FINANCIAL AND FISCAL COMMISSION

Presentation to the Egyptian Ministry of Planning, Monitoring, and Administrative Reform (MPMAR) Study Tour: South Africa

April 13 2016

STRUCTURE OF THE PRESENTATION

1. Background to South Africa's Intergovernmental Fiscal Relations (IGFR) System
2. Division of Revenue
3. Challenges and Opportunities in Intergovernmental Relations in SA
4. Improving Fiscal Performance: The Role of the FFC.

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1. Background

Introduction

- Pre – 1994 race based policies under Apartheid regime informed governance and decentralization structures
  - Tier 1: [4] Provinces; Tier 2: [10] Homelands; Tier 3: White & Black Local Areas

- Post 1994 : A system of decentralization with a strong central authority

- Key challenge faced over past 22 years is to address socio-economic backlogs, regional disparities and inequalities, macroeconomic stability and economic growth

Locating South Africa Current IGFR System

Relatively More Decentralised Fiscal Systems

Relatively More Centralised Fiscal Systems

GERMANY

CANADA

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

USA

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

AUSTRALIA

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

SOUTH AFRICA

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

INDIA

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 (257 after LG elections)
    - Category A and B municipalities (metro and local)
    - Category C (district)
- Associated expenditure responsibilities
- Revenue raising powers

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Key Role Players in IGFR

- **Political**
  - Parliament / Provincial Legislatures; Parliamentary Budget Office; Cabinet / Provincial Exco
- **Policy and Planning**
  - FFC; MinComBud; Treasury Committee; Extended Cabinet; Budget Council; Budget Forum; SALGA
- **Monitoring and Evaluation**
  - Technical Commission on Finance; Spending Agencies; Auditor-General

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The Financial and Fiscal Commission: A Brief Outline Of Its Role & Functions

- Established Constitutional Body
  - Legislatively defined role - Section 220 of the 1996 Constitution & FFC Act (2015)
  - Accountable to parliament and legislatures

- Function
  - Serves purely an independent advisory body and an institution that serves as countervailing check and balance on the executive

- Focus
  - Primarily on the equitable division of nationally collected revenue among the three spheres of government and any other financial and fiscal matters
  - Can make recommendations on any fiscal and financial matter

