

TABLE OF CONTENTS

Contents	2
Figures	5
Tables	8
Acronyms	10
Editorial	11

Part 1: Macroeconomic and Fiscal Outlook **13**

Chapter 1: South Africa's Transition to a Consolidated Budget	14
1.1 Introduction	14
1.2 Background and Methodology	14
1.3 Methodology	16
1.4 Results	16
1.5 Conclusion	18
References	19

Chapter 2: Fiscal Rules for South Africa	20
2.1 Introduction	20
2.2 What Are Fiscal Rules?	20
2.3 Why Fiscal Rules?	23
2.4 Fiscal Variables and the South African Economy	24
2.5 Design, Timing and Implementation of Fiscal Rules	28
2.6 International Experience	29
2.7 Recommendations	30
References	31

Chapter 3: Fiscal Imbalances and Intertemporal CGE Modelling	33
3.1 Introduction	33
3.2 Literature Review	34
3.3 Data Description	37
3.4 Model Description	40
3.5 Simulations and Results	43
3.6 Conclusion	47
References	47

Chapter 4: Realising Millennium Development Goals Through Intergovernmental Fiscal Transfers	50
4.1 Introduction	50
4.2 Status of MDG achievement in South Africa	51
4.3 Data Description	55
4.4 The Model Used	64
4.5 Results	69
4.6 Conclusion and Ongoing Work	77
References	77

Chapter 5: A Multi-Region General Equilibrium Analysis of Fiscal Consolidation	79
5.1 Introduction	79
5.2 The AGE Model	80
5.3 The Data	85
5.4 Conclusion	91
Annexure 5A Graphs and tables	92
References	93

Part 2: Vibrant Urban Economies	95
Chapter 6: How Effective, Credible and Sustainable are Local Government Budgets?	96
6.1 Introduction	96
6.2 Macroeconomic Environment and Economic Outlook	99
6.3 Local Government Budgetary Trends and Outcomes	100
6.4 Budget Analysis	114
6.5 Conclusion and Recommendations	119
References	121
Chapter 7: Estimating the Factors That Influence Municipal Expenditure	122
7.1 Introduction	122
7.2 Defining and Understanding Municipal Expenditure	124
7.3 Literature Review	126
7.4 Data Sources and Methodology	127
7.5 Model Estimations and Results	130
7.6 Conclusion	131
Annexure 7A	132
References	132
Chapter 8: Measuring the Efficiency of Local Government Expenditure: an FDH Analysis of a Sample of South African Municipalities	133
8.1 Introduction	133
8.2 Structure and Expenditure Performance of Local Government	134
8.3 Defining Economic Efficiency	138
8.4 Overview of Methodology and Data Sources	138
8.5 Review of Previous Empirical Studies	142
8.6 Research Limitations	143
8.7 FDH Analysis	143
8.8 Tobit Regression Analysis	147
8.9 Conclusion and Recommendations	151
Annexure 8A	152
References	153
Chapter 9: Municipal Consumer Debt in South Africa	155
9.1 Introduction	155
9.2 Literature Review	157
9.3 Overview of Municipal Consumer Debt in South Africa	159
9.4 Reasons for Non-Payment	162
9.5 Government's Response to Municipal Consumer Debt	164
9.6 Key Issues Requiring Attention	165
9.7 Conclusion and Recommendations	167
References	168
Chapter 10: Economic and Fiscal Costs of Inefficient Land-use Patterns	170
10.1 Introduction	170
10.2 Method 1: Current State of South African Cities	171
10.3 Method 2: Methodology to Measure City Efficiency	176
10.4 Summary of Findings	193
Annexure 10A Scenario Assumptions	198
References	199
Chapter 11: Impact of Current Land-use Patterns on Public Transport and Human Settlements	202
11.1 Introduction	202
11.2 Literature Review	203
11.3 Research Methodology	206

