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Briefing on the Submission for 2014/15 Division of Revenue

22 November 2013

For an Equitable Sharing of National Revenue

BACKGROUND

- Submission made in terms of:
  - Section 214(1) of the Constitution (1996)
  - Section 9 of the Intergovernmental Fiscal Relations Act (1998)
  - Section 4(4c) of the Money Bills Amendment Procedure and Related Matters Act (Act 9 of 2009)
- Overarching theme underpinning Submission: **“Fiscal Levers for National Development”**
  - Submission divided into 3 interrelated parts: national, provincial, local

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FISCAL LEVERS FOR NATIONAL DEVELOPMENT

National levers for inclusive growth in a post crisis fiscal response

- Budget Consolidation in SA
- Economic and Social Value of Social Grants
- Funding of SA FET Sector
- Financing Research in Higher Education
- Evolution of Conditional Grants

Provincial fiscal levers: State capability and performance

- Assessing and Improving Fiscal Performance of Provinces
- Managing the Provincial Wage Bill to Contain Fiscal Stress and Build a Capable State
- Effective Devolution of Transport Functions to Municipalities
- Effective Intergovernmental Planning and Budgeting

Collaborative governance for effective and sustainable municipalities

- Measuring Fiscal Stress in SA Local Government
- Improving Performance of Municipalities through Performance Based Grants
- Challenges, Constraints and Best Practices in Maintenance and Rehabilitation
- A Collaborative Effort to Enhance Revenue Generation in Rural Municipalities

1. Budget Consolidation In South Africa

- Following 2008/09 crisis, economic recovery has been slow and further exacerbated by inability of the economy to create jobs and other factors (recent industrial unrest and credit downgrades)
- Premise of the research: sound public finances are a prerequisite for sustainable economic growth and for maintaining welfare
  - "Growth-friendly" fiscal consolidation can create a solid foundation for long term economic development in SA
- Question: Should SA government be pursuing spending cuts (and if so, what spending cuts?) and/or tax increases (and if so, what tax increases?) in order to consolidate its budget?

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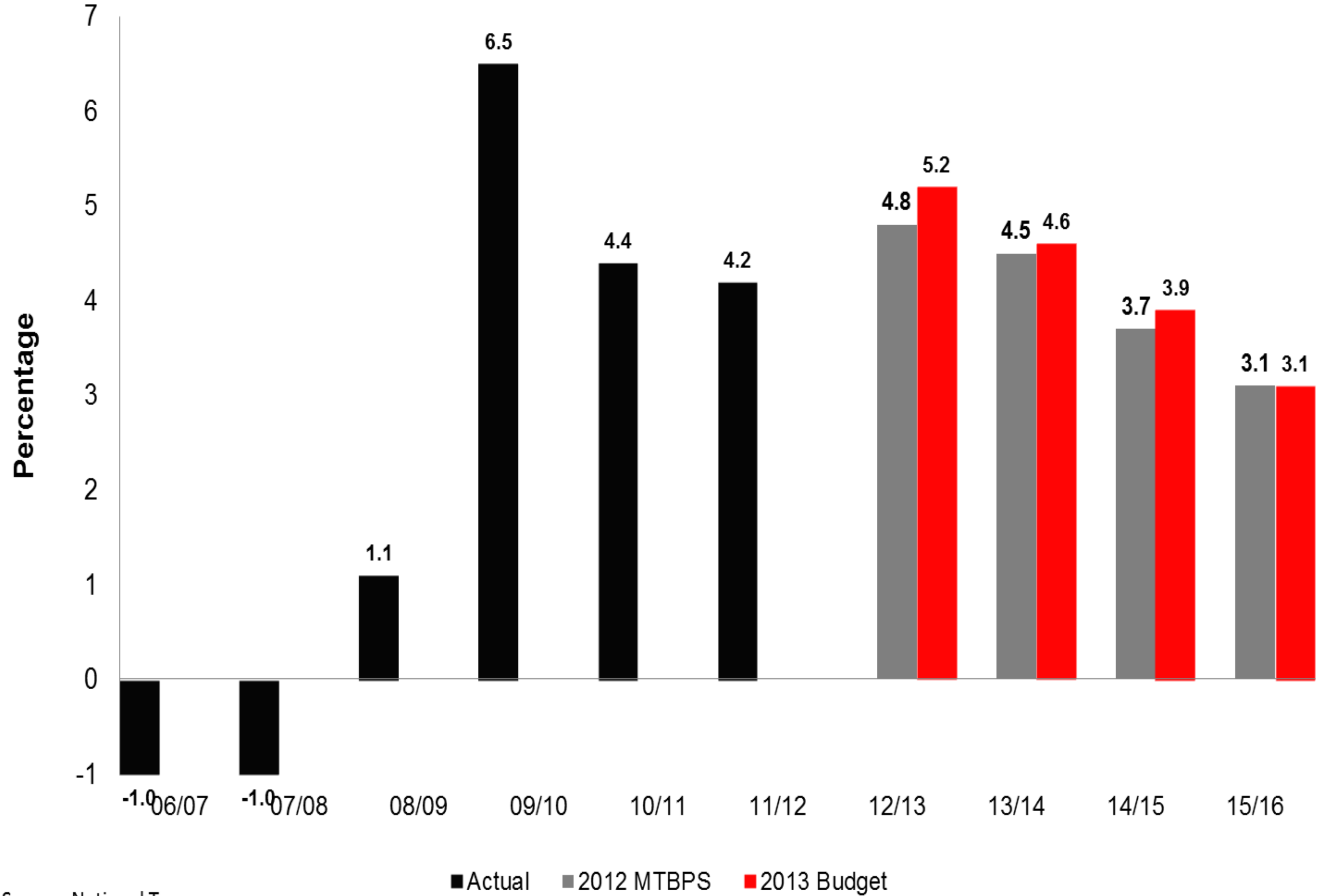
Budget deficit as a percentage of GDP



Source: National Treasury

Fiscal Consolidation: Pros and Cons

Pros

- Process is contractionary (austerity) and eliminates potential to respond to current market conditions and trigger growth
- Costly to implement (↓ AD in ST, higher unemployment)
- Difficult to implement
- Output (GDP) can decrease faster than decrease in debt (implications for debt-to-GDP ratio)

Cons

- Process is difficult but end result is beneficial for all
- Can increase economic growth (credible commitment to austerity increases investor confidence and decreases interest rates)
- Can be expansionary (expect lower taxes in the future, thus encourages private spending)

Both proponents agree that fiscal consolidation can be beneficial in certain instances - what are those instances in the case of SA?

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RECOMMENDATIONS

- Government should continue its efforts to moderate growth in expenditure components such as the public sector wage bill (which constitutes 60% of government expenditure), as decreases in government expenditure increase probability of a successful fiscal consolidation in SA
  - More effort must be made to improve effectiveness of public finances, through greater and more rigorous oversight to ensure elimination of fruitless, wasteful, and unauthorised expenditure, and corrupt practices in managing public finances
- Government to explicitly consider economic growth as an important factor for fiscal consolidation in SA
  - The most obvious manner in which SA could improve its fiscal situation is if the economy grew faster
    - This would help generate higher growth in tax revenue and thus budget deficits could decline a lot faster, and public debt would begin to reduce accordingly

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2. Economic and Social Value of Social Grants

- SA an upper-middle income country yet social indicators resemble that of a lower-income country
- Government has followed policies that promote poverty alleviation without ameliorating unemployment
- Given social deprivation and limited fiscal space, is it time to reform Child Support Grants (CSG)? Are there enough steps being taken to include eligible children in the system?