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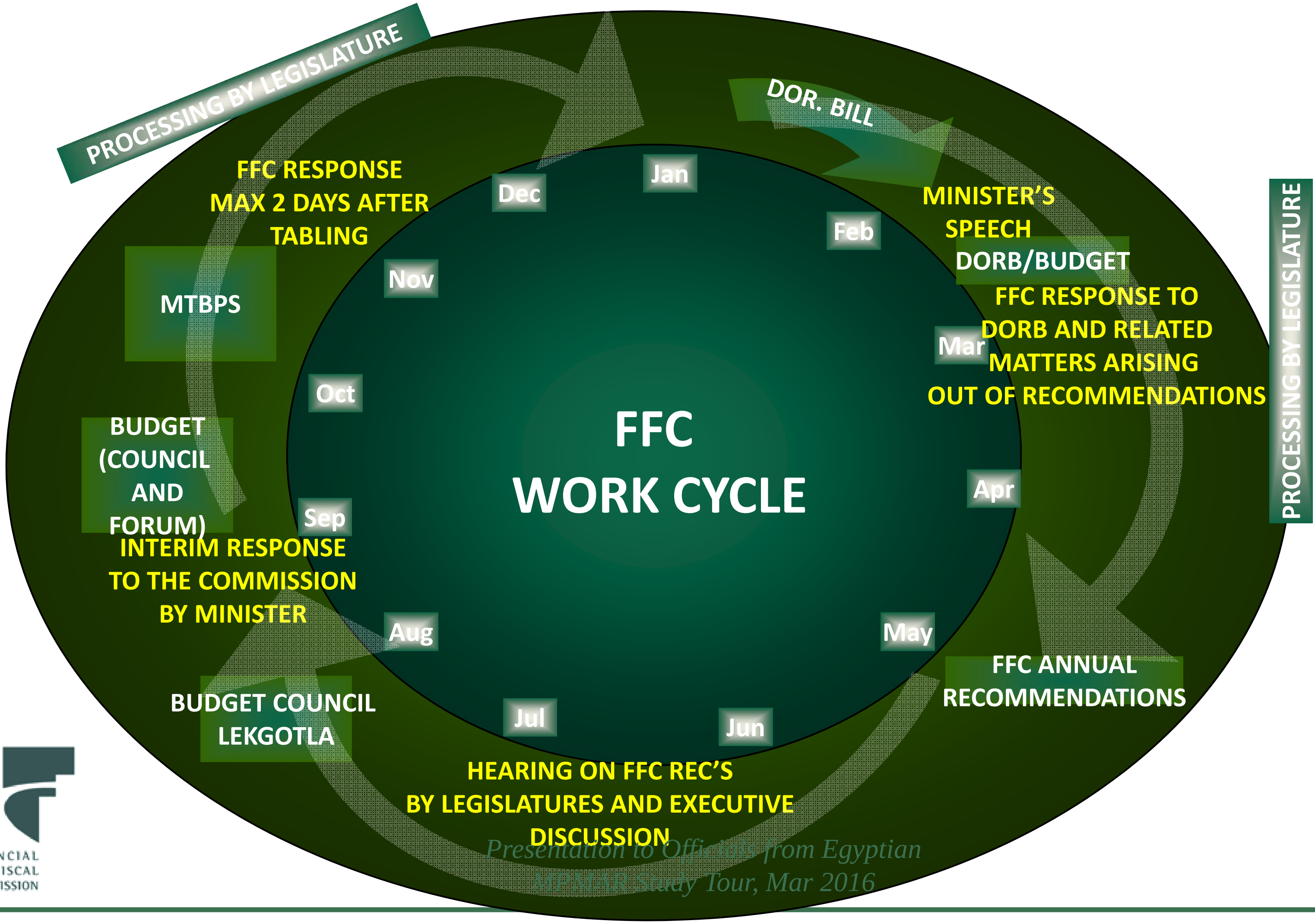
How The FFC Functions



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2. Division of Revenue: Budgeting For Constitutional Expenditure Responsibilities

