



BRIEFING TO THE SELECT COMMITTEE ON  
APPROPRIATIONS ON THE 2016 DIVISION OF  
REVENUE BILL

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12 April 2016

*For an Equitable Sharing of National Revenue*

# LAYOUT OF THE SUBMISSION

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1. Background to economic environment
2. Major revisions to Clauses of the 2016 DoRB
3. Major Changes and additions to the DoR: National and Provincial Fiscal framework
4. Major Changes and additions to the DoR: Local Government Fiscal Framework
  - A. Further reforms to LG conditional grants
5. Government responses to Commission and SCoA recommendations
6. Conclusion

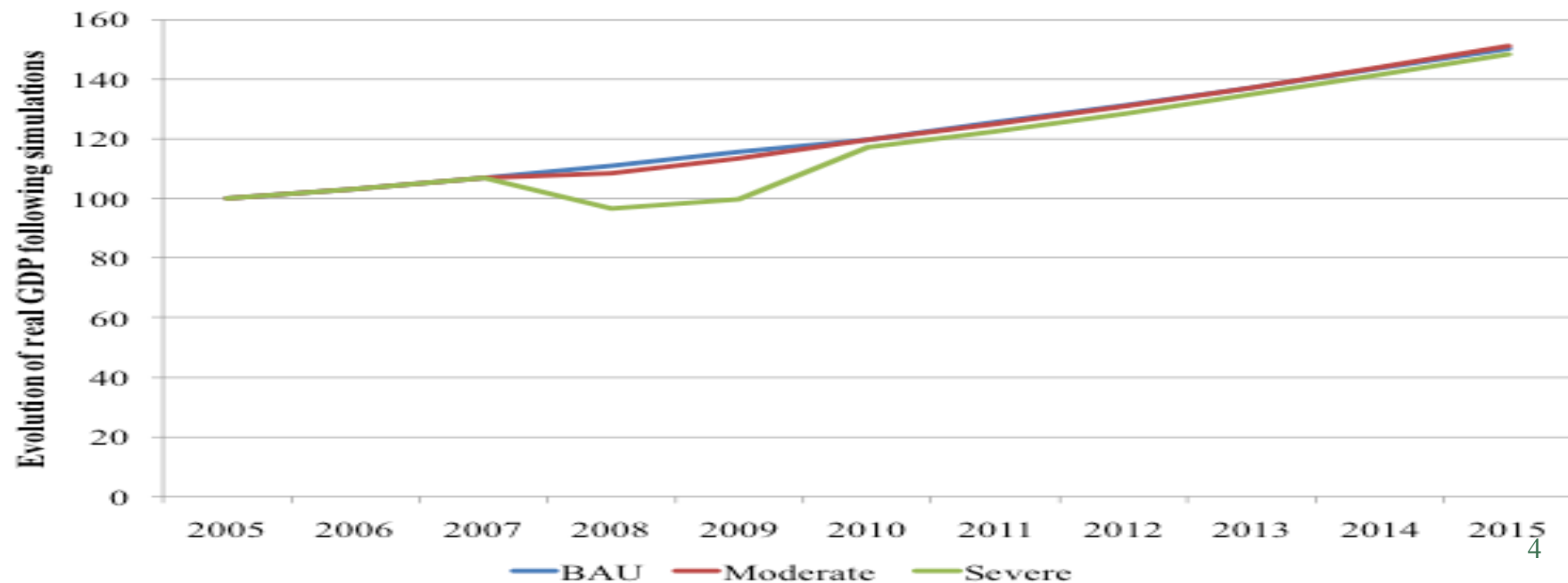


# ECONOMIC ENVIRONMENT UNDERLYING 2016 DoRB

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# GENERAL ECONOMIC OUTLOOK

- Economy remains vulnerable to slow global recovery and domestic challenges
- ↓ revisions to economic growth
  - Confirms Commission's GDP projections



# ECONOMIC BACKGROUND UNDERLYING THE BUDGET

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- The 2016 Budget is tabled within an environment of escalating internal and external economic headwinds
  - Export performance is weak, high inflation outlook, weaker Rand and deterioration in terms of trade
- Third straight year of downward revision to growth forecasts
  - cumulative 2.5% between 2014 – 2017
- Low fragile growth below NDP targets substantially constrains Government's ability to address triple challenges – unemployment, inequality and poverty
- Government must continue to exercise fiscal restraint and improve the composition and quality of spending to minimise long term-fiscal risks



