Financial and Fiscal Commission

Commission Response to Division of Revenue Bill 2008/09

FINANCIAL
AND FISCAL
COMMISSION

For an Equitable Sharing of National Revenue

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1. Introduction

The Financial and Fiscal Commission's submission on the 2008 Division of Revenue Bill is made in terms Section 214 (1) of the Constitution of the Republic (1996) and Section 35 of the Intergovernmental Fiscal Relations (IGFR) Act (1998). The IGFR Act requires that the Minister of Finance consult the Commission at least 14 days prior to the tabling of the Division of Revenue Bill in Parliament. This submission is therefore also made in the context of the consultations that have taken place with the Minister of Finance (through the Budget Council) and National Treasury officials during the course of 2007/08 fiscal year. These consultations involved discussions around the Commission's recommendations and also around the broader objectives of government in as far as they are relevant to the Commission's mandate.

The submission is presented as follows. First there are in-principle observations with respect to certain clauses that appear in the Bill. Secondly there is an assessment of the various schedules attached to the Bill that deal with different grants and the frameworks for different conditional grants. The final section presents the Commission's comments on the Government's response to the recommendations that it tabled in its Submission for the 2008 Division of revenue.

2. General observations on the Bill

The Commission generally welcomes the DoR Bill as tabled and makes specific comments relating primarily to changes that have been introduced compared to what was contained in the 2007/08 DoR Act. The following are the specific comments of the Commission.

Comments on the Bill

Clause 15

The requirement that the municipal infrastructure grant be transferred via a category C to a category B municipality has been removed irrespective of the conditions that accompanied it. The changes implemented in this clause imply that grants will have to be transferred directly to the municipality that has the powers and functions in line with the relevant section of the Municipal Structures Act. There are further reporting requirements that the transferring officer must comply with that are introduced to ensure that program spending performance information is available and any material problems experienced regarding the allocation are addressed through the appropriate interventions. The Commission supports this principle as it will assist in the identification of capacity and therefore resolving of capacity issues through the relevant departments rather than through a category C municipality.

Clause 16:

The wording in subsection (2) is very confusing. The Commission proposes that a clearer wording should be used for ease of understanding. In the current formulation it is not very clear what the subsection means.

Clause 17:

The Commission notes that the clause has been changed to remove the subsection on the need for municipalities to be accredited in line with Section 10 of the Housing Act (1997). It will be recalled that the Commission first made recommendations around the need for those municipalities that have the capacity to be accredited so that the roll-out of the housing delivery program could be speeded up in its submission for the 2006 DoR. As a follow up on the progress, the Commission is currently conducting an investigation on the implementation of this clause of the Act by the relevant authorities and will be making further comments on the matter in its forthcoming submission on the 2009 Division of Revenue. One of the key concerns is the slow pace of the accreditation process which has a negative impact on the roll-out of the housing program and also the negative incentives associated with uncertainty on the part of municipalities.

Clause 18:

The Bill lays out the framework for government funding of 2010 FIFA World Cup. Part 5, (18), item 1(a) in particular might need to be reworked to take into account current economic issues that might affect the budgets or cots associated with the Cup, for example, the upsurge in inflation, fuel costs and electricity interruptions. These issues may combine and result in budget overruns that are outside the control of the hosting cities. Government should consider inserting a clause that where budgets are exceeded, sound reasons must be provided [this would be consistent with item 4 (ii) of the MIG section] and this will be consistent with FFC recommendation last year that '…where National Government has ascertained that cost escalations are genuinely outside the control of host-cities and suppliers, it should compensate for such shortfalls'. This negates the genuine risk that money meant for other services will end up being diverted towards financing world cup expenditures that would have risen due to factors beyond a municipality's control.

Clause 31

The Commission notes and supports the changes that have been introduced in this clause compared to what was provided for in the 2007 DoRA. It is the view of the Commission that 31(2a) in particular is a very important ingredient to the advancement of the principles of transparency and accountability in the management of public finances. It will enhance the information base for monitoring and evaluation of the performance of government programs. It is particularly important for schools, hospitals and municipalities to know what transfers they will be receiving over the MTEF to enable them to integrate their plans. For example, where transfers from the Integrated Human Settlement Grant to a municipality are unknown, the municipality may not be able to appropriately plan for the roll-out of complimentary infrastructure from the MIG allocation. This can often result in the lack of alignment between the two programs. The new additions go a long way towards addressing a past recommendation of the FFC on the need to align or link the two grants.