Expenditure Responsibilities

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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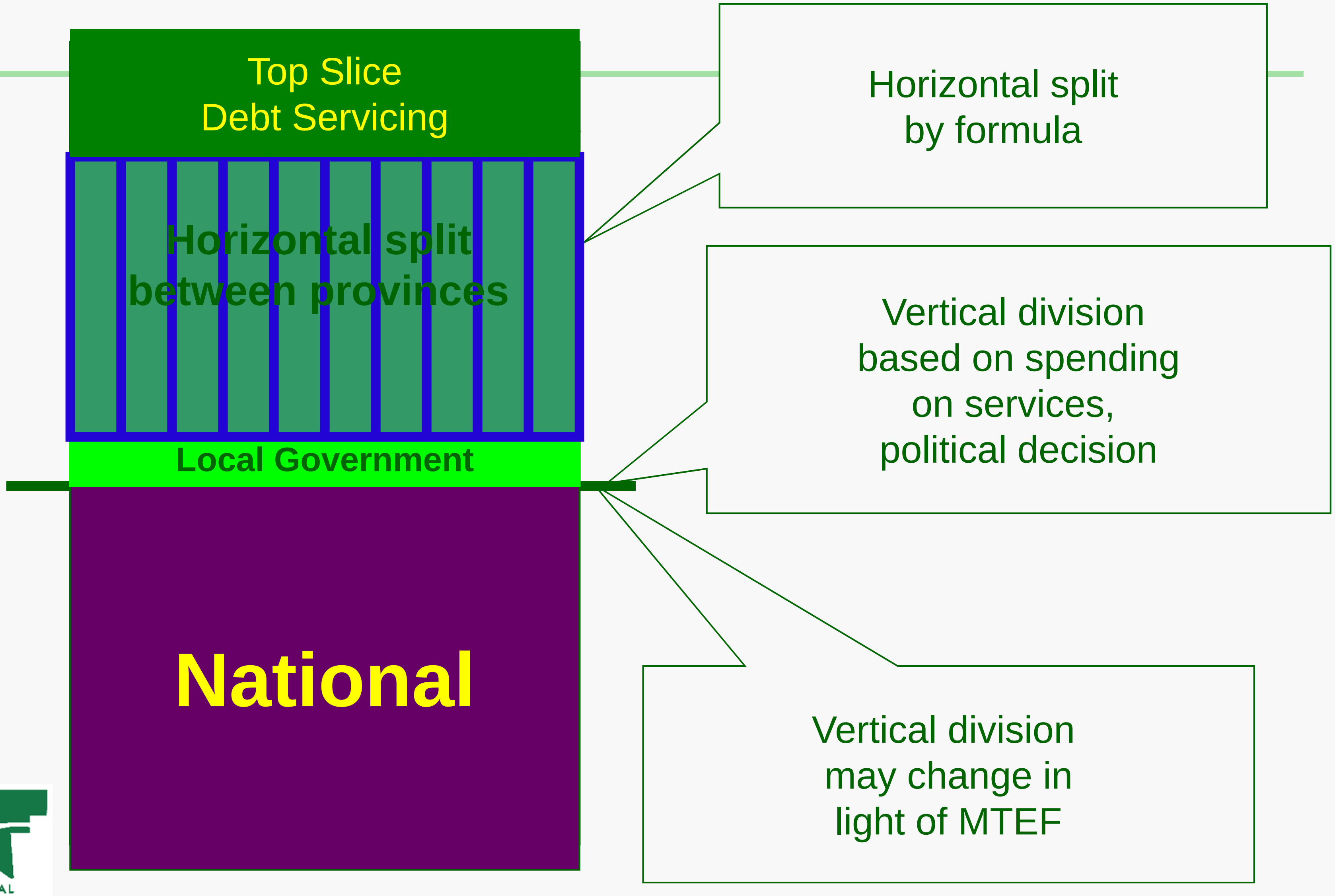
VERTICAL DIVISION OF REVENUE



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Sub-National Government Financing Mechanisms

OWN REVENUE	
Motor Vehicle Licenses, Gambling , Liquor, Hospital Fees	Property Rates, User Charges (for water, sanitation, electricity, refuse removal)
INTERGOVERNMENTAL FISCAL TRANSFERS	
Discretionary/unconditional Provincial Government Equitable Share Allocation (PES)	Discretionary/unconditional Local Government Equitable Share Allocation (LES)
Provincial Conditional Grants (non-discretionary grants)	Municipal Conditional Grants (non-discretionary grants)
DEBT FINANCING	
Borrowing from public, private institutions	

Intergovernmental Transfers

- A mechanism for addressing vertical fiscal gap stemming from
  - Limited taxation powers assigned to provincial and some local governments
  - Addressing varied resource endowment across sub-national governments, which results in a vertical fiscal gap

- Intergovernmental transfers
  - Enshrined in the Constitution as a right
  - Carried out through Unconditional and Conditional basis
  - Structured to vertical fiscal gap, ensure fiscal harmony and cater for inter-regional spillovers

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Division of Revenue Process – 2015/16

R Billion	Revenue allocation	Percentage of Total
National Allocation	546.8	49%
Provincial	471.8	42%
Equitable Share	386.5	35%
Conditional Grants	85.3	8%
Local	99.7	9%
Equitable share	50.5	5%
Conditional Grants	38.5	3%
Total	1118.3	100%

Source: National Treasury Budget Review, 2016

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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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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LGES Allocation: Formula Structure

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

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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	18.3	Municipal Infrastructure	15
Comprehensive HIV/AIDS	13.7	Urban Settlement Development	10.6
National Tertiary Services (health)	10.4	Public Transport Network Infrastructure	6
Education Infrastructure	9.4	Municipal Water Infrastructure	1.8
Provincial Roads Maintenance	9.8		

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3. Challenges and Opportunities in Intergovernmental Fiscal Relations in South Africa