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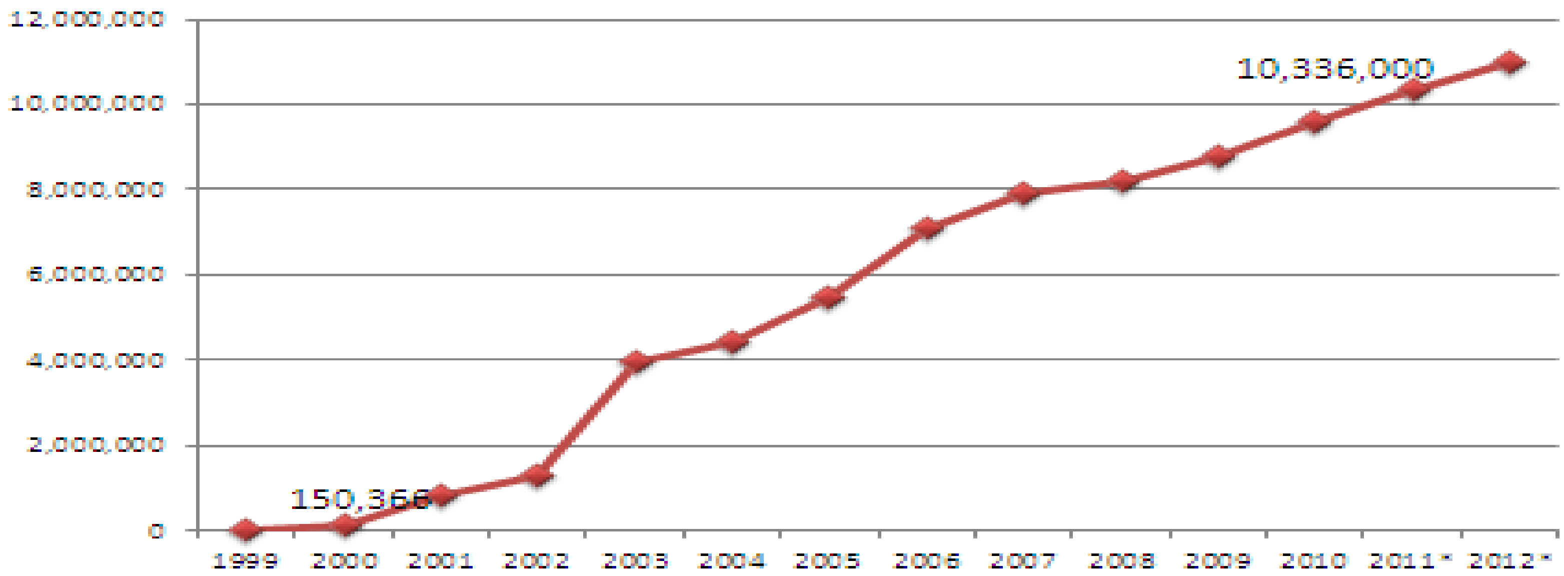
Social Grant Expenditure by Type, 2007/08-2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	% Growth
R million		Actual		Revised estimate		Projected		Per Annum
Old-age	22,801	25,934	29,826	33,797	36,571	39,913	42,975	11.10%
War veterans	22	20	17	14	12	11	10	-12.30%
Disability	15,280	16,474	16,567	17,080	17,813	19,439	20,626	5.10%
Foster care	3,414	3,934	4,434	4,898	5,536	5,833	6,281	10.70%
Care dependency	1,132	1,292	1,434	1,582	1,727	1,885	2,129	11.10%
Child support	19,625	22,348	26,670	30,594	35,564	38,810	41,993	13.50%
Grant-in-aid	87	90	146	160	177	190	205	15.40%
Social relief of distress	106	623	165	143	160	175	190	10.20%
Total	62,467	70,715	79,260	88,268	97,560	106,256	114,409	10.60%

GROWTH OF CHILD SUPPORT GRANT, 1999-2012



•CSG is largest social assistance programme in SA and one of the largest globally

• CSG is also one of most rapidly growing grants in SA

•Social grants grow from 2% to 3.5% of GDP between 1994 and 2006

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RECOMMENDATIONS

- Government should make more resources available through the transfer system to enable progressive realisation of an ideal child support system (package)
  - An ideal child-support system is a system that relaxes the existing means test and moves towards faster universalisation of the CSG
    - This should happen even under fiscal consolidation because of social and economic benefits
- Government should put in place a system to ensure coverage is extended to children currently excluded from accessing the CSG for administrative reasons

RECOMMENDATIONS [CONT.]

- Government should move faster towards consolidating various social protection instruments (CSG, Foster Child Grant, UIF, social wage, etc.), as part of the longstanding reform of the social security system because of the significant effects on reducing child poverty
- National Treasury should provide advice to departments /agencies working with children on developing major cross-portfolio initiatives aimed at eliminating child poverty
  - To date, a range of child poverty measures have been accommodated and scattered across many agencies
    - These should be nested within a new unified outcomes framework of related agencies because of synergies with related programmes

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3. Funding of FET Sector

- A well-functioning post-school education system = a key lever to break out of poverty and inequality and sustain a higher development trajectory
  – An effective further education and training (FET) college system is a critical component of a well-established, good quality, post-school education system
- FET colleges are migrating from provincial to national sphere
  – Rationale for this shift is to develop an integrated post-school education and training sector
- Discussion highlights key issues for consideration with respect to full transfer of FET function in line with the requirements of the FFC Act (99 of 1997)

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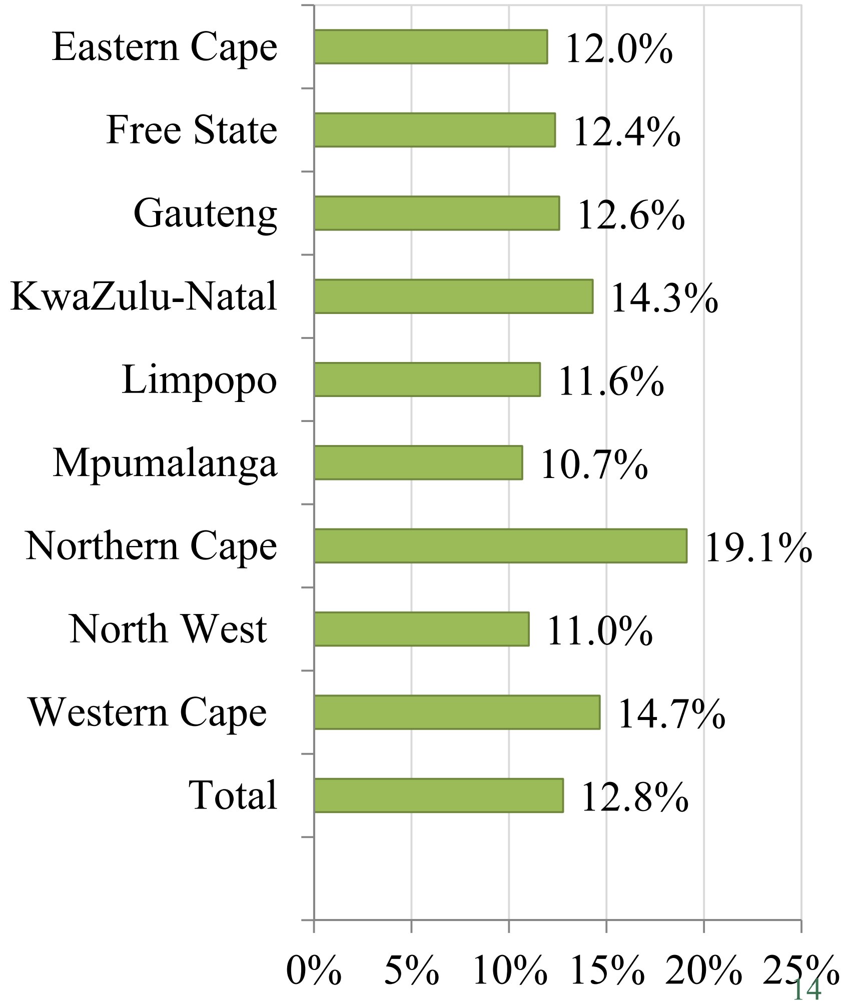
FET COLLEGES FUNDING – 2010/11 TO 2013/14

