FINANCIAL AND FISCAL COMMISSION

Peer Learning Exchange With The Vietnam Mission

11 December 2011

For an Equitable Sharing of National Revenue

PRESENTATION OUTLINE

- About the Financial and Fiscal Commission (FFC)
- Interaction with Stakeholders
- Fiscal Imbalance
  – Vertical and horizontal imbalance: Division of revenue processes and mechanics
  – Legislative and economic principles underpinning Local Equitable Share and Provincial Equitable Share
- Budget Transparency: What has worked and not worked?
- Lessons from South Africa

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I. Role and Function of the Financial and Fiscal Commission

VISION AND MISSION

Vision

To provide influential advice for an equitable, efficient and sustainable Intergovernmental Fiscal Relations System

Mission

To provide proactive, expert and independent advice on promoting a sustainable and equitable Intergovernmental Fiscal Relations system, through evidence-based policy analysis to ensure the realisation of our constitutional values

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REGULATORY FRAMEWORK

- Constitution, 1996
  - Financial and Fiscal Commission Act, 1997 (Act No 99 of 1997) (as amended)
  - Intergovernmental Fiscal Relations Act, 1997 (Act No 97 of 1997) (IGFR Act)
  - Money Bills Amendment Procedure and Related Matters Act, 2009 (Act No 9 of 2009)
  - Local Government: Municipal Systems Act, 2000 (Act No 32 of 2000) (as amended)
  - Provincial Tax Regulation Process Act, 2001 (Act No 53 of 2001)
  - Local Government: Municipal Finance Management Act, 2003 (Act No 56 of 2003) (as amended)
  - Municipal Fiscal Powers and Functions Act, 2007 (Act No12 of 2007)
  - Borrowing Powers of Provincial Government Act, 1996 (Act No 48 of 1996)

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II. Interaction With Stakeholders

CONSTITUTIONAL AND LEGISLATIVE MANDATE

- Financial and Fiscal Commission (FFC)
  - Permanent statutory body established in terms of Section 220 of Constitution
  - Independent and subject only to Constitution and the law
  - Must function in terms of an act of Parliament
- Mandate of FFC
  - Makes recommendations, envisaged in Chapter 13 of the Constitution or in national legislation to Parliament, Provincial Legislatures, and any other organs of state determined by national legislation

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General Principles

- FFC is concerned with IGFR
  - Legislative provisions or executive decisions that affect either provincial or local government from a financial and/or fiscal perspective
  - Includes regulations associated with legislation that may amend or extend such legislation
  - Commission must be consulted in terms of the FFC Act
- Important stakeholders for consultation in IGFR
  - Ministry of Finance, The Presidency, Organised Local Government, Ministry of Cooperative Governance and Traditional Affairs, Parliament, Provinces, National Planning Commission

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Stakeholder Relationship

- The FFC consults with Provincial Legislatures in terms of its mandate as provided for in the Constitution and enabling legislation
- Makes recommendations and provides advise
- Interacts on financial and fiscal matters as per agreed protocols
- Comment and provide advisories on financial and fiscal matters
- Provides training to Parliamentary committees, councillors and researchers on request

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STAKEHOLDER RELATIONSHIPS

- All engagements are guided by legislation and the mandate of the Commission
- Financial and Fiscal Commission
  - required by law to report on its work to provincial legislatures
  - partakes in initiatives by its stakeholders namely key focussed programmes, roundtables and continuous engagements
  - ensures that it continuously engages with its stakeholders on its research, findings and recommendations, positions, priorities, decisions, programmes, services and other initiatives
  - is able to actively engage in the design, delivery, review and improvement of its Stakeholder's work

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STAKEHOLDER RELATIONSHIPS

- The FFC engages through the following:-
  - ➢Publication of its Annual Submission on the Division of Revenue
  - ➢Submissions on Division of Revenue Bill, Fiscal Framework and Revenue Proposals, Amendment Bill and Medium Term Budget Policy Statement
  - ➢Technical Reports
  - ➢Policy briefs
  - ➢Presentations
  - ➢Briefing sessions
  - ➢Public hearings and working groups
  - ➢Annual Report, Strategic Plan and Annual Performance Plan

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FFC AND THE IGFR ROLE PLAYERS

Role Player	Interaction
Parliament/Portfolio Committees	• Annual submission for the Division of Revenue • Briefing on the submission for the Division of Revenue • Briefing on the annual budget • Briefing on the Medium Term Budget Policy Statement • Briefing on Fiscal Framework and Revenue Proposals • Briefing on Commission submission on Appropriation Bill • Submit Commission Annual Report
Provincial Legislatures	• Briefing on the submission for the Division of Revenue • Briefing on the Medium Term Budget Policy Statement • Presentations on request by Stakeholders
National Treasury	• Briefing on the submission for the Division of Revenue • Participate on Technical Committee on Finance • Participate at Budget Council
South African Local Government Association (SALGA) and Department of Cooperative Governance	• Briefing on the submission for the Division of Revenue • Participate in Local Government forums • Submission to address Intergovernmental fiscal challenges within local government sphere