1. Differentiation

- The framing of the LGFF needs to account for:
  - Variation in municipal context (exogenous factors): poverty; economic activity within a municipality, spatial factors such as topography and population density; powers and functions assigned; population dynamics (migration)
  - Variation in municipal performance (endogenous factors): debt collection, expenditure efficiency, vacancy rates; ability to plan and execute budgets
- System needs to reward good performance and sanction poor performance

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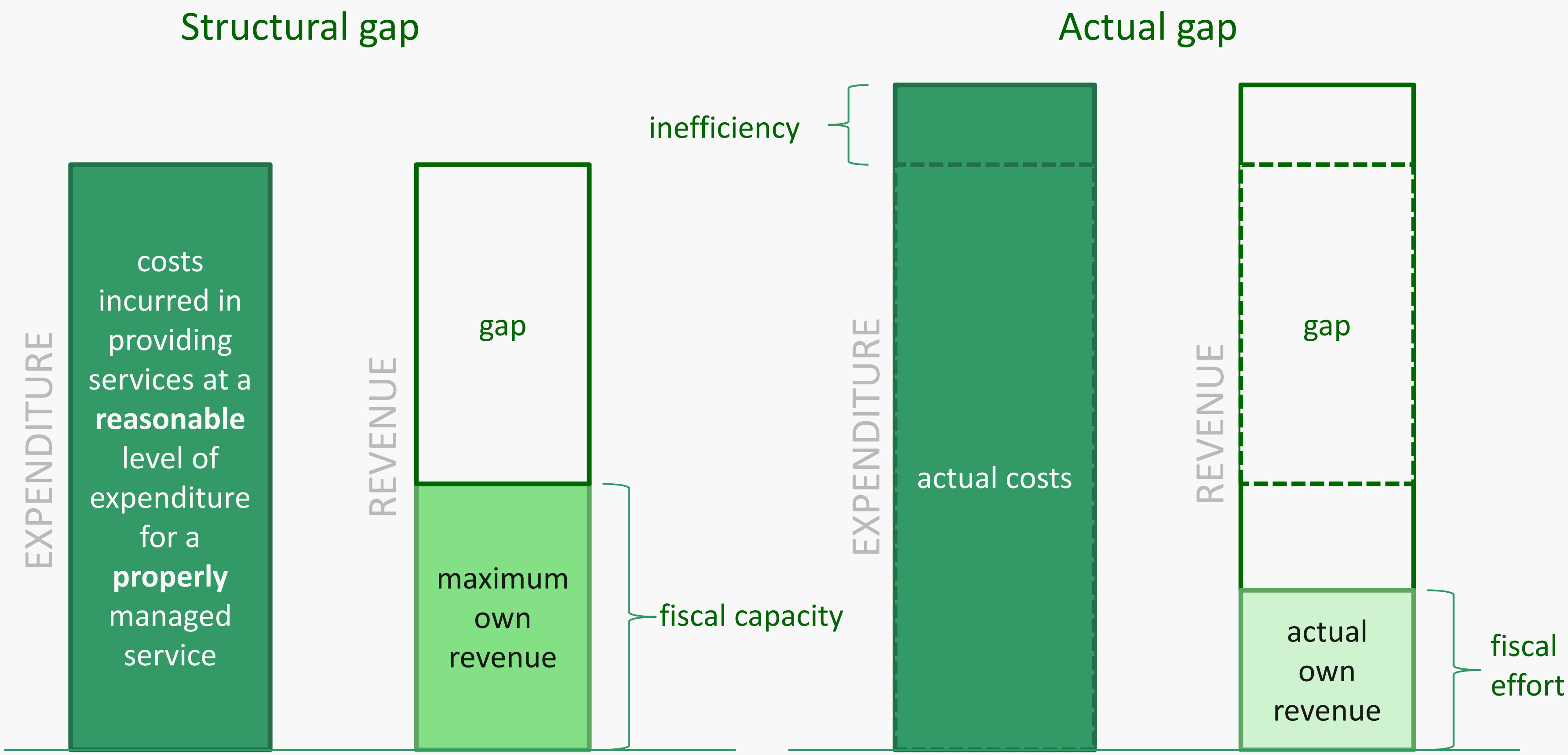
2. The Vertical Fiscal Gap



