expected to fall by 5%, grant beneficiaries are expected to increase from 16.1 million to 17.3 million over the next three years. Despite all of these adjustments, the Commission would like greater clarity from Government on what accounted for the R117 billion downward adjustment of the social development budget over the MTEF period.

1. The Commission's view is that these proposals are worth pursuing but in the context of reforms to resolve more structural issues in the sector. These issues include guaranteeing an effective support/supervision mechanism, ensuring integrated planning of the services rendered by the Department of Social Development and the NGOs involved.

2. Although Government has indicated a commitment to give attention to NGOs, the Commission observes with concern how provincial departments of social development are internally prioritizing away from transfers to NGOs to cost of employment and goods and services. The downward adjustment of transfers to NGOs will further push NGOs, who are already struggling to survive financially, into a crisis. Furthermore, NGOs are implementing agents of departments and as such fulfil important legislative obligations of the Government. The Commission is therefore not in favour of these cuts, especially in the context of the new Financial Awards Policy developed by the Department of Social Development in response to the Free State court judgement that seeks a fair and equitable way of allocating resources to NGOs.

The progressive realization of rights contained in the Bill of Rights for specific target groups (e.g. children) may be compromised by these cutbacks. In addition, with Early Childhood Development (ECD) services a government priority, the implementation of ECD services may be negatively impacted by the reduction in transfers to NGOs, especially as these are meant to play a major role in the up-scaling of ECD services in communities.

5. Proposed Adjustments to Conditional Grants

5.1. For the 2013/14 MTEF conditional grants to provinces are revised upwards by 7.1% amounting to R23 billion in additions to baseline to cover increases for education infrastructure, higher distribution of condoms and antiretroviral medicines. Adjustments will be made in the further education and training colleges' conditional grant (to cover wage agreement costs) and education infrastructure grant (to improve school infrastructure). Further additional resources are allocated to the Comprehensive HIV and AIDS grant to compensate for withdrawal of United States donor funding on HIV/AIDS prevention, and to provide for higher take-up rate in antiretroviral medicines and increased condom distribution. The human settlement development grant is also set for upward adjustment to deal with informal settlement upgrading.

5.2. Local government conditional grants are increased by R111.6 billion over the MTEF. This constitutes an average nominal growth rate of 10% over the MTEF and an average real growth rate of 4%. Local government conditional grants are being reformed in order to (i) prepare for the devolution of the human settlements and public transport functions to urban municipalities, (ii) help municipalities deliver clean drinking water to households, (ii) expand the integrated national electrification programme, and (iv) subsidise refurbishment projects to minimize wastage of water and electricity.

5.3. **Infrastructure**: Efficient and timely delivery of quality infrastructure continues to be problematic owing to deep seated challenges of poor planning, capacity and under-spending by provincial government departments. To circumvent these long-standing problems, the 2012 MTPS is proposing reforms for provincial infrastructure conditional grants with the intention of moving away from an allocation framework that is entitlement-based to a demand-led approach. The proposed approach requires provinces to bid for infrastructure grants two years in advance, and only makes allocations subject to meeting set criteria and demonstrating capacity to spend and/or implement. The approach also has a built in reward system which enables provinces to bring forward part of their outer year allocations. For the Commission, any reforms that intend to improve the performance of infrastructure conditional grants is a welcome development. In its 2011/12 Submission, the Commission made calls for the

review of conditional grants emphasising the need for linking allocations to performance, incentives, administrative accountability, regular evaluations and sunset clauses.

