RESPONSE TO THE 2012 DIVISION OF REVENUE BILL

For an Equitable Sharing of National Revenue

28 February 2012

Financial and Fiscal Commission
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List of Acronyms

AIDS	Acquired Immune Deficiency Virus
ANA	Annual National Assessment
ART	Anti-retroviral treatment
ARV	Anti-retroviral
BAU	Business as usual scenario
CPI	Consumer Price Index
DCOG	Department of Cooperative Governance
DHET	Department of Higher Education and Training
DOH	Department of Health
DORB	Division of Revenue Bill
DPW	Department of Public Works
DSD	Department of Social Development
ECD	Early Childhood Development
EDI	Electricity Distribution Industry
EPWP	Expanded Public Works Programme
FFC	Financial and Fiscal Commission
HIV	Human Immunodeficiency Virus
HPTDG	Health Professional Training and Development Grant
ICS	Improvement in Conditions of Service
IDIP	Infrastructure Delivery Improvement Programme
IGFR	Intergovernmental Fiscal Relations
INEP	Integrated National Electrification Programme
LES	Local Government Equitable Share
MBAPRMA	Money Bills Amendment Procedure and Related Matters Act

MDG	Millennium Development Goal
MFMA	Municipal Finance Management Act
MISA	Municipal Infrastructure Support Agency
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
NHI	National Health Insurance
NTSG	National Tertiary Service Grant
OSD	Occupation Specific Dispensation
PES	Provincial Equitable Share
PFMA	Provincial Finance Management Act
PHC	Primary Health Care
RED	Regional Electricity Distribution
RSC	Regional Services Council
SALGA	South African Local Government Association

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1. Background

1.1. This submission by the Financial and Fiscal Commission (FFC) (hereafter the Commission) on the 2012 Division of Revenue Bill (hereafter the Bill) is made in terms of Section 214 (1) of the Constitution of the Republic of South Africa (1996) and the Intergovernmental Fiscal Relations (IGFR) Act (1997).

1.2. The Commission's submission consists of six sections. The second section gives comments on clauses of the 2012 Division of Revenue Bill. The third section looks briefly at the macroeconomic outlook and division of revenue proposals. Section 4 assesses sub national fiscal frameworks while Section 5 responds to Government's response to the Commission's recommendations tabled for the 2012 Division of Revenue and Section 6 is the conclusion.

1.3. Similar to the 2011 submissions, the national fiscal framework, revenue proposals and policy stance submission is tabled separately under the Money Bills Amendment Procedure and Related Matters Act, Act No 9 of 2009.

2. Comments on the 2012 Division of Revenue Bill

2.1. The Commission and National Treasury have consulted extensively throughout the 2011/12 year on the various drafts of the Bill. The consultations resulted in consensus being reached on most of the proposed changes prior to Government finalising the Bill. It is the Commission's view that the consultations between itself and government represented by the National Treasury were very useful and took the Bill to a level consistent with recommendations that were made by the Commission in 2010. Consequently, the Commission is in general agreement with Government on the 2012 Division of Revenue Bill. The Commission will continue its engagement with Government on the Division of Revenue Bill to address outstanding and emerging issues as the system evolves.

2.2. A specific comment from the Commission pertains to Chapter 3 (15) {3}[a] and [b] of the Bill. This clause states that "The National Treasury may, at any time after consultation with or at the written request of a transferring officer; and after submitting a revised framework to Parliament for parliamentary for parliamentary comment for a period of 14 days when Parliament is in session, revise or amend a framework published in terms of subsection (1)(c) or (2) (a) to correct any error or omission." While there are merits in this proposal, the Commission's view is that the problems that this intervention aims to solve may be symptomatic of poor grant design and that this underlying problem requires serious attention. The underlying problem seems to be that amendments to the conditional grants framework in-year could undermine parliament's will, as expressed in the original Division of Revenue Appropriation. In year changes are often as a result of under spending, and final allocations could differ markedly from the original appropriations in the DORA, which could undermine ex ante grant objectives such as equity. However, this should be balanced against the need for some operational flexibility for transferring departments in managing conditional grants.

