

# ANNUAL REPORT

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# 2015/2016







*For an Equitable Sharing of National Revenue*

# ANNUAL REPORT 2015/2016

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2<sup>nd</sup> Floor, Montrose Place, Bekker Street,  
Waterfall Park, Vorna Valley, Midrand, South Africa  
Private Bag X69, Halfway House 1685  
Tel: 086 1315 710, Fax: +27 (0) 11 207 2344

**[www.ffc.co.za](http://www.ffc.co.za)**

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# FOREWORD

It is a great pleasure to submit the Financial and Fiscal Commission's Annual Report which covers the 2015/16 financial year. The Annual Report is presented in terms of the provisions of section 220 of the Constitution, 1996, section 40 and 65 of the Public Finance Management Act, 1999 and section 26 of the Financial and Fiscal Commission Act, 1997 (as amended). During the period under review, the Financial and Fiscal Commission Amendment Act, 2015 was passed which finally alleviated the governance challenges that was prevalent at the Commission. The Commission is continuing to work hard to ensure the implementation of the Amendment Act. It was gratifying to have been working with Commissioners with vast experience and expertise in the financial, fiscal and other sectors during the period under review.

I am delighted to report that the Commission has for the first time since establishment obtained a unqualified audit opinion with no findings on audit of predetermined objectives and compliance with legislation for 2015/2016. The processes and systems that were put in place went a long way in enabling the Commission to make true its commitment to clear all audit queries from the prior year. The Commission has in some cases exceeded expectations in terms of key targets that it had set for itself although there is a need to evaluate the impact of the outputs going forward. The Commission maintained a high performance culture within its workforce and ensured compliance and maintenance of sound and high standards regarding all activities during the period under review. The legislative environment was consistently monitored and scanned to ensure that the Commission complied with relevant laws and corporate governance principles. Adherence to the approved reporting frameworks, responsibilities and accountability were accomplished during the period under review.

The legislative required submissions on the Medium Term Budget Policy Statement, Division of Revenue Bill, Fiscal Frameworks and Revenue Proposals and Appropriations Bill were met in line with the Annual Performance Plans. The Research and Recommendations program continued to improve and keep up to date with latest issues and methods through its publications program. It is pleasing to note that the Commissioners and Secretariat have been active in publishing in peer reviewed journals and contributing to book chapters. The Annual Submission for the Division of Revenue 2016/2017 was

tabled in Parliament timeously. This was later followed by the release of the technical report and policy brief series that informed the recommendations contained in the submission and constituted a big component of the stakeholder engagement process. Over and above the prescribed deliverables, the Commission also made numerous rapid responses and submissions in response to requests from its stakeholders in the legislatures, the executive, organized local government and other organs of state. This was particularly the case with the numerous requests received from various Portfolio Committees in Parliament for assistance with the Budgetary Review and Recommendations Report process.

As a Commission we continued to engage more directly in "joint research initiatives" on various themes by giving effect to Memoranda of Understanding (MOU) signed with the South African Local Government Association, Municipal Demarcation Board, and the Food, Agriculture and Natural Resources Policy Analysis Network. These MOU's provide a means of extending the limited human and financial resources available to the Commission. The Commission also finalized and tabled the report on Municipal Viability that was done in collaboration with the University of Western Cape (Chair of Multi-Level Governance) and the Municipal Demarcation Board.

I am further pleased to report that the Commission partnered successfully with the South African Research Chair in Multilevel Government at the University of Western Cape, HSRC's Programme Democracy, Governance and Service Delivery and the HSRC's BRICS Research Centre in hosting a roundtable conference entitled "The BRICS Partnership and Multilevel Government in Member Countries: An Unexplored Dimension".

The challenge experienced by the Commission in the Corporate Services Manager being indisposed for the entire financial year was successfully mitigated in that the human resources capacity provided by the Financial Services Board during a major part of the year provided a welcome relief. The further challenges regarding the failure by the landlord to refund the overpayment regarding the rental; and the growing number of stakeholder requests for presentations or to participate in task teams will be carried over to the current financial year.

Greater importance has been placed during the year on the prudent management of the Commission's financial resources. Other key areas receiving cost containment focus included but were not limited to travel and venue hiring costs. Cost containment measures continue to be implemented and have been institutionalised within the Commission's policies. I am pleased to state that the Commission has a reliable compass for mapping its way forward in that the Strategic Plan 2014-2019 and Annual Performance Plan 2016/2017 were tabled on 8 March 2016 in compliance with the provisions of Treasury Regulations for Departments, trading Entities, Constitutional Institutions and Public Entities in terms of the Public Finance Management Act, 1999 (as amended). These plans are invaluable

in ensuring that the Commission and Secretariat have a clear understanding and direction on the way forward. The Commission will continue to ensure compliance and maintenance of sound and high standards regarding all its activities.

I would like to thank the Minister of Finance, the Chairpersons of the Finance and Appropriations Committees in Parliament and Commissioners for the support provided during the period under review. I would also like to acknowledge and thank the members and Secretariat of the Commission for their hard work during the year in ensuring that the Commission carries out its mandate expeditiously and professionally.



**Mr Bongani Khumalo**

Acting Chairperson/Chief Executive

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# CHAPTER 1

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## The Commission

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# THE COMMISSION

## 1.1 Constitutional and Legislative Mandate

The Financial and Fiscal Commission (Commission) derives its mandate from the Constitution of the Republic of South Africa Act, 1996 (as amended). The duties and functions of the Commission are encompassed in sections 214(2), 220, 222, 228(2)(b), 229(5), 230(2), and 230A(2) of the Constitution, 1996 which provides, among others, that the Commission is an independent and impartial advisory institution, that Government has to consult with regard to the division of revenue among the three spheres of government and in the enactment of legislation pertaining to provincial taxes, municipal fiscal powers and functions, and provincial and municipal loans.

Its mandate is enabled through the Financial and Fiscal Commission Act, 1997 (Act No 99 of 1997) (as amended), Intergovernmental Fiscal Relations Act, 1997 (Act 97 of 1997), Money Bills Amendment Procedures and Related Matters Act, 2009 (Act No 9 of 2009), Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (as amended), Provincial Tax Regulation Process Act, 2001 (Act No 53 of 2001), Intergovernmental Relations Framework Act, 2005 (Act 13 of 2005) and the Municipal Fiscal Powers and Functions Act, 2007 (Act No 12 of 2007).

## 1.2 Vision, Mission and Values

### 1.2.1 Vision

To provide influential advice for an equitable, efficient and sustainable Intergovernmental Fiscal Relations (IGFR) system

### 1.2.2 Mission

To provide proactive, expert and independent advice on promoting a sustainable and equitable IGFR system, through evidence based policy analysis to ensure the realization of our Constitutional values.

### 1.2.3 Values

To enable the Commission to deliver on its mandate, it subscribes to the following values as enshrined in the Batho Pele principles:-

- Professionalism, which implies fairness and equal treatment; the free sharing of information; striving for quality; and time management
- Respect for each other as colleagues and for the diversity of the workforce
- Empowerment in employing policies to increase delegation rather than to stifle it; the tolerance of different views and ideas; and making resources available when required
- Trust which requires openness and transparency; humility; Integrity; and honesty in all undertakings
- Teamwork, which encourages cross-functional integration; voluntary mentorship and coaching; taking responsibility; and flexibility
- Innovation, which allows intellectual space; provides systems to support innovation; and tolerates mistakes as opportunities for learning.

### 1.3 Strategic outcomes-oriented goals of the Commission

The following Commission strategic outcomes-oriented goals identify the areas of institutional performance that are critical to the achievement of its mandate.

Strategic Outcome-Oriented Goals		
1	Goal 1	A Stable and Innovative IGFR System
	Goal Statement	The system of Inter-governmental Fiscal Relations (IGFR) is progressive, sustainable and equitable
2	Goal 2	Strategic foresight
	Goal Statement	"No surprises" and future-oriented
3	Goal 3	Influential and informed policy advice
	Goal Statement	Effective policies that are evidence-based result from comprehensive and value-added engagement
4	Goal 4	Knowledge management
	Goal Statement	Relevant knowledge that enhances developmental impact is created and mobilised through the balance of internal and external specialist talent commensurate with the needs of the Commission
5	Goal 5	"Success" culture
	Goal Statement	A dynamic, productive organisational culture is created and nurtured
6	Goal 6	Balance
		The balancing of present and future demands, leading to effective performance within the constraints of available resources.

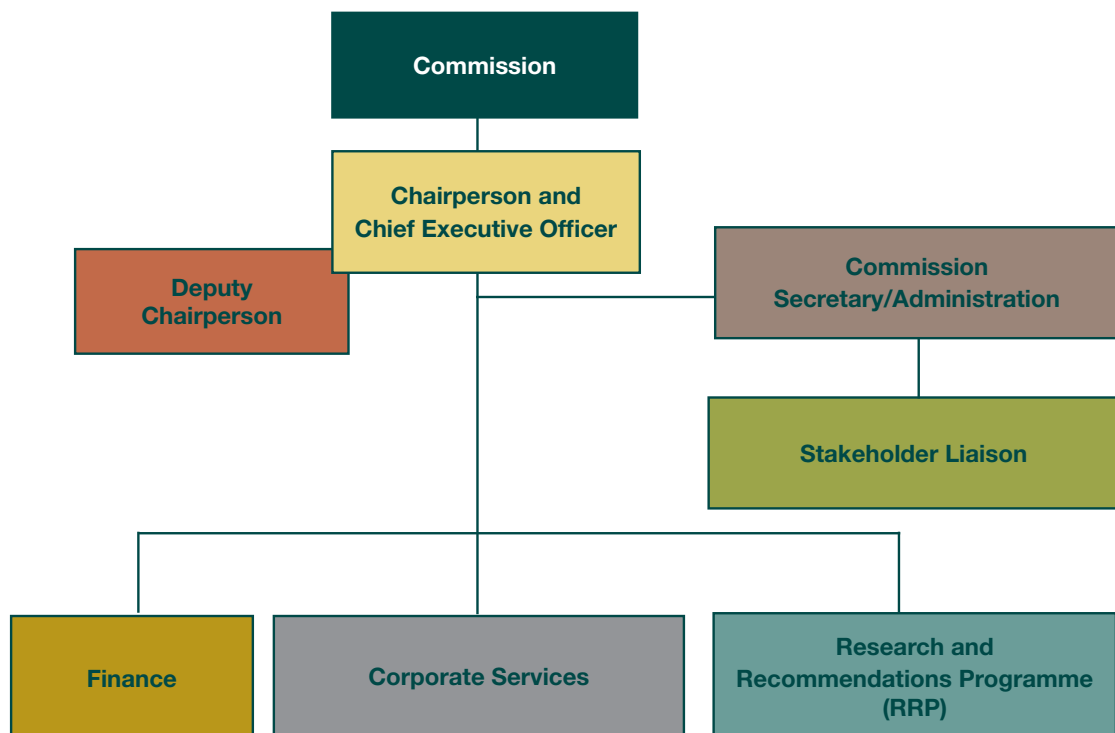
## 1.4 Composition and Organisational Structure

*The Commission comprises the following nine persons:*

1. Chairperson and Deputy Chairperson;
2. Three persons, appointed after consultation with the provincial premiers, from a list compiled in accordance with a process prescribed by national legislation;
3. Two persons, appointed after consultation with organised local government, from a list compiled in accordance with a process prescribed by national legislation; and
4. Two other persons.

Commissioners are appointed in terms of the Constitution, 1996 and the Financial and Fiscal Commission Act, 1997 (as amended). All appointments are made by the President of the Republic of South Africa. Commissioners are appointed for five years. A person may not hold office as a member of the Commission for a period of more than 10 consecutive years. The Chairperson is in the full-time employment of the Commission while the rest of the Commissioners are employed part-time.

The Commission Secretariat has four divisions: Commission Secretary, Finance, Corporate Services and Research and Recommendations Programme. The Executive Management Committee (EXCO) is chaired by the Chairperson/Chief Executive. EXCO is committed to principles of transparency, accountability, efficiency and effectiveness, and the practical application of these principles to enable delivery of the constitutional mandate.



## 1.4 Commissioners

### 1.4.1 Full Time Commissioners

*Mr Bongani Khumalo (1 September 2010-28 February 2013) (reappointed: 1 March 2013-28 February 2015) (reappointed: 1 March 2015- 31 August 2016)*

Mr Bongani Khumalo is the Acting Chairperson/CE of the Financial and Fiscal Commission. He was previously the Program Manager for Fiscal Policy in the Secretariat of the Commission. He has worked on a variety of areas within the South African intergovernmental fiscal relations system, including the design of revenue sharing formulae, the financing of education, health care and social assistance, and sub national borrowing and taxation issues and on the design of conditional grants. Upon completing a Master of Science (Economics) degree from the University of Zimbabwe, Bongani Khumalo lectured at the same University in the areas of International Trade and Development and Public Finance. He then moved to Rhodes University in Grahamstown in 1994 where he lectured Public Policy, International Trade Policy and Development Economics until 1999 when he joined the Financial and Fiscal Commission as a Researcher. He has published articles and contributed book chapters on Intergovernmental Fiscal Relations and on Public Finance.



### 1.4.2 Part Time Commissioners



*Mr Kenneth Fihla (1 September 2013- 31 August 2018), Commissioner (part-time)*

Mr Fihla is the Head of Client Coverage, Corporate and Investment Banking/CIB Franchise Head, South Africa, The Standard Bank of SA Limited. He is responsible for corporate client relationship management across 19 African countries and 20 countries on other continents where Standard Bank operates. Mr Fihla is also responsible for management of the Standard Bank's Corporate and Investment Bank (CIB) South Africa Client Franchise business. He is a respected leader with extensive investment banking experience. Mr Fihla joined Standard Bank as Head of Investor Services in September 2006. In March 2007, he was appointed onto the Executive Committee of Standard Bank's CIB. In April 2008, he became Head of Transactional Products and Services South Africa. Mr Fihla studied Mechanical Engineering at the Harare Polytechnic. He has an MSc in Financial Economics from the University of London and an MBA from the University of Witwatersrand.



*Mr Krish Kumar (1 March 2013 – 28 February 2018), Commissioner (part-time)*

Mr Krish Kumar commenced work as a trainee Accountant with the erstwhile Durban City Council in 1981 and progressed through the ranks to become City Treasurer of the North and South Central Local Councils in 1997. In addition, in 1999 he was appointed City Treasurer of the Durban Metropolitan Council and in 2001 Deputy City Manager: Treasury. Krish is a member of the South African Local Government Association's (SALGA) Finance working Group, Fellow of the Institute of Municipal Finance Officers (IMFO), Chairperson of the Municipal Chief Financial Officers (CFO) Forum, past President of IMFO, and has served two terms as a member of the Accounting Standards Board. He is also chair of the eThekweni Risk and Managing the Municipality Committee.



*Mr Sipho Lubisi (28 July 2014 – 27 July 2019), Commissioner (part-time)*

Mr Sipho Lubisi commenced work at TSB Sugar Holdings in 1981. He served as a shop steward of the Food and Allied Workers Union (FAWU) at TSB Sugar Holdings. He was elected as the chairperson of (FAWU) Nelspruit Branch from 1986 to 1988, and at the same period he served as the Chairperson of COSATU for the Nelspruit Local. He served as FAWU Transvaal Regional Treasurer from 1988 to 1990. In 1990 to 1993 he served as the National Treasurer of FAWU. He was elected as the chairperson of the Congress of South African Trade Unions (COSATU) Eastern Transvaal Region in 1989 to 1993 and also served as a member of Central Executive Committee of COSATU. Mr Lubisi served as a member of the African National Congress (ANC) Provincial Executive Committee from 1992 to 2008. He was elected as the ANC Provincial Deputy Chairperson in 2002 to 2005. In 2002 to 2007 he served as member of the South African Communist Party (SACP) Central Committee. He is currently serving as a member of the Executive Committee of the SACP in Mpumalanga province. Mr Lubisi was elected as a Senator in the then Senate of the Republic of South Africa in 1994 to 1996, and served as the Permanent Delegate in the National Council of Provinces (NCOP) from 1996 to 1998. He joined the Mpumalanga Provincial Legislature and was elected as the Speaker of the Legislature in 1998 to 2004. He served as a Member of the Executive Council (MEC) of the Mpumalanga Department of Health and Social Development in 2004 to 2005, appointed as an MEC for Economic Development and Planning in 2005 to 2007. In 2007 to 2008 he was reappointed as an MEC for Health and Social Development. From 2008 to 2009 Sipho Lubisi served as a Member of the Mpumalanga Provincial Legislature and served as Chairperson of the Portfolio Committee on Agriculture and Land Administration; Economic Development and Planning. Mr Lubisi served as the Speaker of the Mpumalanga Legislature from 2009 to 2014.



*Prof Gilingwe Mayende (28 July 2014 - 27 July 2019), Commissioner (part-time)*

Professor Gilingwe Mayende holds a BA (Sociology and History) from the University of Botswana, an MA in Development Sociology (1987) and PhD in Sociology from the University of Hull in the United Kingdom (1990). He also holds a Diploma in Executive Leadership (Senior Executive Programme) from Harvard University. After completing his PhD in 1990, he was selected to the position of Visiting Fellow and Senior Associate Member of St Antony's College at Oxford University in the United Kingdom, where he conducted research on the land question in South Africa over a period of nine months. Between 1995 and 2005 Professor Mayende served as a senior public servant in the democratic South African government – a career which included a five-year stint as the Director General of the Department of Land Affairs (from 2000 to 2005). He also served as the Deputy Director General of the Eastern Cape Provincial Government, between January 1999 and April 2000. From March 1995 to December 1998 he was the Regional Land Claims Commissioner for the Eastern Cape and Free State Provinces. He is currently employed at the University of Fort Hare as a Deputy Vice Chancellor: Institutional Support.



*Dr Sibongile Muthwa (28 July 2014 – 27 July 2019), Commissioner (part-time)*

Dr Muthwa obtained her BA (SW) (Fort Hare), BA (SW) Hons (Wits), MSc (SPPDC), PhD (London). She has international work experience in non-government, development, and public sectors, as well as in academia. Dr Muthwa is currently the Deputy Vice Chancellor: Institutional Support at the Nelson Mandela Metropolitan University



*Prof Daniel Plaatjies  
(1 September 2013 – 31 August  
2018), Commissioner (part-time)*

Prof Daniel Plaatjies has a BSocSc (Hons) from University of Cape Town in Policy, Planning, Administration and Management, an MPhil in Policy, Planning and Management from University of Western Cape and a PhD in the study of Governance, Public Policy and Public Finance from the University of the Witwatersrand. He is currently Special Adviser to the ministry of public enterprises in the Government of South Africa. Prof Plaatjies is former Head and Director of the WITS School of Governance and is currently a Visiting Professor at the University Of Free State School Of Business. He has served in various senior to executive management positions, including special adviser within the South Africa national and provincial government's public service. He is the author and editor of *Future Inheritance - Building State Capacity in Democratic South Africa* (Jacana, 2011) and *Protecting the Inheritance - Governance and Public Accountability in Democratic South Africa* (Jacana, 2013) and leader editor of HSRC's 2016 State of Nation publication. He has also authored a number of government publications and articles contributing to the public intellectual discourse on government, governance, public finance, public policies and public leadership, administration and management.



*Prof Nico Steytler (1 September  
2013 – 31 August 2018),  
Commissioner (part-time)*

Prof Nico Steytler (BA LLB (University of Stellenbosch), LLM (University of London), PhD (University of Natal), Dr (honoris causa) University of Fribourg, Switzerland) is a professor of public law and the South African Research Chair in Multilevel Government, Law and Policy at the Dullah Omar Institute of Constitutional Law, Governance and Human Rights, the University of the Western Cape. Formerly he was the Director of the Community Law Centre, a research and advocacy institute that works on governance and human rights. His main field of research is multilevel government, including local government. He has written extensively on the subject, including co-authoring the Local Government Law of South Africa. He has advised governments at all levels on constitutional and statutory design and implementation of multilevel governance. He was a technical adviser to the Constitutional Assembly drafting the 1996 Constitution as well as a technical advisor to the Western Cape Provincial Legislature on the drafting of a provincial constitution (1996-1997). He was a member of the Municipal Demarcation Board from 2004 to 2014. He also works on multi-level government elsewhere in Africa, and with Professor Yash Pal Ghai edited *Kenya-South Africa Dialogue on Devolution* (2015). He is the president of the International Association of Centres for Federal Studies (2010-2016) and was an UN-appointed expert, advising Yemen's Constitutional Drafting Committee on the design of a federal constitution (2014).

## 1.5 Achievements

The Commission successfully and timeously tabled, briefed, advised and participated in the following in terms of its mandate:

Subject	Parliament	Provincial Legislatures	Local Government	Other Organs of State		
2016/ 2017 Submission for the Division of Revenue	Tabled and briefed	Tabled and briefed	Tabled and briefed			
2015 Medium Term Budget Policy Statement	Tabled and briefed					
Submission on the 2016 Division of Revenue Bill	Tabled and briefed					
Fiscal Frameworks and Revenue Proposals	Tabled and briefed					
Appropriations Bill	Tabled and briefed					
City of Johannesburg-Strategic Planning Session	Participated					
Portfolio Committee on Health-Department of Health Strategic Plans	Briefing					
Portfolio Committee on Agriculture Forestry and Fisheries-Strategic Planning Workshop	Briefing					
Gauteng Social Service and Development Forum		Participated				
Select Committee on Appropriations-LES	Briefing					
Select Committee on Appropriations-Municipal Infrastructure Grant	Briefing					
Portfolio Committee on COGTA-Disaster Management Amendment Bill	Briefing					
SALGA PEC Lekgotla (Presentation on LES allocation)			Briefing			
Standing Committee on Finance-Briefing on quarter 4 report	Briefing					
University of Stellenbosch-Stimulating economic growth and job creation					Participated	
Western Cape Legislature- FFC Amendment Bill	Briefing					
Standing Committee on Finance- New Development Bank	Briefing					
Standing Committee on Appropriations - ESKOM Special Appropriation Bill	Briefing					
Select Committee on Appropriations - ESKOM Special Appropriation Bill	Briefing					
Standing Committee on Appropriations – LES allocation	Briefing					
Select Committee on Appropriations – Municipal Infrastructure Grant Expenditure	Briefing					
Standing Committee on App-Stoppage on Local Government equitable share allocations	Briefing					
PC on Rural Development and Land Reform	Briefing					



Subject	Parliament	Provincial Legislatures	Local Government	Other Organs of State
MDB – Capacity assessment, powers, and functions				Briefing
PC on Health – Departments spending patterns and the FFC's Recommendations	Briefing			
PC on Agriculture, Forestry and Fisheries - Briefing on the Departments spending patterns and the FFC's Recommendations	Briefing			
PC on Economic Development – Briefing on the EDD's performance for 2014/15 financial year	Briefing			
PC on Women in the Presidency – Briefing on the Department's spending patterns and the CGE	Briefing			
PC on Higher Education – Briefing on the Budget Analysis of the DHET and NFAS for Annual reports 2014/15	Briefing			
Standing Committee on Appropriations – Strategic Planning Review Session	Briefing			
PC on Environmental Affairs – Briefing on Audit Outcomes of the Annual Performance Report and its entities 2014/15	Briefing			
Joint Briefing – Standing and Select Committees on Finance - Medium Term Budget Policy Statement (MTBPS)	Briefing			
Joint Briefing – Standing and Select Committees on Appropriations - Medium Term Budget Policy Statement (MTBPS)	Briefing			
SALGA Eastern Cape Provincial Member's Assembly			Briefing	
Standing Committee on Appropriations – Briefing on the Finance Bill and the New Development Bank Special Appropriations Bill	Briefing			
Public Service Commission- Roundtable discussion on the State of the Public Service 2014 Report				Participated
Commission of Gender Equality- RoundTable discussion with the special rapporteur on violence against women				Participated
Presentation: Portfolio Committee on COGTA and Select Committee on COGTA: Public hearings on the traditional and Khoi-San leadership Bill (23-2015)	Briefing			
Gauteng Provincial Legislature (Infrastructure Development Portfolio Committee): Briefing on the Submission for the 2016/2017 Division of Revenue		Briefing		
Portfolio Committee on Labour: Briefing on the 2nd and 3rd quarterly performance of the Department of Labour in 2015/2016	Briefing			
Portfolio Committee on Mineral Resources-Briefing on the Department of Mineral Resources and its entities on their Strategic Plans,	Briefing			



# CHAPTER 2

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## Corporate Governance

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# CORPORATE GOVERNANCE

## 2.1 Introduction

Corporate governance embodies processes and systems by which public entities are directed, controlled and held to account. In addition to legislative requirements based on a public entity's enabling legislation, corporate governance with regard to public entity's is applied through the precepts of the Public Finance Management Act, 1999 and the principles contained in the King's Report on Corporate Governance.

The Commission is fully committed to ensuring sound corporate governance processes thus ensuring that its operations are conducted ethically and within prudent risk parameters. The Commission subscribes to the following corporate governance principles:

- Responsibility
- Accountability
- Transparency
- Fairness

Good corporate governance involves the establishment of structures and processes with appropriate checks and balances. Governance practices and processes will continue to receive the Commission's and its committees' consideration and attention thus ensuring that its operations are conducted ethically and within prudent risk parameters.

## 2.2 Compliance with Laws and Regulations

The Commission has complied with applicable legislation, Policies and Procedures. A compliance checklist that is aligned to the Public Finance Management Act, 1999 has been developed and is applied monthly. Various internal controls are implemented to ensure compliance with all applicable laws and regulations within affecting the Commission. Delegations of authority are also in place to ensure accountability.

## 2.3 Commission Meetings and Attendance

The table below indicates frequency of Commission meetings and attendance during 2015/2016.

Name of Member	Position	Meetings Attendance and Dates			
		31 July 2015	26 November 2015	14 December 2015	28 January 2016
<i>Mr Bongani Khumalo</i>	Commissioner, Chairperson	✓	✓	✓	✓
<i>Mr Kenny Fihla</i>	Commissioner	-	✓	-	✓
<i>Mr Krish Kumar</i>	Commissioner	✓	✓	✓	✓
<i>Mr Sipho Lubisi</i>	Commissioner	✓	✓	✓	✓
<i>Prof Gilingwe Mayende</i>	Commissioner	✓	✓	-	-
<i>Dr Sibongile Muthwa</i>	Commissioner	✓	✓	✓	✓
<i>Professor Daniel Platjies</i>	Commissioner	✓	✓	✓	✓
<i>Prof. Nico Steytler</i>	Commissioner	✓	✓	✓	-

## 2.4 Commission Committees

The Commission oversees its operations through a governance structure comprising various committees. Each committee has its own terms of reference that is reviewed regularly in line with best practice.

### 2.4.1 Audit and Risk Committee

The Commission, with the assistance of the audit and risk committee, needs to ensure that an effective, efficient and transparent system of internal control is implemented and maintained so that the Commission can meet its strategic objectives and goals. The Audit Committee was established primarily to assist the Commission in overseeing the quality and integrity of the financial statements, and public disclosures thereof; the scope and effectiveness of the external audit function; and the effectiveness of the Commission's internal controls and internal audit function.

The Audit Committee continues to operate within its approved terms of reference. The Audit Committee met four times during the financial year under review. In these meetings, the Accounting Officer and executive management were always represented. The Auditor-General is always invited to attend, thus ensuring that such meetings are as effective and transparent as possible. Reliance is also placed on the internal and external audit, as these functions play an important role in providing assurance that the effective internal control systems are maintained.

The mandate of the Committee also includes oversight of the Commission's performance against predetermined objectives and the Commission's financial and non-financial risk management and fraud prevention efforts. The table below indicates the Audit Committee composition, frequency of meetings and attendance during 2015/2016.

Name of Member	Position	Meetings Attendance and Dates			
		25 May 2015	17 July 2015	24 November 2015	18 March 2016
<i>Mr Jerry Sithole</i>	Independent, Chairperson	✓	✓	✓	✓
<i>Mr Duncan Ntuli</i>	Independent Member	✓	✓	✓	✓
<i>Mr Mkuseli Bashe</i>	Independent Member	✓	✓	✓	✓
<i>Ms Mmathabo Sukati</i>	Independent Member	✓	-	✓	-
<i>Mr Kenny Fihla</i>	Commissioner, Member	✓	✓	✓	-
<i>Mr Krish Kumar</i>	Commissioner, Member	✓	✓	✓	✓
<i>Mr Sipho Lubisi</i>	Commissioner, Member	✓	✓	✓	✓

### 2.4.2 Human Resources Committee

The role of the Human Resources Committee is to provide human resource guidance to the Commission on human resource matters. The Committee facilitates and promotes communication regarding human resource related matters. It also receives, processes and interprets

inputs, reports and provides human resources advice to the Acting Chairperson/CE, Commissioners and, the Commission's sub committees. The table below indicates the Human Resources Committee composition, frequency of meetings and attendance during 2015/2016.

Name of Member	Position	Meetings Attendance and Dates			
		10 July 2015	10 November 2015	23 February 2016	18 March 2016
<i>Dr Sibongile Muthwa</i>	Commissioner, Chairperson	✓	✓	✓	✓
<i>Mr Caleb Mabaso</i>	Independent Member	✓	✓	-	✓
<i>Mr Andre Michaux</i>	Independent Member	✓	✓	✓	✓
<i>Mr Sipho Lubisi</i>	Commissioner, Member	-	✓	✓	✓
<i>Ms Nontobeko Scheppers</i>	Independent Member	✓	✓	✓	-

### 2.4.3 Research Committee

The role of the Research Committee is primarily to assist the Commission in overseeing research and recommendations work of the Commission. The Research Committee provides strategic support and oversight for the work of the Commission's Research and Recommendations Programme. Meetings are held on a quarterly basis, or more

frequently if needed. Activities involve monitoring research plans, resources, outputs and external inputs, reviewing research proposals, and providing strategic direction and guidance during the research process. Equally critical is the Research Committee's role in managing the policy impact of the Commission's recommendations. The table below indicates the Research Committee composition, frequency of meetings and attendance during 2015/2016.

Name of Member	Position	Meetings Attendance and Dates			
		25 June 2015	13 November 2015	9 March 2016	10 March 2016
<i>Professor Nico Steytler</i>	Commissioner, Chairperson	✓	✓	✓	✓
<i>Professor Daniel Plaatjies</i>	Commissioner, Member	-	✓	✓	-
<i>Professor Gilingwe Mayende</i>	Commissioner, Member	✓	-	✓	✓
<i>Dr Sibongile Muthwa</i>	Commissioner, Member	✓	✓	-	-

## 2.5 Remuneration of Commissioners

Section 221(3) of the Constitution and Section 8 of the Financial and Fiscal Commission Act deal with the tenure of office of Commissioners. Section 9 of the Financial and Fiscal Commission Act and Section 219(5) of the Constitution covers the remuneration, allowances and other benefits of the Commissioners. The Commission has made representations regarding the review of its remuneration, which process is still continuing.

## 2.6 Sustainability

### 2.6.1 Funding

The funds of the Financial and Fiscal Commission consist of money appropriated by Parliament for the purpose of the Commission, money earned on bank savings, money received from donors, money obtained by the disposal of movable or immovable property, money accruing to the Commission from any other source, and money otherwise becoming available to the Commission.

### 2.6.2 Risk Management

The Commission identifies and manages strategic risks associated with the objectives in its strategic plan, as well as operational risks in line with its mandate. The Risk Register provides guidelines to the Commissioners and Secretariat regarding the way in which risks should be managed. A risk report is filed monthly by the Executives and reported on at all Commission meetings. Risk management forms an integral part of the Commission's plan to deliver effectively and efficiently on its mandate.

The Commission has developed a risk register which identifies strategic risks and mitigating actions. The register is reviewed monthly thus ensuring that it is up to date, and new or emerging risks are identified. Any significant risk is considered at the Executive Management Planning meetings that take place weekly to contain the risk and prevent it from becoming an incident. The Commission is satisfied that the function is robust and has contributed to improvements in operational performance.

### 2.6.3 Fraud and Corruption Prevention

There is a duty on all staff members to report knowledge or suspicion on fraud and corruption to the relevant personnel within the Commission. The implementation and monitoring is done at the weekly Executive Management Planning meetings, monthly at Management and Executive Committee meetings and is also part of the quarterly Commission Committee meetings.

## 2.6.4 Performance Budgeting and Management

The Commission has customised and adopted the National Treasury Framework for Managing Programme Performance Information and the National Treasury Framework for Strategic Plans and Annual Performance Plans.

### 2.6.5 Code of Ethics

The Commission has developed and adopted a Code of Ethics which has been reviewed regularly. The Code of Ethics applies to all employees and sets out the standard of conduct expected of employees relative to the employer, fellow employees and service providers. Employees must adhere to the code at all times, and failure to do so may lead to disciplinary action. The code addresses principles relating to ethics, conduct, confidentiality and so forth.

### 2.6.7 Health, Safety and Environment Issues

The Commission cares for its employees and their work environment and seeks to ensure, as far as is reasonably possible, the health and safety of all employees in the workplace and all other persons conducting business on its premises. The Commission is committed to the fulfilment

of the requirements stipulated in the Occupational Health and Safety Act. No material health, safety or environmental issues were raised during the year.

### 2.6.8 HIV/AIDS and Health Programme

The Financial and Fiscal Commission has an HIV/Aids Policy that was developed and implemented in 2002. The HIV/Aids Policy make a clear statement regarding the issue of discrimination and protection of employees who are HIV-positive or perceived to be HIV-positive.

With regards to risk of occupational exposure, no specific units or employee categories have been identified to be at high risk of contracting HIV and related diseases.

The Human Resources Strategy includes the implementation of staff HIV/Aids Awareness and Health Promotion Programmes. The Human Resources Strategy also includes the implementation of an Employee Assistance Programme to address broader issues related to employee well-being and health.

## 2.7 Internal Controls

The Commission has developed and implemented a comprehensive system of internal controls as follows:

### 2.7.1 Research and Recommendations Programme

The responsibility of the research function is to translate and implement the strategic direction of the Commission for research and recommendations which is effected through (1) qualitative innovative and independent research, (2) effective administration<sup>1</sup> and (3) intensive and innovative stakeholder engagement<sup>2</sup>. The overarching Commission objective given effect to is to *“Generate quality, innovative, pioneering research that informs key IGFR strategic debates and choices”*. To this end, quality research is a critical core business enabler of evidence-based recommendations. However, excellence in research is unlikely to be impactful, unless policy analysis is packaged in a way that is understood by our stakeholders and adds value to their processes. Accordingly, effective dissemination of research insights and recommendations and effective stakeholder management is the third pillar of the Programme’s work. This includes follow-up on recommendation implementation and innovations on how we engage.

### 2.7.2 Finance

The responsibility of the finance function is to assist the Accounting Officer in the effective, efficient and transparent financial management of the resources of the Commission, including the exercise of sound budgeting and budgetary control practices, the operation of internal controls and the timely production of financial reports.

### 2.7.3 Commission Secretary

The responsibility of the Commission Secretary function is to translate and implement the strategic direction of the Commission for Communication/Stakeholder Management, ensure administrative efficiency and compliance.

### 2.7.4 Corporate Services

The responsibility of the corporate services function is to translate and implement the strategic direction of the Commission for HR management, information and communication technology (ICT) and facilities management.

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<sup>1</sup> This is effected through Research Policy, Research Management and Research Indicators, Time Management and Research Planning and Reporting.

<sup>2</sup> This is effected through Stakeholder Strategy, marketing, communications, knowledge management, branding and outreach activities.



# CHAPTER 3

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## Performance

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# PERFORMANCE

## 3.1 Statement of Responsibility for Performance Information

The Chief Executive is responsible for the preparation of the Commission's performance information and for judgments made on this information. This involves establishing, and implementing a system of internal control designed to provide reasonable assurance as to the integrity and reliability of performance information.

The Auditor-General currently performs the necessary audit procedures on the performance information to provide assurance on audit conclusions. The audit conclusion on the performance against predetermined objectives is included in the report to management. In my opinion and as corroborated by the Auditor General, the performance information fairly reflects the operations of the Commission for the financial year ended 31 March 2016.



**Mr Bongani Khumalo**

Acting Chairperson/Chief Executive

31 May 2016

### 3.2 Measurable Strategic Objectives

The measurable strategic objectives outlined in the Commission's Strategic Plan against which achievements of the Commission are assessed are as follows:

1. To profile the Commission with a special focus on the Commission's Mandate, Vision, Mission and Role, the Commission's Short- and Long-Term Strategy, the Commission's position on specific issues, the Commission's Challenges and Achievements (objective 5.1.1).
2. To ensure that Commission research is converted to policy advice and recommendations written in a language that is accessible to policymakers (objective 5.1.2).
3. To ensure the generation of quality, innovative, pioneering research that informs key IGFR strategic debates and choices (objective 5.1.3).
4. To ensure the progressive and innovative management of human resources that attracts, develops and retains key talent, and leverages external expertise (objective 5.2.1).
5. To ensure the coordinated, coherent, high-quality, innovative and cost-effective approach to ICT that meets the needs of the Commission, the Commission Secretariat and stakeholders (objective 5.2.2).
6. To ensure the coordinated, cost-effective and innovative management of Commission assets in support of delivery on the Commission's mandate (objective 5.2.3).
7. To ensure compliance with legislation and adherence to relevant corporate governance best practice (objective 5.2.4).
8. To ensure superior performance (objective 5.2.5).
9. To ensure the creation of new knowledge, the institutionalization of such knowledge and its transfer to other role players within the intergovernmental fiscal relations system (objective 5.3.1).
10. To ensure prudent and transparent management of the financial resources of the Commission (objective 5.4.1).
11. To ensure access to alternative sources of funding (objective 5.4.2).

The detailed performance information provided below indicates that the Commission has continued making quite significant progress in relation to its medium-term goals while at the same time showing marked improvement in its financial condition as reflected in the audited annual financial statements.

### 3.3 Performance Information 2015/2016

Project/ Activities(Input)	Output (Deliverable)	Key Performance Measure/ Indicator	2014/15 Annual Actual Targets	2015/2016 Annual Planned Targets	2015/2016 Annual Actual Achieved	Variance/ Explanation
<b>Measurable Strategic Objective 5.1.1: Profile the Commission with a special focus on the Commission's Mandate, Vision, Mission and role; approach, the Commission's Short and Long-term Strategy; the Commission's position on specific issues; and the Commission's Challenges and Achievements</b>						
<b>Legislature and Government Plan</b>	Dissemination of Commission proffering, engagement with stakeholders and issues management	Number of briefings on 2016/2017 Submission for the Division of Revenue	2	2 Parliament	2	
			9	9 Provincial Legislatures	9	
			1	2 SALGA	2	
		Number of briefings on 2015 Medium Term Budget Policy Statement	3	1 Parliament	4	3 Additional Committees of Parliament briefed.
		Number of briefings on Commission Submission on the 2016 Division of Revenue Bill	2	1 Parliament	4	3 Additional Committees of Parliament briefed.
		Number of briefings on Fiscal Framework and Revenue Proposals	2	1 Parliament	4	3 Additional Committees of Parliament briefed.
		Number of briefings on Commission Submission on Appropriations Bill	1	1 Parliament	1	
		Number of briefings on Commission Annual Report annually by financial year end	1	1 Parliament	1	
		Number of TCF <sup>3</sup> Meetings	6	4	4	
		Number of Budget Council Meetings and Forum meetings	3	4	4	
		Number of Presentations on request by Stakeholders	12	8 Stakeholder Presentations	41	The Commission responded to invitations that were received. This was due to increase in demand for Commission assistance with BRR reports
<b>Measurable Strategic Objective 5.1.2: To ensure that Commission research is converted to policy advice and recommendations written in language that policymakers can understand</b>						
<b>Use of Official Languages</b>	Accessible Commission profferings	Development of Use of Official Languages Policy	-	1 Use of Official Languages Policy Developed	1	

<sup>3</sup> Technical Committee on Finance

Project/ Activities(Input)	Output (Deliverable)	Key Performance Measure/ Indicator	2014/15 Annual Actual Targets	2015/2016 Annual Planned Targets	2015/2016 Annual Actual Achieved	Variance/ Explanation
Measurable Strategic Objective 5.1.3: To ensure the generation of quality, innovative, pioneering research that informs key IGFR strategic debates and choices						
Research and Recommendations Programme	Better stewardship of public funds/ Value for Money	2015/16 Annual Submission for Division of Revenue in Q1	1	1	1	Invitation was received subsequent to year end on the 10th May 2016.
		2015 Medium Term Budget Policy Statement Submission in Q3	1	1	1	
		2016 Division of Revenue Bill Submission in Q4	1	1	1	
		2016 Fiscal Frameworks and Tax Proposals Submission in Q4	1	1	1	
		2016 Appropriations Bill Submission in Q4	1	1	-	
		2015/2016 Annual Submission Technical Report in Q2	1	1	1	
Measurable Strategic Objective 5.2.1:To ensure the progressive and innovative management of human resource that attracts, develops and retains key talent, and leverages external expertise						
Human Resource Management	People organised effectively for performance	Human Resource Strategy reviewed by Q4	1	Approved Human Resource Strategy reviewed in Q4	1	
		Number of Human Resource Management Policies and Procedures reviewed	8	4	4	
		Remuneration of staff at rates not below DPSA published rates in 2014/2015	100%	SMS and non-SMS staff remuneration not below DPSA rates by Q2	100%	
		Number of unoccupied but budgeted posts	12.1%	No more than 15% of total number of budgeted positions by Q4	3%	
		Number of rate of absenteeism <sup>4</sup>	2.3%	Max 5%	4.3%	
		Number of employees disciplined for misconduct <sup>5</sup>	3%	>10%	3%	
		Number of days in training and development per employee per annum	3.1	Average 3 days year per employee by Q4	1	Not achieved due to capacity challenges.

<sup>4</sup> Total Days Absent/Total Working Days %<sup>5</sup> Incidents/Total Staff Compliment %

Project/ Activities(Input)	Output (Deliverable)	Key Performance Measure/ Indicator	2014/15 Annual Actual Targets	2015/2016 Annual Planned Targets	2015/2016 Annual Actual Achieved	Variance/ Explanation
Human Resource Management cont...	People organised effectively for performance	Number of ratio of male to female staff	SMS 80/20 Professional 31/69 Non- SMS 27/73 Organisation 44/56	SMS 60/40	SMS 73/27	Scarcity of qualify- ing and suitable candidates.
				Professional 50/50	Professional 38/62	Promotion of male employee into Pro- fessional category.
				Non- SMS 50/50	Non- SMS 8/92	Females previously serving as interns were promoted to permanent posi- tions.
				Organisation 50/50 by Q4	Organisation 39/61	No new vacancies during the year.
Measurable Strategic Objective 5.2.2: To ensure the coordinated, coherent, high-quality, innovative and cost-effective approach to ICT that meets the needs of the Commission, the Commission Secretariat and stakeholders						
ICT Management	ICT organised effectively for performance	Number of ICT Policies and Pro- cedures reviewed by Q4	1	4 ICT Policies reviewed and ap- proved by Q4	4	
		Disaster Recovery Plan (DRP) reviewed by Q4	1	Approved Disaster Recovery Plan	1 Approved Disaster Recovery Plan	
		Business Continuity Plan (BCP) reviewed by Q4	1	Approved Business Continuity Plan	1 Approved Busi- ness Continuity Plan	
Measurable Strategic Objective 5.2.3: To ensure the coordinated, cost-effective and innovative management of Commission assets in support of delivery on the Commission's mandate						
Facilities Man- agement	Space, infrastructure, people and organization effectively coordinated for performance	Number of Facilities Management Policies and Procedures reviewed by Q4	1	8	8	
Measurable Strategic Objective 5.2.4: Compliance with legislation and adherence to relevant corporate governance best practice						
Compliance	Commitment to legal and ethical standards, and do- ing the right thing	Strategic plan to National Treasury by due date		Draft 1 to National Treasury in Q2	1	
				Draft 2 to National Treasury in Q3	1	
				Final Strategic Plan to National Treasury in Q4	1	
				Final Strategic Plan to Parliament In Q4	1	
		Tabling of Submission for the Division of Revenue per IGFR Act	1	Tabling of Submission by May 2015	1	
		Submission of 2014/15 and 2015/2016 Quarterly Financial and non- Financial Perfor- mance Information to National Treasury by due date	1	Q4 2014/2015 Reports to National Treasury by 30 April 2015	1	
		1	Q1 2015/2016 Reports to National Treasury by 31 July 2015	1		

Project/ Activities(Input)	Output (Deliverable)	Key Performance Measure/ Indicator	2014/15 Annual Actual Targets	2015/2016 Annual Planned Targets	2015/2016 Annual Actual Achieved	Variance/ Explanation
Compliance cont...	Commitment to legal and ethical standards, and doing the right thing		1	Q2 2015/2016 Reports to National Treasury by 31 October 2015	1	Risk Framework and Risk Policy updated. Risk workshop postponed to May 2016
			1	Q3 2015/2016 Reports to National Treasury by 31 January 2016	1	
		Submission of 2014/2015 Financial and non-Financial Performance Information to Auditor-General by due date.		Unaudited 2014/2015 annual financial statements and Performance Information to Auditor General by 31 May 2015	1	
		2015/2016 MTEF Submission to National Treasury by due date		Submission to National Treasury by Q2	1	
		Submission and tabling of 2014/2015 Annual Report before Parliament, Provincial Legislatures, Organised Local Government, National Treasury and Auditor-General by due date.		Submission of Draft 2014/2015 Annual Report to Auditor General in Q2	1	
				Submission of Draft 2014/2015 Annual Report to National Treasury by 30 September 2015	1	
				Tabling of 2014/2015 Annual Report by 30 September 2015	1	
		2015/2016 Budget Adjustment Estimates Submission to National Treasury by due date		Budget Adjustment Estimates to National Treasury in Q2	1	
		Enterprise Risk Assessment		Risk Management Register updated	-	
				Fraud Prevention Plan reviewed	-	
		Estimates of National Expenditure (ENE) Submission to National Treasury by due date	-	ENE Submission to National Treasury in Q3	1	
		Commission Governance as prescribed by the Financial and Fiscal Commission Act and approved Committee Terms of Reference by Q4	5	4 Commission meetings held as per schedule	3	Partially Achieved Fourth meeting held on 8 April 2016 due to quorum
		Commission Governance as prescribed by the Financial and Fiscal Commission Act and approved Committee Terms of Reference by Q4	12	12 Committee meetings held as per schedule (4 Audit Committee, 4 Human Resources Committee and 4 Research Committee)	11	Number of Research Committee meeting amended to 3 during the year.
			12	12 EXCO Meetings as per approved schedule <sup>6</sup>	12	
			12	12 MANCO Meetings as per approved schedule <sup>7</sup>	12	

<sup>6</sup> Monthly Executive Committee<sup>7</sup> Monthly Management Committee

Project/ Activities(Input)	Output (Deliverable)	Key Performance Measure/ Indicator	2014/15 Annual Actual Targets	2015/2016 Annual Planned Targets	2015/2016 Annual Actual Achieved	Variance/ Explanation
Measurable Strategic Objective 5.2.5: To ensure superior performance						
Performance Management	Consistent attainment of organisational goals	Number of 2015/2016 Performance Targets achieved in Q4	-	100%	88%	
Measurable Strategic Objective 5.3.1: To ensure the creation of new knowledge the, institutionalization of such knowledge and its transfer to other role players within the Intergovernmental fiscal relations system						
Information Management, Enterprise Content Management, and Knowledge Management	Preserve institutional memory	Number of peer-reviewed publications in accredited journals as per Research Policy by Q4	10.6	4	7	Exceeded due to aggressive attendance at conferences, superior innovations and academic leadership
		Number of recognised book chapters or working papers or Technical Reports published as per Research Policy by Q4	13.2	8	9	Exceeded: Technical Report with 7 Chapters published 2 Book Chapters Published.
Measurable Strategic Objective 5.4.1: To ensure prudent and transparent management of the financial resources of the Commission.						
Financial Management	Organizational agility through the allocation of scarce resources amongst competing interests and opportunities	Financial Management Policy and Procedure reviewed by Q4	1	Financial Management Policies and Procedures reviewed and approved by Q4	1	
		Supply Chain Management Policy reviewed by Q4	1	Supply Chain Management Policies reviewed and approved by Q4	1	
		AG Audit Report of 2014/2015 AFS and Performance Information with no matters of emphasis in Q2	1	2014/2015 AG Audit Report with no matters of emphasis in Q2	1	
		Percentage deviation from budget allocation by Q4	1%	No more and no less than 5% of allocation by Q4	2.8%	
Measurable Strategic Objective 5.4.2: To ensure access to alternative sources of funding						
Collaboration and Partnerships	Cooperating to create and/or acquire knowledge	Number of partnerships, sponsorships, collaboration agreements or special projects by Q4	5	1partnership, sponsorship, collaboration agreement or special project by Q4	1	


**Mr Bongani Khumalo**

Acting Chairperson/Chief Executive  
31 July 2016



### 3.4 Commission Submission for the 2016/2017 Division of Revenue

The idea that governments should invest in public infrastructure, to support production and trade (and thus growth and development), is well established. The argument for public investment rests on the belief that resources allocated to investment translate into an equivalent value of public capital stock, which benefits the private sector and affects overall growth by lowering the cost of production or distribution. In the post-war years (1950s and 1960s), the economic models underlying the five-year plans and industrialisation strategies relied heavily on high levels of public investment. However, South Africa has certain challenges that hinder the effective use of resources for development. South Africa faces shortages in economic and social infrastructure, and government is expected to be the main player in closing these deficits, through enabling public policy, and complemented by private investment and innovation. Investment – in (capital) equipment and in new (technological and managerial) ideas – is a crucial engine of growth. Investing in capital allows firms to incorporate new technologies and to reorganise production processes according to global best practice. Therefore, fostering a supportive environment for investment and innovation is central to having a dynamic and productive economy.