# MAJOR REVISIONS TO CLAUSES OF THE 2016 DoRB

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# MAJOR REVISIONS TO CLAUSES OF 2016 DORB

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- There are 5 main revisions to Bill clauses:
  - **Clause 20(3): Allowing grant funds to be reprioritised for disaster relief**
  - **Clause 21(2): Responding to corruption in procurement.**
  - **Clause 39: Transitional measures for municipal elections in 2016**
  - **Clause 19: Clarifying provisions for withholding and stopping of allocations**
  - **Clause 10(10): Gazetting Human settlement allocations to cities**

## ALLOWING GRANT FUNDS TO BE RE-PRIORITISED (1)

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- The Commission welcomes inclusion of this clause seeking to institutionalise disaster risk management strategies as a response to the drought within the existing grant framework
  - This allows for trade-offs between planned expenditures and pressing expenditures necessitated by previously unforeseen vagaries of weather to be transparent and in line with fiscal prudence



# RESPONDING TO PROCUREMENT IN CORRUPTION

## (2)

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- The Commission welcomes this clause because it is in line with the Commission recommendation for 2016/17 division of revenue to raise procurement to a strategic level
  - As well as using conversion to indirect grants as a measure of last resort. Transgressions in procurement do constitute serious reasons that warrant such intervention.
  - Furthermore, the clause is welcome as it puts in place a mechanism that ensures fast-tracking of spending and reclassification of grants in accordance with justifiable and necessary processes
  - There is need to ensure that the clause is much clearer in setting the threshold levels of procurement transgression at which point the grant is converted to an indirect grant and the timeframe within which the grant remains an indirect grant after conversion

# TRANSITIONAL MEASURES FOR MUNICIPAL ELECTIONS (3)

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- The Commission supports this measure as it is prudent and shows good forward planning
  - The Commission recommended a conditional grant be designed in order to support the affected municipalities with the restructuring process

# CLARIFYING PROVISIONS FOR WITHHOLDING AND STOPPING OF FUNDS (4)

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- On withholding of funds, a new clause 19 clarifying provisions for withholding and stopping of allocations has been inserted
  - The Commission would like to reiterate its previous recommendations that:
    - Proper diagnostics of the root cause of non-payment be done and if it is due to bad management, appropriate consequences should be rendered;
    - Stricter measures should be imposed on individuals within municipalities that are responsible for continuously flouting MFMA rules;
    - The electricity and water undertakings must be ring fenced; and
    - IGFR forums dedicate sufficient time to find lasting solutions to the debt problems within the Local government sector.

# GAZETTING HUMAN SETTLEMENT ALLOCATIONS

## (5)

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- Efforts are made to address anticipated shift of transport function to Metros
- A new clause (Clause 10(10)) requires provinces to gazette housing allocations to Metros before they receive the funds
  - This is a welcome development as it enable metros to undertake integrated planning
  - Gazetted allocations must be aligned to APPs



MAJOR CHANGES AND ADDITIONS TO THE 2016  
DIVISION OF REVENUE: NATIONAL AND PROVINCIAL  
FISCAL FRAMEWORK

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# NATIONAL FISCAL FRAMEWORK

- Notwithstanding the slowdown, government is projected to spend R4.7 trillion over 2016 MTEF
- National and Provinces take the lion share of the total expenditure, but municipal allocations grow the fastest
- National indirect transfers to provinces and municipalities are declining

Real Year on Year Growth	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
National Departments		2.0%	7.0%	-4.4%	-0.2%	1.5%
Provincial		1.0%	2.7%	-0.8%	2.2%	1.6%
Local Government		0.1%	9.1%	-1.5%	1.7%	5.1%
Non-Interest Allocations		1.4%	5.3%	-2.6%	1.0%	1.9%

# NATIONAL FISCAL FRAMEWORK

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- The higher growth in National share of revenue for 2016 arises from Higher Education allocations to address student debt and freezing of fee increases
  - The Commission looks forward to the review of costing for PSET and urge government to look beyond enrolment and focus on attainment – which is critical for the labour market
- SoEs continue to dominate government infrastructure spend followed by provinces and municipalities
  - The Commission welcomes continuous investment in infrastructure – projects must be delivered on time and the quality of spend must be emphasised.