3. The Fiscal Framework for 2012

Table 1: Division of Revenue 2011/12-2014/15

R million	2011/12 Revised estimate	2012/13 Medium-term estimates	2013/14	2014/15
Division of available funds				
National departments	**383 747**	**412 368**	**446 220**	**478 828**
Provinces	**362 626**	**384 487**	**411 092**	**437 004**
Equitable share	291 736	309 057	328 921	349 351
Conditional grants	70 891	75 430	82 171	87 653
Gautrain loan				
Local government	**68 180**	**77 342**	**83 858**	**90 707**
Equitable share[1]	32 876	37 873	40 582	43 639
General fuel levy sharing with metropolitan municipalities	8 573	9 040	9 613	10 190
Conditional grants	26 732	30 429	33 663	36 878
Total	**814 554**	**874 197**	**941 170**	**1 006 539**
Percentage shares				
National departments	47.1%	47.2%	47.4%	47.6%
Provinces	44.5%	44.0%	43.7%	43.4%
Local government	8.4%	8.8%	8.9%	9.0%

3.1.1. In the 2012 MTEF the share of national sphere of the allocations increase slightly, from 47.2 % in 2012/2013 to 47.6 % at the end of the 2012 MTEF period. The local government share grows from 8.4% in 2011/12 to 9.0 % in 2014/15. Compared to the MTBPS the shares for national and local government are projected to increase slightly higher by 0.9% and 0.4 % respectively, while those for provinces declines by 1.2 %

for the same period. The increase in the shares of allocation to national and a decrease for provinces could be a reflection of government's tightening grip of the fiscus through a shift of grants like the FET and other expenditure responsibilities. The Commission notes the increased share to local government which would assist municipalities in dealing with service delivery demands.

3.1.2. The 2012 budget priorities include infrastructure, supporting employment creation and improving local government services. The budget is made under unfavourable economic conditions, as such most of the improvement in services will come from efficient and effective use of existing baselines.

4.1 Provincial Government Fiscal Framework

(a) The Provincial Equitable Shares (PES) are adjusted upward by R3.2 billion in-year (2011/12) to cover higher than budget for wage agreements. For the 2012 Medium Term Expenditure Framework (MTEF), provinces received an addition combined allocation of R19.4 billion over the next three years. Seventy per cent of this R3.3 billion allocated in the first year is earmarked for personnel cost, leaving just below R1 billion for provinces to deal with other pressing needs. Increases in personnel costs remain a major concern. Because such costs are *de facto* a first charge on budgets, there is a real possibility that this may seriously compromise future service delivery. There is a pressing need to not only deal with personnel issues but also efficiency issues pertaining to complementary inputs (i.e. the other goods, services, infrastructure and other resources needed to deliver public services) and how they deployed.

(b) A province-by-province analysis from the third quarter section 32 Public Finance Management Act (PFMA) reports shows that provinces received an adjustment of R5.3 billion to their baselines (R3.2 billion through the provincial equitable share and R2.1 billion through conditional grants). Provinces that exhibit over-expenditure above the provincial average include KwaZulu-Natal, Gauteng and Limpopo. The biggest cost driver for all the provinces that overspend is personnel, which currently makes up 59.9 per cent of all provincial expenditure. KwaZulu-Natal still over spent its adjusted budgets after cutting back on its goods and services and capital. Of all provinces, KwaZulu-Natal has the biggest cost for personnel at 21.2 %. Provinces that also remain a concern in respect of personnel expenditure are Gauteng, Limpopo and the Eastern Cape.

(c) There are concerns that human resource systems and practices and controls in a number of provinces are inadequate or failing. Generally, if overspending on personnel is a true reflection of pressures on provincial budgets, it may be necessary for government to undertake an audit of all government employees to ensure that no funds are lost due to ‘ghost’ employees or double payments and organisational design interventions to ensure the appropriate mix of skills, frontline versus back office personnel etc. Part of the problem as has been highlighted by the Commission in the past is national government’s negotiation strategy which is outside the direct control of provinces. Provinces really only control the numbers, and because of labour laws, retrenchments are a protracted and costly procedure. There are also instances where human resource management has failed, where certain provinces continue to hire employees or fill post without a budget. To address this problem the relevant accounting officers should be made accountable through the PFMA. There is also a need for a focus on value for money and productivity of personnel, with particular emphasis on whether wage levels are appropriate and ensuring that the right skills are deployed.