The additions to the clause are also important for schools especially non-section 21 schools to know their allocations in advance. The requirement for gazzetting should in fact be extended to publication on the websites of relevant departments and community newspapers in order to empower school governing bodies and parents and entrench accountability and transparency. There have been cases in the media indicating that some schools that have been declared no fee schools have been seen to be charging fees because the process has not been transparent.

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3. General Comments on the Allocations to Provincial and Local Government

The 2008 MTEF division of revenue is premised on five key policy priorities namely, investment in economic and social infrastructure, improved quality of public services in health, education, other social services including agricultural extension services and post resettlement support, increasing the efficiency of the criminal justice sector and raising the productive capacity of the economy. These policy priorities are accommodated through a process of reprioritization and additions in the resource envelope to the three spheres of government over the MTEF. The Commission notes that in arriving at the final allocations government needs to balance competing demands of the social sector and those of the economic services sector that ultimately have an impact on the sustainability of the improvements in access to basic services through the creation of jobs and improvements in infrastructure.

Allocations to provincial governments

Provinces

Year	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Equitable Share	134,706	150,753	171,271	199,377	225,500	246,300
Conditional grant	74,567	25,926	31,494	38,699	42,692	47,334
Total	209,273	176,679	202,765	238,076	268,192	293,634
CG as % total	0.36	0.15	0.16	0.16	0.16	0.16

The Commission notes that there has been an increase in conditional grants as a share of total transfers to provinces. While the 2005/06 scenario is explained by the conditional grants for social security transfers, the increase between 2006/07 and over the 2008 MTEF could be reflective of an increased appetite for conditional grants by the National Departments. If indeed that is the case, the Commission reiterates its recommendation that government should in principle reduce conditional grant funding to only those areas where there are spill-overs and where there are programs that require institutionalization in provincial budgets and in the latter case phase into the equitable share.

For the 2008 MTEF the provincial equitable share is revised upwards by R24, 4 billion while conditional grants are increased by R12, 7 billion. There are slight changes to the revisions made in the 2007 MTEF period. During 2007 revisions to equitable share were estimated to be R24, 6 while conditional grants were R14, 6 billion. The change in the 2008 MTEF revisions to the provincial allocations baseline may be an indication towards a movement to a relatively tighter fiscal framework. The overall transfers to provinces increase from R205, 5 billion in 2007/08 to R238 billion in the 2008/09 financial year.

During the last financial year the equitable share formula the Commission agreed that the formula would not be revised to cater for the re-demarcation of provincial boundaries. The full impact of demarcation has generally been fully reflected in the formula with only a few exceptions whose financial situation has been addressed through the adjustments estimates process. There was no need to phase in the changes. For the 2008 MTEF the formula still maintains its structure and the only changes effected are updates for new data in the various components. The formula update for data from the Community Survey however generated certain shocks and in order to cushion the provinces from the shocks, government has decided to phase-in the changes over three years. The Commission would like to note that the process of dealing with shocks through the phasing-in of changes should not be institutionalized. In this regard, the current review of the PES formula will focus on some of the structural problems that generate these unintended outcomes when the formula is updated for new data. It may well be the case that the over-reliance of the formula on demographics creates problems as migration intensifies and may have counter-productive results on the quest for equity across the provinces.

Conditional grant allocations to provinces

For the 2008 financial year two changes are effected to the current conditional grant framework. The FET college re-capitalisation grant is phased into the provincial equitable share formula from 1 April 2009. The Commission welcomes this as FET colleges are a direct function of the provinces. A new grant (devolution of property rates grant) is introduced for dealing with the devolution of property rates payments from the department of public works to provinces. The grant is allocated R2, 9 billion over the MTEF period starting from 2008. While the Commission supports the logic for not including this allocation in the equitable share, it would be prudent to ensure that there is a timeframe over which this transitional grant will be in existence and ultimately phased into the equitable share.