- FET Colleges allocation ↑ from R3,8 billion in 2010 to R5,45 billion in 2013/14
- Northern Cape recorded the highest average annual increase over the MTEF, followed by Western Cape and KwaZulu- Natal
- Mpumalanga had the lowest annual average increase



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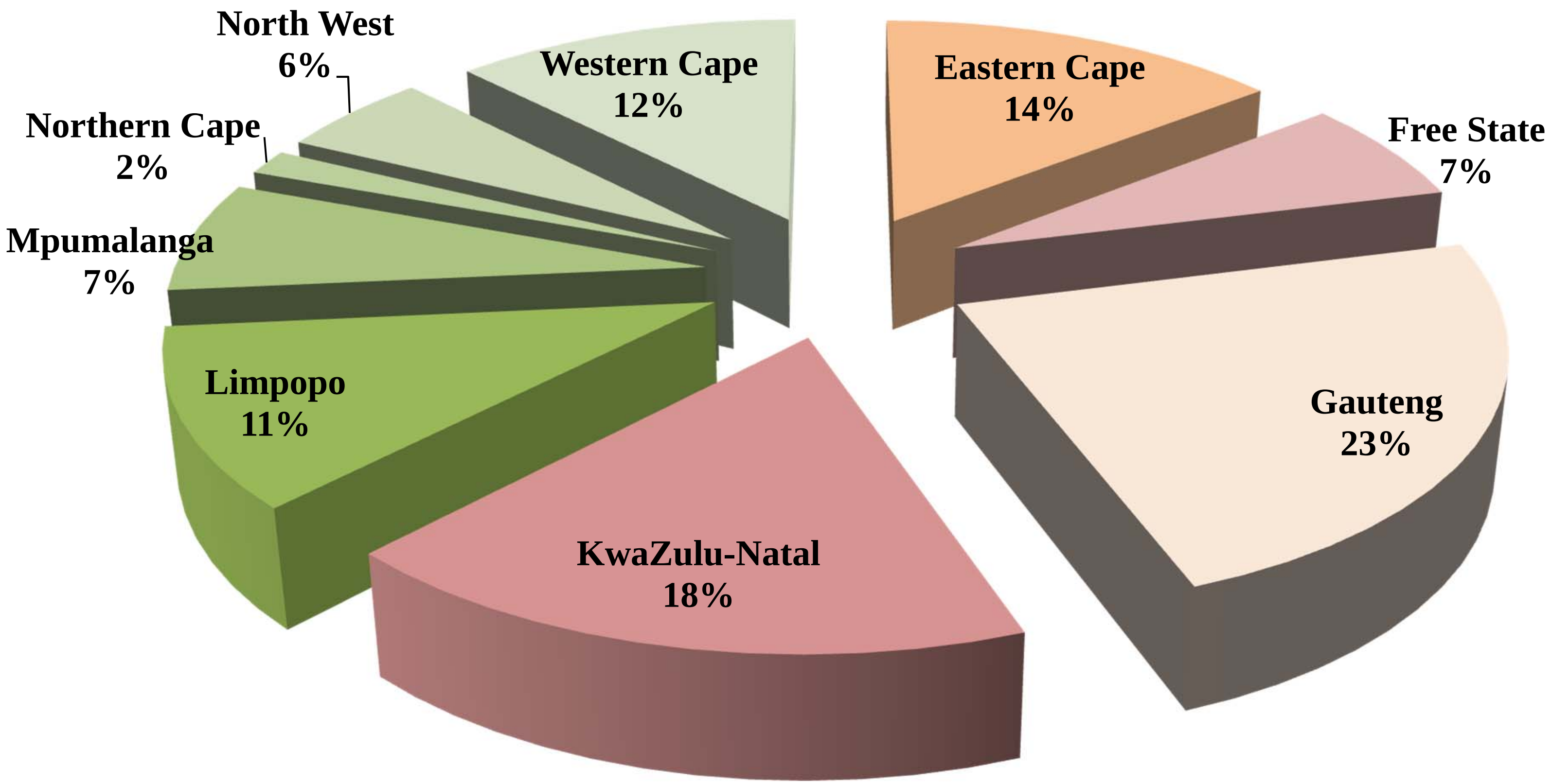
Provincial Distribution of MTEF Allocation Estimates – 2015/16



Recommendations

- Following the function shift, the funding model for the FET sector should ensure that:
  - Baseline funding does not perpetuate past underfunding of the function in certain provinces
  - Additional allocations are used to achieve a more equitable funding regime across provinces
  - Ongoing infrastructure development and maintenance are provided for
- Transfer of the FET function to DHET should include development of sound systems and uniform templates for financial reporting, designed in a manner that ensures that DHET can proactively monitor the financial health of FET colleges.
  - This should be complemented by holistic interventions to improve fiscal governance in FET colleges including recruitment of appropriate skills, ongoing training, and credible financial systems and processes

4. Financing Research in Higher Education

- SA's gross expenditure on research and development (GERD) is considered to be highest in Africa
  - But GERD as a % of GDP is relatively low when compared with some BRIC countries (Brazil, Russia and China)
- In 2004 SA introduced a new funding framework (NFF) for research and tuition in all institutions of higher education
  - Little research has been conducted to evaluate the funding framework's effectiveness, and whether actual research outputs from universities and technikons have increased significantly
- Discussion evaluates effectiveness of current government funding framework for higher education research
  - Assesses whether NFF for research has yielded the desired outcome of increased research outputs in SA

