

# ANNEXURES

In addition to the material published in the *Budget Review*, the following annexures are available at [www.treasury.gov.za](http://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

### ■ 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 (BRR) 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 allocation 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 assessing 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.

The BRR reports were tabled by the relevant portfolio committees between October and December 2011. Due to the large number of BRR reports, a separate document will be tabled in Parliament with detailed responses to the Portfolio Committees' recommendations. In many cases, however, the different committees have made the same recommendations to a number of departments. This report contains a summary of these overarching concerns, drawing on responses to the specific issues raised on each committee's report set out in the detailed document.

### **General issues**

The concerns consistently raised by the BRR reports across departments are often related, and it is neither possible nor necessary to prioritise between them; their ordering below is not significant.

- **Filling vacant positions:** Many departments are struggling to fill vacant positions. In a number of cases, the committees raised concerns that even critical and high-level positions such as Director-General are unfilled. The committees also felt that acting appointments should be kept to a minimum, and that irregular or 'ghost' employees were unacceptable.
- **Reducing staff turnover:** A connected issue is the high staff turnover in some departments. The committees recommended that this be addressed, in part through human-resource development strategies.
- **Enhancing capacity:** Committees questioned whether certain departments had adequate capacity to spend their budget. Enhancing skills within departments should be a priority of government; performance agreements play a key role in evaluating employees' progress and strengthening accountability.
- **Use of external consultants:** A number of committees noted the high expense incurred by some departments in recruiting external consultants. Recourse to consultants should be reduced across government, in part by developing skills within departments.
- **Disabled workers:** Departments were reminded of the importance of adhering to their commitment regarding the employment of people with disabilities.
- **Monitoring and evaluation:** Departments must establish mechanisms for monitoring and evaluating the programmes for which they are responsible. This requires departments to attach measurable objectives to these projects, as well as clear timeframes.
- **Stronger internal audit and financial controls:** Internal audit capacity should be strengthened in a number of departments to ensure compliance with relevant legislation. Financial controls are needed to reduce irregular spending as well as fruitless or wasteful expenditure.
- **Engagement with the Auditor General:** The committees urge departments to engage regularly with the Auditor General and to adhere to the recommendations that emerge from these engagements.
- **Better supply chain management:** Departments should place emphasis on proper supply chain management in order to combat corruption.
- **Prompt payment of service providers.** Departments have a responsibility for the prompt payment of service providers.
- **Regular and credible reporting:** Committees noted the importance of regular and credible reporting by departments.
- **Greater coordination across government:** A number of committees called for greater coordination of activities within departments, as well as between departments and across the three spheres of government.

## ■ Recommendations of the Standing Committee on Appropriations on the 2011 Medium Term Budget Policy Statement

### Support the capacity of underperforming provinces and municipalities

*The Department of Human Settlements should support the capacity of underperforming provinces and municipalities to speed up the delivery of housing development projects considering the increase of the medium-term expenditure framework (MTEF) allocations in this area.*

The Department of Human Settlements has various programmes in place to build capacity and provide project support to provinces and municipalities. This includes support for unblocking projects, for priority projects and for informal settlement upgrading.

### Stringent measures to manage unanticipated and unforeseen increases in compensation

*National Treasury and the Labour Federation unions should put more stringent measures in place to manage the always unanticipated and unforeseen increases in the compensation of employees across government which lead to increases in the wage bill for government.*

The Minister notes and supports the recommendation. This matter is also dealt with under the response to the recommendation made by the Standing Committee on Finance on the 2011 *Medium Term Budget Policy Statement* on reducing the wage bill.

### Prioritising health infrastructure

*The National Treasury and Department of Health should prioritise health infrastructure in the 2012/13 financial year. Also, the Department of Health should ensure that programmes such as hospital revitalisation are well implemented before the introduction of national health insurance.*

A new grant, the *nursing colleges and schools grant*, is introduced in 2012/13 to fund the upgrading and rehabilitation of nursing colleges and schools. Funds from the first years of the MTEF period have been shifted to the outer year of the MTEF of the *hospital revitalisation grant* and R128 million has been added to the baseline of this grant for the construction of large hospitals. The rescheduling will provide sufficient time for the planning of the construction of these large facilities. The National Department of Health will complete an audit of all health facilities in the country in early 2012 and is working with the Council for Scientific and Industrial Research (CSIR) and the Development Bank of Southern Africa to develop a targeted response to the infrastructure needs of the sector.

