Managing Wealth and natural Resources through decentralisation: The south African experience

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Capacity-building workshop

Khartoum, Sudan

9 December 2015

For an Equitable Sharing of National Revenue

Republic of South Africa
Capital: Pretoria
Population: 54.9 million (2015 est.)

INTRODUCTION

- Previous Apartheid regime came to power in 1948 and introduced Bantustan Policy which demarcated jurisdictions based on race
  - Gave rise to skewed distribution of resources resulting in varying levels of capabilities and economic activity across the various apartheid governance structures
- Multi-party negotiations led to a political compromise that resulted in the first democratic elections in 1994
- South Africa opted for a system of decentralization with a strong central authority
- The system has undergone substantial reforms since 1994
- Key challenge faced over past 20 years is to address socio-economic backlogs, regional disparities and inequalities, macroeconomic stability and economic growth
- Despite the socio-economic challenges, South Africa has abundant natural resources and is a major exporter of diverse range of minerals

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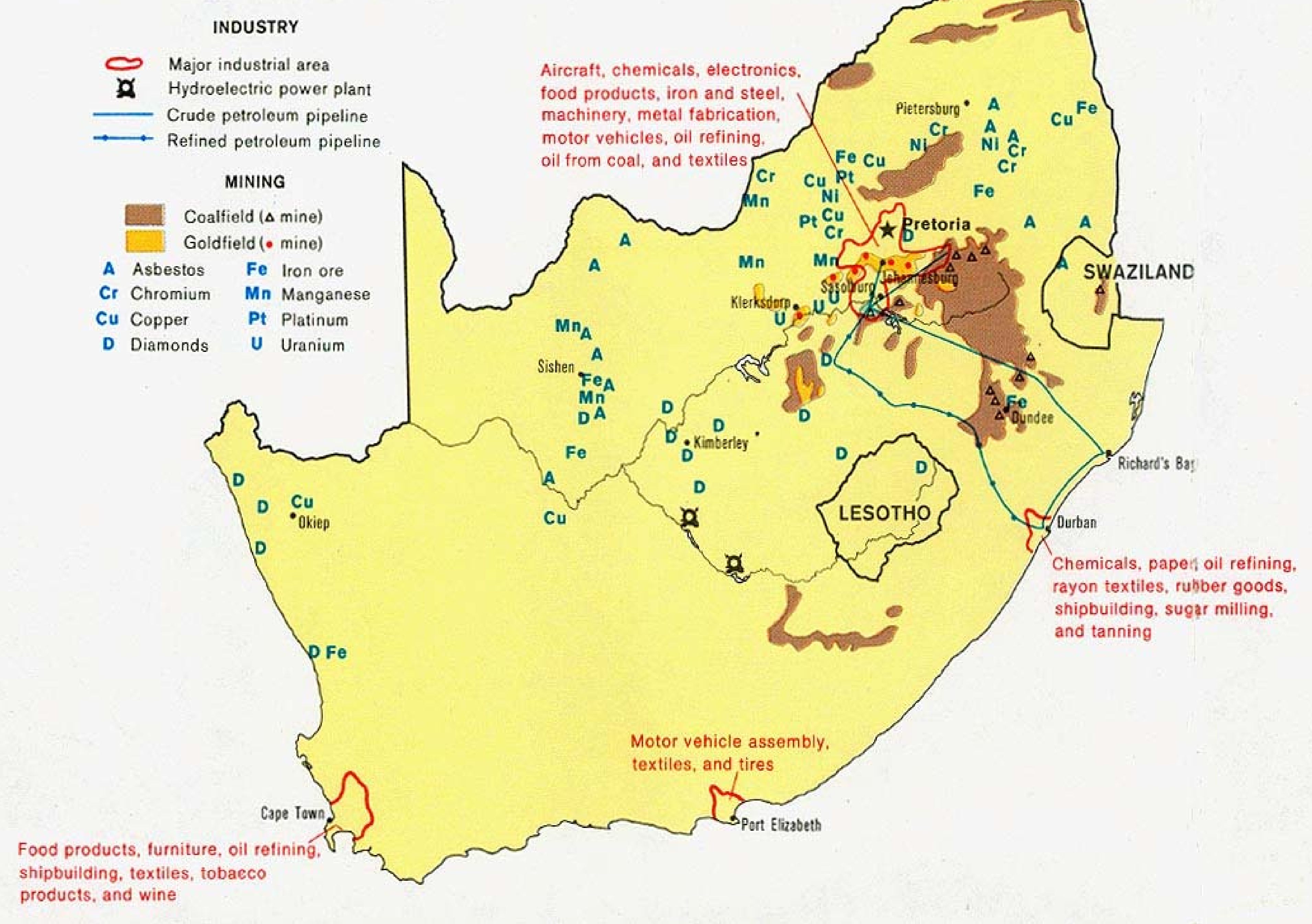
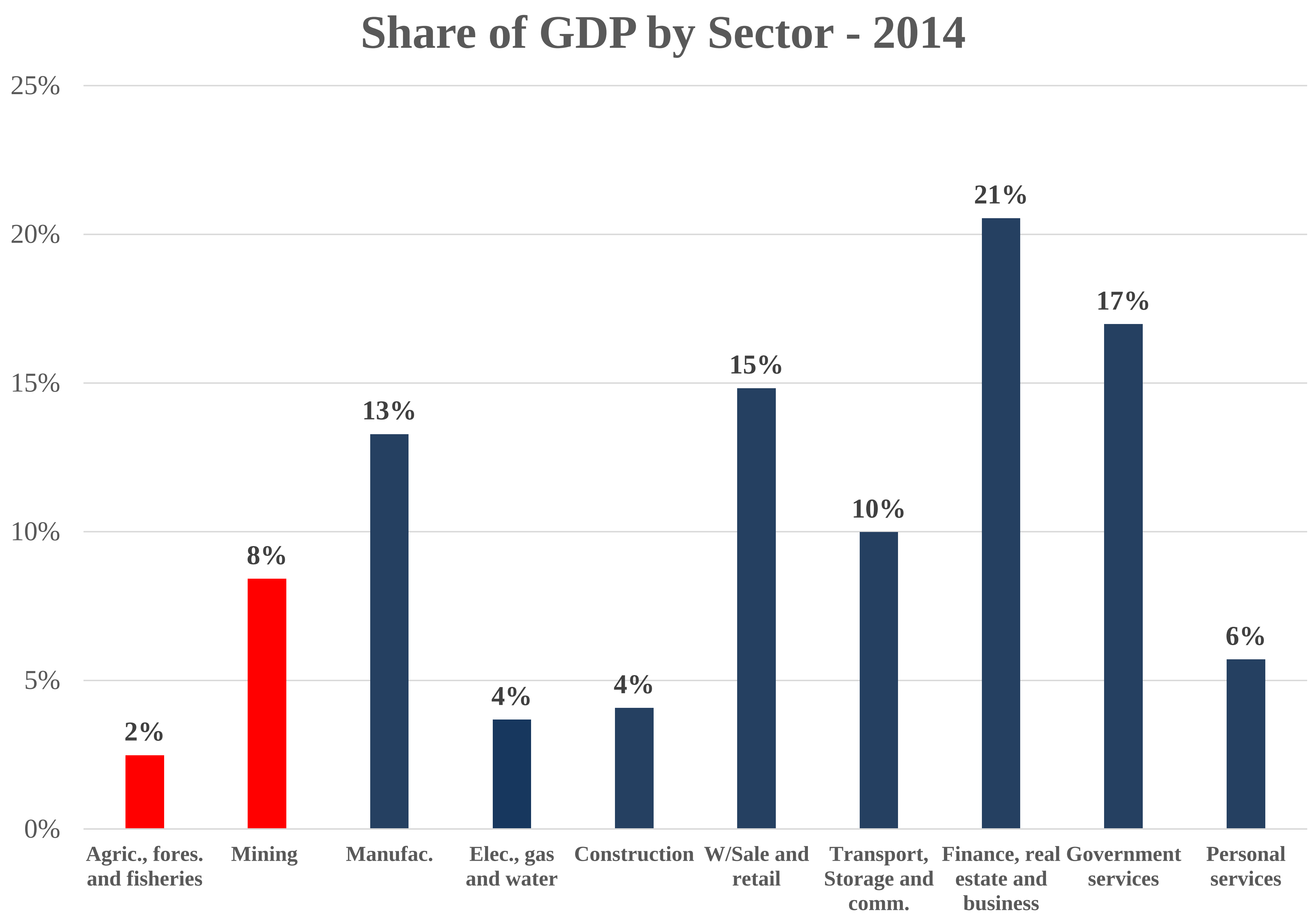
Industry and Mining





