

ANNEXURES

In addition to the material published in the *Budget Review*, the following annexures are available at www.treasury.gov.za

- Annexure W1: Explanatory memorandum to the division of revenue
- Annexure W2: Structure of the government accounts

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Report of the Minister of Finance to Parliament

Response to recommendations on the Medium Term Budget Policy Statement, the fiscal framework and the division of revenue

■ Introduction

Section 7(4) of the Money Bills Amendment Procedure and Related Matters Act (2009) (the act) prescribes that the Minister of Finance (the Minister) must submit a report to Parliament at the time of the budget, explaining how the Division of Revenue Bill and the national budget give effect to, or the reasons for not taking into account, the recommendations contained in:

- Budgetary review and recommendation reports submitted by committees of the National Assembly in terms of section 5 of the act.
- Reports on the fiscal framework proposed in the *Medium Term Budget Policy Statement* (MTBPS) submitted by the finance committees in terms of section 6 of the act.
- Reports on the proposed division of revenue and the conditional grant allocations to provinces and local governments set out in the MTBPS submitted by the appropriations committees in terms of section 6 of the act.

■ Budgetary review and recommendation reports

Section 5 of the act sets out a procedure to be followed prior to the introduction of the national budget by the National Assembly, through its committees, for assessment of the performance of each national department. This procedure provides for committees to prepare budgetary review and recommendation reports which:

- Must provide an assessment of the department's service delivery performance given available resources.
- Must provide an assessment of the effectiveness and efficiency of the department's use and forward allocation of available resources.
- May include recommendations on the forward use of resources.

At the time of tabling the annual budget, the Minister is required to explain how the budget gives effect to these recommendations, or why they have not been taken into account.

No budgetary review and recommendation reports were submitted to the Minister for his consideration in the 2010 Budget.

■ Joint recommendations on the fiscal framework

As provided for in section 6(1) of the act, the Minister submitted an MTBPS to Parliament on 27 October 2009. The act provides in section 6(7) that reports of the finance committees of the National Assembly and the National Council of Provinces on the proposed fiscal framework for the next three financial years should be submitted to the Minister. The reports of the committees as tabled on 10 November 2009 contain the following joint conclusion and recommendations:

*Having considered the 2009 MTBPS and conducted public hearings, the Standing Committee on Finance and the Select Committee on Finance **accept** the macro-economic projections and the consolidated revised fiscal framework.*

The Committees recommend that the National Assembly and the National Council of Provinces consider the following:

- *The setting up of the Parliamentary Budget Office in the near term in order to support the work of the Finance and Appropriations Committees especially in respect of ‘value for money’ oversight and accountability. It would therefore be ideal for the Director of the Parliamentary Budget Office to be appointed in January 2010;*
- *The strengthening of a working relationship amongst Parliament’s committees and Statistics South Africa, the newly established Ministries of Performance Monitoring and Evaluation and of Co-operative Governance and Traditional Affairs in order to design and implement a co-ordinated approach towards ‘value for money’ oversight and accountability;*
- *The Committees be provided with sufficient capacity in terms of administrative, content and research support in order to fulfil its legislative and oversight function;*
- *The parliamentary programme should allow for adequate time for parliamentary committees to engage with the MTBPS;*
- *The National Assembly and the National Council of Provinces should expedite the process of the current Southern African Customs Union (SACU) revenue formula that is currently reviewed. As the distribution and transferral of revenue to other member states forms a critical part in terms of the amount of revenue the economy generates.*

The report of the Standing Committee on Finance was adopted by the National Assembly on 11 November 2009, and that of the Select Committee on Finance by the National Council of Provinces on 17 November 2009.

It is noted that the macroeconomic projections and the proposed fiscal framework set out in the 2009 MTBPS were accepted by Parliament without recommendation for amendment. Parliament is advised that the 2010 Budget proposals are based on updated macroeconomic projections and a revised fiscal framework, which is materially similar to the accepted framework. Details are set out in the 2010 *Budget Review*, Chapters 2 and 4.

The Minister notes the specific further recommendations of the finance committees, which are for the attention of the Houses, and will work with Parliament in taking these matters forward.

■ Recommendations of the Standing Committee on Appropriations

In accordance with the requirements of section 6 of the act, the Standing Committee on Appropriations tabled a report on the MTBPS dated 9 November 2009 after giving consideration to:

- The spending priorities of national government for the next three years.
- The proposed division of revenue between the spheres of government and between arms of government within a sphere for the next three years.
- The proposed substantial adjustments to conditional grants to provinces and local government, if any.