In addition, the *national health insurance grant*, a new provincial conditional grant, is introduced in 2012/13 to pilot innovations as part of the phased implementation of national health insurance.

### Ensuring conditional grant expenditure to avoid rollovers

*The Department of Agriculture Forestry and Fisheries should ensure that the Comprehensive Agriculture Support Programme (CASP) and Illima/Letsema conditional grants are completely spent to avoid rollovers to the next financial year since these conditional grants are meant to ensure poverty alleviation and sustainable livelihoods.*

The Department of Agriculture Forestry and Fisheries convenes the National Assessment Panel (NAP) in December each year, at which all provinces present their business plans. Each province's business plan is interrogated by specialists from the national department and the provinces are guided as to how to strengthen their business plans. There have been notable improvements to these business plans in the last two years due to the work of the NAP. During 2012/13 the Department will finalise a framework for a

standard operating procedure for CASP that will require greater involvement of private sector and non-profit organisations in farmer support, which should facilitate improved performance and impact of the grant.

### **Measures to ensure increase in education spending produces quality**

*The Department of Basic Education should put in place measures to ensure that the increase in education spending produces not only quantity but also quality of outcomes for South African people.*

The Annual National Assessments performed on grades 3 and 6 last year provided an indication of the specific problem areas in each school. Interventions can now be tailored to address these challenges. Additional funds (R235 million over the 2012 MTEF period) are allocated for the extension of these assessments to grade 9 and to strengthen the existing annual national assessments for grades 1 to 6.

### **Action to ensure no under expenditure from schools infrastructure backlogs grant**

*The Department of Basic Education should take action to ensure that there is no under-expenditure emanating from the schools infrastructure backlogs grant of R700 million to avoid rollovers.*

To achieve the impact intended from the schools infrastructure backlogs grant within the envisaged timeframes, it is critical that the Department of Basic Education have a thorough and comprehensive roll-out plan. The Department has taken care to ensure that contracts funded from this grant will lead to accelerated delivery and value for money. The full allocation for the grant is committed to projects and National Treasury will recommend that committed funds be rolled over from 2011/12 into the 2012/13 financial year as long as the Department provides a credible plan.

## **Recommendations of the Select Committee on Appropriations on the 2011 Medium Term Budget Policy Statement**

### **Resolving capacity issues in provinces and municipalities**

*All government departments should ensure that capacity issues (especially in provincial and local government) are resolved urgently if the goals of the 2011 Medium Term Budget Policy Statement with respect to infrastructure investment, education, health, rural development and others are to be achieved.*

The Minister notes and welcomes the recommendation. National Treasury continues to work with provincial departments of education and health to strengthen their infrastructure delivery units as part of the Infrastructure Delivery Improvement Programme and engages with all national departments to ensure that they provide the necessary support to provinces and municipalities in the implementation of national policies. National Treasury works closely with provincial treasuries to ensure that government's policy objectives are adequately funded. National Treasury drives a range of interventions aimed at building the capacity of municipalities, including support for implementation of the Municipal Finance Management Act.

Additions were made to the baseline of the Department of Basic Education over the 2011 MTEF period to strengthen their planning and provincial oversight. The National Department of Health has entered into a partnership with the DBSA and CSIR to assist with the delivery of health infrastructure.

### **Proper mechanisms for financing national health insurance**

*National Treasury should provide details regarding the financing of the national health insurance's pilots and the overall national health insurance's financing mechanism. It is critical that the process of choosing the most viable financing*

*mechanism is transparent from the beginning of the process in order to secure buy-in from stakeholders, namely tax payers.*

The national health insurance green paper was released in August 2011 for comment and the period for comment closed in December 2011. Drafting of the white paper can now begin and the legislative reform will follow, which will be a consultative processes. *The national health insurance conditional grant* to provinces, which starts in 2012/13, will pilot a range of interventions in district health authorities and central hospitals, including testing and refining financing mechanisms. The National Department of Health will evaluate and refine the interventions and engage with stakeholders before rolling these out on a national scale.