Source: StatsSA (2015)

Locating South Africa

Relatively More Decentralised Fiscal Systems

Relatively More Centralised Fiscal Systems

GERMANY

CANADA

USA

AUSTRALIA

SOUTH AFRICA

INDIA

Provinces have strong legal, fiscal and functional power, and strong control over local governments, institutional role in central government; ehnic and regional diversity

States have strong fiscal power, extensive authority over local government, informal and fragmented institutional role in central government affairs; sharing of functional authority

States have an institutional role in national affairs, strong control over local governments, centralised revenue structure works against regional autonomy, greater functional power than the USA

Potential for provinces to play an institutional role in national affairs, provinces at present have little control over local government affairs (but may assume oversight role over local government in future), sharing of functional responsibility with national government, highly centralised revenue structure

National government appoints state governors, ethnic and cultural diversity, more centralised fiscal power. Fiscal dependence of states

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SYSTEM OF GOVERNANCE

- Three distinct but interdependent spheres of government
  - National
  - 9 provincial governments
  - 278 municipalities
    - Category A and B municipalities (metro and local)
    - Category C (district)
- Associated expenditure responsibilities
- Revenue raising powers

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Cooperative governance

- Principles of cooperative governance Chapter 3
  - Respect the powers and functions of other spheres
  - Not assume powers and functions of other spheres
  - Exercise powers without encroaching on the geographical and functional integrity of another sphere
  - Cooperate in mutual trust and faith
    - Coordinating actions
    - Informing one another on matters of common interest
    - Adhering to agreed procedures
    - Avoiding legal actions against each other

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Key Role Players in Wealth Sharing

- Parliament / Provincial Legislatures
- Parliamentary Budget Office
- Cabinet / Provincial Exco
- FFC
- MinComBud
- Treasury Committee
- Extended Cabinet
- Budget Council
- Budget Forum
- TCF
- Spending Agencies

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ROLE OF THE FINANCIAL AND FISCAL COMMISSION OF SA

- Role defined by Constitution (section 220) & FFC Act
- Accountable to parliament and legislatures
- Purely an advisory body and independent
- Created by Constitution as a countervailing check and balance on the executive
- Can make recommendations on any fiscal and financial matter

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KEY ROLE PLAYERS IN NATURAL RESOURCE MANAGEMENT

- The Minister of Finance (through the National Treasury) sets tax policy and is responsible for amending the Income Tax and associated tax legislation
- The South African Reserve Bank (SARS) administers the implementation of the Income Tax and associated tax legislation
- The Minister of Natural Resources (through the Department of Mineral Resources (DMR)) sets mineral resource policy and administers the Mineral and Petroleum Resources Development Act (MPRDA)
- The Minister of Water and Environmental Affairs (through the department of Water Affairs) set water policy and administers the National Water Act and the Water Services Act
- The South African National Parks (SANParks) manages the biodiversity of the country
- The Minister of Environmental Affairs (through the Department of Environmental Affairs) sets policy and oversees the environmental and ecological protection, conservation and development of the country
  - SANParks is an agency under department and manages the country's biodiversity
  - Provinces are implementing agencies and implements national policy on environmental affairs