Table 2. Provincial Personnel Expenditure as at 31 December 2011

R thousand	Adjusted budget	Projected outcome	Actual spending as at 31 December 2011	*Actual spending as % of adjusted budget*	(Over)	Under	*% (Over)/ under of adjusted budget*	*% share of Personnel to total provincial expenditure*	*% share of personnel to total Personnel expenditure*	2010/11: Outcome as at 31 December 2010
Eastern Cape	33 920 637	34 507 744	26 075 130	*76.9%*	-587 107	–	*-1.7%*	*64.8%*	*16.0%*	23 975 307
Free State	14 112 549	14 147 721	10 522 457	*74.6%*	-35 172	–	*-0.2%*	*58.7%*	*6.5%*	9 308 826
Gauteng	36 424 670	37 199 542	27 633 688	*75.9%*	-774 872	–	*-2.1%*	*55.1%*	*16.9%*	24 412 968
KwaZulu-Natal	44 715 945	46 499 017	34 620 316	*77.4%*	-1 783 072	–	*-4.0%*	*59.7%*	*21.2%*	29 915 341
Limpopo	28 879 352	29 540 351	22 051 661	*76.4%*	-660 999	–	*-2.3%*	*67.4%*	*13.5%*	19 585 313
Mpumalanga	17 182 620	17 323 555	12 687 790	*73.8%*	-140 935	–	*-0.8%*	*59.0%*	*7.8%*	11 495 782
Northern Cape	5 718 710	5 656 286	4 183 185	*73.1%*	–	62 424	*1.1%*	*52.6%*	*2.6%*	3 777 931
North West	14 316 262	14 361 715	10 470 910	*73.1%*	-45 453	–	*-0.3%*	*61.0%*	*6.4%*	9 386 523
Western Cape	20 105 038	20 095 521	14 814 934	*73.7%*	–	9 517	*0.0%*	*56.2%*	*9.1%*	13 325 657
Total	**215 375 783**	**219 331 452**	**163 060 071**	***75.7%***	**-4 027 610**	**71 941**	***-1.8%***	***59.9%***	***100.0%***	**145 183 648**

Source: National Treasury 2011, Section 32 PFMA report.

(d) For 2012, basic and higher education account for the second largest expenditure area of government spending, at more than 23% of non-interest allocations. The key to realising sustained and inclusive economic growth is for government to create high quality education systems that will teach its citizens the necessary skills for them to be able to obtain jobs. A lot still needs to be achieved before we can realise this objective especially against a background where (according to the 2011 Annual National Assessment report) 69% of learners in grade 6 scored below 35% in mathematics on average. As noted in the Commission's response to the 2011 MTBPS, education expenditure should be directed towards the hiring of quality teachers, subsidies for transport, supplies for teaching aids, building of new and safer schools, and prioritisation of learners with special needs. Such increase in government spending will have an impact on the rest of the economy as well as on the realisation of millennium development goals (MDGs).

(e) Health spending for all spheres is set to increase by 3.2 % in real terms, from R258 billion in the current year to R280 billion in R2012/13. The focus on primary health care is in line with the Commission's recommendation that there should be re-examination of the distribution of resources between the different levels of care. Without weakening the role played by tertiary hospitals, there is a need for strengthening the role played by primary health care in the health system of the country, improved patient responsiveness and accountability.

Other Provincial Issues

(f) The Commission is aware that a number of provincial departments are under administration and will follow up with respective National Departments and provinces on developments in those departments. The Commission is of the view that there is a need for a regulatory framework for section 100 interventions to be developed going forward. In this regard the Commission will be developing a set of indicators of fiscal distress or fiscal distress indices during the course of this year that can be used to provide early warning for potential areas of intervention.