## **Recommendations of the Select Committee on Appropriations on the 2011 Division of Revenue Amendment Bill**

### **Continued enhancement and capacity building in municipalities and provincial departments**

*The committee recommends that there should be continuous enhancement and capacity building in municipalities and provincial departments that are unable to spend and manage conditional grants.*

The Minister welcomes and supports this recommendation. There are a number of initiatives across government aimed at building capacity in local government. The Municipal Infrastructure Support Agency is being established in the Department of Cooperative Governance. Its aim is to accelerate service delivery and enhance capacity through focusing on municipal infrastructure assessment and the identification of solutions to challenges; to provide municipal infrastructure support and municipal implementation support; to provide capacity development including internships for unemployed graduates within municipalities; and to focus on effective monitoring and evaluation.

The *financial management grant* continues to provide support in building the financial administration capacity necessary to implement conditional grants. A new internship programme focussing on engineering skills is also being introduced in 2012. This is in addition to the continued efforts of national departments to build capacity in their sectors. Provinces also have substantial capacity-building programmes for municipalities.

On the provincial side, National Treasury continues to support provinces in building capacity to implement infrastructure programmes through the Infrastructure Delivery Improvement Programme. Commencing on 1 April 2012, National Treasury will implement the Financial Management Improvement Programme in provincial treasuries which will strengthen the support given to provincial departments, including addressing weaknesses in conditional grants performance. In addition, National Treasury provides support to provinces on an ad-hoc basis, including the placement of specialists in provincial departments.

### **Dealing with the adjustments for increased cost of salaries**

*The Committee recommends that in dealing with the adjustments for increased cost of salaries as well as the expansion and implementation of the occupation specific dispensation, government should be mindful of the rising public sector wage bill relative to other priorities. Government should consider entering into multi-year wage agreements with organised labour.*

The Minister notes and supports the recommendation. This matter is also dealt with under the response to the recommendation made by the Standing Committee on Finance on the 2011 *Medium Term Budget Policy Statement* on reducing the wage bill.

### **Technical assistance to smaller municipalities**

*The Department of Public Works should provide technical assistance to smaller municipalities in order for them to benefit from the expanded public works programme incentive grant.*

Grants for the Expanded Public Works Programme have been revised to make them easier to plan for and spend. They also now include a bias towards rural municipalities in their allocations. The Department of Public Works will provide technical assistance to provinces and municipalities (with a focus on municipalities with weak capacity) to assist with the technical design of labour-intensive projects, the implementation of these projects and improvements in reporting.

## **Recommendations of the Standing Committee on Finance on the 2011 Medium Term Budget Policy Statement**

### **Changing spending patterns**

*National Treasury should present a detailed plan to the Committee on how it plans to change spending patterns from current consumption expenditure to productive spending.*

The 2012 Budget Review provides Parliament with further details regarding the spending plans of government over the MTEF period. These reflect the policy priorities outlined in the *Medium Term Budget Policy Statement*, including detailed plans to change the composition of spending.

As outlined in the *Medium Term Budget Policy Statement*, our goal is to realise a current balance in 2013/14. This means that revenue would be sufficient to cover all current spending, and borrowing will be required only to finance investment. Shifting expenditure patterns towards infrastructure will be a critical part of this objective, and three issues stand out as necessary in achieving this:

- Moderating the rapid growth in the government wage bill witnessed over the last five years;
- Realising substantial savings from goods and services expenditure; and
- Ensuring that capital budgets are spent as allocated.

### **Reducing leakage from public finances**

*National Treasury should present a detailed plan to the Committee on the steps to be taken to reduce leakage from the public financial system.*

The problem of leakage from the public financial systems is of on-going concern to the Minister and is regularly discussed in the Ministers Committee on the Budget. National Treasury continues to look into ways of improving financial management and measuring the performance of budgets in order to address these issues.

### **Contingency plan for economic downturn**

*National Treasury should provide the Committee with a contingency plan in the event that macro-economic variables do not result as expected in the revised fiscal framework.*

Government remains committed to fiscal sustainability. Should the economy fail to recover as forecast, resulting in lower-than-expected tax revenues, meeting this commitment might require a combination of slower spending growth and policy measures to raise tax revenue, including measures to reduce tax fraud and increase compliance. National Treasury routinely considers a range of scenarios and their consequences for policy formulation; even under assumptions of slower GDP and revenue growth, national debt is forecast to stabilise and fiscal sustainability will be achieved.