11.4	Current Challenges in Land Use and the Built Environment	206
11.5	Recommendations	215
	References	215
Chapter 12: Environmental Sustainability and Climate Change in the Local Government Sphere		218
12.1	Introduction	218
12.2	The State of the South African Environment	219
12.3	Literature Review	220
12.4	Methodology and Data Analysis	221
12.5	Results and Discussion	225
12.6	Dealing with Climate Change in the Local Government Sector	230
12.7	Conclusions and Recommendations	232
	References	233
Part 3: Improving Development Outcomes of the Intergovernmental Fiscal Relations System		237
Chapter 13: Budget Analysis and Exploration of Issues for Improved Performance in Basic Education		238
13.1	Introduction and Background	238
13.2	Methodology	239
13.3	Resource Allocation for Basic Education in South Africa	239
13.4	The Performance of Basic Education in South Africa	240
13.5	Learner Transport	245
13.6	Inclusive Education	245
13.7	Observations and Recommendations	245
13.8	Conclusion	248
	References	248
Chapter 14: Burden of Diseases, Health Financing and Fiscal Impacts		250
14.1	Introduction and Background	250
14.2	Literature Review	251
14.3	Performance of the Public Health Care System	252
14.4	Budget and Economic Analysis of Health Resource Allocations	253
14.5	Observations and Recommendations	257
14.6	Conclusion	258
	References	259
Chapter 15: The Impact of Unfunded Mandates in South African Intergovernmental Relations		261
15.1	Introduction	261
15.2	Legislative Framework for Transferring Powers and Functions	262
15.3	Literature Review	265
15.4	International Case Studies on Eliminating Unfunded Mandates	265
15.5	The Existence of Unfunded Mandates	270
15.6	The Impact of Unfunded Mandates between Spheres of Government	272
15.7	Observations	274
	Annexure 15A Summary Tables	276
	References	279

LIST OF FIGURES

Figure 1.1	Framework	15
Figure 1.2	The effects of different fiscal consolidation paths on public debt, output gap and output volatility	17
Figure 1.3	Impulse responses of GDP, debt and interest rate to a fiscal shock	18
Figure 2.1	South African fiscal indicators (% of GDP)	22
Figure 2.2	Equivalent variation of initial consumption expenses (%)	27
Figure 2.3	Variation in Theil indices (%)	27
Figure 3.1	Share of grouped sectors in GDP	38
Figure 3.2	Source of income for households	39
Figure 3.3	Sources of income for government	40
Figure 3.4	Simulation 1 – Impact of increased public current expenditure on debt-to-GDP ratio (BAU = 1)	44
Figure 3.5	Simulation 1 – Impact of increased public current expenditure on deficit-to-GDP ratio (BAU = 1)	44
Figure 3.6	Simulation 2 – Impact of increased public investment on debt-to-GDP ratio (BAU = 1)	46
Figure 3.7	Simulation 2 – Impact of increased public investment on deficit-to-GDP ratio (BAU = 1)	46
Figure 3.8	Simulation 2 – Impact of increased public investment on GDP (BAU = 100)	46
Figure 3.9	Simulation 2 – Impact of increased public investment on debt-to-GDP ratio (BAU = 1)	47
Figure 4.1	Share of grouped sectors in GDP	56
Figure 4.2	Source of income for households	58
Figure 4.3	Sources of income for government	59
Figure 4.4	Total headcount enrolment in tertiary education, 1986–2007	61
Figure 4.5	Impact on MDG4	70
Figure 4.6	Impact on MDG5	70
Figure 4.7	Impact on MDG6	71
Figure 4.8	Impact on domestic borrowing	71
Figure 4.9	Impact on GDP (at basic prices)	72
Figure 4.10	Impact on MDG4	73
Figure 4.11	Impact on MDG5	73
Figure 4.12	Impact on MDG2	73
Figure 4.13	Impact on the domestic borrowing	74
Figure 4.14	Impact on GDP (at basic prices)	75
Figure 4.15	Impact on MDG4	75
Figure 4.16	Impact on MDG5	76
Figure 4.17	Impact on MDG2	76
Figure 4.18	Impact on GDP	77
Figure 5.1	Schematic representation of the IMAGE model	80
Figure 5.2	Structure of the interregional trade in goods and services	82
Figure 5.3	Interregional mobility of factors	83
Figure 5.4	National Government spending-to-income ratio by region (%)	87
Figure 5.5	Equivalent variation of initial consumption expenses (%)	88
Figure 5.6	Variation in Theil indices (%)	88
Figure 5.7	Change in GDP (%)	90
Figure 5.8	Unemployment rates by province (%)	93
Figure 6.1	Number of Service Delivery Protests in South Africa	97
Figure 6.2	Macroeconomic indicators	100
Figure 6.3	Real municipal capital expenditure (R'000)	101