4.2 Proposed Adjustments to Conditional Grants

(a) A new specific purpose (schedule 5) grant, the National Health Insurance Grant was introduced to cover NHI pilot projects in ten districts focused on comprehensive primary health care to test the feasibility of policy proposals in the NHI Green Paper and models of delivery. The Commission welcomes the pilot route taken by Government as a way of going about the introduction of a reform with far reaching consequences for sustainability of fiscal frameworks as the NHI. If well implemented, key shortcomings will start to be addressed in the pilots and addressed before the full scale launch of the scheme.

(b) A new schedule 5 grant called Nursing Colleges and Schools Grant intended to fund refurbishment and upgrading of nursing colleges is introduced. This grant will supplement other infrastructure grants by allowing the National Department of Health to plan, package and procure projects. This grant is welcomed by the Commission as it should help to resuscitate and redirect the increased supply of nurses.

(c) An additional R166 million has been added to the Further Education and Training Colleges Grant for wage agreement cost. In its 2010 response to the DoR Bill, the Commission raised a concern that the move to ring fence a portion of the equitable share to fund FET colleges equated to conditionalising part of the equitable share. The Commission’s view was that a constitutional amendment reassigning the function was required before funding could be determined. Part of the reasons for the Commission’s concerns were linked to the legacy of the underfunding of FET colleges by provinces which was also partly due to a lack of norms and standards in the area. The Commission did not get a response to that issue and thus is still awaiting further response from government.

(d) Another significant change is the reintroduction of the Expanded Public Works Programme (EPWP) Incentive grant. The EPWP Incentive grant was introduced as part of phase II of the original EPWP of 2004. The original EPWP grant was seen as an opportunity to address poverty on a larger scale. In 2008/2009 government introduced the EPWP Incentive grant as a new form of a Schedule 8 grant (special performance-based incentive) to provinces and municipalities to contribute to the employment creation efforts of the Expanded Public Works Programme through employment of those unemployed. In terms of the grant framework from the original grant, provinces and municipalities had to spend their budgets on EPWP projects and after that the grant will be paid quarterly as an incentive (after employment has been created).

i. In its submission on the response to the DoR Bill 2010 and the 2011 MTBPS the commission re-iterated its views on what the challenges with this grant were. The Commission is still of the view that the grant has not succeeded in achieving initially intended goals within the specified time. There has not been a formal assessment of the achievements made by this grants both in terms of expenditure and service delivery outputs including how many direct and full time jobs have been created against the allocated funds. The Commission requires that there be an independent review before the grant is reincarnated so that lessons can be drawn from the past experience to avoid a replication of past mistakes. The Commission is aware of the joint team of the National Treasury, Department of Public Works, Department of Cooperative Governance and South African Local Government Association that has been working on this and looks forward to the final report of the team.

(e) The Commission continues to be concerned about the spending performance and achievement of some of the conditional grants and believes serious and far reaching reforms are in order. The Commission reflected on a range of non-compliance matters in the implementation of conditional grants in reviewing the DoR Bill. These non compliance ranges from late submission, lack of monitoring and evaluation, late approval of business plans, material under spending and diversion of funds. The Auditor General has also raised these issues in departmental reports. The Commission wishes to emphasise a need for government to put in place disincentive measures to deter such non-compliances especially where they recur. Departments need to have adequate capacity to manage grants, and be able to evaluate their needs explicitly and often. In 2012 the Commission will be initiating a special project that takes a detailed look at a specific conditional grant and propose ways of how grant design and implementation could be enhanced. A report will be tabled to Parliament on completion.

4.3 Local Government Fiscal Framework

(f) Local Government Fiscal Framework

(a) As far as the baseline increases/decreases are concerned, the total local government allocation is set to increase by R5.3 billion over the MTEF period.

(b) Of the R5.3 billion increase, R2.2 billion is in respect of the equitable share allocation to municipalities, whilst local government conditional grants are set to increase by R3.1 billion.