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III. How the Problem of Fiscal Imbalance is Addressed

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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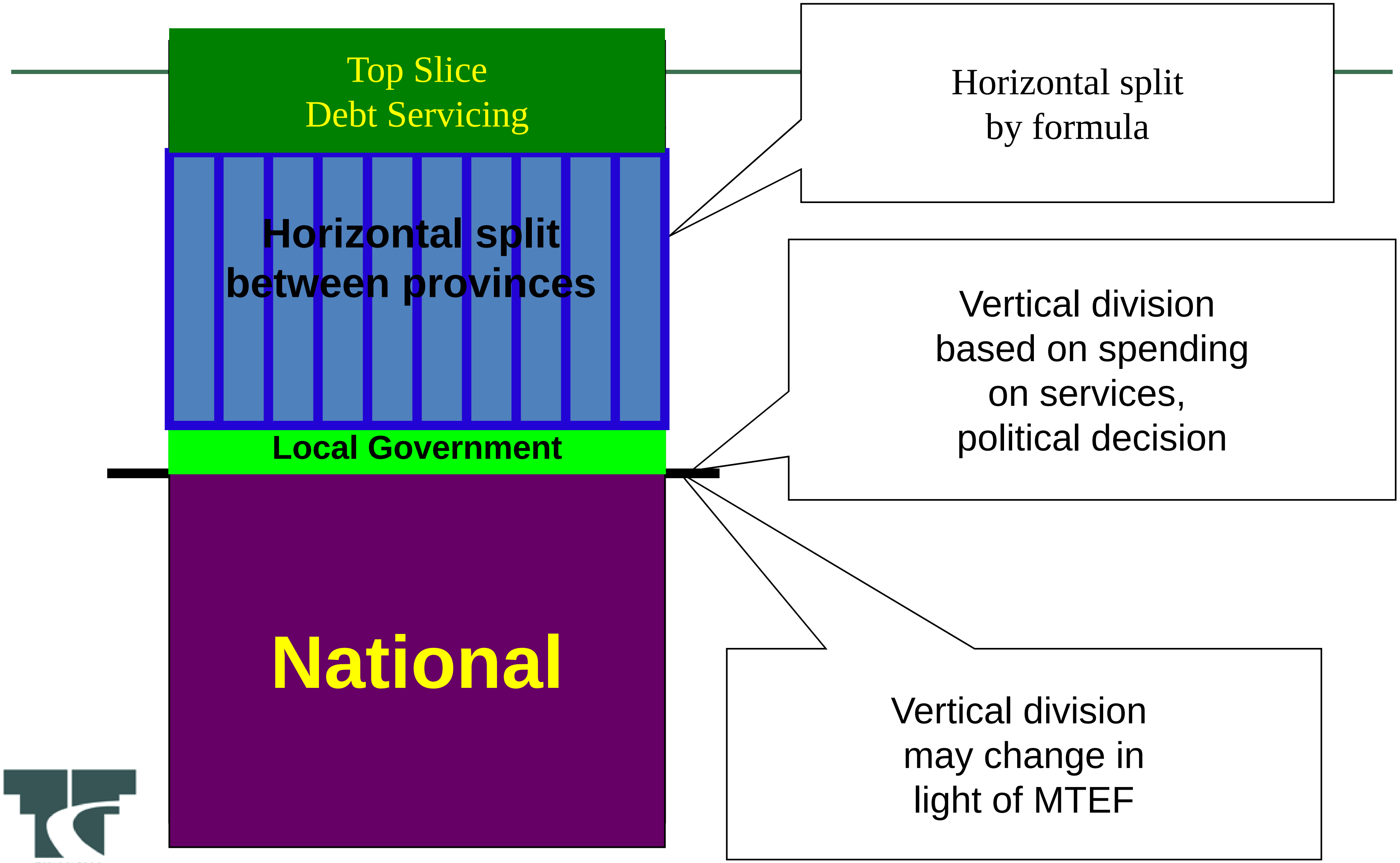
VERTICAL DIVISION OF REVENUE



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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

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Division of Revenue – Vertical Process

- This is a consultative political process
- Informed by changing political priorities
- Gradual decline in national share since 2005

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
National	53%	51%	50%	50%	50%	48%	47%	47%
Provinces	42%	43%	42%	42%	42%	44%	45%	44%
PES	37%	36%	35%	35%	34%	36%	36%	36%
CG	5%	7%	7%	8%	8%	8%	9%	9%
Local	5%	6%	8%	8%	7%	8%	8%	9%
LES	3%	4%	4%	4%	3%	4%	4%	4%
CG	2%	2%	3%	3%	3%	3%	3%	3%

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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

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

2 Institutional and Community Services: 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)

3 Correction & Stability: 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

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

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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ONGOING PES/LES CHALLENGES

- Inappropriate Component and rigid weightings
  - Absence of social development component
- Appropriateness of variables to derive provincial shares
  - Population biased
  - Need indicators
- Perpetuates historical imbalance
- Undermine provincial expenditure discretion
  - Misalignment between policies and budgets
- Absence of funding and expenditure Norms and Standard
  - Variation in levels of services and funding
  - Norms and Standard not enforced
- Overloading the transfer system with too many objectives