The committee's report addresses in some detail the proposed budget framework adjustments to the expenditure estimates and medium-term spending priorities, including:

- Expanding employment and safeguarding social security
- Improving the quality of education and skills development
- Enhancing the quality of health care
- Rolling out a comprehensive rural development strategy
- Creating a built environment to support economic growth
- A broad-based approach to fighting crime.

The committee's endorsement of the proposed medium-term spending priorities is noted. The Minister wishes to record appreciation for the advice set out in the committee's report on measures to address the challenges of employment creation and social security, education and skills development, health care, rural development, the built environment and fighting crime. These issues are addressed further in Chapters 3, 7, 8 and 9 of the *Budget Review*, and in relevant chapters of the *Estimates of National Expenditure*.

The concluding recommendations of the committee, as adopted by the National Assembly on 11 November 2009, are set out below, together with the response of the Minister.

Municipal infrastructure grant: poor-performing municipalities

*While the Public Finance Management Act and the Treasury Regulations allow for the shifting of funds and rollovers, this practice in the context of the Municipal Infrastructure Grant (MIG) has a potential to disadvantage poor performing municipalities. The Committee is of the view that no **rolled-over** conditional grants should be shifted from one municipality to another due to a lack of capacity to spend by any municipality. Instead, the Committee recommends that, as stipulated in section 154(1) of the Constitution and in section 34 of the Municipal Finance Management Act (MFMA), the Department (COGTA) must in consultation with the National Treasury convene a meeting of the Provincial Department of Local Government and the Provincial Treasury to set up supporting structures to assist the municipality and report to the House in three months.*

The Minister agrees that steps should be taken to ensure that procedures for the shifting of funds and rollovers do not have the effect of disadvantaging poor-performing municipalities, and that priority should be given to supporting structures to assist such municipalities.

Strengthening of capacity-building support for municipalities is therefore planned for the period ahead. The National Treasury and the Department of Cooperative Governance have agreed to work on an enhanced coordination framework to improve current capacity-building initiatives.

In compliance with the Intergovernmental Relations Frameworks Act and section 154 of the Constitution, the National Treasury will continue to be part of the team that assists municipalities that have weak spending capacity, or which experience difficulties in complying with the conditions of any conditional grant, including the *municipal infrastructure grant*.

The Division of Revenue Bill, and the accompanying medium-term expenditure framework (MTEF) estimates of conditional grant allocations, seek to strike an appropriate balance between providing

certainty to provinces and municipalities regarding future allocations, and at the same time providing incentives to enhance performance, including effective and timely utilisation of available resources. With regard to the rollover of conditional grants to municipalities, it should be noted that the Division of Revenue Bill provides for in-depth monthly monitoring of expenditure. In cases where withholding, stopping or reallocating transfers are under consideration, the Transferring National Officer (TNO) may make specific interventions to help municipalities improve their spending.

- First, a TNO may, on a monthly basis, withhold transfers to municipalities for a period of less than 30 days while assisting the municipalities to improve their spending.
- Second, the TNO may request the National Treasury's approval to withhold funding for a period of more than 30 days. This allows the TNO and municipalities to work closely together to resolve whatever challenges may be faced.
- Third, once the withholding process has been exhausted, and if municipalities still struggle to improve their spending, the National Treasury may at its own discretion, or at the request of the TNO, invoke relevant sections of the Division of Revenue Act in accordance with section 38 of Municipal Finance Management Act (2003). The MFMA provides for the National Treasury to engage municipalities, the Cabinet members responsible for transfers, and provincial MECs for Local Government on decisions to stop and reallocate grant funding for non-performing municipalities. Any such decision must be gazetted and published once all stakeholders have been consulted in terms of section 38 of MFMA.

All of the above processes occur during the year of appropriation of the grant funding.

Rollover requests are considered as part of the annual adjustments budget process, and are subject to regulations prescribed in terms of the Public Finance Management Act. While it is important to ensure that rollover decisions do not disadvantage poor-performing municipalities, it is also vital that assistance should also be provided in-year through the withholding clauses, because applications for rollover of funds are subject to stringent qualifying criteria.

Land reform and rural development

Land is central to the implementation of the government's comprehensive rural strategy. The Committee recommends that financial resources be prioritised for land reform programmes in order to ensure that the objectives of this strategy should be achieved. The Committee further recommends that the National Department of Rural Development and Land Reform meet with the National Treasury, Standing Committee on Appropriations as well as the Portfolio Committee on Rural Development and Land Reform before the end of the 2009/10 financial year to engage on the above matter.