(c) Local Government Equitable Share Issues

i. There are no major changes to the LES formula for the 2012/13 financial year. In addition to inflation related adjustments, an additional amount of R300 million is added to support the funding of administrative costs to poorer municipalities. The R300 million will be added into the current envelope for special support for councillor remuneration but undertaken separately via another formula. The total allocation published in the Bill will be the sum of the special support for councillor remuneration and the funding of ward committees.

ii. Although the Commission supports the principle of targeting poorer rural municipalities by providing them with additional resources, it is also important to note that such a funding stream may actually disincentivise councillors and ward committees from collecting more own revenues and also may create problems with the accountability framework for municipalities. The Commission will be making further comments when details of how this grant would work are clear.

iii. The Commission supports Government's proposal to align the development of a new LES formula to the release of the 2011 census. This will allow the design of the new formula to be based on the new data set.

iv. Updating the data of the LES formula will continue to be a problem following the 2011 census. Government needs to urgently take a firm stance over the use of other available and frequently collected local government data sets.

v. In addition, it is important to note that the Statistics Act 06 of 1999 makes provision for a census to be undertaken every 5 years. Therefore, going forward it is critical for government to consider implementing this legislative provision. The Government should also consider Annual Community surveys to fill data gaps created by 10 year censuses.

(d) Local Government Conditional Grant Issues

i. For the 2012/13 financial year, direct transfers to municipalities' increase by R312 million. With 300 million being geared towards the funding of ward committees through the LES, this effectively means that direct conditional grants to municipalities increases by R12 million. This amount is the net effect of the technical adjustments and savings. There are thus no increases to the baseline amounts of the Urban Settlements Development Grant (USDG) and the Integrated National Electrification Programme (INEP).

ii. The Commission welcomes government's attempts to entrench the principles of differentiation as evidenced in the allocation of local government conditional grant (examples include the Urban Settlements Development Grant and the Rural Transport Services and Infrastructure Grant). The Commission would like to note the following developments with respect to local government conditional grants:

1. That the Commission supports the tightening of the systems and processes around unspent conditional grant funding. However, returning money to the National Revenue Fund (NRF) should be weighed against the consequences this action may have on service delivery. It is also important that the tightening of systems and process around unspent conditional grants is accompanied by strategies that are aimed at addressing the root causes of under-spending especially in very poor, low capacity municipalities. The risk of having the equitable share allocation to offset against unspent conditional grant funding, does have an effect in terms of motivating municipalities to use conditional grants appropriately and for the purpose they were designed for in the first place.

2. That the Commission supports the establishment of the Infrastructure Skills Development Grant as an attempt to build the necessary capacity within local government. This grant will see the development of critical skills that are lacking in many municipalities and will also assist in the transfer of such skills to rural areas where their attraction and retention is a major challenge. While the grant is welcomed in principle, the Commission is concerned about the incremental introduction of capacity building grants despite the growing evidence of their limited impact. For maximum impact, the Commission suggest that the grant be aligned with other skills development initiatives such as the Skill development Levy, Sector Education and Training Authorities and the FET colleges grant.

It is also important that baseline indicators are taken before the grant is implemented and compared with the grant's actual impact in terms of building capacity.

3. Within the context of trying to ensure a certain level of stability and predictability within the local government fiscal framework and to allow municipalities to plan adequately, the Commission suggests that the existing approach to establishing and terminating local government conditional grants be tightened. The Commission further reiterates its previous recommendation on the need to improve grant design by national transferring departments, and that National Treasury should interrogate such grant designs. The over or under-spending in some local government grants (see examples in Table ** below) can partially be traced to poor grant design in the first place. It is the view of the Commission that with proper grant design, the performance of some grants will improve.