Figure 6.4	Real per capita capital expenditure (rands)	101
Figure 6.5	Per capita capital expenditure and economic growth rates (%)	102
Figure 6.6	Capital expenditure shares for all municipalities (%)	103
Figure 6.7	Per capita capital expenditure by function	103
Figure 6.8	Real operating expenditure (R'000)	104
Figure 6.9	Per capita operating expenditure (rands)	105
Figure 6.10	Per capita operating expenditure and economic growth rates (%)	105
Figure 6.11	Actual expenditure on repairs and maintenance relative to budgeted amounts 2003/04–2008/09	108
Figure 6.12	Division of revenue between spheres of government	109
Figure 6.13	Growth in property rates	112
Figure 6.14	Growth rate of grants and own revenue (%)	113
Figure 6.15	Aggregate operating expenditure, budgeted versus outcomes, 2003/04–2008/09 (R'000)	115
Figure 6.16	Credibility of budgeted versus actual capital expenditure, 2003/04–2008/09 (in R'000)	117
Figure 6.17	Expenditure and own-revenue growth rates	118
Figure 8.1	Composition of municipal operating expenditure (%), 2008/09	137
Figure 8.2	Composition of municipal capital expenditure (%), 2008/09	137
Figure 8.3	Production possibility frontier and technical efficiency	139
Figure 8.4	FDH of a given sample	140
Figure 8.5	Best practice frontier, 2008/09	146
Figure 9.1	Disaggregation of municipal consumer debt by customer grouping (R'000)	161
Figure 9.2	Average municipal consumer debt according to income source (R'000)	161
Figure 9.3	Reasons for non-payment of water, 2004–2008	162
Figure 9.4	Period for which municipal consumer debt was outstanding, 2004/05–2009/10	165
Figure 10.1	Historical, current and future transport expenditure (R million), 2006–2013	173
Figure 10.2	Example of a hypothetical city with sample development zones	177
Figure 10.3	Framework for financial flows in South African cities	178
Figure 10.4	Total recurrent cost for the hypothetical city (R million)	184
Figure 10.5	Recurrent costs broken down by financial 'actor' (R million)	185
Figure 10.6	Average recurrent household expenditure by income category (R)	186
Figure 10.7	Household expenditure breakdown by zone – year 1 (%)	186
Figure 10.8	Household expenditure breakdown by zone – year 10 urban sprawl scenario (%)	187
Figure 10.9	Household expenditure breakdown by zone – year 10 compact city scenario (%)	187
Figure 10.10	Total capital investment over ten years for the two growth scenarios (R million)	188
Figure 10.11	Total capital investment in housing/buildings over ten years, by income group (R million)	188
Figure 10.12	Total capital investment over ten years by financial 'actor' (R million)	189
Figure 10.13	Total capital investment over ten years by service and financial 'actor' (R million)	190
Figure 10.14	Housing subsidies for low-income households over ten years (R million)	190
Figure 10.15	Transport capital subsidies over ten years (R million)	191
Figure 10.16	Infrastructure subsidies over ten years (R million)	192
Figure 10.17	Environmental impacts	193
Figure 10.18	Projected total capital and recurrent costs for six South African metros under two growth scenarios (R million), 2010–2050	197
Figure 11.1	Population density in South African major cities and other cities in developing countries	208
Figure 11.2	Comparison of cities' annual growth, 2006–2020 (%)	209
Figure 11.3	Variations in household size between inner and outer cities	210
Figure 12.1	GHG emissions in South Africa	219
Figure 12.2	GHG emissions as a percentage of GDP in South Africa	220

