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Reference: *DOF 12/1/1*

PROVINCIAL TREASURY CIRCULAR NO. 26 (a): OF 2012

TO:

THE ACCOUNTING OFFICER: VOTE 1: OFFICE OF THE PREMIER (MR JM RABODILA)
THE ACCOUNTING OFFICER (ACTING): VOTE 2: PROVINCIAL LEGISLATURE (MR. S. SANYANE)
THE ACCOUNTING OFFICER (ACTING): VOTE 3: FINANCE (MR JB MBATHA)
THE ACCOUNTING OFFICER: VOTE 4: COOPERATIVE GOVERNANCE AND TRADITIONAL AFFAIRS (MR D MAHLOBO)
THE ACCOUNTING OFFICER: VOTE 5: AGRICULTURE, RURAL DEVELOPMENT AND LAND ADMINISTRATION (MS NL SITHOLE)
THE ACCOUNTING OFFICER: VOTE 6: ECONOMIC DEVELOPMENT, ENVIRONMENT AND TOURISM (DR DV DLAMINI)
THE ACCOUNTING OFFICER: VOTE 7: EDUCATION (MS MOC MHLABANE)
THE ACCOUNTING OFFICER: VOTE 8: PUBLIC WORKS, ROADS & TRANSPORT (MR KM MOHLASEDI)
THE ACCOUNTING OFFICER: VOTE 9: COMMUNITY SAFETY, SECURITY & LIAISON (MR ST SIBUYI)
THE ACCOUNTING OFFICER: VOTE 10: HEALTH (MR RM MNISI)
THE ACCOUNTING OFFICER: VOTE 11: CULTURE SPORTS AND RECREATION (MS SP MJWARA)
THE ACCOUNTING OFFICER: VOTE 12: SOCIAL DEVELOPMENT (MS NL MLANGENI)
THE ACCOUNTING OFFICER: VOTE 13: HUMAN SETTLEMENTS (MR D DUBE)
THE CHIEF FINANCIAL OFFICER: VOTE 1: OFFICE OF THE PREMIER (MR T NKOJOANA)
THE CHIEF FINANCIAL OFFICER: VOTE 2: PROVINCIAL LEGISLATURE (MS PD SIMELANE)
THE CHIEF FINANCIAL OFFICER: VOTE 3: FINANCE (MS P SEMENYA)
THE CHIEF FINANCIAL OFFICER: VOTE 4: COOPERATIVE GOVERNANCE AND TRADITIONAL AFFAIRS (MR MD SHIPALANA)
THE CHIEF FINANCIAL OFFICER: VOTE 5: AGRICULTURE, RURAL DEVELOPMENT AND LAND ADMINISTRATION (MR C. DLAMINI)
THE CHIEF FINANCIAL OFFICER: VOTE 6: ECONOMIC DEVELOPMENT, ENVIRONMENT AND TOURISM (MS JP HLATSHWAYO)
THE CHIEF FINANCIAL OFFICER: VOTE 7: EDUCATION (MR CB MNISI)
THE CHIEF FINANCIAL OFFICER (ACTING): VOTE 8: PUBLIC WORKS, ROADS & TRANSPORT (MR S SHONGWE)
THE CHIEF FINANCIAL OFFICER: VOTE 9: COMMUNITY SAFETY, SECURITY & LIAISON (MR BH NGOMA)
THE CHIEF FINANCIAL OFFICER: VOTE 10: HEALTH (MS G MILAZI)
THE CHIEF FINANCIAL OFFICER: VOTE 11: CULTURE SPORTS AND RECREATION (MR M KHOZA)
THE CHIEF FINANCIAL OFFICER: VOTE 12: SOCIAL DEVELOPMENT (MS P MORGAN)
THE CHIEF FINANCIAL OFFICER (ACTING): VOTE 13: HUMAN SETTLEMENT (MS B MOJAPELO)

THE GENERAL MANAGER: SUSTAINABLE RESOURCE MANAGEMENT (PT) (MS N NKAMBA)
THE GENERAL MANAGER (ACTING): ASSETS AND LIABILITIES MANAGEMENT (PT) (MS E VISSER)
THE GENERAL MANAGER: FINANCIAL GOVERNANCE (PT) (MS J BEZUIDENHOUT)

SUBMISSION OF FIRST DRAFT OF BUDGET DOCUMENTS (ESTIMATES OF PROVINCIAL REVENUE AND EXPENDITURE AND ANNUAL PERFORMANCE PLANS FOR 2013 MTEF PERIOD) (UPDATED VERSION)

This circular is issued in line with Sections 6.1 and 6.2 of Treasury Regulations which requires that annual budget circulars be issued by Provincial Treasury for Accounting Officers of departments and other institutions to comply with the set budget guidelines and format as set by National Treasury.