EXPENDITURE ASSIGNMENT

CONCURRENT

Housing, health, education, social welfare, agriculture

NATIONAL	PROVINCIAL	LOCAL
defence, justice, correctional services, security	regional development	water, electricity, sanitation, refuse removal

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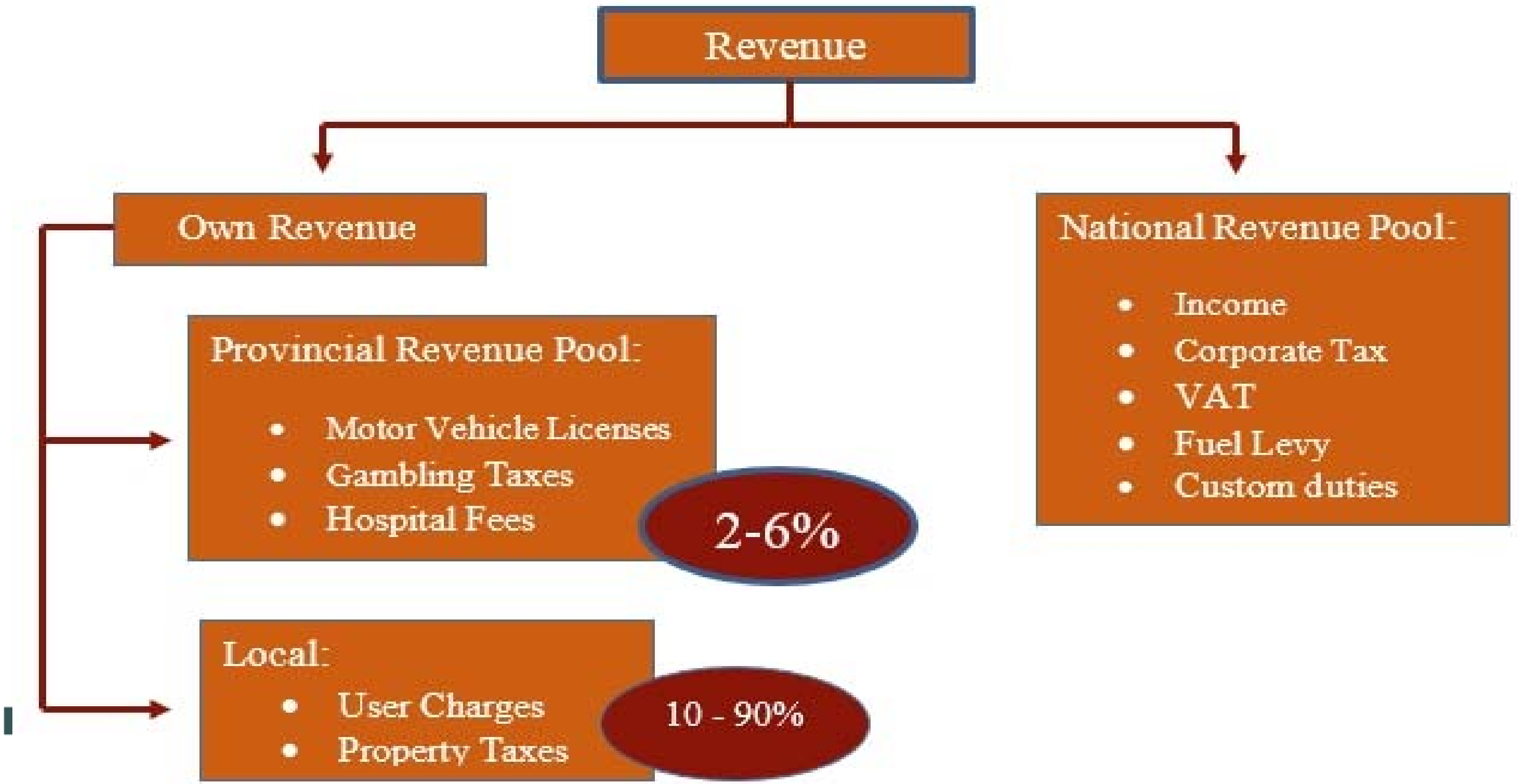
Assignment of Taxation Powers across Spheres



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NATIONALLY RAISED REVENUE AND RESOURCE TAXATION

- National government collects revenues from mineral resources through revenue raising instruments such as Corporate Income, Vat, Personal Income Tax and minerals royalty and puts it into the national revenue pool
  - Personal Income (37%), Vat (30%) and Corporate Income Tax (19%) are the three main sources of tax revenue raised nationally
  - Minerals royalty was introduced in 2010. The minerals royalty is compensation to the state (custodian) by private enterprise for the right to mine and also for the permanent loss of non-renewable resources
- Nationally raised revenue is shared amongst the three spheres of government according to minimum national norms and standards
- Currently there is a debate about whether the costs and benefits of resource extraction are distributed fairly and if benefits should be enjoyed more widely