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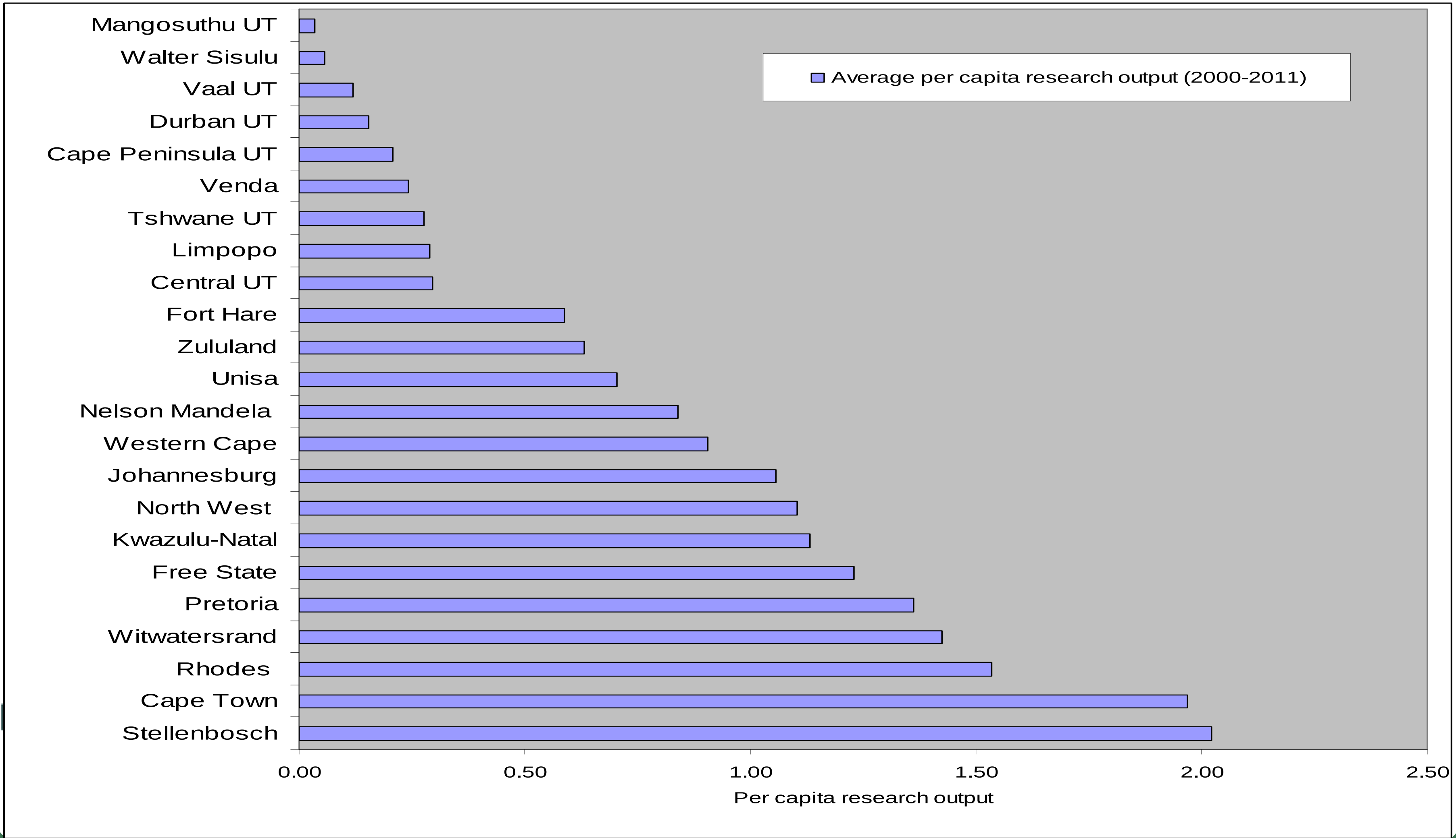
TOTAL PER CAPITA RESEARCH OUTPUT



RECOMMENDATIONS

- The Commission recommends a review of the current funding framework for higher education research and that DHET:
  - Redesigns and allocates specific funds in the MTEF budget to the research development plan
  - Reassesses the appropriateness of targets and, if necessary, adopts differential targets for each university/university of technology

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5. Evolution of Conditional Grants

- Conditional grants have been used increasingly as a mechanism to transfer funding to provinces and municipalities for the purpose of achieving particular national government policy objectives
- The Commission has a long history of studying the use of conditional fiscal transfers in its various submissions made on the DoR
- FFC's 10-year (2000/01–2009/10) review of conditional fiscal transfers to provincial governments and municipalities found that the application of conditional grants had evolved substantially over time
  - Documents conditional fiscal transfers and highlights some interesting and relevant patterns

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RECOMMENDATIONS

- The section in DoRA dealing with preparation for the next financial year to be reviewed to make consultation with the Commission mandatory when planning for conditional grants for the forthcoming year
  - This would assist departments with grant design, especially in the case of new grants, phased-out grants, and material redesign of existing grants
- Efficacy of conditional grants must be reviewed, specifically in relation to necessity and purpose of some of the grants, criteria for allocations, targeting, reporting on non-financial data, performance, and value for money
- National Treasury should build capacity of transferring national departments for effective grant design, monitoring and evaluation to ensure that guidelines are adhered to

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RECOMMENDATIONS [CONT.]

- Commission reiterates 5 key principles established for grant administration:
  - Introduction and termination of grants
    - Mandatory, systematic process required for design/planning of grants and independent evaluation of grant performance required when grants are terminated/merged with other grants
  - Transparency in the criteria used to allocate conditional grants
    - Criteria, measures, baselines and division of grant allocations to be transparent
  - Importance of non-financial performance data
    - Reporting on delivery should form basis for awarding grants
  - Achieving results-based accountability through incentive-oriented grants
    - Grants should be used to create a competitive service delivery environment
  - Rethinking the financing of natural disasters
    - Changing climate patterns require Government to re-evaluate institutional responsibilities for plans/financing of disasters

6. Assessing and Improving Provincial Fiscal Performance

- Provincial fiscal performance = vital to maintain fiscal sustainability
- Rising need for basic services and low revenues threaten fiscal sustainability
- Policy makers in SA divided on extent of provincial fiscal performance
- Study seeks to assess underlying causes of perceived poor fiscal performance reflected by a set of fiscal stress indicators
- Poor fiscal performance appears to be mostly attributable to internal factors, such as expenditure management, maladministration and wasteful expenditure

Composite Fiscal Stress Index

	Weight	Eastern Cape	Free State	Gauteng	Kwazulu-Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape
Budget balance	5	1	1	1	1	1	1	1	1	1
Cash balance	10	0	0	0	0	0	0	0	0	0
Expenditure buoyancy/growth	5	5	4	2	1	3	1	1	5	2
Expenditure rigidity	5	4	4	1	4	5	4	2	2	2
Unfunded mandates	10	0	0	0	0	0	0	0	0	0
Wastage and irregular expenditure	15	4	3	5	3	3	2	2	2	1
Budget and expenditure control	15	5	5	5	4	4	2	4	3	1
Maladministration / management capacity	15	5	5	2	2	3	1	4	3	1
Minimum efficient expenditure	10	3	1	5	5	3	1	2	1	3
Service needs/ burden	10	3	3	5	4	3	2	2	1	3
Overall Fiscal stress score (Weighted)	100	3.2	2.8	3	2.55	2.55	1.35	2.1	1.8	1.3
Overall Fiscal stress score (unweighted)		3	2.6	2.6	2.4	2.5	1.4	1.8	1.8	1.4

RECOMMENDATIONS

- National and provincial treasuries to put in place an agreed-upon measurement and assessment framework for fiscal performance against which provinces are evaluated. The assessment framework must:
  - Take into account various factors that capture fiscal performance holistically, including services burden, expenditure efficiency, funding and delivery norms etc;
  - Incorporate information from internal audit reports and be used as an early warning system to complement Section 32 reports and National Treasury benchmarking exercises;
  - Provide for monitoring and disclosure of key fiscal performance indicators of provincial departments, particularly when deviation (as defined by the PFMA) from a healthy fiscal trajectory is prolonged;

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RECOMMENDATIONS [CONT.]