1. While the spirit within which proposed reforms are introduced is supported, the Commission makes cautionary remarks on the potential unintended effect of the new allocation framework in entrenching inter-provincial inequities. Effectively, a capability driven allocation framework distorts the corrective mechanism of national transfers in addressing jurisdictional disparities. Generally, and perhaps in contrast to rational expectations, provinces whose infrastructure grant performance is sub-optimal tend to be those with lowest socioeconomic attributes and high infrastructure needs. Given the likelihood that infrastructure resources may be diverted away from needy provinces, as predicated in public sector game theory models, the new approach must be introduced with circumspect. One way to do this is by way of making provision for minimum infrastructure allocations (average spending on infrastructure grant) for provinces with impaired capabilities over a given period, allowing them to build required capacity. Alternatively, the Commission would be more supportive of an approach which provides provinces with clearly defined plans and timelines (at least 3 years) within which to prepare and build capacity for full adoption of the new framework. This is especially useful because proposed reforms are administratively cumbersome and skill-intensive.

2. The Commission is of the view that Government should use the current reforms to deal holistically with problems besieging the infrastructure conditional grant. Contrary to popular belief, which seems to apportion blame on the part of provinces for poor performance, national government should also take part of the blame for increasingly introducing a plethora of conditional grants which do not always recognise provincial peculiarities. If the current structure and the number of infrastructure conditional grants are not harmonised in response to these peculiarities, a move to a bidding system could result in low uptake rate for certain pool of funds. A demand-led funding framework should start at a point at which grants are introduced rather than retrofitting the need-basis imperatives when the program is already in place. The mere fact that provinces are under-spending on infrastructure conditional grants is partly a reflection of poor program conception and a lack of consensus about appropriate funding instruments to address national priorities. It is not uncommon to find national government without proper controls and monitoring to support implementation of its conditional grants. Thus, proposed infrastructure conditional grants reforms should guard against penalising provinces for problems caused by national government.

5.4. **Human Settlements Conditional Grant (HSDG)**: In the 2011/2012 Division of Revenue the Urban Settlements Development Grant (USDG) to metropolitan municipalities was introduced. The Commission welcomed this development as a step

in the right direction but pointed out the need for other infrastructure related grants to be aligned with the USDG (namely regional bulk infrastructure grant, electrification grant and neighbourhood development grant). To date there has not been any progress in aligning these grants to the HSDG. Furthermore, the USDG has performed very poorly over the period. Out of R6.2 billion allocated during 2011/12, only R2.7 billion (or 44%) was spent by municipalities as at 31 March 2012 (National Department of Human Settlements 2011/12 Annual Report). Even though at the time of reporting municipalities had three months before the end of their financial year, it is unlikely that R3.5 billion could have been spent in three months. In this instance, it is therefore important for the National Department of Human Settlements together with provincial departments responsible for human settlements to ascertain the underlying challenges on the performance of the USDG and develop plans to assist municipalities to improve performance.

5.5. **Rural Household Infrastructure Grant**: In a bid to improve the provision of sanitation and in particular to eliminate sanitation backlogs, Government established a schedule 7 Rural Households Infrastructure Grant (RHIG) in 2010 for the provision of onsite water and sanitation infrastructure. Since inception, RHIG has underperformed. Of the 100 million RHIG allocation in 2010/11, only R66.7 million was spent (i.e. 33% underspending). For the 2011/12 financial year R187.3 million (or about 72%) of the R257.5 million adjusted allocation was spent. Furthermore, a large percentage of funds spent over the last two financial years was done so between February and March (33% in 2010/11 and 72% in 2011/12) before financial year end. It is therefore recommended that an evaluation be undertaken to establish underlying causes of the financial and delivery underperformance associated with this grant. Such evaluation should then inform plans on how the grant should be reconfigured.

5.6. **Housing Disaster Relief Grant**: This is a new grant made available to provinces. It is meant to provide emergency relief in support of housing construction work and related infrastructure damaged during a natural disaster. Only 18% of allocated funds were spent during the 2011/12 financial year.