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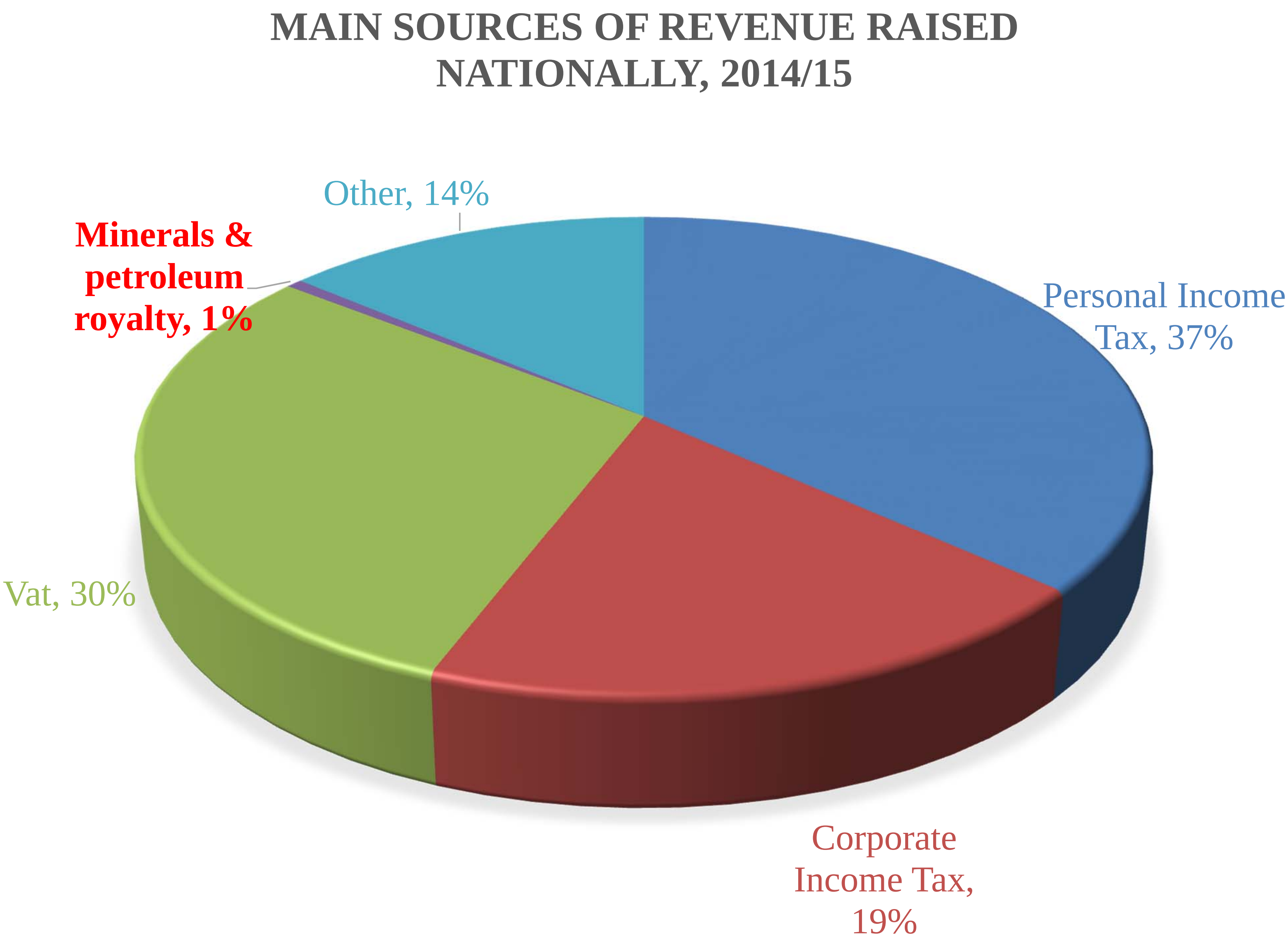