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ONGOING PES/LES CHALLENGES

- Formula input data
  - Additional variables and quality
- Service delivered at minimum feasible cost
- Role of executive in setting delivery standards that fit within the budget constraint
  - Pareto optimal budget
- Balancing national control against subnational autonomy
- Optimal equalisation framework

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BUDGET TRANSPARENCY: WHAT HAS WORKED

BUDGET REFORMS SINCE 1994

- Three-year budgeting system
  - National and provinces (1998/99 Budget), Municipalities (2001)
- Budget decentralisation and certainty
  - Own budgets by provinces and municipalities, grant certainty
  - Division of Revenue Act and schedule of all national allocations ***per province, per municipality for each of three coming years***
- PFMA (1999) and MFMA (2003)
  - Modernising financial management in the public sector
  - ***Minister responsible for outcomes and policy, administrative head of dept responsible for implementation and outputs***
- No bail-out/guarantees for provinces/municipalities
  - Up-front allocation certainty, no ad-hoc in-year allocations
- Development of provincial/local fiscal framework

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MTEF BUDGETING

- In 1998 shifted from one-year incremental budgets to three-year rolling budgets
  - Publish 3 year budgets, but appropriate only for one year only
  - Use outer 2 years as baseline for next budget, and allocate only additional funds from contingency reserve and new revenue
- Lays basis for better planning, more consultative budget processes and better intergovernmental fiscal relations

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INTERGOVERNMENTAL BUDGETING

- SA system ensures grant certainty
  – Three year allocations per province, per municipality, for every grant
- Equitable share allocation main allocation to provinces
  – Clear formula to divide funds
  – Provincial formula linked to key social sectors (main constitutional mandates)
  – Local government formula linked to poor households (access to basic municipal services)
- Conditional grants
  – Infrastructure, tertiary health services and other national priorities
  – Different formula for each conditional grant
- Annexure E in Division of Revenue Bill

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INTERGOVERNMENTAL GRANTS

- Discretionary Funding,
  - unconditional grants work better than conditional grants
    - focusing on broad priorities related to entire budget
- Resist sectors who prefer conditional grants
  - Principled approach: Spill-overs and national priorities
- Redistributive horizontal division of revenue formulae for non-conditional grants
  - How do we achieve equalisation?
  - Needs versus performance?
- Data problems
  - is it possible to get comparable usage and cost data for all provinces or municipalities?

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REGULAR REPORTING

- Financial management improves dramatically if we start
  - Publishing of monthly in-year reports on budget implementation
  - Requiring financial statements from all departments and entities to submit for audit within 60 days of end of financial year, and audited and tabled in Parliament within 6 months
- Many benefits follow from above, including in-year accountability, better management and further feedback mechanisms to improve budget allocation process

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ONE EFFICIENT COLLECTION AGENCY

- Success of one national collecting revenue agency (SARS) for the major taxes
- You cannot spend or divide revenue that you fail to collect!
- We divide revenue anticipated to be collected before the start of the financial year

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Budget Transparency: What Still Needs to be Improved?

FINDING A PATH THROUGH THE GLOBAL CRISIS AFTERMATH

- Excessive accumulation of debt – Debt burdens continue to weigh on growth.
- Limited fiscal resources are confronted by rising demand for social services.
- Widespread inequality, is fuelling public anger and political instability.
- Unemployment has increased, with the challenge of mass joblessness among youth.

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What we still need to improve: challenges

- Deepened political oversight required
- Policies seem to be abandoned before they gain traction
  - Unresolved policy issues (RDP, GEAR, ASGISA and New Growth Path….)
- Poor programme costing
- Unfunded policy mandates
- Weak interdepartmental coordination

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WHAT STILL NEEDS TO BE IMPROVED

- Pursuit of for economic growth (geared towards creating a more equitable future) must go hand in hand with job creation. Through shifting of the Composition of Spending towards
  - Expanding construction of economic and social infrastructure,
  - Increased economic competitiveness,
  - Moderation of public sector remuneration,
  - Sustaining investment and job creation

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What Still Needs To Be Improved..

- Are we seeing value for money (from doubling in expenditure since 2002/03)
  - Despite consistent growth in public spending over the past decade, rising allocations not matched by commensurate improvement in service-delivery outcomes.
  - Government needs to take steps to strengthen efficiency in public spending
  - Eliminate wastage
  - Improve the alignment between allocations and policy priorities
  - Root out corruption.

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PERFORMANCE AND ACCOUNTABILITY: CHALLENGES

- We are still striving to get more performance accountability
  - Budget reforms to facilitate greater performance in public sector as a whole
  - Has three year budgeting reached lower down to the level of project or facility?
- How do we get better customer accountability?
- How can we get better political accountability through legislatures?
  - Does political failure increase the risk of service delivery failure?
  - What do we do when things go wrong?
  - Do we apply all our laws without fear?

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Lessons From South Africa

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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THANK YOU

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