5.7. Overall, the Commission commends efforts by Government to protect conditional grants given the tight fiscal framework. Conditional grants are fundamental in maintaining and improving service delivery to communities. The Commission raises the following points for consideration by Government:

1. Government's efforts to improve monitoring systems in order to ensure that conditional grants are being spent by municipalities are welcomed. However, concomitant punitive measures that are applied in instances of under-spending such as the reduction of the LES by R500 million to date for 2012/13 may be counterproductive. Such measures do not remedy the root cause of under-spending. Rather, there is need for a systematic and comprehensive analysis of the causes of under-spending so that appropriate long-term interventions are designed and implemented to encourage municipalities to spend grant transfers timeously and effectively. It is also important to note that improved spending

does not necessarily result in improved outputs and outcomes in the form of better-quality service delivery to communities. Outcomes and impacts of conditional grant expenditure, in particular infrastructure related grants, can only be improved if Government improves its monitoring and undertakes constant evaluations of the outcomes.

2. The Commission raises concerns over the state of the conditional grant framework and the direction Government is taking in maintaining the system. The Commission has raised issues around the proliferation of grants in the past but also notes the several piecemeal interventions applied to solve fundamental problems of operational failure in the system. This is in relation to the continuous shifting of grant administration from one department to another (particularly funds pertaining to the Municipal Infrastructure Grant (MIG)) which effectively results in different components of one grant being administered by two departments. This suggests that the failure of achieving the envisaged outcomes of conditional grants is not only hindered by poor planning and expenditure, but also by poor administration and coordination by national and provincial departments. In this respect, the Commission welcomes Government efforts to review the current local government conditional grant system and will contribute to this review.

6. Local Government Policy Issues

6.1. The Commission notes the review to the LES formula and acknowledges its representation at a technical level in the review task team. The Commission has advocated for a formula that ensures municipalities (and poorly resourced municipalities, in particular) are appropriately funded to deliver on their constitutional mandates. In essence, the Commission supports the general structure of the proposed formula but will further engage Government on the implementation details of the new formula. With that in mind, the Commission would like to highlight the following:

1. It is important that the LES is linked to the infrastructure grant framework, such that the increased roll out of infrastructure results in the concomitant operating costs being funded through the LES.
2. Although the Commission supports greater funds being allocated via the LES to poorly resourced municipalities, it is important that these municipalities have the capacity to spend such funds. If the municipalities in question have no capacity then targeting of funds to these municipalities in the LES may contribute to wasteful expenditure and poor service delivery outcomes. Ancillary measures to ensure effective spending, and enhance community oversight of these additional funds then appear to be critical.

3. The Commission emphasises the importance of accounting for municipal own revenue raising potential in the LES formula in order to improve the allocation of funds to resource-constrained municipalities. However, such revenue raising capacity measures should not violate legislation and the principles of grant design.

6.2. The Commission would like to note National Treasury efforts at improving revenue management practices of municipalities, and in particular the focus on addressing billing challenges as part of the revenue value chain.

6.3. The Cities Support Programme is an important initiative aimed at stimulating local growth in metropolitan municipalities and secondary cities. However, overall funding to support capital expenditure around the urban built environment may be limited by (i) a tight national fiscus, (ii) constraints in terms of leveraging credit finance induced by recent municipal credit rating downgrades, and (iii) diminishing surpluses on municipal operating budgets. As the local government sector has significant economic growth hubs within its ranks, constrained capital spending in this sector will significantly undermine the growth prospects of the economy. It is important that municipalities and in particular metropolitan municipalities look beyond conditional grants for capital investments by, for example, exploiting the alternative of debt financing, or land based finance instruments such as development charges. Reforms to conditional grants to cities will need to explicitly account for this imperative.

6.4. The Commission welcomes Government efforts to find innovative ways of getting the economy to create more jobs and especially "green" jobs at the municipal level. Through the grant framework, the Government should take advantage of the opportunities for job creation in the solid waste management sector.

6.5. The Commission also welcomes Government efforts to improve capacity in the local government sphere, especially through the Municipal Infrastructure Support Agency (MISA) program. Capacity constraints in the local government are real and constitute one cause of the major inhibitors to enhanced performance of the sphere. There should be a common understanding of what constitutes capacity challenges. Capacity should be viewed holistically to encompass individual, organisational and institutional aspects.