In these uncertain times, it is incumbent on policy makers to devote even greater attention to contingency plans that take account of different scenarios. While attending to this task, we should carefully consider the usefulness and potential risks of committing ourselves to a particular course of action associated with one or more outcomes that may or may not happen. In particular, National Treasury would be concerned about the effect that this would have on the flexibility of our response in an uncertain, complex and dynamic situation.

Also, the path of economic recovery is strongly related to the expectations of private agents. The messages contained in documents such as the *Medium Term Budget Policy Statement* or *Budget Review* aim to guide these expectations. Placing detailed contingency plans in the public domain could have the unintended consequence of diluting these messages or adding to uncertainty, with consequences for our economy.

### **Keeping inflation within the target range**

*National Treasury and the South African Reserve Bank should take due care to ensure that the inflation rate remains in the target range of 3 to 6 per cent within the next three years.*

In developing the budget we take cognisance of the need to coordinate fiscal and monetary policy in order to support the South African Reserve Bank's role in managing inflation.

### **Reducing the wage bill**

*National Treasury should take all the necessary steps to ensure that the percentage of the state wage bill is brought back to under 40 per cent of GDP in the next three years.*

Returning the wage bill to a sustainable path will require us to ensure that the extent of public-sector wage settlements must be balanced by the consideration of the share of spending allocated to social and economic priorities, such as infrastructure and social security. In terms of the expenditure path outlined in the *Medium Term Budget Policy Statement*, government's wage bill will be reduced from 35 per cent of consolidated government spending in the current year to below one third in the outer year.

One element in realising this path is the wage settlements reached with public sector unions. Given the rapid real growth in public sector wages over the past few years – in part a consequence of the settlement on occupational specific dispensations – an opportunity exists for a more moderate path of wage growth over the next few years.

A second element of the wage bill is the number of government employees. Should wage growth be more moderate this could result in greater scope for government employment. In order to meet the objectives outlined in the *Medium Term Budget Policy Statement*, government will have to strike a balance between the size of wage settlements and the number of people the state can afford to employ.

### **Policy plans**

*National Treasury should provide the Committee with a detailed plan on the following:*

- *Intergenerational equity policy,*
- *Counter-cyclical fiscal policy, and*
- *Debt management policy.*

As reported in the *Medium Term Budget Policy Statement*, the fiscal guidelines proposed in the 2011 *Budget Review* are the foundation of our fiscal stance. Applied consistently, the principles of counter-cyclicity, long-term debt sustainability and intergenerational equity will enable government to

improve social conditions in a sustainable manner, and strengthen South Africa's fiscal sovereignty in a turbulent global environment.

We do not see these principles as a fixed blueprint, but rather as the parameters within which we are able to respond to events in a dynamic world. In our view, the current *Medium Term Budget Policy Statement* reflects an appropriate fiscal stance premised on these principles in the current environment.

Nevertheless, further work is required to clarify the meaning and content of the fiscal principles. This is one of the objectives of the long-term fiscal report, which we will publish in the coming year. The report is intended to encourage greater public debate of the fiscal principles and it is hoped that parliament will play a leading role in such a debate. Through public deliberation and close scrutiny of our fiscal policy decisions, we hope to arrive at a common view of the fiscal guidelines in the South African context.

## ■ **Joint recommendations of the Standing and Select Committees on Finance on the Revised Fiscal Framework**

### **Education on the importance of savings**

*National Treasury should launch a campaign to educate the nation about the importance of saving and the broad implication both on their lives and the economy in general.*

National Treasury launched an awareness campaign in 2011's national savings month to promote savings and retail savings bonds in rural areas. Together with the Financial Services Board, National Treasury has also undertaken an extensive stakeholder consultation process with over 40 organisations around a consumer financial education policy and strategy. The consensus from the engagement process was that a national strategy for enhancing savings should be developed under the guidance of National Treasury.

### **Job creation in small enterprises**

*More support, including relaxation and/or reviewing of constraining laws, should be given to small business enterprises to create jobs.*

National Treasury supports the recommendation and is reviewing the small business sector in cooperation with the Economic Development Department and the Department of Trade and Industry. In 2011, Cabinet approved the merger of Khula Enterprise Finance and the South African Micro-Finance Apex Fund with the Industrial Development Corporation's small business unit. The merger is scheduled for implementation on 1 April 2012 and will produce a new entity, the Small Business Finance Entity, which will be a wholly owned subsidiary of the Industrial Development Corporation.