Today, unemployment, poverty and inequality are just as important concerns as they were in 1994. Government has adopted a strategy aimed at ensuring the benefits of growth are shared more evenly across the population. The National Development Plan (NDP) sets ambitious goals for economic progress<sup>8</sup> and encapsulates the role of infrastructure in achieving a common 2030 vision for South Africa. The infrastructure drive is propelled by economic growth imperatives and broader social concerns (to eliminate poverty and reduce inequality by 2030). In line with the NDP, government seeks to kick-start economic growth through investing in public infrastructure, which is an important strategic responsibility shared across different spheres and sectors of government. This shared responsibility makes managing public infrastructure financing and implementation complex, and requires substantial and competent coordination. Sub-national governments also need to be able to work collaboratively in designing and implementing investment projects.

The theme of last year's submission was "Balancing fiscal sustainability with socio-economic impact", which is what was needed to address the challenges of potential public debt unsustainability and high levels of poverty and inequality. At the same time, the economy has to grow fast enough to provide the necessary revenue for government's socio-economic programmes. The key is a robust economy able to respond more effectively to shocks and to continue pursuing the NDP goals. A robust economy requires two basic invest-

ments, in people (human capital) and in equipment and physical structures (infrastructure), as well as effectively and efficiently delivered public services, at a cost that South Africans can afford. The focus of this year's Submission is the intergovernmental fiscal relations (IGFR) challenges associated with public infrastructure.

The Submission's point of departure is that current infrastructure is both inadequate and inefficient to meet the NDP goals relating to economic growth, poverty, unemployment and inequality. Government's public investments display relatively high inefficiency because of a manifold of reasons, of which the main ones are:

- Limited short-term capital, resulting in inadequate and inefficient infrastructure, but the question is at what long-term cost.
- Large infrastructure projects often require productivity improvements, life cycle asset management, and complex procurement challenges, which can result in significant delays and cost escalation.
- Weak intergovernmental coordination processes, which may lead to delays in both project evaluation and project oversight and implementation.
- Allocating resources to a project is typically a multiyear commitment, which may pose particular challenges in a budget system with insufficient capacity to spend effectively and given a lack of institutional mechanisms to ensure accountability in infrastructure delivery.
- Projects may also be driven by productivity improvements and use of information and communication technologies (ICTs) that, if widely applied, may improve public infrastructure management but is not the case at this stage.

Added to these challenges is that of corruption in public procurement and investment. As the global economy slowed down from 2007/8 to 2012/13, the spotlight again fell on public infrastructure, as an instrument to revive economic activity. South Africa moved towards an expansionary policy of fiscal stimulus, accompanied by the notion of infrastructure-led growth. South Africa already spends significant amounts of money on public investment, but there are problems of quality. Furthermore, despite substantial resources directed at infrastructure, the outcomes have often fallen short of expectations because of poor infrastructure planning and implementation, escalating costs, supply chain management fraud and inefficiency, and inadequate maintenance.

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<sup>8</sup>For example it sets out to eliminate poverty and reduce unemployment, improve the quality of school education, deconstruct the spatial patterns of the apartheid system, reduce the level of inequality (as measured by the Gini coefficient) from 0.7 in 2007 to 0.6 in 2030, become a less resource-intensive economy, adopt sustainable development practices, etc.

There is a pressing need to harness the power of public infrastructure, given its importance for national development and regional performance. With uncertain future economic prospects and tight fiscal conditions, public infrastructure must be better managed, to achieve the highest value for money and the greatest growth impact from spending public money. Improving the quality of investment governance can help, especially through coordinating investments and building capacity within subnational governments. Levels of public investment are limited by fiscal constraints, and so efficiency needs to be maximised, through better economic growth and investment spending.

This Submission contains analysis and case studies showing the high returns that can result when resources are transformed into assets that support growth and development in line with the NDP. The Submission is structured into three sections. Section I traces major economic and fiscal developments in the past 21 years that affect public infrastructure development, providing a context to the rest of the Submission. It summarises the main economic episodes, policy trends and performance and then goes on to highlight specific problems that continue to beset public infrastructure and are discussed in the rest of the Submission.

The rest of the Submission looks at how South Africa, especially through the IGFR system, can create better conditions for delivering public infrastructure, through designing grants and accountability systems and investing in human capital. Section II examines the grant design and accountability, in particular, South Africa's experiences with direct and indirect conditional grants, and local government's experiences of accountability for public infrastructure delivery. Section III focuses on early childhood development, secondary education productivity and ICT. The Submission contains seven chapters that cover:

- Responding to South Africa Infrastructure Challenges
- Economic Growth Effects of Municipal Capital Spending
- A Review of Direct and Indirect Conditional Grants – The Case of Selected Conditional Grants
- Accountability in Infrastructure Delivery in South Africa: The Case of the Local Government Sphere
- Fiscal Arrangements for Financing Early Childhood Development Infrastructure
- Public Sector Productivity – The Case of Secondary Education.
- Improving Government Operations through Use of Information and Communication Technologies

## The Recommendations

Below is the list of the recommendations of the Commission for the 2016/17 Division of Revenue.

*With respect to creating conditions for the future prosperity of all South Africans from infrastructure-led growth, the Commission recommends that Government:*

1. Develops the National Infrastructure Plan's funding strategy, so that the plan is fully funded to ensure projects are delivered on time and in accordance with the plan. Additional funds need to be raised to cover additional costs of all existing and future infrastructure plans. This has to be done in a sustainable and affordable way, and ensure that such expenditures required for the future operations and maintenance of these assets are catered for.
2. Redesigns capital conditional grants by (a) allowing for payment of infrastructure upstream costs of provinces and municipalities (e.g. a special fund for feasibility and pre-procurement studies), (b) making capital grants pledgeable where an authority has adopted a well-founded and approved long-term capital strategy and (c) extending the existing incentive/support for long-term capital planning by provinces and municipalities
3. Raises public debt, aggressively using the available borrowing space, to help finance deserving and rigorously appraised infrastructure plans (e.g. based on performance and governance profiles). Municipalities should seek to expand debt financing of capital expenditures, with due regard for prudential benchmarks and ratios to ensure sustainability. The increase in debt levels should not trigger a review of the country's credit rating: well-planned and executed infrastructure ultimately pays its way through higher economic growth, and hence the country need not suffer a credit rating downgrade related to such funding mechanisms.
4. Improves acceptability of the user charge principle for higher levels of infrastructure services by (a) using equitable sharing (conditional and unconditional grants) to demonstrate better efforts being made to balance consumer's affordability to pay increased service charges (i.e. water, electricity, transport etc.), (b) undertaking transparent and robust willingness to pay (WTP), (c) making available better data on WTP and affordability, and (d) developing costing models for various services and impacts to demonstrate how such charges could/should be calculated (also determines appropriate level of service)

5. Ensures infrastructure procurement planning, contract award and management work in tandem at the highest strategic level with other elements of infrastructure management to raise efficiency. This can be done through ensuring that all conditional capital grants should not just give money but make sure, from a human resources perspective, that the requisite procurement and engineering skills are there.
3. Comprehensive capacity-building plans are developed, with clearly determined targets and time-frames, in cases where indirect grants are considered as a result of poor capacity within a province or municipality.

*With respect to improving accountability on local government infrastructure delivery, the Commission recommends that:*

*With respect to improving the economic growth effects of municipal capital expenditures, the Commission recommends that:*

1. Grant allocations for infrastructure investment reflect the prioritisation (or weighting) of growth-enhancing infrastructure programmes, to enable municipalities to play their (envisaged critical) role in promoting economic development and growth.
2. Government establishes either an incentive grant or a reserve fund, which can be used to assist or reward municipalities. Funds would be for maintaining and renewing infrastructure, to ensure the long-term sustainability of critical socio-economic infrastructure and enhance local economic growth.
3. Government establishes a transitional capacity-building grant to fund technical assistance for building necessary capacity that will enable municipalities to prepare and implement credible infrastructure asset management plans.

*With respect to managing direct and indirect conditional grants, the Commission recommends that:*

1. National Treasury and line departments consider the use of indirect grants as a measure of last resort while continuing to build capacity in provinces and municipalities.
2. Clear criteria are developed to guide the scheduling and rescheduling of conditional grants, taking into account:
  - a. Historical financial performance
  - b. Non-financial performance
  - c. Time period before converting a direct grant to an indirect grant. The responsible government sphere should be given sufficient time (at least three years) to administer and implement a direct grant before considering conversion to an indirect grant. Such conversion must be implemented through a differentiated approach

1. National Treasury and the Department of Cooperative Governance develop a framework to guide accountability for indirect infrastructure grants. The framework should identify accountability lines, mechanisms, and enforcement, and spell out the consequences for undermining the accountability arrangements.
2. Accountability structures and infrastructure within the local government are strengthened, and incentives are provided within the existing transfer streams for research and technical support. Committees should be provided with adequate technical and research support, and sufficient resources to engage with and account to the communities. Smaller and adjacent municipalities should endeavour to pull together such support to aid the work of accountability committees.
3. That social accountability is institutionalised (established as a convention or norm in the local government sector) and an accountability framework is developed by SALGA, to guide communities on how to hold local governments accountable. This framework should also contain indicators for rating municipality performance on social accountability in general and infrastructure development in particular.

*With respect to fiscal arrangements for financing ECD the Commission recommends that:*

1. Government provides a full or partial capital subsidy for constructing and/or upgrading community- and NPO-based ECD facilities, through the municipal infrastructure conditional grant. The funding will facilitate compliance with the required infrastructure norms and standards, ensure that capital expenditure for ECD is carried out through municipalities and minimise inequities in quality standards and service levels.
2. The Department of Social Development introduces a temporary funding programme from within its allocated budget through which self-identified private ECD facilities in poor areas can apply for capital subsidy assistance, on condition that they agree to meet pre-specified deliverables such as enrolment targets, operational sustainability, educational activities and financial accountability.

3. The national and provincial departments of social development develop an ECD infrastructure sector plan, indicating areas that requires urgent intervention, to inform the allocations and investment in ECD infrastructure by the different government spheres and departments.
4. The provincial departments of social development lobby for the ECD infrastructure plan to be incorporated in municipal IDPs.
5. Government makes available technical intermediary services to ECD facilities that are able to build or upgrade facilities on their own.

*With respect to measures to improve public sector productivity, the Commission recommends that:*

1. A framework on measuring public productivity is developed as a first step to benchmark improvements in the public sector over time. Officials should be trained on the concept of public productivity, and productivity measures should be piloted in certain cluster organisations before rolling them out en masse.
2. The Division of Revenue Act implements the finalised framework on measuring productivity. This may require the implementing agent of a conditional grant to report on the attainment of both quantitative and qualitative indicators of an output, including productivity indicators that track improvements of the service over time.
3. Socio-economic programmes of government which improve living standards and income for households are continued, especially those that lead to improved educational outcomes. Such programmes include the school nutrition programme, no-fee school policy, scholar transport, social security grants and public employment programmes. Research shows higher human capital results in improved labour productivity.
4. Government investigates funding and non-funding mechanisms to improve productivity in public ordinary schools. Such mechanisms should involve enhancing governance and accountability in schools through the appropriate appointment of school principals and enforcing norms and standards that principals must adhere to. Teachers should be supported through training, and the performance management system for teachers should be linked to overall school outcomes. e-Education should be explored as a learning platform to provide both teachers and learners with access to new knowledge.

*With respect to improving government operations through the use of ICT, the Commission recommends that:*

1. The policy and regulatory framework underpinning the ICT sector is simplified, and roles and responsibilities are clearly delineated, particularly for the roll-out of broadband and eGovernment.
2. The department responsible for devising and finalising the eGovernment policy is identified. Finalisation of the policy along with a fully costed implementation plan should be expedited if the NDP goals around eGovernment are to be met within the required time-frame.
3. A fully costed implementation plan is published and made publicly available, to ensure that the NDP goals for rolling out broadband are attained and that sufficient funding is prioritised.
4. eGovernment services are made more attractive to citizens, by offering a wide range of services and ease of access.

# CHAPTER 4

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## Financial Information

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#### 4.1 Statement of Responsibility of the Commission for the Financial Statements for the Year Ended 31 March 2016

The Commission is responsible for preparing financial statements that fairly present the financial position, performance and cash flows for the period and for the related information contained in the annual report.

The Commission maintained adequate accounting records and an effective system of internal controls and risk management and compiled in all material respects with applicable laws and regulations.

The Commission has prepared the annual financial statements presented on pages 45 to 68 using Standards of Generally Recognised Accounting Practice (GRAP). Appropriate accounting policies supported by reasonable and prudent judgements and estimates have been used consistently.

The external auditors are responsible for reporting on whether the financial statements are fairly presented. Their report is presented on page 43.

The Commission is financially dependent on a transfer payment from National Treasury. On the basis that the transfer payment has been listed on the Estimates of National Expenditure, the Commission believes that it will continue to be a going concern in the year ahead. For this reason, the Commission prepared the annual financial statements on a going concern- basis.

The annual financial statements for the year ended 31 March 2016 were approved by the Commission and are signed on its behalf by the undersigned.



**Mr Bongani Khumalo**

Acting Chairperson of Commission

Date: 31 July 2016

## 4.2 Report of the Audit Committee for the Year Ended 31 March 2016

### 4.2.1 Introduction

We are pleased to present the Audit Committee Report for the financial year ended 31 March 2016 in terms of the sections 38(1)a and 77 of the Public Finance Management Act, 1999 and Treasury regulation 3.1.11.

### 4.2.2 Membership and Attendance

The Audit Committee consists of five (5) members. Four(4) of the five (5) members are independent, which is in line with good corporate governance practice. During the year under review, the Audit Committee held four (4) meetings as per the approved terms of reference.

### 4.2.3 Audit Committee Responsibility

The Audit Committee confirms that it has complied with its responsibilities according to section 38(1) (a) of the Public Finance Management Act, 1999 and Treasury Regulation 3.1.13.

The Audit Committee has regulated its affairs in compliance with its approved charter and has discharged all its responsibilities as contained therein.

### 4.2.4 Effectiveness of Internal Control

The review of the effectiveness of the system of internal control by the Audit Committee is informed by the reports submitted by Internal Audit and management, who are responsible for the development and maintenance of the internal control system.

The system of control is designed to provide cost effective assurance that assets are safeguarded and that liabilities and working capital are efficiently managed. In line with the PFMA and the King III report on Corporate Governance requirements, Internal Audit provides the Audit Committee and management with assurance that the internal controls are appropriate and effective. This is achieved by means of the risk management process, as well as the identification of corrective actions and suggested enhancements to the controls and processes.

From the various reports of the Internal Auditors, the Audit Report on the Annual Financial Statements together with the management report of the Auditor-General, it was

noted that no significant or material non-compliance with prescribed policies and procedures have been revealed. Accordingly we can report that the system of internal control for the period under review was efficient and effective.

The internal control environment has been continuously improving as evidenced by the willingness to address the control weaknesses identified by the auditors.

### 4.2.5 Risk Management

The Audit Committee has an oversight responsibility over Commission internal risk management processes. In the year under review the Committee monitored the implementation of Risk Management and reviewed progress quarterly.

Review and assessments of Commission strategic risk will continue to be done on a quarterly basis by the Audit Committee.

### 4.2.6 Risk Management Monthly and Quarterly Reports Submitted in terms of PFMA

The Audit Committee is satisfied with the content and quality of monthly and quarterly reports prepared and issued by the management of the Commission during the year under review.

### 4.2.7 Evaluation of Financial Statements

The Audit Committee has:

- Reviewed and discussed the audited annual financial statements to be included in the annual report, with the Auditor-General and the management;
- Reviewed the Auditor-General's management report and management's response thereto; and
- Reviewed significant adjustments resulting from the audit.

The Audit Committee concurs and accepts the Auditor-General's conclusions on the annual financial statements, and is of the opinion that the audited annual financial statements be accepted and read together with the report of the Auditor-General.



**Mr Jerry Sithole**

Chairperson of Audit Committee

Date: 31 July 2015



### 4.3 Statement of Responsibility of the Accounting Officer for the Financial Statements for the Year Ended 31 March 2016

The Accounting Officer is required by the Public Finance Management Act (Act No.1 1999), to maintain adequate accounting records and is responsible for the content and integrity of the financial statements and related financial information included in this report. It is the responsibility of the Accounting Officer to ensure that the financial statements fairly present the state of affairs of the Commission as at the end of the financial year and the results of its operations and cash flows for the period then ended. The Auditor General has the responsibility of expressing an independent opinion on the financial statements and performance information of the Commission and was given unrestricted access to all financial records and related data. The financial statements have been prepared in accordance with Standards of GRAP including any interpretations, guidelines and directives issued by the Accounting Standards Board. The financial statements are based on appropriate accounting policies being consistently applied and supported by reasonable and prudent judgments and estimates.

The Accounting Officer is ultimately responsible for the system of internal financial control established by the Commission and places considerable importance on maintaining a strong control environment. To enable the Commission to meet these responsibilities, the Accounting Officer sets standards for internal control aimed at reducing the risk of error or deficit in a cost effective manner. The standards include the proper delegation of responsibilities within a clearly defined framework, effective accounting procedures and adequate segregation of duties to ensure an acceptable level of risk. These controls are monitored throughout the Commission and all employees are required to maintain the highest ethical standards in ensuring the Commission's business is conducted in a manner that in all reasonable circumstances is above reproach. The focus of risk management in the Commission is on identifying, assessing, managing and monitoring all known forms of risk across the Commission. While operating risk cannot be

fully eliminated, the Commission endeavours to minimise it by ensuring that appropriate infrastructure, controls, systems and ethical behaviour are applied and managed within predetermined procedures and constraints.

The Accounting Officer is of the opinion, based on the information and explanations given by management that the system of internal controls provides reasonable assurance that the financial records may be relied on for the preparation of the financial statements. However, any system of internal financial control can provide only reasonable, and not absolute, assurance against material misstatement or deficit.

The Accounting Officer has reviewed the Commission's cash flow forecast for the year to 31 March 2016 and, in the light of this review and the current financial position, is satisfied that the Commission has or has access to adequate resources to continue in operational existence for the foreseeable future. Because the Commission is wholly dependent on the Government for continued funding of its operations, the financial statements are prepared on the basis that the Commission is a going concern and that the Government has neither the intention nor the need to liquidate or curtail materially the scale of the Commission.

The Accounting Officer is supported by the Auditor General in ensuring the integrity of the financial affairs of the Commission. The Auditor General is responsible for independently reviewing and reporting on the Commission's financial statements. The financial statements have been examined by the Auditor General and the Auditor General's report is presented on page 43.

The financial statements set out on pages 45 to 68, which have been prepared on the going concern basis, have been approved by the Accounting Officer on 31 May 2016 and duly signed:



**Mr Bongani Khumalo**

Accounting Officer

Date: 31 July 2016



### 4.3.1 Report of the Accounting Officer for the year ended 31 March 2016

Report by the Accounting Officer to the Executive Authority and Parliament of the Republic of South Africa.

#### 1. Review of Activities

The *first* concern for the Commission from a governance perspective during the financial year end was the enactment of the Financial and Fiscal Commission Amendment Act, 2015. The key amendment was the provision for the reconfiguration of roles of the Chairperson and the Chief Executive Officer. The separation of the roles paves the way for the Commission to improve corporate governance as an entity.

*Second* was to strengthen internal controls regarding the audit finding that impacted in the prior years' audit report. During the year the Commission ensured that it strengthened its internal controls which resulted in the Commission obtaining a clean audit report.

*Third* was to ensure that all predetermined objectives are met, the research strategy implemented and general commission submissions are improved in quality and impact which has substantively been addressed. The Commission has in some cases exceeded expectations in terms of its key objectives.

*Fourth* was the compliance to the legislative required submissions that were met according to the Annual Performance Plans. Adherence to the approved reporting frameworks, responsibilities and accountability were accomplished during the period under review.

*Fifth* was the successful partnering in joint initiatives which resulted in the tabling of the report on Municipal Viability that was done in collaboration with the University of the Western Cape (Chair of Multi-Level Governance) and the Municipal Demarcation Board; and the hosting of the roundtable conference entitled "The BRICS Partnership and Multilevel Government in Member Counties: An Unexplored Dimension", that was done jointly with the South African Research Chair in Multilevel Government at the University of Western Cape, HSRC Programme Democracy, Government and Service Delivery and the HSRC'S BRICS Research Centre.

#### Annual Appropriation

The total appropriation for the Financial and Fiscal Commission for the year ending March 31 2016 was R41 156 000.

#### 2. Secretariat Structure

The Commission Secretariat consists of the following Divisions: Research and Recommendations Programme, Corporate Services, Finance and Office of the Commission Secretary. The Research and Recommendations Programme translates and implements the strategic direction of the Commission for research; the Corporate Services Division translates and implements the objectives of the Commission for Human Resource Management, Information and Communications Technology and Facilities Management; the Finance Division assists the Accounting Officer of the Commission in the effective financial management of the Commission including the exercise of sound budgeting and budgetary control practices, the operation of internal controls and the timely production of financial reports; and Office of the Commission Secretary provides governance, secretariat and legal support to the Commission.

#### Revenue Received

The Commission received a total of R42 419 731 in revenue for the reporting period which consisted of R41 156 000 of government grant and R1 313 744 of other income.

#### 3. Donor Funds

A donor funding of R40 000 was received

#### 4. Events after the Reporting Date

The Commission successfully partnered with DNA Economics (Pty) Ltd and hosted a National Health Insurance Colloquium which took place successfully on 1 June 2016. The colloquium explored an array of issues relating to the linkages between the present inter-governmental fiscal relations system and the proposed National Health Insurance. The colloquium has paved the way for further engagements on this matter by the Commission.

#### 5. Major Event Expenditure

The Commission did not incur any expenditure in respect of a major non-mandate event during the period under review.

## 6. Services Rendered by Commission

The core business of the Commission is fully set out in Chapter 1 of this Report. The Commission is not a service delivery institution and does not render services in the public domain on a cost recovery basis.

## 7. Constraints

In a knowledge intensive domain, the Commission remains critically dependent on its key staff. Not only is suitable research expertise difficult to retain, but the specialist technical skills required mean there is not a large pool from which to recruit talent. The Commission still struggles to develop a critical mass of research experience. The attraction of talent, and its management and retention remains a key priority of the Commission.

The cost of compliance with the prescripts of among others, the Copyright Act, 1978; Electronic Communications and Transactions Act, 2002; Promotion of Access to Information Act, 2000; and the requirements and directives of the National Archives and Record Service of South Africa Act, 1996 remains prohibitive.

The gains made in eliminating of accumulated deficit may however be eroded by numerous rapid responses and submissions made in response to stakeholders in line with the requirements of the Financial and Fiscal Commission Act, 1997 and other legislations.

## 8. Corporate Governance Arrangements

### 8.1 Internal Audit Function (IAF)

The IAF of the Commission is outsourced. The current service provider is Nkonki Inc. The IAF is an integral part of the Financial and Fiscal Commission System of Governance.

The IAF provides objective and independent assurance to management and to the Audit Committee on the adequacy and effectiveness of internal controls, risk management and governance processes within the Commission. In pursuing this activity, the IAF is guided by a fully functional Audit Committee which operates in terms of an approved Audit Charter.

The IAF through comprehensive engagement with internal stakeholders formulated a comprehensive three-year rolling plan, incorporating an annual plan that was approved by the Audit Committee. The annual internal audit plan was fully executed during the year under review. The IAF also performed a number of consulting activities and relationships with management improved

as evidenced by the number of unplanned specialised audits, which in turn indicate that Management sees the value of IAF within its system of governance.

The head of the IAF has complete access and a direct reporting line to the Audit Committee and reports at each Audit Committee meeting on control weaknesses and other internal audit activities.

### 8.2 Audit Committee

The Audit Committee continues to operate within its written terms of reference, which are reviewed annually. The Audit Committee met four times during the year. In these meetings, the accounting officer and executive management were represented. The Auditor-General of South Africa and his staff are always invited to attend, thus ensuring that such meetings are as effective as possible.

### 8.3 Risk Management

Because of its size, the Commission does not have a separate Enterprise Risk Management (ERM) Unit under the leadership of a Chief Risk Officer (CRO). The discharge of this responsibility devolves on all members of Executive Management and is coordinated by one such member.

The responsible member of Executive Management has continued to coordinate and support the implementation of risk management activities and Management has reviewed the Commission's Enterprise Risk Management Strategy, which informed the continuous integration of risk management into the day to day activities of the Commission.

Management has championed good governance practices by creating awareness and instituting approved risk management processes and procedures in alignment with regulations and the Public Sector Risk Management Framework. The ongoing risk management activities have culminated in an updated Risk Profile for the Commission that is monitored, on an ongoing basis, by internal governance structures, including the Executive Committee and the Audit Committee. The Executive responsible for coordinating ERM has commenced a process of coordinating the Commission's Business Continuity and Disaster Recovery processes, and will continue to manage this process going forward.

During the course of developing its risk profile, the Commission has identified corruption risks that it may face. In line with the Commission's zero tolerance stance on corruption, activities to mitigate corruption risks have been

incorporated into the reviewed Fraud Prevention Plan for implementation by the identified risk owners. The implementation of the Plan will be monitored to ensure that corruption and risks are managed and a strong ethical culture is maintained throughout the Commission.

#### 8.4 Internal Policy Review

During the period under review, the Executive Committee approved among others the following governance policies and prescripts for implementation and final approval by the Accounting Officer:

- Human Resources management Policies
- Financial Policies and Procedures
- Information Technology Policies and Procedures

#### 8.5 Other Governance Matters

In addition to the governance arrangements listed above, the following governance issues were also given attention:

- Business Continuity/Disaster Recovery Plan

### 9. Discontinued Activities

No activities were discontinued during the course of the reporting period

### 10. New Activities

Except for requests received from stakeholders in terms of Section 3 of the Financial and Fiscal Commission Act, 1997 there were no other new activities during the course of the reporting period.

### 11. Asset Management

In terms of section 38(1)(b) of the Public Finance Management Act, 1999 (as amended), the Accounting Officer of the Commission is responsible for the effective, efficient, economical and transparent use of the resources.

In addition to the normal day-to-day administration and management of the Commission's Asset Register, the Finance and Corporate Services Divisions of the Commission undertook several key activities to improve on the overall asset management environment of the Commission. These activities are as follows:

#### 11.1 Asset verification

Assets are Commission resources that should be disclosed in the Commission's annual financial statements. As such the Commission ensured that all its assets are properly tagged, verified and accounted for and that any lost or redundant assets are identified and removed from the asset register on a timely basis.

An asset verification process was conducted during the current financial year in order to ensure that Commission assets are accounted for and reported accurately in the annual financial statement.

#### 11.2 Asset disposal

During the reporting period, the Finance and Corporate Services Divisions of the Commission, in line with the National Treasury Asset Management Disposal Policy, National Regulations and Governance report pertaining to corporate social responsibility, managed to dispose of redundant and obsolete assets as follows:

- Disposed for recycling legacy information technology and other equipment in a certificated environmentally friendly manner.
- Identified and disposed of legacy and excess assets through a bid process to Commission staff members. These comprised of office furniture.

The Commission will continue to act in an environmentally friendly manner and to support needy communities in the future.

#### 11.3 Acquisition of ICT Assets

The Commission follows Supply Chain Management processes in the acquisition of assets. The Commission has an Information Communication and Technology (ICT) Steering Committee. Each functional Division is represented in the Committee. The terms of reference of the Committee were reviewed in the 2015/16 financial year and an assessment of the effectiveness of its operation was carried out.

### 12. Performance Information

Divisional heads have reported to the Accounting Officer on a regular basis on the progress made with regard to functional delivery and measurable objectives, as contained in the Commission's Strategic Plan.

### 13. Standing Committee on Public Accounts (SCOPA)

There were no SCOPA resolutions in the 2015/2016 financial year relating to the Financial and Fiscal Commission

### 14. Prior Modifications to Audit Reports

None

### 15. Audit Outcomes

I am satisfied that the Annual Financial Statements and the Report on Performance Against Predetermined Objectives of the Commission for the year ending 31 March 2016 are compliant with all applicable legislation and fairly present

in all material aspects the financial status and performance of the Commission. I am supported in this view by the Commission and the Audit Committee of the Commission.

All technical misstatements that were observed during the course of the audit were corrected. This was done with the assistance and support of the Auditor General. I am indebted to the Auditor-General in this respect.

Management is committed to ensuring that future audit engagements with the Auditor General are more efficient and value-adding, time spent on audits is minimized.

### Approval

The Annual Financial Statements set out on pages 45 to 68 have been approved by the Accounting Officer.



**Mr. Bongani Khumalo**

Acting Chairperson/Chief Executive  
31 July 2016

## 4.4 Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Financial and Fiscal Commission for the year ended 31 March 2016.

### Introduction

1. I have audited the financial statements of the Financial and Fiscal Commission (FFC) set out on pages 45 to 68, which comprise the statement of financial position as at 31 March 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the SA Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of Public Finance Management Act of South Africa, 1999 (Act No. 1 of 1999) (PFMA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

### Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the FFC as at 31 March 2016 and their financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the PFMA.

### Emphasis of matter paragraph

7. I draw attention to the matter below. My opinion is not modified in respect of this matter.

### Restatement of corresponding figures

8. As disclosed in note 25 to the financial statements, the corresponding figures for 31 March 2015 have been restated as a result of an error discovered during the audit for the year 31 March 2016.

### Report on other legal & regulatory requirements

9. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected strategic objectives presented in the annual performance report, compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### Predetermined objectives

10. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected strategic objectives presented in the annual performance report of the FFC for the year ended 31 March 2016.

- Strategic objective 5.1.1: Profile of the commission with a special focus on the commission's mandate, vision, mission and role, approach, the commission's short and long-term strategy, the commission's position on specific issues, and the commission's challenges and achievements, on page 26
  - Strategic objective 5.1.2: To ensure that commission research is converted to policy advice and recommendations written in language that policymakers can understand, on page 26
  - Strategic objective 5.1.3: To ensure the generation of quality, innovative, pioneering research that informs key Intergovernmental Fiscal Relations (IGFR) strategic debates and choices, on pages 27
  - Strategic objective 5.3.1: To ensure the creation of new knowledge, the institutionalisation of such knowledge and its transfer to other role players within the IGFR system, on page 30
  - Strategic objective 5.4.1: To ensure prudent and transparent management of the financial resources of the commission, on page 30
11. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPi).
  12. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
  13. I did not raise any material findings on the usefulness and reliability of the reported performance information for the selected strategic objectives.

### Additional matter

14. Although I did not raise any material findings on the usefulness and reliability of the reported performance information for the selected strategic objectives, I draw attention to the following matter:

### Achievement of planned targets

15. Refer to the annual performance report on pages 22 to 34 for information on the achievement of the planned targets for the year.

### Compliance with legislation

16. I performed procedures to obtain evidence that the FFC had complied with applicable legislation regarding financial matters, financial management and other related matters. I did not identify any instances of material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PM.

### Internal control

17. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. I did not identify any significant deficiencies in internal control.

*Auditor-General*

Pretoria  
31 July 2016



## FINANCIAL AND FISCAL COMMISSION

## 4.5 FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2016

## 4.5.1 Statement of Financial Position as at 31 March 2016

Figures in Rand	Note(s)	2016	2015
<b>Assets</b>			
<b>Current Assets</b>			
Receivables from exchange transactions	3	7 936	-
Cash and cash equivalents	4	3 660 900	3 305 395
		<b>3 668 836</b>	<b>3 305 395</b>
<b>Non-Current Assets</b>			
Deposits	5	143 862	143 862
Property, plant and equipment	6	1 145 439	689 082
Intangible assets	7	84 545	19 784
		<b>1 373 846</b>	<b>852 728</b>
<b>Total Assets</b>		<b>5 042 682</b>	<b>4 158 123</b>
<b>Liabilities</b>			
<b>Current Liabilities</b>			
Payables from exchange transactions	8	1 164 992	1 748 646
Provisions	9	1 671 303	1 293 710
		<b>2 836 295</b>	<b>3 042 356</b>
<b>Non-Current Liabilities</b>			
Operating lease liability	10	129 334	133 642
<b>Total Liabilities</b>		<b>2 965 629</b>	<b>3 175 998</b>
<b>Net Assets</b>		<b>2 077 053</b>	<b>982 125</b>
Contributed capital	11	918 752	918 752
Accumulated surplus		1 158 301	63 373
<b>Total Net Assets</b>		<b>2 077 053</b>	<b>982 125</b>

## FINANCIAL AND FISCAL COMMISSION

### FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2016

#### 4.5.2 Statement of Financial Performance

Figures in Rand	Note(s)	2016	2015
<b>Revenue from non-exchange transactions</b>			
Government grants	12	41 156 000	45 288 000
Service-in-kind	27	1 223 731	1 223 731
Donor funds		40 000	28 180
		<b>42 419 731</b>	<b>46 539 911</b>
<b>Other income</b>			
Sundry Income	14	1 000 000	16 900
Interest received		308 266	192 818
Gains on disposal of assets		5 478	3 142
<b>Total other income</b>		<b>1 313 744</b>	<b>212 860</b>
<b>Operating expenses</b>			
Employee costs	15	26 046 121	21 946 754
Depreciation and amortisation	13	104 335	83 740
Professional services	17	5 078 108	6 992 573
Other operating expenditure	18	11 409 983	17 485 247
<b>Total operating expenses</b>		<b>42 638 547</b>	<b>46 508 314</b>
<b>Surplus for the year</b>		<b>1 094 928</b>	<b>244 457</b>



## FINANCIAL AND FISCAL COMMISSION

### FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2016

#### 4.5.3 Statement of Changes in Net Assets

Figures in Rand	Contributed capital	Accumulated surplus	Total net assets
<b>Balance at 01 April 2014</b>	<b>918 752</b>	<b>(181 086)</b>	<b>737 666</b>
Changes in net assets Surplus for year	-	244 456	244 456
Total changes	-	244 456	244 456
<b>Balance at 01 April 2015</b>	<b>918 752</b>	<b>63 373</b>	<b>982 125</b>
Changes in net assets Surplus for year	-	1 094 928	1 094 928
Total changes	-	1 094 928	1 094 928
<b>Balance at 31 March 2016</b>	<b>918 752</b>	<b>1 158 301</b>	<b>2 077 053</b>

## FINANCIAL AND FISCAL COMMISSION

## FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2016

## 4.5.4 Cash Flow Statement

Figures in Rand	Note(s)	2016	2015
<b>Cash flows from operating activities</b>			
<b>Receipts</b>			
Government grants		41 156 000	45 288 000
Interest received		308 266	192 818
Donor funds		40 000	28 180
Sundry income		1 000 000	16 900
		<b>42 504 266</b>	<b>45 525 898</b>
<b>Payments</b>			
Employee costs		(25 829 421)	(21 614 794)
Suppliers		(15 699 367)	(22 599 661)
		(41 528 788)	(44 214 455)
<b>Net cash flows from operating activities</b>	19	<b>975 478</b>	<b>1 311 443</b>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment	6	(552 524)	(68 344)
Proceeds from sale of property, plant and equipment	6	6 839	14 620
Purchase of other intangible assets	7	(74 288)	-
<b>Net cash flows from investing activities</b>		<b>(619 973)</b>	<b>(53 724)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>355 505</b>	<b>1 257 719</b>
Cash and cash equivalents at the beginning of the year		3 305 395	2 047 676
<b>Cash and cash equivalents at the end of the year</b>	4	<b>3 660 900</b>	<b>3 305 395</b>

## FINANCIAL AND FISCAL COMMISSION

### FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2016

#### 4.5.5 Statement of Comparison of Budget and Actual Amounts

##### Budget on Cash Basis

Figure in Rands	Approved Budget	Adjustment	Final Budget	Actual Amounts on comparable-basis	Difference between final budget and actual	Refer-ence
<b>Statement of Financial Performance</b>						
<b>Receipts</b>						
Sundry Income	-	1 000 000	<b>1 000 000</b>	1 000 000	-	
Interest received	-	-	-	308 266	<b>308 266</b>	
Government grants	40 556 000	600 000	<b>41 156 000</b>	41 156 000	-	note 12
Services in kind	-	-	-	1 223 731	<b>1 223 731</b>	note 27
Donor funds	-	40 000	<b>40 000</b>	40 000	-	
<b>Total revenue from non-exchange transactions</b>	<b>40 556 000</b>	<b>640 000</b>	<b>41 196 000</b>	<b>42 419 731</b>	<b>1 223 731</b>	
<b>Total receipts</b>	<b>40 556 000</b>	<b>1 640 000</b>	<b>42 196 000</b>	<b>43 727 997</b>	<b>1 531 997</b>	
<b>Payments</b>						
Employee costs	(25 243 503)	(600 000)	<b>(25 843 503)</b>	(26 046 121)	<b>(202 618)</b>	note 15
Depreciation and amortisation	-	-	-	(104 335)	<b>(104 335)</b>	note 13
Professional services	(5 304 932)	(1 040 000)	<b>(6 344 932)</b>	(5 078 108)	<b>1 266 824</b>	note 17
Other operating expenditure	(10 007 565)	-	<b>(10 007 565)</b>	(11 409 983)	<b>(1 402 418)</b>	note 18
<b>Total expenditure</b>	<b>(40 556 000)</b>	<b>(1 640 000)</b>	<b>(42 196 000)</b>	<b>(42 638 547)</b>	<b>(442 547)</b>	
Gain on disposal of assets and liabilities	-	-	-	5 478	<b>5 478</b>	
<b>Surplus</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1 094 928</b>	<b>1 094 928</b>	

## ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented unless otherwise stated.

### 1. Basis of preparation

The annual financial statements have been prepared in accordance with the Standards of Generally Recognised Accounting Practice (GRAP) including any interpretations of such statements issued by the Accounting Practices Board.

These annual financial statements have been prepared on an accrual basis of accounting and are in accordance with historical cost convention as the basis of measurement, unless specified otherwise. They are presented in South African Rand.

These annual financial statements have been prepared on the going concern basis. This is due to the Commission being entirely dependent on funding from Government, with no indication having been received that such funding will cease in the foreseeable future.

A summary of the significant accounting policies, which have been consistently applied in the preparation of these annual financial statements, are disclosed below.

These accounting policies are consistent with the previous period.

#### 1.1 Revenue recognition

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to contributions from owners.

An exchange transaction is one in which the Commission receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of goods, services or use of assets) to the other party in exchange.

Non-exchange transactions are those transactions where an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Revenue is recognised when it is probable that future economic benefits or service potential will flow to the Commission and these benefits can be measured reliably.

Revenue comprises of government grants, other income, gains on disposals and interest received.

Government grants are the Commission's main source of revenue and are treated with reference to the guidance provided by GRAP 23: Revenue from Non-exchange Transactions. The Commission has developed an appropriate accounting policy on this basis, namely that revenue from non-exchange sources is only recognised to the extent that a corresponding asset satisfies the recognition criteria, but limited to the amount of any outstanding obligation in the form of conditions attached to the grant.

Donor funds received are managed by the Commission in order to enable facilitation of research projects. The funds are recognised as revenue.

#### Rendering of services

Other income is recognised in the reporting period in which the services are rendered, by reference to the stage of completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

The gain arising from the derecognition of an item of property, plant and equipment is included in revenue when the item is derecognised. The gain arising from the derecognition of an item of property, plant and equipment is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Interest is recognized on a time proportion basis, taking into account the principal outstanding or invested and the effective rate over the period to maturity when it is determined that such income will accrue to the Commission.

#### 1.2 Property, plant and equipment

Property, plant and equipment are tangible non-current assets that are held for use in the production or supply of goods or services, rental to others, or for administrative purposes, and are expected to be used during more than one period.

The cost of an item of property, plant and equipment is recognised as an asset when:

- it is probable that future economic benefits or service potential associated with the item will flow to the entity; and
- the cost of the item can be measured reliably. Property, plant and equipment is initially measured at cost.

The cost of an item of property, plant and equipment is the purchase price and other costs attributable to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Trade discounts and rebates are deducted in arriving at the cost.

Property, plant and equipment is carried at cost less accumulated depreciation and any impairment losses.

Property, plant and equipment are depreciated on the straight line basis over their expected useful lives to their estimated residual value.

The useful lives of items of property, plant and equipment have been assessed as follows:

Item	Average useful life
Furniture and fixtures	25 years
Motor vehicles	10 years
Office Equipment	25 years
Computer equipment	10 years
Leasehold improvements	Amortised over the period of the lease

The residual value, and the useful life and depreciation method of each asset are reviewed at the end of each reporting date. If the expectations differ from previous estimates, the change is accounted for as a change in accounting estimate.

Reviewing the useful life of an asset on an annual basis does not require the entity to amend the previous estimate unless expectations differ from the previous estimate.

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately.

The depreciation charge for each period is recognised in surplus or deficit unless it is included in the carrying amount of another asset.

Items of property, plant and equipment are derecognised when the asset is disposed of or when there are no further economic benefits or service potential expected from the use of the asset.

The gain or loss arising from the derecognition of an item of property, plant and equipment is included in surplus or deficit when the item is derecognised. The gain or loss arising from the derecognition of an item of property, plant and equipment is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

No depreciation is provided on paintings, which are considered investment assets. Artwork is valued at cost.

### 1.3 Intangible assets

An intangible asset is recognised when:

- it is probable that the expected future economic benefits or service potential that are attributable to the asset will flow to the Commission; and
- the cost or fair value of the asset can be measured reliably.

The Commission assesses the probability of expected future economic benefits or service potential using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

Where an intangible asset is acquired through a non-exchange transaction, its initial cost at the date of acquisition is measured at its fair value as at that date.

Expenditure on research (or on the research phase of an internal project) is recognised as an expense when it is incurred. Intangible assets are carried at cost less any accumulated amortisation and any impairment losses.

An intangible asset is regarded as having an indefinite useful life when, based on all relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows or service potential. Amortisation is not provided for these intangible assets, but they are tested for impairment annually and whenever there is an indication that the asset may be impaired. For all other intangible assets amortisation is provided on a straight line basis over their useful life.

The amortisation period and the amortisation method for intangible assets are reviewed at each reporting date.

Reassessing the useful life of an intangible asset with a finite useful life after it was classified as indefinite is an indicator that the asset may be impaired. As a result the asset is tested for impairment and the remaining carrying amount is amortised over its useful life.

Internally generated goodwill is not recognised as an intangible asset.

Amortisation is provided to write down the intangible assets, on a straight line basis, to their residual values as follows:

Computer software	10 years
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Intangible assets are derecognised:

- on disposal; or
- when no future economic benefits or service potential are expected from its use or disposal.

The gain or loss arising from the derecognition of an intangible assets is included in surplus or deficit when the asset is derecognised (unless the Standard of GRAP on leases requires otherwise on a sale and leaseback).

#### 1.4 Use of estimates

The preparation of financial statements require management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent liabilities at the date of the financial statement. Estimates are based on current conditions and on other assumptions that are believed to be reasonable under the circumstances. Significant items subject to judgment and such estimates include estimated useful lives and the recoverability of the carrying value of assets.

#### 1.5 Leases

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

Leases under which the risks and benefits of ownership are effectively retained by the lessor, are classified as operating leases. Obligations incurred under operating leases are charged to the statement of financial performance on a straight line basis over the period of the lease, except when an alternative method is more representative of the time pattern from which benefits are derived.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognized as an expense in the period in which termination takes place.

#### 1.6 Provisions

Provisions are recognised when:

- the Commission has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and
- a reliable estimate can be made of the obligation.

The amount of a provision is the best estimate of the expenditure expected to be required to settle the present obligation at the reporting date.

Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate. Provisions are reversed if it is no longer probable that an outflow of resources embodying economic benefits or service potential will be required, to settle the obligation.

A provision is used only for expenditures for which the provision was originally recognised.

A contingent asset is a possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the entity.

A contingent liability is: (a) a possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognised because:

- it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
- the amount of the obligation cannot be measured with sufficient reliability.

After their initial recognition contingent liabilities recognised in entity combinations that are recognised separately are subsequently measured at the higher of:

- the amount that would be recognised as a provision; and
- the amount initially recognised less cumulative amortisation.

Contingent assets and contingent liabilities are not recognised in the Annual Financial Statements. Contingencies are disclosed in note 26.

Provisions are recognised when the Commission has a present legal or constructive obligation as a result of past events, when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are recognised at the present value of the future amount required to settle the obligation at reporting date.

### 1.7 Employee benefits

The Commission operates a defined contribution plan, the assets of which are generally held in separate trustee-administered funds. This plan is funded by payments from employees and the Commission.

The cost of short-term employee benefits, which are those payable within 12 months after the service is rendered, such as annual leave, sick leave and bonuses, are recognised in the period in which the service is rendered and are not discounted.

The expected cost of bonus payment sharing and bonus payments is recognised as an expense when there is a legal or constructive obligation to make such payments as a result of past performance.

### 1.8 Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include cash on hand and bank overdrafts.

### 1.9 Impairment of non-financial assets

Cash-generating assets are assets managed with the objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity.

Non-cash-generating assets are assets other than cash-generating assets.

Impairment is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation (amortisation).

Carrying amount is the amount at which an asset is recognised in the statement of financial position after deducting any accumulated depreciation and accumulated impairment losses thereon.

A cash-generating unit is the smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

Costs of disposal are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

Depreciation (Amortisation) is the systematic allocation of the depreciable amount of an asset over its useful life.

Fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

Recoverable service amount is the higher of a non-cash-generating asset's fair value less costs to sell and its value in use. Useful life is either:

- (a) the period of time over which an asset is expected to be used by the commission; or
- (b) the number of production or similar units expected to be obtained from the asset by the commission.

### 1.10 Budget information

Commission is typically subject to budgetary limits in the form of appropriations or budget authorisations (or equivalent), which is given effect through authorising legislation, appropriation or similar.

General purpose financial reporting by commission provides information on whether resources were obtained and used in accordance with the legally adopted budget.

The approved budget covers the fiscal period from 2015/04/01 to 2016/03/31.

The annual financial statements and the budget are not on the same basis of accounting therefore a reconciliation between the statement of financial performance and the budget have been included in the annual financial statements.

Comparative information is not required.

### 1.11 Related parties

The commission operates in an economic sector currently dominated by entities directly or indirectly owned by the South African Government. As a consequence of the constitutional independence of the three spheres of government in South Africa, only entities within the national sphere of government are considered to be related parties.

Management are those persons responsible for planning, directing and controlling the activities of the entity, including those charged with the governance of the entity in accordance with legislation, in instances where they are required to perform such functions.

Only transactions with related parties not at arm's length or not in the ordinary course of business are disclosed.

### 1.12 Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or a residual interest of another entity.

Financial instruments carried on the statement of financial position include cash and bank balances, receivables and trade creditors. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

A financial asset is:

- cash;
- a residual interest of another entity; or
- a contractual right to:
  - receive cash or another financial asset from another entity; or
  - exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity.

A financial liability is any liability that is a contractual obligation to:

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Liquidity risk is the risk encountered by an entity in the event of difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk.

A financial asset is past due when a counterparty has failed to make a payment when contractually due.

### Recognition

Financial instruments are initially recognised at fair value when the Commission becomes party to the contractual arrangements of the instrument.

### Measurement

Subsequent to initial recognition these instruments are measured as set out below:

### Financial assets

Trade and other receivables

Receivables from exchange transactions are categorised as loans and receivables and consist of prepaid expenses and rental deposits. These are initially measured at fair value, and subsequently measured at amortised cost, being the initially recognised amount, plus any interest accrued, less any repayments, less any impairments.