6.6. The release of the 2011 Census data is an important development that will have profound impacts on the local government fiscal framework, particularly on formulae-driven grants. Firstly, the data will allow for a thorough evaluation of the outcomes of a decade of municipal expenditures and investment in terms of improved and extended services to communities. Secondly, it allows for an updating of formula-driven grants. In terms of the latter, the Commission raises the following:

1. Large shifts in allocations are likely given the fact that the grant formula has not been updated in over 10 years. The appropriate phasing-in arrangements are required to ensure that municipal budgets are protected from shocks to allocations.

2. The current arrangement in terms of updating grant formula with the census (i.e. effectively every ten years) requires urgent review. Government needs to take a firm decision on the frequency of the national census, which by law is expected to occur every five years, or alternatively, propose arrangements to ensure the frequency of data in-between censuses. Another possibility can include data projections or technical adjustments within grant formulae to account for population and service dynamics at the municipal level.

7. Review of Actual Spending by National Departments and Provincial Government – 1 April to 30 September 2012/13

7.1. Expenditure smoothing implies government spending that is evenly distributed through the four quarters of the financial year. If such smoothing were to occur, it would be expected that total expenditure up to September would be at 50% of the main budget. This would obviously differ depending on whether a government program that the department is dealing with is recurrent or capital-expenditure driven. Expenditure smoothing would most likely lead to improved quality of spending and reduced level of unauthorised spending.

7.2. Table 5 shows aggregate spending and deviation from this norm.

1. Total government spending as at September 2012 is below the assumed norm of 50% by 2% at R465 billion against a total of R969 billion. A total of all votes at national level have also spent 2.7% (or R257 billion of the main budget) below the 50% norm. This figure increases when looked at as a total direct charge against national revenue fund to 0.5% (R208 billion of the main budget) below the 50% norm.

2. Using key selected government programmes that drive government recent priorities (such as education, health, justice and policing, and key built environment programmes such as energy, human settlements and rural development), government is below the norm by 0.1% at R112 billion.

7.3. With respect to the equitable share, provinces have spent 50% of the main vote which is within the 50% norm. The expenditure can be expected to rise significantly quicker with the advent of the implementation of the agreed upon wage settlement.

Table 5: Aggregate Spending and Deviation from the Norm

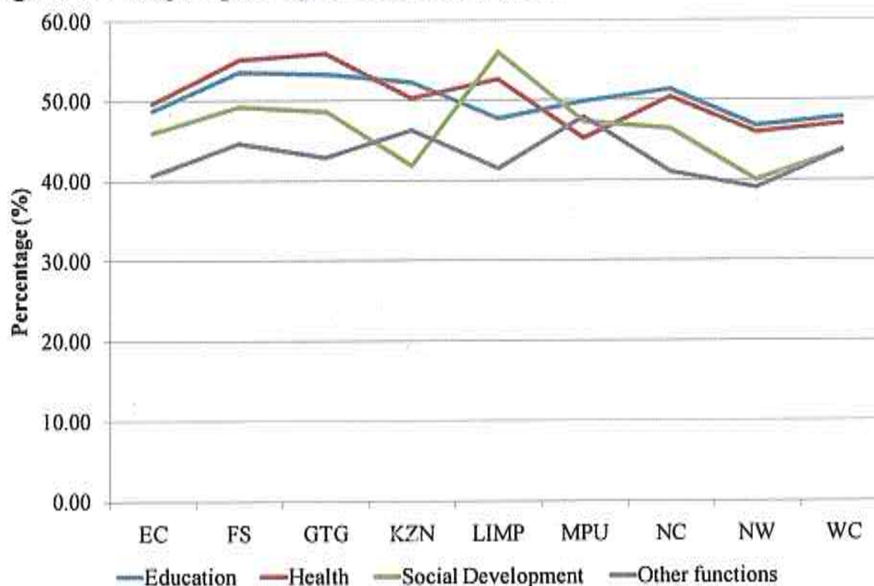
R'000	Main Budget	Spending as at September 2012	% expenditure
Total Expenditure	419,926	**207,766**	**49.5%**
Appropriation by Vote	543,630	257,071	47.3%
Direct charges against National Revenue Fund	969,366	464,837	48.0%
Fuel levy	9,040	3013	**33.3%**
State debt cost	89,388	43,546	48.7%
Other charges against National Revenue Fund	12,441	6,679	53.7%
PES Transfers from National	309,057	**154,529**	**50.0%**
Selected Key budget Votes	224,111	**111,883**	**49.9%**
6. Public Works	7,994	4,137	51.8%
14. Basic education	16,344	7,506	45.9%
15. Health	27,557	14,041	51.0%
16. Higher Education and Training	31,500	22,240	70.6%
20. Correctional Services	17,732	7,996	45.1%
23. Justice and Constitutional Development	13,080	6,112	46.7%
24. Police	62,485	29,965	48.0%
25. Agriculture, Forestry and Fisheries	5,799	2,968	51.2%
27. Economic Development	673	330	49.0%
28. Energy	6,806	3,151	46.3%
30. Human Settlements	25,263	10,056	39.8%
32. Rural Development and Land Reform	8,878	3,381	38.1%
PES Expenditure at provincial level	309,057	**154,529**	**50.0%**
Education	163,655	82,400	50.3%
Health	117,829	60,000	50.9%
Other	27,573	12,129	44.0%