### **Infrastructure development**

*National Treasury should expedite infrastructural development through partnerships with the private sector. These partnerships will also require the review of the public private partnerships in their current form.*

National Treasury recognises that infrastructure development can be expedited through partnerships with the private sector and that public private partnerships are one means of achieving this. However, a range of other interventions are also required – in particular skills development and capacity-building within government.

*National Treasury should intensify its monitoring of borrowed monies for infrastructure development, and ensure it is spent on infrastructure investment.*

National Treasury is institutionalising processes for closely monitoring spending on infrastructure investment. National Treasury reports on infrastructure spending by municipalities on a quarterly basis and is also monitoring infrastructure spending by state-owned enterprises over the same timeframe.

## Department of Public Works agreements

*The Department of Public Works should ensure competitive pricing when entering into lease or rental agreements on behalf of the state. Escalation clauses in new building contracts should be kept to a minimum, as should professional fees.*

National Treasury notes and supports this recommendation. The principles and practices of competitive pricing and cost-effectiveness underpin the operations of the Department of Public Works. Through engagement between the two departments on the future of the Department of Public Works, National Treasury will ensure that competitive pricing and cost-effective escalation clauses are acknowledged in the property management arrangements of the Department of Public Works.

## Rural development

*The proposed fiscal framework should take into account the need to shift the creation of economic activities to rural communities as part of the rural development strategy.*

This recommendation is noted. The Department of Rural Development and Land Reform is allocated R3 billion over the MTEF period to implement the Comprehensive Rural Development Strategy. These funds will be used for infrastructure development, job creation and to generate economic activity.

## Enhancing economic growth

*While growth is expected to pick up over the medium term, structural reforms are required to set the economy on a different trajectory that increases labour absorption, raises competitiveness and ensures that the benefits of growth are shared.*

Government will focus on infrastructure spending and reducing the costs of doing business to crowd-in private investment and foster job creation. The President's State of the Nation Address identified five infrastructure project clusters. These include infrastructure investment in rail, road and water to access the mineral potential of Limpopo; enhancing the Durban-Free State-Gauteng logistics and industrial corridor; supporting industrial and agricultural development and capacity in the Eastern Cape; improved water, roads, rail and electricity infrastructure in the North West Province; and enhanced iron-ore transport capacity between Sishen and Saldanha Bay.

Targeted interventions to lower the cost of doing business in South Africa will include lowering port charges and broadband costs. In order to improve labour absorption, the newly created Jobs Fund has committed more than R1 billion and the budget for the Community Works Programme is being expanded (see recommendation on the Community Works Programme below).

## Youth Employment Incentive

*Government should ensure that fiscal support for lower wage employees and new entrants in the labour market is strengthened, including the introduction of the youth wage subsidy as announced by the Minister.*

Following the release of the discussion paper proposing the implementation of a youth employment incentive, government has undertaken a process of consultation, engaging key stakeholders. This has not only involved consultation with social partners in Nedlac, a process that began in May 2011, but also within government at meetings of the Economic Sectors and Employment Cluster, and the Joint Social Protection, Community Development and Human Development Cluster. These discussions and engagements are on-going.

### **Community Works Programme**

*Community works programmes should support low income households and bring more people into the labour market. These should be strengthened.*

National Treasury is committed to supporting the Community Works Programme (CWP). Over the MTEF period, R3.5 billion has been added to the CWP's baseline of R2.4 billion. This will enable the programme to reach 250 000 participants by 2014/15, up from 90 000 in March 2011.

### **Wasteful and irregular expenditure**

*The Minister of Finance should provide the Committee with a detailed report on plans to eliminate wasteful and irregular expenditure from the public finance system.*

The Public Finance Management Act (1999) places the onus on accounting officers and accounting authorities to ensure that the financial resources of their respective institutions are utilised in an effective, efficient, economical and transparent manner. The Minister and National Treasury fully support departments and their accounting staff in their efforts to prevent, detect and report on wasteful and irregular expenditure.