# PROVINCIAL FISCAL FRAMEWORK

- The provincial fiscal framework [inclusive of conditional grants] is revised downwards by R19 billion over the 2016 MTEF in comparison to 2015 MTBPS
- Despite downward revisions, both PES and conditional grants still expected to grow on average at above the rate of inflation over 2016 MTEF. Nevertheless, PES and conditional grants decline in real terms in 2016/17, with conditional grants hardest hit at -2.3%
  - Provinces should still be able to deliver their constitutionally mandated basic services without any serious service delivery implications, while national priority expenditure areas funded through conditional grants may come under pressure in 2016/17

	2015/16	2016/17	2017/18	2018/19	Annual Average Real Growth Rate
<b>R'million</b>					
PES	360	386.5	412.2	447.6	
Conditional grants	80	85.3	91.2	101.2	
<b>Real Annual Growth Rate</b>					
PES		-0.3%	1.4%	1.6%	0.9% <sup>16</sup>
Conditional grants		-2.3%	6.7%	1.7%	2.0%



# PROVINCIAL FISCAL FRAMEWORK

[CONT.]

- Provincial Equitable Share
  - An amount of R2.3 billion that was previously part of the devolution of property rates funds grant will be fully phased into PES during 2016/17
  - Funds from the PES will also be used to expand the human papilloma virus grant so that the programme continues
  - The Commission supports both initiatives as they enhance efficiencies and mainstream these activities into the workflows of provinces
- Provincial Equitable Share formula
  - The weights assigned to the six components of the PES remain the same in 2016/17
  - Given the potential disruptive nature of Census 2011, the Commission supports the ongoing assistance provided to the Eastern Cape, KwaZulu-Natal, Free State and Limpopo to cushion the impact of declining provincial equitable shares due to reduction in population figures

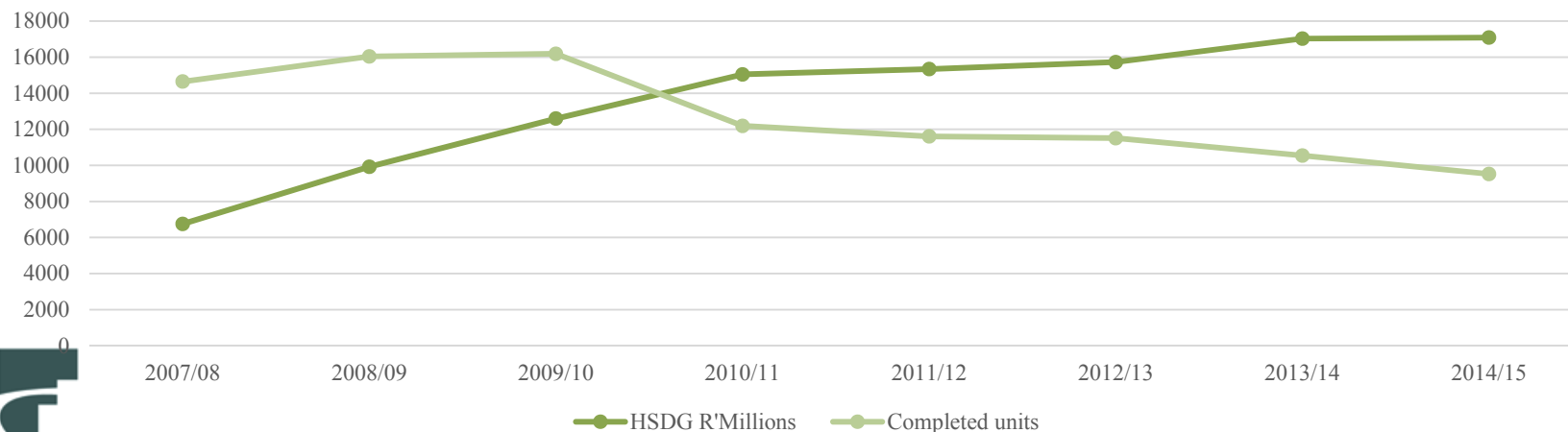
# CHANGES TO PROVINCIAL CONDITIONAL GRANTS

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- Provincial conditional Grants are revised downwards by R3.5 billion over MTEF
- Total allocation are still considerably high with projected allocation of R108bn in 2018/19
  - HSDG is revised downward by R1.6 billion
  - HFRG is reduced by R200 million
- The Commission support reprioritisation of funds to the extent that cuts are equitably distributed and targeted at non performing grants