- Government to consider reducing or replacing minimum allowed threshold for over and under-expenditure with relative inflation-adjusted figures, to avoid “budget creeping”
- National and Provincial Accounting Officers should rigorously enforce Section 86 of PFMA, which provides for instigation of criminal and disciplinary proceedings for persistent contravention, especially for wasteful and unauthorised expenditure; and, where individuals are found guilty, consistent sanctions should be applied
- Provincial treasuries must carry out mandatory expenditure reviews (overseen by an independent expert) after every MTEF cycle specifically focussing on composition, efficiency, economy and effectiveness of expenditure as well as access to services and re-alignment of spending with programme objectives and delivery targets

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7. Managing Provincial Wage Bill

- Public sector wage bill has remained largest component of government expenditure
  - Provinces accounting for largest component of personnel expenditure
- Key questions
  - What are the underlying causes to growth in the wage bill?
  - Are increases due to increases in staff establishments?
  - Is there an appropriate mix of skills?
  - Are ↑ in the wage bill commensurate with productivity? Do ↑ result in increases in economic growth?

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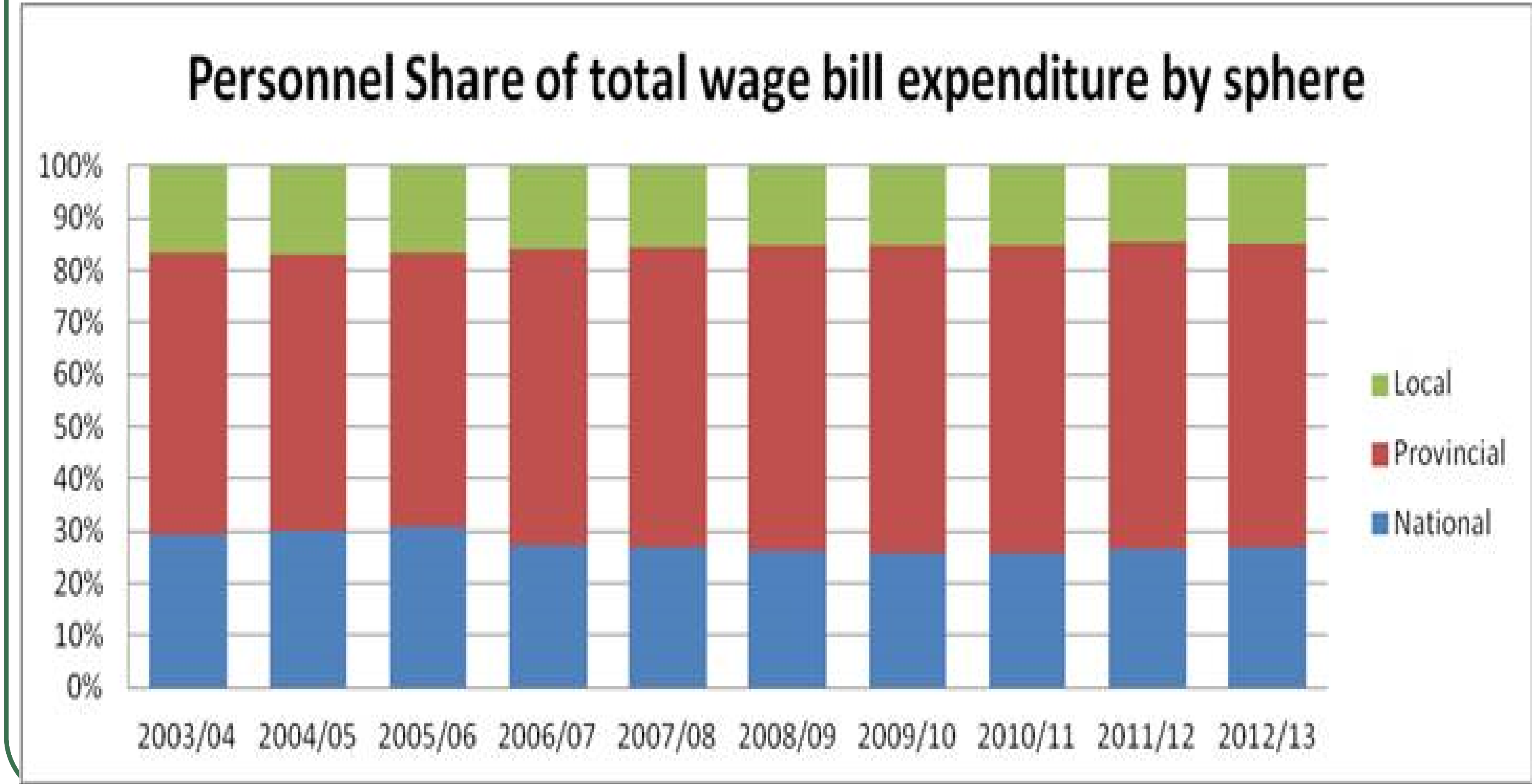
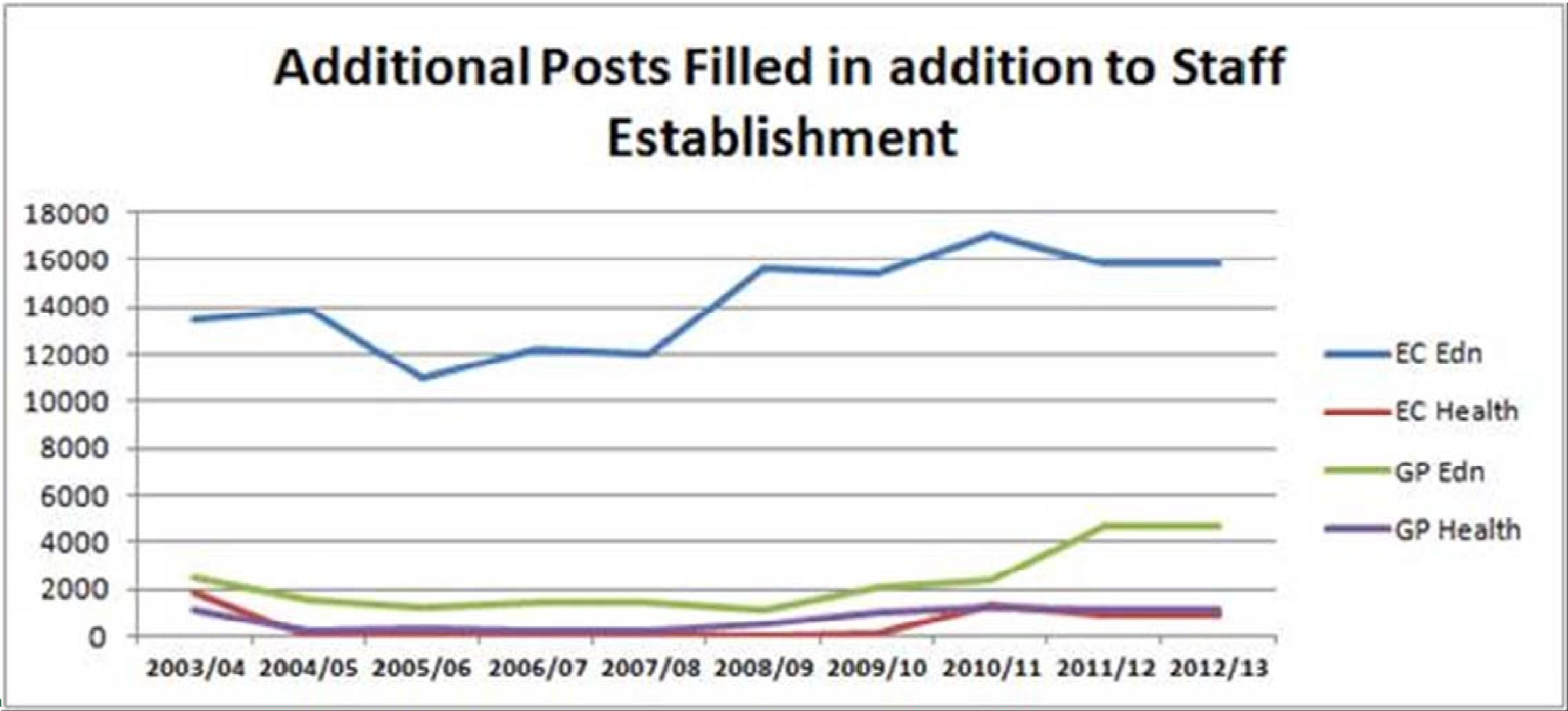
KEY FINDINGS: PROVINCIAL WAGE BILL