### Impairment of financial assets

At each reporting date the Commission assesses all financial assets to determine whether there is objective evidence that a financial asset or group of financial assets has been impaired. For amounts due to the Commission, significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy and default of payments are all considered indicators of impairment.

Impairment deficits are recognised in the Statement of Financial Performance. Impairment losses are reversed when an increase in the financial asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to the restriction that the carrying amount of the financial asset at the date



that the impairment is reversed shall not exceed what the carrying amount would have been had the impairment not been recognised.

Where financial assets are impaired through use of an allowance account, the amount of the deficit is recognised in the statement of financial performance within operating expenses. When such assets are written off, the write off is made against the relevant allowance account. Subsequent recoveries of amounts previously written off are credited against operating expenses.

### Financial liabilities

The Commission's principal financial liabilities are accounts payables, categorised as other financial liabilities measured at amortised cost. Initial measurement is at fair value, with subsequent measurement being at amortised cost, being the amount initially recorded plus any accrued finance charges, less repayments made.

### 1.13 Irregular and fruitless and wasteful expenditure

Irregular expenditure as defined in section 1 of the PFMA is expenditure other than unauthorised expenditure, incurred in contravention of or that is not in accordance with a requirement of any applicable legislation, including -

- (a) this Act; or
- (b) the State Tender Board Act, 1968 (Act No. 86 of 1968), or any regulations made in terms of the Act; or
- (c) any provincial legislation providing for procurement procedures in that provincial government.

National Treasury practice note no. 4 of 2008/2009 which was issued in terms of sections 76(1) to 76(4) of the PFMA requires the following (effective from 1 April 2008):

Irregular expenditure that was incurred and identified during the current financial and which was condoned before year end and/or before finalisation of the financial statements must also be recorded appropriately in the irregular expenditure register. In such an instance, no further action is also required with the exception of updating the note to the financial statements.

Irregular expenditure that was incurred and identified during the current financial year and for which condonement is being awaited at year end must be recorded in the irregular expenditure register. No further action is required with the exception of updating the note to the financial statements.

Where irregular expenditure was incurred in the previous financial year and is only condoned in the following financial year, the register and the disclosure note to the financial statements must be updated with the amount condoned.

Irregular expenditure that was incurred and identified during the current financial year and which was not condoned by the National Treasury or the relevant authority must be recorded appropriately in the irregular expenditure register. If liability for the irregular expenditure can be attributed to a person, a debt account must be created if such a person is liable in law. Immediate steps must thereafter be taken to recover the amount from the person concerned. If recovery is not possible, the accounting officer or accounting authority may write off the amount as debt impairment and disclose such in the relevant note to the financial statements. The irregular expenditure register must also be updated accordingly. If the irregular expenditure has not been condoned and no person is liable in law, the expenditure related thereto must remain against the relevant programme/expenditure item, be disclosed as such in the note to the financial statements and updated accordingly in the irregular expenditure register.

Irregular expenditure is recorded in the notes to the financial statements when confirmed. The amount is recorded is equal to the total value of the irregularity unless it is impracticable to determine in which case reasons therefore is provided in the note. Irregular expenditure is removed from the note when it is either:

- (a) condoned by the National Treasury or the relevant authority;
- (b) it is transferred to receivables for recovery; or (c) it is not condoned and is irrecoverable. A receivable related to irregular expenditure is measured at the amount that is expected to be recovered and must be de-recognised when the receivable is settled or subsequently written off as irrecoverable.

Fruitless and wasteful expenditure means expenditure which was made in vain and would have been avoided had reasonable care been exercised. Fruitless and Wasteful expenditure is accounted for as an expense in the Statement of Financial Performance and where recovered, it is subsequently accounted for as revenue in the Statement of Financial Performance.

### 1.14 Translation of foreign currencies Transactions and balances

Transactions denominated in foreign currencies are translated into South African Rand (i.e. functional currency) at the foreign exchange rate prevailing at the date of the transaction. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Monetary transactions are translated at exchange rates prevailing at the close of the reporting period.

## Forex profit and loss

Foreign exchange gains or losses resulting from the settlement of such transactions and are recognised in statement of Financial Performance.

At each statement of financial position date:

- (a) foreign currency monetary items are reported using the closing rate,
- (b) non-monetary items, which are carried in terms of historical cost denominated in a foreign currency, are reported using the exchange rate at the date of transaction, and
- (c) non-monetary items which are carried at fair value denominated in a foreign currency, are reported using the exchange rates that existed when the values were determined.

Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at the rates different from those at which they initially recorded during the period, or reported in previous financial statements, are recognized as income or expenses in the period in which they arise.

### 1.15 Commitments

Items are classified as commitments when an entity has committed itself to future transactions that will normally result in the outflow of cash.

Disclosures are required in respect of unrecognised contractual commitments.

Commitments for which disclosure is necessary to achieve a fair presentation should be disclosed in a note to the financial statements, if both the following criteria are met:

- Contracts should be non-cancellable or only cancellable at significant cost (for example, contracts for computer or building maintenance services); and
- Contracts should relate to something other than the routine, steady, state business of the entity – therefore salary commitments relating to employment contracts or social security benefit commitments are excluded.

### 1.16 Revenue from non-exchange transactions

Revenue comprises gross inflows of economic benefits or service potential received and receivable by an entity, which represents an increase in net assets, other than increases relating to contributions from owners.

Control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Transfers are inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.

## Recognition

An inflow of resources from a non-exchange transaction recognised as an asset is recognised as revenue, except to the extent that a liability is also recognised in respect of the same inflow.

As the Commission satisfies a present obligation recognised as a liability in respect of an inflow of resources from a non-exchange transaction recognised as an asset, it reduces the carrying amount of the liability recognised and recognises an amount of revenue equal to that reduction.

Except for financial guarantee contracts, the Commission recognises services in-kind that are significant to its operations and/or service delivery objectives as assets and recognise the related revenue when it is probable that the future economic benefits or service potential will flow to the entity and the fair value of the assets can be measured reliably.

Where services in-kind are not significant to the Commission's operations and/or service delivery objectives and/or do not satisfy the criteria for recognition, the entity discloses the nature and type of services in-kind received during the reporting period.

## Measurement

Revenue from a non-exchange transaction is measured at the amount of the increase in net assets recognised by the entity.

When, as a result of a non-exchange transaction, the Commission recognises an asset, it also recognises revenue equivalent to the amount of the asset measured at its fair value as at the date of acquisition, unless it is also required to recognise a liability. Where a liability is required to be recognised it will be measured as the best estimate of the amount required to settle the obligation at the reporting date, and the amount of the increase in net assets, if any, recognised as revenue. When a liability is subsequently reduced, because the taxable event occurs or a condition is satisfied, the amount of the reduction in the liability is recognised as revenue.

## Notes to the Annual Financial Statements

Figures in Rand	2016	2015
<b>2. New standards and interpretations</b>		
<b>2.1 Standards and interpretations issued, but not yet effective</b>		
<p>The following approved Standards of GRAP have been approved and issued by the Accounting Standards Board, but only become effective in the future or have not been given an effective date by the Minister of Finance. The Commission has not early-adopted any new standards, but has in some cases referred to them for guidance in developing appropriate accounting policies in accordance with the requirements of Directive 5: Determining the GRAP Reporting Framework:</p>	<p>that result from principal-agent arrangement, but provides guidance on whether the revenue, expenses, assets and/or liabilities should be recognised by an agent or the principal.</p>	
<b>GRAP 20 - Related Parties</b>	<p>The following interpretations have also been issued and are expected to have an insignificant impact on the financial statements, since they generally reflect the interpretations and principles already established under SA GRAP. It is unlikely that the Commission will encounter any of these issues in the normal course of its business.</p>	
<p>This standard is drawn primarily from IPSAS 20: Related Party Disclosures. Since IPSAS 20 has been applied in developing the current accounting policy and levels of disclosure no significant impact on the financial statement of the Commission is expected. This standard does not yet have an effective date.</p>	<p><b>IGRAP1</b> - Applying the Probability Test on Initial Recognition of Exchange Revenue.</p>	
<b>GRAP 32 - Service Concession Arrangements: Grantor</b>	<p><b>IGRAP2</b> - Changes in Existing Decommissioning Restoration and Similar Liabilities.</p>	
<p>This standard prescribes the accounting for service concession arrangements by the grantor, a public sector entity. The arrangement involves the operator providing a mandated function related to the service concession asset on behalf of the grantor. The operator providing the mandated function can either be a private party or another public sector entity. The standard is unlikely to have an impact on the financial statements of the Commission in the foreseeable future. This standard does not yet have an effective date.</p>	<p><b>IGRAP3</b> - Determining Whether an Arrangement Contains a Lease.</p>	
<b>GRAP 108 - Statutory Receivables</b>	<p><b>IGRAP4</b> - Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds.</p>	
<p>This standard provides for the treatment of receivables that arise from legislation or from equivalent means. The impact of the standard on the financial statements of the Commission is still being assessed, but it is unlikely that the Commission will undertake specific legislative transactions in the foreseeable future. This standard does not yet have an effective date.</p>	<p><b>IGRAP5</b> - Applying the Restatement Approach under the Standard of GRAP on Financial Reporting in Hyperinflationary Economies.</p>	
<b>GRAP 109 - Accounting by Principals and Agents</b>	<p><b>IGRAP6</b> - Loyalty Programmes.</p>	
<p>This standard outlines principles to be used by the Commission in assessing whether it is party to a principle-agent arrangement, and whether it is a principal or agent in undertaking transactions in such an arrangement. The standard does not introduce new recognition or measurement requirements for revenue, expenses, assets and/or liabilities</p>	<p><b>IGRAP7</b> - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.</p>	
	<p><b>IGRAP8</b> - Agreements for the Construction of Assets from Exchange Transactions.</p>	
	<p><b>IGRAP9</b> - Distributions of Non-cash Assets to Owners.</p>	
	<p><b>IGRAP10</b> - Assets Received from Customers.</p>	
	<p><b>IGRAP11</b> - Consolidation - Special Purpose Entities.</p>	
	<p><b>IGRAP12</b> - Jointly Controlled Entities - Non-Monetary Contributions by Ventures.</p>	
	<p><b>IGRAP13</b> - Operating Leases – Incentives.</p>	
	<p><b>IGRAP14</b> - Evaluating the Substance of Transactions Involving the Legal Form of a Lease</p>	
	<p><b>IGRAP15</b> - Revenue – Barter Transactions Involving Advertising Services.</p>	
	<p><b>IGRAP16</b> - Intangible Assets - Website Costs.</p>	

## Notes to the Annual Financial Statements

Figures in Rand	2016	2015
<b>3. Receivables from exchange transactions</b>		
Other receivables	7 936	-
<b>4. Cash and cash equivalents</b>		
Cash and cash equivalents consist of:		
Cash on hand	1 453	1 416
Bank balances	3 659 447	3 303 979
	<b>3 660 900</b>	<b>3 305 395</b>
<b>5. Deposits</b>		
Rental Deposits	143 862	143 862

Deposits relate to rental deposits on the premises occupied by the Commission.

**6. Property, Plant and Equipment**

	2016			2015		
	Cost/ Valuation	Accumulated depreciation and impair- ment	Carrying Value	Cost/ Valuation	Accumulated depreciation and impair- ment	Carrying Value
Furniture and fixtures	2 429 650	(2 144 852)	284 798	2 408 593	(2 127 088)	281 505
Motor vehicles	236 829	(199 363)	37 466	236 829	(190 466)	46 363
Computer equipment	1 454 526	(751 830)	702 696	1 020 106	(729 734)	290 372
Leasehold improvements	475 942	(394 269)	81 673	413 211	(381 175)	32 036
Artwork	38 806	-	38 806	38 806	-	38 806
<b>Total</b>	<b>4 635 753</b>	<b>(3 490 314)</b>	<b>1 145 439</b>	<b>4 117 545</b>	<b>(3 428 463)</b>	<b>689 082</b>

**Reconciliation of property, plant and equipment – 2016**

	Opening Balance	Additions	Disposals	Depreciation	Total
Furniture and fixtures	281 505	21 056	-	(17 763)	284 798
Motor vehicles	46 363	-	-	(8 897)	37 466
Computer equipment	290 372	468 737	(1 361)	(55 052)	702 696
Leasehold improvements	32 036	62 731	-	(13 094)	81 673
Artwork	38 806	-	-	-	38 806
	<b>689 082</b>	<b>552 524</b>	<b>(1 361)</b>	<b>(94 806)</b>	<b>1 145 439</b>

**Reconciliation of property, plant and equipment – 2015**

	Opening Balance	Additions	Disposals	Depreciation	Total
Furniture and fixtures	296 305	7 410	(3 855)	(18 355)	281 505
Motor vehicles	55 260	-	-	(8 897)	46 363
Computer equipment	279 317	60 934	(7 623)	(42 256)	290 372
Leasehold improvements	41 412	-	-	(9 376)	32 036
Artwork	38 806	-	-	-	38 806
	<b>711 100</b>	<b>68 344</b>	<b>(11 478)</b>	<b>(78 884)</b>	<b>689 082</b>

**7. Intangible assets**

	2016			2015		
	Cost / Valuation	Accumulated amortisation and accumulated impairment	Carrying Value	Cost/Evaluation	Accumulated depreciation and impairment	Carrying Value
Computer software	244 310	(159 765)	84 545	225 422	(205 638)	19 784

**Reconciliation of intangible assets - 2016**

	Opening balance	Additions	Amortisation	Total
Computer Software	19 784	74 288	(9 527)	84 545

**Reconciliation of intangible assets - 2015**

	Opening balance	Amortisation	Total
Computer Software	24 640	(4 856)	19 784

**Figures in Rand**

	2016	2015
<b>8. Payables from Exchange Transactions</b>		
Trade payables	316 634	244 356
Accrued expenses	848 358	1 504 292
	<b>1 164 992</b>	<b>1 748 648</b>

Figures in Rand	2016	2015
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## 9. Provisions

### Reconciliation of provisions - 2016

	Opening Balance	Additions	Utilised during the year	Total
Performance Bonus	539 306	639 846	(539 306)	639 846
Leave benefits	754 404	277 938	(885)	1 031 457
	<b>1 293 710</b>	<b>917 784</b>	<b>(540 191)</b>	<b>1 671 303</b>

### Reconciliation of provisions - 2015

	Opening Balance	Additions	Utilised during the year	Total
Bonus	315 967	539 306	(315 967)	539 306
Leave benefits	645 783	175 952	(67 331)	754 404
	<b>961 750</b>	<b>715 258</b>	<b>(383 298)</b>	<b>1 293 710</b>

In terms of the Financial and Fiscal Commission's leave policy, employees are entitled to accumulated vested leave pay benefits not taken within a leave cycle, provided that any leave pay benefits not taken within a period of one year after the end of a leave cycle are forfeited. A provision for R639 846 (2015:R539 306) was recognised for performance bonuses and will be paid in the following financial year, in accordance with the Commission's performance management policy.

## 10. Operating lease liability

Accrual in respect of straight line operating lease	129 334	133 642
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## 11. Contributed capital

Value of Assets received from National Treasury at the establishment of the Commission	918 752	918 752
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## 12. Government grants

### Operating grants

Revenue comprises amounts received from National Treasury	41 156 000	45 288 000
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## 13. Depreciation and Amortisation

Property, plant and equipment	91 090	78 884
Intangible Assets	13 245	4 856
	<b>104 335</b>	<b>83 740</b>

## 14. Other Income

Sundry Income	1 000 000	16 900
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Sundry Income during the year relates to funds received from South African Local Government Agency (SALGA) in partnership with the Commission for the "Cost of Municipal Services" project.

Figures in Rand	2016	2015
<b>15. Employee Costs</b>		
Basic	23 520 857	19 838 804
Performance bonus	639 846	702 073
Leave pay provision charge	277 052	108 621
UIF	58 412	50 799
Long-service awards	257 864	249 026
Other personnel costs	1 168 219	997 431
<b>Total</b>	<b>26 046 121</b>	<b>21 946 754</b>
<p>The cost of short-term employee benefits, which are those payable within 12 months after the service is rendered, such as annual leave, sick leave and bonuses, are recognised in the period in which the service is rendered and are not discounted</p> <p>The expected cost of bonus payment sharing and bonus payments is recognised as an expense when there is a legal or constructive obligation to make such payments as a result of past performance.</p>		
<b>16. Related Parties</b>		
<p>All National Departments of Government and National State-controlled entities are regarded as related parties in accordance with IPSAS 20. The Financial and Fiscal Commission is a constitutional institution reporting to Parliament from which it received grants in the current and prior years. Transactions with related parties that are on the same terms as those generally available in the sector and related to transactions in the ordinary course of business are not discloseable in terms of IPSAS 20. Payments to Commissioners and Management are reflected below.</p>		
<b>Executive Commissioners - B. Khumalo</b>		
Annual Salary	1 550 541	1 506 569
Other Contributions	100 320	91 467
<b>Total</b>	<b>1 650 861</b>	<b>1 598 036</b>
<b>Non-Executive Commissioner – T. Ajam</b>		
Annual Salary	-	195 732
<b>Total</b>	<b>-</b>	<b>195 732</b>
<b>Executive Commissioner – N. Shezi</b>		
Annual Salary	-	3 559
<b>Total</b>	<b>-</b>	<b>3 559</b>
<b>Non-Executive Commissioner – S Muthwa</b>		
Annual Salary	91 250	16 190
<b>Total</b>	<b>91 250</b>	<b>16 190</b>



Figures in Rand	2016	2015
<b>Non-Executive Commissioner – S Lubisi</b>		
Annual Salary	21 016	57 220
Travel expenses	3 683	14 030
<b>Total</b>	<b>24 699</b>	<b>71 250</b>
<b>Non-Executive Commissioner – N Steytler</b>		
Annual Salary	97 653	61 694
Travel expenses	-	1 200
<b>Total</b>	<b>97 653</b>	<b>62 894</b>
<b>Non-Executive Commissioner – D Plaatjies</b>		
Annual Salary	368 394	125 657
<b>Total</b>	<b>368 394</b>	<b>125 657</b>
<b>Non-Executive Commissioner – K Kumar</b>		
Annual Salary	14 461	24 990
<b>Total</b>	<b>14 461</b>	<b>24 990</b>
<b>Non-Executive Commissioner – G Mayende</b>		
Annual Salary	21 016	33 436
Travel expenses	5 052	4 172
<b>Total</b>	<b>26 068</b>	<b>37 608</b>

<b>31 March 2016</b>	<b>Salary</b>	<b>Performance Bonus</b>	<b>Other</b>	<b>Total</b>
Ramos Mabugu, Research Director	1 327 280	45 114	4 163	1 376 557
Mavuso Vokwana, CFO	1 103 777	28 864	436	1 133 077
Ansuyah Maharaj, Commission Secretary	1 042 976	-	1 491	1 044 467
	<b>3 474 033</b>	<b>73 978</b>	<b>6 090</b>	<b>3 554 101</b>

<b>31 March 2015</b>	<b>Salary</b>	<b>Performance Bonus</b>	<b>Other</b>	<b>Total</b>
Ramos Mabugu, Research Director	1 208 995	48 020	7 027	1 264 042
Mavuso Vokwana, CFO	1 031 374	-	3 099	1 034 473
Anton van Niekerk, Corporate Services Manager	842 322	-	36 381	878 703
Ansuyah Maharaj, Commission Secretary	711 976	-	3 524	715 500
Mashumi Mzaidume, Commission Secretary (Resigned)	101 088	32 013	13 084	146 185
	<b>3 895 755</b>	<b>80 033</b>	<b>63 115</b>	<b>4 038 903</b>

## 17. Professional Services

<b>Figures in Rand</b>	<b>2016</b>	<b>2015</b>
Legal Fees	128 151	-
External Audit Fees	1 149 881	1 120 436
Risk Management Fees	245 270	224 003
Internal Audit Fees	886 977	1 417 966
Commissioned Research	2 667 829	4 230 168
<b>Total</b>	<b>5 078 108</b>	<b>6 992 573</b>

Figures in Rand	2016	2015
<b>18. Other operating expenditure – Material classes of transactions</b>		
<b>Total other operating expenditure includes the following material transactions:</b>		
Software licences	484 176	421 740
Internet connection	470 993	653 088
IT support	375 523	409 160
Workshops & meetings	1 241 349	5 815 904
Printing & publications	525 371	1 185 244
Communication & cell phones	905 282	848 562
Office rent	1 731 661	1 737 410
Travel expenses	2 705 192	3 307 057
	<b>8 439 547</b>	<b>14 378 165</b>
<b>19. Cash generated from operations</b>		
Surplus	1 094 928	244 458
<b>Adjustments for:</b>		
Depreciation and amortisation	104 335	83 740
Loss (gain) on sale of assets and liabilities	(5 478)	(3 142)
Movements in operating lease assets and accruals	(4 308)	39 383
Movements in provisions	377 593	331 960
<b>Changes in working capital:</b>		
Receivables	(7 936)	306 544
Payables from exchange transactions	(583 656)	308 500
	<b>975 478</b>	<b>1 311 443</b>

Figures in Rand	2016	2015
<b>20. Commitments</b>		
<b>Operating leases - as lessee (expense)</b>		
<b>Minimum lease payments due</b>		
- within one year	637 037	589 849
- in second to fifth year inclusive	565 789	1 202 826
	<b>1 202 826</b>	<b>1 792 675</b>

Operating lease payments represent rentals payable by the entity for certain of its office premises. Leases are negotiated for an average term of five years and have an 8% escalation clause. No contingent rent is payable..

## 21. Going concern

Attention is drawn to the Statement of Financial Performance which indicates that the Commission realised a net surplus of R1 094 928 (2015: R244 457) in the year ended 31 March 2016, and thus increasing the Commission's accumulated surplus from R63 373 to a surplus of R1 158 301. Furthermore the Commission's assets exceed its liabilities at the reporting date by R2 077 053 (2015: R982 125). The Commission's ability to continue as going concern depends largely on the continued support of government means of annual appropriation. The Commission will make declaration and request approval from the National Treasury to retain part of the entire cash surplus.

Figures in Rand	2016	2015
<b>22. Irregular expenditure</b>		
Opening balance	-	1 290 200
	-	-
Less: Amounts condoned	-	-
Less: Amounts not recoverable (not condoned)	-	1 290 200
	-	-

Figures in Rand	2016	2015
<b>23. Financial Risk Management</b>		

**Liquidity Risk**

Financial liabilities which potentially subject the Commission to concentrations of liquidity risk are trade and other payables. Loans and The Commission's risk to liquidity is a short fall in funds available to pay its payables. The payables are all due within the short term. The Commission manages its liquidity risk by holding sufficient cash in the bank account.

At 31 March 2016	Less than 1	Between 1 and 2 years	Between 2 and 5 years	Over 5 years
Trade and other payables	1 000 190	-	-	-
At 31 March 2015	Less than 1	Between 1 and 2 years	Between 2 and 5 years	Over 5 years
Trade and other payables	1 748 646	-	-	-

**Credit risk**

Financial assets which potentially subject the Commission to concentrations of credit risk is principally of receivables. Loans and Receivables are of a sundry nature and the credit risk is therefore limited, the credit risk is managed through periodic reviews of the level of bad debts. Accordingly the Commission has no significant concentration of credit risk.

Trade and other payables	7 936	-
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**Market risk***Interest rate risk*

The Commission has cash and cash equivalents placed with financial institutions and is therefore exposed to interest rate fluctuations and such changes in market interest rates affect the fair value of cash. The interest rate risk embodies not only the potential for loss but also the potential for gain and is managed through the cash management policy.

*Fair values*

At 31 March 2016 the carrying amounts of accounts payable and accounts receivable approximated their fair value due to the short term maturities of these assets and liabilities. Since the Commission does not undertake any significant investment strategy there is no significant sensitivity to fair value fluctuations of financial instruments.

*Foreign currency risk*

The Commission transacts with foreign persons from time-to-time. The Commission is relatively insensitive to subsequent fluctuations in currency since most transactions are settled in advance, resulting in there being few monetary items that would again require translation at reporting date. The Commission's management will continue to assess the frequency and nature of these transactions to determine whether further foreign currency risk management strategies are required but at this stage the risk is limited.

**24. Retirement benefit information****Defined contribution plan**

During the year, the Financial and Fiscal Commission contributed to Momentum Provident Fund for all its employees. This constituted a defined contribution fund governed by the Pension Fund Act (Act 24 1956, as amended). In terms of the rules of the fund, the Commission is committed to contribute 12.5% of pensionable emoluments towards the retirement fund and 3.5% of pensionable emoluments towards an accident compensation fund. An amount of R3 177 494 (2015: R2 587 819) was recognised as an expense during the year for contributions to the retirement fund. The FFC has no liability to members beyond what is contributed to the fund.

## Figures in Rand

2016

2015

**25. Prior period errors**

A prior period adjustment of R1 223 731.44 was made to account for services in kind received from the Department of Public works in the previous financial year. The restatement has no effect on net assets or liabilities.

The correction of the error(s) results in adjustments as follows:

**Statement of Financial Performance**

Revenue from services in kind	1 223 731	1 223 731
Office rental	1 223 731	1 223 731

**26. Contingent assets**

These amounts are not recognised in the Annual Financial Statements and are disclosed to enhance the fair presentation of the Annual Financial Statements.

The Commission has since 2010 incurred rental expenses relating to the Midrand office and has paid rental costs to the landlord JHI. Simultaneously the Department of Public Works has made payment relating to the same office space on behalf of the Commission to JHI. The Commission has subsequently requested that the landlord return the payments to the Commission.

This matter is currently being investigated by National Treasury and contingent asset has been disclosed as it is possible that economic benefits might flow to the entity that arises from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

The amount disclosed as a contingent asset was based on historical payments made by the Commission into the landlord's banking account.

**Nature of contingent asset**

Midrand lease rental	3 054 127	3 054 127
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**27. Services-in-kind****Department of Public Works**

Office Rental	1 223 731	1 223 731
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The Commission has recognised services in kind related to the office accommodation in Midrand. Department of Public Works has traditionally entered into contractual agreements and paid for the rental on behalf of the Commission.

**28. Budget differences****Material differences between budget and actual amounts**

The excess of final budget over the actual expenditure of 21% in other professional services was due to stringent measures put in place to curb spending on external consultants.

# CHAPTER 5

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## Human Resources Management

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# HUMAN RESOURCES

## 5.1 Introduction and Oversight Overview

The employment of dedicated and competent employees is fundamental to the Commission meeting its goals and objectives. The Commission strives to create a work environment that supports employee growth and development. It aims to provide employees with the skills and tools they require to perform their jobs and meet the needs of the organisation. The Human Resources Division is the custodian of the overall human capital management function, with the responsibility to ensure that the Commission is able to achieve its vision, mission and strategic goals through the optimum organisation of its human

resources. During the year under review, the Commission streamlined its processes to enhance its management of human resources. The Commission further reviewed its policies. Employee engagements, leadership effectiveness and employment equity assessments were all part of the year under review performance.

The Commission is pleased with its learnership and internship programmes. The programmes are a work-based programmes that combines a structured learning component with practical work experience. Employment equity in the workplace is fully supported by the Commission.



## 5.2 Oversight Statistics

### 5.2.1 Workforce

**Table 1 Employment and Vacancies by Salary Bands, 31 March 2016**

Salary Band	Number of Posts	Number of Posts Filled	Vacancy Rate %	Additional to the Establishment
Salary levels 1–2	1	1	-	-
Salary levels 3–5	3	3	-	-
Salary levels 6–8	2	2	-	-
Salary levels 9–12	14	14	-	-
Senior management (13–16)	12	12	-	-
<b>Programme total</b>	<b>32</b>	<b>32</b>	<b>-</b>	<b>-</b>

### 5.2.2 Expenditure

**Table 2 Personnel Costs by Salary Bands, 2015/16**

Salary Bands	Personnel Expenditure	% of Total Personnel Cost	Average Personnel Cost Per Employee
Salary levels 1–2	134 844	0.5%	134 844
Salary levels 3–5	1 121 812	4.6%	373 937
Salary levels 6–8	887 547	3.7%	443 774
Salary levels 9–12	9 624 708	40.2%	687 479
Salary levels 13–16	12 191 808	51%	1 015 984
<b>Total</b>	<b>23 960 720</b>	<b>100%</b>	<b>748 773</b>

**Table 3 Salaries, Overtime and Medical Assistance by Salary Bands, 2015/2016**

Salary Bands	Salaries		Overtime		Medical Assistance	
	Amount (R'000)	% of Personnel Cost	Medical Assistance	% of Personnel Cost	Amount (R'000)	% of Personnel Cost
<b>Salary levels 1–2</b>	134 844	0.5%	-	-	47 147	35%
<b>Salary levels 3–5</b>	1 121 812	4.6%	-	-	207 237	18.47%
<b>Salary levels 6–8</b>	887 547	3.7%	-	-	51 605	5.8%
<b>Salary levels 9–12</b>	9 624 708	40.2%	-	-	902 619	9.4%
<b>Salary levels 13–16</b>	12 191 808	51%	-	-	705 214	5.8%
<b>Total</b>	23 960 720	100%			1 913 822	
<b>Salary levels 6–8</b>	887 547	3.7%	-	-	51 605	5.8%
<b>Salary levels 9–12</b>	9 624 708	40.2%	-	-	902 619	9.4%
<b>Salary levels 13–16</b>	12 191 808	51%	-	-	705 214	5.8%
<b>Total</b>	23 960 720	100%			1 913 822	

### 5.2.3 Employment Changes

**Table 4 Annual Turnover Rates by Salary Bands for the Period 01 April 2015 to 31 March 2016**

Salary Bands	Number of Employees per Level as at 1 April 2015	Appointments and Transfers In	Terminations and Transfers Out	Turnover Rate
Salary levels 1–2	1	-	-	-
Salary levels 3–5	3	-	-	-
Salary levels 6–8	2	-	-	-
Salary levels 9–12	14			
Senior management 13–16	12	-	-	-
<b>Total</b>	<b>32</b>			

**Table 5 Reasons for Staff turnover**

Termination Type	Number	% of Total Turnover
Death	-	-
Resignation	-	-
Expiry of Contract	-	-
Dismissal – organisational changes	-	-
Dismissal – misconduct	-	-
Dismissal – inefficiency	-	-
Discharge due to ill-health	-	-
Retirement	-	-
Other	-	-
<b>Total</b>	-	-

## 5.2.4 Employment Equity

Table 6 Total Number of Employees (Secretariat) per Occupational Level as at 31 March 2016

Occupational Bands	Male				Female				TOTAL
	African	Coloured	Indian	White	African	Coloured	Indian	White	
Top management	3	0	0	1	0	0	1	0	5
Senior management	4	0	1	0	1	1	0	0	7
Professionally qualified and experienced specialists and mid-management	3	1	0	0	3	2	0	0	9
Skilled technical and academically qualified workers, junior management, supervisors, foremen and superintendents	0	0	0	0	5	0	0	2	7
Semi-skilled and discretionary decision making	1	0	0	0	1	1	0	0	3
Unskilled and defined decision making	0	0	0	0	1	0	0	0	1
Total permanent	11	1	1	1	11	4	1	2	32
Non-permanent employees	1	0	0	0	3	0	0	0	4
Total	12	1	1	1	14	4	1	2	36
Persons with disabilities	0	0	0	0	0	0	0	0	0

**5.2.5 Terminations****Table 7 Terminations for the Period 1 April 2015 to 31 March 2016**

Occupational Bands	Male				Female				TOTAL
	African	Coloured	Indian	White	African	Coloured	Indian	White	
Top management	0	0	0	0	0	0	0	0	0
Senior management	0	0	0	0	0	0	0	0	0
Professionally qualified and experienced specialists and mid-management	0	0	0	0	0	0	0	0	0
Skilled technical and academically qualified workers, junior management, supervisors, foremen and superintendents	0	0	0	0	0	0	0	0	0
Semi-skilled and discretionary decision making	0	0	0	0	0	0	0	0	0
Unskilled and defined decision making	0	0	0	0	0	0	0	0	0
<b>Total permanent</b>	0	0	0	0	0	0	0	0	0
Non-permanent employees	0	0	0	0	0	0	0	0	0
<b>Total</b>	0	0	0	0	0	0	0	0	0

## 5.2.6 Training

Table 8 Skills Development for the Period 01 April 2015 to 31 March 2016

Occupational Categories	Male				Female				TOTAL
	African	Coloured	Indian	White	African	Coloured	Indian	White	
Legislators, senior officials and managers	6	1	0	1	0	0	0	0	8
Professionals	1	1	0	0	1	1	0	0	4
Technicians and associate professionals	0	0	0	0	2	0	0	2	4
Clerks	1	0	0	0	0	0	0	0	1
Service and sales workers	0	0	0	0	0	0	0	0	0
Skilled agricultural and fishery workers	0	0	0	0	0	0	0	0	0
Craft and related trades workers	0	0	0	0	0	0	0	0	0
Plant and machine operators and assemblers	0	0	0	0	0	0	0	0	0
Elementary occupations	0	0	0	0	0	0	0	0	0
<b>Total permanent</b>	8	2	0	1	3	1	0	2	17
Non-permanent employees	0	0	0	0	1	0	0	0	1
<b>Total</b>	8	2	0	1	4	1	0	2	18
<b>Persons with disabilities</b>	0	0	0	0	0	0	0	0	0

**Table 9: Training Provided 01 April 2015 to 31 March 2016**

Occupational Categories	Gender	No. of Em- ployees as at 01-Apr-15	Learnerships	Skills Pro- grammes and Other Short Courses	Other Forms of Training	Total
<b>Legislators, senior officials and managers</b>	Female	1	0	1	0	1
	Male	8	0	9	1	10
<b>Professionals</b>	Female	9	0	4	3	7
	Male	6	0	2	2	4
<b>Clerks</b>	Female	6	3	4	0	7
	Male	1	1	1	0	2
<b>Elementary occupations</b>	Female	1	0	1	0	1
	Male	0	0	0	0	0
<b>Total</b>		32	4	22	6	32

**5.2.7 Performance Reward****Table 10 Performance Reward by Salary Band for Personnel below Senior Management Service, 1 April 2015 to 31 March 2016**

Salary Band	Number of Beneficiaries	Number of Employees	% of Total within Group	Cost	Average Cost per Employee	Total Cost as % of Total Personnel Cost
Salary levels 1–2	1	1	100%	4 591	4 591	3.4%
Salary levels 3–5	3	3	100%	32 745	10 915	2.9%
Salary levels 6–8	2	2	100%	33 099	16 550	3.73%
Salary levels 9–12	12	14	86%	237 832	19 819	2.5%
<b>Total</b>	18	20	96,5%	308 267	51 875	12,5%

**Table 11 Performance-related Rewards by Salary band, for Senior Management Service, 1 April 2015 to 31 March 2016**

Salary Band	Number of Beneficiaries	Number of Employees	% of Total within Group	Cost	Average Cost per Employee	Total Cost as % of Total Personnel Cost
Salary levels 13–16	10	12	83%	337 819	33 782	2.8%
<b>Total</b>	10	12	83%	337 819	33 782	2.8%

### 5.2.8 Leave Utilisation

**Table 12 Sick Leave 1 April 2015 to 31 March 2016**

Salary Band	Total Days	% Certification	# of Employees Using Sick Leave	% of Total Employees Using Sick Leave	Average Per Employee	Estimated Cost	Total Days with Medical Certification
Salary levels 1–2	13	100%	1	100%	13	4 803,00	13
Salary levels 3–5	18	100%	3	100%	6	18 822,00	18
Salary levels 6–8	7	100%	2	100%	3,5	8 161,00	7
Salary levels 9–12	42	100%	12	86,00%	3,5	73 131,00	42
Salary levels 13–16	74	100%	8	67%	9,25	195 744,00	74
<b>Total</b>	160	100%	26	90,60%	6,15	300 661	116,5

**Table 13 Incapacity Leave (temporary and permanent), 1 April 2015 to 31 March 2016**

Incapacity leave	1
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**Table 14 Annual Leave, 1 April 2015 to 31 March 2016**

Salary Bands	Total Days Taken	Number of Employees in Grade	Average per Employee
Salary levels 1–2	10.3	1	10.3
Salary levels 3–5	67	3	22.33
Salary levels 6–8	48.37	2	24.19
Salary levels 9–12	299.94	14	21.42
Salary levels 13–16	202.48	12	16.87
<b>Total</b>	628.09	32	19.63

**Table 15 Leave Payouts for the Period 1 April 2015 to 31 March 2016**

Reason	Total Amount (R'000)	Number of Employees	Average Payment Per Employee (R'000)
Leave payout for 2014/15 due to non-utilisation	-	-	-
Current leave payout on termination of service	-	-	-
<b>Total</b>	-	-	-



### 5.2.9 Labour Relations

**Table 16 Misconduct and Disciplinary Hearings Finalised, 1 April 2015 to 31 March 2016**

Outcomes of Disciplinary Hearings	Number
Correctional counselling	0
Verbal warning	0
Written warning	2
Final written warning	0
Suspended without pay	0
Dismissal	0
<b>Total</b>	<b>2</b>

**Table 17 Grievances Lodged for the Period 1 April 2015 to 31 March 2016**

Number of grievances lodged	One
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**Table 18 Precautionary Suspensions for the Period 1 April 2015 to 31 March 2016**

Precautionary suspensions for the period	None
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### 5.2.10 Injury on Duty

**Table 19 Injury on Duty, 1 April 2015 to 31 March 2016**

Nature of Injury	Number	% of total
Required basic medical attention only	0	0
Temporary total disablement	0	0
Permanent disablement	0	0
Fatal	0	0
<b>Total</b>	<b>0</b>	<b>0</b>



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# Appendices

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# APPENDIX A

## Acronyms

APP	Annual Performance Plan	HFRG	Health Facility Revitalisation Grant
ARV	Antiretroviral	HIV/AIDS	Human Immunodeficiency Virus/ Acquired Immunodeficiency
BOP	Balance of Payments	HPV	Human Papillomavirus
BRICS	Brazil, Russia, India, China, South Africa	HSDG	Human Settlement Development Grant
CASP	Comprehensive Agriculture Support Programme	ICT	Information and Communication Technology
CET	Community Education and Training	IDI	Ideal Clinic Initiative
CoE	Compensation of Employees	IGFR	Intergovernmental Fiscal Relations
CoGTA	Department of Cooperative Govern- ment and Traditional Affairs	IMF	International Monetary Fund
CWP	Community Works Programme	INEP	Integrated National Electrification Grant
DFIs	Domestic Financial Intermediaries	LES	Local Equitable Share
DHET	Department of Higher Education and Training	LGFF	Local Government Fiscal Framework
DHS	Department of Human Settlements	MDB	Municipal Demarcation Board
DoR	Division of Revenue	MFMA	Municipal Finance Management Act
DoRB	Division of Revenue Bill	MHSCG	Municipal Human Settlements Capacity Grant
ECD	Early Childhood Development	MIG	Municipal Infrastructure Grant
EIG	Education Infrastructure Grant	MSG	Municipal System Improvement Grant
EPWP	Expanded Public Works Programme	MTBPS	Medium Term Budget Policy Statement
FET	Further Education and Training	MTEF	Medium Term Expenditure Framework
FFC	Financial and Fiscal Commission	MTSF	Medium Term Strategic Framework
FLISP	Finance Linked Individual Subsidy Programme	MWIG	Municipal Water Infrastructure Grant
GDP	Gross Domestic Product	NDMC	National Disaster Management Centre
		NDP	National Development Plan

NERSA	National Energy Regulator of South Africa	SALGA	South Africa Local Government Association
NHG	National Health Grant	SANRAL	South African National Roads Agency
NHI	National Health Insurance	SARB	South African Reserve Bank
NSFAS	National Student Financial Aid Scheme	SARS	South African Revenue Services
NSNP	National School Nutrition Programme	SCoA	Standing Committee on Appropriations
OCPO	Office of the Chief Procurement Officer	SIBG	School Infrastructure Backlogs Grant
PEP	Public Employment Programme	SME	Small and Medium Enterprises
PES	Provincial Equitable Share	SOC	State Owned Company
PFMA	Public Finance Management Act	SOEs	State Owned Enterprises
PIT	Personal Income Tax	SSA	Sub-Saharan Africa
PRC	Presidential Review Commission	TB	Tuberculosis
PRC	Presidential Review Commission	TTR	Teaching Training and Research
PRRC	Presidential Remuneration Review Commission	TVET	Vocational Education and Training Colleges
PSET	Post School Education and Training	US	United States
PTNG	Public Transport Network Grant	USDG	Urban Settlement Development Grant
PTOG	Public Transport Operating Grant	WEO	World Economic Outlook
R&D	Research and Development	WSIG	Water Service Infrastructure Grant
RBIG	Regional Bulk Infrastructure Grant	WSOSG	Water Services Operation Subsidy Grant
RDLR	Rural Development and Land Reform		
RHIG	Rural Household Infrastructure Grant		
S&P	Standard and Poor		
SAA	South African Airways		

# APPENDIX B

## Full Year Publications and Dissemination

### 1. Peer Reviewed Journal Publications

1. Mabugu, R., Maisonnave, H., and Chitiga, M., (2016) "Analysing Job Creation Effects of Scaling Up Infrastructure Spending in South Africa", *Development Southern Africa*, Taylor and Francis Publishers. <http://dx.doi.org/10.1080/0376835X.2015.1120650>
2. Ncube, M., Madubula, N., Ngwenya, H., Zinyengere, N., Zhou, L., Francis, J., Mthunzi, T., Olivier, C., Madzivhandila, T., 'Climate change, household vulnerability and smart agriculture: The case of two South African provinces', *Journal of Disaster Risk Studies*, Vol 8, No 2 (2016), 14 pages
3. Mabugu, R., Fofana, I., and Chitiga, M., (2015) "Pro-Poor Tax Policy Changes in South Africa: Potential and Limitations", *Journal of African Economies* (2015), **24**(2): 73-105, Oxford University Press. doi: 10.1093/jae/eju038
4. Mabugu, R., and Simbanegavi, W., (2015) "Tax and Expenditure Reforms in Africa: An Overview", *Journal of African Economies* (2015), **24**(2): 3-15, Oxford University Press. doi: 10.1093/jae/eju037
5. Mabugu, R., Maisonnave, H., and Chitiga, M., (2015) "Economywide consequences of attaining Millenium Development Goals in South Africa", *Economics Bulletin*, Volume 35, Issue 2, pages 1118-1127
6. Lydia Ntenga and Nicholas Odhiambo, (2015) 'Higher Education Research Expenditure in South Africa: A Review of the New Funding Framework', *Industry and Higher Education*, Vol 29, Number 4, pages 283-291.
7. Ncube, M., and Tullock, Z., (2015) 'Accountability in infrastructure delivery in South Africa: The Case of the Local Government Sphere', *Public and Municipal Finance*, Volume 4, Issue 2, pp46-55.

### 2. Book Chapters Published

8. Maluleka, S., and Ruxwana, N., (2016), Cloud Computing as an Alternative Solution for South African Public Sector: A Case for Department of Social Development, in A. Rocha et al (eds.), *New Advances in Information Systems and Technologies, Advances in Intelligent Systems and Computing* 444, Springer International Publishing Switzerland 2016, DOI: 10.1007/978-3-319-31232-3\_45
9. Khumalo, B., Dawood, G., and Mahabir, J., (2016). South Africa's Intergovernmental Fiscal Relations System, Chapter 10 in Steytler, N., and Ghai, Y. (eds), *Kenyan-South African Dialogue on Devolution*, Juta Publishers.

### 3. Op-Eds and Newspaper Articles

10. Eddie Rakabe, (2016), The budget is not a growth plan, Polity.org.za
11. Ramos Mabugu and Steve Koch, (2015), How South Africa could fund steeper higher education, *The Conversation.com*
12. Ramos Mabugu and Eddie Rakabe, (2015), The urgent need for proper early childhood development infrastructure, *Mail and Guardian*

13. Ramos Mabugu and Ghalieb Dawood, (2015), Public service efficiency is key to a developmental state, *Mail and Guardian*
14. Sasha Peters and Sabelo Mtantato, (2015), National Bodies Fall Flat in Service Delivery, *Business Day*
15. Ramos Mabugu and Sasha Peters, (2015), Leveraging tech to improve service delivery to the poor, *IT News Africa*
16. Eddie Rakabe, (2015), Uber drives home need to innovate, *Mail & Guardian*
17. Ramos Mabugu and Bongani Khumalo, (2015), State has to make sensible build choice, *Business Day*

#### 4. Conference Presentations

18. Simon Maluleka attended and presented a paper at the World Conference on Information Systems and Technologies (WorldCIST) held at Recife, Brazil 22 to 24 March 2016
19. Thembe Ntshakala attended and presented at 8th Annual SPMA International Conference on Public Administration and Management (29 to 30 October 2015) held at the University of Pretoria.
20. Thembe Ntshakala presented a paper at the prestigious 'International Association of Schools and Institutes of Administration (IASIA)' Conference, Paris, France.
21. Hammed Amusa presented a paper on 27th August workshop on comparative decentralization between South Africa and Japan jointly organized by the School of Public Administration (SPA) at the University of Pretoria and the Japanese International Co-operation Agency (JICA)
22. Mkhululi Ncube attended the Climate Smart Agriculture Dialogue in Zambia
23. Mkhululi Ncube and Bongani Khumalo presented a paper at a conference at University of Stellenbosch, Western Cape
24. Sasha Peters, Sabelo Mtantato and Hammed Amusa presented papers at the ESSA Conference in September 2-4, University of Cape Town
25. All Research staff attended the FFC Conference: IGFR Instruments and Rural Development (on 13 October 2015)
26. Thando Ngozo and Ramos Mabugu attended and presented paper at the international conference jointly organized by the FFC, the Human Sciences Research Council (HSRC) and the University of the Western Cape (UWC). The conference was themed "BRICS Partnership and Multilevel Governance: An Unexplored Dimension" (on 14-16 October 2015)
27. Poppie Ntaka presented at 6th International Association for the Evaluation of Educational Achievement (IEA) Research Conference, (CPT, 24-26 June 2015).
28. Hammed Amusa presented a paper titled "The Impact of Fiscal Decentralization on Regional Inequality in South Africa" at the public economic working group workshop convened by the Economic Research Southern Africa at Stellenbosch Institute for Advanced Study (STIAS), 26 May

# APPENDIX C

## Submission on the 2015 Medium Term Budget Policy Statement

### 1 . Background

1.1. The 2015 Medium Term Budget Policy Statement (MTBPS) is formulated against the backdrop of an economy that is vulnerable to negative domestic and external factors. Gross Domestic Product (GDP) growth has been revised downwards to 1.5 percent for this year from 2.0 percent as at the time of the February 2015 Budget, to 1.7 percent for next year from 2.4 percent at the time of the Budget and to 2.6 percent for 2017 compared to 3.0 percent at the February Budget. In light of the downward revisions to growth forecasts and the associated revenue growth forecasts it is somewhat surprising that the associated budget deficits for the 2015/16 fiscal year comes in slightly reduced to -3.8 percent of GDP from -3.9 percent of GDP at the time of the February Budget although deficits in the outer years subsequently rise significantly.

1.2. The present environment of low fragile growth is making it difficult to tackle the triple challenges of high social ills (unemployment, poverty and inequality), fiscal and external imbalances. Indeed, rising levels of impatience with deteriorating social conditions have made this one of the toughest MTBPS to craft. In the last few days, student protests have erupted at universities across South Africa triggered by what students perceived as exorbitant fee increases and dissatisfaction with speed of progress towards universal free high education. Student protests at universities culminated in a moratorium on fee increases for next year that was unbudgeted for at the time of tabling the MTBPS. Similarly, the public sector three-year wage agreement reached between the government and trade unions is way above what was allocated in the February 2015 Budget and will largely be absorbed by the cumulative contingency reserve. This leaves little over to cater for unforeseen emergencies such as higher education fees, drought or another global financial downturn from contingency reserves. The spending levels are highly constrained and exacerbated by economic shocks to gross fixed capital formation, households, continuing unemployment and increasing levels of poverty and inequities.

1.3. The Financial and Fiscal Commission (the Commission) is of the view that a credible commitment to fiscal consolidation (within the framework of fiscal guidelines announced) is necessary to ease the frequency of sovereign debt downgrades as Government demonstrates its ability to control spending pressures. This financial stability is only a necessary but not sufficient condition for sustainable national development that brings much needed social cohesion and stability.

1.4. The South African government recognises the importance of economic growth in job creation as well as the contribution of different sectors to economic growth. In this regard, the country needs to drive up its performance in relation to two key components: productivity and participation. This growth should also satisfy three desired characteristics - solidarity, cohesion and sustainability. "Higher, inclusive growth, and above all sustained" (as Minister of Finance often put it) needs to be accompanied by improvements in skills and education. The country faces enormous pressure to upgrade human capital skills. It suffers from competitive disadvantage in terms of the quality of its human capital, its investment in research and development (Rand D), and information and communication technology (ICT) penetration. The country will need to increase investments and quality of spending in education and bolster spending on RandD. These supply-side factors constitute most pressing key long-term challenges confronting the country and necessitate consideration of long-term fiscal risk.