Table 3: Spending on Conditional Grants

Conditional Grant (R'000)	2006/07 Expenditure as % of Allocation	2008/09 Expenditure as % of Allocation	2009/10 Expenditure as % of Allocation
Municipal Infrastructure Grant	90%	43.4%	78.9%
Local Government Financial Management Grant	34%	36%	110.9%
Municipal Systems Improvement Grant	67%	34.4%	94.3%
National Electrification Programme (Municipal Grant)	79%	53.4%	86.4%

4. The increases in the baseline amounts of local government conditional grants are a welcome development. However, one needs to consider seriously the respective capacities of certain municipalities in spending these extra funds. In some cases, it is possible that some municipalities will find it difficult to absorb and effectively spend these extra resources, thus increasing the likelihood of under spending on such grants. Previous spending

performance on conditional grants (see Table ** above) and related capacity issues should be considered when increasing the quantum of conditional grants to some municipalities.

5. The Commission notes the introduction of the Cities Support Programme. This needs to be supported in terms of the importance of cities to the economy and the Local Government system, but also in providing an outcomes driven framework to which a specific conditional grant (e.g. the Urban Settlement Development grant, the Public Transport and Infrastructure Systems grant) can respond and coordinate within. The fiscal ramifications of the programme need to be clearly articulated and grant programmes aligned to this ASAP. The committee should question departments (i.e DHS, NDoT) on what they are doing in this respect and how their grants will support this initiative.

(e) Budgeting and Financial Performance Issues

i. As in previous submissions, the Commission is concerned with unrealistic budgeting or spending on capital, and repairs and maintenance.

1. Generally municipalities rely on intergovernmental transfers for capital spending. On average, intergovernmental transfers comprised 40% of total capital revenue in 2008/09 (FFC, 2011/12). For certain categories of municipalities, particularly rural municipalities and medium to smaller towns, this component is in excess of 50% of total capital revenue. Municipalities find themselves in a difficult position where, due to poor credit worthiness, they are unable to access external loans. When one examines budgeted versus actual capital expenditure, many municipalities spend significantly less than

what is budgeted for. For example in 2009/10 municipalities spent on average, 79% of what had been budgeted for (FFC 2011/12). However there are dramatic differences between Metros on one hand, and other municipal categories on the other. Metro spending is on is often in excess of 90% while all other municipal categories barely spend 70% of what had initially been budgeted for capital. This hints then at the severity of unrealistic budgeting.

Unless poor municipal planning and spending on capital is improved, Government's plans to invest in economic and social infrastructure as a means of promoting economic growth and creating employment will be compromised.

2. With respect to repairs and maintenance, the Commission's research indicates that there is poor spending in this component right across all municipalities, with an overwhelming majority of municipalities over budgeting but under spending. The perennial problems of poor maintenance and rehabilitation of existing/new infrastructure has compromised sustainable service delivery. As indicated in the Commission's 2012/13 recommendations, low spending on maintenance could be due to poor planning and low technical capacity (e.g. engineers). In addition, municipal tariffs have a long history of not being cost reflective (despite the requirements of Section 74(2) of the Municipal Systems Act which require tariffs that are charged for a service to factor in repairs and maintenance costs). This again highlights the need to adequately cost municipal services.

3. Enforcement of sound governance and financial management practice should be balanced against the costs of compliance, particularly in the case of poorer, rural municipalities.

(f) Municipal Capacity Issues

Skilled human capital is the engine of municipal service delivery, and in this regard, the Commission takes note the establishment of the Municipal Infrastructure Support Agency (MISA) to tackle capacity challenges. The establishment of MISA is in accordance with Section 154(1) of the Constitution and Section 34 of the Municipal Finance Management Act (MFMA) both of which envisage national and provincial government taking a proactive stance on the issue of capacity building in the local government sphere.

However in view of past failures of similar capacity building initiatives, (e.g. see the Commission submission on Siyenza Manje on http://www.ffc.co.za/index.php/submissions/commission-submissions.html), the Commission would cautiously welcome the establishment of the new agency. The Commission believes that for MISA to be successful, a number of preconditions need to be put in place first, e.g. MISA's own capacity, proper governance structures, and proper oversight by DCOG. The Commission is hopeful that MISA will spearhead a more coordinated and innovative approach to addressing municipal capacity challenges and that the risk of institutional fragmentation will be guarded against.

g. Other Issues

i. The Commission notes that climate change is increasingly becoming a formidable threat to infrastructure in general and local government in particular as mitigation and adaptation mechanisms are weak. The Commission welcomes government's commitment to the climate change agenda. However, the Commission is keen on seeing that these commitments are translated into well funded mitigation and adaptation programmes in the local sphere.