- Provinces by far spent the largest on wages



KEY FINDINGS: POSTS FILLED IN ADDITION TO STAFF ESTABLISHMENT

- Additional posts filled in relation to staff establishment – unfunded posts



RECOMMENDATIONS

- A transition over the medium to long term is required, towards a more appropriate balance between wage and non-wage components of provincial budgets for social spending (starting with education and health)
  - This should be in the form of national sector departments setting a norm/ratio of frontline versus administrative staff to total expenditure per sector and/or by specific occupational categories, and developing accurate and up-to-date management information systems to monitor employee compensation expenditure against those norms
- When HR functions have been delegated to them, accounting officers are required to adhere to agreed staff establishment norms when filling posts
  - This requirement must be enforced through existing regulations and performance agreements. Furthermore, each accounting officer must be held accountable for establishing effective personnel spending controls, ensuring up-to-date and credible personnel information to act as an early warning, and for taking prompt corrective action when necessary

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RECOMMENDATIONS [CONT.]

- Capability of HR functions within provincial line departments to cost and budget for staff establishments, establish necessary control systems, respond to Auditor-General queries, and manage financial and non-financial information – should be enhanced
  – Provincial treasuries and Offices of the Premier should enhance their capacity to monitor, support and supervise management of employee compensation
- Methods to improve productivity of health and education sectors should be considered, such as computerisation of certain processes, reorganising and streamlining workflow, and organisational design
  – The non-wage components of provincial budgets should include adequate provision for health technologies and technologies for e-education (ICT) and supporting organisational innovations in order to enhance productivity in the social sector

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8. Devolution of Transport Functions to Municipalities

- The National Land Transport Act (2009) allows for some transport functions to be devolved to municipalities
  - The main reason is to address current fragmentation of transport functions that has led to historical suboptimal investment in public transport sphere
- The Commission's past research has shown devolution is a necessary but not a sufficient condition to address public transport planning and implementation challenges
- Key question addressed is: "Under what conditions will devolution of transport functions be effective?"
- Study found devolution becomes effective only when related functions are consolidated, the municipality is well resourced, adequate funding is available, and full authority to the network is given to the municipality

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RECOMMENDATIONS

- The national Department of Transport (DoT) should select eThekwini and Cape Town metropolitan municipalities to pilot the devolution of transport functions in the form recommended by the investigation. The DoT should reach the necessary agreements with all concerned stakeholders to provide sufficient support and required resources to allow for the pilots to be successfully implemented
- The baseline funding for transport functions is thoroughly understood by recipient municipalities, beginning with eThekwini and Cape Town metropolitan municipalities

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9. INTERGOVERNMENTAL PLANNING FOR BETTER OUTCOMES

- Public sector performance management undergoing radical change
- SA adopted NDP and outcomes approach to service delivery
- Decentralisation poses operational problems
  - coordination, weak accountability, sectoral interdependence, policy ambiguities and rivalry
- Effective implementation requires requires budget reforms to link outcomes and budgeting directly

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Structure and Contents of Delivery Agreements

- Delivery agreements not fully compliant with guide

Outcome	Lead department	No of strategic or delivery partners	No of output measures	Budget allocations per delivery partner
(1) Improved quality of education	Department of Basic Education	17 national departments and nine provincial departments of education	4 (37 indicators)	Not provided
(2) Health	Department of Health	11 national departments nine provincial departments of health and social development, NGOs, CBOs and international health organisations	4 (31 indicators)	Not provided
(4) Decent employment	Different department by different output	16 national departments, nine provinces and 283 municipalities	7 (21 indicators)	Not provided
(8) Sustainable human settlements	Department of Human Settlements	Six national departments, nine provinces, 283 municipalities and banking industry	4	Not provided

Recommendations

- National Treasury and DPME to introduce budget process reforms necessary for reconciling collective responsibility for delivery agreement outcomes and individual department-focused budget-bidding process by:
  - Realigning the budget process along service delivery agreements such that MTEC hearings are conducted at an outcome level, where applicable, rather than the current sectoral, individual institutional approach
  - Directly linking resource allocation to realistic, measurable and few performance targets per outcome. Programme expenditure reviews must be undertaken at the end of each targeting period

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RECOMMENDATIONS [CONT.]

- Government should consolidate and reorient existing conditional grant incentives to reward successful achievement of delivery targets/outcomes rather than specific, individual, department-specific programme objectives
- Delivery partners, who are party to service deliver agreements, should be evaluated on the basis of contributions and participation in implementing delivery agreements, where aspects such as required budgetary contributions, and meeting agreed-to targets and timelines are constantly monitored
- Service delivery agreements should be fully compliant with requirements of the Guide to the Outcomes Approach before being accepted or signed into a binding document

10. Measuring Fiscal Stress in Local Government

- Fiscal distress refers to sustained inability of a municipality to fund delivery of basic public goods and other requirements as per their constitutional mandate
  - Fiscal distress seldom develops overnight, so establishing an early warning system is essential
- An early warning system can play a critical role in preventing occurrence or mitigating impact of fiscal distress
  - Despite this, SA has no formal early warning system to alert policy makers, oversight bodies, politicians, citizens etc, of municipalities heading for fiscal distress

Objective of research is to construct a set of fiscal distress indicators and develop an early warning mechanism that identifies municipalities heading towards fiscal distress

Findings

Year	2011/12	2012/13
Fiscally neutral	34%	24.4%
Fiscal watch	58%	67.3%
Fiscally distressed	8%	8.3%

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RECOMMENDATIONS

- Government should develop and institutionalise an early warning system, which would identify municipalities that are heading towards fiscal distress
- Government should use the early warning system as a tool to monitor and assist municipalities heading towards fiscal distress and those already in fiscal distress

11. Incentive Based Grants to Improve Municipal Performance

- Since 1994 government has instituted a number of reforms to improve LG performance
  - Includes legislative reforms, benchmarking exercises, capacity building initiatives, performance based contracts
- In addition, quantum of transfers has increased to improve service delivery in the sector
- Despite all this, performance gaps still cause for concern – no commensurate improvements in service delivery
  - Need a rethink of ways and means of maximising value from transfers so as to unlock value of LG sector
  - Good transfer should have incentive elements

