MEDIA RELEASE

Submission for the 2017/18 Division of Revenue

For an Equitable Sharing of National Revenue

30 May 2016

Financial and Fiscal Commission
Montrose Place (2nd Floor), Bekker Street,
Waterfall Park, Vorna Valley, Midrand,
Private Bag X69, Halfway House 1685
www.ffc.co.za
Tel: +27 11 207 2300
Fax: +27 86 589 1038

[30 May 2016] On 27 May 2016, the Financial and Fiscal Commission (the Commission) tabled at Parliament its Annual Submission for the Division of Revenue. The Submission is made in terms of Section 214(1) of the Constitution of the Republic of South Africa (1996), Section 9 of the Intergovernmental Fiscal Relations Act (1998) and Section 4(4c) of the Money Bills Amendment Procedure and Related Matters Act (2009).

This Submission is part of the Commission’s constitutionally defined processes, to advise Parliament and state organs on how the money collected by national government should be allocated fairly and equitably among the three spheres of government, to enable them to carry out their constitutional and other legal mandates. Intergovernmental fiscal transfers are a dominant feature in South Africa, as the bulk of government revenue is raised at national level and then allocated to subnational government (municipalities and provinces) through the equitable share and other grants.

Eight years after the 2008 global economic and financial crisis, South Africa’s economy remains vulnerable to slow global recovery and, increasingly, to domestic factors. The mining and manufacturing sectors, which are major exporters, are shrinking and beset by strikes. Compounding an already dire economic situation is one of the worst droughts in 35 years, which has led to a steep decline in agricultural output. As a result, South Africa is having to import (rather than export) maize. The problem is further aggravated by the exchange rate’s sharp depreciation, which has driven up other food import prices, in particular wheat. Rising food prices affect poor households the most, especially within rural provinces and municipalities, while the sluggish economy means that unemployment rates have remained high. This fragile economic growth is a significant threat to the future prioritisation of rural development initiatives. Put simply, South Africa’s current economy is not strong enough to sustain the tax burden needed to fund infrastructural programmes that stimulate demand and create employment in rural areas.

Rural areas cover 80% of South Africa’s land and are home to almost 40% of the population. Although poverty and economic deprivation have reduced significantly since 1994, rural areas lag behind the country as a whole. Despite increased funding, rural regions are not performing as well as urban areas, and the unemployment rate, particularly among the youth, in rural areas is much higher than the national unemployment rate. Poverty is a manifestation of under-development emanating from a range of factors including historical legacies, under-investment and structural issues. As a result of historical social engineering policies and weak regional economies, rural areas carry the highest burden of poverty. This burden imposes additional demands for services and funding on rural provinces and municipalities.

Government has recognised the need for integrated rural development – one of the key objectives of the National Development Plan (NDP) is an "Integrated and Inclusive Rural Economy" by 2030, while rural development is one of the priority areas identified in the Medium Term Strategic Frameworks (MTSF) of 2009–2014 and 2014–2019. However, this new approach has not yet been accompanied by a substantial reallocation of resources. Part of the problem is that, like many other countries, South Africa does not have a government-wide, officially agreed and accepted definition of "rural". This lack of a common definition has led to a plethora of rural development programmes across government departments.

To date, the fiscal framework has not had a significant impact on rural development for various reasons, including (a) the transfer system from national government; (b) uncollected property rates and/or service charges that are not cost-reflective; (c) leakages, including bad management, inefficient procurement, under-spending and institutional challenges. The Submission provides evidence on how improving the efficiency of intergovernmental fiscal relations can assist national government, public entities, provinces and municipalities to stimulate rural development through prioritising public investments and interventions.

Rural development is a complex process and is not just about agricultural development, as agriculture contributes less than 3% to South Africa's economy. Indeed farm families increasingly rely on off-farm employment and social grants. Therefore, land reform needs to go beyond agriculture and farm-based activities. Rural areas require new economic engines and initiatives that seek to expand industrial activities, enhance agricultural productivity, and foster greater production linkages within agro-processing industries.

Given this complexity, rural development requires proper coordination among the institutions and departments involved. Coordination is needed at both local level and between national and subnational governments, to integrate sectoral approaches, to involve private partners and to achieve the appropriate geographic scale. Public entities, such as state-owned companies (e.g.

Eskom, Telkom) and development finance institutions (e.g. Land Bank, Industrial Development Corporation) also have a responsibility to support rural development. However, they invest modestly in rural areas and do little to crowd in the private sector.

Perhaps the most challenging aspect of rural development is ensuring that provinces and municipalities are well funded, through own revenues and transfers from nationally collected revenue. Rural provinces have limited economic activity and a narrow tax base, which means that they rely heavily on central government for funding. As a result, they have little spending discretion (i.e. ability to direct resources towards province-specific needs). While the principle of supporting the poorer regions or provinces through grants or special projects is generally well-supported, there is no agreed method for determining poverty levels and related needs among regions. In addition, government's current rural strategies are often sector-based and do not allow for the different developmental needs of rural regions, many of which depend on exploiting special local resources. For example, policies to encourage rain-fed activities, such as livestock and cropping, are clearly not suitable for all areas. This sector-based approach, coupled with the lack of intergovernmental coordination, has led to the two main rural grants servicing the same target audience and funding the same activities. Greater alignment is needed between the land reform programme and other rural development policies.

Like rural provinces, the majority of municipalities in rural areas depend heavily on transfers to fulfil their mandate. This is in part because they have limited scope for economic diversification, deficient services and infrastructure, and declining revenue bases because of high unemployment and population losses through migration. In addition, rural municipalities face the dilemma of expanding expenditure requirements, including caring for the farm dwellers and workers who are evicted from farms – these evictions are the unintended consequences of laws introduced since 1994 to regulate the rights of farm workers. Municipalities have to use their own funds because currently the intergovernmental fiscal instruments do not cater for evictions.

The theme of the Submission for the 2017/18 Division of Revenue is ***the Intergovernmental Fiscal Relations System and Rural Development in South Africa***. The Submission provides evidence on how improving the efficiency of intergovernmental fiscal relations can assist national government, provinces and municipalities to stimulate rural development through prioritising public investments and interventions.

The Commission's recommendations for the 2016/17 Division of Revenue cover:

- Conditions for creating prosperity in rural areas through agriculture-led growth.
- The role of agriculture and non-agricultural linkages in enabling economically, socially and environmentally balanced regional development.
- Measures to improve land reform impacts on rural development.
- Public entities as drivers of infrastructure-led growth in rural areas.
- Fiscal arrangements for funding rural development mandates of provinces.
- Fiscal arrangements for funding rural development mandates of local and district municipalities.
- Job creation in rural areas through public works programmes.
- Farm evictions and their negative impact on rural municipal finances
- The development of new sources of municipal income.
- Effectiveness of sanitation fiscal instruments in enhancing rural development.

If managed properly, fiscal reforms for rural development can bring about greater inter-regional equity and potential economic growth. While the focus of this Submission is on rural areas, the debate should not be an "either-or-choice" between urban and rural development, as both exist in parallel throughout South Africa. The Commission is also interested in urban development, as both rural and urban regions can contribute to national growth and poverty alleviation.