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Issues on Vertical and Horizontal Equity

- Vertical division adequate for operating expenditure
  - Estimated to be R21 Billion in 2009/10 without grants
  - Total LES package was R23.7 billion
    - LES formula was R20.2 billion
    - Replacement grant and Councillor Support was R3.5 billion
  - The quantum of resources allocated to local government for operating expenditure is sufficient but there are inequities in its distribution across municipalities
- Commission notes that new LES formula addresses horizontal concerns
- Commission estimates shortfall in vertical division on capital expenditure –This needs to be addressed
  - Estimated at R42 billion without grants
  - Total shortfall of R25 billion with infrastructure grants at R16.8 bn

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3. Concerns on LG Conditional Grants

- Commission has raised numerous concerns about conditional grants
  - Inadequate planning and implementation of conditional grants
  - Poor monitoring and evaluation
  - Continued proliferation of LG conditional grant system
  - Poor targeting of grants – allocations do not reflect need
- The Commission supports a rationalised LG conditional grant system that:
  - Does not duplicate aims and objectives of conditional grants
  - Is easy to monitor and implement and does not lead to an unnecessary administrative burden being placed on both the transferring department and municipality
  - Ensures there is capacity to spend grants before grants are allocated
  - Is based on outputs and outcomes and not just spending patterns

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4. Issues on Own Revenues

- An ideal LGFF should promote greater revenue instruments to urban municipalities (where there is a relatively strong tax base) such that transfers can distribute more funds to rural municipalities (where the tax base is constrained)
- The Commission is concerned with both urban and rural municipalities progressively becoming more dependent on grants
  - Greater macroeconomic constraints (external factors)
  - Increasing municipal consumer debt levels (internal inefficiencies)
- The Commission supports the devolution of additional taxation powers to metros and other urban areas to support greater economic growth in the urban built environment
  - Should not compromise macroeconomic policies and stability of the country

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5. Human Capital

- Lack of adequately skilled human capacity
  - Finding by Auditor-General (AG) in 2011= at 70% of municipal auditees people in key positions do not have minimum competencies/skills to perform their jobs
  - One in every 3200 people in South Africa is an engineer

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6. Sustainability of Basic Service Delivery

- Poor spending on maintenance and renewal of infrastructure
  - Infrastructure-led national development
  - Infrastructure funded through conditional (non-discretionary) grants
  - Maintenance/renewal of infrastructure = responsibility of the municipality
  - Under budgeting and underspending on maintenance/renewals
  - Infrastructure underpinning delivery of basic services in a state of decay