5. Government Response to the Commission's Recommendations

5.1 Government has accepted most of the recommendations made by the Commission. This section discusses certain of the recommendations made for which government partially responded or has classified as not accepted or partially accepted. The Commission seeks to clarify where necessary any misinterpretation of these recommendations by government.

5.2 The Commission recommended that national and provincial treasuries' efforts to improve the credibility of municipal budgets through annual benchmarking exercises should continue to be supported, the results of these evaluations be reported to Parliament and provincial legislatures, and placed in the public domain. This may incentivise effective financial management among municipalities.

(a) Government response: The benchmark processes are opportunities where national, provincial and municipal officials engage in robust and in-depth technical discussions on municipal budgets. The benchmarking documents are shared on an official level with institutions that form part of the benchmarking exercise, including the FFC, SALGA, and Department of Cooperative Governance. Broader circulation of these documents are however not advisable as the benchmarking processes are intended as technical support to municipalities but do not replace the formal budget processes of municipalities where budgets are approved by individual municipal councils. The formal budget process includes public consultation and adopted municipal budgets are made available to the public.

(b) The Commission is of the view that in the spirit of facilitating greater transparency and more active citizen participation, releasing this type of information can assist communities in holding their municipalities more accountable. This does not mean that technical or sensitive information is released, but a selection of relevant indicators, so that key trends can be tracked. *Government has already started moving in this direction – the publishing of individual school results in District Annual National Assessment results to inform parents, is an example thereof. To reduce duplication between parliament and government, it is important to share such information "results" as it would empower and apprise Committees of parliament making*

them more strategic in their role and allowing state organs to provide information to enhance their oversight role.

5.3 The Commission recommended that government should consider providing municipalities with a performance-based conditional grant, which rewards or incentivises actions that are environmentally efficient and responsive to the adaptation and mitigation challenges of climate change. The design of the proposed grant should pay attention to municipality specific factors, such as the area, topography, coastal/or otherwise, and vulnerability to climate change. Specific focus areas for this grant should include:

- Efficient water management practices, including the minimisation of water losses, effective asset management or rehabilitation programmes, and demand management;
- Efficient energy management practices, including the minimisation of electricity losses (unaccounted for electricity), the elimination of illegal connections and energy savings by both households and industry; and
- The implementation of green procurement principles.

(a) *Government response: The poor uptake of existing incentive grants shows that incentive grants are not the most efficient way to influence the behaviour of municipalities. There may be merit in a specific conditional grant to address major climate change related infrastructure requirements, e.g. coastal breakwaters or storm water management systems. However more research needs to be done as to how such a grant should be structured.*

(b) The Commission agrees that more work needs to be done on the structure of a climate change grant. However the poor performance of incentive grants may not necessarily originate from the incentive driven nature of the grant per se, but also from inappropriate design and implementation of the grants (e.g. inadequate differentiation between high capacity and low capacity municipalities). The Commission will continue to work on this matter and make further recommendations.

5.4 The Commission recommended that government should finalise the implementation of occupation specific dispensation and formalise the performance evaluation system.

In dealing with the expansion and implementation for occupational specific dispensation, government should:

- Be mindful of the rising public sector wage bill relative to other priorities;
- Rethink funding of personnel costs, which are centrally determined but funded by provinces through the equitable share. A full costing of the occupational specific dispensation implementation must be undertaken, and national government must take the responsibility for funding, preferably through a specific purpose conditional grant; and
- Formalise performance evaluation with the aim of boosting performance by emphasising high competence for education and health personnel.