Allocations to Local Government

Local Government

Year	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Equitable shares	7,811	9,808	18,442	21,297	25,750	31,011	36,766
Infrastructure CG	6,936	8,053	9,300	17,309	18,018	18,393	20,581
Capacity Building CG	768	654	664	929	430	988	773
Total CG	7,704	8,707	9,964	18,238	18,448	19,381	21,354
Total transfers	15,515	18,515	28,406	39,535	44,198	50,392	58,120
CG as % of total	0.50	0.47	0.35	0.46	0.42	0.38	0.37

National transfers to local government are projected to increase from R44, 2 billion in 2008/09 to R58, 1 billion in 2010/11. For the previous MTEF allocations to municipalities were estimated as follows R 34.3 billion in 2007/08, 41.8 billion in 2008/09 and R45 billion in 2009/10. The current MTEF projection represents a significant increase in annual growth rate from 6.5% to 7.7%. The share of conditional grants as a percentage of total transfers to local government is declining and this is a welcome development that will allow an increasing amount of non-conditional funding to local government.

The Commission notes the on-going work on the local government fiscal framework that the government is currently engaged in and will also be making recommendations on some of the issues in its forthcoming submission on the division of revenue for the 2009 MTEF.

4. Some Observations on Conditional Grant Frameworks

The Commission notes that there have not been too many significant changes to the conditional grant frameworks. There are however issues that the commission would like to raise with respect to the grants associated with the FIFA 2010 World Cup.

Stadium Development Grant

This grant is designed to fund the design and construction of new stadia and upgrading of designated stadia and supporting bulk infrastructure in World Cup host cities.

The **measurable outputs** section suggests that this substantial investment is warranted because it will bring significant economic benefits — in terms of 40,000 new jobs (30,000 short term and 10,000 long term jobs).

Unfortunately, economic studies show that soccer stadiums do not promote such high economic development and that public subsidies for stadium construction do not "pay for themselves" by generating increased tax revenues. Most of the jobs directly created by stadiums are day-of-game jobs, which are part-time and have low pay and limited benefits. Many independent economic analyses of the impact of stadiums have found no predictable positive effects on output or employment. Some studies have even concluded that there is a possible negative impact.” These perhaps surprising findings largely reflect the fact that families and individuals who spend money to attend a soccer game spend less on other forms of entertainment than they would in the absence of a stadium as well as crowd out effects of such investments. As a result, the new jobs created through the grant would be offset by reduced employment in other parts of the area.

Given these uncertainties, this measurable output appears unrealistic and an over kill. The Commission's proposal is that the measurable output be changed to "Short term jobs created", Long term jobs created" and "Gender of job recipients" without assigning a quantitative magnitude to these given huge uncertainties with such quantitative outputs.

The **conditions section** of this grant stipulates that "If there is a shortfall in funding for the construction of the stadium, the municipality…May approach the Development Bank of Southern Africa for a concessionary loan. The interest on the loan will be subsidized from the National Revenue Fund up to a maximum amount provided for in the Division of Revenue Act and only in financial years 2009/2010 and 2010/2011. To claim the interest subsidy the municipality must provide the loan agreement to the transfer".

Because stadiums do not contribute strongly to economic growth, public subsidies for stadium construction typically do not generate enough new tax revenue to offset the construction costs. Publicly financed soccer stadia would not contribute substantially to the local economy's economic growth, and it would have real costs that would limit resources for other public services.

As a result, alternative proposals for funding such stadia construction must be found without necessarily resorting to borrowing for this purpose.

Public Transport Infrastructure and Systems Grant

This grant is for the provision of accelerated planning, establishment, construction and improvement of new and existing public transport and non-motorised transport infrastructure and systems. The fund is permanently created, with an initial, specific focus on projects linked to the 2010 FIFA World Cup

The Commission is of the view that as a matter of principle, this grant should have a termination date and eventually become part of the equitable share as it deals with a constitutionally assigned function for local government.

5. Comments on Government's Response to Recommendations for 2008 Division of Revenue.

The response from government to the recommendations of the FFC focuses on those recommendations that have been deemed to be relevant to the division of revenue for 2008. The response of government is made in compliance with Section 214 (1) of the Constitution and Section 10 of the IGFR Act (1997) and details how the recommendations of the FFC have been taken into account in finalizing the division of revenue for the 2008 MTEF period.