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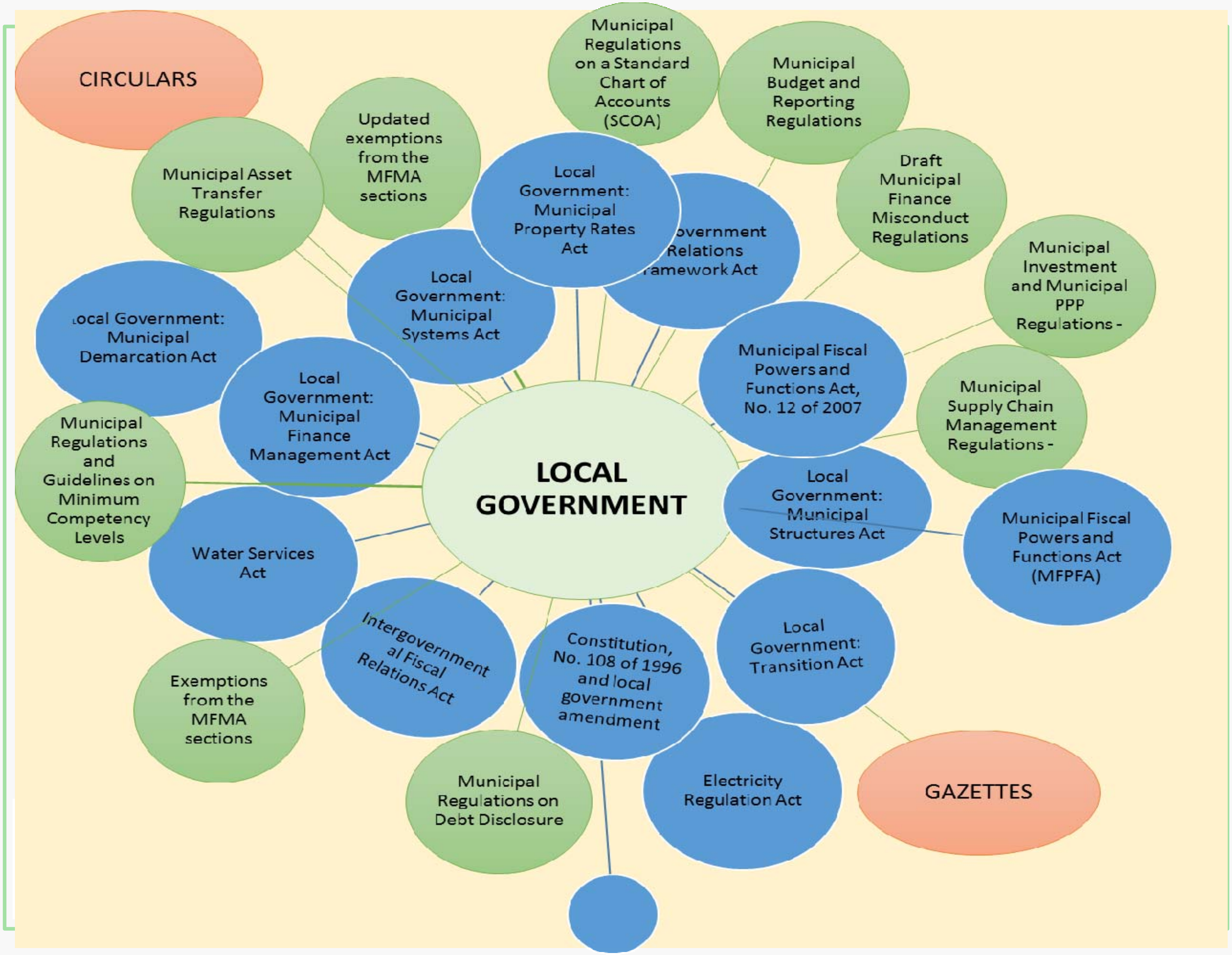
7. Poor Financial Management

- Poor financial management
  - Improve internal controls
  - Pockets of improvement in financial reporting in terms of in-year monitoring, availability of performance data has a while to go
  - Concern raised by AG = lack of consequences for poor performance
- Municipalities in a state of fiscal distress
  - FFC conducted research on fiscal distress in municipalities in 2012
  - As at 2012/13: 24.4% municipalities = fiscally neutral, 67.3%= fiscal watch and 8.3% = fiscally distressed

8. Regulatory Burden on Municipalities

- Legislation and regulation in LG has been increasing with many regulators
  - Compliance related legislation since the advent of democratic local government include:
    - MFMA (National Treasury)
    - MSA (Cooperative Governance)
    - MPRA (Cooperative Governance and Traditional Affairs)
    - MFPFA (National Treasury)
  - Related regulations
    - Municipal Regulations and guidelines (National Treasury)
    - Water and electricity related (DWA, DOE)
- LG currently the most regulated sphere in the country


CIRCULARS
Updated exemptions from the MFMA sections
Municipal Regulations on a Standard Chart of Accounts (SCOA)
Municipal Budget and Reporting Regulations
Municipal Asset Transfer Regulations
Local Government: Municipal Property Rates Act
overnment Relations ramework Act
Draft Municipal Finance Misconduct Regulations
Local Government: Municipal Systems Act
Municipal Investment and Municipal PPP Regulations -
ocal Government: Municipal Demarcation Act
Municipal Fiscal Powers and Functions Act, No. 12 of 2007
Local Government: Municipal Finance Management Act
Municipal Supply Chain Management Regulations -
Municipal Regulations and Guidelines on Minimum Competency Levels
LOCAL GOVERNMENT
Local Government: Municipal Structures Act
Municipal Fiscal Powers and Functions Act (MFPFA)
Water Services Act
Intergovernmental Fiscal Relations Act
Constitution, No. 108 of 1996 and local government amendment
Local Government: Transition Act
Exemptions from the MFMA sections
Municipal Regulations on Debt Disclosure
Electricity Regulation Act
GAZETTES