1.5. The moratorium on university fee increases next year and the prospects of other far reaching reforms necessitate government finding additional funding to fill gaps that were not addressed at the tabling of the 2015 MTBPS. The Commission is of the view that in order to build a higher education system that endures over the long term and help meet the goals of the National Development Plan (NDP), the past investment in the sector should be consolidated and further increased but it is recognised that any changes have to be accommodated within the current public financial pressures. There are elements of the current system to be commended and retained but there are also some significant changes to the funding and student finance system that will improve the system to the benefit of government and other funders, students and employers.

1.6. It is against this background that this submission on the 2015 MTBPS is made by the Commission in terms of Section 4 (4c) of the Money Bills Amendment Procedure and Related Matters Act (2009). 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.



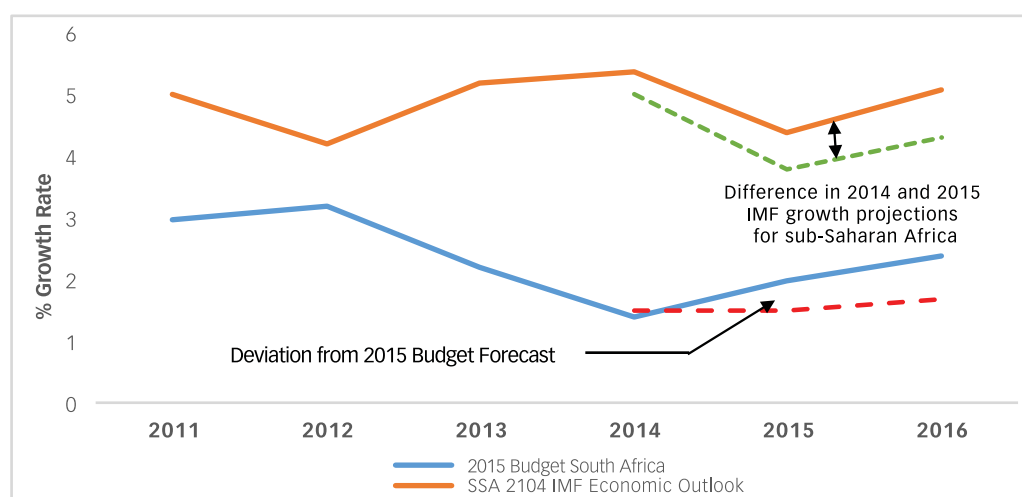
## 2. Macroeconomic and Fiscal Policy Outlook

### ECONOMIC GROWTH AND EMPLOYMENT

2.1. Based on expectations of moderate improvements to South Africa's growth outlook, the 2015 Budget presented in February projected that GDP will grow by 2 percent in 2015, eventually rising to 3 percent by the 2017/18 financial year. In line with recent economic growth projections for

major emerging market economies, South Africa's growth forecast has been revised downwards. The 2015 MTBPS projects South Africa's growth to be 1.5 percent and 1.7 percent in both 2015 and 2016, respectively. As shown in Figure 1, this downward revision translates into growth in 2015 and 2016 that is 0.5 percent and 0.7 percent lower than at the time of the 2015 Budget announcement.<sup>1</sup>

**Figure 1. Actual and projected growth in GDP, 2011-2016**



Sources: 2015 Budget Review; 2015 MTBPS; 2014, 2015 World Economic Outlook.

2.2. The decline in projected economic growth mirrors the Commission's 2011 GDP simulations which predicted that under a severe scenario<sup>2</sup>, South Africa's GDP will not recover to its pre-2008 levels without shocks and deliberate interventions to counteract the negative impacts of the world economic crisis. The predicted slowdown in economic growth highlights continued weakness in global economic conditions, and constraints imposed by domestic factors.

2.2.1. Given that infrastructure has been identified as the key driver for economic growth and job creation, it is somewhat paradoxical that investment has been revised downwards in 2015 MTBPS. Proportionately the biggest downward revisions within the overall GDP were in respect of gross fixed capital formation where growth was revised down by -1.0 percent for 2015, -1.9 percent for 2016 and -0.6 percent for 2017. Domestically, infrastructure supply constraints - especially within the electricity sector, continue to dampen growth prospects. Household consumption is also revised down, but by much less than for gross fixed capital formation. The poor performance for capital formation is a major concern because this is one of the main drivers of sustainable long-term economic growth, which is the single most pressing issue right now.

2.2.2. Between 2009 and 2014, the South African economy experienced over R 17 billion in net portfolio inflows. The announcement by the United States Federal Reserve of its intention to raise its benchmark interest rates before the end of 2015 has resulted in the strengthening of the U.S. dollar against the Rand (and other global currencies). Rising interest rates in the U.S. have two potential effects: first, they attract portfolio/capital inflows away from emerging markets (such as South Africa) causing domestic currencies to either depreciate or come under pressure; second, the increased rates raises the cost of financing debt denominated in dollars.

2.2.3. Post-2015 Budget, the Rand has experienced sharp declines against major world currencies. Theoretically, the depreciation in the value of the Rand should facilitate a balance of trade improvements as changes in relative prices induce consumers in export markets to demand more of locally produced goods. However, as shown in Figure 2, the decline in the value of the Rand against major currencies (especially the US Dollar) has coincided with sustained episodes of declining growth in net gold exports widening current account deficit. The potential positive impact of the currency depreciation on exports

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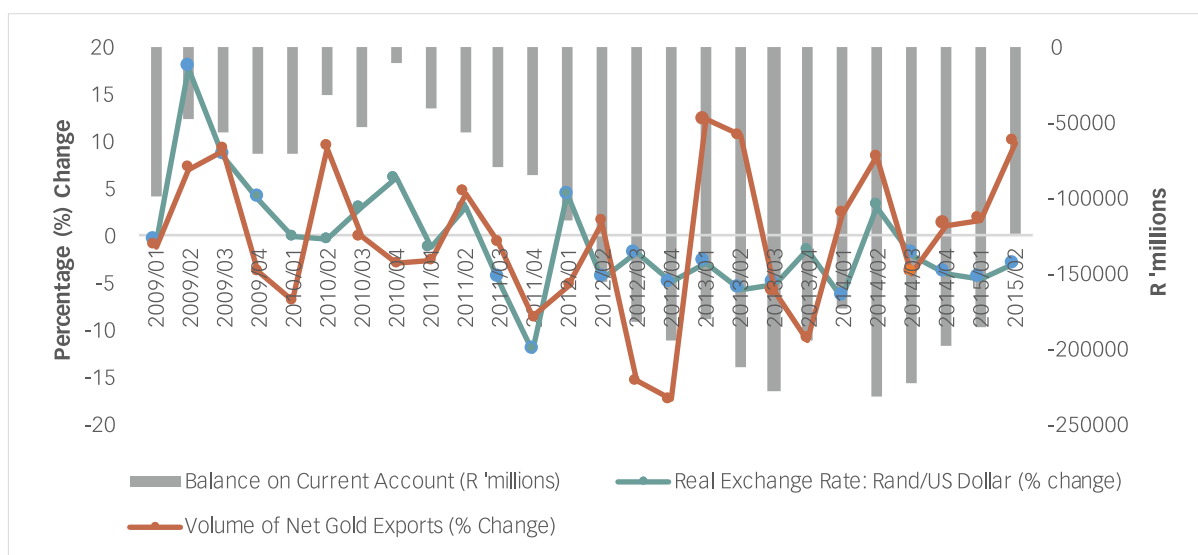
<sup>1</sup> These projections are very similar to the less than 1.5 percent growth forecast for 2015 and 2016 periods by the International Monetary Fund in its October 2015 Global Economic Outlook.

<sup>2</sup> A severe scenario reflects a protracted slow global growth era and implies tight public budgets for some time to come.

has remained muted mainly due to slow growth among major trading partners and falling commodity prices (especially metals such as iron-ore, platinum and manganese). The deceleration in China's growth trajectory and its shift

towards a policy aimed at reducing its reliance on import intensive investment, is expected to have negative effect on South Africa which depends on the Chinese market for almost 15 percent and 80 percent of its total exports and commodity exports, respectively.

**Figure 2. Change in Rand/Dollar Exchange Rate, Net Gold Exports and Balance on Current Account, 2009/01-2015/02**



Source: South African Reserve Bank (2015).

2.3. The present environment of fragile growth is making it difficult to tackle the triple challenges of high unemployment, fiscal and external imbalances. The economy needs to achieve the 5.4 percent annual growth target of the NDP required in order to provide jobs for young workers,

tackle the growing social tensions, and reduce poverty and inequality. Figure 3 shows a relatively flat employment/population ratio against a stubbornly high unemployment rate in the face of sluggish growth between 2012 and 2015.

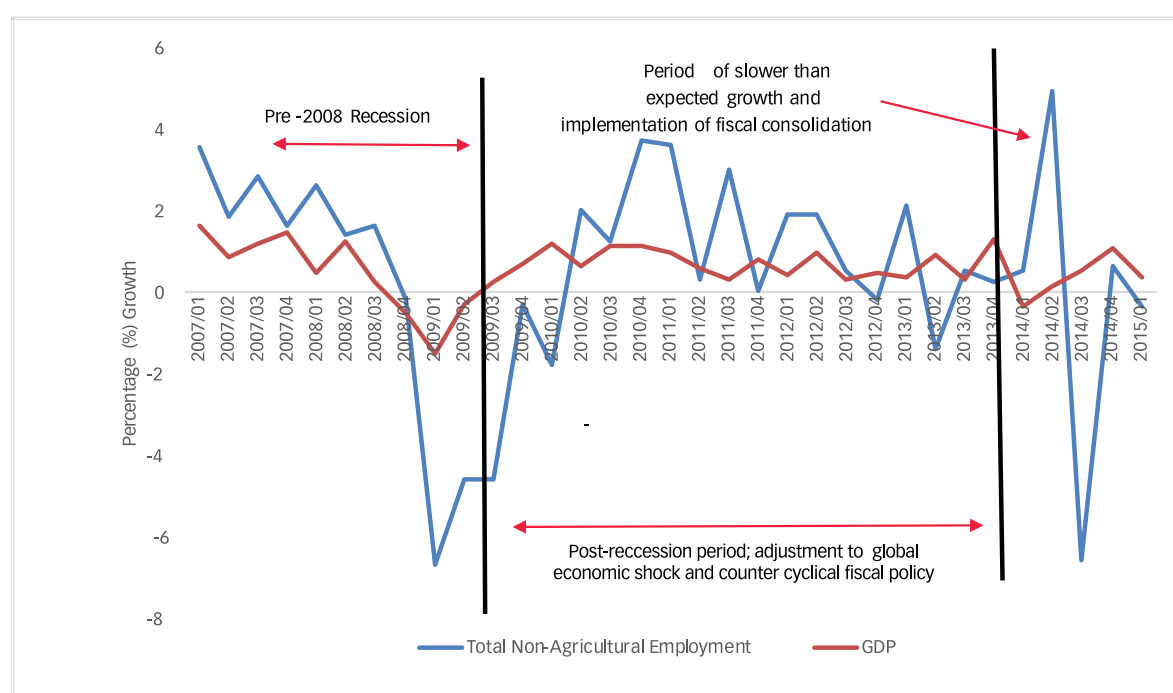
**Figure 3. Unemployment and employment rate and GDP growth, 2012-2015**



2.4. The response of output and employment growth to changing economic conditions in the period following the 2007/2008 financial crises indicates that labour demand and supply rigidities have adversely impacted on the capacity of the labour market to adjust to exogenous economic shocks and ensure that wages respond to levels that can address significant levels of unemployment. Figure 4 shows that South Africa's economy was adversely impacted in the immediate period following the global financial crises. Between the second quarters of 2008 and 2009, real output declined by 0.2 percent while aggregate employment fell by almost 2 percent. Despite some stimulus assisted recovery between 2010 and 2013, the constraints of muted global economic recovery and domestic infrastructure bottlenecks have contributed to relatively strong employment losses over the period due to fiscal consolidation and slowdown in South Africa's real

output growth. If the current high unemployment and sluggish growth rates persist, South Africa will struggle to achieve a tangible boost to growth and incomes from its increasing working age population. In an environment of slow economic growth, government faces severe challenges in promoting policies that address the country's large labour surplus, especially among the low-skilled segment of the population. Beyond raising the potential of job creation and ensuring the addressing of the skills mismatch, reforming South Africa's labour market within a low-growth environment will require policies that strike an appropriate balance between ensuring workers' rights, and economic efficiency, which requires flexibility and decentralization, especially with respect to regulations governing small enterprises and collective bargaining arrangements within both the public and private sectors, respectively.

**Figure 4. Output and employment growth, 2007/01-2015/02**



## FISCAL AND PUBLIC DEBT OUTLOOK

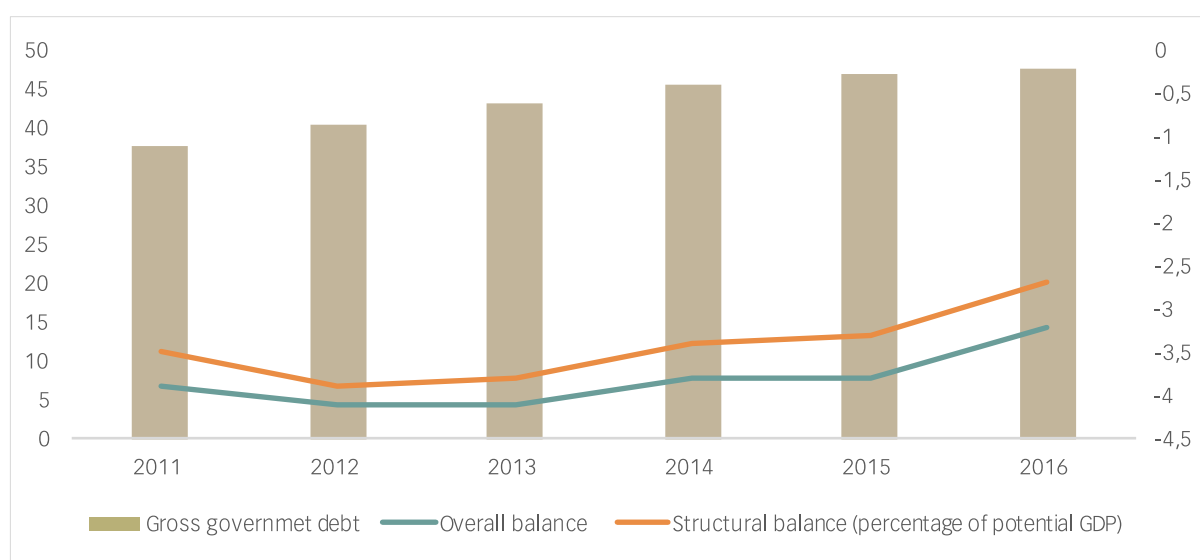
2.5. The downward revision of economic growth forecasts resulted in a substantial downward revision of growth forecasts for government revenue, especially in the later years. In the face of global economic headwinds, the current fiscal position is such that the countercyclical approach has run its course. The structural budget deficit can no longer be reduced through a cyclical upturn in revenues. The 2015 budget, therefore, announced the im-

plementation of various measures aimed at narrowing the budget deficit, stabilising debt and rebuilding fiscal space. A fiscal reform package consisting of a lower expenditure ceiling and higher taxes is expected to reduce the deficit from an estimated 3.9 percent of GDP in 2014/15 to 2.5 percent by 2017/18. Net debt was projected to stabilise at 43.7 percent of GDP in 2017/18 (see Figure 5).

2.6. However, the budget balance and debt position have slightly deteriorated. The 2015 MTBPS reflects some slippage in medium-term budget deficit projections in the outer years. A combination of factors, including the downward revision to economic growth, revenue shortfalls, higher than anticipated public sector wage settlement agreement and a weaker exchange rate have resulted in an upward revision of the debt-to-GDP ratio. The 2015 budget projected that net debt will stabilise at 43.7 percent of GDP in 2017/18. However, net debt will now stabilise at 45.7 percent of GDP in 2019/20. The rising debt service payments could put pressure on social and economic spending in the current framework.

2.7. The overall direction or fiscal stance is summarised by the primary balance (the gap between government revenue and non-interest spending). The structural primary balance is projected to improve by 1 percent of GDP over the medium term. Indeed it has been declining progressively since 2011 which suggests that a large element of the budget deficit is simply being applied to servicing debt rather than being a function of general spending exceeding revenue. Ratings agencies look at the trends of the primary balance as importantly as the overall budget deficit in assessing the country's credit worthiness and on this score Government has done very well.

**Figure 5. South Africa's fiscal position, 2011-2016**



Source: International Monetary Fund

2.8. Further exacerbating the risk are spending pressures imposed by increased public sector wage bill. In terms of the public sector wage settlement reached in June 2015, public sector workers will receive wage increases of 7 percent in the current fiscal year, and 1 percent above inflation increases in the outer two years of the medium term.

2.9. Between 2006 and 2009, above-inflation wage increases ensured that combined wage bill of the national and provincial spheres grew by 17.1 percent, while head count grew at an average rate of 3.9 percent over the same period. In the aftermath of global recession, this increasing trend was reversed as a result of measures implemented to safeguard public finances. Between 2009 and 2014, personnel head count at provincial and national spheres declined to 1.3 percent per year, while real growth in compensation fell from 9 percent in 2010/11 to 2 percent in 2013/14. As shown in Figure 6, compensation of employees forms the largest component of government's recurrent

expenditure. The recent above-inflation increases awarded public sector workers will ensure that in absolute terms, growth in consolidated government's wage bill averages almost 10 percent between 2015/16 and 2017/18.

2.10. In the medium-term, managerial interventions such as controls on automatic pay progression and performance bonuses as well as reduction in the rate of hiring in noncritical areas may assist government in its commitment to ensuring that the upward trend in the wage bill does not adversely impact its budget deficit targets. In the long-term, ensuring that the rise in the public wage bill within a constrained economic growth environment does not crowd-out or limit resources available for implementing key socio economic programmes, will require fundamental reforms that link public sector remuneration with performance and productivity. As shown in Figure 7, this aspect is particularly important given that growth in public (as well as private) sector remuneration has outstripped the growth in labour productivity. As noted in the Commission's past

recommendations for the 2016/17 Division of Revenue (DoR), clearly defined systems and processes are needed to encourage public sector personnel to function optimally. Where necessary, policy disincentives should be introduced to discourage poor performance, with public sector bodies performing below established and acceptable 'productivity' levels penalized through measures such as

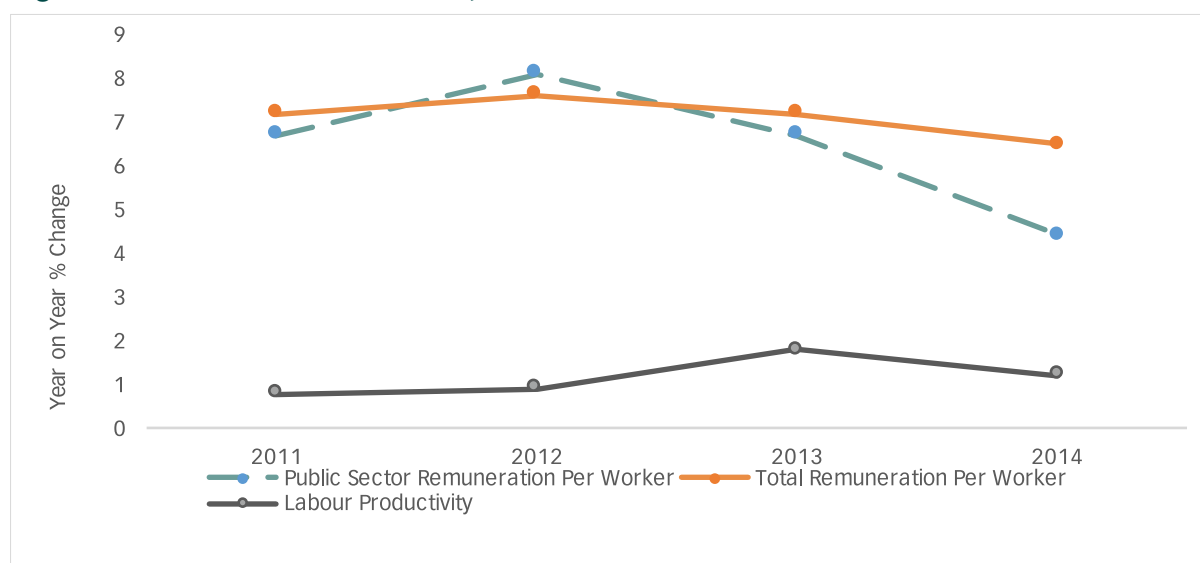
budget cuts. The Commission further reiterates the urgent need to finalize the work of the Presidential Remuneration Review Commission (PRRC) in tabling policy recommendations on how to make the public service more effective and efficient, as well as mechanisms that can be put in place to ensure the sustainability of the public-sector wage bill and guarantee fiscal stability.

**Figure 6. Components of government's total current payments, 2011/12-2017/18**



Source: National Treasury, Budget Review 2015.

**Figure 7. Growth in remuneration, 2011-2014**



Source: Reserve Bank, Quarterly Bulletin (September 2015)

### 3. Fiscal Frameworks and Revenue Proposals

#### FISCAL FRAMEWORK

3.1. As discussed above, the medium term estimates are presented under a depressed macroeconomic outlook with projected weaker revenue and higher debt services costs. This situation imposes constraints on the broader fiscal framework as shown in Table 1, which outlines the proposed fiscal framework for the 2016 MTEF period. In total, Government is expected to spend over the three years R4.291 trillion relative to a revenue envelope of

R3.762 trillion. Over the 2016 MTEF period, real annual average growth in expenditure is projected at 2.6 percent. A marginally stronger 3.0 percent growth is projected in respect of revenue. The bulk of resources are allocated in respect of non interest allocations in the form of equitable share and conditional grant funding. The key components of the fiscal framework are discussed in greater detail below.

**Table 1. Consolidated fiscal framework, 2012/13-2018/19**

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	
R billion/Percentage of GDP		Outcome		Budget	Revised	Medium-term estimates		
Main budget Revenue	800.1	887.3	963.6	1 049.3	1 070.7	1 147.7	1 249.1	1 365.0
<i>of which: asset disposals</i>					25.4			
Expenditure <i>of which</i>	965.5	1 047.8	1 132.0	1 222.3	1 246.9	1 313.1	1 426.9	1 551.1
<i>Non-interest allocations</i>	877.4	946.6	1 017.2	1 095.9	1 093.8	1 168.0	1 260.8	1 361.5
<i>Special appropriations</i>					25.2			
<i>Debt-service costs</i>	88.1	101.2	114.8	126.4	127.9	142.6	157.2	174.6
<i>Contingency reserve</i>						2.5	9.0	15.0
Main budget balance	-165.4	-160.5	-168.4	-173.1	-176.3	-165.4	-177.8	-186.1
	-5.0%	-4.4%	-4.4%	-4.1%	-4.3%	-3.7%	-3.7%	-3.5%
Primary balance	-77.2	-59.3	-53.6	-46.6	-48.4	-22.8	-20.7	-11.5
	-2.3%	-1.6%	-1.4%	-1.1%	-1.2%	-0.5%	-0.4%	-0.2%
Budget balances of social security funds, public entities and provinces	29.5	24.3	31.5	10.9	18.4	20.1	25.1	28.0
Consolidated budget balance	-135.8	-136.2	-136.9	-162.2	-157.9	-145.3	-152.8	-158.2
	-4.1%	-3.8%	-3.6%	-3.9%	-3.8%	-3.3%	-3.2%	-3.0%

Source: MTBPS, 2015.

#### NON-INTEREST ALLOCATIONS: DIVISION OF REVENUE

3.2. Table 2 summarises the division of non-interest allocations amongst the three spheres of Government. After accounting for national debt, there are estimated receipts of R 1.168 trillion to share amongst the three spheres in the 2016/17 financial year. The budget available for sharing is projected to increase to R 1.261 trillion in the 2017/18 financial year and R 1.362 trillion in the outer year.

3.3. Over the 2016 MTEF period, the division of revenue amongst the three spheres will generally be characterised by marginal growth increases with a total real annual

average growth of 1.9 percent being projected. Over the medium term, the main driver of this growth will be allocations to the local government sphere (projected to grow by a real annual average of 3.5 percent) and, to a lesser extent, provincial allocations which are set to grow by 2.3 percent per annum in real terms. Allocations in the form of conditional grants drive the growth in provincial allocations over the medium term. Whereas 2014 saw significant growth in allocations to the national sphere as a result of various functions shifts (including the colleges function moving from provinces to the national sphere), over the 2016 MTEF period, muted real growth of 1.2% per annum is projected for this sphere.

**Table 2. Medium term expenditure framework division of revenue (R billion)**

Division of Revenue	2015 Budget	2015 MTBPS	2015 MTBPS			Real Annual Average Growth rate
	2015 M/term estimate	2015/16 Revised	2016/17	2017/18	2018/19	(2016/17-2018/19)
National allocations	523	550	558	597	642	1.2%
Provincial allocations	468	472	503	549	591	2.3%
Equitable share	383	387	412	448	482	2.1%
Conditional grants	85	85	91	101	109	3.1%
Local government allocations	100	101	107	115	128	3.5%
<b>Total allocations</b>	<b>1 091</b>	<b>1 123</b>	<b>1 168</b>	<b>1 261</b>	<b>1 361</b>	<b>1.9%</b>

Source: 2015 Budget Review, 2015 MTBPS. Commission calculations.

## REVENUE AND TAX PROPOSALS

3.4. Tax revenues for 2014/15 were projected to be R14.7 billion less than the 2014 Budget Review forecast and R4.6 billion below the 2014 MTBPS forecast, reflecting a deceleration in GDP growth. The tax revenue outcome for 2014/15 was R986 billion, a 9.6 percent increase on collections in 2013/14 and R7.3 billion higher than the 2015 Budget target. Revenue was higher than projected largely due to strong growth in personal income tax (PIT) as a result of less-than-full fiscal drag relief and fairly high wage growth, particularly for high-income earners. This trend appears to support the notion that tax policy is more aligned to efficient tax collection and administration, as opposed to expanding the tax base.

3.5. The sharp decrease in commodity prices and the slowdown in economic activity have resulted in a further downward revision of tax revenues. The 2015 MTBPS has revised gross tax revenue downwards by R7.6 billion in 2015/16, R14.6 billion in 2016/17 and R1 2.4 billion in 2017/18. This is attributable to weak performance of corporate income tax collection in the year to date due to the steep decline in commodity prices and the slowdown in economic activity. Table 3 shows revenue projections and actual outcomes for 2014/15 as well as budgeted and revised revenues for 2015/16.

**Table 3. Tax revenues budgeted and revised, 2014/15-2015/16**

R billion	2014/15				2015/16		
	Budget	Revised	Deviations	Outcome	Budget	Revised	Deviations
Gross tax revenue	993.7	983.6	- 10	986.3	1081.3	1073.7	-7.6
Consolidated-budget revenue	1099.2	1093.9	-5.4	1091.3	1188.9	1220.8	31.9

Source: National Treasury MTBPS 2014, 2015



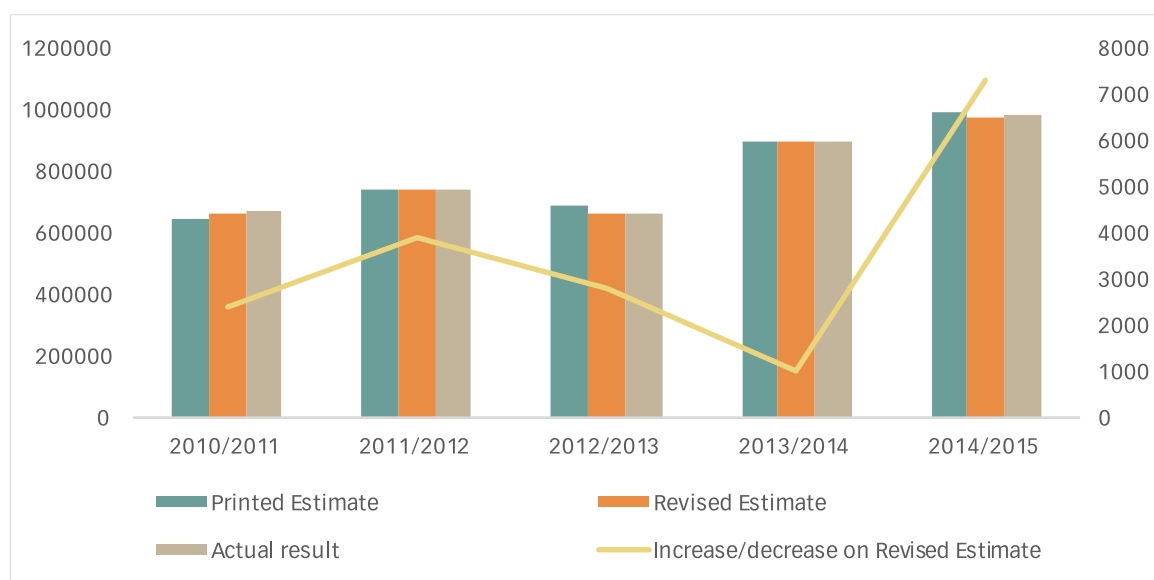
3.6. Given the projected economic outlook, proposals for additional taxes may be necessary to fund government's policy imperatives. Over the medium term, government is committed to tax policy reforms that will promote an efficient and progressive tax system, largely informed by the recommendations of the Davis Tax Committee. Measures to combat base erosion, profit shifting and the misuse of transfer pricing are currently being considered. The introduction of an annual tax on net wealth, a progressive annual tax on net individual wealth to address income inequality is also currently being debated.<sup>3</sup>

3.7. The 2015 Budget also proposed revenue measures required to stabilise the public finances. The proposals, on the main, were a one percentage point increase in personal income tax rates for all but the lowest income bracket, along with increases in the fuel levies. However, the low oil prices cushioned consumers from sharp fuel/petrol prices increases that would have otherwise emanated from the increase in fuel levies. The gross tax revenue impact of these proposals amounted to R16.8 billion, with an estimated net increase of R8.3 billion after taking into account relief for fiscal drag.

3.8. Over the past five years, revenue collection has consistently outpaced economic expansion. While nominal GDP growth has averaged 8.6 per cent over the past five years,

tax revenue has averaged 10.5 per cent growth during this period. Over the medium term, gross tax revenue collection is projected to continue growing faster than nominal GDP, but by a narrower margin than in the recent past. The 2015 Budget tax proposals, increases in income tax rates and the fuel levy, are expected to sustain revenue collection over the medium term. Another important factor in sustaining revenue collection is the important role played by the South African Revenue Services (SARS). As shown in Figure 8, policies instituted by SARS to enhance efficiency in tax collection has helped ensure that revenue growth remained resilient, partly compensating for revenue collection shortfall caused by a slowing economy. In 2010/11, tax revenue collected amounted to R674.2 billion, reflecting an over collection of R2.4 billion against the revised estimate. In 2011/12, tax revenue collected amounted to R742.7 billion, reflecting an over collection of R3.9 billion surplus against the revised estimate. In 2012/13, tax revenue collected amounted to R662.8 billion for the 2012/13 financial year, reflecting an over collection of R2.8 billion surplus against the revised estimate of R660 billion. In 2013/14, tax revenue collected amounted to R900 billion, reflecting an over collection of R1 billion surplus against the revised estimate. In 2014/15, tax revenue collected amounted to R986 billion, reflecting an over collection of R7.3 billion surplus against the revised estimate

**Figure 8. Tax revenue performance, 2010/11-2014/15**



Source: South African Revenue Service Annual Report (various years), MTBPS 2014, MTBPS 2015

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<sup>3</sup> The debate has been sharpened by Thomas Piketty's address to the 13th Nelson Mandela Annual Lecture, at the University of Johannesburg's Soweto campus on 3 October 2015. He proposed that South Africa introduces an annual tax on net wealth, a progressive annual tax on net individual wealth. For example, zero percent for R1 million in wealth, 0.1% between R1-million and R10-million and 0.5% above R10-million. Critics point out that investments in education and skills development are more important in tackling inequality as opposed to an additional progressive tax.



## UNALLOCATED RESOURCES AND ECONOMIC CLASSIFICATION

3.9. In previous submissions, the Commission noted that allocations in respect of contingency reserve/unallocated resources were markedly lower in the MTBPS compared to the Budget in a particular year. In Budget 2015 unallocated reserves increased over the MTEF period from R5 billion in 2015/16 to R45 billion in 2017/18. The Commission has noted that these funds are to serve as a buffer for future years. Consistent with the historical trend, there are significant drawdowns to unallocated reserves, with cuts in 2016/17

and 2017/18 from R 15 billion and R45 billion to R9 billion and R15 billion respectively in order to accommodate the higher than expected wage-bargaining settlement and social priorities. The R5 billion contingency reserve in 2015/16 was fully absorbed by the wage bargaining agreement. The Commission is concerned that by depleting the contingency reserve to settle weaknesses in the wage bargaining arrangement removes the fiscal buffer that is necessary to protect public finances in an economic environment facing prospects of a ravaging drought as well as uncertain global economy and rising social demands of entitlement.

**Table 4. Adjustments to unallocated reserves, 2013/14-2018/19**

'billion	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Budget 2013	4	6.5	10			
MTBPS 2013		3	6	18		
Budget 2014		3	6	18		
MTBPS 2014			5	15	45	
Budget 2015			5	15	45	
MTBPS 2015				2.5	9	15

Source: Budget Review (2013, 2014, 2015); MTBPS (2013, 2014, 2015).

3.10. Table 5 provides details of the economic classification of consolidated government expenditure. Over the period reviewed (2014/15 to 2018/19), not surprisingly Compensation records the highest real average annual growth rate (3 percent). Disaggregating this average growth to real year on year growth the following trends are notable:

3.10.1 The compensation budget grows by 5.4 percent in 2015/16 and outpaces inflation by above 2 percent on average over the MTEF period. The growth in compensation is higher than forecasted at the time of Budget 2015 largely as a result of the three year wage bargaining agreement. The increase in the compensation budget is being offset by savings, reallocations and drawdowns on the contingency reserve. The Commission has noted previously that wage increases should be linked to productivity. In its efforts to strengthen the link between pay and performance, government should note a recommendation in the Commission's submission on the 2016/17 DoR which called for a framework for measuring productivity as a first step to benchmark improvements in the public sector overtime. The Commission welcomes further steps being taken by government to reform remuneration in the public sector such as improving the payroll systems, simplifying remuneration policies, streamlining bonuses and allowances and ensuring that institutional arrangements for collective bargaining are effective.

3.10.2 In line with the push to contain spending on goods and services, especially in non-essential items, growth of this component remains subdued over the MTEF period. Whereas growth reached 2.2 percent in real terms in 2015, growth is expected to decline to 0.5 percent by 2018/19. In

2015, government had budgeted R190 billion for goods and services. Since its establishment, the Office of the Chief Procurement Officer (OCPO) has initiated a number of reforms aimed at delivering lower cost goods and service more efficiently and transparently. Some of these reforms include establishing a central supplier database as a way of reducing administrative and cost burden of procurement, eTender portal which gives government departments an opportunity to purchase routine supplies through transversal contracts and simplifying procurement documents. A further development in the pipeline is the tabling of the Public Procurement Bill, which will replace all other legal instruments governing public procurement. The Commission welcomes these initiatives and calls for appropriately formulated indicators that can track the impact of these reforms in achieving value for money and reducing graft in government operations

3.10.3 Allocations in respect of capital assets only grow by 0.3 percent on average over the MTEF period. The slow growth in capital is likely as a result of diversion of resources to offset the increase in the compensation budget. It appears the weak growth of government's capital budget is being offset by large investments in public infrastructure by state-owned companies, which is expected to exceed R400 billion over the MTEF period. While funding infrastructure investment through state owned companies (SoCs) may seem a viable fiscal strategy, weak management and the inability of government to effectively intervene, has contributed to poor outcomes among SoCs. The Commission welcomes attempts to improve the efficiency of capital spending through the introduction of a capital budgeting framework. The framework intends to improve the planning and execution of infrastructure projects.

**Table 5. Real growth in government consolidated expenditure by economic classification**

R'billion	2014/15	2015/16	2016/17	2017/18	2018/19	Real Annual Average Growth Rate
Compensation of employees	441.1	486.2	524	569.4	615.6	3.0%
Goods and services	173.9	186.1	198.1	212.6	226.1	1.1%
Transfers and subsidies	400	445.5	479.9	435.7	468.9	-1.3%
Payments capital assets	87.6	97.2	98.4	104.2	110.4	0.3%
Real Year on Year Growth (%)	2014/15-2015/16	2015/16-2016/17	2017/18-2018/19	2017/18-2018/19		
Compensation of employees	5.4%	1.6%	2.8%	2.3%		
Goods and services	2.2%	0.2%	1.4%	0.5%		
Transfers and subsidies	6.6%	1.5%	-15.1%	1.8%		
Payments capital assets	6.2%	-5.0%	0.0%	0.2%		

Source: MTBPS (2015); Commission Calculations.

#### EXPENDITURE PRIORITISATION BY FUNCTIONAL CLASSIFICATION

3.11. While total consolidated expenditure is expected to increase by 7.2 percent in nominal terms over the MTEF period, in real terms expenditure growth amounts to 2.1 percent.

3.12. Education, health care and social protection services, with a combined allocation share of 43 percent, reflects government's efforts to prioritise core services and advance social upliftment. Over the MTEF nominal allocations to the three sectors grow the fastest with an annual average growth rate of 8 percent. The nominal figures however mask the extent and impact of low growth on the allocations. In the 2014 MTBPS, allocation to the social sectors where expected to grow at annual average growth rate of 3.3 percent, driven in part by the optimistic growth projections. For the 2016/17 MTEF the annual average growth rate in the allocations are expected to slow down to 2.6 and 2.7 percent for education and health respectively while social protection receives a slightly lower average growth of 1.9 percent (See Table 6). The slowdown in the allocation is most likely to affect the quality of social serviced delivered to the vulnerable as government attempt to ration limited resources across a growing demand basket. Government will find it increasingly difficult to accommodate new social services beneficiaries, such as those entering school for the first time or registering for social assistance. Social grants beneficiaries are expected to reach 18.1 million in 2018/19.

3.13. Reversing the trend of growing social services beneficiaries will require government to make hard trade-offs between funding current expenditure and investment. Higher education expenditure is one such area in which concerted investment will have lasting benefits. Growth in the allocations to post school education and training decline by 0.8 percent in real terms in 2016/17 amid the growing strife for accessible and affordable quality higher education. As household incomes decline in real terms and people are laid off over time, pressure will mount on government to increase spending on higher education. Allocations to functions which are critical to cushion the economy against protracted deceleration such as infrastructure, industrial development and science and technology grow at a slower real annual average rate of 1.2 percent.

3.14. The rest of the other functions as shown in Table 6 also experience a slower real growth rate in the allocations over the MTEF ranging from -0.6 percent to 1 percent. Overall, the Commission welcomes the manner in which government has attempted to balance its expenditure priorities under the current constrained fiscal environment.

**Table 6. Real growth in expenditure by functional classification, 2016/17 to 2018/19**

	2016/17	2017/18	2018/19	Real Annual Average Growth 2016/17 - 2018/19
Basic education	2.1%	3.1%	2.2%	2.6%
Health	2.8%	2.7%	2.7%	2.7%
Defence, public order and safety	2.0%	2.1%	0.6%	2.7%
Defence and state security	1.1%	1.7%	0.5%	1.1%
Police services	2.0%	2.0%	1.8%	1.4%
Law courts and prisons	3.1%	2.6%	0.2%	1.4%
Post-school education and training	-0.8%	1.2%	1.9%	1.5%
Economic affairs	3.0%	-3.1%	-0.8%	1.2%
Industrial development, trade and innovation	1.2%	4.8%	0.9%	-2.9%
Employment, labour affairs and social security funds	6.6%	-3.1%	-2.7%	-2.9%
Economic infrastructure and network regulations	2.2%	-2.5%	3.2%	0.3%
Science, technology, innovation and the environment	-2.6%	-2.7%	4.2%	0.7%
Housing settlement and municipal infrastructure	-1.2%	1.3%	3.1%	2.2%
Agriculture Rural development and land reform	-1.2%	0.5%	0.1%	0.3%
Arts, sport, recreation and culture	-3.8%	1.4%	-0.9%	0.3%
General public services	-5.8%	-0.7%	-0.5%	-0.6%
Social protection	4.3%	1.7%	2.0%	1.9%
Consolidated expenditure	0.5%	1.9%	2.4%	2.1%

Sources, MTBPS 2015. Commission calculations

The following section discusses developments within selected key priority areas:

### Housing Development and Municipal Infrastructure

3.15. The funding and provision of human settlement has to be implemented in a coordinated manner. This requires a strong link between programs and the funding for social infrastructure including education facilities (schools), health facilities (hospitals and clinics) as well as basic services infrastructure (electricity, sanitation and water). Therefore aligned and coordinated infrastructure investment plans have to remain a key priority of the government in order to ensure that housing developments are connected to the basic services and key amenities. But, in doing so, the government should always strike a balance with respect to the resource allocation between investing on new social infrastructure and on sustaining existing infrastructure (asset management).

3.16. The Commission welcomes the implementation of a differentiated approach to municipalities as it acknowledges different capacity levels. A differentiated approach

links with a recommendation made by the Commission in 2005 and 2008 with respect to level three housing accreditation for metros that have demonstrated capacity to undertake the administration of the housing function. In 2013, the process of shifting the housing function to metros was initiated by the Department of Human Settlements (DHS) and in 2014/15 Division of Revenue a new Municipal Human Settlements Capacity Grant (MHSCG) which aims to operationalise the housing function shift, was introduced and the Commission supported the development. It is a concern for the Commission that disbursement of this grant was stopped in July 2014 and only released in March 2015 hence the spending of 8.5 percent of the allocated funds. Due to this underperformance, the grant has been terminated completely and its baseline has been reprioritised. Going forward, the Government has utilised funding from the Urban Settlements Development Grant to fund capacity building programmes even though it was never originally intended for such a purpose. The Commission is of the view that withholding MHSCG and reducing the allocation by R200 million for 2015/16, has the potential to undermine the credibility of the DoR processes.

3.17. The allocation for human settlements and municipal infrastructure between 2015/16 and 2018/19 will grow at an average annual rate of 7.6 percent. The Commission welcomes this growth as it is above inflation and indicates government's commitment to investment on basic infrastructure. The Commission however maintains its previous position with respect to housing. The current funding and housing delivery is fiscally unsustainable and needs to be reviewed with the view of promoting active citizenry and self-built housing initiatives.

## Health

3.18. Government, has shown commitment to priority spending on health over the 2016 MTEF with nominal growth rates of about 8.3 percent. In relation to health, these include programmes such as the national antiretroviral (ARV) treatment programme. Real expenditure growth on health for 2015/16 is at 2 percent while in 2016/17 it records -0.5 percent, followed by 0.1 percent in 2017/18 and -0.2 percent in 2018/19.

3.19. The Commission notes with concern the proposed changes to the indirect component of the National Health Grant in so far as funding the Human Papillomavirus (HPV) is concerned. This is due to the National Department of Health's request that the grant remain as an indirect grant over the 2016 MTEF so that provinces can get the necessary capacity required to administer this grant. The HPV indirect component of the grant was introduced in the 2013/14 financial year with the commitment that it will be phased into the provincial equitable share by 2016/17. Instead of the grant being phased into the provincial equitable share as per the original plan, a new proposal seeks to extend the life of the grant for another two years and thereafter convert it into a direct grant by 2018/19 on the grounds that HPV vaccination does not form part of the routine provincial vaccinations. The proposal further suggests that R600 million will be deducted from the provincial equitable share over the 2016/17 MTEF and re-allocated to the National Health Grant. The abrupt changes in the duration of the grant shows that proper planning was not carried out at inception as per the Commission recommendations made in its Submission on the 2014 Division of Revenue Bill 2014. The Commission recommended the need for proper financial planning and infrastructure to the roll out of the HPV. Further, the Commission recommended that funding for the HPV vaccine via the conditional grant and then phasing into the provincial equitable share is unlikely to be sustainable given high cost of the vaccine and that in other countries the funding of the vaccine is through Public Private Partnerships (PPPs). Lastly, the proposed changes to the HPV where funds would need to be taken out of the PES back to the indirect component of this grant will have negative impact on provincial health budgets which are already fiscally constrained.

## 3.19.1 Comprehensive HIV/AIDS grant

- The HIV/Aids grant has been in existence for a while and is one of the largest in the provincial fiscal framework and amounts to about R46.6 billion over the 2015 MTEF period with an average annual growth rate of 12.3 percent. Due to the ongoing fiscal constraint the grant is not allocated any addition to baseline, over the first two years of 2016 MTEF but will be allocated R1 billion in 2018/19. Instead in 2016 MTEF for the year 2015/16 the budget for the grant was about R13.7 billion and has been adjusted to R13.6 billion. Notwithstanding the stagnant allocations, the grant scope has been extended to cover tuberculosis (TB) testing and program interventions following a study which estimated a need for additional R4 billion in 2017/18 and 2018/19 to deal with TB cases.
- The Commission fully supports the efforts to fund TB cases as long as new priorities do not displace original intentions of the grant. The HIV/AIDS grant is increasingly put under pressure to accommodate new outputs and activities including laboratory fees for HIV and TB tests. In the 2015 MTEF, the grant was allocated an additional R 1.2 billion to cater for higher ARV take-up rate. Increasing scope would ultimately crowd out the ARV Program and thus place the country 's HIV/AIDS treatment in jeopardy.

## 3.19.2 National Health Laboratory Services

- In the 2015/16 MTEF an amount equating to R1.2 billion will be deducted from the provincial equitable share and the Comprehensive HIV and Aids Grant to fund the Teaching, Training and Research (TTR) function of the National Health Laboratory Services (NHLS) which have since been transferred to national government. Prior to the transfer the TTR function was funded through cross subsidisation from the tariffs. The Commission welcomed the deduction as this had been accompanied by commensurate reductions in NHLS tariffs charged provinces and reforms to address operational inefficiencies. Provinces must continue to monitor their laboratory costs to ensure that they do not fund NHLS inefficiencies but most importantly and in line with the Commission's recommendation to implement standard clinical procedures to minimise clinical waste at the health facilities level. Reduction of unnecessary tests could reduce provincial spending of laboratory fees.

### 3.19.3 National Health Insurance

- The Commission welcomes the decision to shift Western Cape's indirect allocation of the National Health Grant into a direct allocation. The shift is consistent with the Commission's recommendation to reduce the growing prevalence of indirect conditional grants. This will further provide the province with flexibility to meet its National Health Insurance (NHI) contracting requirements and address the funding gaps experienced by the NHI pilot implementation. However, the piecemeal and unsystematic fashion in which the shifting of the allocation is carried out is of concern to the Commission. Not only does this potential undermine the conditional grant system but also the DoR Act which governs the allocations. The choice to opt out of indirect conditional grants allocations should be extended to all provinces which have demonstrated capacity to implement existing indirect grants in other sectors. The Commission recommends that National Treasury add the necessary enabling clause in the DoR bill to facilitate such options.

### Basic Education

3.20. The Commission welcomes the proposed merging of the School Infrastructure Backlogs Grant (SIBG) and Education Infrastructure Grant (EIG) in 2017/18. This is in line with previous recommendations made by the Commission that grants with the same purpose need to be streamlined for efficiency and effectiveness. However, the Commission would like to re-iterate on its previous recommendation that merging of the grant due to non-performance is not a panacea as causes for non-performance need to be investigated and addressed. Further the Commission would like to highlight that in the 2015 MTEF, the SIBG, due to under-spending, was reduced by about R297 million and this was a concern for the Commission as raised in the response on the 2015 DoR Bill due to the role that this grant plays in building and upgrading schools which is one of the key inputs to improving education outcomes.

3.21. The Commission also notes and welcomes the review of the National School Nutrition Programme (NSNP) due to the misalignment between provincial and national school quintile classification which resulted in a number of eligible schools not benefiting from the program. The Commission would like to emphasise the need for the program to meet the minimum requirements in respect of providing nutritious meals to all learners in national quintiles 1 to 3 at both primary and secondary schools as per the National Norms and Standards for School Funding. In the 2015 MTBS, for the year 2015/16 the grant allocation was a R5.7 billion and was adjusted to R5.6 billion. With the limited adjustment made to the grant, the review could entail an increase in the number of eligible schools, thus putting pressure on existing allocations.