Departments are required to submit the following budget documents to Provincial Treasury:

1. Database;
2. Estimates of Provincial Revenue & Expenditure;
3. Annual Performance Plan

A risky global economic environment

The global economic and financial crisis is becoming more serious. The crisis and the accompanying slow and uncertain economic recovery will be with us for some years. South Africa's growth is slowing and revenue collections will be negatively affected. The space within our fiscal envelope is narrowing for example; we cannot borrow any more funds for consumption expenditure of government. The economy depends on investment in infrastructure and other forms of capital investment by government to sustain the minimal levels of growth we see presently. Job creation, which is a crucial priority of government, is happening too slowly.

The next Budget has to be different and take account of these factors. We have to reflect on the productivity of the public sector and our inability to implement decisions and policies more effectively. We have to show a stronger commitment to ensuring that the millions of poor people in South Africa receive much better services from all government institutions. We have to make a real difference in their lives.

As heads of departments and their executive authorities formulate plans for the next MTEF the following must receive careful consideration:

1. *Deterioration in domestic economic outlook*: Since the publication of the 2012 Budget Review, the economic outlook has shifted in a manner which highlights many of the risks that we were concerned about in February 2012;

2. *European economic prospects*: The situation in Europe remains largely unresolved and economic growth prospects for the European countries have been revised down;

3. *American economic prospects*: The recovery in the United States of America has yet to take hold, and the threat of significant fiscal retrenchment in the future remains unresolved; and

4. *Economic prospects in fast growing countries*: Expectations that China, India and Brazil would be able to provide a fillip to the global economic performance have

softened as economic growth in all three countries has performed below expectations.

These developments present a potential challenge to our own growth outlook. It will make it more difficult for South Africa to sell the products that our economy produces and will affect the investment decisions made by the private sector.

Prepare for fiscal constraints over the next few years

In response to difficult global economic circumstances, the government has expanded government's contribution to the economy. This has enabled government to meet demands for higher public sector salaries, sustain the social wage which accrues to South Africans through the fiscus, and continue to allocate substantial resources to investment.

Financing this expansion at the same time as declining government income has meant a significant increase in borrowing by National Treasury. Since 2008/09, the government's stock of debt has more than doubled, and with it, the cost of servicing that debt has also accelerated. Higher borrowing and interest costs have meant that fiscal space is being eroded and the country's economy will have to finance a relatively larger government interest bill for many years. This means less money will be available for other purposes.

During these risky times:

- Low levels of economic growth and the recent acceleration in borrowing means that additional resources acquired through tax revenue and borrowing will not be available;
- National government must borrow only for investment - not consumption;
- Government must stabilise the growth in debt service costs so that we have more resources to spend on our social and economic programmes;
- The policies announced in the 2012 Budget will therefore continue to serve as the basis for constructing the 2013 medium term expenditure framework;
- The government must be much more efficient in how it delivers goods and services to the public and achieve greater value for money; and
- Government's focus must be on substantially improving its capacity to implement its policies and achieving the objectives it has set.

Shifting the composition of spending from consumption to investment

Over the next few years the government must give greater effect to the 2012 Budget announcement that the government will shift the composition of our spending **in favour of investment**.

The shift from current consumption to investment requires that:

1. We continue to invest in priority areas that support social development, and economic growth and transformation;

2. Finding the resources to sustainably undertake this investment be the primary focus of the coming budget;

3. A pool of saved resources be identified with urgency in order to fund critical interventions;

4. Departments objectively evaluate the performance and efficiency of each of their programmes and activities, with a view to identifying those that can be closed and discontinued in order to provide fiscal space for more productive or urgent priorities to be financed;

5. Further and more urgent efforts be made to find savings;

6. Much more effective management of the public sector wage bill through:

- Increases in labour productivity, linked to deliberate human resource development through improved education and skills training;
- Much better controls over human resource administration for example, leave and sick leave;
- Stringent management of personnel growth, proportional to the demand for programme outputs; and
- Serious limit on hiring of additional staff and if hiring then only for front line service delivery.

7. Review of government entities and agencies to rationalise these and find synergies and other cost-saving opportunities, for example whether boards are needed and the size of boards.