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Improving Fiscal Performance: The Role of The FFC

Ensuring an Effective LGFF

- LG performance needs to improve to ensure objectives of LGFF are achieved
  - Internal controls
  - Act on AG's concerns
- Greater support for LG from other spheres
  - As per Section 154 of the Constitution
  - Improved monitoring and evaluation
  - Improved capacity support
  - Direct and structured intervention
    - Appropriate implementation of Sections 139 and 216(2) of the Constitution
- Ensure MFMA and MSA provisions for competent municipal officials are enforced

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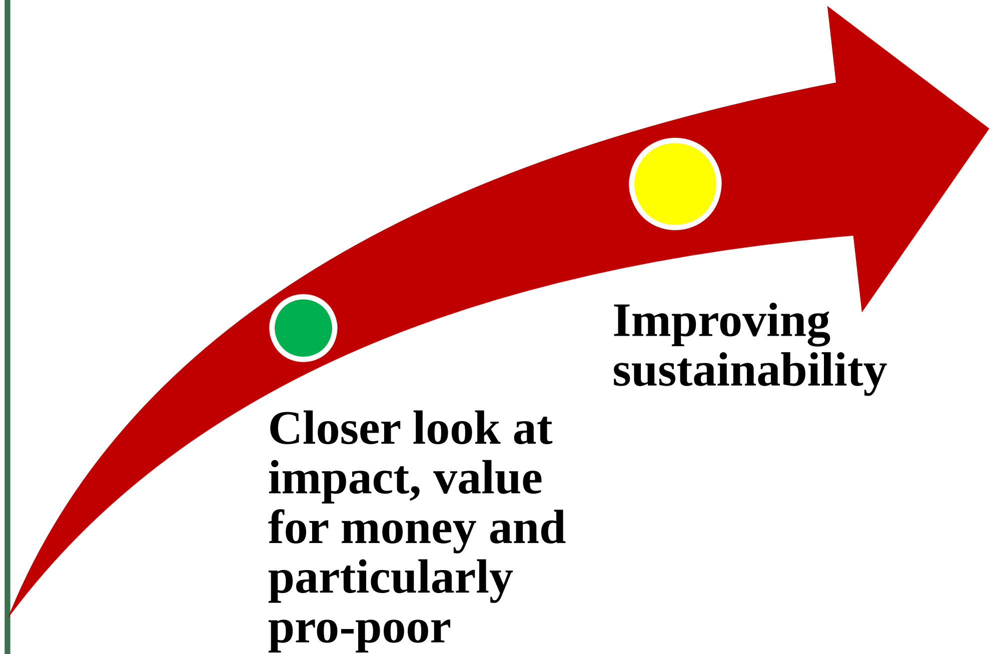
SUPPORT MEASURES DURING NATIONAL BUDGET PROCESS: 3 PILLARS

1. **Providing recommendations to Committee 10 months before budget**
2. **Making submissions on basis of IGFRA and MBAPRMA**
3. **On request advise and ensuring value for money**

PILLAR III: ENSURING VALUE – DEVELOPMENTAL IMPACT



- Allocative efficiency and value for money
- Focus on Inclusive Growth
- Adding more modules (gender, environment, and energy etc.)
- Poverty and inequality impact

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FFC Work Around Value For Money

- **Dimensions of value-for-money covered in FFC work:**
  - **Efficiency:** Achieving more output from the same input, while maintaining quality [Cost function work]
  - **Economy:** Reducing the cost of resources used as inputs [Consolidation]
  - **Effectiveness:** Achieving better outcomes by changing the nature of outputs [Wage Bill].
- Programmes not covered on the budget can be financed by reallocating spending from non-performing programmes
- Expenditure Limits and Quality

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THANK YOU.

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