### Higher Education and Training and Recent Developments

3.22. MTBPS 2014 and Budget 2015 placed significant emphasis on post school education and training as a lever for alleviating the skills constraint and facilitating economic activity and growth. The pace at which key functional spending categories are set to grow over the 2016 MTEF period, suggests a slight shift in prioritisation, away from the previous strong emphasis on post school education. Over the 2016 MTEF period, the top three spending categories projected to grow the strongest are Health, Defence Public Order and Safety (which are both projected to grow by a real annual average of 2.7 percent) and Basic Education which is projected to grow by a real annual average of 2.6 percent per annum (See Table 6). As a preamble, funding for universities is based on three sources, namely government subsidies, student fees and third stream income such as private sector endowments and investment income. The proportion of government funding towards total income of higher education institutions has declined from 49 percent in 2000 to 40 percent in 2012. Much of this decline seems to have been absorbed through increasing the portion of income derived through student fees (which have increased from 24 percent of total income in 2000 to 31 percent of income as at 2012).

3.23. The spending prioritisation framework proposed in MTBPS 2015 will pose challenges in terms of addressing the issues around university fee increments that have sharply come to the fore with the recent outbreak of student protests, specifically the recent announcement to implement a 0% fee increase in 2016 as well as other far reaching reforms such as fee-free university education.

3.24. There are short term implications with respect to the 0% fee increase for 2016 and longer term considerations around the broader issue of free tertiary education. The short term issue revolves around finding the resources to respond to the shortfall that the zero fee increase will result in.

- One option for financing this amount is for universities to reduce their expenditure by the said amount. The moratorium in university fee increases, even to match inflation, and the prospects of government finding additional funding to fill the gap, may have the unintended consequence of universities having to reduce spending on research for example. Overall, this is not a desirable option as it erodes quality.
- If this option is undesirable, the next logical option is for the state to intervene with financing. Here there are a range of sub-options.



- a. The first sub-option for financing this amount would be through a reprioritisation of funding within the DHET itself and thereafter, more broadly across other national departments.
  - b. The second sub-option which is generally relied upon in unforeseen/emergency situations like the one that has arisen, is to utilise the unallocated (contingency) reserves. However, as a result of higher than anticipated public sector wage increases the unallocated reserves have been significantly drawn down to the extent where only R2.5 billion has been set aside for the 2016/17 financial year which commences in April 2016. Some of the shortfall could be financed utilising these reserves. The risk is that should any natural or other disasters (droughts, floods) strike during the course of 2016, there would be no cushion available to Government.
  - c. The third and final sub-option would be through the sale of state assets. There is precedence to this approach as recently the same approach was used to fund the R23 billion equity injection to Eskom. The attractive feature of this approach is that it demonstrates commitment to fiscal consolidation as steps to avoid increasing the budget deficit are being taken. The decision to sell state assets could be signalling that government is cautious about the impact of its support package to universities on the fiscal framework and may have reached its debt to GDP tolerance level. However, on the downside, government's balance sheet is still being negatively affected. Importantly, the sale of state assets is a once off cash injection and cannot be called upon again to balance off future expenditure needs that government may have.
- A combination of sub-option one together with universities exercising greater fiscal austerity is recommended and would, in the view of the Commission set the example for the private sector to respond. It should however be kept in mind that the combination of all three policies plus a lower inflation rate has the effect of making it appear that the cost of the system (in direct fee payment terms) is lower than it was before although in real terms it has just amounted to a re arrangement where the state and hence taxpayers in general assume responsibility for ensuring no fee increases rather than students or their families.
- 3.25. The longer term issue around the provision of free education at tertiary institutions will require a significant amount of additional funding. Options around financing this revolve around (a) a significant reprioritisation of state funding, (b) committed implementation of plans to sell nonstrategic assets, (c) increasing the tax burden and (d) borrowing. To estimate the implications of each of the reforms requires substantive research and the current task team that has been established would need to incorporate such research.
- 3.26. In the absence of such research, the Commission's past submissions made on related matters are also instructive. In 2012 the Commission carried out a budget review of South Africa's public universities. Some of the key findings from this research already hinted at the dire issues being experienced currently. For example the analysis showed that the increasing burden resulting from lower government subsidies to universities was being met by increasing student fees<sup>4</sup>. Importantly the research identified that the funding framework underpinning universities is in dire need of differentiation. The research also raised the need for major adjustments to the principles and assumptions of the principles underpinning the university funding framework. The Commission is of the view that the following elements are vital to a new long term funding and finance system on the basis of this related previous work and ongoing interactions:
- It should be borne in mind that in addition to the pressures presented by limited state funding in respect of universities, the DHET is confronted by pressing contending priority areas. The DHET has been on a concerted drive to refocus priority on the college system (consisting of Vocational and Education and Training Colleges (TVETs) which were formerly referred to as Further Education and Training (FET) colleges and the more recent introduction of Community Education Training (CET) colleges). In an attempt to restructure the post school education and training sector into a seamless and more equitable arrangement, Government shifted the colleges function from provinces to the national DHET. The varied and inadequate funding of colleges whilst under provincial control has meant that the DHET will have to significantly increase funding to college funding if it is to reap any benefits from shifting the function. Inadequate funding challenges within the higher education and training sector thus encompasses more than just the university sector.

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4 See pages 53 and 54 of FFC Submission for DoR 2013/14

- Given the pressures within the higher education sector, the Commission supports task team that has been set up to review the funding model underpinning the existing high university fees. The Commission further advises that the task team consider the broader system within which universities operate and that any proposals that emanate from the task team do not lead to a shifting of high fees in one part of the system to another part. The system needs to be looked at holistically and a long-term, viable solution must be the aim. Further it is advised that a clear system of differentiation in the determination of free education be devised. Such a system needs to acknowledge and respond to: (a) those that are better able to pay fees (the richest 10 to 20 percent), (b) the 'missing middle' whose children do not qualify for student financial aid but who also cannot afford the cost of higher education and (c) indigent households. This system of differentiation should be extended beyond the individual/student and should permeate the manner in which institutions are funded.
- If the shift to free tertiary education is to be sustained, it is critical for government to clarify its policy stance around access to education and, more precisely the definition of free education should be determined. In considering these issues, the broader challenge around existing outstanding student debt needs to be factored in as it may be perpetuating inequality.
- As argued above, the Commission is of the view that in order to build a higher education system that endures over the long term and help meet the goals of the NDP, the past investment in the sector should be consolidated and further increased but it is recognised that any changes have to be affordable within the current public financial pressures.
- Finally, much has been said about the involvement of employers. The Commission's view is that government needs to review the tools that it has at its disposal and which can assist in inducing greater private sector involvement. These include the power to legislate or to provide greater tax incentives. In each instance however, an assessment of the costs and benefits of each option is required to determine the best and most workable lever to achieve greater private sector involvement.

### Job creation and social protection

3.27. The 2015 MTBPS is tabled against the background of looming jobs cuts in the mining and steel industries. Job creation in the formal sector has slumped and continues to lag economic growth. With the outlook of weak economic activity, government spending needs to be directed towards activities which stimulate investment, growth and job creation. The 2015 Budget placed notable priority on employment tax incentives, support for enterprise development, skills development and Public Employment Programs (PEPs) as the key flagship government programs for contributing both directly and indirectly to employment creation. A total of R38.9 billion has been allocated to these programs over the 2015 MTEF and should continue to find prominence in the subsequent budgets. The Commission welcomes these allocations as they seek to address South Africa's high unemployment challenges and the social deprivation that comes with it.

3.28. As with many other important government programmes, the Commission is of the view that funding allocations to stimulate employment should be underpinned by a number of crucial principles. Firstly, programmes must be appropriately designed to maximise effectiveness and minimise unintended consequences. PEPs such as the Expanded Public Works Program (EPWP), Community Works Program (CWP) and the Jobs Fund should not be seen as instruments to directly increase the number of available jobs but instead to improve labour market outcomes, moderate the effect of cyclical downturn, address structural problems or support vulnerable employers or in industries. In their current form, PEPs are not only jobs centred, but too generic and rarely customized to respond to the prevailing economic conditions. Participants seldom exit the programme and transition into sustainable jobs.<sup>5</sup>

- Effective PEPs are measured on the basis of increasing the take-up rate of workers into regular employment and improving wages and productivity. These indicators should be used to determine the overall allocations and growth rate. Second, government must continue to complement employment creation programmes with structural reforms entailing systematic skills development programs that respond to the needs of the economy. In particular, the surplus fund on the National Skills Development Fund (NSF) should be used to finance a coherent National Skills Development Strategy which have been consulted with institutions of higher learning and industry.

#### 4. Review of Actual Spending by National Departments and Provincial Government - 1 April to 30 September 2015

4.1. 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 percent of the main budget. This would of course 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

4.2. Table 7 shows aggregate spending and percentage spent six months into 2015/16 financial year. Total government spending is approximately equal to the norm of 50 percent.

Spending by all votes also approximates the 50 percent mark (R339.8 billion of the main budget). With respect to the provincial equitable share, 50 percent of the total amount has been transferred.

4.3. Using selected national departments that are driving government priorities (education, health) and key built environment programmes for example, transport, energy and water and sanitation, government has spent R165 478 billion which is equal to the norm. An assessment of individual departmental performance shows somewhat uneven spending patterns. On the one hand certain departments such as Basic Education, Higher Education and Energy far exceed the norm, whereas others such as Departments of Public Works, Rural Development and Land Reform and Water and Sanitation have recorded spending rates of below 40 percent.

4.4. Excessive deviations below or above the norm is undesirable from an expenditure smoothing perspective. Unless a department's in-year cash management plan explicitly identifies under or over spending as a chosen spending profile, departments should attempt to remain within the confines of spending performance guidelines.

**Table 7. Aggregate spending and deviation from the norm (April-September 2015)**

R'million	2015/16		
	Main Budget	Actual Spending April - September	% Spending
Total	1 222 345	606 821	50%
Total Appropriation by vote	679 498	339 824	50%
Total direct charges against the National Revenue Fund General fuel levy	537 847	266 997	50%
Debt-service costs	10 659	3 553	33%
Provincial equitable share (National Treasury)	126 440	62 645	50%
Selected Key Budget Votes	382 673	191 337	50%
7 Public Works	328 107	165 478	50%
15 Basic Education	6 411	2 499	39%
16 Health	21 511	12 294	57%
17 Higher Education and Training	36 468	18 132	50%
21 Correctional Services	41 844	29 491	70%
25 Police	20 618	9 876	48%
26 Agriculture, Forestry and Fisheries	76 377	36 004	47%
28 Economic Development	6 383	3 467	54%
29 Energy	886	424	48%
31 Human Settlements	7 482	4 550	61%
33 Rural Development and Land Reform	30 943	13 127	42%
37 Transport	9 380	3 611	38%
42 Water and Sanitation	53 357	27 195	51%
Provincial Level	16 447	4 808	29%
Education	483 597	235 290	49%
Health	198 863	95 852	48%
Social Development	176 523	88 024	50%
Other	13 725	6 864	50%
	94 486	44 550	47%

Source: MTBPS 2015; Commission Calculations



## 5. Local Government Financing Issues

### TOTAL ALLOCATIONS TO THE LOCAL GOVERNMENT SPHERE

5.1. The MTBPS is allocating more funds to the local government sector than the February 2015 budget (Table 8) and the allocations to the local government sphere continue to grow at a faster rate than those for national and provincial spheres. The sphere will receive R101.2 billion in 2015/16, and this is expected to increase to R128.4 billion by 2018/19.

On average and in real terms, total allocations to the sphere are expected to grow by 3.5 percent from 2016/17 to 2018/19 (Table 8). During the same period, conditional grants allocations will exhibit faster real growth (at 5.5 percent) than the local equitable share (LES) allocation (at 2.9 percent), and the fuel levy, which is envisaged to contract by 0.6 percent. The increase in allocations to the sphere is a welcome development as it signifies government's desire to build a capable local government sector, while at the same time improving access to basic services for many South Africans.

**Table 8. Medium term expenditure framework division of revenue (R'million)**

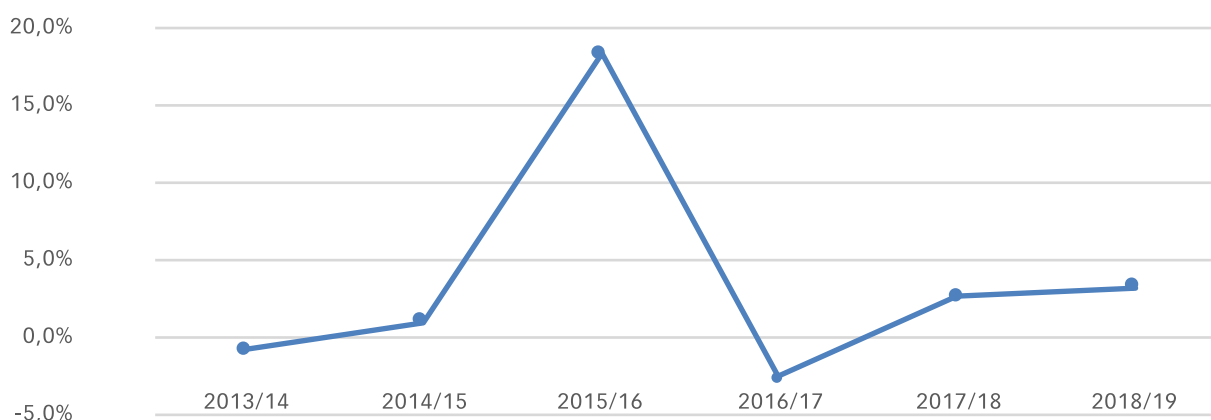
Division of Revenue	2015 Budget	2015 MTBPS	2015 MTBPS			Real Average growth rate (2016/17-2018/19)
	2015M/term estimate	2015/16 revised	2016/17	2017/18	2018/19	
<b>Local government allocation</b>	<b>99 754</b>	<b>101 252</b>	<b>106 949</b>	<b>115 319</b>	<b>128 423</b>	<b>3.9%</b>
LES allocations	50 208	51 707	52 869	57 512	62 732	2.9%
Conditional grants	38 887	38 887	42 857	46 022	53 222	5.5%
General fuel levy	10 659	10 659	11 224	11 785	12 469	-0.6%

Source: Source: MTBPS (2015), Commission Calculations

### LOCAL GOVERNMENT EQUITABLE SHARE

5.2. The Commission supports the redistribution of resources through the LES which gives more funds to lesser resourced municipalities. The allocation of resources through the LES enables municipalities to fulfil their constitutional mandate of affording poor members of society with basic services. An amount of R6 billion will be added to the LES over the MTEF period. Given that municipalities face extensive pressures emanating from rising electricity prices and population growth, among others, the Commission welcomes the additional resources channelled to the local government sector through the LES formula. These allocations increased from R41.6 billion in 2014/2015 to R51.7 billion in 2015/16 and are expected to grow over the next two years from R52.9 billion in 2016/17 to R62.7 billion in 2018/19. The worrying development is that the LES will in outer years grow far less (Table 8 and Figure 9) than the growth in the cost of basic services: bulk electricity and

bulk water. The 2.9 percent real growth in the LES in the outer years is particularly worrying considering that the LES is supposed to fund basic services; services whose costs (electricity and bulk water) are envisaged to grow at rates far above that of the LES. Under this situation many municipalities will be forced to absorb most of the bulk water and bulk electricity cost pressures. This tight fiscal space that municipalities will find themselves in, will need municipalities to use the available resources more efficiently and effectively, and achieve "value for money" wherever possible. It is also important that municipalities improve on revenue collection. In addition, the Commission reiterates its previous recommendation for the 2015/16 DoR that national and provincial governments should come up with more effective capacity-building initiatives in order to support weaker rural municipalities to ensure improved revenue collection.

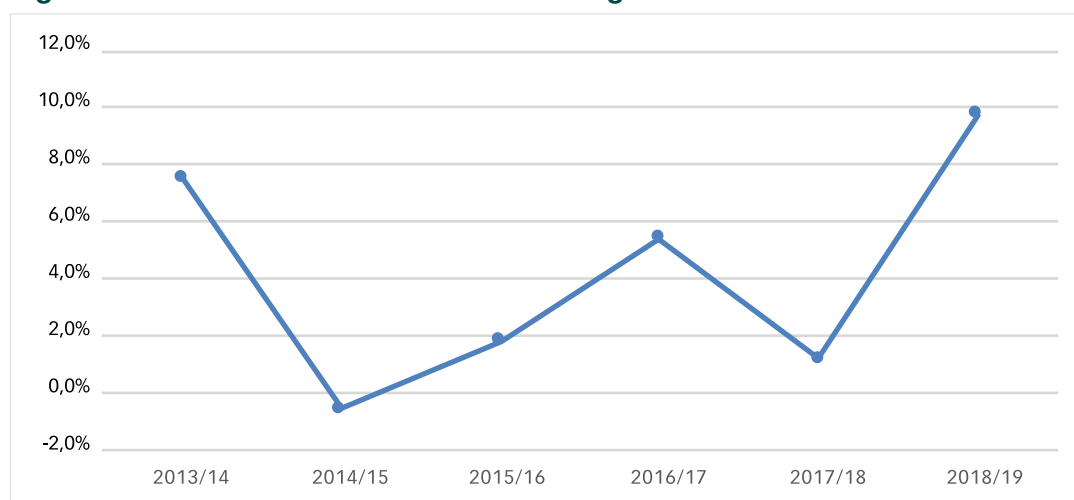
**Figure 9. Real Growth Rate in LES allocation**

Source: Division of Revenue Bill, 2013, 2014, 2015. Commission's calculations.

### CONDITIONAL GRANTS

5.3. The Commission notes the significant growth in conditional grant allocations to municipalities. Conditional grants increased from R36.0 billion in 2014/15 to R38.9 billion in 2015/16 and are forecast to increase to R53.2 billion in 2018/19. The real growth rates of the conditional grant allocations are shown in Figure 10.

5.4. In line with the Commission's previous observations that indirect grants are proliferating and their performance is weak, it is important to note that the 2015 MTPBS changes to the baselines of indirect grants to local governments will decline further in the outer years (Figure 11). The decline in the baseline of indirect grant allocations is mainly a result of a shift towards direct grants. The Commission welcomes this shift.

**Figure 10. Real Growth Rate in conditional grant allocations**

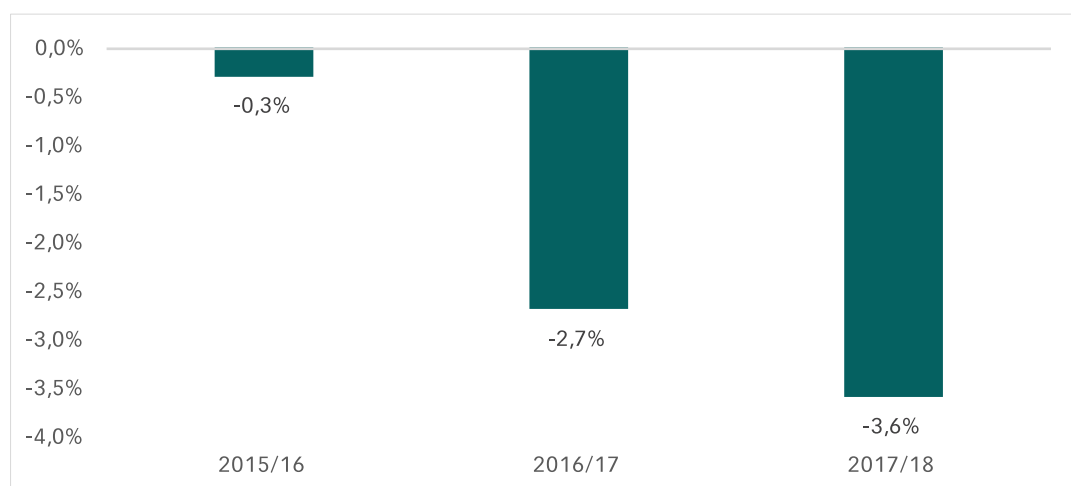
Source Division of Revenue Bill 2013, 2014, 2015, MTBPS, 2015. Commission's calculations.

5.5. The Commission continues to be concerned with the capacity of some municipalities to efficiently utilise conditional grants. The challenge of under-spending on capital budgets in particular remains.

### LES WITHDRAWAL

5.6. The 2015 MTBPS notes that National Treasury, the Department of Public Enterprises, the Department of Cooperative Governance and Traditional Affairs (CoGTA) and the South African Local Government Association (SALGA) have assisted municipalities that had defaulted on their debt

to Eskom to enter into agreements with Eskom to repay the R4.9 billion outstanding debt. So far 59 municipalities have signed such agreements. The main issue was that many municipalities had persistently not complied with measures specified in Section 216 (1) of the Constitution, and in particular they had not adhered to the 30 day debt payment rule. In line with Section 216 of the Constitution, and Section 17 and 18 of the DoR Act of 2015 and subsequent regulations prescribed in the Municipal Finance Management Act (MFMA), National Treasury had to take punitive measures in the form of stopping allocations of municipalities owing Eskom and Water Boards. On the

**Figure 11. Changes to the baseline of indirect conditional grants to local government**

Source: National Treasury MTBPS document, p53

onset, the Commission noted that such punitive measures should only be done as a matter of last resort and with minimum interruptions on service delivery. Although the Commission was initially concerned that the National Treasury approach to resolving the issue was one sided, it has been encouraged by indications that the issue is being dealt with holistically as National Treasury has been putting pressure on national and provincial departments to honour their debt to municipalities. The Commission restates the point that it made to Parliament in its submission on the issue that officials responsible for non-payment within 30 days should also be sanctioned. On the issue of agreements noted in the MTBPS, the Commission is concerned that many municipalities have subsequently ignored these agreements. To this end, the Commission encourages municipalities to take their fiduciary responsibilities seriously by honouring agreements. It is also encouraging that the associated problems of the accuracy of the billing systems are being resolved by the task team established last year to deal with the issue.

## BOUNDARY RE-DETERMINATIONS

5.7. Following the 2013 municipal boundary changes, there has been a new wave of amalgamations that will come into effect on the date of the 2016 local government elections. The MTBPS proposes an allocation in the 2016 budget to cover demarcation related costs that will be incurred by merging municipalities. Previous Commission research has shown that boundary changes have significant cost implications for municipalities concerned. To cushion municipalities from these high demarcation costs, a Demarcation Transition Grant worth R139 million over the 2015

MTEF was provided for municipalities affected by the 2013 amalgamations. In 2015 the MDB had to respond to a new set of proposals by CoGTA on the re-demarcation of municipalities and categorisation of metropolitan municipalities. The CoGTA proposal marked a major shift from the existing approach to local government demarcations because municipal viability was placed at the centre of boundary changes. Although not all the proposals were accepted, the number of new mergers to take place in 2016 has increased significantly. Although the Commission welcomes MTBPS proposals to grant each major re-demarcation an allocation in the 2016 budget, it is important that the full financial impact of the demarcations be determined and that the receiving municipality is made aware of such costs. The Commission also welcomes the spirit of differentiation embraced in the demarcation transition grant. The Commission would encourage Provincial Treasuries and the CoGTA to put in place mechanisms of monitoring this grant in order to ensure that these resources are strictly used to defray costs related to demarcations. In addition, the Commission cautions role players in the demarcation space against considering financial viability as being synonymous to financial self-sustainability or that dependency on transfers is a problem. In fact, transfers are designed to fill the resource gap in municipalities that are not financially self-reliant, and compensate for the lack of revenue base. Dependency is in effect part of the design of the local government fiscal system, and Section 214 of the Constitution refers to fiscal capacity as one of the factors that should be considered in the equitable division of revenue process, and this implicitly means that municipalities that have no revenue base must be funded through the transfer system.

## INFRASTRUCTURE GRANT REVIEW

5.8. In 2011 the Commission undertook a comprehensive review of the local government fiscal framework (LGFF), which raised concerns regarding the performance of Infrastructure grants. National Treasury, in collaboration with the Department of Cooperative Governance and Traditional Affairs, the Department of Planning, Monitoring and Evaluation, the South African Local Government Association and the Commission, beginning in 2014, embarked on a comprehensive review of infrastructure grants with a view to enhancing “value for money” of these grants. The Commission thus welcomes the proposed reforms to the infrastructure grants, namely

- The merger of a multiple of water and sanitation grants
- Introduction of a formula-driven Public Transport Network Grant
- Introducing greater differentiation for secondary cities and creating a MIG Cities (MIG 2) grant with new planning requirements for secondary cities
- Merging urban grants (USDG, NDPG, INEP) over the MTEF, and
- Amendments to the municipal infrastructure grant to allow its funds to be used for the maintenance and refurbishment of municipal roads.

5.9. As part of the infrastructure grant review project, the Commission supports the merger of water and sanitation grants as well as the proposed merger of urban grants as

this will enhance the administrative efficiency of these funding windows. The Commission is also encouraged by the introduction of far reaching asset management reforms that would see municipalities pay more attention to asset care and maintenance and that capital grants will, besides funding new investments, also incentivise and fund repairs and maintenance. The introduction of a formula driven Public Transport Network grant is welcomed as it will introduce predictability and transparency in the grant framework. Equally important are the amendments to the MIG that will allow for maintenance of municipal roads. Well maintained municipal roads will go a long way towards improving connectivity and economic activity within municipal spaces.

## 6. Revised Division of Revenue 2015/ 16

6.1. Declared unspent funds amounted to R3.18 billion of which the bulk relates to underspending by national departments.

6.2. The Adjustments Budget makes provision amounting to R1.6 billion for roll-overs. Unlike previous years, the roll-over amount has increased while the number of departments receiving roll-overs has declined in the 2015/16 adjustments budget. In particular, the Department of Cooperative Governance dominates the roll-overs, with R1.5 billion approved in the adjustments budget. The roll-over funds is for the local government equitable share for municipalities to pay ESKOM and the Water Board accounts.

**Table 9. Rollovers of selected national votes, 2010/11-2015/16**

R'million	2010 MTBPS	2011 MTBPS	2012 MTBPS	2013 MTBPS	2014 MTBPS	2015 MTBPS	TOTAL
<b>Total</b>	3737	1789	1506	894	157.7	1616.8	9700 .5
<b>Selected Budget Votes</b>							
Cooperative Gov- ernance	430 .8	5.6	139.5	72	80.2	1498.8	2226.9
Public Works	120	0	87.1	0	0	0	207.1
Basic Education	1	29.9	104.7	14.7	9.7	0	160
Health	49.8	231.3	87.2	22.2	0	0	390.5
Social Develop- ment	0	0	0	0	10.5	0	10.5
Agriculture, For- estry	15.6	37.5	68.2	0	0	0	121.3
Communication	19.8	112.2	0	0	0	0	132
Energy	61	88.2	25.8	28.1	18.9	35.5	257.5
Human Settle- ments	82.7	64.6	13.5	120.5	0	0	281.3
Rural Development and	495.7	0	96	0	0	0	591.7
Water Affairs/Water and	79	145.8	416.6	188	28.7	0	858.1

Source: Adjustment Estimates of National Expenditure 2010 - 2015. Commission's calculations.

## 7. Concluding Remarks

7.1. The 2015 MTBPS has been crafted in very difficult circumstances characterised by downward economic growth forecasts and rising impatience with social outcomes deemed by the population to fall short of expectation. Bearing this in mind, government has done a good job that promises a deficit reduction programme for the next three years and thereby prevents public debt from spiralling out of control.

7.2. Overall, this year's MTBPS contrasts the conflicting objectives between social development and fiscal consolidation in the short term. However, the question becomes will South Africa achieve higher growth through its fiscal stance? The Commission notes that growth is considerably lower in the economy than was projected in February 2015. Hence efforts to improve the fiscal framework should ultimately be premised on re-igniting growth. Current economic growth estimates fall short of the required growth rate to fulfil NDP expectations and compares unfavourably with other developing economies.

### 7.3. The Commission is of the view that:

7.3.1. This year's MTBPS and corresponding frameworks are noteworthy in one major respect, reflecting explicit recognition by the Executive of the need to take account of long-term issues in budget formulation in the form of guidelines that are a hybrid of (a) an expenditure rule, (b) a structural budget balance rule (where outer year is targeted for operational traction) and (c) a revenue rule. Continued credible commitment to fiscal consolidation (within the framework of these fiscal guidelines) is necessary to ease the frequency of sovereign debt downgrades as Government demonstrates its ability to control spending pressures. Such commitment should be geared to ensuring that the policy remains credible. In this regard, it is critical that such a perspective is shared both by executive and legislative branches. As with most other emerging countries, South Africa needs to take account of potential long-term structural developments and risks threatening social stability. There are fiscal dimensions to many of these risks and these dimensions involve dealing with problems for which there are fundamental uncertainties.

7.3.2. South Africa should continue to focus its strategy for reigniting growth on improving education expenditure outcomes in particular, increasing skills bases, maintaining strong growth on social safety net spending and increasing productivity of public infrastructure .

7.3.3. Government's plans to intensify efforts to carry out expenditure reviews aimed at increasing efficiency of spending and combating waste should be supported. In particular, in-house reviews should be complemented by independent expenditure reviews. The call to have cost benefit analysis before legislation is changed is most welcomed in this respect.

7.3.4. The moratorium on university fee increases next year and the prospects of other far reaching reforms necessitate government finding additional funding to fill gaps that were not addressed at the tabling of the 2015 MTBPS. The Commission's concern in the main is with respect to the size, direction and impact of funding higher education and the post-school system as a whole. In order to build a higher education system that endures over the long term, the past investment in the Higher Education and Training sector should be consolidated and further increased but it should be recognised that any changes have to be affordable within the current public financial pressures.

7.3.5. Government must review the assumptions underlying the funding model for public universities and ensure that runaway increases in student fees are not used as a substitute for falling government funding of universities; and therefore accentuate the need to increase resources going to Higher Education and Training to enable it to meet the objectives of the National Development Plan.

7.3.6. Serious concern should be expressed with regard to reduced national efforts to facilitate economic growth through infrastructure-led growth. To this end growth in the percentage of gross fixed capital formation is lower than last period. Government should continue sending a firm message regarding the ethos of 'infrastructure led growth' and that agents should invest more than they consume and give practical effect to it. The MTBPS does not do this as consumption falls less than fixed capital formation.

7.3.7. There needs to be a major drive for the private sector to take full advantage of the depreciation of the rand and maximize exports as well as inward investments .In this regard there needs to collective responsibility led by Government to send the right signals to bring back stability and confidence into the economy .There needs to be a joint initiative addressing inter alia the electricity crisis, growth in the economy and the stabilization of salary increases and productivity as well as other competitive levers.

7.3.8. Weak commitment to wage growth moderation in the public sector resulted in an agreement that has blown a big hole in the fiscus that will largely be absorbed by the cumulative contingency reserve leaving little over to cater for unforeseen emergencies such as higher education fees, drought or another global financial downturn. In the medium-term, managerial interventions such as controls on automatic pay progression and performance bonuses as well as reduction in the rate of hiring in noncritical areas may assist government in its commitment to ensuring that the upward trend in the wage bill does not adversely impact its budget deficit targets. In the long-term, ensuring that the rise in public wage bill within a constrained economic growth environment does not crowd-out or limit resources available for implementing key socio-economic programmes, will require fundamental reforms that link public sector remuneration with performance and productivity.

# APPENDIX D

## Submission on the 2016 Division of Revenue Bill

### 1. BACKGROUND

1.1. The 2016/17 Division of Revenue Bill is tabled in an economic environment in which the country's growth prospects are confronted by escalating external and internal headwinds. The external environment as characterised by the decline in the demand-driven commodity price cycle, largely as a result of slowest expansion of the Chinese economy since the 2008 financial crises, has contributed to decelerated investment domestically. Export performance has weakened despite a prolonged and sharp depreciation of the effective exchange rate. Import growth also decelerated in reaction to lower domestic demand and exchange rate depreciation. The resultant worsening terms of trade have translated into an elevated current account deficit. Following the sharp depreciation of the Rand, the combined effects of a moderation in growth of export volumes and increased domestic demand for relatively inelastic imports, particularly capital and intermediate goods attributable to South Africa's large infrastructure spending, resulted in South Africa moving from a trade surplus position to a trade deficit of almost R14 billion in the third quarter of 2015. The impact of drought on agricultural production, private investment contraction, uncertainty around electricity supply and the spate of often violent protests over a range of socio-economic issues have also weighed on investment.

1.2. Economic growth has been on a downward trajectory, slowing down from 3.1% in 2011 to 1.5% in 2014. In the October 2015 Medium Term Budget Policy Statement (MTBPS), the economy was forecast to grow at 1.7% in 2016. By January 2016, slowdown in the Chinese economy, increased policy uncertainty regarding the direction of fiscal policy and the manifestations of the impact of the worst drought in three decades, prompted the World Bank to revise South Africa's projected 2016 GDP growth downwards to 0.8%. This is the third straight year that South Africa has posted a downward revision to the growth forecasts, with the revisions translating to a cumulative downward GDP revision of 2.5% over the period 2014 -2017.

1.3. The present environment of low fragile growth is making it difficult to tackle the triple challenges of unemployment, poverty and inequality, as well as plans to stabilize the fiscal deficit fiscal and external imbalances. In order to respond to these triple challenges while simultaneously maintaining South Africa's investment-grade status, Government will

need to ensure the full implementation of growth-enhancing structural reforms embodied in the National Development Plan (NDP). Complementing such reforms, will require a long-term approach to carry out broad range of structural reforms aimed at ensuring higher levels of domestic savings and investments rates, sustained restraint in public debt accumulation, and reducing rigidities in labour and product markets as a means of incentivising innovation and increased productivity.

- (a) The Financial and Fiscal Commission (the Commission) has already stated in past recommendations that a credible commitment to more aggressive fiscal consolidation is necessary to ease the frequency of sovereign debt downgrades as Government demonstrates its ability to control spending pressures. In this regard, the Commission welcomes Government's strong intent re-emphasised in the 2016 Budget to adhere to spending ceilings, combat waste, inefficiency and corruption and notes special provisions to deal with issues related to waste, inefficiency and corruption. These provisions should be enforced where applicable. The Commission also supports efforts to moderate the public sector wage bill. *The financial stability this brings about is only a necessary but not sufficient condition for sustainable national development that brings much needed social cohesion and stability.*
- (b) Debt in state-owned enterprises (SOEs) continues to be a key risk to the projected debt trajectory. A number of state-owned enterprises such as the South African Airways (SAA) and the South African National Roads Agency Limited (SANRAL) already account for a substantial share of contingent liabilities. Beyond political and policy factors, the continued poor performance of some SOEs resulting in the massive injection of capital and finance by Government has been cited as key risk to ratings of South Africa's credit worthiness by international ratings agencies. In this regard, the Commission welcomes Government's commitment to fast-track the implementation of a number of recommendations contained in the Presidential Review Commission (PRC) report on SOEs. Primarily, the report recommends a transformation of SOEs, including partial listings and privatisations, as well as



the establishment of an overarching state authority to coordinate the government's big infrastructure related companies. The Commission supports the recent pronouncement during the Budget Speech by the Minister of Finance of a new approach aimed at increasing private sector participation via the sale of equity in SOEs and a rationalisation programme to enhance efficiency and long-term viability of SOEs through closure of some, and the merging of other entities.

- (c) In previous work, the Commission noted that gross domestic product (GDP) will not recover substantially without positive shocks and deliberate interventions to counteract the negative impacts of the world economic crisis. In this regard, the country needs to drive up its performance in relation to two key components: productivity and participation. This growth should also satisfy three desired characteristics -solidarity, cohesion and sustainability. Economic growth needs to be accompanied by improvements in skills and education. The country faces enormous pressure to upgrade human capital skills. It suffers from competitive disadvantage in terms of the quality of its human capital, its investment in research and development (R&D), and information and communication technology (ICT) penetration. The country will need to increase investments and quality of spending in education and bolster spending on R&D. These supply side factors constitute most pressing key long-term challenges confronting the country and necessitate consideration of long-term fiscal risks.

1.4. It is against this background that this submission on the 2016 Division of Revenue Bill is made by the Commission in terms of Section 214 (1) of the Constitution of the Republic of South Africa (1996) and Section 35 of the Intergovernmental Fiscal Relations (IGFR) Act (1998). The submission is also made in terms of Part 1 (3) {1} of the Financial and Fiscal Commission Act (2015) 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.

## 2. Major Revision of Clauses of the Division of Revenue Bill

2.1. The 2016 Division of Revenue Bill has 5 main revisions to its clauses designed to take account of specific policy adjustments as follows:

1. **Clause 20(3): Allowing grant funds to be reprioritised for disaster relief:** The Clause has been changed to allow grant funds to be reprioritised to disaster relief or recovery. Funds must remain within the same sector. The Transferring Officer and the NDMC must agree on the need for this and National Treasury must approve any reprioritisation.

- (a) The Commission welcomes inclusion of this clause seeking to institutionalise disaster risk management strategies as a response to the drought (mitigation/adaptation/vulnerability) within the existing grant framework.
- (b) The Commission further notes that this allows for trade-offs between planned expenditures and pressing expenditures necessitated by previously unforeseen vagaries of weather to be transparent and in line with fiscal prudence.

### 2. Responding to corruption in procurement:

- (a) A new clause in section 21(2) of the 2016 Division of Revenue Bill has been added, which states that, 'the National Treasury at its discretion after consulting with the relevant transferring officer or at the request of the transferring officer or the affected receiving officer may convert a portion of a direct allocation to an indirect allocation, if there is satisfactory evidence that a municipality has failed to follow procurement procedures stated in the Municipal Finance Act'.

- (b) The Commission welcomes this clause because it is in line with the Commission recommendation for 2016/17 division of revenue to raise procurement to a strategic level as well as using conversion to indirect grants as a measure of last resort. Transgressions in procurement do constitute serious reasons that warrant such intervention.

- (c) Furthermore, the clause is welcome as it puts in place a mechanism that ensures fast-tracking of spending and reclassification of grants in accordance with justifiable and necessary processes. There is need to ensure that the clause is much clearer in setting the threshold levels of procurement transgression at which point the grant is converted to an indirect grant and the time frame within which the grant remains an indirect grant after conversion.



### 3. Transitional measures for municipal elections in 2016:

(a) The 2016 MTEF is characterised by a large number of major and small re demarcations. This had an impact on the government budget policies for the 2016/17 financial year. A new clause 34 has been added to enable National Treasury to re-gazette allocations in the event that elections take place after the start of the municipal financial year and to set in place interim measures for grant planning and spending in re-demarcated municipalities. The Commission supports this measure as it is prudent and shows good forward planning. In line with this clause, the Commission would like to highlight in line with its recommendation that a conditional grant be designed in order to support the affected municipalities with the restructuring process, the Division of Revenue Bill makes provision for a transitional grant in the allocations to local government.

### 4. Clarifying provisions for withholding and stopping of allocations: Clause 19 clarifies the grounds on which funds can be stopped by making explicit the linkages to section 216 of the Constitution and Section 38(1)(b) (i) of the Municipal Finance Management Act.

(a) The Commission supports this clause as it draws a direct link from the Constitution to the Municipal Finance Management Act in line with the Commission recommendation when it made a submission on withholding of LES last year. As a matter of principle the Commission also called for the decision to withhold LES to be made as a last resort, approach to debt should be fair and not one sided, debt issue should be resolved within the IGFR system and not in courts, and compliance with the 30 day payment rule should be enforced on municipalities, national and provincial government departments and entities alike.

(b) Against these principles, the Commission would also like to reiterate its previous recommendations on the issue namely: that proper diagnostics of the root cause of non-payment be done and if it is due to bad management, appropriate consequences should be rendered; stricter measures should be imposed on individuals within municipalities that are responsible for continuously flouting MFMA rules; the electricity and water undertakings must be ring fenced; and that IGFR forums dedicate sufficient time to find lasting solutions to the debt problems within the Local government sector.

### 5. Gazetting Human settlement allocations to cities:

(a) Clause 10(10) requires provincial departments to gazette transfers to municipalities for Human Settlements Development Grant (HSDG) funded projects before the grant can be transferred to provinces.

(b) The Commission has over the past number of years raised concerns and the implications thereof regarding the inability or unwillingness of provinces to gazette housing allocations to municipalities and in particular, the metros which have been accredited to deliver houses. The lack of housing allocations undermine integrated and spatial planning efforts and further hinders ability of a municipality to address apartheid spatial forms effectively. It is in this regard the Commission welcomes the tightening of the Division of Revenue Bill through clause 10 (10) which makes the transferring of the Human Settlement Development Grant to provinces conditional upon gazetting of transfers to municipalities.

(c) The Commission is of the view that this clause should be tightened further by requiring that provinces align gazetted allocation with planned housing units to be delivered as stated in the Annual Performance Plan (APP) and further provision made for the National Treasury to stop or withhold the allocations if the set requirements are not adhered to.

## 3. Major Changes and Additions to the Division of Revenue Bill

### A. CHANGES AND ADDITIONS TO THE NATIONAL FISCAL FRAMEWORK

3.1. Over the period 2016/17 to 2018/19, government is expected to spend R4.7 trillion relative to a revenue envelope of R4.3 trillion. The bulk of the resources are allocated in respect of non-interest allocations in the form of equitable share and conditional grant funding.

3.2. A consolidated revenue target of R 1 324 billion is set for 2016/17, or 30.2% of gross domestic product (GDP). Expenditure will be R1 463 billion, leaving a budget deficit of R139 billion, or 3.2% of GDP. Table 1 outlines the fiscal framework for the 2016 MTEF. Local government receives the highest real annual average growth in expenditure of 5.1% compared with 1.5% and 1.6% for national government and provinces respectively .

**Table 1: Division of Nationally Raised Revenue, 2013/14 to 2018/19**

R'million	Outcome		Revised Estimate	Medium Term Estimates		
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
National Departments	453.4	490.0	546.8	559.81	594.1	637.8
Provincial	410.6	439.5	471.8	499.8	542.3	582.9
Local Government	82.6	87.7	99.7	104.9	113.3	125.8
Non-Interest Allocations	946.6	1 017.2	1 118.2	1 164.6	1 249.8	1 346.5
<i>Real Year on Year Growth</i>						
National Departments		2.0%	7.0%	-4.4%	-0.2%	1.5%
Provisional		1.0%	2.7%	-0.8%	2.2%	1.6%
Local Government		0.1%	9.1%	-1.5%	1.7%	5.1%
Non-Interest Allocations		1.4%	5.3%	-2.6%	1.0%	1.9%

Source: National Treasury, 2016

3.3. Table 2 outlines the allocations of the division of revenue at the national sphere specifically indicating the extent of indirect transfers to provinces and local government. The Commission notes the slowdown in growth in indirect transfers to provinces and local government

compared to previous years which is a welcome development as there is Commission research generally pointing out that direct conditional grants tend to perform better than indirect grants.

**Table 2: Overview of Revenue Allocations within National Departments, 2013/14 to 2018/19**

R'million	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	Real Annual Average Growth
National Departments: of which	453.4	490.0	546.8	559.8	594.1	637.8	1.0%
Indirect transfers to provinces	2.7	5.8	3.2	3.6	1.7	1.8	1.2%
Indirect transfers to local government	5.9	8.9	10.5	7.8	7.4	7.7	2.5%

Source: National Treasury, 2016

## SECTOR SPECIFIC ALLOCATIONS

**3.4. HIGHER EDUCATION AND TRAINING:** The 2016 Division of Revenue Bill has brought a subsidy for no increase in university fees. The Commission welcomes the significant changes to the funding and student finance system because it directly responds to an agreed priority following the 2015 MTBPS. Though the government took into consideration the pressures associated with the no increase in university fees, it overlooked persistent competing priority areas confronting the Department of Higher Education and Training (DHET). A case in point is that effective from 2015/16 a key change that occurred is the shift of the Further Education and Training (FET) (now known as Vocational Education and Training Colleges (TVETs)). The DHET has been on a

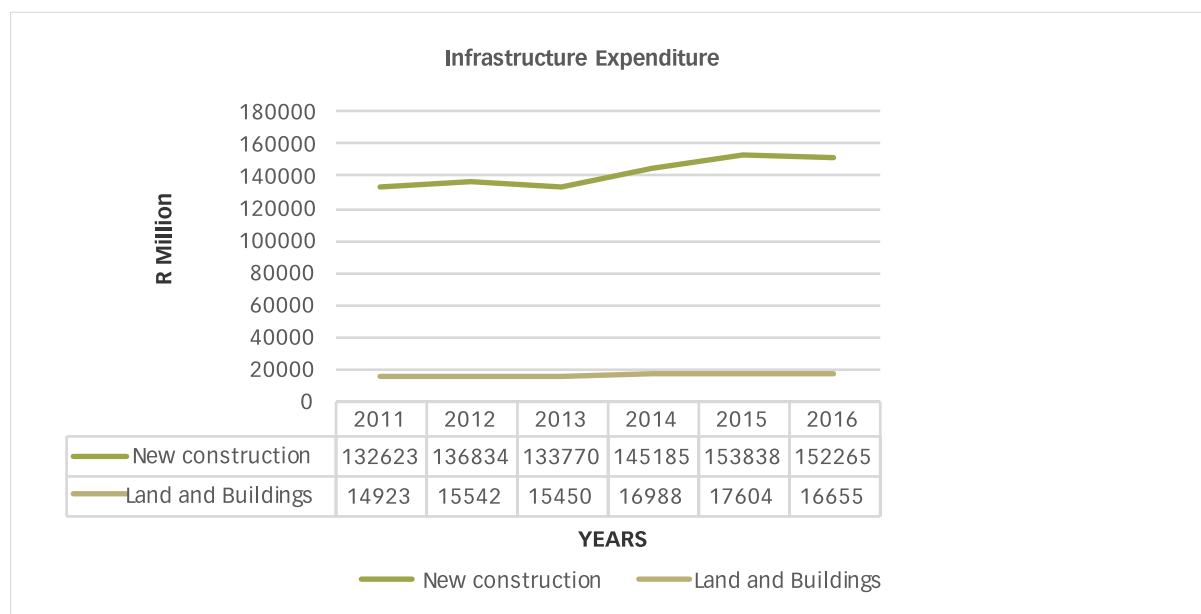
concerted drive to refocus priority on the college system consisting of TVETs and the more recent introduction of Community Education Training (CET) colleges. In order to build a higher education system that endures over the long term and help meet the National Development Plan (NDP) - goals, the Commission urges government to look beyond just enrolments in Tertiary Institutions as is presently the case but instead focus more on the attainment of qualifications. This approach will ensure that students make progress towards finishing qualifications and ultimately leave with credentials that have value in the labour market.

### 3.5. INFRASTRUCTURE AND ECONOMIC DEVELOPMENT:

The Commission welcomes Government's continuous investment in economic infrastructure (such as roads) and social infrastructure (such as schools, hospitals and clinics) to stimulate economic development, create jobs and address economic and social disparities. This is aligned with the NDP and past recommendations made by the

Commission. Key to achieve sustained economic growth is ensuring that aligned and coordinated infrastructure investment plans remain a key priority for government. Figure 1 outline the infrastructure expenditure on new construction, land and buildings<sup>1</sup> In 2013 there was a slight decrease in the expenditure for new construction but an increase is planned for 2014, 2015 and 2016.

**Figure 1: Infrastructure expenditure for new construction, land and buildings**



Source (Stats SA; 2014 and 2013)

## B. CHANGES AND ADDITIONS TO THE PROVINCIAL FISCAL FRAME WORK

3.6. Table 3 shows the 2016/17 provincial fiscal framework inclusive of conditional grants. Within the constraints of reduced overall economic growth compared with earlier forecasts and an associated reduction in budgeted revenue growth, the total baseline reductions to provinces over the MTEF period is R19 billion compared to 2015 MTBPS. Much of this downward revision is as a result of across the board reductions in baseline budgets to support fiscal consolidation and the need to finance new and changing government priorities. The Commission notes that downward revisions in the outer years of the 2016 MTEF are much larger than for the current 2016/17 financial year. This is welcomed as it allows provincial governments' sufficient time to update programmes and reprioritise spending within the available baseline allocations. Compared to the 2015 Division of

Revenue Act, the provincial allocations as reported in the 2016 Division of Revenue Bill has in fact increased by R3 billion and R1 6 billion in 2016/17 and 2017/18 respectively. The increase, however, is much smaller than the allocations in the 2015 MTBPS. The provincial fiscal framework was projected to increase by R7 billion in 2016/17 and R22 billion in 2017/18 in the 2015 MTBPS compared to the allocations in the 2015 Division of Revenue Act. While previously, downward revisions in provincial fiscal framework was done through a balanced approach where key service delivery areas were protected, the magnitude of the reductions in the 2016 Division of Revenue Bill suggest this will still be the case in 2016/17 while in the outer years, key service delivery areas may be negatively impacted, unless the economy rebounds or provinces achieve significant efficiency gains in spending.