# IMPLICATION OF CUTS ON HOUSING DELIVERY

- The big cut on HSDG will accelerate the rate of decline in house delivered per allocation
- Government must support other housing programs (self-built & FLISP) to reduce pressure on HSDG
- Housing investment in mining towns must be carefully considered and informed by needs and preferences



# HEALTH GRANTS CHANGES AND PERFORMANCE REVIEW

- Health grants are showing good spending trajectory
- The comprehensive HIV/AIDS and HFRG are revised downward by R176 million (once-off) and R365 Million over MTEF
- This reduction must be carefully managed to minimise impact on delivery
- Budget cuts must be informed by thorough expenditure reviews

Health	2009/10	2010/11	2011/12	,2012/13	2013/14	2014/15
Comprehensive HIV and Aids Grant	98%	98%	97%	99%	99%	99%
Health Facility Revitalisation Grant	-	-	-	-	84%	94%
Health Infrastructure Component	-	-	93%	93%	88%	-
Hospital Revitalisation Component	73%	76%	90%	85%	83%	-
Nursing Colleges and Schools Component	-	-	-	77%	69%	-
Health Professions Training and Development Grant	108%	99%	100%	99%	100%	100%
National Health Insurance Grant	-	-	-	55%	82%	72%
National Tertiary Services Grant	109%	99%	100%	99%	100%	99%

# BASIC EDUCATION GRANTS CHANGES AND PERFORMANCE REVIEW

- Key changes to basic education conditional grants are
  - Reduction of the EIG baseline by R160 million
  - Merger of school infrastructure backlog grant with EIG
  - Introduction of ECD grant as recommended by the Commission in its 2016/17 submission
- Education grants that cannot expend 100% of their allocation must be used to relieve budget pressures in other areas.

Basic Education	2009/10	2010/11	2011/12	,2012/13	2013/14	2014/15
Dinaledi Schools Grant	-	-	88%	82%	80%	82%
Education Infrastructure Grant	-	-	97%	93%	100%	94%
HIV and Aids (Life Skills Education) Grant	92%	87%	90%	86%	74%	88%
National School Nutrition Programme Grant	98%	95%	96%	98%	98%	99%
Technical Secondary Schools Recapitalisation Grant	-	76%	71%	74%	67%	87%
Occupation Specific Dispensation for Education Sector Therapists Grant	-	-	-	-	-	90%

# NHI REFORMS

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- Health conditional grants have undergone numerous reform since introduction of NHI
- For 2016 the NHI grant is merged into a new National Health Grant intended to fund Ideal Clinic Initiative among other things
- The commission is concerned with endless changes to grants synonymous with the sector as this introduces uncertainties, duplications and erodes old priorities.

# INCENTIVISING MAINTENANCE

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- With need to make better use of scarce resources, the Commission supports current reforms to use a larger share of infrastructure conditional grants, specifically in education and health, to beef up maintenance spending
- This will assist government in addressing maintenance backlogs that have accumulated in the health and education sector over the years
- The principle of rewarding provincial departments through the incentive grant component for meeting maintenance targets is supported, although under-capacitated provinces should not unduly lose out for not being able to meet targets due to lack of capacity