Source: National Treasury (2012), Commission's own calculations.

7.4. Education, health and social development comprise approximately 75% of the total provincial budget. These functions are typically labour intensive and tend to be important drivers of budget pressures. The Commission's calculations show that compensation of employees' accounts for approximately 75% of the education budget and 60% of health budget, respectively. In the figure below, four provinces (Free State, Gauteng, Kwazulu-Natal and Northern Cape) spent more than 50% of their education budget halfway into the financial year, with Free State (53.5%), Gauteng (53%) and Kwazulu-Natal (52%) in danger of overspending their education budgets for 2012/13. It is also important to note that the Limpopo Department of Education is

under administration, with the department's fiscal position midway into 2012/13 standing more prudent at 47.7% this year compared to 51.6% last year. The Commission notes with concern that this spending conservatism by the Department is at the cost of delayed or reduced funding to schools.

Figure 7: Budget spent up to September 2012



Source: National Treasury (2012), Commission's own calculations.

1. Five provinces spent over 50% of their total health budget midway into the 2012/13 financial year, with Gauteng (55%) and Free State (55%) once again showing early signs of overshooting 2012/13 allocation. It should be noted, that the Gauteng and Limpopo Departments of Health were subject to Section 100 intervention by national Government. At the same stage last year, both provinces were in a better position than they are in now, with Gauteng spending 49.3% and Limpopo 50.8 % of their health budgets, respectively. The Commission therefore expresses concern about the health budgets of these two provinces and that they could register major deficits in 2012/13 if not monitored closely.

2. It is highly likely that the over-expenditure on health and education at the mid-year mark is a result of higher than anticipated cost of living adjustment and the increase in headcount as a result of increased spending on posts with no available budget attached. The Commission supports the call by the PSC for departments to scrap unfunded posts on the staff establishment because it creates the wrong impression that staff vacancies are high when in fact, no funding for those posts are available.

3. When relative spending performance is assessed, it is the Commission's view that Free State, Gauteng and Limpopo are still not managing their resources

diligently and there is an urgent need to improve accountability and oversight structures in these provinces even though some of the departments in these provinces are already under Section 100 administration.

7.5. **Section 100 interventions:** The commission welcomes the progress made by national government in stabilising finances of the three provinces put under administration. Since intervention, the provincial fiscal positions, especially that of Limpopo, improved drastically moving from projected deficits to positive outlooks within the financial year. In its submission on Section 100 interventions the Commission strongly emphasised the need for Government to act swiftly against cases of fiscal profligacy at all levels of government in order to dispel misconceptions of soft budget constraints and regulation laxity. The recent experiences have however indicated that there is regulation vacuum in which interventions are carried out. There is a need for a refined framework for intervention with clear parameters setting out triggers for intervention, clarifying roles, responsibilities and lines of accountability during intervention as well as timelines for interventions for all stakeholders, including legislatures.