(a) *Government response: Government is mindful of the rising public sector wage bill and works with the labour unions on the matters raised above. Government does not support the recommendation that national government must take full responsibility for funding personnel costs, especially through a conditional grant as these will create perverse incentives that will undermine government's efforts to address the above issues raised by the Commission.*

(b) The current dislocation of national policy from funding creates perverse incentives for national government not to exert wage discipline but to pass that on to the provinces. In addition, the provinces have insignificant own revenue sources. These two factors, coupled with poor financial management by municipalities has resulted in the volatile provincial over-spending episodes. The accountability framework has not addressed improper OSD implementation. The Commission's agree with governments on the principle matters although it differs with government on the solution to be adopted. The proposed approach to centralising the financing of the OSD through a specific purpose funding instrument is just but one proposal to the recommendation. There is a concern that human resource practices across board are not in place thereby crowding out service delivery and frontline workers from being hired. It is therefore an issue of how PERSAL can be turned into a strategic instrument y government.

5.5 The Commission recommended that increases in education spending should be directed towards investments that will have the biggest impact on quality, including learner and teacher support materials. In this regard, government should improve quality and prioritise epistemological access to education by:

- Developing capacity to evaluate the academic performance of learners throughout their academic careers;
- Ensuring that the required amount of time is spent on teaching by relieving teachers of administrative duties through the hiring of administrative assistants;
- Supporting the training and development of teachers and making explicit the amount spent for this purpose through the Division of Revenue; and
- Improving the accountability of schools for learner performance.

(a) Government response: The introduction of literacy and numeracy Annual National Assessments for Grades 3 and 6 is an important step towards enabling government to evaluate the performance of learners throughout their schooling. Government intends to extend these assessments to Grade 9, which will ensure that learner performance will be measured at the end of each educational phase. Assessing learner performance will only lead to improved performance if the system is able to use the results effectively. Government does not support the proposal to explicitly specify upfront the amounts to be spent for supporting training and development of teachers. Training and development in provinces is currently funded from their equitable share and provinces decide the amounts to be allocated for this purpose in line with their specific requirements.

(b) Our concern is that with Occupation Specific Dispensation (OSD) and general personnel spending pressures, these investments would be crowded out. Increasing the spend on these can also be fostered through setting explicit standards, costing those standards, benchmarking provinces and making this information available to Parliament and the legislatures. Specific performance targets could be set in the Annual performance plans (APP) and duly monitored by the Auditor General. The third quarter section 32 benchmark reports has also attested to the fact that provincial spending on capital, good and services have either stagnated or reduced to fund personnel costs in provinces. Government's response should therefore shed light into how they are going to hold provinces accountable to ensuring that these funds are allocated in line with their originally intended purpose. National Treasury is also responsible for the budget templates wherein they are able to encourage provinces to create line items to reflect on these allocations.

5.6 The Commission notes that the Government has not responded to issues raised on unfunded mandates which were contained as an Annexure in the Submission. In a related matter, the Commission is in receipt of a memorandum from SALGA that raises concerns on the impending implementation of AARTO in April, 2012 and potential implications on municipal finances. The Commission has requested information from the Department in terms of the Section (3) Financial and Fiscal Commission Act (2003) as amended.

6. Concluding Remarks

6.1 This submission on the Division of Revenue Bill by the Commission details and highlights the key issues emerging from the 2012 Budget Review and tries to link the issues with the Commission's recommendations that were tabled in May 2011. This approach is taken partly to enable Parliament to understand the extent to which its recommendations find resonance with Government's own direction and also to enable Parliament to be able to process the Bill and take on board the Commission's recommendations in accordance with the legislation.

6.2 The Commission continues to be concerned with the performance of some of the conditional grants and believes serious and far reaching reforms are in order. The Commission will be initiating a special project that takes a detailed look at a particular conditional grant and propose ways of how grant design and implementation could be enhanced. A report will be tabled with Parliament.

6.3 The Commission has agreed to develop a set of indicators of fiscal distress over time, to provide the early warning system tool to assist government in the management of provincial departments or municipalities in distress.

6.4 The Commission looks forward to engaging further with the Bill in accordance with the relevant legislation in the future.

For and on behalf of the Financial and Fiscal Commission

Mr Bongani Khumalo

Acting Chairperson/CE