# LOCAL GOVERNMENT FISCAL FRAMEWORK

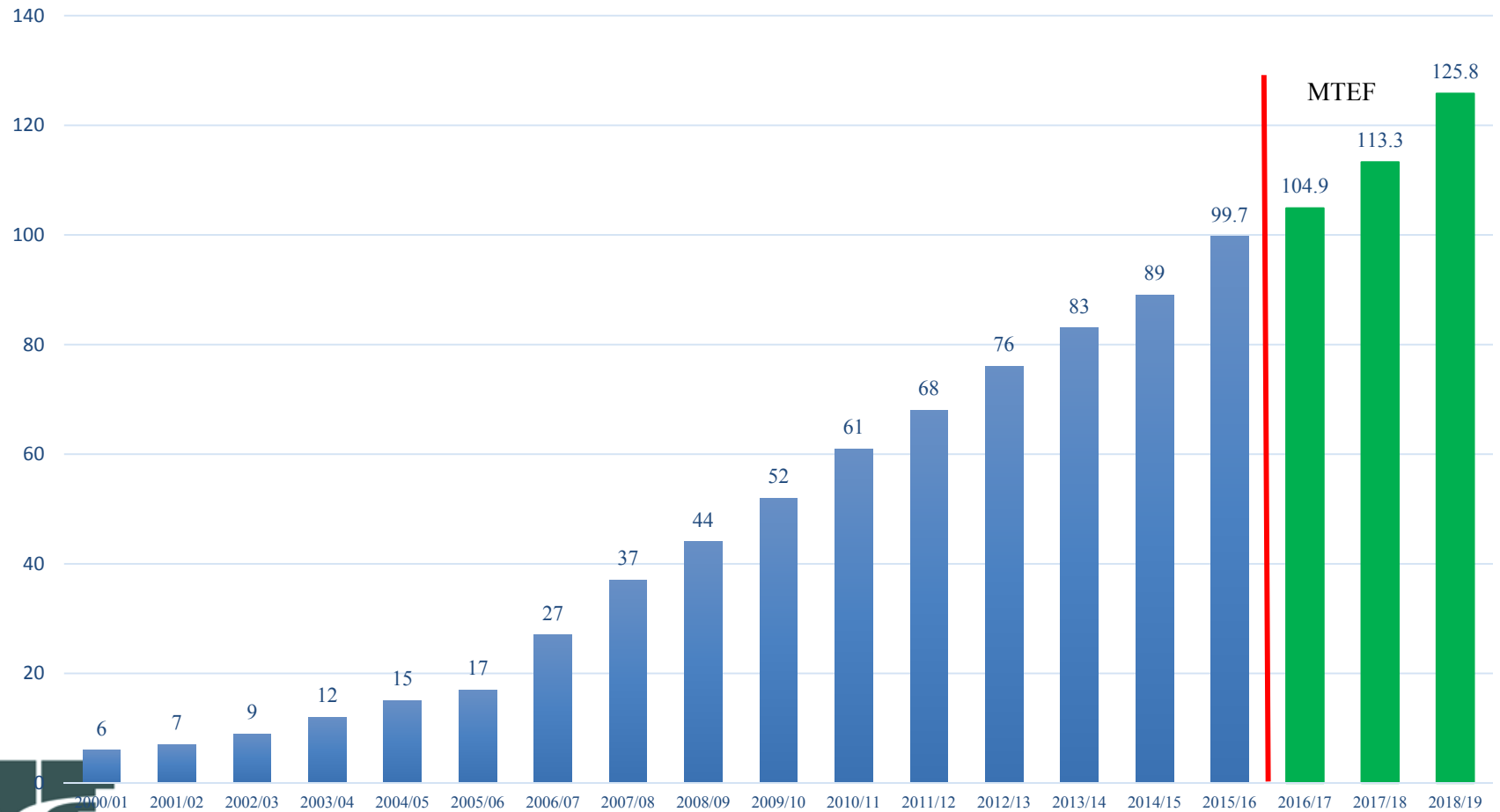
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# LOCAL GOVERNMENT FISCAL FRAMEWORK

- Local Governments will
  - Be affected by the slowdown in economic growth, the current recession facing the mining and agriculture sectors, the prevailing drought, and the oncoming local government elections
  - Experience one of the most wide ranging boundary redeterminations the country has witnessed since introduction of the current system of local government in 2000
  - Be affected by tariff hikes larger than inflation rates
- The sphere continues to receive increasing amounts of nationally acquired revenues:
  - It will receive about R334 billion in total revenues over the 2016 MTEF, which translates into an average share of 9.1%.