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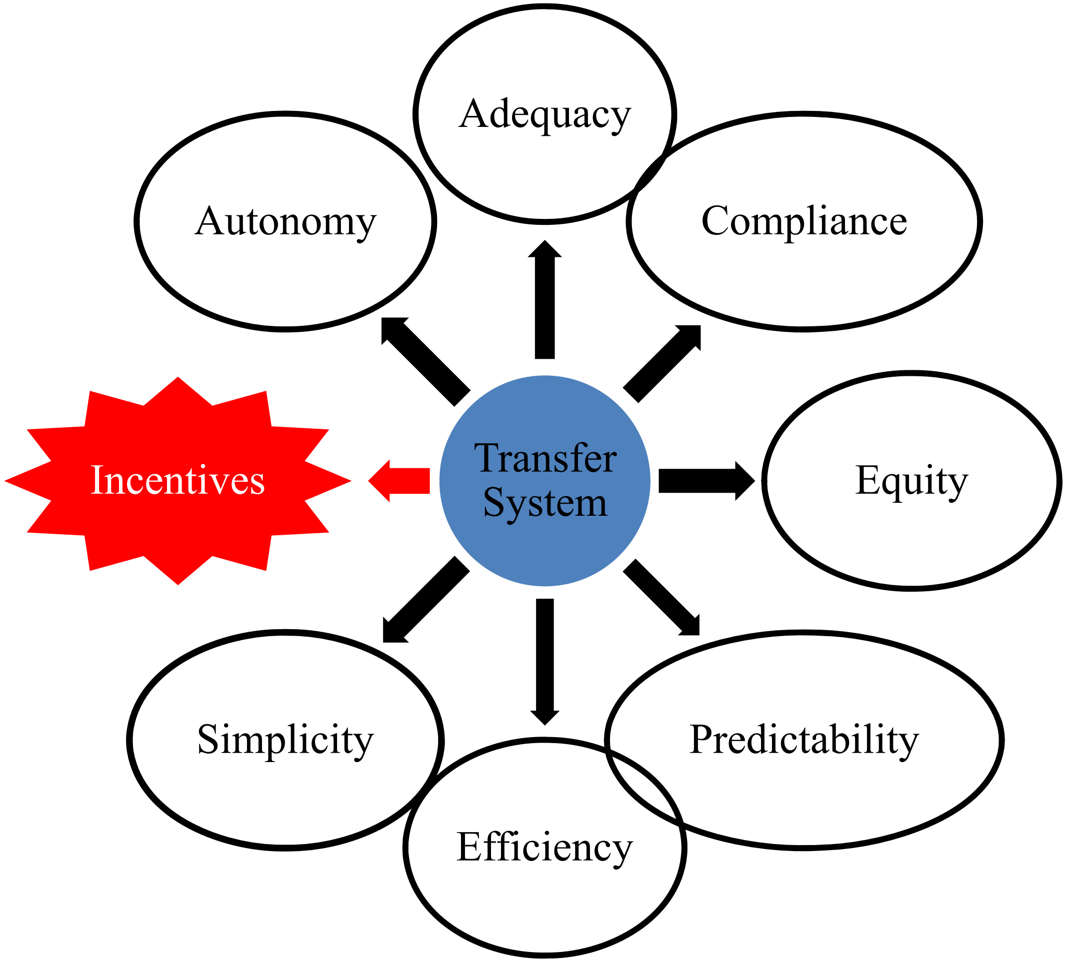
FRAMEWORK

Good transfer system should have incentive elements (World Bank ,2002)



RECOMMENDATIONS

- With respect to the **impending review of the Local Government conditional grants**, the Commission recommends that:
- Performance-based grants are based on principles and guidelines. The following principles should guide design of performance-based grants:
  - Incentives should have sufficient monetary value to motivate desired behaviours by municipalities
  - Incentive and performance indicators should be periodically revised and renegotiated between national government and municipalities
  - Performance measures should capture performance unambiguously and be within the control and influence of the municipalities
  - Performance incentives and associated performance measures should be evaluated at regular and scheduled intervals, and allow time for learning from each cycle

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RECOMMENDATIONS [CONT.]

  - Incentives should be achievable and evaluated within the specified timeframe
  - Transferring officials and the municipality should be sufficiently capacitated to understand the purpose and impact of incentives
  - Incentives should be tailor-made to suit specific situations
- The National Treasury and CoGTA to ensure that there is sufficient awareness on the nature of performance-based grants, the value of incentives, relevant indicators, assessment criteria and potential benefits thereof, and how potential implementation risks could be managed

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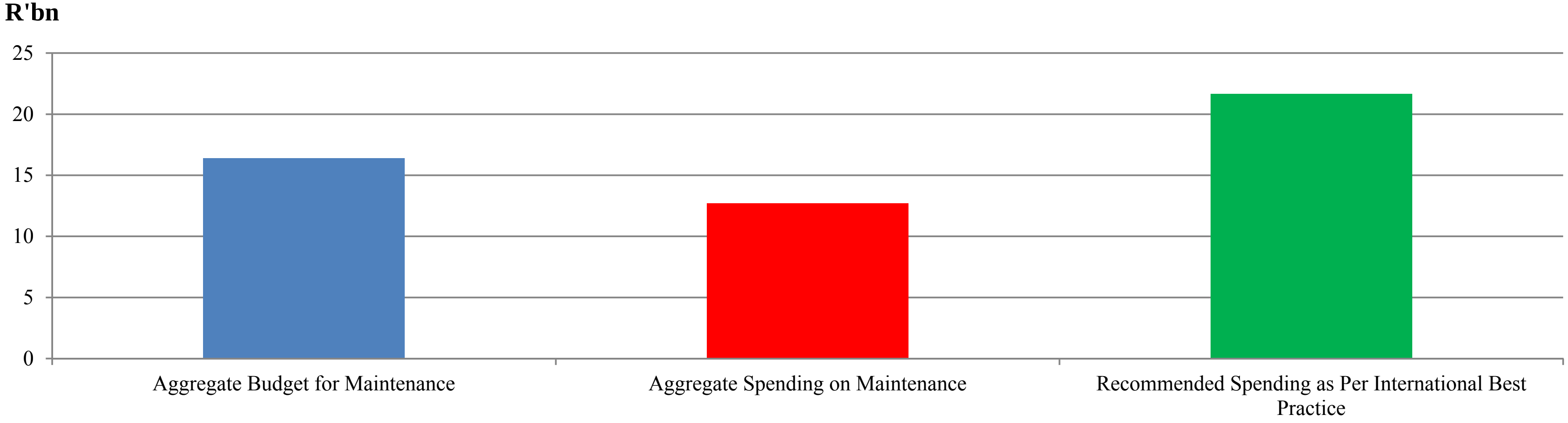
12. Best Practice in Maintaining Water and Electricity Distribution Infrastructure

- Investment in infrastructure is a key lever through which the state can contribute to accelerated and shared growth
- Equally important is maintenance and renewal of existing infrastructure
  - Adequate and effective spending on asset care = expenditure lever capable of protecting investment in infrastructure and contributing to sustainable service delivery
- Asset management practice is very poor across SA LG sphere
- Assess whether municipalities spend adequately on asset care activities – if not, what can Government do to encourage greater investment in maintaining/renewing municipal infrastructure?