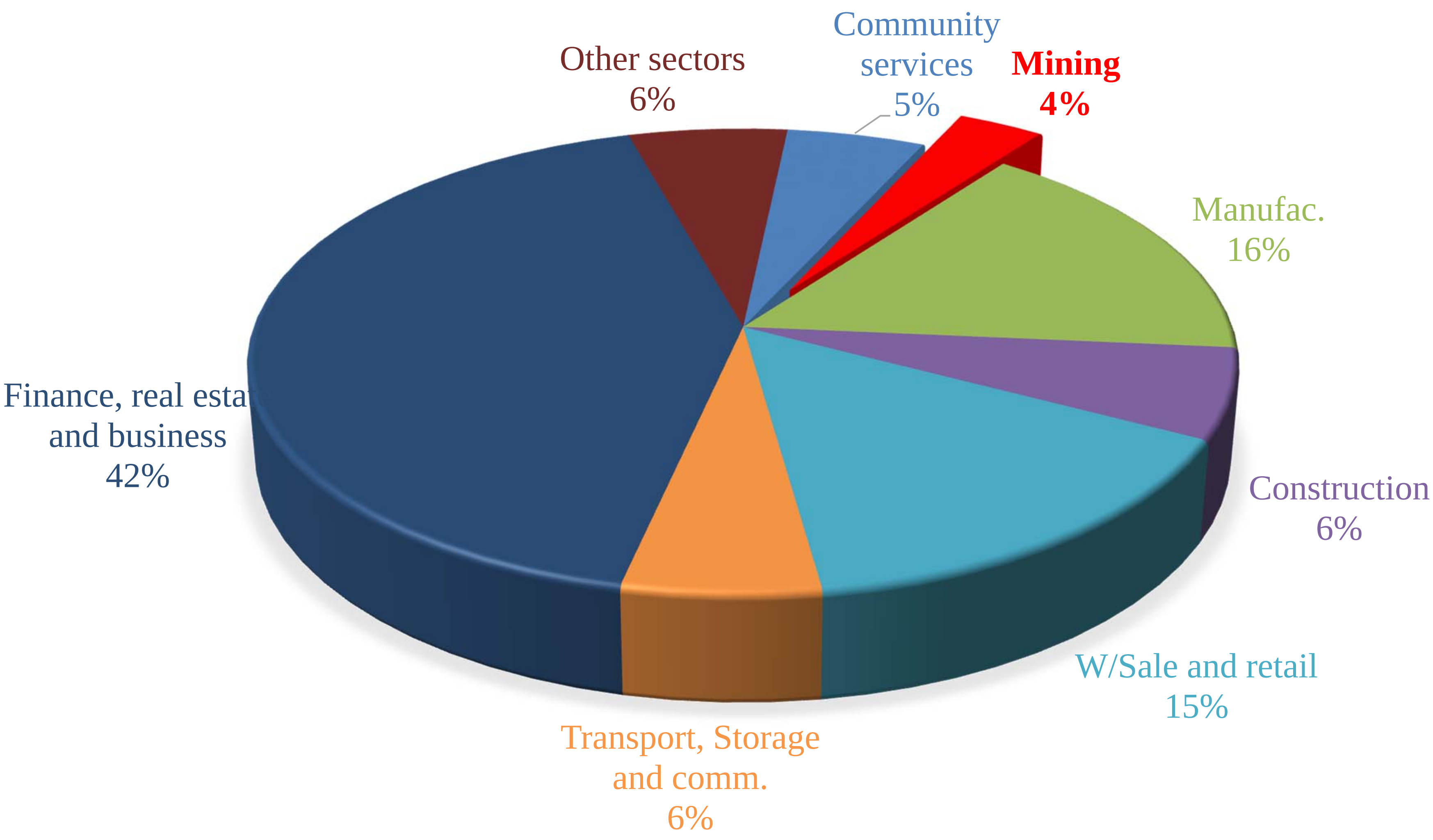
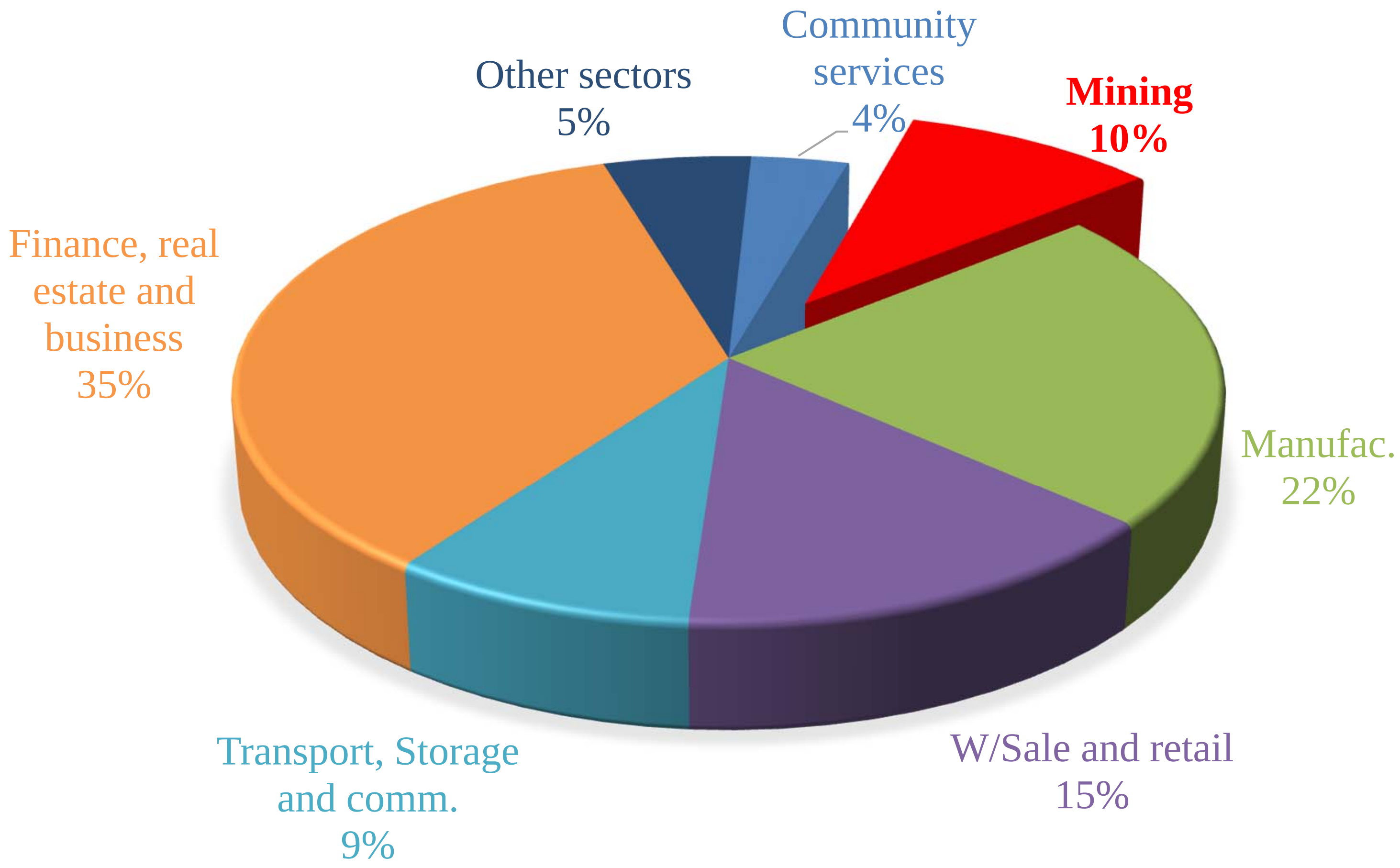