# VALUE OF TRANSFERS TO LG (BILLIONS)



# LOCAL GOVERNMENT BASELINE ADJUSTMENTS

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- Over the 2016 MTEF, the total baseline allocations to Local Government are set to decrease by R6.3 billion, and of this amount,
  - R5.5 billion will be in the form of direct conditional transfers to municipalities and R500 million will be transferred as indirect conditional grants
  - R300 million will be on the LGES
- The Commission notes these adjustment and understands the need for reprioritisation of budgets towards more urgent priority areas

# DEMARCATIION PROCESSES

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- The number of municipalities will be reduced from 278 to 257
- Each major amalgamation will be provided with a transitional grant to assist municipalities defray all costs associated with transition
- The Commission encourages National Treasury, Provincial Treasuries and CoGTA to put in place mechanisms for monitoring this grant in order to make sure that these resources are strictly used to offset costs related to demarcations
- The Commission underscores the point that the full financial impact of all demarcations should be established prior to boundary changes, and affected municipalities made aware of such costs
- All stakeholders in the demarcation process should also consider a post demarcation review to assess the full impact of current and previous demarcations. This review will assist all stakeholders to fully appreciate the impact of boundary changes on local government viability, budgets and overall local economic development.

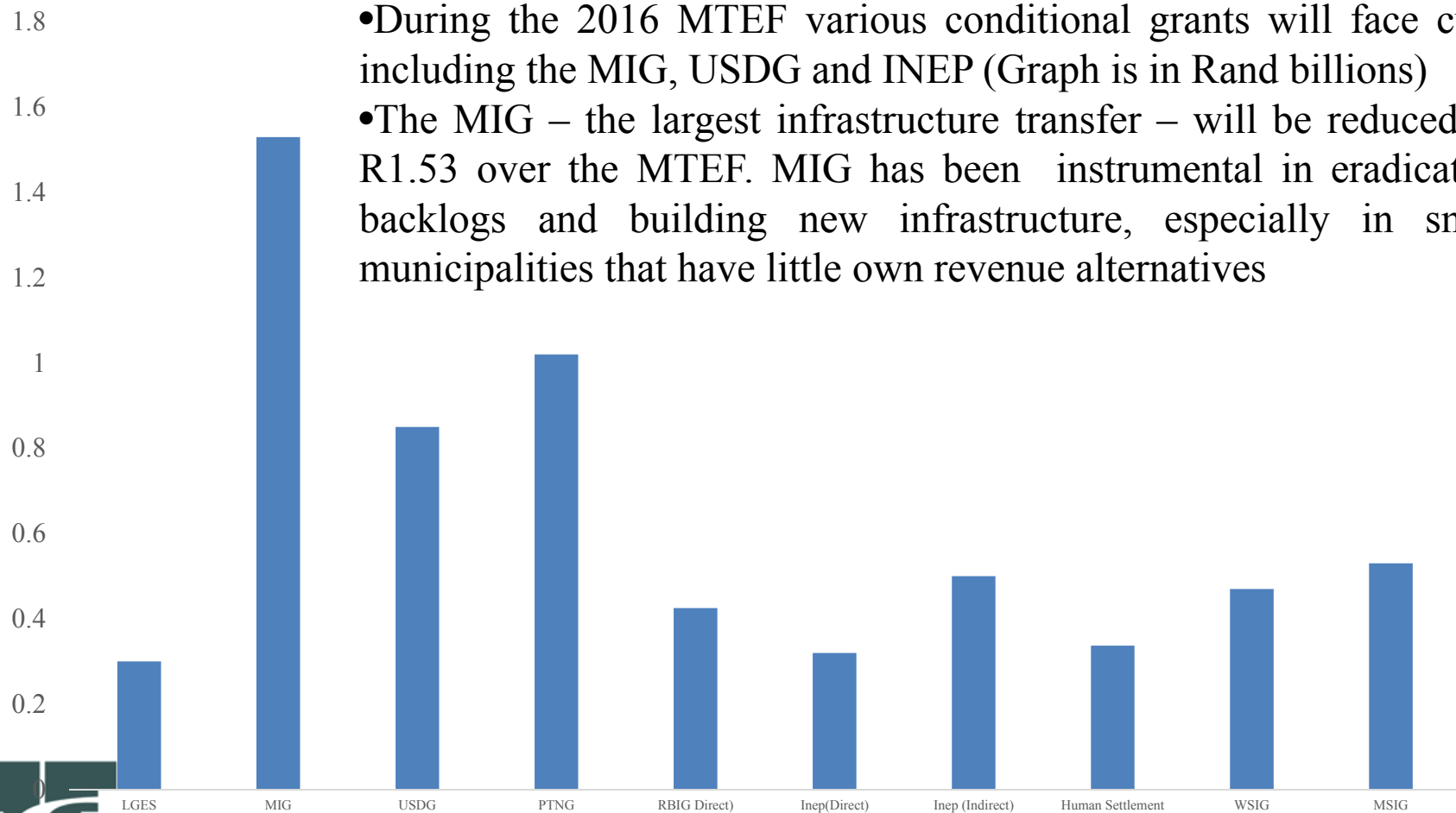
# LES AND LOCAL CONDITIONAL GRANTS

Division of revenue	2015 Budget (Revised)	2016/7		Estimates		Average Real Growth Rates 2016/17 to 2018/19	
		2015/16MTBPS	2016/17 Budget	2017/18	2018/19	2015 MTBPS	2016 Budget
Local government allocation	99650	106 949	104 925	113340	125811	3.90%	2.20%
LES allocations	50507	52 869	52 569	57012	61732	2.90%	1.00%
Conditional grants	38 485	42 857	41 132	44543	51611	5.50%	4.40%
General fuel levy	10 659	11 224	11 224	11785	12469	-0.60%	-0.50%

## Local Equitable Share

- The reductions in the LES are mainly on the institutional and community services components, which had risen very rapidly in value in 2015/16 financial year with a growth of 28% in one year.
- The Commission,
  - Supports the option of reducing these components by not more than 10%
  - Is of the view that reductions on the institutional and community services and preservation of basic services component is not likely to affect service delivery directly, but may compromise administrative efficiency, which may have a bearing on service delivery

# BASELINE REDUCTIONS ON TRANSFERS VS HISTORICAL PERFORMANCE ON LG GRANTS



- During the 2016 MTEF various conditional grants will face cuts: including the MIG, USDG and INEP (Graph is in Rand billions)
- The MIG – the largest infrastructure transfer – will be reduced by R1.53 over the MTEF. MIG has been instrumental in eradicating backlogs and building new infrastructure, especially in small municipalities that have little own revenue alternatives