8. Adjustment Estimates 2012/13

8.1. Adjustment estimates are mainly driven by ICS to cover the cost of the wage settlement of 7 per cent that was agreed to later in the year (which is higher than the initial 5% that provinces had budgeted for). Provinces received R3.95 billion to cover the actual cost of the agreement based on personnel numbers at the end of March 2012 to assist for the remainder of the 11 months of the fiscal year. The continued higher than expected increase to the cost of living adjustment will put further pressure on the Government to reign in the provincial salary bill. The opportunity cost of these increases impact on resuscitating the economy through increased investment expenditure.

8.2. The Commission, however, welcomes the Government approach towards shifting composition of expenditure over the MTEF towards capital expenditure as it is in line with what it proposed in the 2011 MTBPS. The 2012 MTBPS notes that over the MTEF real growth in compensation of employees will average 1.3% growth while capital payments will grow at 4.3%. The Commission also welcomes that for the first time, a three year wage agreement of Consumer Price Index (CPI) increases plus 1% has been reached between Government and the public sector unions. This will assist Government in planning budgets and forecasting. Long-term measures such as norms or ratio on the costs of personnel in relation to provincial total expenditure need to be put in place and strictly enforced.

8.3. An additional R87 million is proposed to cover the cost of ICS in further education and training (FET) colleges lecturers.

8.4. Government is allocating R461 million to host the Orange Africa Cup of Nations (AFCON) in 2013, of which R323 million will go towards national departments to cover the costs of hosting the tournament and R123 million to local municipalities hosting the games. The Commission is of the view that such expenditure is not meant to be redistributive as benefits accrue disproportionately to host cities and higher income earners because of the need to host.

1. A similar grant to the Emergency Medical Services (EMS) of 2010 FIFA World Cup event is proposed for the Orange Africa Cup of Nations and is allocated R15 million to host provinces. The provinces that have been proposed as recipients of R3 million each are Eastern Cape, Gauteng, Kwazulu-Natal, Mpumalanga and the North West.

8.5. The financial viability of South African National Roads Agency Limited (SANRAL) will depend on balancing Gauteng Freeway Improvement Project (GFIP) e-tolling revenues and receiving financial support from the fiscus. The Commission has already shared its views on these issues. The SANRAL short experience has allowed identification of "irreversible" national decisions concerning short-term implementation and further development of electronic tolling. With conditions in place to charge motorists as a function of mileage performed on GPIF, Gauteng should be used as the test field for "second-generation" national approaches to make 'road users and polluters pay' in South Africa and for using resulting revenue to expand capacity and standards of transport networks. Then, progressively, other provinces will start introducing electronic tolling in their practice, largely based on domestic considerations, but letting this become established practice. In the interim, the National Department of Transport should set out guidelines for e-tolling of facilities that have private sector involvement in financing, delivery or management. From the Commission's perspective, at the very least, these guidelines should include:

1. Only major projects that result in significant increases in capacity will be subject to tolling.
2. Tolls will be implemented only if there are clear, demonstrable net benefits for the users.
3. Tolls will be implemented only if a reasonable untolled alternative is available. The public has a right to a basic level of toll-free access.
4. The level of tolls and limits on the amount and frequency of increases will be established in advance. This is intended to provide certainty to the public.
5. Tolls will be used to generate revenue for transportation projects.
6. The Commission should be consulted prior to implementation of the e-tolling projects.