The Minister agrees that both land reform and complementary aspects of the government's rural development strategy must be prioritised, and welcomes the proposal that discussions should be held between responsible parliamentary committees and representatives of the departments involved.

As indicated in the MTBPS, additional allocations have been made to the Department of Rural Development and Land Affairs amounting to R860 million over the 2010 MTEF period. Subsequent to the MTBPS proposals, a new conditional grant for rural water and sanitation facilities has been added to the Human Settlements vote, amounting to R1.2 billion over the 2010 MTEF period.

Department of Public Works: asset register and qualified audits

The Department of Public Works must capacitate itself adequately in order to address the issue of the asset register and thereby avoid further qualified audit

outcomes by the Auditor General and provide Parliament with a response within three months.

This recommendation is noted and has been brought to the attention of the Cabinet member responsible for Public Works.

Department of Water Affairs: maintenance of water infrastructure

The Department of Water Affairs must make adequate provision in its planning and budgeting to fund the maintenance of water infrastructure.

This recommendation is noted and has been brought to the attention of the Cabinet member responsible for Water Affairs. Parliament's attention is also drawn to the rising allocations to municipalities in both the local government equitable share transfers and the *municipal infrastructure grant*, which contribute to the capacity of municipalities to maintain water infrastructure.

Recommendations of the Select Committee on Appropriations

In accordance with the requirements of section 6 of the act, the Select Committee on Appropriations tabled a report on the MTBPS dated 13 November 2009 after giving consideration to:

- The spending priorities of national government for the next three years.
- The proposed division of revenue between the spheres of government, and between arms of government within a sphere, for the next three years.
- The proposed substantial adjustments to conditional grants to provinces and local government, if any.

The committee's report addresses in some detail the proposed budget framework adjustments to the expenditure estimates and medium-term spending priorities, including:

- Expanding employment and safeguarding social security
- Improving the quality of education and skills development
- Enhancing the quality of health care
- Rolling out a comprehensive rural development strategy
- Creating a built environment to support economic growth
- A broad-based approach to fighting crime.

The committee's endorsement of the proposed medium-term spending priorities is noted, and the Minister wishes to record appreciation for the advice set out in the committee's report on measures to address the challenges of employment creation and social security, education and skills development, health care, rural development, the built environment and fighting crime. These issues are addressed further in chapters 3, 7, 8 and 9 of the *Budget Review* and in relevant chapters of the *Estimates of National Expenditure*.

The concluding recommendations of the Select Committee on Appropriations, as adopted by the Council of Provinces on 17 November 2009, are set out below, together with the response of the Minister.

Economic development of rural communities

The National Treasury considers allocating additional funds during the 2010 National Budget to the Department of Rural Development and Land Reform for economic development of rural communities. The Committee also recommends that:

- *The Department of Public Works extends their Expanded Public Works Programme to rural areas in the medium and long term with the aim of creating decent jobs and providing much needed infrastructure;*
- *The Department of Water and Environmental Affairs expands their water projects to rural areas in order to provide them with water for agricultural and domestic use and providing people in rural areas with decent jobs; and*
- *The Department of Cooperative Governance and Traditional Affairs develops programmes to assist municipalities in rural areas in their development agenda.*

The committee's recommendations are noted and agreed. The 2010 Budget takes account of the need to prioritise the economic development of rural communities, which requires the reinforcement of several complementary spending programmes in a number of departments, including those recommended by the committee.

Official statistics confirm that there are substantial backlogs in sanitation (3.3 million households) and water (1.4 million households) in rural areas. These backlogs have to be addressed through various infrastructure and service delivery solutions, as network connections to bulk infrastructure are not always possible, partly due to low residential densities and associated costs of service delivery. Since 2007, good progress has been made in piloting alternative technologies to address sanitation backlogs through the Operation Gijima programme of the Department of Water Affairs. Water Affairs has also been working on alternative solutions for water (including boreholes and rainwater harvesting).

A new allocation amounting to R1.2 billion has been set aside to provide rural households with water and sanitation over the 2010 MTEF on the Human Settlements vote.

Measures have already been taken to ensure that smaller and more rural municipalities will be included in the *expanded public works programme incentive grant* in the 2010/11 year. The Department of Public Works has set aside funds for this purpose, including specific allocations for management capacity enhancements that are required for the more effective participation of low-capacity municipalities. The new community works programme will be rolled out in the period ahead, directed largely at rural municipalities and smaller towns.