12. KEY FINDINGS

Budgeted Versus Spending Versus Benchmark Allocation for Asset Maintenance as at 2011/12



Summary of Estimated Renewals Backlog

Scenarios for quantifying backlogs against different standards	Water and Sanitation		Electricity	
	Amount	Years to Eradicate Backlog	Amount	Years to Eradicate Backlog
Optimum	R39 billion	10	R 41 billion	11
Sub-optimal	R19 billion	5	R 25 billion	7
Absolute Baseline	R4 billion	1	R 8 billion	2

RECOMMENDATIONS

- National Treasury, in collaboration with relevant stakeholders such as CoGTA and SALGA should develop LG-specific infrastructure asset management legislation, similar to the Government Immovable Asset Management Act. The proposed legislation should:
  - Cover decision-making, planning and control over acquisition, use, safeguarding, and disposal of LG assets to maximise service delivery potential and benefits, and minimise their related risks and costs over their entire life
  - Define asset management practices appropriate to different categories of municipality given the nature, extent and complexity of infrastructure as well as financial and administrative capacity of the municipality and other relevant factors

RECOMMENDATIONS [CONT.]

- National Treasury should devise LG infrastructure asset management guidelines
  - These guidelines should be positioned within the broader system of capacity development and performance oversight. Technical assistance to be provided to municipalities to prepare infrastructure asset management plans
- Provincial and national authorities must increase scrutiny of the operating implications of capital funding so as to ensure that municipalities are able to adequately maintain and renew infrastructure

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13. Revenue Enhancement in Rural Municipalities

- Fiscal decentralisation results in devolution of expenditure functions and taxation powers
  - Characteristics and size of the tax base indicate the taxability of the base
- Can rural municipalities support their expenditure mandates with current revenue instruments?
  - Are the instruments adequate?
    - Does revenue capacity exist in rural areas?
    - What factors influence this capacity?
  - Is it an administration problem?
    - Do rural municipalities have capacity to maximise revenues
    - The impacts of historical and political dynamics?
  - What levers are available to first maximise / extend bases?

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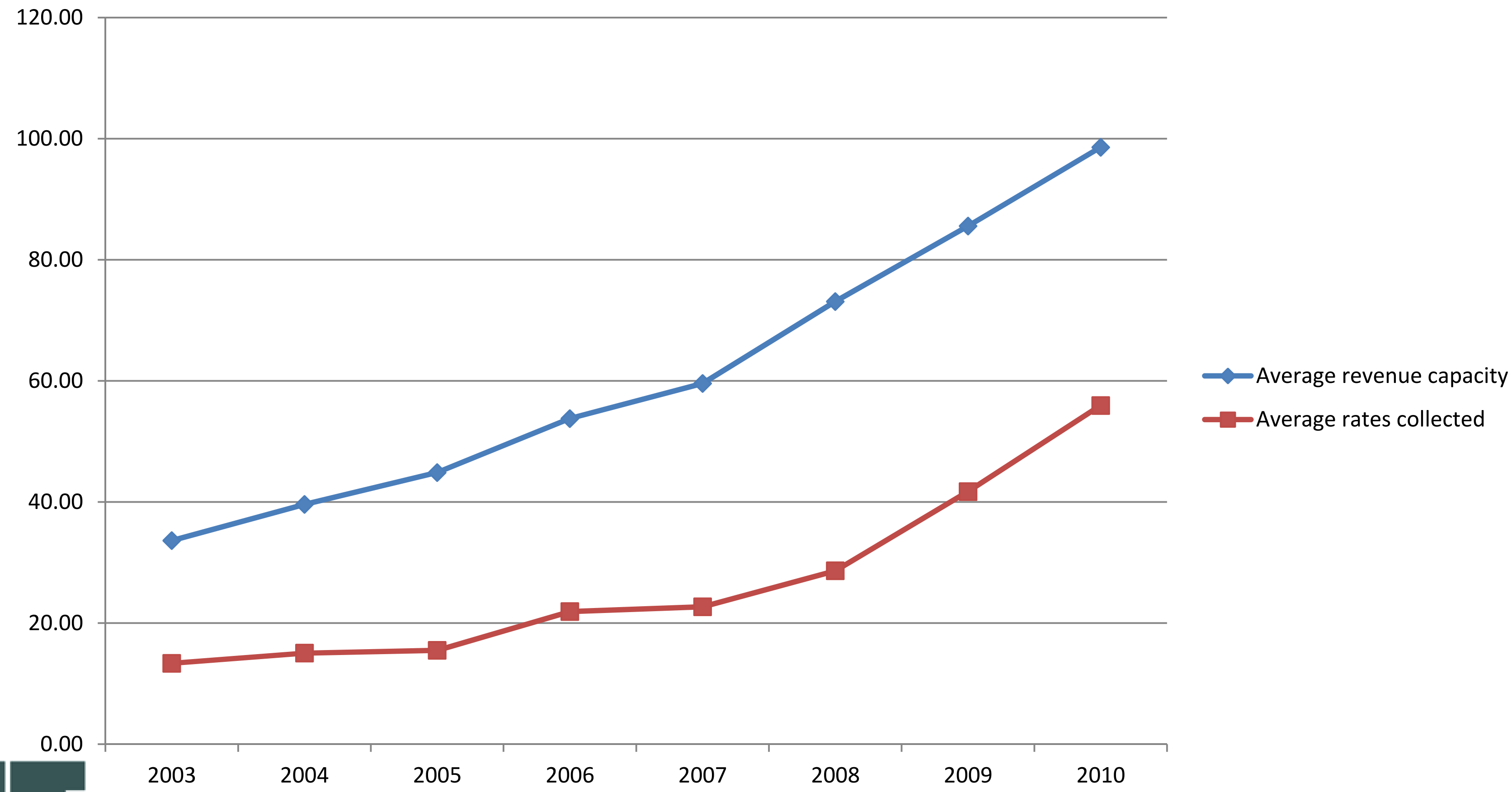
Collection and Capacity



Factors Impacting on Revenue Capacity and Effort

Revenue capacity	Revenue effort
•Economic activity •Unemployment •Poverty	•Local demographic and social issues
•Local demographics •High proportions of pensioners and children	•Resource constraints

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RECOMMENDATIONS

In the short term:

- National and provincial governments should support weaker rural municipalities to ensure improved revenue and expenditure outcomes. This should be done through:
  - Improved assistance in formulating and implementing budgets, IDPs, LED, debtor management and credit control policies
  - More effective capacity-building initiatives, which deal holistically with governance, systems and business processes, as well as recruitment, retention and the development of requisite skills
- National and provincial governments to ensure that grant funding to rural municipalities is linked to capacity-building initiatives and structured assistance, so that systems are built to improve the municipality's ability to collect revenues due and increase the quality of spending

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RECOMMENDATIONS [CONT.]

- Municipalities should ensure that revenue-enhancement strategies are sensitive to broader constraints, such as inequality, unemployment, local politics and land tenure issues so that revenue effort is maximised

In the long term

- Given skills and resource shortages in rural areas, municipalities should explore greater collaboration with district municipality, neighbouring local municipality and province to pool resources in order to ensure greater regional planning and investments.
  - Where rural municipalities are adjacent to better performing municipalities, best practice methods should be shared through peer learning arrangements among municipalities

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THANK YOU

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