Regaining public trust

There is an increasing trust deficit between the public and government. This budget must begin to address this challenge that has emerged due to perceptions of public sector wastefulness, inefficiency and abuse of state resources. The taxpayers' money must be used optimally to service the public as a whole. Government must not tolerate any conduct that compromises the effective and efficient use of public funds. Consideration is being given to more urgently respond to instances where funds are not being utilised for the correct purpose or if delivery of key services is failing.

Fiscal objectives over the 2013 MTEF

The medium term fiscal stance is framed by the principles of countercyclicality, debt sustainability and intergenerational equity. In the current macro-fiscal environment, government is committed to achieving the following objectives in the 2013 medium term framework:

- *Keep spending within the overall ceiling established by Budget 2012.* This means that **no additional resources will be added in the first two years of the MTEF**; that is for 2013/14 and 2014/15, as set out in the 2012 Budget. The budget baseline provided for each of the fiscal years of the MTEF period is regarded as the expenditure ceiling. The outer year, 2015/16, has been generated by an inflationary adjustment to the 2014/15 budget baseline.

- *Finance spending pressures and new priorities from within the spending baseline.* Finding resources to meet service delivery priorities from within existing allocations will be a major focus of the 2013 budget process. Allocations will be examined with a view to identifying low performing or low priority programmes which can be closed to provide fiscal space for more productive or urgent priorities to be financed.

- *Shift the composition of spending away from current consumption towards investment.* This is a key budget objective of the 2013 MTEF. High levels of investment in economic and social infrastructure promote more rapid GDP growth, support employment and broaden economic activity. The Ministers' Committee on the Budget will focus its attention on changing the composition of spending to redirect budget funding towards infrastructure and economic development.

In meeting the 2013 MTEF fiscal objectives, all institutions are expected to:

- Reprioritise their baseline allocations, and in so doing to pursue all opportunities for shifting funds from low efficiency/priority expenditures towards areas of higher efficiency/priority in determining new 2013 MTEF baseline expenditure estimates. As part of reprioritisation, institutions must also identify underperforming programmes that can be closed; as well as where funding taken from such programmes can be redirected towards. Baseline reprioritisation must provide for the current level of services as well as any new projects and activities for which funding was approved in the 2012 MTEF budget. Any other new institutional priorities should also be addressed through 2013 MTEF baseline reprioritisation.

- **Implement baseline reductions** by providing their estimates of spending reduced by 1% in 2013/14, 2% in 2014/15 and 3% in 2015/16. The funds emanating from these reductions will allow government to increase allocations to infrastructure projects, and to finance the impact of higher than expected wage increases. The decision to action any baseline reductions proposed will be taken by the Ministers' Committee on the Budget and will be guided by policy priorities and discussion of spending pressures that may emerge from the Medium Term Expenditure Committee (MTEC). Details of where the percentage reductions have been effected, and of the supporting information required, are provided in the technical MTEF guidelines.

Performance information

Performance information is a critical factor in successful programme budgeting and requires continuous refinement. It is also fundamental to realising government's strategic and policy priorities and it encourages accountability within government institutions. **Performance information within institutions, and the management and use thereof, requires urgent attention to improve on the quality.**

National Treasury and the Department of Performance Monitoring and Evaluation will work with institutions to refine and agree on the list of core indicators that will be used throughout the budget decision making process.

Compensation of employees

Historically higher than expected wage increases are evident in the 35% of the 2012/13 total budget that compensation of employees account for. This ratio has continued to increase in the recent past; the current offer in respect of wage bill increases has led to significant changes to the underlying assumptions of the 2012 Budget and it poses a major risk to the sustainability of the wage bill growth over the medium term. Institutions must report on the implications of the higher than expected wage costs for their budget baselines and also show how their efforts to accommodate such costs are reflected within their compensation and vote budget baselines.

Infrastructure

Government's proposal to engender growth and development critically includes an enhanced focus on investment in infrastructure. The specific projects included in government's long term infrastructure plan are outlined as the Presidential Infrastructure Coordinating Commission (PICC) Strategic Integrated Projects (SIPs). MTECs will work with institutions in respect of PICC projects for which funding from the fiscus is required over the 2013 MTEF. Focus will be on determining the schedule of projects that will comprise the PICC long term infrastructure plan, spanning across various government institutions and across all spheres of government. Institutions should:

- Reprioritise institutional baselines to accommodate these projects. Consideration will be given to projects that have progressed beyond feasibility assessments and are ready for implementation.