# SUMMARY

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- The Commission is aware that cuts on baseline allocations were unavoidable consequences of poor economic growth and reprioritisation of allocations to more urgent government priorities
- Reductions due to reprioritisation should as a matter of principle take into account the historical performance of individual grants and this has been the case
- There is need to minimise the unintended consequences of such cuts, especially considering the fact that incidences of the cuts will fall disproportionately on poor households due to their heavy reliance on grants
- The government should ensure that such cuts do not compromise delivery of free basic services and the overall government infrastructure investment programme
- The Commission implores the Local Government sector to manage resources efficiently.



# ONGOING CONDITIONAL GRANTS REFORMS

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# REVIEW OF LOCAL GOVERNMENT INFRASTRUCTURE GRANTS

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- Local government infrastructure grant are currently undergoing review
- The review intends to improve the efficacy and effectiveness of the entire system
- The Commission welcomes the review and is encouraged that government is implanting some of the ensuing recommendations
  - Sanitation and water grants have been merged
  - MIG has been amended to allow maintenance and refurbishment of roads
  - Public Transport Network Grant is allocated through a formula



# GOVERNMENT RESPONSES TO COMMISSION AND SCoA RECOMMENDATIONS

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# GOVERNMENT RESPONSES TO COMMISSION RECOMMENDATIONS

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- The commission tabled its submission for the 2016/17 division of revenue in May 2015.
- The submission comprised 7 chapter and 27 recommendations
- Government agrees with the recommendations and is already implementing some of them
  - Proposal to incentivise maintenance budget
  - An ECD grant has been introduced to fund infrastructure maintenance and number of subsidised children.

# GOVERNMENT RESPONSES TO SCoA RECOMMENDATIONS

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- SCoA made a comprehensive list of recommendations to government which have been responded to.
- The FFC fully supports the recommendations and agree with most of the responses.
- In certain cases, more work is needed to address the concerns
  - For example, in the case of managing shortfall budgets the Commission is of the view that staff verification must be carried out throughout government

# CONCLUSION

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- The 2016 budget was crafted under difficult economic circumstances
  - The Commission commends government effort to curb deficit increase
  - The Commission is aware that cuts in allocations were inevitable
- The 2016 budget agrees with most aspects in the Commission's submission for 2016/17 DoR
- Efforts to protect infrastructure allocation and improve the system of local conditional transfers are commendable
- Building state capabilities is a necessary condition for improving spending outcomes and economic growth



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END

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