Funding has been set aside on the Water Affairs vote to accelerate progress in bringing water and associated economic opportunities to rural areas.

The National Treasury will continue to work closely with the Department of Cooperative Governance in supporting rural municipalities with their development agenda.

Framework response to the global economic crisis

The Committee recommends that the training layoff scheme and other programmes encapsulated in the Framework Response to Global Economic Crisis by the National Economic Development and Labour Council (NEDLAC) are implemented within six (6) months to help mitigate the effects of the economic crisis.

The committee's recommendation is noted and agreed, and has been brought to the attention of the Leader of Government Business. Implementation of the training layoff scheme, which is financed by the National Skills Fund and the Unemployment Insurance Fund, is in progress. Other measures envisaged in the NEDLAC framework and reflected, where relevant, in the 2010 Budget proposals include:

- Sustained and expanded investment in public infrastructure.
- A countercyclical fiscal and monetary response.
- Industrial and trade policy measures aimed at supporting local industrial capacity and avoiding de-industrialisation, focused particularly on vulnerable sector and small business, and including

increased investment by the Industrial Development Corporation and other development finance institutions in labour-intensive businesses.

- Implementation of phase 2 of the expanded public works programme.
- Targeted social interventions, including emergency food relief, attention to the food supply chain and strengthened enforcement of competition measures where collusion leads to inflated food prices.
- Strengthened global coordination through the G-20 and other multilateral forums, aimed at a more stable global macroeconomic environment and sustained assistance to developing countries.

Wage-based incentives for employment creation

The Committee recommends that government extend the wage-based incentive mechanism to other sectors to help drive a massive increase in employment creation.

The Committee's recommendation is noted and agreed.

As set out in Chapters 3, 8 and 9 of the *Budget Review*, support for employment creation is one of the highest priorities of government for the period ahead. Additional wage-based incentive allocations are proposed for all sectors of the expanded public works programme in the 2010 Budget, and in most cases these allocations have been assigned to the responsible implementing departments. As these are performance-based allocations, actual increases in quarterly and annual allocations will depend on measured progress in creating job opportunities.

As outlined in Chapter 3 of the *Budget Review*, options for wage-based incentives to support broader employment creation across the economy, focused particularly on young work-seekers, are also under review.

Efficiency and effectiveness of education expenditure

The Committee recommends that the Presidency reviews the efficiency and effectiveness (outcomes) of education expenditure that is amongst the highest, as a percentage of gross domestic product, in the world.

The committee's recommendation is noted and agreed. Progress has been made by the Presidency, in consultation with other departments, in identifying key outcome goals and associated activities for education. These are summarised in Chapter 8 of the *Budget Review*.

Implementation of national health insurance

The Committee recommends that government facilitate the implementation of the much-needed National Health Insurance system.

The Committee's recommendation is noted and agreed.

Government is investigating and developing options for the implementation of a national health insurance system. The Minister of Health has established an advisory committee for this purpose and Cabinet has referred the financing and fiscal implications to the inter-ministerial committee that is dealing with social security reform.

Capacity-building support for municipalities

The Committee recommends that National Treasury, Provincial Treasuries and the Department of Cooperative Governance and Traditional Affairs work together in capacitating under-spending municipalities instead of shifting funds from under-spending municipalities to adequately spending municipalities as the latter practice will create additional backlogs in service delivery.

The committee's recommendation is noted and agreed.

As indicated in the Minister's response to the recommendations of the Standing Committee on Finance (above), procedures have been adopted aimed at both strengthening capacity-building support for poor-performing municipalities, and linking initiatives to withhold, stop or reallocate grants to specific interventions to address capacity constraints.

Proposed additions to health budgets

The Committee recommends that additional increases in health budgets are appropriated in 2010 to improve the efficiency and quality of service in the public sector.

The committee's recommendation is noted and agreed.

Public health services have indeed been prioritised in preparing the 2010 expenditure proposals. The framework agreed between Cabinet and the provincial premiers and finance MECs for the 2010 Budget will include about R3.8 billion more in 2010/11, R4.8 billion more in 2011/12 and R6 billion more in 2012/13 for health services. Additional allocations have been allocated for HIV and Aids treatment and prevention programmes, and provision for the occupation-specific dispensations for doctors, pharmacists, emergency medical staff and for 30 categories of health therapeutic personnel (physiotherapists, psychologists etc.), as well as for other improvements in conditions of service. Provision is also made to support a mass campaign against measles, and for expansion of the activities of the Office of Standards Compliance.