- Provide a 10-year time horizon for planning and costing these government infrastructure projects, as opposed to the 3 years of the MTEF, including the planning and costing of projects commencing further in the future, maintenance of infrastructure and carry-through implications (to be included in the database).

- Identify infrastructure projects that have been underspending over a number of years and provide the reasons for underspending, as well as a description of measures taken to address the underspending.

Key points of MTEF process compliance:

All institutions must consider their key performance indicators and targets when reprioritising and reducing their three-year programme allocations. The information should be provided according to programme and subprogramme, as well as main economic classification category as per the Appropriation Act.

Institutions will continue to work within functional Medium Term Expenditure Committee (MTEC) structures in preparation of final programme allocations and estimates of expenditure.

Budgeting by programme

Cost estimates for each programme are the primary information inputs into the budget decision making process, particularly for purposes of policy options analysis. Institutions must bear in mind the differential effect of inflation on the various inputs required for service delivery.

Projections for headline CPI inflation for the 2013 MTEF are:

2012/13: 5.9 per cent
2013/14: 5.3 per cent
2014/15: 4.9 per cent
2015/16: 4.6 per cent

Compensation of employees

Given that changing the composition of spending from current to capital is a main focus area, institutions should consider the different ways of changing their personnel profile to achieve cost-effectiveness in programme service delivery.

Currently, the wage negotiations reflect higher than budgeted cost of living and other remuneration adjustments. Institutions must report on the implications of these higher costs for their budget baselines and also show how their efforts to accommodate such costs are reflected within their compensation and vote budget baselines.

Institutions should use the cost projection information below, which includes that related to the current wage bill offer by government, together with other information that they have in respect of managing their budget programmes, in order to determine their estimates of expenditure.

Current projections for cost of living adjustments to payroll remuneration are:

2012/13 – 7 per cent with effect from 1 May 2012
2013/14 – CPI plus 1 per cent
2014/15 – CPI plus 1 per cent
2015/16 – CPI plus 1 per cent

Proposed changes in respect of conditions of service:

1. Long service recognition

    20 years continuous service: a cash award of R7500
    30 years continuous service: a cash award of R15000
    40 years continuous service: a cash award of R20000

2. Night shift allowance

    R2.69 per hour from 1 July 2012
    R3.35 per hour from 1 July 2013
    R4.00 per hour from 1 July 2014

3. Housing allowance

An additional R100 per month from the current R800 per month

Departments and entities are reminded that they are required to budget for the full costs of personnel, including increases in staff establishment, temporary or supplementary personnel, overtime allowances and other benefits, as well as the annual inflation-related adjustment. All aspects of compensation of employees funding must be provided for within the budget baseline.

Public entities

Public entities' budgets will be discussed in the relevant functional MTEC processes; hence entities must improve the expenditure information on programmes/objectives/activities that is provided for the financial years and link that to performance indicators. In the functional MTEC baseline reprioritisation and reduction processes, in addition to shifting of funds between programmes within an institution, shifts between programmes across institutions, including entities, must also be considered.

In order to enable consolidated expenditure estimates to be prepared, budget projections for public entities must be organised into programmes/objectives/activities, as well as by main economic classification, and provided in this format. It is critical that the database be accurately completed for submission to National Treasury by 17 August 2012, as only one database will be used for both the MTEF and ENE processes. A database template has been sent to each entity for completion.

Donor assistance

Donor assistance includes both cash and in-kind contributions. Reporting on donor assistance needs substantial improvement in light of the lack of sufficient funding information received in prior financial years from institutions. All institutions should provide a comprehensive schedule of all donor funding by programme or objective/activity and economic classification over the seven year period, a brief description of what the funds will achieve (outputs) and the associated timelines (template provided in the database). The information for in-kind contributions must be accurate. Donor information should include approved allocations funded from the general budget support modality.

If some donor information is not available within institutions it should be sought from relevant donors. Specific outputs per donation that are concise and comprehensible must be stipulated on the donor funding sheets in the database.

ADDITIONAL BUDGET REQUIREMENTS

New budget requirements should be funded through reprioritisation.

SUBMISSION DATES

All votes are requested to submit all budget documents (Annual Performance Plans, Database, Estimates of Provincial Revenue Expenditure chapters as well as cost per head) by **24th August 2012**.

Your co-operation will be highly appreciated.

MR. JB MBATHA
ACTING HEAD OF DEPARTMENT

DATE: 20/8/2012