Figure 12.3	Causal-loop diagram	222
Figure 12.4	Lowess estimation of Water and Rainfall variability	226
Figure 12.5	Lowess estimation of Electricity and Rainfall variability	226
Figure 12.6	Predicted average expenditures for different levels of rainfall variability	229
Figure 12.7	Changes in predicted average expenditures for different levels of rainfall variability	229
Figure 13.1	Highest level of education among population aged 20 years and above, 1996, 2001 and 2007	240
Figure 13.2	Gross enrolment ratio in South Africa	240
Figure 13.3	Grade 12 pass rates in South Africa	240
Figure 13.4	Mathematics pass rates (2008–2010)	243
Figure 13.5	Physical Science pass rates (2008–2010)	243
Figure 14.1	Government spending trends on policy priorities, 1995/96–2011/12	254
Figure 14.2	Causes of infant mortality in South Africa, 2000–2005	255
Figure 14.3	Ratios for health services in South Africa	256

LIST OF TABLES

Table 2.1	Summary of tax elasticities for South Africa	25
Table 2.2	Summary of revenue elasticities for South Africa	25
Table 3.1	The impact of an increase in the stock of public capital on output	35
Table 3.2	The impact of an increase in the stock of public capital on output in South Africa	36
Table 3.3	Summary of revenue elasticities for South Africa	37
Table 3.4	Activities in the SAM	38
Table 3.5	Sectoral value added in GDP in 2005	39
Table 3.6	Simulation 1 – Impact of increased current public expenditures on macroeconomic variables (deviation from BAU in %)	44
Table 3.7	Simulation 2 – Impact of increased public investment (2011 to 2015) on macroeconomic variables (deviation from BAU in %)	45
Table 4.1	South Africa – Millennium Development Goals, 1990–2015	51
Table 4.2	Activities in the SAM	56
Table 4.3	Share of sectoral value added in GDP in 2005	57
Table 4.4	Repartition of the value added between factors	57
Table 4.5	Sources of income for households (in %)	58
Table 4.6	Structure of households’ spending	59
Table 4.7	Structure of its expenditures	59
Table 4.8	Levels of government spending and shares	60
Table 4.9	Levels and share of different education cycles in education spending	60
Table 4.10	Repetition rates in 2008	60
Table 4.11	Enrolment in public schools in 2005	61
Table 4.12	Enrolment in private schools in 2005	61
Table 4.13	Years in school cycles	62
Table 4.14	Learners entering Grade 1 for the first time, by age, 1997–2005 (%)	62
Table 4.15	Shares of students’ behaviours	63
Table 4.16	Interest accounting matrix 2005	64
Table 4.17	Impact on government spending (in % compared to BAU)	70
Table 4.18	Impact on unemployment rate in 2015 (in %)	71
Table 4.19	Impact on households (in % compared to BAU)	71
Table 4.20	Impact on government (in % compared to BAU)	71
Table 4.21	Impact on investment (in % compared to BAU)	72
Table 4.22	Impact on government’s consumption on health services (in % compared to BAU)	72
Table 4.23	Impact on unemployment rate in 2015 (in %)	74
Table 4.24	Impact on households (in % compared to BAU)	74
Table 4.25	Impact on government (in %, compared to BAU)	74
Table 4.26	Impact on investment (in % compared to BAU)	74
Table 4.27	Impact on households (in % compared to BAU)	76
Table 4.28	Impact on government (in % compared to BAU)	77
Table 4.29	Impact on investment (in %, compared to BAU)	77
Table 5.1	Percent change in EV of initial consumption expenses, low scenario	89
Table 5.2	Percent change in EV of initial consumption expenses, high scenario	89
Table 5.3	Percent change in revenues, low scenario	90
Table 5.4	Percent change in revenues, high scenario	91
Table 5.5	Dimension of the regional SAMs	92
Table 5.6	Income elasticity of consumption products	92
Table 5.7	Armington elasticities	92
Table 6.1	Access to basic services	96
Table 6.2	Audit opinions	97
Table 6.3	Categorisation of municipalities	99
Table 6.4	Performance of key sectors of the economy	100
Table 6.5	Spending on conditional grants	104
Table 6.6	Actual operating expenditure by function	106
Table 6.7	Actual capital revenue	110
Table 6.8	Actual operating revenues shares	111