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<sup>1</sup> Both the expenditure for new construction and land and buildings, encompass various sectors such as national government, provincial government, municipalities, public corporations, higher education institutions and extra budgetary accounts and funds.

**Table 3: Changes to the Provincial Fiscal Framework -2015/16 -2018/19**

R' billion	2015/16	2016/17	2017/18	2018/19
Changes from 2015 DORB to 2015 MTBPS	4	7	22	
Changes from 2015 DORB to 2016 DORB		3	16	
Changes from 2015 MTBPS to 2016 DORB		-4	-7	-8

Source: Division of Revenue Bill (2015, 2016), MTBPS (2015); Commission Calculations

3.7. A key fiscal risk to the provincial framework identified at the time of the 2015 MTBPS was the ongoing escalation of the public sector wage bill through above inflation increases agreed to through wage bargaining agreements. While a three-year wage settlement deal signed in 2015 will bring much needed stability to the economy, the fiscal impact these increases will have on limited state resources and expanding social priorities should be seriously considered. The Commission therefore welcomes cost saving initiatives highlighted in the 2016 budget to manage the ever increasing public sector wage bill. The Commission has previously noted the lack of any linkage between wage increases and productivity in the public sector and would like to reiterate the recommendation made in the submission for 2016/17 division of revenue that a framework for measuring public sector productivity be finalised as a matter of priority.

3.8. The provincial equitable share is expected to grow on average by 0.9% per annum in real terms over the 2016 MTEF period while conditional grants grow at 2% per annum over the same period. However, despite positive growth over the MTEF, both the PES and provincial conditional grants decline in real terms in 2016/17, with conditional grants taking a significant knock at -2.3% decline in real growth

while the PES declined marginally at - 0.3%. This is a significant reversal on previous historical patterns which has seen provincial conditional grants consistently the fastest growing provincial revenue source since 1996. Nevertheless, one would still expect provinces to deliver on their constitutionally mandated basic services without any serious service delivery implications, while national priority expenditure areas funded through conditional grants may come under pressure in 2016/17. The Commission would like to emphasize the need for provinces to evaluate each aspect of their spending plans to ensure any inefficiencies in provincial service delivery systems are eliminated. National departments should also carefully monitor and support provinces in this regard, especially around planning for service delivery related to conditional grants, so that spending programmes funded by conditional grants in particular, are properly implemented.

3.9. The provincial equitable share includes an amount of R2.3 billion that was previously part of the devolution of property rates funds grant and will be fully phased in during 2016/17. During the 2016 MTEF period, funds from the PES will also be used to expand the human papilloma virus grant so that the programme continues.

**Table 4: MTEF Growth Rates of provincial Grant Transfers**

Division of Revenue	2015/16	2016/17	2017/18	2018/19	Real Annual Average Growth
PES	360	386.5	412.2	447.6	
Conditional grants	80	85.3	91.2	101.2	
<b>Real Annual Growth Rate</b>					
PES		-0.3%	1.4%	1.6%	0.9%
Conditional grants		-2.3%	6.7%	1.7%	2.0%

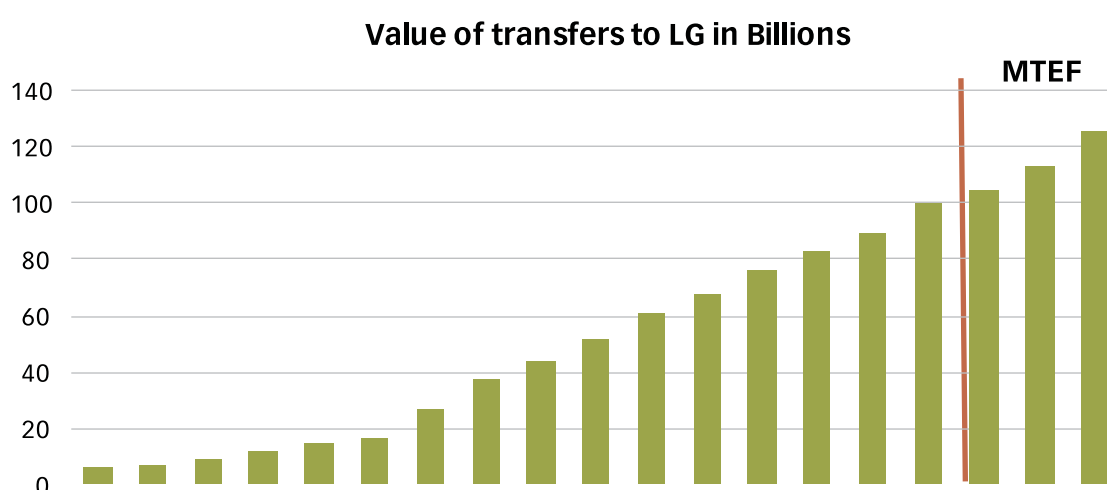
Source: Commission calculations based on Division of Revenue Bill (2016) and MTBPS (2015)

3.10. There are no changes to the weights assigned to the six components of the PES formula. Since the formula is largely population driven, allocations capture shifts in population across provinces. The Commission agrees with the principle that any effects on updates to the PES is phased in over a three-year period as this provides for stability of the IGFR system and smoothing of expenditure over time. Given the potential disruptive nature of the 2011 census, a top-up was added to the PES and allocated to Eastern Cape, Kwazulu-Natal, Free State and Limpopo to cushion the impact of declining shares due to reduction in population figures. The phase-in period of this top-up came to an end in 2015/16. The Commission supports the initiative to further manage service delivery disruption in these four provinces as is the case in 2016 Division of Revenue Bill where monies were taken out of the PES and allocated to these provinces. Eastern Cape, KwaZulu-Natal, Free State and Limpopo had the slowest growth in PES allocations in 2016/17 as a result of the baseline reductions.

### C. CHANGES AND ADDITIONS TO THE LOCAL FISCAL FRAME WORK

3.11. As with other spheres of government, local government budgets will seriously be affected by, inter alia, the slowdown in economic growth, the current recession facing the mining and agriculture sectors, the prevailing drought, tariff hikes, and the oncoming local government elections. The local government sector will also experience one of the most wide ranging boundary redeterminations that the country has experienced since the introduction of the current system of local government in 2000. In terms of transfers, the local sphere continues to receive increasing amounts of nationally acquired revenues (see Figure 2). Over the 2016 MTEF the sector will receive about R334 billion in total revenues, which translates into an average share of 9.1% over the MTEF.

**Figure 2: Value of Transfers to local government - 2000/01 - 2018/19**



Source: Commission Calculations

3.12. Over the 2016 MTEF, the baseline allocations (both LES and conditional grants) to the Local Government sector are set to decrease by R6.3 billion, and of this amount R5.8 billion will be in the form of direct transfers to municipalities, and R500 million will be transferred as indirect grants. It is also important to note that over R5.3 billion will be added to Local Government baseline allocations: R4.5 billion to the LES, R309 million for demarcation related expenses; R155 million to the Regional bulk infrastructure

grant and R350 for the bucket eradication programme. Thus, the net decrease in allocations to the local government will amount to 968 million over the MTEF. The reductions in allocations are largely due to reprioritisation of budgets towards more urgent areas. The slowdown in allocations reported in the 2015 MTBPS outweighs that envisaged in the 2015 Budget Statement. Table 5 below present a comparison of the 2015 MTBPS allocations and the 2016/17 budget.

**Table 5: Medium term expenditure framework division of revenue (R'million)**

Division of Revenue	2015 Budget (Revised)	2016/17		Estimates		Real Annual Average Growth	
Local government allocation	99 650	106 949	104 925	11 3340	125 811	3.9%	2.2%
LES allocations	50 507	52 869	52 569	57 012	61 732	2.9%	1.0%
Conditional grants	38 485	42 857	41 132	44 543	51 611	5.5%	4.4%
General fuel levy	10 659	11 224	11 224	11 785	12 469	-0.6%	-0.5%

Source: MTBPS (2015), 2016 Budget and Commission Calculations

### LOCAL GOVERNMENT EQUITABLE SHARE

3.13. The LES allocations will be reduced by R300 million in 2016/17, while the two outer years will receive additions of R1.5 billion and R3 billion respectively. The reduction in 2016/17 is mainly on the institutional and community services components, which had risen very rapidly in value in 2015/16 financial year. The growth in the institutional and community services components was more than 28% in one year. To avoid causing immense shocks to the system, the Commission supports the option of reducing these components by no more than 10%. This is made possible by scaling the number of poor households funded through the formula in 2016/17 by 0.7%. The reduction in the institutional and community services and preservation of the basic services component is not likely to affect delivery of free basic services. The Commission welcomes the cushioning of free basic services component and further urges the local government sector to manage and use the LES resources more efficiently and effectively. It is also important that the gap between poor households receiving free basic services and households that the formula allocates for free basic services is minimised. Currently the LES formula allocates free basic services to 9.2 million households, while on the other hand, only 5.3 million poor households receive free basic water, and another 2.5 million free basic electricity.

3.14. The Commission notes that the new LES formula is beginning to yield positive distributional impacts compared to its predecessor. Poor municipalities are now receiving more resources from the LES relative to their well to do counterparts. The Commission will continue to monitor and evaluate the impact of the new LES formula and suggest more refinements in future if necessary. Already research by the Commission and SALGA, aimed at finding realistic unit costs of basic services to inform the LES formula is at a very advanced stage.

### BOUNDARY RE-DETERMINATION

3.15. In 2015 the Municipal Demarcation Board (MDB) announced new municipal amalgamations that shall come into effect with the 2016 Local government elections. The number of municipalities will be reduced from 278 to 257. Each major amalgamation will be provided with a transitional grant to assist municipalities defray all costs associated with transition. The Commission proposes that National Treasury, Provincial Treasuries and the Department of Cooperative Governance and Traditional Affairs (CoGTA) to put in place mechanisms for monitoring this grant in order to make sure that these resources are strictly used to offset costs related to demarcations. As was noted in the 2015 Commission submission on the MTBPS and pointed out earlier in the highlights, the Commission would like to underscore the point that the full financial impact of all demarcations should be established prior to boundary changes, and affected municipalities made aware of such costs. In addition, the Commission encourages all stakeholders in the demarcation process to consider a post demarcation review to assess the full impact of current and previous demarcations. This review will assist all stakeholders to fully appreciate the impact of boundary changes on local government viability, budgets and overall local economic development.

## 4. CONDITIONAL GRANTS BUDGET ANALYSIS

### A. PROVINCIAL CONDITIONAL GRANTS

4.1. The effect of the economic slowdown has resulted in baseline reductions on provincial conditional grants of R3.5 billion. Despite this reduction provincial conditional transfers remain considerably high with a total allocation of R89 billion in 2016/17 growing to R108 billion in the outer year. The Commission welcomes the reduction in the number and allocation of indirect conditional transfers to provinces; the proportion of indirect conditional transfers to total conditional grants declined from 4% to 1% over the 2016/17 MTEF. Grants which receive the highest baseline reductions in 2016/17 financial year are the Human Settlement Development Grant (HSDG (R1.6 billion)), Health Facility Revitalisation Grant (HFRG (R200 million)), Comprehensive HIV/AIDS Grant (176 million) and the Education Infrastructure Grant (EIG (R146 million)). The Commission supports the reprioritisation of allocations to fund unexpected budget pressures. However, budget cuts should be spread equitably across the different spheres of government and expenditure programs. In particular, programs

that have a history of underspending and not oriented to infrastructure development should carry the heaviest burden or reprioritisation.

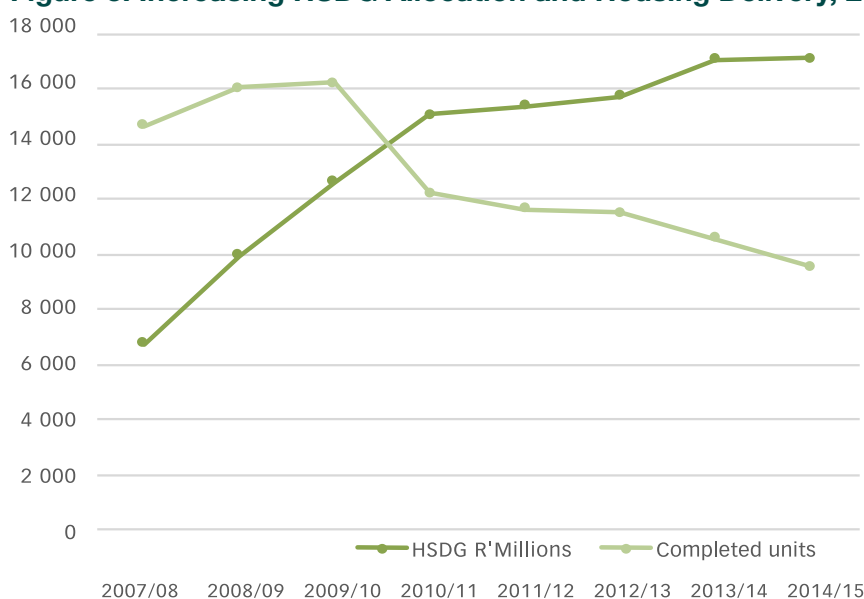
4.2. The biggest downward revision is on the HSDG grant. There has been an underspending in 2015/16 particularly by Gauteng province on this grant. This underspending and policy changes (particularly housing function assignment to some metros which is currently underway) within the sector are the main reasons for this downwards revision. It is of concern to the Commission that the reduction of the baseline is due to administrative reasons which include inability of the province to gazette housing allocations in time to the metropolitan municipalities. The Commission welcomes the decision to keep funding allocated flat at R18.2 billion in 2016/17 compared to R18.3 billion in 2015/16. The Commission, however recommends that government should finalize policy changes within the sector without further delays and that an upward adjustment in the baseline in future be implemented to reverse the rate of decline in the number of houses delivered per annum as shown in Figure 3. The Commission further welcomes the new 2016 Division of Revenue Bill clause which compels provinces to gazette HSDG allocations before the grant is transferred them.

**Table 6: Human Settlements Development Grant performance, 2009/10 to 2014/15**

Year	Outcome R'million		
	Allocation	Expenditure	Percentage spending
2008/09			
2009/10	12 442	12 250	98%
2010/11	15 249	14 692	96%
2011/12	15 337	14 262	93%
2012/13	15 978	15 195	95%
2013/14	17 028	16 468	97%
2014/15	17 388	17 039	98%

Source: National Treasury database



**Figure 3: Increasing HSDG Allocation and Housing Delivery, 2008/09 and 2014/15**

Source: Commission  
computations

4.3. The recommendation made by the Commission in the past that government should support self-built housing initiatives and consider investing more resources in programs (such as for example investment incentives using tax rebate and housing vouchers among others) that are likely to stimulate additional funding from the private sector as well as household contributions towards housing delivery is important for relieving delivery pressure from HSDG. The Finance Linked Individual Subsidy Program (FLISP) introduced in 2012 aimed to address housing gap market (households earning between R3 501 and R1 5 000.00 per month) can play a significant role if the current implementation challenges are speedily resolved.

4.4. In 2015/16, a once-off amount of R1 80 million was allocated to accelerate the upgrading of informal settlements in mining towns in an attempt to reduce informal settlements around mining towns. In 2016/17, an amount of R3.6 billion is ring-fenced for the same purpose. The Commission cautions against provision of permanent housing structures in areas that comprises predominately

migrant labour. Government should consider providing rental options or a balanced mix in order to match supply and household preferences on the basis of well identified needs and preferences.

4.5. **PUBLIC TRANSPORT.** For a number of years, the bus operating subsidy funded through the Public Transport Operations Grant (PTOG) has not kept pace with increases prior to the 2009 economic recession. The shortfall in operators' income is being compensated through higher fare increases affecting commuters' affordability. In order to reduce the shortfall, the government announced an MTEF baseline addition of R1.4 billion during the 2015 MTBPS which have since been reduced to R700 million due to the economic slump. This grant has consistently recorded good spending rate as seen in Table 7 and has been spared from expenditure cuts. The less than expected baseline increase will impact on poor commuters and restrict extension of subsidised routes to new areas. Government must find ways to introduce public transport subsidy reforms as per Commission recommendation made in 2015/16.

**Table 7: Public Transport Operations Grant Performance, 2009/10 to 2014/15**

Year	Outcome R'million		
	Allocation	Expenditure	Percentage spending
2009/10	3 531	3 506	98.6%
2010/11	3 863	3 648	89.2%
2011/12	4 381	4 370	99.7%
2012/13	4 321	4 319	99.9%
2013/14	4 552	4 609	101.2%
2014/15	4 832	4 791	99.1%

Source: National Treasury database



4.6. **HEALTH.** A review of health conditional grants shown in Table 8 shows that most of the grants are spending well. The 2016 budget shows plans to reduce baseline allocation of Comprehensive HIV/AIDS by a once-off 176 million and the Health Facility Revitalisation Grant (HFRG) with R365 million over the MTEF. The reduction in Comprehensive HIV/

AIDS Grant needs care and good management especially because its scope has been extended in 2016 to cover tuberculosis (TB). The Commission would like to reiterate that ideally baseline reductions need to be preceded by a thorough expenditure review to determine the extent to which the objectives of the grant are affected.

**Table 8: Health Conditional Grant Expenditure Performance**

Health	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Comprehensive HIV and Aids Grant	98%	98%	97%	99%	99%	99%
Health Facility Revitalisation Grant	-	-	-	-	84%	94%
Health Infrastructure Component	-	-	93%	93%	88%	-
Hospital Revitalisation Component	73%	76%	90%	85%	83%	-
Nursing Colleges and Schools Component	-	-	-	77%	69%	-
Health Professions Training and Development Grant	108%	99%	100%	99%	100%	100%
National Health Insurance Grant	-	-	-	55%	82%	72%
National Tertiary Services Grant	109%	99%	100%	99%	100%	99%

Source: Commission calculations based on National Treasury conditional grant database

4.7. **EDUCATION.** Budget analysis shown in Table 9 shows that education conditional allocations have an average spending performance of 90%. Major changes to the education conditional grants includes the merger of the School Backlogs Infrastructure Grant into the EIG as well as the introduction of a new Early Childhood Development Grant as per the Commission recommendations for

2016/17 division of revenue. The EIG will receive a once-off baseline reduction of R160 million in 2016/17 recovering to an additional R4.8 billion in the outer year. The Commission is of the view that government should have funded the current budget priorities through baseline reduction of education grants that are consistently unable to reach 100% expenditure as shown in Table 9.

**Table 9: Basic Education Expenditure Performance**

Division of Revenue	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Dinaledi School Grant	-	-	88%	82%	80%	82%
Education Infrastructure Grant	-	-	97%	93%	100%	94%
HIV and Aids (Life Skills Education) Grant	92%	87%	90%	86%	74%	88%
National School Nutrition Programme Grant	98%	95%	96%	98%	98%	99%
Technical Secondary Schools Recapitalisation Grant		76%	71%	74%	67%	87%
Occupation Specific Dispensation for Education Sector Therapists Grant		-	-	-	-	90%

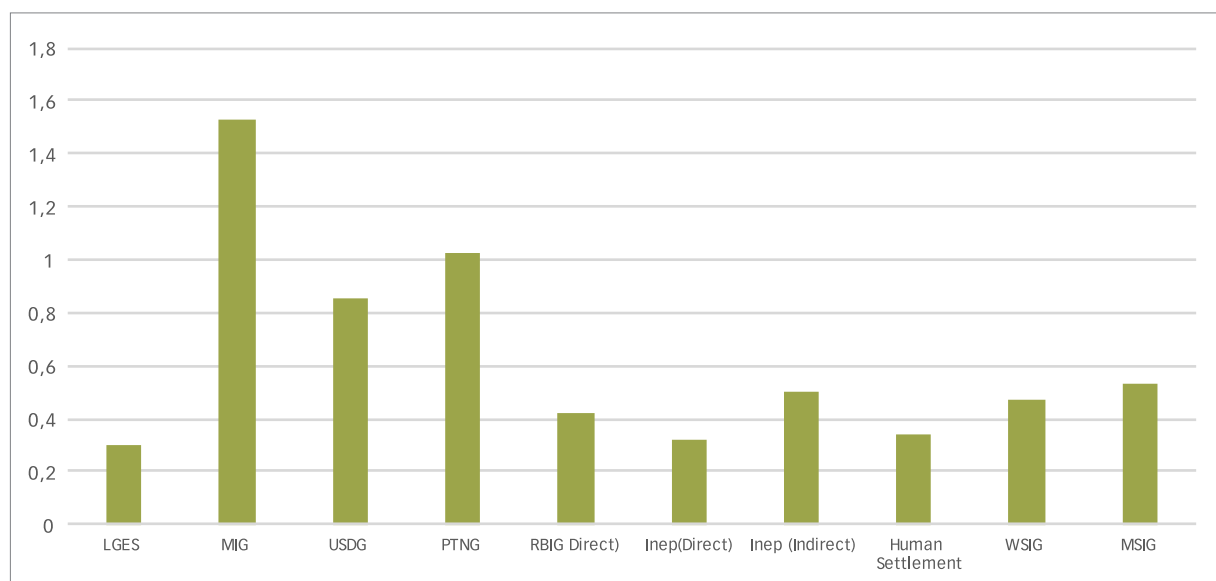
Source: Commission calculations based on National Treasury conditional grant database

## B. LOCAL CONDITIONAL GRANTS

4.8. During the 2016 MTEF various conditional grants will face cuts as shown by seven grants in Figure 4. The Commission notes these adjustments and understands the motive behind the cuts. The Commission is in agreement in principle with government that the historical performance

of individual grants should be taken into consideration, when reductions are made. The Commission's budget analysis shows that underspending grants were targeted for cuts.

**Figure 4: Baseline reductions to local government transfers - 2016 MTEF (R' billion)**



Source: Commission Calculations

4.9. To understand the cuts on various grants, some brief budget analysis on the historical performance of a few grants is key. The information on the historical performance of the local government grants is presented in Table 10. The Municipal Infrastructure Grant (MIG) - the largest infrastructure transfer - will be reduced by R1.53 billion over the MTEF, in order to redirect funding to more urgent priority areas.

This MIG has been instrumental in eradicating backlogs and building new infrastructure, especially in small municipalities that have little own revenue alternatives. Between 2011 and 2014/15 MIG spending has averaged 87%, which implies that the reductions will cut into the underspending with minimal effects of infrastructure developments in the local sphere.

**Table 10: Spending as a share of total allocations for conditional grants**

	2010/11	2011/12	2012/13	2013/14	2014/15
<b>Infrastructure Transfers</b>					
Municipal infrastructure grant	78%	84%	85%	96%	92%
Public transport infrastructure grant	56%	49%	77%	84%	86%
Integrated national electrification programme (municipal) grant	88%	93%	81%	81%	105%
Neighbourhood development partnership grant (capital grant)	49%	95%	104%	88%	73%
Rural roads assets management systems grant	84%	32%	103%	95%	93%
Municipal water infrastructure grant				68%	95%
Rural households infrastructure grant (Direct)				38%	76%
Municipal disaster recovery grant				52%	17%
<b>Capacity Building and Other Current Transfers</b>					
Local government financial management grant	104%	100%	96%	98%	94%
Municipal systems improvement grant	93%	101%	106%	98%	96%
Infrastructure skills development grant			77%	82%	138%
Energy efficiency and demand side management grant	75%	91%	49%	67%	78%
Water services operating subsidy grant	129%	139%	113%	92%	72%
Public transport network operations grant				78%	84%
Municipal human settlements capacity grant					26%

Source: National Treasury

4.10. The reprioritisation of funds towards drought relief, among other things, will see the Water Services Infrastructure Grants (WSIG) and the Regional Bulk Infrastructure Grant (Direct) (RBIG) being reduced in the 2016/17 financial year by R120 million and R150 million, respectively. The Water Services Infrastructure grant is a new grant, born out of a merger of the Municipal Water Infrastructure Grant (MWIG), Water Services Operating Subsidy Grant (WSOG) and Rural Household Infrastructure Grant (RHIG). The performance of the three merged grants is shown in Table 10. The performance of the Indirect RHIG and MWIG has been poor. Spending on RHIG (indirect) has averaged 57% between 2013/14 and 2014/15 while MWIG has recorded an average spending rate of 82% over the same period. The poor spending on RHIG and MWIG make the merged grant a proper candidate for cuts. Although the basis for the merger was to minimise duplication and improve efficiencies, the cuts on the WSIG is a welcome development as it reflects the poor spending in the two of the three merged grants. The reallocation of scarce/unspent resources to areas with an evident need is welcome and should, in principle be encouraged, provided the root causes for underspending are within the municipal's control. In addition, it should be noted that merging two underperforming grants with a good performing grant will not necessarily yield a good performing grant.

4.11. The RBIG has improved its performance over the years, achieving 100% in 2014/15. The Commission notes the preservation of this grant in the 2016 budget. The Urban Settlements Development Grant (USDG) will be reduced by R250 million in 2016/17, R250 million in 2017/18 and R350 million in 2018/19. The USDG has shown tremendous improvements over the years: from 88% spending in 2011/12 to almost 100% in 2013/14. Considering the above average spending for the USDG the cuts in the allocations will likely weaken efforts aimed at upgrading informal settlements and other ancillary infrastructure.

4.12. The direct Integrated National Electrification Programme (INEP) will be reduced by R90 million in the 2016/17 financial year. Spending on this grant has averaged 89% between 2010/11 and 2014/15, thus making it a good candidate for cuts. The NDP recognises the role of metros and major cities as catalysts for inclusive economic growth and development. The Commission welcomes government's commitment to the development of major cities in the 2016 budget through allocating significant budgetary resources to major projects and transport networks in the cities. For example, R6 billion is allocated for the bus rapid transit systems in 2016/17. These transport investments, combined with over 90 integrated land development projects in progress across major cities, will spur growth in cities and attract much needed private investments into city regions.

## 5. Reforms to Conditional Grants Ongoing

5.1. Subsequent to the FFC's 2011 review of the local government fiscal framework, a comprehensive review of infrastructure grants is underway. The purpose of this review is to enhance the performance effectiveness and efficiency of the entire array of infrastructure grants. Although the process is continuing, the Commission welcomes the fact that government has already effected some of the recommendations of the Task Team dealing with this matter (comprising of FFC, National Treasury, COGTA and Department of Performance Monitoring and Evaluation). Of note is that the government has merged the multiple water and sanitation grants, introduced a formula-driven Public Transport Network Grant (PTNG), and amended the MIG to allow its funds to be used for the maintenance and refurbishment of municipal roads. These reforms will, among other things, enhance the administrative efficiency and reporting of these grants; minimise overlaps and duplications, see municipalities pay more attention to asset care and maintenance; and further introduce transparency and predictability through a formula driven Public Transport Network grant.

5.2. For the 2016/17 financial the National Health Insurance Grant is phased out and incorporated into the National Health Grant (NHG). The Commission welcomed the NHI grant when it was introduced in 2012/13 in order to fund NHI pilots and to test the readiness of provinces in rolling out full scale NHI scheme. The NHI pilot review revealed teething problems related to structuring of the funding and yet the NHI grant is terminated before appropriate funding arrangements are finalised. Even though the original NHI grant objectives will still continue through the indirect component of the National Health Grant, it is a concern to the Commission that health grants are undergoing endless reforms which introduces policy uncertainty regarding the roll out of NHI. The Commission is especially concerned about the incremental addition of new spending priorities that happens with every reform of the health grants and erosion of old priorities. Among other things, the new NHG is intended to fund Ideal Clinic Initiative (IDI) defined as a clinic with good infrastructure, adequate staff, adequate medicine and supplies, good administrative processes, sufficient adequate bulk supplies and support structures. Some of the objectives of NHG are catered for in other health grants and therefore amounts to duplication.

5.3. One of major developments envisaged during 2016/17 within the transport sector is the assignment of public transport function to certain metropolitan municipalities. As discussed earlier, the Commission supports this proposed development as it is in line with its recommen-

dations made in the Submission for the 2014/15 Division of Revenue. The Commission however recommends that assignment decision be taken as a matter of urgency to avoid policy uncertainty which could have a negative impact on services delivery. The Commission further supports that funding follow function in case of assignment. The assignment of public transport function to metropolitan municipalities could improve both efficiency and effectiveness as metros could be able to align their different funding streams relating to transport services and transport infrastructure among other things.

## 6. Government Responses to the Commission and Standing Committee On Appropriations Recommendations

### A. RESPONSE TO COMMISSION RECOMMENDATIONS

6.1. The Commission tabled its Submission for the Division of Revenue 2016/17 to Parliament in May 2015. As required by the IGFR Act, Government published its response to the recommendations made by the Commission when the Minister of Finance tabled the annual Division of Revenue Bill with the annual budget in the National Assembly.

6.2. The 2016/17 submission comprises 7 chapters with a total of 27 recommendations. Government has responded to recommendations in 6 of the chapters within the submission. These recommendations have a direct and indirect impact on the division of revenue. Overall the Commission welcomes the extensive consultative process and the manner in which Government has responded to the recommendations and further invite parliament to exercise oversight in the implementation of the accepted recommendations.

6.3. Government agrees with the recommendations made by the Commission and in some cases has indicated processes that are already underway to address some of these recommendations. As part of increased infrastructure investment Government has developed a plan that will assist municipalities to increase their ability to access long term financing. This will assist municipalities to increase their own funding on infrastructure investments. Furthermore Government is proposing to incentivise better prioritisation of existing maintenance funds for infrastructure. Government has proposed that more work be done to help guide municipalities on the best way to invest in Early Childhood Development (ECD) facilities. The Commission requests that Government identify the relevant party that should do further work to guide municipalities to invest in ECD facilities

## B. RESPONSES TO STANDING COMMITTEE ON APPROPRIATIONS RECOMMENDATIONS

6.4. Various committees of the National Assembly produce reports on the budget review, the fiscal framework and division of revenue with recommendation that are addressed to Government. Section 7 of the Money Bills and Amended Procedures and Related Matters Act requires the Minister of Finance to table the budget with details of how such recommendations have been taken into account. The 2016/17 budget review lists 15 such recommendations that Government has responded to. The recommendations cover a wide array of issues mainly targeted at Government's investment in infrastructure. This section responds to the request from the Standing Committee on Appropriations (hereinafter the Committee) to assess the Committee recommendations and Government responses.

6.5. The recommendation made to revise the conditional grant framework for the health facility revitalisation grant by the Committee was accepted by Government. As a follow up National Treasury introduced a new component to the information component of the indirect National Health Insurance Grant in the 2015 Division of Revenue Amendment Bill. All allocations under this component will be used to roll out the new patient-based primary care information system beyond pilot districts. The Commission agrees with this response by National Treasury.

6.6. The Committee recommended that National Treasury strengthen monitoring and oversight on provinces. The National Treasury has been strengthening the mechanism to benchmark provincial and municipal budgets. All draft provincial budgets are benchmarked and analysed for quality, extent of funding for government priorities and compliance with the legislative framework. The National Treasury is supporting provincial treasuries to improve their capacity to fulfil their oversight responsibilities for the budgets of delegated municipalities in accordance with the PFMA and the MFMA. Eight provincial treasuries have agreed to implement province-specific municipal support strategies. The Commission's view is that if National Treasury continues with the above mentioned strategies, there will be huge improvement in performance by both Provinces and Municipalities.

6.7. With respect to strengthening compliance with the conditional grant framework, the Commission is of the view that National Treasury has sufficient systems in place to ensure compliance. However there is still a lot of work to be done to ensure good performance of both Provinces and Municipalities on spending of the conditional grants.

6.8. On funding for shortfall in compensation of employees in provinces, the Committee recommended that National Treasury should provide further details on how provinces were able to fund the shortfalls in personnel budgets. Furthermore, the National Treasury should indicate how incidences of ghost employees might be contributing to the current compensation of employees' costs and also indicate if all provinces have conducted and completed a personnel head count. The response by National Treasury speaks to the recommendations that the Commission made on the Wage Bill. The Commission is of the view that more work needs to be done to complete the staff verification exercise across whole of government and not just Provincial departments.

6.9. With respect to funding for the zero percent fee increase for higher education institution, the Committee recommended that National Treasury provide details of how this will be funded. The Commission agrees with the proposed reprioritisation as it will not affect the operational needs significantly of the Department of Higher Education and Training.

6.10. On alignment of budgets with core priorities, the Committee recommended that National Treasury should exercise its Constitutional mandate to ensure that the budgets of the various spheres of government are in compliance with the core priorities as outlined by the National Development Plan; the 2014-2019 Medium Term Strategic Framework, The Provincial Growth and Development, Development Strategies, and Municipal Integrated Development Plans. The Committee also recommended that the Commission should also be involved in the ongoing discussion between National Treasury and South African Local Government Association on the issues of unfunded mandates within municipalities. The Commission agrees with this recommendation and has always taken part in the budget benchmarking exercises that are coordinated by National Treasury.

6.11. On the issue of the withholding of funds to municipalities by the National Treasury, the Committee recommended that National Treasury should brief Parliament about the situation with regard to these municipalities. The Commission's view is that there must be more clarity on the actual criteria to be used in the process of withholding the municipality's equitable share. The Committee recommended that National Treasury should facilitate discussion among the relevant stakeholders to look into the issue of municipal debts. The stakeholders should include, but may not be limited to, the National Treasury, the South African Local Government Association, the Commission and the Department of Cooperative Governance and Traditional Affairs. The Commission agrees with this recommendation and will continue to be part of this process going forward.

6.12. With respect to phasing out of conditional grants, the Committee recommended that National Treasury ensure that the process of phasing out provincial and municipal conditional grants that are due to end in the 2015 MTEF or those that are due to be phased into the provincial and local government equitable shares does not compromise service delivery. The Commission agrees with this recommendation and from the list of grants being phased out none will disturb service delivery.

6.13. The recommendation by the Committee on energy efficiency, that National Treasury in partnership with the Commission explore systems and mechanisms that will encourage the utilization of energy efficient methods in the delivery of government's infrastructure programmes. The Commission agrees with this recommendation and is also of the view that more work be done in the exploration of alternative forms of energy that can be used in service delivery.

## 7. Concluding Remarks

7.1 The 2016 Division of Revenue Bill has been crafted in very difficult circumstances characterised by downward economic growth forecasts and rising impatience with social outcomes deemed by the population to fall short of expectation. Bearing this in mind, government has done a good job that promises a deficit reduction programme for the next three years and thereby raise the chances of preventing public debt from spiralling out of control.

7.2 In May 2015, the Commission tabled at Parliament its Annual Submission for the 2016/17 Division of Revenue. The Submission agrees in most aspects with the 2016 Budget that has been crafted in a constrained environment characterised by downward economic growth forecasts. Bearing this in mind, Government has done a good job that promises faster deficit reduction programme for the next three years and thereby prevents public debt from spiralling out of control. The Commission welcomes in particular the manner in which Government has handled and responded to its recommendations on the 2016/17 division of revenue.

7.3 Overall, this year's Division of Revenue Bill contrasts the conflicting objectives between social development and fiscal consolidation in the short term. The Commission notes that growth is considerably lower in the economy than was projected in October 2015. Current economic growth estimates fall short of the required growth rate to fulfil NDP expectations and compares unfavourably with other developing economies.

7.4 South Africa should continue to focus its strategy for reigniting growth on improving education expenditure outcomes in particular, increasing skills bases, maintaining strong growth on social safety net spending and increasing productivity of public infrastructure.

7.5 The Commission is aware that cuts on baseline allocations were an unavoidable consequence of poor economic growth and reprioritisation of allocations to more urgent government priorities. The Commission is of the view that government should minimise the unintended consequences of such cuts, especially considering the fact that incidences of the cuts will fall disproportionately on poor households due to their heavy reliance on grants. The government should ensure that such cuts do not compromise delivery of free basic services and the overall government infrastructure investment programme. There is also an added risk that reductions in allocations on infrastructure grants may result in the medium to long term compromising spending on repairs and maintenance, an often soft target when budgets are cut, which may cause a vicious cycle of deteriorating infrastructure and impaired service delivery. On the part of the provinces and local government, the Commission implores them to manage resources efficiently.

7.6 Finally and as in last several years, what is very clear is that the economy remains far below the economic growth rates required to make the dent on unemployment and inequality. Rebuilding state capabilities should continue to be prioritised with efforts aimed at both economic and social capabilities for citizens and infrastructure and how these will be managed within the context of current consolidation measures.

# APPENDIX E

## Briefing on the 2016 Fiscal Framework and Revenue Proposals

### 1. Background

1.1 This submission is made in terms of Section 4 (4c) 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 (hereafter FFC or the Commission) when considering Money Bills. It is also made in terms of the FFC 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 Table 1 below shows the consolidated government fiscal framework. It indicates that a consolidated revenue target of R 1 324 billion is estimated for 2016/17, or 30.2 per cent of GDP. Whilst, expenditure will be R 1 463 billion, leaving a budget deficit of R139 billion, or 3.2 per cent of GDP. The deficit is estimated to decline to 2.4 per cent in 2018/19.

**Table 1: Consolidated Government Fiscal Framework (2014/14 - 2018/19)**

	2014/15	2015/16	2016/17	2017/18	2018/19
R'billion/percentage of GDP	Revised estimate	Revised estimate		Medium-term estimates	
Revenue	1091.0	1 223.1	1 324.3	1 436.7	1 571.6
	28.1%	30.0%	30.2%	30.2%	30.4%
Expenditure	1243.4	1 380.9	1 463.3	1 572.1	1 695.2
	32.0%	33.9%	33.3%	33.1%	32.8%
Budget balance	-152.4	-157.9	-139.0	-135.3	-123.6
	-3.9%	-3.9%	-3.2%	-2.8%	-2.4%

Source: National Treasury

1.3 The Commission welcomes government's stance that the pace of fiscal consolidation will be accelerated as this is in line with its recommendation made at the outset of the global economic crisis on how to respond to the crisis (see Table 2).

1.4 The submission consists of five sections. Section 2 provides an overview of the economy and public finances, with a particular focus on long-term fiscal risks confronting South Africa. Section 3 discusses the key components of the fiscal framework and revenue proposals for 2016. Section 4 gives options for improving two key social priorities and the final section presents concluding remarks.

**Table 2: Projected State Debt (2014/14 - 2018/19)**

	Projected State Debt				
R billion/percentage of GDP	2014/15	2015/16	2016/17	2017/18	2018/19
Net loan debt	1 584.0	1 804.4	2 003.4	2 194.8	2 382.4
	40.8%	44.3%	45.7%	46.2%	46.2%
Debt-service costs	115.0	129.1	147.7	161.9	178.6
	3.0%	3.2%	3.4%	3.4%	3.5%

Source: National Treasury



## 2. Macroeconomic Outlook and Long-Term Fiscal Risks Confronting South Africa

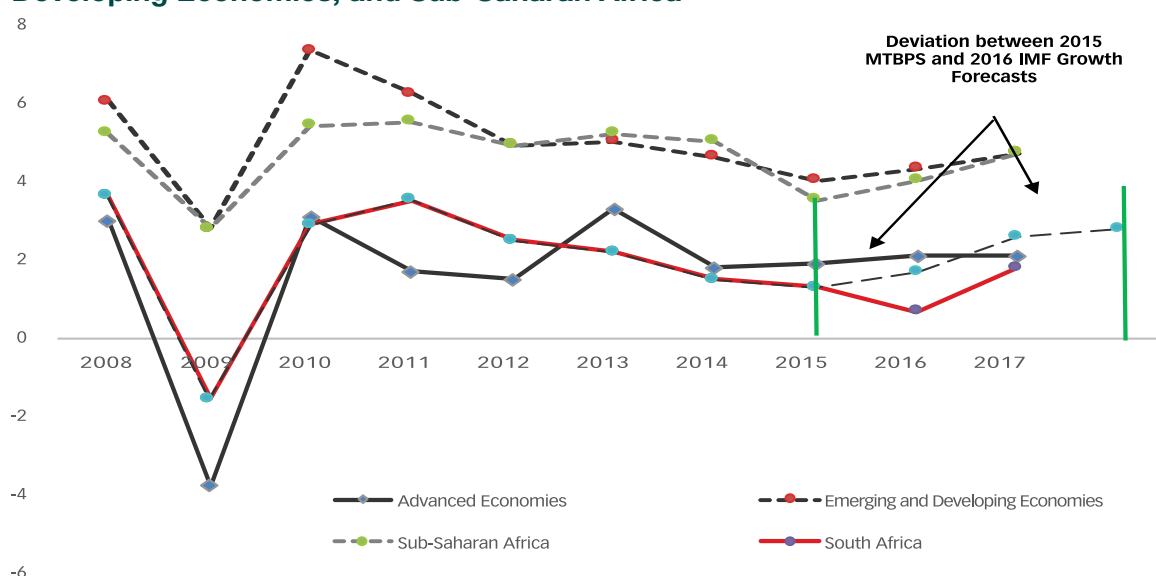
### ECONOMIC GROWTH

2.1 South Africa's economic growth outlook has deteriorated as a result of escalating external and internal headwinds. Forecasts in the October 2015 Medium Term Budget Policy Statement (MTBPS) indicated moderate economic growth of 1.7 and 2.6 percent for 2016 and 2017, respectively. However, a combination of factors and events in both the global and domestic economy have ensured a downward revision to the projected levels economic growth set out in the MTBPS (see Figure 1). For much of 2015, the global economy had to contend with major headwinds in the form of a marked slump in global commodity prices, subdued economic performance across major industrialized nations,

and the deceleration in the growth trajectory of the Chinese economy. Domestically, South Africa's worst drought in 30 years, increased uncertainty over the country's investment credit rating as well as plans to reform laws governing investments in property and mineral exploration, and existing supply-side constraints in power and bulk transport infrastructure have contributed to holding back South Africa's return to levels of economic activity enjoyed prior to the 2008 global financial crises.

The -0.6 and -0.3 percent lower than forecast growth for 2016 and 2017, respectively, represents significant obstacles to Government stated aim to achieve key targets set out in the National Development Plan (NDP) of growing the economy at 5.4 percent and eliminating extreme poverty through the reduction of unemployment by 14 percent by 2030.

**Figure 1: Economic Growth for South Africa, Advanced Economies, Emerging and Developing Economies, and Sub-Saharan Africa**



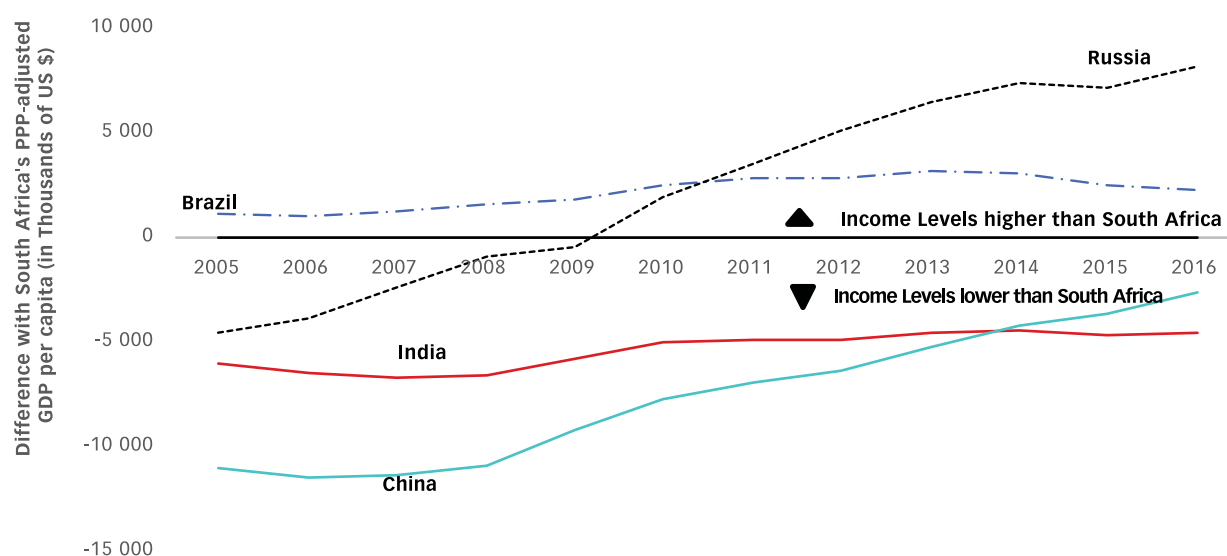
Source: WEO (Various years), MTBPS October 2015 and Commission calculations

2.2 The sluggish growth of the economy is also widening the gap in levels of income per capita between South Africa and those of its peers within the BRICS grouping, as well as the major economies in sub-Saharan Africa. Figure 2 shows that with the exception of India and relative to other BRICS states, South Africa's has lagged behind Brazil and Russia in GDP per capita (adjusted for PPP). Despite the recent slowdown in economic growth, income levels in China are

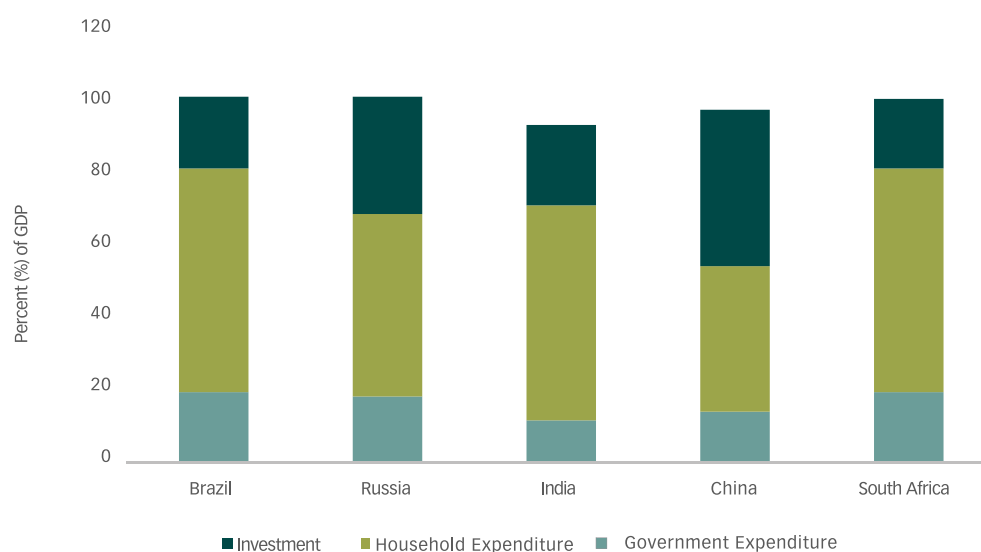
expected to exceed those of South Africa by an average of over US\$ 2,000 between 2014 and 2020.

Since 2000, consumption by households and general government has formed the biggest components of South Africa's GDP. This is in sharp contrast to the economies of Russia and China where investment spending is in excess of 30 percent of GDP (see Figure 3).



**Figure 2: South Africa's Income Relative to BRICS countries, 2005-2016**

Source: World Economic Outlook (WEO) Database and Commission calculations.

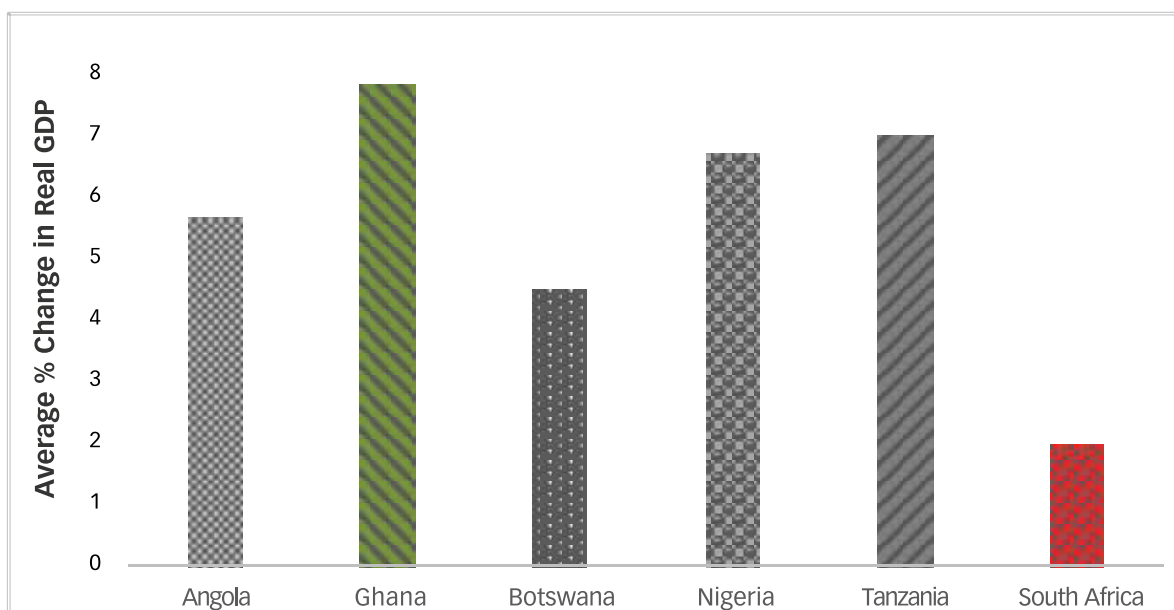
**Figure 3: Average Composition of GDP in BRICS Countries, 2000 -2014**

Source: World Bank Economic Indicators Statistical Database.