MAIN SOURCES OF REVENUE RAISED NATIONALLY, 2014/15
Other, 14%
Minerals & petroleum royalty, 1%
Personal Income Tax, 37%
Vat, 30%
Corporate Income Tax, 19%

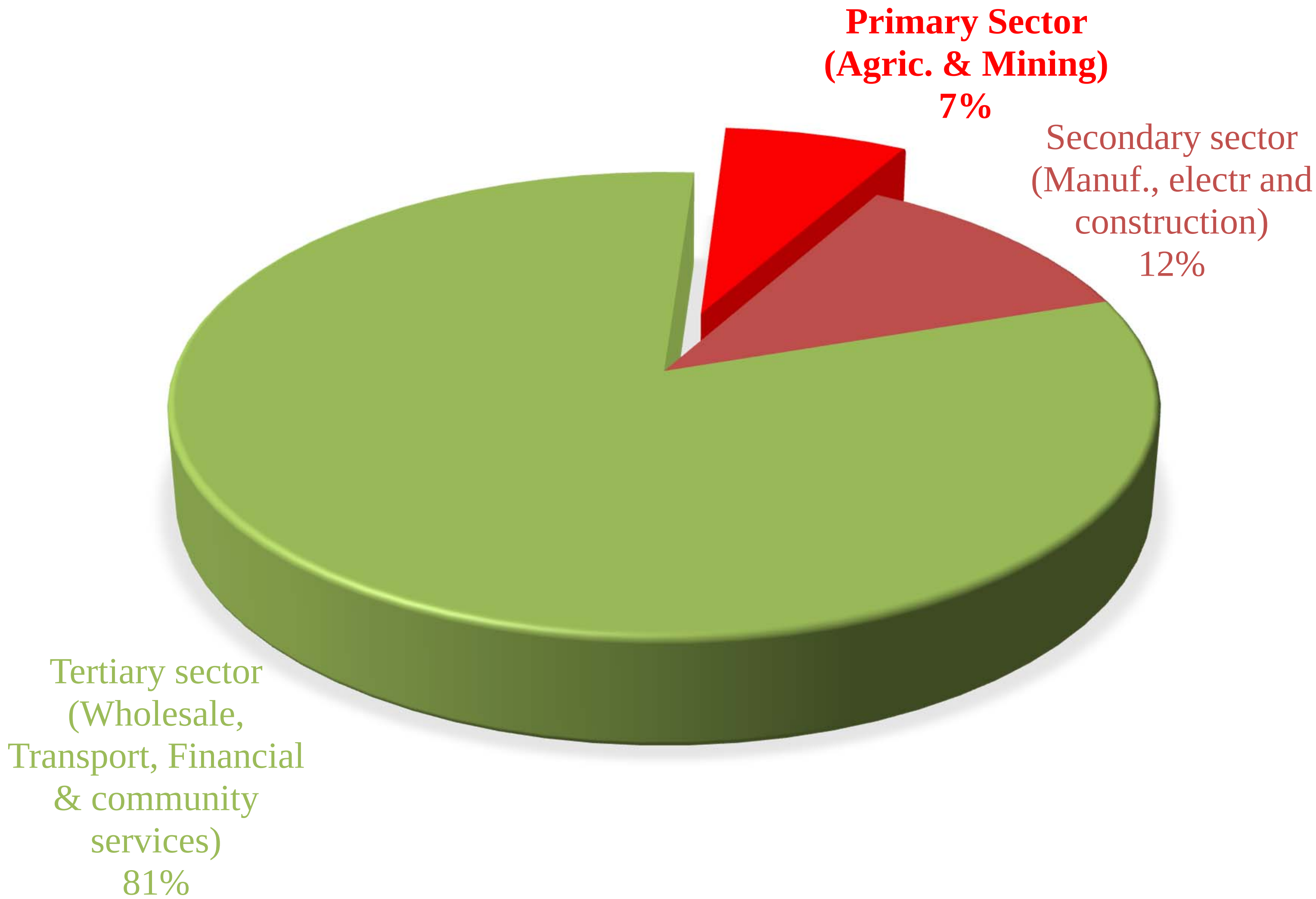
VAT PAYMENTS BY ECONOMIC ACTIVITY, 2014/15



COMPANIES' TAX BY ECONOMIC ACTIVITY, 2013/14



PERSONAL INCOME TAX BY ECONOMIC ACTIVITY, 2014/15



Intergovernmental Transfers

- The system recognizes the limited taxation powers assigned to provincial and local government, which results in a vertical fiscal gap
- The Constitution therefore enshrines the right of provincial and local government to a share in the revenue raised nationally (S. 214 of Constitution)
- The Constitution also makes provision for other allocations to provinces and local government, which are conditional in nature
- The annual division of revenue process divides the revenue raised nationally among the three spheres of government
  – local government share very small but increasing pressures due to free basic services

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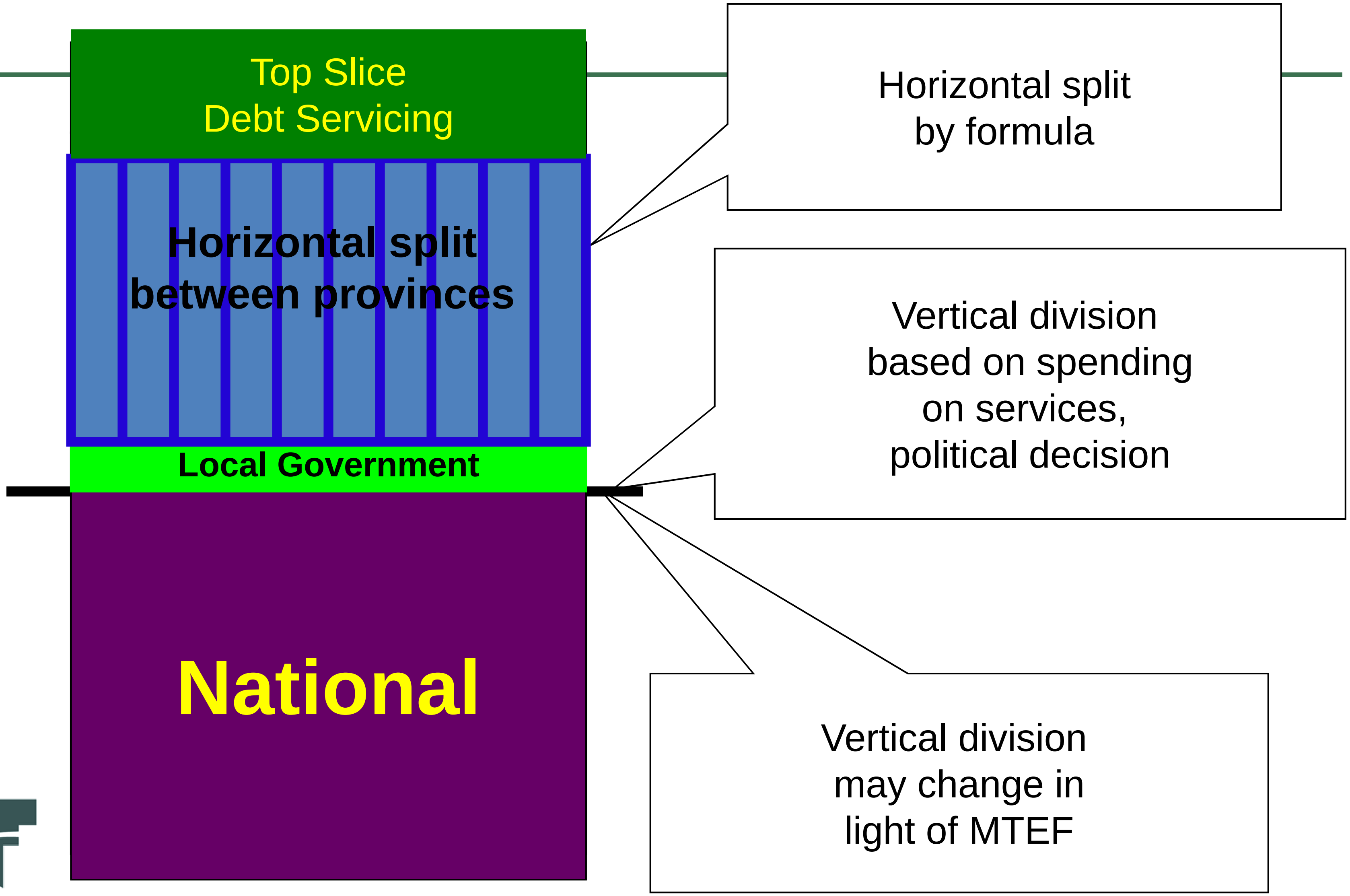
Vertical Division of Revenue