Table 6.9	Testing for crowding-out effects (independent variable: municipal own revenue)	114
Table 6.10	Credibility of operating expenditure disaggregated by municipal category, 2003/04–2008/09	115
Table 6.11	Budgeted versus actual revenue derived from service charges, 2003/04–2008/09 (in %)	116
Table 6.12	Budgeted versus actual capital expenditure by municipal category, 2003/04–2008/09	117
Table 6.13	Sustainability ratio per municipal category	119
Table 6.14	Sustainability ratio per type of municipality	119
Table 7.1	Municipal operating and capital expenditure 2003/04–2008/09	124
Table 7.2	Operating expenditure per line item	125
Table 7.3	Expenditure, demographic, social and economic profiles of municipalities, 2007/08	126
Table 7.4	Estimation results – robust standard errors estimation, 2007/08	130
Table 8.1	Budgeted and actual expenditure per municipality type, 2008/09	136
Table 8.2	Types of economic efficiency	138
Table 8.3	Efficient municipalities (%), 2005/06–2008/09	145
Table 8.4	Top ten efficiency scores (%), 2005/06–2008/09	145
Table 8.5	Ten least-efficient municipalities (%), 2005/06–2008/09	146
Table 8.6	Tobit regression results	149
Table 9.1	Municipal reporting on consumer debt, 2004/05 to 2009/10	156
Table 9.2	Real average municipal consumer debt per municipal category, 2004/05–2009/10 (R'000)	160
Table 9.3	Real average municipal consumer debt as a proportion of real average operating revenue, 2004/05–2009/10 (%)	160
Table 9.4	Summary of government-led policy interventions	164
Table 10.1	Comparing efficiency of South African and international cities	171
Table 10.2	Service backlogs and deadlines for eradication	174
Table 10.3	Economic growth rate used in CECM model (%)	181
Table 10.4	Household growth rates used in CECM model (%)	181
Table 10.5	Subsidised housing delivery assumptions	181
Table 10.6	Assumed type of housing delivery for each scenario (%)	181
Table 10.7	Default characteristics of housing typologies	182
Table 10.8	Real increase municipal property rates over ten years (%)	182
Table 10.9	Real cost increases over ten years (%)	182
Table 10.10	Basis for infrastructure operating subsidy assumptions	183
Table 10.11	Basis for infrastructure capital subsidy assumptions	184
Table 10.12	Transport operating subsidy assumptions (%)	184
Table 10.13	Transport capital subsidy assumptions (%)	184
Table 10.14	Sensitivity analysis on total capital cost versus land cost increases	189
Table 10.15	Summary of state contributions (subsidies) in year 10	195
Table 10.16	Summary of city contributions in year 10	196
Table 10.17	Summary of total government contributions in year 10	196
Table 11.1	Land-use categories	203
Table 11.2	Indicators and urban development models	204
Table 11.3	Purpose for weekday trips, by settlement type (%) in 2003	207
Table 11.4	Trip purpose by gender (%) in 2003	207
Table 11.5	Urbanisation in South African major cities	210
Table 11.6	Percentage of monthly household income spent on public transport, 2001	211
Table 12.1	Definition and descriptive statistics of the variables used in the econometric model	225
Table 12.2	Pooled and random effects regression results for water and electricity models	227
Table 12.3	Distribution of water	231
Table 13.1	Quintile 1 schools with a pass rate of 10% or less in 2009	242
Table 13.2	Quintile 1 schools with a pass rate of 10% or less in 2010	242
Table 13.3	Independent school statistics by province, 2009	244
Table 14.1	Health 10 Point Plan	250
Table 14.2	The revised provincial equitable share formula for the 2011 MTEF	252
Table 14.3	Consolidated funding flows in the South African health sector	253
Table 14.4	Comparison of health care expenditure and health status indicators in developed and developing countries	254
Table 14.5	Medical personnel and hospital facilities utilisation rates in developed and developing countries	256
Table 15.1	The role of each sphere of government and legislation for the assignment of functions	262
Table 15.2	Unfunded mandates by Metropolitan Municipality (nominal terms)	272
Table 15.3	Unfunded mandates by Province and Department – 2011/12	274