With economic analysis clearly showing that long-run economic growth of advanced and emerging economies is largely determined by investment spending, South Africa's relatively low investment rate represents a limiting factor to promoting inclusive growth and addressing constraints including low levels of skills and product market competition vital to raising the country's international competitiveness. South Africa has been trailing a number

of African countries in terms of economic growth (see Figure 4). Despite struggling with weak commodity prices, economies such as Angola, Tanzania and Nigeria have in the post-2008 financial crises period, averaged growth rates in excess of 3 percent as a result of these countries experiencing increased domestic consumer spending and higher levels of investment in energy, transport and socio-economic infrastructure.

**Figure 4: Figure 4: South Africa's Average GDP Growth 2008 – 2016) Relative to Selected African Countries**

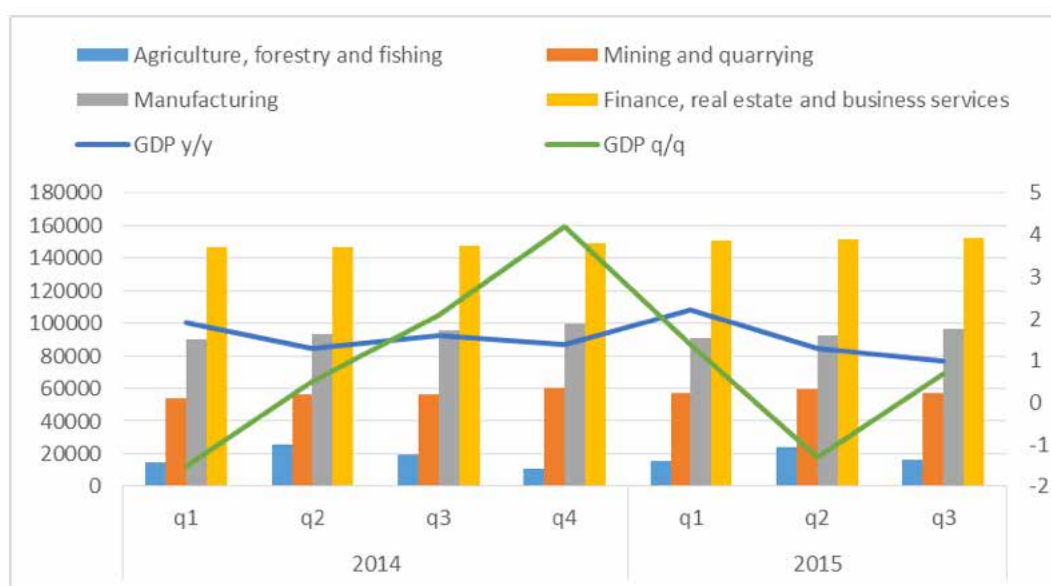


Source: Statistics South Africa

2.4 Figure 5 shows the value added by key industries and GDP year-on-year and quarter on-quarter spanning the period 2014 to 2015. The sectoral analysis presents an assessment of the current condition and future prospects

of the different sectors of the economy and provides more insight into on how well the sectors are expected to perform as a whole.

**Figure 5: Quarterly value added by industry and GDP year-on-year and quarter-on-quarter, 2014-2015**



Source: Statistics South Africa

In response to falling commodity prices, the mining sector contracted by 6.4 percent and 9.8 percent quarter-on-quarter in the second quarter and third quarter of 2015. The drought, impacted negatively on the agriculture sector, quarter-on-quarter, the agriculture sector contracted at double-digit rates through the first three quarters of 2015 (-18.0, -19.7 and -12.6 in quarter 1, 2 and 3 respectively). Manufacturing contracted in the first half of 2015 but staged a comeback in the third quarter, growing at 6.2 percent quarter-on quarter. Finance and real estate outpaced all other sectors, growing at an average of 2.9 percent quarter-on-quarter in the first three quarters of 2015 and contributing 0.6 percentage points to headline growth. The sector accounts for

18.7 percent of GDP, roughly maintaining its share since the global financial crisis. The overall contribution of the primary and secondary sectors to GDP growth in 2015 is expected to be negative with only the tertiary sector making a positive contribution.

## CURRENT ACCOUNT

2.5 The current account deficit marginally narrowed in 2015. In 2015, the trade deficit improved from a first quarter deficit of R68 billion to a positive trade balance of R14 billion in the second quarter before reverting to deficit of R14 billion in the third quarter. Figure 6 below shows the quarterly Balance of Payments (BOP) on current account for the period spanning 2014 to 2015. The financing of the current account deficit through volatile financial flows and portfolio flows remains a key contributor to vulnerability and instability of the BOP account. Debt outflows have increased in response to the slipping fiscal deficit, as well as in anticipation of the normalisation of the monetary policy in the United States (US). A combination of concerns over South Africa's credit rating and the interest rate hiking cycle in the US could result in further capital outflows that could trigger a further depreciation of the rand. However, the ongoing contractionary monetary policy in South Africa could counter these trends.

**Figure 6: Balance of Payments on current account, 2014-2015**



Source: South African Reserve Bank.

2.6 Despite a substantial and prolonged exchange rate depreciation<sup>1</sup> South Africa's export performance response has been very weak. The exchange rate depreciated to unprecedented levels in 2015 and beginning of 2016. By December 2015, the rand had depreciated by 49 percent from its December 2010 peak in nominal trade-weighted terms, and by 21 percent during 2015. In real trade weighted terms, it depreciated by 28.4 percent and 9.8 percent respectively. The Rand weakened further over the course of January 2016. Figure 7 below shows the weighted average exchange rate-Rand per US Dollar, for the period November 2015 to February 2016.

However, in relative terms, exports growth have averaged about 82 percent those of its trading partners' imports growth between 2011 and 2014, translating to one of the lowest proportions amongst its developing and emerging countries' peers. Weak exports and relatively inelastic imports, partly attributable to large infrastructure project, have resulted in the widening of the current account deficit. The competitiveness from the rand depreciation has been attenuated by binding structural impediments to the production function of exporters. Mining exporters, in particular, who are more energy-intensive and increasingly exposed to labour unrest disruptions in the production process, have been deprived of higher export growth in response to the weaker rand<sup>2</sup>.

**Figure 7: Weighted average exchange rate: Rand per US Dollar, November 2015 to February 2016**



Source: South African Reserve Bank.

## INFRASTRUCTURE INVESTMENT

2.7 The NDP aspires to economic growth of more than 5 percent per year to achieve employment, economic and social transformation objectives. Among other things, achieving such high growth will require vastly more infrastructure. Alleviating infrastructure bottlenecks, especially in electricity, transport and telecommunication sectors is therefore vital. The untangling of infrastructure bottlenecks through increased infrastructure investment in these sectors is particularly important given their strategic importance in enhance export competitiveness and economic growth.

2.7.1 The transport and logistics infrastructure is an important source of competitive advantage for South Africa's exports. Government through Transnet plans is increasing infrastructure investment and expanding capacity on commodity export lines in response to capacity constraints experienced during the commodity boom. However, the success of these investments largely depends on the ability to increase the share of rail freight transport. While such a shift has proved difficult in other countries because of faster and more flexible road transport, structural measures such as separating freight service provision from rail infrastructure could help to make railways more competitive and thus more attractive for much needed investment in infrastructure.

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<sup>1</sup> In a group of 20 emerging market peers, South Africa's real effective exchange rate (REER) witnessed one of the longest and largest exchange rate depreciation spells in recent years, with its real effective exchange rate (REER) weakening by around 25 percent during January 2011-July 2014.

<sup>2</sup> See Anand, R., Perrelli, R., and B. Zhang, 2016, "South Africa's Exports Performance: Any Role for Structural Factors?" IMF Working Paper No. WP/16/24. (Washington : International Monetary Fund).

2.7.2 The transport and logistics infrastructure bottlenecks are further compounded by the pricing strategy for freight. The tariff structure supports import substitution and cross-price subsidization thus disadvantaging smaller, labour intensive exporters<sup>3</sup>. For instance, port tariffs for containers are much higher when compared to the global average whereas port tariffs on bulk commodities are way below the global average<sup>4</sup>. Rail freight has similar price distortions. These price distortions discourage the development of new mineral sectors, agricultural exports, and processed manufactures like steel.

2.7.3 These price distortions also translate into misallocation of infrastructure investment that entrench the infrastructure bottlenecks at the expense of export growth. For instance, while infrastructure investments have transformed the iron ore rail lines into a world class rail system capable of handling volumes that meet and in some instances surpass global benchmarks, the rest of the rail system is in relatively poor condition. Similarly, the Port of Richards Bay which is responsible for handling coal exports and the Port of Saldanha which is responsible for iron ore are highly efficient, whereas the general terminal at Durban can only handle 17 containers an hour compared to the international average of at least 35 containers an hour. Further investment in transport and logistics infrastructure to eliminate these bottlenecks will therefore be required and any slow take in infrastructure investment in the sector will delay the necessary reforms and affect competitiveness and growth.

2.8 Over the past year, Eskom has implemented much needed comprehensive maintenance plans that have stabilized electricity supply. Despite such measures, electricity supply remains constrained owing to delays in completing the construction of new power plants (at Medupi and Kusile) finalization as well as an ageing and often inefficient power infrastructure struggling to keep up with modern demands forced frequent power outages in 2015. Power supply constraints are expected to continue in the short to medium-term as the completion of current investment plans is expected to increase electricity generation capacity is only expected to be fully operational by 2021<sup>5</sup>. An additional infrastructure challenge is that some municipalities use their distribution tariffs for cross-subsidisation without investing sufficiently in the maintenance of their distribution network<sup>6</sup>. Infrastructure investment in expanding electricity generation capacity is crucial for growth and 1 and competitiveness will be affected by infrastructure disinvestments

2.9 Efficient Information and Communications Technologies (ICTs) are an essential precondition for developing modern services exports. The otherwise advanced South African telecommunications network is constrained by regulatory restrictions that hamper competition and growth of the sector. The World Bank's Knowledge Economy Index show that South Africa's rank on ICT infrastructure has regressed from 55th in 2000 to 98th in 2012, partly as a result of low penetration. In 2011, for instance, South Africa had only 2 fixed broadband subscribers per 100 people, translating to only one sixth the level when compared with China and Russia. The regression is also a reflection of inadequate access to a key service. For instance, South Africa ranks 88th out of 169 countries on fixed broadband prices, with prices approximately double the level of those in Mauritius<sup>7</sup>. There is also limited competition amongst resellers of mobile phone services. As a result, the economy has slow internet connections by international standards while fixed-line penetration remains very low<sup>8</sup>. However, promoting competition requires structural measures such as the confirmation of the spectrum auction for 4G licencees and facilitation of competition between resellers of mobile phone services. Investment in ICT infrastructure is required to improve penetration and speed of internet connection which is important for services exports and growth. A slow uptake in ICT infrastructure investment will negatively affect competitiveness and growth.

2.10 Gross Fixed Capital Formation is an indicator of how much of the new value added in the economy is invested as opposed to what is consumed. Real gross fixed capital formation was outpaced by real final consumption expenditure by general government in 2015, meaning more resources went to consumption rather than investment. Capital investment by private business enterprises, constituting the largest part of total capital formation, contracted while capital outlays by general government increased at a slower pace. This means that there was less of the new value invested in the economy by the private sector. It also means that while the rate at which new value invested by the public sector into the economy was increasing it was increasing at a decreasing rate.

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<sup>3</sup> See Gumede and Chasomeris (2013), Assessing Stakeholders' Perspective on Maritime Port Pricing in South Africa

<sup>4</sup> See Ports Regulator of South Africa (2012)

<sup>5</sup> See National Treasury (2015) Budget Review

<sup>6</sup> See Steyn (2011), The impact of Economic Regulation on Management Performance of South Africa State Owned Enterprises

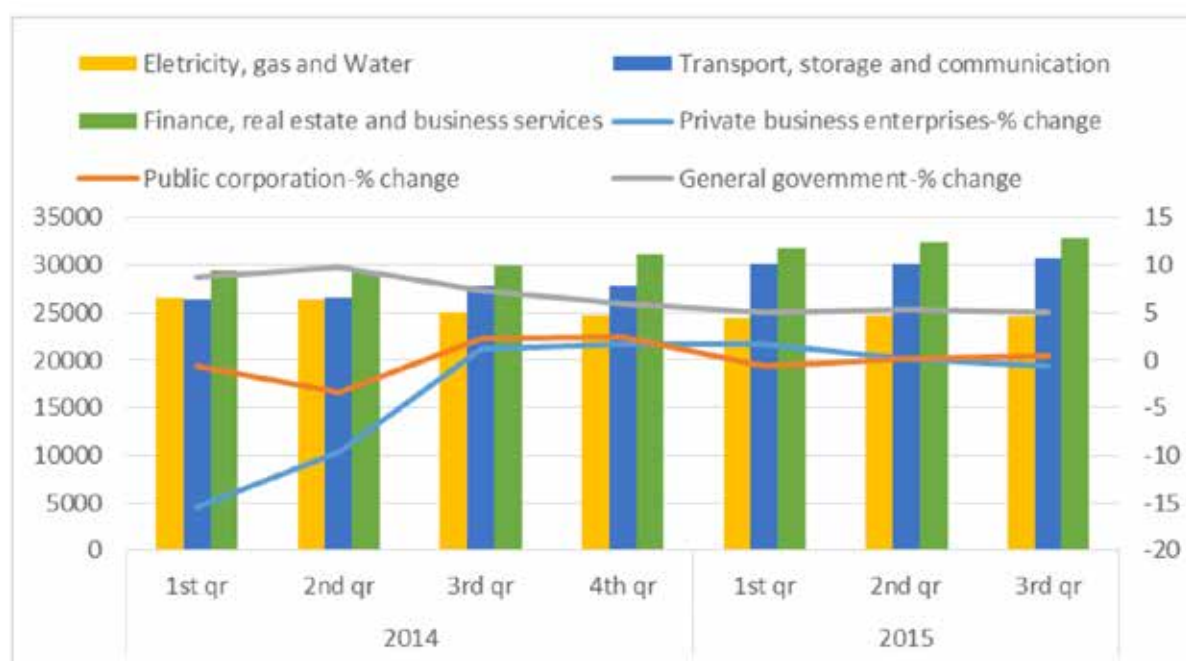
<sup>7</sup> International Telecommunications Union 2013

<sup>8</sup> See Akamai (2015), The State of the Internet: Q3 2014 Report

2.10.1 Real fixed capital spending by public corporations increased at a marginally faster pace. The increase was driven by the electricity and transport sectors on construction works, transport equipment, machinery and equipment and growth in real capital outlays. The new value added invested in the economy was therefore largely driven by public corporations.

2.10.2 Higher capital spending by provincial government departments was focused on freeway rehabilitation, the improvement of storm water infrastructure and the refurbishment of bridges, while local government focused on the improvement of social and economic infrastructure and service delivery. Figure 8 shows the real gross fixed capital formation by type of organisation and kind of economic activity for the period 2014 -2015. The disinvestment by the private sector in infrastructure remains a concern given the constrained fiscal policy and weak growth outlook.

**Figure 8: Real gross fixed capital by type of organisation and service delivery, 2014-2015**



Source: South African Reserve Bank.

## GLOBAL AND DOMESTIC RISKS

2.11 Multiple risks stemming from external and domestic factors are set to define South Africa's growth outlook for 2016.

2.11.11 Two issues are likely to drive the impact of external factors on economic performance. Firstly, continued slowdown and contraction in industrial output of the Chinese economy will have serious knock-on effects on South Africa's economy through commodities, exports and real investment channels. Second, with increased global financial market volatility, concerns over South Africa's credit ratings could impact on capital flows into South Africa and Government's objective of stabilizing both the size and costs of debt to finance its fiscal deficit.

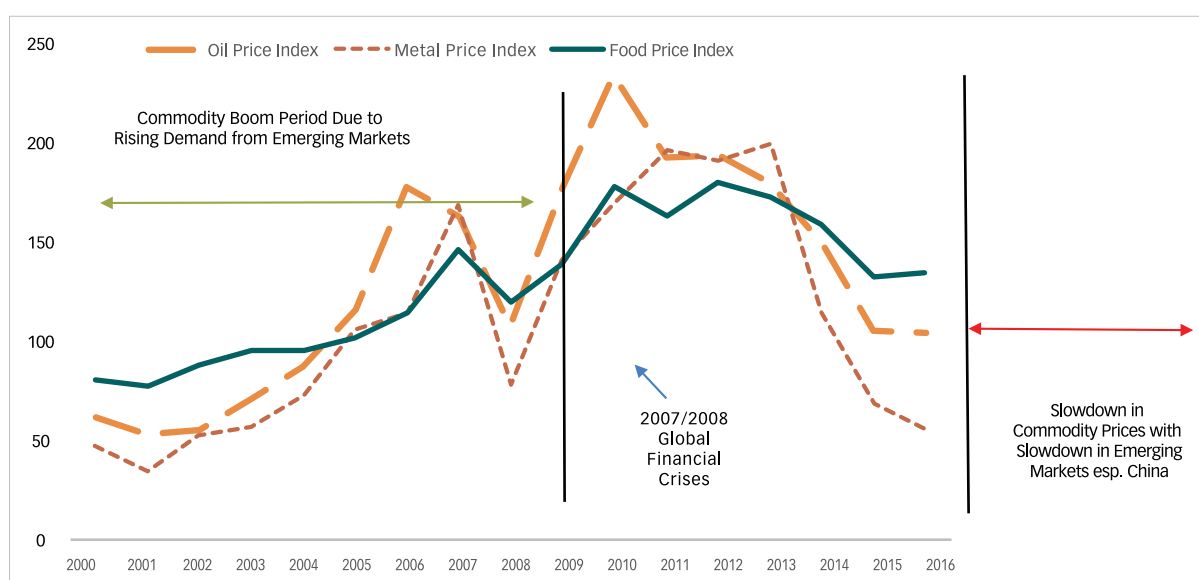
2.11.2 In 1995, China's share of South Africa's export and imports stood at 2.7 and 2 percent, respectively. Fuelled by market reforms that promoted rapid industrialization and urbanization in the first decade and a half of the 21st century. China's is now South Africa's most important trading partner, accounting for over 9 and 18 percent of South Africa's total exports and imports, respectively. With commodities accounting for over 80 percent of exports to China, measures by Chinese authorities to rebalance their economy from an investment-driven to a consumption-driven growth model could put further downward pressure on global commodity prices and adversely impact South Africa's export earnings as well as its trade account deficit. A surging Chinese economy was able to mitigate against the shortfall in global demand for commodities following the 2007/08 financial crises

that affected much of Europe and the U.S, consuming half of commonly used metals such as iron ore, steel and platinum. Reduced Chinese demand has meant declining global commodity prices (see Figure 9) and significant repercussions for emerging commodity-intensive exporting countries in Africa, Latin America as well developed countries such as Canada and Australia.

2.11.3 While the slowdown of the Chinese economy is expected to be gradual, its impact via reduced commodity prices poses significant downside risks for South Africa. Combined effects of falling prices and escalating operational costs has prompted struggling

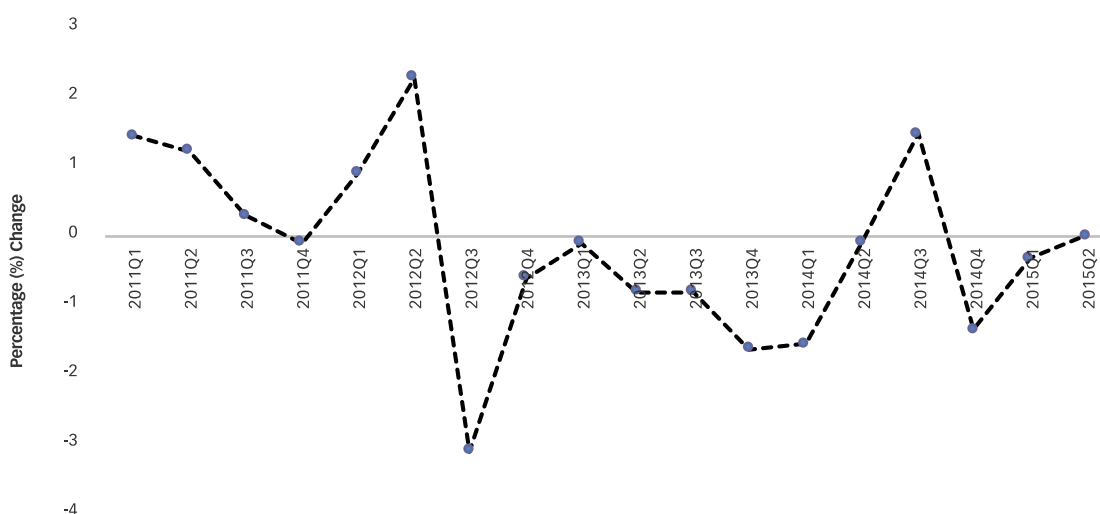
firms within South Africa's mining sector to implement cost cutting measures including reduced production, sale or closure of mine operations and scaling down of workforce. As Figure 10 shows, the mining sector in the post-2008 period has been generally characterised by a negative trend in employment growth. In January 2016, Government acknowledged that about 32,000 more jobs may be lost in the mining sector if commodity price slump remains, an outcome that would have severe repercussions given the significant indirect multiplier effect created by the induced impact of mining employees spending.

**Figure 9: Trend in Commodity and Food Prices Indexes, 2000 – 2016**



Source: WEODatabase

**Figure 10: Trend in Employment Growth in Mining Sector, 2011-2015**



Source: SARB Quarterly Bulletin Statistics

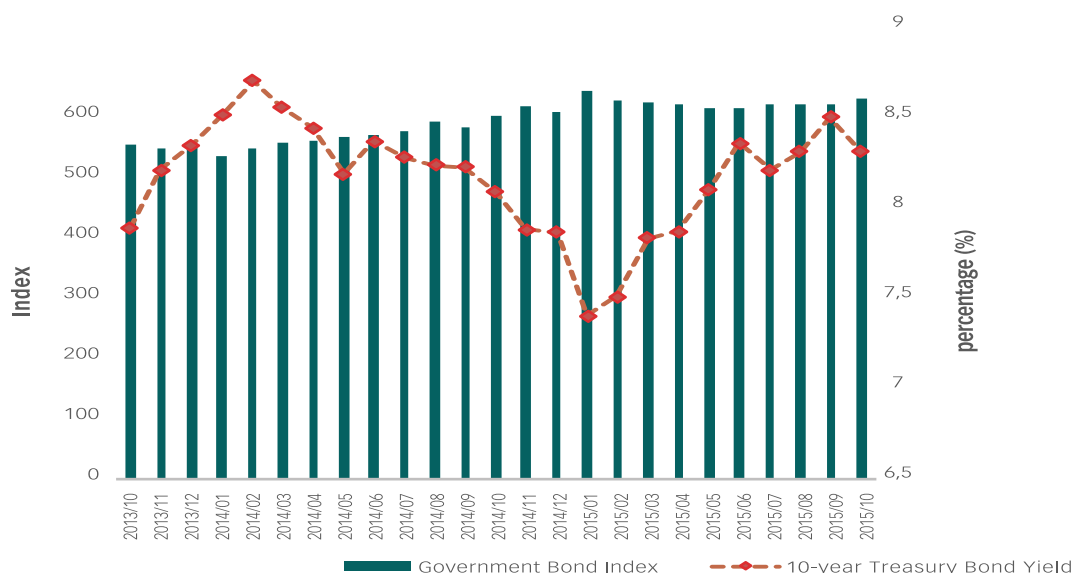


2.11.4 The realisation of growth rates below 2015 MTBPS projections for the MTEF 2016 - 2018 period pose significant risks to Government's plans to stabilize the debt burden and reduce overall fiscal deficit. Further slippage in the fiscal deficits carries significant adverse Any further credit rating downgrades to sub-investment-grade status will result in an exacerbation in already rising costs for borrowing and servicing public debt (see Figure 11), placing additional constraints on the ability of Government to meet growing demands to expand social welfare programs targeted at poverty reduction and address the significant levels of inequality.

2.11.5 Declining confidence in the long-term growth prospects of commodity intensive export countries, anticipated normalization of monetary policy in the

United States and substantial volatility in China's equity markets has driven institutional investors to reduce their exposure across developing and emerging stock markets. In addition to South Africa's sluggish growth prospects, political decisions on appointments to key portfolios within cabinet has raised investor uncertainty over the management and direction of macroeconomic policy, especially Government's plans to tackle rising debt levels and stabilize the debt-to-GDP ratio. Further uncertainty that undermines investor confidence in Government's commitment to maintaining the country's investment-grade status is likely to have an adverse impact on already declining and volatile levels of capital flows, especially foreign direct investment which is critical to ongoing efforts to stimulate growth and employment (see Figure 12).

**Figure 11: Yield and Price Indices of Government Debt**



Source: SARE Statistical Database

**Figure 12: Capital Movements - Foreign Assets (Direct and Portfolio Investments)**



Source: SARB Statistical Database



On the domestic front, the worst drought in over three decades has the potential to worsen economic slowdown. The immediate impact of the drought has started to manifest as agricultural sector output contracted at an average of almost 5 percent through the first three quarters of 2015 (see Figure 13). This contraction is in stark contrast to the 2013 - 2014 period when the growth rate of value added output by the agriculture sector averaged almost 1.5 percent.

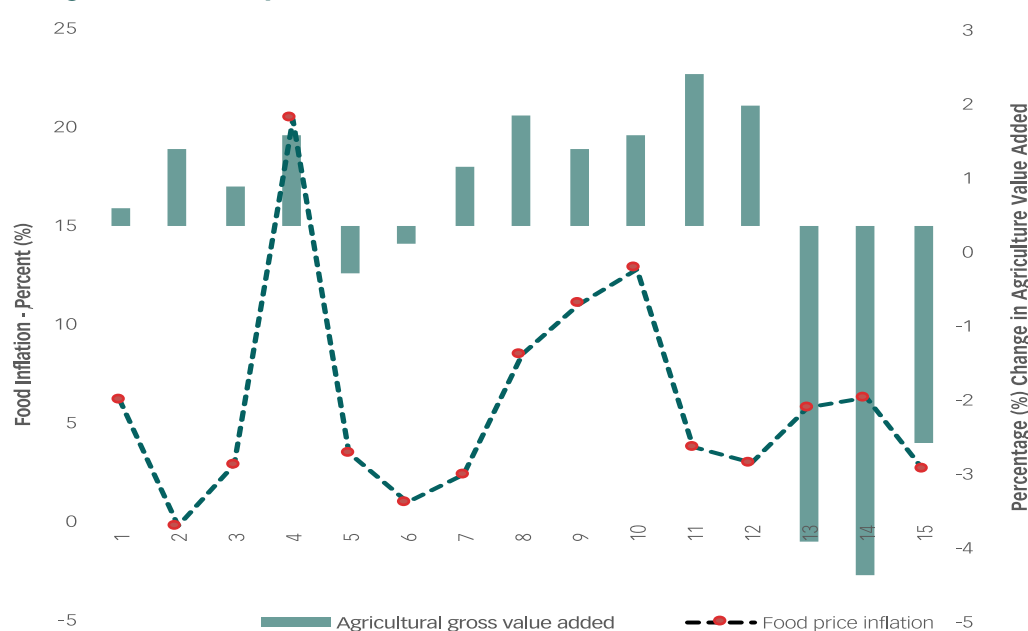
2.11.6 The decline in agricultural output carries significant spillover effects. As a result of the reduction in domestically produced tonnage, South Africa will for the first time in seven years become a net importer of significant quantities of maize in 2016. Using the official production forecast of 7.4 million tons of maize, provided by the Crop Estimates Committee of the Department of Agriculture, Forestry and Fisheries, South Africa would import 856 000 tons of white maize and 1.9 million tons of yellow maize, at a cost of R11.5 billion. Forecasts by Grain South Africa estimates that a total of 5 million tons of maize imports and 2 million tons of wheat imports for the grain marketing year running from May 2016 to April 2017. With all seven local ports able to support a maximum capacity of 4 million tons, the unprecedented import volumes between 2016 and 2017 will place severe pressure on Transnet's port terminals for agricultural bulk operations. Ensuring that grain imports occur timeously and efficiently, the infrastructure capacity of existing ports currently used for grain trade needs attention.

2.11.7 A potential consequence of lower agriculture production is higher inflation as increased importation of grains in an environment of steadily rising global prices and depreciating Rand exchange rate (see Figure 14) will likely translate into higher food prices and increased importation of maize.

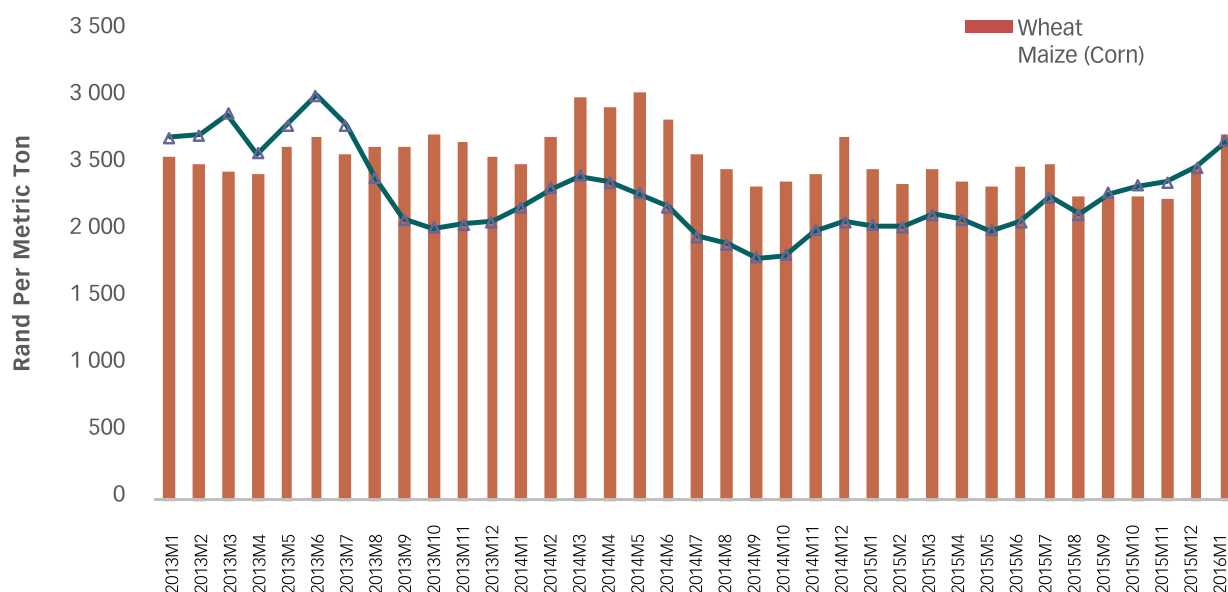
An increase in food price inflation is likely to push headline inflation above the upper end of the 3 - 6 percent target band with which the SARB utilizes in implementing its inflation-targeting framework. The persistence of underlying inflationary pressures from higher food prices is likely to require monetary policy intervention in the form of higher interest rate hikes, an outcome that could exacerbate the slowdown and increase the likelihood of an economic recession. The recent significant depreciation of the Rand, increased food imports is likely to pose additional challenges to addressing a widening current account deficit.

2.11.8 The drought-induced decline in agricultural output carries substantial social effects. Recent analysis by the World Bank indicates that an estimated 50,000 people slipped into poverty due to the drought, with the largest increase in poverty occurring in provinces - Mpumalanga, Eastern Cape, Northern Cape and Limpopo, with large percentage of the population resident in low-income agricultural households or communities. With the sluggish economic growth impacting on plans to grow revenues and widen the tax base, Government's fiscal intervention will involve the reprioritisation of expenditure programmes across the three spheres, including reductions in grant transfers, and rechanneling such funds to address the debilitating effects of the drought (and other emerging priorities). While this intervention represents a budget neutral approach, it is imperative that with the agricultural expected to only recover in 2017, the need to address fiscal deficits and rein in expenditure will pose additional constraints on Government's ability to fully respond to events that could further prolong the impact of the drought beyond its anticipated 2017 recovery period.

**Figure 13: Agricultural Output Growth and Food Price Inflation**



Source: SARE Statistical Database

**Figure 14: World Price of Major Imported Grains**

Source: IMF Commodity Price Database, SARB Online Statistical Database and Commission Calculations

2.11.9 Reigning in public debt could take longer because of the fiscal slippage. The increase in the debt burden also reflects higher borrowing by state owned enterprises (SOEs) largely because of investments aimed at addressing binding infrastructure bottlenecks. Debt in state-owned enterprises (SOEs) continues to be a key risk to the projected debt trajectory, and was one reason S&P cited when changing its rating outlook to negative. There are a number of SOEs constituting significant contingent liabilities for the government such as South African National Roads Agency Limited, and South African Airways.

2.11.10 Governments released the Presidential Review Commission (PRC) report on SOEs in February 2016. The report found that there is no common agenda and understanding of SOEs resulting in the absence of a universal and obligatory long-term vision and plan that clarifies their role and commonly agreed strategic sectors and priorities. The report also noted that there is no balancing of trade-offs between commercial and non-commercial objectives of SOEs. Many SOEs currently require a massive injection of capital and finance policies require close re-examination. According to the report, funding models for social and economic development mandates of SOEs are blurred and confusing, resulting in undercapitalisation, which impedes the SOE's ability to contribute to meeting national challenges.

2.11.11 The PRC report came up with a range of recommendations aimed at providing guidelines in the process of transforming the structure and operational efficiency of SOEs. The key recommendations are focused around

(a) partial listings and privatisations, and (b) the establishment of an overarching state authority to coordinate the government's big infrastructure-related companies. The report suggests that the government 'should adopt a policy shift towards a greater mix of debt and equity finance' - particularly for enterprises on which 'colossal' infrastructure demands have been placed - as the scale of debt 'is not sustainable'. It also recommends expanding private sector partnerships with SOEs to deliver economic and social infrastructure, development of a consolidated funding model for commercial SOEs and DFIs as well as a funding model for the funding of public infrastructure based on a distinction between economic and social infrastructure must be developed. While government continues with its commitment on financially sound SOEs to limit the need for further capitalizations, investors are now looking for a stronger signal of that resolve in key SOEs. The increasing contingent liabilities of SOEs in a constrained fiscal policy environment could impact negatively on future growth prospects.

2.11.12 Further delays in the roll-out of new electricity generation capacity could constrain output and exports. The sale of Vodacom shares to capitalize Eskom is crucial in reducing contingent risks to the fiscal policy. The financial stability of Eskom and its investment program is crucial for growth. The resumption of protracted industrial action could result in wage growth further surpassing productivity gains, eroding export competitiveness and prompting an accelerated hiking cycle of interest rates by the South African Reserve Bank (SARB) with negative impact on growth

## FISCAL CONSOLIDATION

2.12 Sluggish growth and sticky expenditures have translated into persistent fiscal deficits. The fiscal deficits have, to a large extent, represented a countercyclical policy stance. However, as a result of the fiscal slippage, expenditure ceilings were introduced in 2012 to contain spending. In 2014, the deficit on the general government balance widened to an estimated 4.1% of GDP reflecting lower-than-expected revenues because spending was within the ceiling. For the fiscal years 2014/15-2017/18, the expenditure ceiling will limit average annual spending to increases of 7.5 percent in nominal terms, or 1.75 percent in real terms. Against this background, government envisages a budgeted deficit target of 3.9 percent of GDP for 2015/16. The fiscal deficit in 2016/17 and 2017/18 has been revised upwards by 0.7 percentage points of GDP in each year to 3.3 percent and 3.2 percent of GDP respectively. The resultant fiscal slippage has translated into a delayed debt stabilisation target with debt expected to now stabilize at 49.4 percent of GDP in gross terms in 2018/19 and at 45.7 percent in net terms in 2019/20<sup>9</sup>. The fiscal slippage could trigger fears of the risk of a ratings downgrade due to speculation sooner with knock-on implications for growth, poverty reduction, employment and social stability. The obvious question that arises is whether or not the Budget adequately addresses the concerns of the ratings agencies in such a way as to prevent a further reduction in the country's credit rating, especially to junk status in the case of S&P. Rating downgrade will largely depend on successful implementation of spending cuts promised and successful fiscal consolidation broadly.

2.13 The slowdown in economic growth has also resulted in less tax revenue. The gross tax revenue for 2015/16 was revised downward by 0.7 percent owing to the stressed corporate and value-added taxes. Personal income tax grew more strongly than expected as a result of above inflation wage settlements and higher marginal tax rates introduced in the 2015/16 budget. Tax revenue is projected to increase by 8.9 percent from 2014/15. It is apparent though that a new health insurance system and zero percent fees increase for tertiary education will require upscaling of revenue measures to avoid an upward pressure on the fiscal deficit. The generation of tax revenue is constrained by a narrow tax base and weak economic growth performance. However, additional revenue will be required to fund the spending programme, complement spending efficiency and narrow the fiscal deficits.

2.14 The three-year public-sector wage agreement reached in 2015 translated into a 10.1 percent increase in wages and benefits for public servants, significantly above the inflation-based adjustment budgeted. The wage agreement is severely testing the expenditure ceilings resulting in the readjustment of the allocation of expenditure in Medium Term Expenditure Framework. Some of the spending-containing measures employed by government in this regard encompass drawing down the contingency reserve, (R5 billion in 2015/16, R10 billion in 2016/17, and R26 billion in 2017/18), freezing public sector employment for three years, drawing on budget surpluses from provinces for compensation budgets and adjusting compensation targets for individual departments. The weak economic growth outlook and the resultant shortfall in tax revenue means expenditure cuts have to be more aggressive in order to meet the fiscal debt stabilisation and deficits targets and prevent a ratings downgrade to speculative grade.

2.15 General government gross debt has accelerated by 16 percentage points from 2007/08, to 45 percent of GDP in 2013/14. The inclusion of state-owned enterprises (SOEs), push the public debt to 58 percent of GDP. The current fiscal policy stance is forecasted to stabilise the public debt-to-GDP ratio in 2017/18, on condition that growth accelerate to 3 percent in 2017. However, the current economic growth outlook does not support this. The International Monetary Fund (IMF) World Economic Outlook (WEO) January 2016 update projections for South Africa's growth is 0.7 percent and 1.8 percent in 2016 and 2017 respectively. The World Bank Global Economic Prospects, January 2016, projections for South Africa's growth is 0.8 percent and 1.1 percent in 2016 and 2017, respectively. The World Bank Global Economic Prospects, January 2016, projections for South Africa's growth is 0.8 percent and 1.1 percent in 2016 and 2017 respectively. The SARB's projections for South Africa's growth is 0.9 percent and 1.6 percent in 2016 and 2017 respectively.

The public debt targets will therefore not be met as the current growth projections fall short of the initial growth forecasts. Reigning on public debt will therefore take longer. It will also have to entail a mixture of policy reforms aimed at accelerating growth, either attaining a higher structural level of taxation, or cutting spending more aggressively or both.

### 3. Fiscal Frameworks and Revenue Proposals

#### 3.1 Non-Interest Allocations: Division of Revenue

3.1.1 Table 3 summarises the division of non-interest allocations amongst the three spheres of government by comparing allocations at the time of 2015 MTBPS and in the 2016 budget. After accounting for national debt, there are estimated receipts of R 3.8 trillion to share amongst the three spheres over the 2016 MTEF period. Total receipts still grow on average at 0.2 percent annually in real terms, even though at a slower pace than the 0.7 percent projected in the 2015 MTBPS.

3.1.2 Over the 2016 MTEF period, the division of revenue among the three spheres is generally characterised by downward revisions in the allocations to all three spheres

compared to 2015 MTBPS estimates. These downward revisions is largely a result of lower than expected medium term growth forecasts over the medium term. National allocations have seen the biggest reductions as average real growth is projected at -0.9 percent over the 2016 MTEF. This is in contrast to 2014, where we saw significant growth in allocations to the national sphere as a result of various functions shifts

3.1.3 The funding of the local government sphere is aimed at supporting the rollout of basic services to indigent households. Previously, government has always maintained real growth in local government allocations. This is maintained in the 2016 Budget allocations, as average annual real growth per annum is at 1.9% over 2016 MTEF, although this has marginally declined from 2.3% at the time of 2015 MTBPS.

**Table 3 : Medium Term Expenditure Framework (Division of Revenue ( R 'billion)**

Division of Revenue	Total 2016/17 - 2018/19 (R'billion)		Real Annual Average Growth Rate	
	2015 MTBPS	2016 Budget	2015 MTBPS	2016 Budget
National Allocations	1796.3	1791.7	-0.7% .	-0.9%
Provincial Allocations	1643.3	1625	1.8%	1.1%
<i>Equitable Share</i>	1342.3	1327.4	1.7%	0.9%
<i>Conditional grants</i>	301	275.3	2.4%	-5.1%
Local government allocations	350.6	344	2.3%	1.9%
<i>Equitable Share .</i>	173.1	171.3	0.7%	0.7%
<i>Conditional grants</i>	142.1	137.2	5.1%	4.1%
<b>Total</b>	<b>3790.2</b>	<b>3761</b>	<b>0.7%</b>	<b>0.2%</b>

Source: 2015 MTBPS, 2016 Budget Review. Commission Calculations

#### 3.2 Revenue Estimates and Tax Proposals

Taxes were not raised to the extent speculated on before the budget was tabled. Government relied heavily on increasing the fuel levy. A 30 cents per litre increase in the fuel levy, equivalent to 13.7%, is expected to raise R6.8 billion in additional tax revenue. The other changes such as an increase in capital gains tax and increases in excise duties on tobacco products and alcohol, including a sugar

tax on such beverages, amount to no more than R1 billion to R1.5 billion. Although the top marginal tax rate has not been raised, government has relied on inflation of earnings to do the job of raising taxes significantly, especially on higher income groups (bracket creep). The tax burden on lower income groups is likely to be small given measures to have the tax free benefit maintained for lower income households. Other small changes to tax include tax on use of plastic bags and a new tyre wheel tax.

### 3.3. Unallocated Resources and Economic Classification

3.3.1 Unallocated reserves (see Table 4) are meant to serve as a fiscal buffer for government in times of unplanned emergencies. In the Commission's submission on MTBPS 2015, the Commission raised concern around the danger of excessive drawdowns on these resources, and in so doing, creating a risk of having low reserves should an emergency arise. Since MTBPS 2015, potential risks highlighted by the Commission, such as the drought, which is one of the worst to hit South Africa in recent history, and rising social demands such as fees structure at tertiary institutions, have materialised. The Commission is of the view that some of the fiscal pressures due to drought alle-

viation efforts and fees restructuring at universities could have been lessened if government avoided the situation of using the contingency reserve to settle weaknesses in wage bargaining arrangements.

3.3.2 The contingency reserve for 2016/17, has risen from R 2.5 billion at the time of the 2015 MTBPS to R6 billion in the 2016 budget. The contingency reserve for the outer years have remained more or less unchanged. In the face of tight fiscal constraints, the Commission welcomes the increase in the contingency reserve for 2016/17. The Commission would, however, cautions that the amount of the increase is still far from sufficient to provide an adequate fiscal buffer against any major fiscal crisis.

**Table 4 : Adjustments to Unallocated Reserves (2013/14 - 2018/19)**

Division of Revenue	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Budget 2013	4	6.5	10			
MTBPS 2013		3	6	18		
Budget 2014		3	6	18		
MTBPS 2014			5	15	45	
Budget 2015			5	15	45	
MTBPS 2015				2.5	9	15
Budget 2016						

Source: MTBPS (various), Budget Review (various)

3.3.3 Table 5 below provides details of the economic classification of consolidated government expenditure. Allocations in respect of Compensation of Employees show the strongest real annual average growth over the MTEF compared to other categories of expenditure. The increase in compensation puts further pressure on the fiscus in the face of meeting fiscal consolidation targets. Prudent increases in compensation is necessary especially

since it's the largest expenditure category in the government's budget and therefore has a disproportionately larger impact on government's overall fiscal framework. In contrast, allocations to capital assets takes a severe knock with a -2% decline in real annual average growth rate of the 2016 MTEF period. This decline is of concern especially since government's growth path is dependent on an infrastructure-led strategy.

**Table 5: Real Growth of Consolidated Expenditure by Economic Classification**

R'billion	2015/16	2016/17	2017/18	2018/19	Real Annual Average Growth Rate
Compensation of employees	477	517	552	591	1.2%
Goods and services	194	205	222	237	0.7%
Transfers and subsidies	448	476	509	552	1.0%
Payments capital assets	98	100	106	111	-2.0%
<b>Real Year on Year Growth (%)</b>		<b>2015/16-2016/17</b>	<b>2017/18 - 2018/19</b>	<b>2017/18-2018/19</b>	
Compensation of employees		1.8%	0.6%	1.2%	
Goods and services		-0.9%	2.1%	0.9%	
Transfers and subsidies		-0.4%	0.7%	2.5%	
Payments capital assets		-4.6%	-0.2%	-1.2%	

Source: Budget Review (2016)

### 3.3.4 Disaggregating the data by year, the following trends are noticeable

3.3.4.1 The three-year wage bargaining agreement signed with the unions in 2015 implies government is locked into above inflation increases to public sector salaries over the 2016 MTEF period. To accommodate for higher salaries, the compensation bill increases by R74 billion over the 2016 MTEF period, reaching R591 billion in 2018/19. To put this into perspective, the increase of R74 billion amounts to nearly a quarter of the total allocations to payments of capital assets over the 2016 MTEF period. The Commission, however, welcomes government's approach in taking bold steps to reign-in the growth of compensation expenditure. Some of the measures announced in budget 2016 include: reducing administrative and managerial posts in government departments while maintaining frontline service positions particularly in education and health, align organisational structure with approved budgets and potential reforms to collective bargaining and remuneration. These measures have thus stabilised the growth in compensation at around 1.2% in 2018/19, slightly lower than growth of 1.6% predicted in 2016/17. While these proposals are commendable, it is clear a structural shift is required if the direction of spending on Compensation is going to change. The Commission would like to reiterate a previous recommendation made which emphasizes the need to link the salary of public officials with productivity increases. It is also important for government to explore the feasibility of setting norms for administrators and frontline delivery officials in containing the public sector wage bill across all levels and spheres of government

3.3.4.2 In line with a push to limit spending on goods and services, we see a reduction of - 0.9% in real growth for 2016/17. These reductions will come largely from cost savings on non-core items such as catering, conferences, travel and accommodation. Government is planning on releasing further cost containment guidelines as well as guidelines on travel and accommodation. A further initiative are plans to re-negotiate cost reductions from government's 100 top suppliers,

which may result in significant cost savings over the medium term. Nevertheless, despite these measures, growth in goods and services is expected to increase to 2.1% in 2017/18 and 0.9% in 2018/19, largely as a result of increased costs of medicines and other imported items. The Commission would like to reiterate the need to monitor cost reductions from these initiatives so that savings in one area is not outweighed by increased costs in another. The Commission made a recommendation in the 2016/17 Division of Revenue Bill that a framework on public productivity should be developed. Such a framework is critical to ensure cost reduction initiatives are mainstreamed into the workflow processes of government. The Commission therefore proposes a task team be established, headed by National Treasury, Public Service Commission and SALGA to draft the framework on public productivity for approval at Budget Council and Budget Forum.

3.3.4.3 Allocations to payments of capital assets takes a significant knock in 2016/17, with real growth in allocations expected to decline by -4.6%. Further declines of -0.2% and -1.2% are expected in 2017/18 and 2018/19. The reduction in allocations are as a result of underspending capital grants which are reprioritised elsewhere. The Commission is of the view that instead of simply cutting these grants, government should also address the root cause of underspending as capital-related spending programs are key in the delivering of important social services and boosting economic growth.

3.3.5 There are a number of functional areas including agriculture, basic education, health and human settlements that have their funding revised downwards for 2016 MTEF compared to 2015 MTBPS. Programs affected within these functional areas include the Comprehensive Agricultural Support (R60 million), Education Infrastructure (R160 million), health facility revitalisation (R200 million), comprehensive HIV and AIDS (R176 million), National Health Insurance (R10 million) and human settlements (R1.6 billion). Table 6 shows historical performance of these grants. All on average have been performing well with exception of NHL.