In general, government has positively received the recommendations of the Commission and where there are differences; government has generally provided reasons why recommendations are not supported.

With respect to the 2010 FIFA World Cup financing government has agreed with the FFC's observations and recommendations. Government also indicates that it is taking the necessary steps to ensure that the costs of hosting the Cup remain within the budget. Government also emphasizes the fact that despite the large investment associated with the Cup, allocations for social spending are growing and those targeted to the poor receive additional allocations. This implies that government has ensured that the costs of hosting the world cup do not crowd out spending on the delivery of social services and other mandates of government across the three spheres. Furthermore government agrees with the Commission that legacy effects should be costed and managed by the host cities. Government does not however agree with the Commission's advisory that a national agency should be established for this purpose. While the Commission is not entirely aligned to the idea of an agency, there is still a need for government to explain more on why consideration should not be given to such an institution. The Commission's principal point of emphasis is the need to institutionalize the response mechanism to the legacy effects management in whatever form government chooses in order that dedicated resources can be set aside for this purpose.

With respect to the National School Nutrition Program, government agrees in general with the observations and advisories made by the Commission. However, government cautions that the Commission's recommendation that the program be extended to include learners in secondary schools falls outside the scope and mandate of the FFC. While the Commission accepts that the issue of whether or not the program should be extended to secondary schools is a policy matter and therefore may not be within the purview of the Commission's mandate, it should be noted that the recommendation was informed by the work that the Commission carried out in response to a request from the Chairperson of the Select Committee on Finance to investigate the "feasibility" of extending the NSNP to secondary schools. The Commission established that it was indeed feasible to extend the program if its profile were to be raised within the provinces as a key responsibility of PED's for which funds are allocated over and above the allocations from the conditional grant.

In the process of preparing the response to the Chairperson of the Committee's request, the Commission became aware of the significant number of issues and challenges that would need to be addressed before any consideration to extend the program could be considered. In the context of the submission for the division of revenue 2008, therefore, the Commission's views are in principle not in contrast with those of government but rather emphasise the need to ensure that institutions and systems are put in place to address the current implementation challenges faced by the provincial education departments [and the national education department] before any consideration is given to extending the program to secondary schools.

With respect to the financing of school infrastructure and educational outcomes, government agrees with the Commission and also reiterates the need to link school infrastructure delivery through the provincial infrastructure grant and supporting municipal infrastructure roll out. In this regard where misalignment has been identified, government has introduced the electricity and water and sanitation grants to ensure that municipal infrastructure supports the school infrastructure program. The Commission welcomes the additional R2.7 billion to address school infrastructure needs including replacement of unsafe and inappropriate school structures.

With respect to the proposal on learner support materials, government notes that the current definition of LSM is in line with the FFC's recommendations. There is agreement on the proposal that there should be separate line items for LSM and maintenance, repairs and equipment. The 2008 budget formats Guide captures this particular recommendation. The Commission welcomes the fact that this practice is not only limited to education but is extended to all other sectors.

With respect to the proposal on the no-fee school policy, government agrees that the funding should cover all school operations but emphasizes that this should be viewed within the minimum and maximum funding levels. Further government indicates that except for the Eastern Cape, most provinces are already funding at a maximum level. It should be noted that the Commission indicated in its last submission that work around this matter would continue as the program is being rolled out. In this respect, the Commission will be making further inputs on this matter in its forthcoming submission for the 2009 MTEF.

With respect to the proposal on roads and transport infrastructure, government is in agreement with the Commission on the need for provinces to improve systems that will in turn guide the allocation of resources. Government also highlights the large injection of funds through the IGP. The area of concern raised is the implication around the possibility of targeting roads through the formula and the inherent assumption on the impact on spending. However government agrees that the matter be revisited as part of the review of the PES formula. The commission will take this into consideration in reviewing the formula.

With respect to the proposal on homelessness and the allocation formula for the Human Settlement and Development Grant (housing subsidy conditional grant), government agrees that homelessness should be quantified and further adds that the current formula does take homelessness into account when determining needs country wide. The Commission notes that the new formula does indeed include homelessness as an indicator as detailed in the framework for the grant.