ACRONYMS

ALGA	Australian Local Government Association
BPF	best practising frontier
BRT	bus rapid transit
CAB	cyclically adjusted budget balance
CBDs	central business districts
CECM	city efficiency costing model
CFO	chief financial officer
CoGTA	Department of Corporate Governance and Traditional Affairs
DBSA	Development Bank of Southern Africa
DEA	data envelopment analysis
DFA	Development Facilitation Act
DMU	decision-making unit
DoH	Department of Health
DoHS	Department of Human Settlements
DOR	Division of Revenue
FBS	free basic services
FDH	free disposable hull
FFC	Financial and Fiscal Commission
FLISP	Finance-Linked Individual Subsidy Programme
GDP	gross domestic product
GEAR	Growth Employment and Reconstruction Programme
GER	gross enrolment rate
GHG	greenhouse gases
GPI	Gender Parity Index
GVA	gross value added
IGFR	Intergovernmental fiscal relations
IGRT	Intergovernmental Revenue Transfers
LES	local government equitable share
LGTAS	Local Government Turnaround Strategy
LUMB	Land Use Management Bill
MDG	Millennium Development Goal
MFMA	Municipal Finance Management Act
MHS	Municipal Health Services
MIG	Municipal Infrastructure Grant
MSA	Municipal Systems Act
MSFM	Municipal Services Finance Model
MTEF	Medium-Term Expenditure Framework
NFC	non-financial census
NGO	non-governmental organisation
NGP	New Growth Path
NHI	national health insurance
NSDP	National Spatial Development Perspective
OECD	Organisation for Economic Cooperation and Development
OLS	ordinary least squares
OSD	occupational specific dispensation
PES	Provincial Equitable Share
PIE	Prevention of Illegal Evictions from and Unlawful Occupation of Land
PFMA	Public Finance Management Act
PPF	production possibility frontier
PRASA	Passenger Rail Agency of South Africa
SALGA	South African Local Government Association
SBB	structurally adjusted budget balance
SFA	stochastic frontier analysis
SPLUMB	Spatial Planning and Land Use Management
SSA	sub-Saharan Africa
StatsSA	Statistics South Africa
USDG	Urban Settlements Development Grant

EDITORIAL

The Financial and Fiscal Commission (the Commission) provides independent, impartial advice and recommendations on intergovernmental fiscal relations, including the technical evaluation and design of provincial and local fiscal and economic policy. Established by the Constitution of South Africa in 1994, the Commission provides information to all organs of state to help them make informed decisions about complex fiscal issues. In this respect, one of the Commission's main objectives is to help inform the following year's budget by making recommendations on the Division of Revenue among the three spheres of government, as well as recommendations to support government's policy-making on intergovernmental fiscal relations. It does this by submitting annually to Parliament an advisory document summarising the recommendations for the following year, which the executive should take into account when crafting the next budget. This submission for the Division of Revenue is made in terms of Section 214(2) and Section 229(5) of the Constitution, and Section 9 of the Intergovernmental Fiscal Relations Act of 1999.

In May 2011 the Commission tabled with Parliament its latest Submission Document for the Division of Revenue 2012/13. This volume of technical research reports is published as a companion document to that Submission Document. The volume taken as a whole argues that, although South Africa is recovering from the recession induced by the 2008/2009 global economic crisis, unemployment, poverty, inequality and low growth persist. Poverty is still high among African and female-headed households, despite an unprecedented extension of government social grants that have helped to reduce absolute poverty. Poor educational and health outcomes are similarly skewed against the poor. Distorted settlement patterns, which mean that the poor often locate at the urban periphery and in remote rural areas, further exacerbate the challenges. By international standards South African cities are inefficient, as measured by low-density development, high travel times and distances, and high carbon footprints.

The vulnerability of cities implies that a large proportion of South Africa's population and the bulk of economic activity residing there are exposed to climate change-related hazards. While all income groups are worse off financially because of an inefficient urban form, low-income households are most adversely affected by the urban sprawl, having to pay significantly more for transport. There are therefore enormous challenges to face in upgrading human capital skills and well-being, while addressing spatial distortions that are reinforcing the social ills. These challenges are made more urgent by the realisation that the dates for attaining the Millennium Development Goals – many of which are directly linked to issues that provinces have a constitutionally assigned mandate to deliver on – are a mere four years away. While some targets have already been achieved, some gaps remain, particularly in child and maternal mortality, and the environment.