**Table 6: Public Transport Operations Grant Performance (2009/10 - 2014/15)**

YEAR	CASP	EIG	HFRG			NHI	Comprehensive, HIV, AIDS and TB	HSDG
			Hospital	Infra	Colleges			
2009/10	93%						98%	98.6%
2010/11	93%	75%					98%	89.2%
2011/12	94%	97%					97%	99.7%
2012/13	79%	93%				52%	99%	99.9%
2013/14	99%	100%				82%	99%	101.2%
2014/15	97%	94%		94%		72%	99%	99.1%

Source: Commission's calculations based on National Treasury (2016), conditional database



While the Commission understands a need to revise downwards some functional areas, some sectors where these cuts have been effected for example agriculture, could lead to very serious risks for the nation and households with respect to food security and food prices given the current ongoing drought faced by the sector. Three components (Health Infrastructure, Hospital Revitalisation and Nursing Colleges and Schools) were merged in HFRG and reducing allocation is likely to affect the effectiveness particularly given high health infrastructure backlogs to support the implementation of NHL. With respect to HSDG, the Commission is of the view that downwards revision will further reduce the number of housing units and housing opportunity which are already declining since 1990's. This is likely to make HSDG less effective on addressing human settlements backlogs particularly in urban areas where population of poor is increasing as a result of urbanisation among other things. The Commission also supports the merging of EIG and recommends that measures should be put in place to ensure that such cuts do not further depress the sector as it has already been hit by drought and the human settlements sector already experiencing a decline in the number of housing units delivered every year.

3.3.6 The 2016 budget has highlighted government's commitment towards the acceleration of the provision of bulk water and sanitation and extending basic infrastructure into areas without water supply. The Commission urges that in future, government should consider budgeting for maintenance of infrastructure and conservation of water supplies that already exist. Another priority should be addressing drought that is a natural occurrence confronting the country with severe economic and social impact on the country and its people. The water sector is threatened with considerable challenges, such as decaying infrastructure, water leaks, illegal connections etc. This is a pain for consumers as they suffer the consequence of the rise in food prices. This calls for government to tighten the effectiveness of the initiatives such as War on Leaks so that visible results can be realised. It is important for government to investment on research and technology towards conservation and purification measures for instance, targeted at seawater, acid mine water/ drainage be updated once the figures have been received.

## 4. Financing Key Social Programs: Health and Education

### EDUCATION

4.1 South Africa's economic upheavals are slowly manifesting in the volatile social structures, recently illuminated by the nationwide student protest for affordable and free higher education. For considerable period, the country, has been able to cushion the children, including learners in higher education institutions, from their household financial constraints, through social expenditure programs and the rapid increase in household incomes. However, a combination of factors have meant that both the parents and government are increasingly unable to fund the cost of higher education, causing a devastating effect on access to higher education by poor children in particular. Low access to high education undermines South Africa's developmental goals as set out in the NDP. Among other things, the NDP intends to increase the higher education enrolment rate of young population, aged between 20 and 24 years and the graduation/throughput rate by 2030. This goals cannot be achieved if higher education is not accessible.

4.2 The rising costs of higher education are regarded as a key deterrent to accessing higher education. Many academically deserving learners who come from poor and middle class families are financially excluded, because the costs are too high for them to afford higher education without a subsidy. Similarly, South Africa is experiencing a rapid increase in demand for higher education as a result of growing number of matriculant eligible for university education. These learners' struggle to gain entrance into the universities because of limited capacity and further endure the burden of high costs inside the system. The challenge of access to higher education is compounded further by the limited funding support from government. The corresponding rise in demand for higher education and the declining share of government's contribution to total Post School Education and Training (PSET) income will most likely undermine NDP goals in as far as higher education is concerned.

4.3 Total allocations for Post School Education and Training (PSET) are projected to increase by real average growth rate of 1,7 percent From R62.4 billion in 2015/16 to 68.7 billion in 2016/17. Over the 2016/17 MTEF higher education institutions receive a baseline addition of R16.3 billion inclusive of R5.7 billion to cover the funding shortfall from freezing of fees in 2016 and R10.5 for the National Student Aid Financial Aid Scheme (NSFAS) to cover outstanding student debt and scale up the number of beneficiaries. While commission welcomes government efforts to minimise academic exclusion of students due to outstanding fees, it is recommended that future shortfalls in student NSFAS funding be identified upfront at the beginning of the study year to avoid funding costs that are unrelated to education.

4.4 The recent upsurge in student protests are the inadequacy of current higher education financing regime. In its submission to the 2013/14 Division of Revenue, the Commission indicated that the increasing burden of lower government transfers to higher education institutions was being met by increasing student fees. The Commission thus recommended that government introduce a differentiated funding framework for a differentiated public university system, by shifting from a unitary system to a three tier funding framework which rewards 1); advances in equity, development and improved performance in the input and output indicators 2); improved performance in the input and output indicators.

4.5 The Commission welcomes the newly established Presidential Commission of enquiry into funding the PSET and the feasibility of free higher education. The commission is of the view that higher education fees should be funded by general taxes from national government. However an enquiry into how skill levy surplus can structured as systematic private sector contribution to higher education and a permanent funding source could prove useful. There is a need for a delicate balance between subsidies for individual students and the institution as well as clarity on what aspects of PSET cost each subsidy is intended to fund. The former should ideally fund the operational costs (teaching, transportation and accommodation) while the latter deals with the large capital outlays such as laboratories, libraries and buildings. Currently, the subsidy funding level is disproportionately skewed in favour of the institutions receiving three times the amount of transfers compared to NSFAS student level subsidy/aid. Universities need to indicate the extent to which institutional subsidies offset increases in the overall student fees

4.6 The newly constituted Commission must comprehensively assess the cost structures of higher education institutions and determine the key cost drivers. Such an assessment would enable the each institutions to identify cost inefficiencies and most importantly the government to select high cost programs that requires bigger subsidies. Caution should be exercised when adopting solutions that seek to control costs due the potential long term distortionary effects on the pricing of higher education. Instead, most importantly, the Commission should investigate the setting student aid benefit and co payment thresholds for learners with different household incomes.

## HEALTH

4.7 The 2016 DoRB states that in the health sector, emerging priorities will be funded through reprioritisation, i.e. by reducing baseline budgets to find savings for new priorities. The savings would, among other things, be gained from cutting on wasteful expenditures as highlighted by the President in the State of Nation Address (2016), re assessment of the efficiency of public entities, and containing the wage bill as it continues to consume the largest chunk of budget in the sectors. In relation to health, the FFC in its 2015/16 submission highlighted that rising costs and inefficiencies in the health sector are caused by, among other things, the over and under-use of health services resulting in abnormal expenditures on medicines and laboratory services. Under expenditure on health services often results in non-adherence to treatment by patients, while over expenditure often results in preventable hospital admissions or over-prescription of antibiotics. As such the Commission recommends that wasteful expenditure should be addressed in line with international experience in areas of clinical waste, operational waste and behavioural waste.

4.8 The health sector has been undergoing many changes. The NHI White Paper was recently released which suggested changes in the financing of the health system. In relation to intergovernmental arrangements, the White Paper (2015) acknowledges that NHI will result in major changes to the intergovernmental funding arrangements currently in place. However, the degree to which this will happen is uncertain as the policy paper states that it will depend on the extent to which NHI is structured and organised as well as how funds would be pooled, something that is currently not clearly articulated.



## 5. Concluding Remarks

5.1. The 2016 Fiscal Frameworks have been crafted in very difficult circumstances characterised by downward economic growth forecasts and rising impatience with social outcomes deemed by the population to fall short of expectation. Bearing this in mind, government has done a good job that promises a deficit reduction programme for the next three years and thereby prevents public debt from spiralling out of control.

5.2. The Commission is of the view that the frameworks are noteworthy in one major respect, reflecting explicit recognition by the Executive of the need to take account of long-term issues in budget formulation in the form of guidelines that are a hybrid of (a) an expenditure rule, (b) a structural budget balance rule (where outer year is targeted for operational traction) and (c) a revenue rule. Continued credible commitment to fiscal consolidation (within the framework of these fiscal guidelines) is necessary to ease the frequency of sovereign debt downgrades as Government demonstrates its ability to control spending pressures. Such commitment should be geared to ensuring that the policy remains credible. In this regard, it is critical that such a perspective is shared both by executive and legislative branches.

5.3. The Commission welcomes the intention to enhance fiscal consolidation through a downward revision of budget deficits over the next three years to levels below what had been expected. Fiscal consolidation and restructuring of state-owned enterprises (SOEs) formed two integral requirements of ratings agencies to prevent further ratings downgrades and these aspects were addressed in the budget.

5.4. Overall, this year's Fiscal Frameworks contrast the conflicting objectives between social development and fiscal consolidation in the short term. The Commission notes that growth is considerably lower in the economy than was projected in October 2015. Current economic growth estimates fall short of the required growth rate to fulfil NDP expectations and compares unfavourably with other developing economies.

- Improvement in economic growth prospects as a means of generating additional tax revenue to bring down the budget deficits and public debt should be a pre-requisite. South Africa should continue to focus its strategy for reigniting growth on improving education expenditure outcomes in particular, increasing skills bases, maintaining strong growth on social safety net spending and increasing productivity of public infrastructure.

# APPENDIX F

## Briefing on the 2016 Appropriation Bill

### 1. Background

1.1 This 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 Appropriation Bill<sup>1</sup>. The submission is also made in terms of Section 3 of the Financial and Fiscal Commission Act, 1997 (as amended), which requires the FFC to respond to any requests for recommendations by any organ of state on any financial and fiscal matter.

1.2 In line with the request from the Standing Committee on Appropriations (SCoA), this submission focuses on the following four areas:

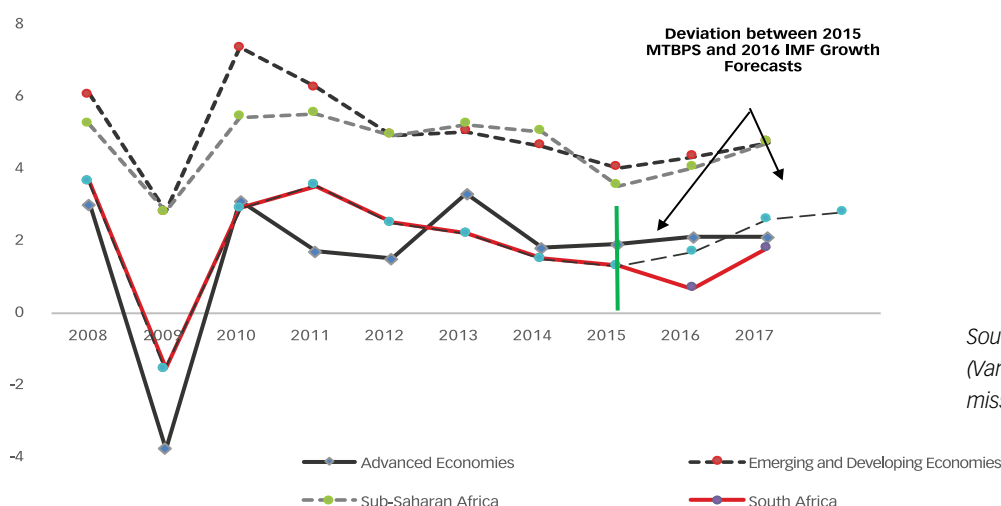
- Assessment of the 2016 Appropriation Bill with regard to effecting Government's five priority areas in the Medium-Term Strategic Framework (MTSF)
- Assessment of the allocative efficiency of the 2016 Appropriation Bill with regards to baseline changes across votes
- Assessment of infrastructure investment in national government, and
- Assessment of possible or existing institutional arrangements, policy areas or mechanisms that can stimulate cost efficiencies.

### 2. General Overview of the 2016 Appropriations Bill

2.1 The 2016 Appropriation Bill comes at a time when South Africa's growth prospects face escalating exogenous and endogenous headwinds. The combined effects of a marked slump in global commodity prices, subdued global economic performance, the deceleration in the growth trajectory of the Chinese economy coupled with the adverse impact of South Africa's worst drought in 35 years have contributed to downward revisions to the country's projected gross domestic product (GDP) growth trajectory (see Figure 1).

2.2 Investor waning confidence around policy credibility given current political climate and associated decisions exacerbates South Africa's already sluggish growth prospects which impact the credibility of the current fiscal regime aimed at addressing deteriorating economic growth. Another matter that undermines investors' confidence are perceptions over Government's commitment to maintaining the country's investment-grade status, which is likely to have an adverse impact on already declining and volatile levels of capital flows, especially foreign direct investment which is critical to ongoing efforts to stimulate growth and employment. Fiscal slippage caused by sluggish economic growth has resulted in several downgrades by the three main credit rating agencies.

**Figure 1: Economic growth for South Africa, Advanced Economies, Emerging and Developing Economies, and sub-Saharan Africa, 2008 -2016/17**



Source: World Economic Forum (Various), MTBPS 2015, Commission Calculations

<sup>1</sup>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.

2.3 Between 1994 and 1999, Fitch and Standard and Poor's (S&P) rated South Africa below the junk status, only Moody's rated South Africa one notch above the junk status. In 2000, S&P and Moody's rated South Africa one notch above the junk status while Fitch maintained its rating below the junk status. In 2000, S&P and Moody's rated South Africa one notch above junk status while Fitch maintained its rating below junk status. Between 2001 and 2011, South Africa's credit rating improved substantially, with Moody's rating South Africa A3, which is just one notch below the highest investment grade. Between 2005 and 2011, Fitch and S&P also rated South Africa BBB+, which is three notches above junk status. Between 2012 and 2015, the credit rating for

South Africa worsened. In 2012, Moody's and S&P downgraded South Africa - by one notch from A3 to Baa1 and BBB+ to BBB respectively. In 2013, Fitch also downgraded South Africa's rating from BBB+ to BBB. In 2014, Moody's and S&P further downgraded South Africa by one notch from Baa1 to Baa2 and from BBB to BBB- respectively. In 2015, Fitch and (S&P) downgraded South Africa's creditworthiness to BBB-, one notch above speculative grade, and S&P placed its rating on negative watch in December 2015. Moody's rating remained at Baa2, but the rating outlook was changed to negative in December 2015. Figure 2 below shows the history of South Africa's credit rating between 1994 and 2015.

**Figure 2: South Africa's credit rating history, 1994 - 2015**



Source: Various Reports: Fitch, S&P and Moody

Key:

A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B
A2	A3	Baa1	Baa2	Baa3	Baa	Ba2	Ba3	B1	B2
4	3	2	1	0	-1	-2	-3	-4	-5

2.4 In order to avoid junk status, Government will have to implement growth-enhancing structural reforms embodied in the National Development Plan (NDP) aimed at raising the economy's potential growth rate and reducing its exposure to external shocks and high unemployment rate. If growth falls short of the projected estimates for the revised deficit targets, stabilization of the debt burden will slip further.

2.5 The risk of a further downgrade will be increased by the resultant widening of the budget deficit and an increase in the ratio of government debt to GDP. The 2016 Budget proposes a prudent, sustainable fiscal policy trajectory, aimed at responding actively to this risk to downgrade the country to sub-investment grade status. In the short to medium term government will mitigate this risk through lowering of expenditure ceiling, bolstering tax revenues, actively managing fiscal risks emanating from state owned companies and sharply restricting the growth of compensation budgets. More specifically, government will achieve this through:

Increasing revenue through tax policy measures that will raise an additional R18.1 billion in 2016/17, and R15 billion in each of the subsequent two years.

Lowering the expenditure ceiling by R10 billion in 2017/18 and R15 billion in 2018/19 by reducing compensation budgets, complemented by measures to restrict hiring.

Reprioritising R31.8 billion over the next three years to meet new spending needs, without increasing the total expenditure envelope.

2.6 Over the longer term, Government has to implement structural reforms aimed at higher domestic savings and investment rates and sustainable, stronger growth, together with sustained restraint in public debt accumulation and on-going implementation of macro and micro-level reforms.

### 3. Assessment of the Composition of Funds in the 2016 Appropriation Bill With Respect to Allocative Efficiency

#### 3.1 Baseline Changes and Service Delivery Implications Of The 2016 Appropriation Bill.

- (a) Table 1 illustrates the baseline changes to the 2016 Appropriations Bill and historical growth of selected key national programs that drive Government priorities (such as education, health, justice and policing) and built environment programs (such as energy, human settlements and rural development) for the period 2013/14 to 2016/17. Given the tight fiscal environment and the imperative to meet expenditure ceiling targets, allocations to the national sphere show a decline of -3.8% in the 2016 Appropriation Bill. The reduction in national allocation is a significant departure from the past three years (i.e. 2013/14 -2015/16) when average spending growth in real terms amounted to 3.5% per annum. Cuts in the 2016 Appropriation Bill are targeted at non-essential goods and services, including travel, cost-containment initiatives and efficiency gains from procurement reforms. In addition, compensation budgets have been reduced for national votes with high vacancy rates, and reductions have also been effected in transfers to national public entities.
- (b) Of the selected votes, Higher Education (10.7%) and Rural Development and Land Reform (RDLR) (3.6%) reflect the fastest growth in real terms in the 2016 Appropriation Bill. The significant increase in Higher Education is a result of extra support provided by compensating for the freeze on university fees for the 2016 academic year and clearing of student debt.

The Commission welcomes the newly established Presidential Commission of Enquiry into funding Higher Education and Training (HET) and the feasibility of free higher education and hopes it goes a long way towards addressing long term problems confronting the sector. Growth in the allocation of RDLR is welcomed as this is in line with the NDP goal of building an inclusive rural economy to support employment and growth. The Commission notes, that among the selected votes, Economic Development (-30.4%), Agriculture (-7.6%) and Human Settlements (-6.1%) recorded the biggest decline in growth rates in the 2016 Appropriation Bill. These votes play a critical socio-economic role and infrastructure delivery. While declines may be related to reprioritisation of funding, especially conditional grants with respect to agriculture and housing, the Commission is of the view that any cuts made to conditional grants should be preceded by an assessment of the likely impact in terms of achieving NDP goals.

- (c) When comparing baseline changes in the 2016 Appropriation Bill with the average growth for the period 2013/14 to 2015/16, the Commission notes that Public Works, Agriculture, Forestry and Fisheries and Energy have declined in both periods. While the negative growth of these votes over both periods may be a result of reprioritization due to slow spending, the Commission is of the view that such continued reductions do not effectively address the underlying long-term systemic problems. Instead, Government should investigate the underlying causes of poor spending, and put in place appropriate mechanisms to unblock constraints hindering service delivery in these sectors.

**Table 1: Baseline changes in key national votes, 2012/ 13 to 2016/17**

National Votes	2013/14	2014/15	2015/16	2016/17 Appropriation Baseline Change (A)	Annual Avg Real Growth (B)	Difference between (A) and (B)
11. Public Works	-22.2%	-6.1%	-1.0%	-2.2%	-9.8%	7.6%
14. Basic Education	8.5%	8.7%	3.2%	-1.0%	6.8%	-7.8%
15. Higher Education and Training	2.8%	1.2%	2.6%	10.7%	2.2%	8.5%
16. Health	1.1%	4.9%	1.8%	1.3%	2.6%	-1.3%
18. Correctional Services	1.9%	-1.4%	0.6%	-1.8%	0.4%	-2.2%
21. Justice and Constitutional Development	0.2%	2.9%	-0.4%	1.5%	0.9%	0.6%
23. Police	3.1%	-0.7%	0.3%	-0.3%	0.9%	-1.3%
24. Agriculture, Forestry and Fisheries	-0.7%	2.4%	-8.3%	-7.6%	-2.2%	-5.4%
25. Economic Development	8.7%	-16.0%	22.7%	-30.4%	5.1%	-35.6%
26. Energy	-8.5%	-10.1%	11.9%	-2.6%	-2.2%	-0.4%
38. Human Settlements	7.6%	0.9%	-0.8%	-6.1%	2.6%	-8.7%
39. Rural Development and Land Reform	0.2%	-6.7%	-7.0%	3.6%	-4.5%	8.1%
Total appropriation by vote	2.4%	1.4%	6.8%	-3.8%	3.5%	-7.3%

Source: Budget Review (2016) and Appropriation Bill (2016)

### 3.2 2015/16 SPENDING OUTCOMES

- (a) Table 2 shows the spending outcomes for 2015/16, including the percentage of the total budget spent for the period 2012/13 to 2015/16 for selected key national votes. While most votes spent on par with the national average (98%) for the period 2012/13 to 2014/15, uneven spending patterns are nevertheless noticeable.
- (b) Programs that are important drivers of job creation and economic development such as Public Works (95%), Basic Education (95%) and Energy (97%), spent below the national average. The allocations for all three votes are declining in real terms, suggesting that poor spending may have been one of the main motivations in receiving reduced allocations. Basic Education in particular, plays a critical role in ensuring that schools comply with minimum norms and standards. Any funds not spent, implies school backlogs are not being dealt with at a pace commensurate with available funding, thus reducing the likelihood that all schools will meet the minimum standards by 2016 as indicated in the NDP.
- (c) In 2015/16, total national spending amounted to 99% of total budget allocated, showing improved spending performance compared to average spending over the previous three years. Unlike previous years, Public Works (98.9%) and Agriculture, Forestry and Fisheries (99.9%) have spent significantly above its average in the previous three years, suggesting a better balance between ability to spend and allocations received. Nevertheless, there is a real possibility that these departments may overspend, given that spending is significantly above the norm at this stage of the financial year. Of concern is the low spending by Basic Education (97.5) compared to the national average (99%) and shows the department's poor spending record in the past three years does not seem to have been adequately addressed.

**Table 2 : Aggregate spending and deviation from the final budget, 2012/13 - 2015/16**

Percentage	% ex- penditure (2012/13)	% ex- penditure (2013/14)	% ex- penditure (2014/15)	Avg % Spending (2012/13 - 2014/15)	% expenditure 2015/16
<b>National Sphere</b>	<b>98%</b>	<b>99%</b>	<b>97%</b>	<b>98%</b>	<b>99%</b>
<b>Selected Key budget Votes</b>					
11. Public Works	90.1	97.2	98.52	95.28	98.92
14. Basic education	91.1	95.2	98.58	94.95	97.52
15. Higher Education and Training	100.3	100.0	100.15	100.13	99.80
16. Health	101.2	98.1	97.73	99.02	99.40
18. Correctional Services	97.6	99.7	99.36	98.91	100.00
21. Justice and Constitutional Development	98.7	96.9	98.22	97.93	99.63
23. Police	101.1	100.0	100.00	100.36	100.00
24. Agriculture, Forestry and Fisheries	100.2	98.9	98.79	99.30	99.86
25. Economic Development	100.1	99.5	99.71	99.78	99.77
26. Energy	97.8	99.6	83.60	93.68	98.24
38. Human Settlements	96.8	96.4	99.81	97.67	98.36
39. Rural Development and Land Reform	100.5	99.9	99.41	99.94	99.7

Source: National Treasury Section 32 Reports (2012 -2016)

#### 4. Assessment of the 2016 Appropriations Bill with Respect To Effecting Government's Five Priority Areas in the Medium Term Strategic Framework

4.1 Government has identified five specific objectives as areas of priority in its Medium Term Strategic Framework (MTSF), namely:

- Promotion of economic growth;
- Education;
- Increased access to high-quality health-care services;
- Job creation and economic transformation; and
- Improved public service.

##### 4.2 Promotion of Economic Growth

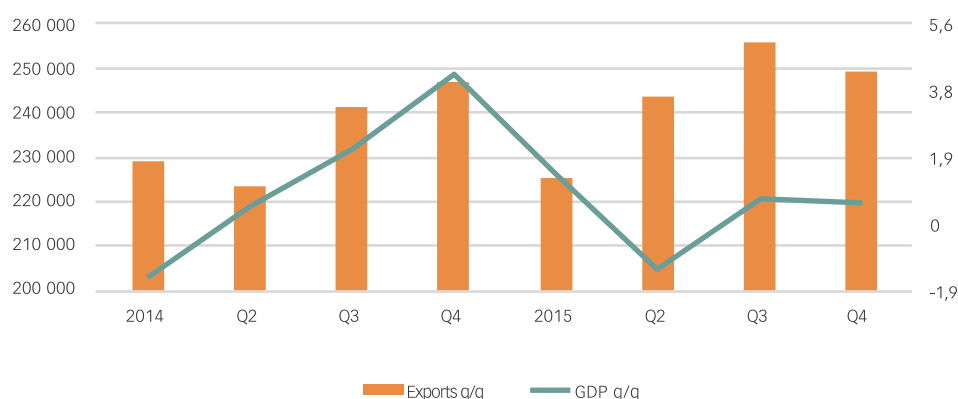
(a) South Africa's GDP growth is lagging behind population growth, which means that per capita incomes are declining. The 2016 Budget commits Government to various policy initiatives and reforms that are specifically aimed at enhancing growth rates over the medium term. Key areas of intervention include:

- Maintaining public infrastructure investment. Infrastructure investment to the tune of R865.4 billion has been set aside for housing, roads, rail, public transport, water, electricity and community infrastructure.
- Partnerships to expand co-investment in economic infrastructure, social facilities, innovation and skills development.

- Increasing electricity supply and improving reliability by mobilizing private-sector co-investment in technologies that promise rapid results.
- Promoting a stable and cooperative labour relations environment.
- Encouraging development of energy-efficient, job-creating industries - such as tourism, agriculture and agro-processing that can benefit from the weaker rand to boost exports.
- Lowering the cost of doing business, removing regulatory constraints - such as easing onerous visa restrictions - and acting swiftly to remove policy uncertainty.
- Stimulating economic activity. Public institutions with strong balance sheets, including development finance institutions and social security funds, will make greater use of their resources to back economic stimulus and job creation.
- Encouraging the growth of small business.
- Transforming the urban landscape. Government has stepped up its support for partnerships between metropolitan municipalities and private investors to develop mixed-use, mixed-income precincts near transport networks and jobs.

- (b) The success of these growth-enhancing reforms is largely dependent on the participation of state-owned companies in the transformation of the economy. Accelerated economic growth over the medium term will also require a shift from monopoly control towards well-regulated, competitive markets in which public companies play a strategic role. In line with these imperatives, Government is implementing the recommendations of the Presidential Review Committee on State owned Entities, aimed at rationalizing the number of entities, and mobilizing equity and technical expertise from the private sector. The Commission welcomes these reforms as they will enhance efficiencies and improve national finances.
- (c) There is also a high potential for South Africa to accelerate economic growth and poverty alleviation by undertaking reforms geared to open up product markets to competition and enhancing product market regulation. As recommended by the Commission in its submission for the 2013/14 division of revenue, it is clear that fiscal policy (infrastructure and current expenditures) alone is not going to solve job creation problems unless complemented by other interventions. What is required are new investments that allow shifts towards jobs and knowledge-intensive production and provision of government services. In all cases there is a need for fiscal policy consistency with long-run fiscal objectives as well as for taking into account limits to direct public sector employment. A prisoner's dilemma scenario that is currently preventing co-ordination of a social compact among the role players who can influence employment requires urgent redress. Some of the concrete suggestions in this regard made by the Commission were for government to re-direct its spending toward those activities directly or indirectly creating jobs (such as health care, durable goods manufacturing, agriculture, community services and hospitality and food service) and (ii) reduce unemployment by addressing factors other than weak demand for goods and services. Such policies could be implemented using mechanisms ranging from re designing state procurement framework to incorporate and grow the informal economy and formal micro-enterprises to earmarking government procurement contracts for low technology or service-oriented contracts (e.g., catering etc.) for informal sector companies or micro enterprises as well as better targeting of supply-side interventions for re-skilling and mobility. Such policies could be implemented using mechanisms such as block grants (e.g. transport subsidy for unemployed vulnerable groups such as women, youth and the disabled so that they are better connected to employment opportunities).
- (d) Electricity bottlenecks and binding rigidities in labour markets have constrained the responsiveness of large exporting companies to exchange rate depreciation whereas small and medium enterprises (SMEs), which export mostly manufacturing goods to sub-Saharan Africa, are more responsive to exchange rate changes<sup>2</sup>. These developments highlight the importance of structural reforms in areas that have hindered external adjustment. Since competitiveness-boost from lower relative prices has been weakened due to binding structural impediments to companies' production function, there has been less than full transmission of domestic policies. This has translated into a missed opportunity to rebalance the economy. Figure 3 below shows exports and GDP growth quarter-on-quarter between 2014 and 2015.

**Figure 3: Exports and GDP growth, quarter on quarter (q/q), 2014/15**



Source: South African Reserve Bank Quarterly Bulletin (MARCH, 2016)

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<sup>2</sup> See IMF working paper: South Africa's Exports Performance-Any Role for Structural Factors?



### 4.3 Education

(a) Education is one of government's key priorities in line with NDP goals. The education budget is R228.8 billion and accounts for 17.6 % of total government expenditure. Key priorities for the sector are:

- Provision of learner and teacher materials to strengthen and improve quality of teaching and learning.
- Ensuring school buildings and facilities meet the gazetted minimum norms and standards as set out in the minimum norms and standards for school infrastructure. Allocations to the education infrastructure grant will grow by 13% over the MTEF.
- Merging of the indirect component of the school infrastructure backlogs grant with the education infrastructure grant by 2017/18.
- Introduction of a new conditional grant to expand and improve early childhood development (ECD) by 2017/18.

(b) The Commission welcomes allocations towards learner and teacher support materials as it has been shown this improves quality of learning. The way the budget is allocated has taken into account previous Commission findings which showed funding towards learner support materials was not clearly defined in terms of how it should be allocated between textbooks and stationery. The Commission supports in principle the merging of the school infrastructure grant and education infrastructure grant as this streamlines grants with the same purpose. However, the reason for merging of grants should not be due to poor performance but rather to improve efficiencies.

(c) Further, the Commission notes the baseline reduction to the education infrastructure grant by R160 million in 2016/17 and by R520 million over the MTEF, given the importance of this grant in constructing, maintaining and refurbishing education infrastructure and schools, which is also a key input required to improve education outcomes. The Commission welcomes the introduction of a grant for Early Childhood Development (ECD), as this is in line with its recommendations made in 2016/17 on financing of ECD programs.

(d) The Commission notes with concern the poor educational outcomes and their overall impact of this on the skills base of the country, despite Education receiving one of the largest allocations in the 2016 Appropriation Bill. The General Household Survey recently revealed a worrying trend in that the older generation (35 years and older) were found to be better skilled than younger people (15 to 35 years). This phenomenon implies that skills are increasingly being obtained outside the education system and that investments in education

is failing to yield the desired results. It also explains why unemployment is rampant among young people. A growing trend of skills acquisition at older age or outside the education system deprives the economy of the productivity gains when people enter the labor market, and may create adverse incentives, as people leave school early to enter the labour market. Government will have to carry the cost of an inefficient education system by making additional investment in programs that incentivise training or employment of unskilled people. In order for the South African economy to achieve sustainable long-term growth the education system must produce the necessary skills, especially among the youth. Therefore the underlying reasons of this worrying phenomenon must be investigated and resolved as a matter of urgency and available resources should be channeled into improving the education throughput rate.

### 4.4 Increased Access to High-Quality Health Care Services

(a) Health remains a priority in the 2016 Appropriation Bill, in line with NDP goals. For 2016/17, Health has been allocated R38.8 billion, including R19.5 billion for hospitals, R16 billion for HIV/AIDS treatment and prevention, and R258 million for primary health care services. Key priorities for the health sector include:

- Expansion of HIV and AIDS treatment and prevention
- Treatment of tuberculosis (TB) including enhanced screening and earlier detection
- The development of a national electronic medicine stock management system.

(b) The Commission welcomes the expansion of HIV and AIDS treatment to include the treatment of TB. Caution and clarity will need to be exercised regarding what this grant in terms of the 'TB' component as the previous grant (Comprehensive HIV/AIDS) funded TB-HIV co infected patients. The Commission is concerned at the R176 million reduction in the grant for 2016/17 as this grant is already under pressure due to increased uptake of anti-retroviral (ARV) treatment every year. Nevertheless, the Commission welcomes expansion of the grant to include TB as it begins to address the sector challenge in terms of medicine stock management.

(c) The Commission supports the proposal for a report reviewing reasons for the conclusion of the National Health Insurance grant (NHI) in 2016/17 as the grant performed poorly since its inception. Among other things, the report will provide reasons for its poor performance and identify possible solutions that will assist the health sector to realize the vision that underpinned NHI through the National Health Insurance indirect grant from 2017/18.



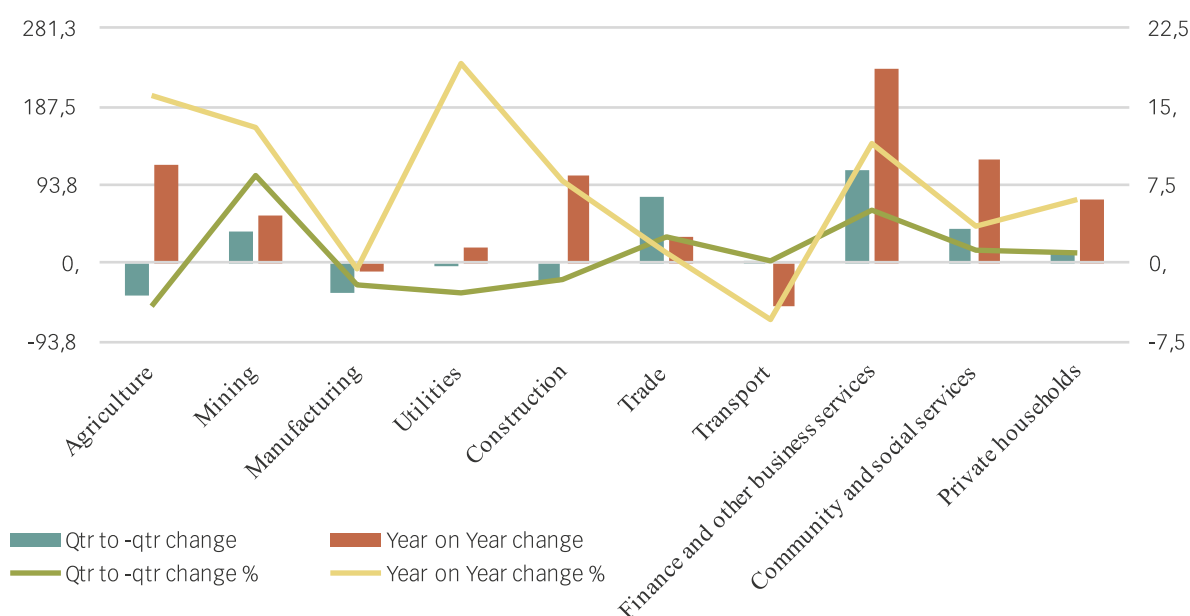
#### 4.5 Job Creation and Economic Transformation

- (a) Job creation remains one of the most pressing concerns for the economy. The crucial task of creating jobs and transforming the economy is being compounded by weak economic growth and limited fiscal resources. Domestic constraints, in particular - power shortages and labour disputes are being worsened by a severe drought. Moreover, wage increases continue to outstrip inflation and productivity growth, further compounding unemployment and job losses.
- (b) Government is committed to improving employment through public employment programmes. Over the next three years, consolidated government expenditure growth will be driven in part by spending on employment programmes and education. Public

employment programmes, including expanded public works and the jobs fund, will increase by 5.8% in the medium term from R11.8 billion in 2016/17 to R13.6 billion in 2018/19.

- (c) In the fourth quarter of 2014, saw an increase in jobs in six industries and a deceleration in construction (16000) and mining (1000). Large employment gains were made in finance and other business services (113 000), trade (80 000) and in the community and social services (42 000) industries. Job losses were recorded in the agriculture, manufacturing, construction, and utilities industries (37 000, 36 000, 21 000 and 4 000, respectively). Figure 4 shows employment by industry quarter-on-quarter for the period from the fourth quarter of 2014 to the fourth quarter of 2015.

**Figure 4 : Employment by Industry 2014-201 5**



Source: StatsSA Labour Force Survey (2015)

- (d) The relationship between demand, output and employment is crucial in understanding the impact of different sectors on output and employment. For example, the sector multiplier view shows that, for every R1 million of extra construction output, output in the entire economy expands by R1.9 million, and total employment rises by 4.9 jobs. Similar impacts are realized in agriculture, and to a lesser extent in finance, real estate and business services.
- (e) At the other end of the spectrum, mining and quarrying as well as electricity, gas and water have minimum impact on both output and employment. It is worth noting that job losses are occurring in sectors with high

impact on both output and employment highlighting the need for support for these sectors in order to make employment creation initiatives more meaningful.

- (f) In line with the NDP, sectors with high potential for job creation and benefits for the rest of the economy must be supported, coupled with critical reforms in product and labour markets, improvements in basic education and strengthening of the capacity of the state. Table 3 below shows sector multipliers based on Statistics South Africa 2012 supply and use tables. In addition to public employment programs, accelerated economic growth is required to achieve the 5.4 % target of the NDP necessary to tackle the high unemployment rate.

**Table 3 : Sector multipliers based on Statistics South Africa 2012 Supply and Use tables**

	Domestic Output Multiplier	Employment Multiplier effect
Agriculture, forestry and fishing	1.7	4.9
Mining and quarrying	1.4	1.6
Manufacturing	1.4	2.6
Electricity, gas and water	1.6	1.4
Construction	1.9	4.9
Transport, storage and communication	1.6	5.3
Finance, real estate and business services	1.7	3.1
Community, social and personal services	1.5	4.1

Source: Budget Review, 2016

#### 4.6 Improved Public Service

- (a) To achieve the developmental agenda, the NDP calls for a capable state that has the capacity to implement government programs. Building a capable state requires appropriate leadership, sound policies, skilled managers and workers, and effective systems.
- (b) Government has continued efforts to implement effective systems in order to achieve greater value for money. Among the main measures adopted in the 2016 Appropriation Bill include modernizing Government's tender systems led by the Office of the Chief Procurement Officer (OCPO). From April 2016, all routine goods and services will be managed through the gCommerce portal, which is expected to reduce corruption by reducing human intervention and the risk of overriding established protocols. A further development in the pipeline is the tabling of the Public Procurement Bill, which will replace all other legal instruments governing public procurement. The Commission welcomes these initiatives and calls for appropriately formulated indicators that can track the impact of these reforms in achieving value for money and reducing graft in government operations.
- (c) As with the implementation of Government's infrastructure plan is a key priority over the medium term, the focus in the 2016 Appropriation Bill is on getting value for money by spending on infrastructure. New procurement standards were issued in November 2015, to allow officials greater flexibility to negotiate lower prices. The Commission welcomes greater use of management contracts, where one contractor is hired to oversee all aspects of a project, thus reducing government exposure to the risk of overruns or delays.
- (d) The Commission welcomes the implementation of compulsory impact assessments of proposed government policy or regulatory change. These impact assessments aim to assess the likely consequences of any policy change and ensure outcomes are integrated with budgetary processes. The Commission has previously indicated that government policies are often developed in the absence of any costing assessment, resulting in unaffordable programs that cannot be adequately funded. More work and thought needs to be put into arriving at a threshold over which an impact assessment becomes cost effective and does not itself become an impediment to efficient delivery.
- (e) . The 2016 Appropriation Bill also features efforts aimed at a broad program of reform to stabilize public entities. Public entities contribute to important development goals, such as being at the forefront of Government's infrastructure led growth strategy. National entities are expected to contribute 94% to total infrastructure spending (R312 billion) over the medium term. To deliver on its mandate, the Commission agrees that national entities need to be financially sound and self-sustaining. Otherwise public entities could pose serious risk to the national fiscus.

## 5. Assessment of Infrastructure Investment in National Government

5.1 Investment in new and existing infrastructure is the responsibility of all three spheres of Government (Table 4). Investment in infrastructure is essential in sustaining economic growth. Over the 2016 MTEF, R275 billion has been allocated in respect of economic infrastructure and network regulation.

5.2 The NDP aspires to economic growth of 5.4% per year to achieve employment, economic and social transformation objectives. Achieving such high growth (among others) will require increased investment in infrastructure, which is key to the generation of growth and jobs in the economy. Total investment in infrastructure is set to increase to R 285 billion in 2016/17, hence public investment in infrastructure is picking up.

5.3 The untangling of infrastructure bottlenecks through increased infrastructure investment in electricity and transport (among others) is crucial given their strategic importance in enhancing economic growth. R34 billion has been allocated to public transport, including commuter

rail, in 2016/17. However, the funding for electrification programmes is R5.7 billion for 2016/17, a decline from R5.8 billion in 2015/16.

5.4 Municipalities will be the key implementers of new economic infrastructure. Previous research conducted as part of the Commission's Submission for the 2014/15 Division of Revenue emphasized the poor state of municipal asset care, particularly with respect to the key basic services, namely electricity and water. Poor asset care runs contrary to the goal of establishing a well-functioning infrastructure network, capable of facilitating improvements in productivity and growth.

5.5 Aligned and coordinated infrastructure investment plans are key to achieving sustained economic growth and should remain a priority for government. The Commission would like to emphasize that while investment in new infrastructure is critical, management of existing infrastructure is also equally important.

**Table 4: Government infrastructure expenditure, 2015/16 - 2018/19**

R'million	Revised estimate		Medium-term estimates	
Economic infrastructure and network regulation	73 613	87 105	90 493	97 460
<i>of which</i>				
<i>Water resource and bulk infrastructure</i>	23 275	29 438	31 012	36 403
<i>Road infrastructure</i>	43 704	45 799	47 984	50 765
Human settlements and municipal infrastructure	178 233	182 631	199 821	216 215
<i>of which</i>				
<i>Human settlements</i>	34 055	33 113	36 544	38 685
<i>Public transport, including commuter rail</i>	31 870	34 558	40 208	42 563
<i>Municipal equitable share</i>	50 507	52 569	57 012	61 732
<i>Municipal infrastructure grant</i>	14 956	14 914	15 991	16 894
<i>Regional and local water and sanitation services</i>	9 126	9 657	9 865	10 465
<i>Electrification programmes</i>	5 811	5 700	6 216	6 466
Education Infrastructure	14 702	15 386	16 318	17 220
<i>University infrastructure</i>	3 301	3 397	3 538	3 708
<i>Education infrastructure grant</i>	9 354	9 614	12 780	13 512
<i>School infrastructure backlogs grant</i>	2 047	2 375		
<b>Total</b>	<b>266 548</b>	<b>285 122</b>	<b>306 633</b>	<b>330 894</b>

## 6. Measures to Stimulate Cost Efficiencies

6.1 The slowdown in economic growth being experienced by the economy has placed government efficiency at the center of government policy and programs. An efficient government is critical in attracting investment and sustaining growth. The Commission has identified the following areas to improve public sector efficiency.

### 6.2 Procurement

(a) Public expenditure has been growing despite the slowdown in the economy. As the single most important spender in the economy, spending efficiency should be the mainstay of all government procurement processes. The Commission continues to be concerned about waste, tender irregularities, poor quality goods and inflated prices and the frequent flouting of supply-chain processes by all layers of government against all the tenets spelt out in Section 117 of the Constitution, the Public Finance Management Act (PFMA) and the Municipal Finance Management Act (MFMA). The Auditor General (AG) has often noted that the bulk of material findings on public sector auditees are associated with supply chain management transgressions. Poorly managed procurement processes in the public sector often translate into highly priced but poor quality public goods and services. This renders the private sector that purchases public goods uncompetitive, and poses a major risk to growth and investment. The Commission strongly believes that the area of procurement provides great opportunities to cut costs and optimising public sector efficiencies. The Commission notes efforts by Government to invest in supply-chain processes and believes such investments should be cascaded to subnational government and government entities as a matter of urgency.

### 6.3 Reduction Of Government Spending On Travel And Accommodation

(a) Government spending on travel and accommodation has continued to grow. The National Treasury (2016), estimates that R 10 billion is spent annually on air and other travel by all spheres of Government. The Commission strongly believes that efforts of the National Treasury to contain such expenditures need to be followed by sub-national government and government agencies. A centrally managed system where travel and accommodation rates can be negotiated for all layers of government should be put in place.

### 6.4 Public Sector Wage Bill

(a) The public sector wage bill continues to exert pressure on public sector budgets. The public sector wage bill

crowds out other government priority expenditures and forces sector departments to reallocate funding from priority areas to fund the wage bill. As part of the fiscal consolidation process, the Government proposed that public sector compensation budgets be lowered by R 10 billion in 2017/18 and by R 15 billion in 2018/19, distributed across national and provincial departments. This will only be achieved by strict management of headcounts over the period, blocking of non-critical vacant posts, and limiting the hire of personnel in administrative and managerial positions. Although such efforts are commendable, it is critical that such strategies are also introduced to local government. A similar strict regimen in managing a bloated public sector workforce and balancing critical and non-critical staff should be followed in the local government sector if the public sector wage bill is to be contained.

(b) The Commission also believes the public sector wage bill should be linked to public sector productivity. In other words the state should derive value for money from the public sector workforce. In this regard the Commission notes the work of the Presidential Remuneration Commission which will shed light on this crucial issue.

### 6.5 Spending Inefficiencies

(a) The Commission continues to be concerned with deep rooted problems of underspending on appropriated funds, and high incidences of irregular and wasteful spending. In 2014/15 the Auditor General estimates put irregular spending by national, provincial and government entities at R25.7 billion. Fruitless and wasteful expenditure was estimated at R936 million in the same year while unauthorised expenditure amounted to R1.6 billion.

(b) Spending inefficiencies noticed in all spheres of government are attributed to many factors including poor and inefficient policy making and planning, absence of consequences on financial transgressions, poorly qualified managers and poorly capacitated monitoring and oversight institutions. Efforts at building capacity of oversight and monitoring bodies, capacitating managers and budget officers should be doubled as they are key to improving spending efficiencies.

### 6.6 Improving Efficiencies in Municipal Spaces

(a) If municipal inefficiencies are dealt with appropriately, this is likely to yield large efficiency gains.

(b) Efficiency gains in the local government can be achieved through reducing water and electricity losses, improving billing systems and ensuring regular repairs and maintenance of infrastructure.

## 7. Concluding Remarks

7.1 The 2016 Appropriation Bill continues the same trend of both the 2016 Division of Revenue Bill and Fiscal Frameworks, and Revenue Proposals by keeping within the expenditure ceilings set by the 2016 Budget Review. Government continues with the thrust of balancing the need to protect social grants, while targeting non-core and non-performing programs as areas where expenditure can be cut.

7.2 While it is understandable that expenditure reductions have been done for reasons related reprioritisation due to slow spending in the main, the Commission is of the view that such continued reductions do not effectively address the underlying long-term systemic problems. Government should investigate the underlying causes of poor spending, and put in place appropriate mechanisms to unblock constraints hindering service delivery in these sectors.

7.3 Similarly, the Commission welcomes the approach of merging school infrastructure to the education infrastructure grant but is of the view that the reasons for such mergers should in principle be towards streamlining grants with same purpose to avoid creating confusion in reporting lines rather than due to reasons of poor performance as in the present case. The reasons for underspending need to be addressed.

7.4 There is a growing trend of skills acquisition at older age or outside the education system which deprives the economy of the productivity gains when people enter the labour market. The underlying reasons of this worrying phenomenon must be investigated by the relevant national department and resolved as a matter of urgency and available resources should be channeled into improving education throughput rate.

7.5 The Commission welcomes the implementation of compulsory impact assessments of proposed government policy or regulatory change. More work and thought needs to be put into arriving at a threshold over which an impact assessment becomes cost effective and does not itself become an impediment to efficient delivery.

7.6 In terms of the nature of infrastructure investment, the Commission reiterates support for the more balanced approach to infrastructure development by Government that attaches priority to caring for existing assets and developing new infrastructure where applicable.

7.7 Real growth of compensation of employees is projected to slow down over the MTEF period. The Commission welcomes measures being taken to reign in the wage bill, but notes that for the compensation projections to be realistic a multi-year wage bargaining agreement will be required, where salaries are pegged close to the inflation rate and productivities. This will enhance the credibility and likely sustainability of the fiscal framework.

7.8 The Commission has made various suggestions for strengthening and stimulating cost efficiencies.



### **Midrand**

2<sup>nd</sup> Floor, Montrose Place, Bekker  
Street,  
Waterfall Park, Vorna Valley,  
Midrand, South Africa

Private Bag X69, Halfway House  
1685

Tel: 086 1315 710

Fax: +27 11 207 2344

### **Cape Town**

12<sup>th</sup> Floor, Constitution House,  
124 Adderley Street  
Cape Town, South Africa

P.O. Box 1505, Cape Town 8000

Tel: 086 1315 710

Fax: +27 21 426 4935

**[www.ffc.co.za](http://www.ffc.co.za)**