8.6. Government guarantees represent a contingent liability to the state that should be monitored closely. The issue is important in view of Government's strategy to fund social infrastructure on budget, and economic infrastructure via public entities balance

sheets. This poses fiscal risks for the country as they constitute explicit, legislated and commitment-related risks. The Commission is of the view that such guarantees should not become frequent practice. The question also remains whether or not Government should tighten the fiscal policy framework further to take account of these issues? The contingency reserve "top slice" amount that South Africa routinely sets aside should be welcomed and further strengthened.

8.7. The Commission also notes the implementation of Section 216(2) of the Constitution by the National Treasury in withholding transfers to Nala Local Municipality in the Free State. Although the Commission understands the rationale provided for imposing Section 216(2) and supports the implementation of punitive measures on serial offenders to ensure sound financial management and the proper use of limited public resources (while further emphasising the need for similar punitive and sanctions being placed on Municipal Managers and Chief Financial Officers), it is the Commission's view that stopping of transfers should only be effected as a last resort when all other remedial measures and support initiatives have failed. It is important to emphasise that the Constitution promotes a cohesive system of cooperative governance in the country, with intergovernmental support structures in place to aid sub-national governments in instances of capacity constraints and mandate failures. In terms of Section 154 of the Constitution, national and provincial Government are required play an important role in monitoring and supporting to deliver on their mandates. Thus, there is also a degree of accountability on the side of national and provincial governments with the failure of a municipality. Therefore, Section 216(2) should be undertaken in exceptional circumstances, should not be a norm of action and it is important that Government is explicit on the various remedial measures and support initiatives provided to the municipality prior to imposing Section 216(2). Furthermore, every effort should be taken to minimise the negative impact of such an action on the population concerned.

8.8. The Commission notes efforts from Government to improve expenditure on rehabilitation and refurbishment of municipal infrastructure networks. Such additions to the existing local government conditional grant framework will attempt to ensure funds are earmarked for such expenditures. Improved systems are required to ensure expenditure on repairs and maintenance on municipal operating accounts are appropriately planned and executed. The spinoffs of this in terms of improved service delivery, job creation and overall economic growth cannot be overemphasised.

9. Concluding Remarks

9.1. Overall, the 2012 MTBPS reflects the major thrust and spirit of the recommendations that the Commission has been making since the onset of the global economic crisis, that growth and employment in South Africa can only be achieved by combining fiscal consolidation and investment into future growth given prevailing economic climate.

1. The Commission fully supports the position in the MTBPS of emphasizing the need to get value for money from Government programmes.

2. Given the current negative economic outlook, the Commission fully supports the government's position on fiscal consolidation and tightening measures to maintain expenditure sustainability. The Commission however would also like to highlight the need for all spheres of government to heed the call around eliminating inefficient and wasteful expenditure. The Commission is inclined to support budget cuts proposals which are preceded by a comprehensive expenditure review as per the recommendation made in its 2009/10 Submission

3. Given the tight fiscal framework, the Commission commends efforts by Government to protect conditional grants as they are fundamental in maintaining and improving service delivery to communities. The Commission supports the proposed review of conditional grants with a view at addressing identified weaknesses it has raised in the past and will be engaging with government and other stakeholders in the exercise.

9.2. The Commission notes the progress with the review to the LES formula and will continue to engage with Government and other stakeholders on this initiative.

9.3. The Commission welcomes Government's efforts at finding innovative ways of getting the economy to create more jobs and especially "green" jobs in the local government sector. Through the grant framework, the Government should take advantage of the opportunities for job creation in the solid waste management sector.

9.4. The proposed adjustments estimates are mainly driven by ICS as a result of a 2% shortfall to cover the cost of a wage settlement of 7% that was agreed to later in the year. The proposed adjustments are supported subject to matters raised by the Commission in this submission.

9.5. The Commission welcomes the progress made by national government in stabilising the finances of the three provinces put under Section 100 administration. The Commission is of the view that the absence of enabling legislation for Section 100 should be addressed as matter of urgency to ensure that accountability and oversight frameworks are not compromised during periods of intervention.

For and on behalf of the Financial and Fiscal Commission

Mr Bongani Khumalo

Acting Chairperson/CE