A direct impact of the 2008/2009 recession is the availability of revenue for division among the three spheres of government, as the growth in sub-national government baselines can be expected to slow down considerably. Because sub-national governments have their own strategic goals to deal with within their mandates over the short to medium term, these goals will now need to be adjusted or delayed for later implementation, or (where funds are locked into the provision of basic services), the funds will now buy less basic services than before, especially for the poor. As the cost of services increases (e.g. electricity, water and food) austerity can be expected to lead to reduced growth in budgets, with the result that fewer services will be provided, or the quality of existing services will be reduced. It therefore becomes important to develop strategies that emphasise a need to protect programmes (such as those for combating HIV/AIDS) from being underfunded or re-prioritised downwards.

At the national level, ever larger social reforms are being proposed to address the problems of poverty, growth and inequality. The national health insurance (NHI) promises to be the largest reform yet undertaken in the health sector since the end of apartheid. Cabinet also approved the New Growth Path for South Africa, launched in October 2010, which aims to accelerate the creation of decent jobs and the reduction of inequality and poverty. There is, by definition, a tension between fiscal restraint and finding resources for the expenditure needs of all three spheres of the government, including these big social programmes.

The Commission's perspective is that staying the course and delivering on the constitutional imperatives is critical to sustaining the current growth momentum. The bedrock of sustainable growth is macroeconomic stability. Maintaining macroeconomic stability, as characterised by low inflation, stable interest rates and a comfortable balance of payments, is critically dependent on redressing fiscal imbalances, re-prioritising and getting full value for money spent. On the way forward to fiscal responsibility and attaining constitutional imperatives, two important qualifications are necessary. First,

fiscal correction is needed, not just at central government level but also in the provinces and local governments. Second, macroeconomic stability is necessary but not sufficient for sustaining and accelerating growth. Attention needs to be paid not only to achieving the targets in quantitative terms but also to the quality of adjustment, which means in particular, improving both the allocative and technical efficiencies of public expenditures. This year's Technical Report explores alternative approaches to tackling these pressing issues from an intergovernmental fiscal relations perspective.

The volume is in three parts. Part 1 is on Macroeconomic and Fiscal Outlook and consists of five chapters. It sets out the background for the report and sketches alternative fiscal policy adjustment paths. Four main observations are made regarding fiscal policy and economic outlook. First, the gap between spending and revenues is likely to remain wide even though the country has emerged from the 2008/09 global economic crisis. Second, fiscal policy cannot be put on a sustainable path just by eliminating waste and inefficiency; further policy changes are needed for consolidation. Third, policy-makers face difficult trade-offs in deciding how quickly to implement policy changes that would reduce future budget deficits. Fourth, the greater focus on job creation and meeting MDGs poses fiscal risks that need to be managed.

Part 2's theme is Vibrant Urban Economy and comprises seven chapters, which focus on local government issues, giving specific attention to the role and conduct of municipalities in their unique spatial environments. Like most aspects of South African society, municipalities are diverse and operate in unique social, demographic and economic spaces. These unique characteristics significantly affect municipal performance and the strategies required to ensure a well-functioning local government sphere. Sustainable development is anchored in a well-functioning local government sector and, in particular, vibrant urban economies, which spur robust developments in all areas of the economy, including rural areas.

Part 3 of the submission consists of three chapters under the theme of Improving Development Outcomes of the IGFR (intergovernmental fiscal relations) System. An argument is made that provinces need to exercise increased fiscal responsibility in the context of government's overall fiscal consolidation stance. This implies slower growing Medium-Term Expenditure Framework allocations coupled with cost pressures (e.g. for occupation specific dispensation – OSD), as well as rising demand for services. In this regard, improving the quality and efficiency of services in education, health and rural development are central. Government should protect such services within existing medium-term allocations so as to cushion the effects of the fiscal consolidation on the most vulnerable and to assist in building the human and social capital critical for future growth development.

Ensuring intergovernmental fiscal institutional arrangements that can robustly and flexibly support these goals would include effectively using equitable and conditional grant allocations, as well as management arrangements of other division of revenue-related issues such as OSD. The issue of unfunded mandates – and the financial (legal) impact on housing, health and library services – and improving assignment of powers/functions becomes critical for service delivery and human capital development. In this regard, the Commission is of the view that what is central is the extent to which such goods or services can be delivered efficiently and, if not, whether or not appropriate mechanisms and/or incentives can be put in place to ensure efficient delivery.