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DIVISION OF REVENUE PROCESS – 2015/16

R Billion	Revenue allocation	Percent of Total
National Allocations	**523**	**48%**
Provincial	**468.2**	**43%**
equitable share	382.7	35%
Conditional Grants	85.5	8%
Local	**99.8**	**9%**
equitable share	50.2	5%
Conditional Grants	38.9	4%
Total	**1091**	**100%**

Source: National Treasury Budget Review, 2015

PROVINCIAL EQUITABLE SHARE

- The provincial equitable share (PES) formula was introduced in 1998 as a mechanism to allocate the provincial share of nationally raised revenue equitably across the nine provinces
- The formula has remained relative stable since its introduction with minor changes to components and relative weights
- The formula is largely population-driven and captures shifts in population across provinces
- Although the PES is unconditional, provinces are required to fund constitutionally mandated services from the PES

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Components of the Provincial Equitable Share Formula

- *Education share* **(48%)** based on size of school age population (ages 5 – 17) and the number of learners (Grade R to 12) enrolled in public ordinary schools
- H*ealth share* **(27%)** based on risk-adjusted capitation and caseloads at hospitals
- B*asic share* (**16%**) derived from each province's share of the national population
- P*overty component* (**3 %**) reinforcing the redistributive bias of the formula and based on each province's share of the poorest 40 % of the population
- E*conomic output component* (**1%**) based on GDP-R per region
- I*nstitutional component* (**6%**) divided equally between the provinces

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PROVINCIAL EQUITABLE SHARE FORMULA – PROVINCIAL BREAKDOWN

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	48%	27%	16%	3%	1%	5%	100%
Eastern Cape	15.1%	13.5%	12.6%	16.2%	7.5%	11.1%	14.0%
Free State	5.3%	5.4%	5.2%	5.3%	5.2%	11.1%	5.6%
Gauteng	17.7%	21.4%	23.9%	17.1%	34.7%	11.1%	19.5%
KwaZulu-Natal	22.5%	21.8%	19.8%	22.2%	15.8%	11.1%	21.3%
Limpopo	13.0%	10.4%	10.4%	13.6%	7.1%	11.1%	11.8%
Mpumalanga	8.5%	7.3%	7.8%	9.2%	7.1%	11.1%	8.2%
Northern Cape	2.3%	2.1%	2.2%	2.2%	2.2%	11.1%	2.7%
North West	6.5%	6.7%	6.8%	8.1%	6.4%	11.1%	6.9%
Western Cape	9.0%	11.3%	11.3%	6.1%	14.0%	11.1%	10.1%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Local Government Equitable Share

- As in the case of provincial government, the horizontal division of revenue across 278 municipalities is also done using a formula-based mechanism since 1998
- The general aim of the formula is to support the delivery of basic municipal and community services along with municipal administrative costs
- The formula is designed to redistribute resources where taxation powers or ability to raise revenue is limited
  - Ability to generate own revenue differ considerably across municipalities
- Decentralisation allows local commuters to hold municipalities accountable for their use of revenue resources

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COMPONENTS OF THE LOCAL GOVERNMENT EQUITABLE SHARE

Formula

1 **Basic Services** + 2 **Institutional and Community Services** ± 3 **Correct-ion & Stability**

How it works

Allocation for every poor household in the country to enable municipalities to fund the cost of free basic services (including maintenance costs)

Made up of three parts:

Institutional funding + **Funding for Community Services**

Revenue Adjustment factor

Ensures more funds go to the municipalities with less own revenue capacity

(Factor of between 0% and 100% applied)

Ensures guarantees are met and smoothes changes in allocations

LGES Allocation

CONDITIONAL GRANTS

- Provinces and municipalities receive grants from national government that must comply with certain conditions attached
- Rationale for conditional grants:
  - provide for national priorities
  - Promote national norms and standards
  - compensate for spill-over effects of certain services e.g. specialised/academic hospitals
  - Effect transition by supporting capacity building and structural adjustments
- Provincial and local government conditional grants mostly focused on infrastructural spending aimed at addressing historical backlogs that existed predominantly in the former homeland areas
- Local government also receives capacity-building grants which aim to improve municipal institutions in areas where human skills are underdeveloped

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MAIN CONDITIONAL GRANTS TO PROVINCIAL AND LOCAL GOVERNMENTS – 2015/16

Main Provincial Conditional Grants (2015/16)	R'billion	Main Local Government Conditional grants	R'billion
Human Settlements Development	18.2	Municipal Infrastructure	15
Comprehensive HIV/AIDS	13.7	Urban Settlement Development	10.7
National Tertiary Services (health)	10.4	Public Transport Network Infrastructure	6
Education Infrastructure	9.5	Municipal Water Infrastructure	1.8
Provincial Roads Maintenance	9.7		

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Table W1.6 Total transfers to provinces, 2015/16

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	54 312	10 060	**64 372**
Free State	21 757	6 609	**28 367**
Gauteng	73 413	17 123	**90 537**
KwaZulu-Natal	82 254	16 881	**99 135**
Limpopo	45 377	6 742	**52 120**
Mpumalanga	31 030	6 851	**37 881**
Northern Cape	10 138	3 665	**13 803**
North West	26 151	6 942	**33 093**
Western Cape	38 242	10 507	**48 749**
Unallocated	–	103	**103**
Total	**382 673**	**85 485**	**468 159**

Source: National Treasury

Link between natural resource and wealth sharing and subnational government [1]

- For the past 21 years revenue collection from resource wealth have been largely centralised and shared cross the three spheres of government
- This practise has achieved economies of scale, reduced regional tension and ensured equitable allocation of revenue throughout the republic
- However, provinces and municipalities in which most of the natural resources are located, do not benefit proportionally more from the nationally shared revenue raised compared to other provinces and municipalities
- The mining industry sometimes causes severe environmental damage in the area where the mine is located, yet the local community is not compensated for the social costs incurred
  - There are therefore increasing calls for local communities and municipalities to benefit in a more direct way from mines located in their jurisdictions

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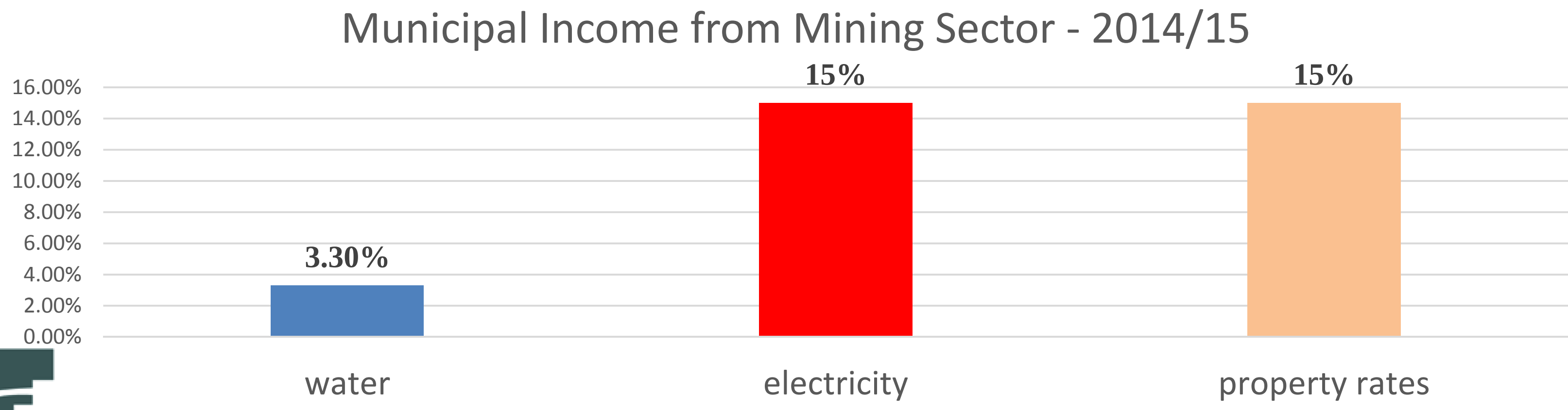
LINK BETWEEN NATURAL RESOURCE AND WEALTH SHARING AND SUBNATIONAL GOVERNMENT (2)

- Provincial own revenue accounts for only 2.5% of total provincial revenue. Provinces do not receive any direct rents from the natural resources sector, except what is provided for through the division of revenue process
- Own revenue accounts for on average 79% of total municipal income
  – Municipalities also earn income from the resources sector through the provision of basic services such as water, electricity and property tariffs. The share of income earned by municipalities from the mining sector on property rates, water and electricity tarriffs is indicated in the table below



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SUB-NATIONAL BORROWING POWERS

- Borrowing powers at subnational level is restricted to:
  – Capital financing
  – Bridging finance for operating expenditure
    - Needs to be paid back by end of financial year
- Provincial borrowing
  – Little discretion
    - Current agreement for no provincial borrowing
  – Loans coordinating committee with FFC oversee borrowing
  – National government is lender of first resort
- Local government borrowing
  – Varying ability to leverage finance – dominated by metros

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System of Support and Intervention

Regulatory Oversight and Coordination

Financial Reporting	Auditor General/FFC

Support and Advice

IGR Forums	Benchmarking

Hands on Support

Capacity building	Section 154

Legal Interventions

Section 100/139	Section 216 (2)

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LESSONS FROM SOUTH AFRICA IN MANAGING WEALTH AND NATURAL RESOURCES

LESSONS FROM SOUTH AFRICA

- Adherence to constitutional principles and the need for an independent constitutionally enshrined Commission
- The need for strong institutions to support the financing system
- The need for transparency in all processes
- Strong system of cooperative governance and intergovernmental coordination
- System should be designed around the specific characteristics of the country and no system can be applied uniformly across countries

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LESSONS FROM SOUTH AFRICA

- Strong budget reform processes and certainty across the system
- Effective planning, evaluation and monitoring of sub-national entities
- The need to ensure a dynamic funding system that responds to the ever evolving system of decentralised government

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