Response to the Submission for the Division of Revenue 2009/10

FINANCIAL
AND FISCAL
COMMISSION

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1. Introduction

1.1. This Submission is made in terms of Section 214(1) of the Constitution and Section 10 (4) of the Intergovernmental Relations Act (1997).

1.2. The submission takes account of the consultations that have taken place with National Treasury officials during the course of 2008/09 financial year. It also takes into consideration consultations through the Budget Council and the Budget Forum. Responses to the Financial and Fiscal Commission's recommendations that were submitted by the various Government departments through the Public Hearings on its recommendations convened by the Select Committee on Finance in 2009 are also taken into account. Following on these processes, the Commission has identified six key strategic issues that have been raised in its previous Submissions but have not been addressed fully by Government and as a result may be impacting negatively on the evolution of the intergovernmental fiscal relations system in general and the division of revenue in particular.

1.3. The key strategic issues are

1.3.1 The Commission is of the view that the Division of Revenue Act (DORA) is increasingly becoming complex, voluminous and too wide-ranging on the issues that it covers. It is now a "hold all" document. The problem with this is that this development not only reduces the transparency and accessibility of the DORA to a wider audience but also makes it less coherent. In this regard the Commission calls for a conceptual reflection on the DORA with a view to simplifying it, streamlining it and making it more cohesive. There are a number of clauses that appear in the DORA that should ideally be in the Public Finance Management Act (PFMA) or Municipal Finance Management Act (MFMA) for instance. Similarly, now that there is the Intergovernmental Government Fiscal Relations (IGFR) Act that deals with disputes, there is no need to put issues of dispute resolution in the DORA. It is important to note that the DORA actually preceded the legislation listed, and has grown incrementally since. The Commission further recommends that the reflection task on the DORA and how it was conceptualized should not just focus on a particular year but look at how it has evolved over time. For its own purposes the Commission will be conducting a review of the DORA and making recommendations during its forthcoming research cycle.

1.3.2 The Commission notes with concern that there is an increased proliferation of conditional grants (Water Grants, Transport Grants, and Disaster Management). In its recommendations for the 2006 division of revenue, the Commission had raised the matter of the proliferation of conditional grants, especially very small ones and Government at that time had agreed that most of the grants were being reviewed with a view to consolidation and also to incorporation into the equitable share. The Commission is aware of the fact that there have been strong pressures for the proliferation of conditional grants in this year's Division of Revenue Bill. The Commission's view, however, is that the discussion on conditional grants should instead have been focused on consolidation of the grants. The Commission is also of the view that proposals for new grants should be subjected to sufficiently rigorous analysis justifying their introduction. Currently, the Commission is not part of the process of informing decisions on whether grants should be conditional or non-conditional. Issues of when and how a conditional grant is introduced are at the centre of the Commission's concerns. While the Commission notes that a number of the conditional grants introduced are small in Rand terms and once-off, the proliferation is of concern as it may be a signal of tension between competing objectives of national and sub national governments in areas of concurrent functions. There may also be perceptions of national priorities being inadequately funded.

1.3.3 The Commission is concerned in relation to a number of instances where policy implementation stalls, resulting in negative impacts on the intergovernmental fiscal system. Delays in implementing agreed policy positions lead to uncertainty and poor service delivery. In this respect the delay in effecting reforms implied by the Regional Electricity Distributors (REDS) and accreditation of municipalities to perform certain housing functions is having negative impacts on the performance of Local Government. With respect to REDS, the delay in implementation has led to uncertainty among stakeholders involved in the electricity distribution industry. The uncertainties are likely to culminate in challenges such as lack of maintenance of electricity distribution infrastructure by both municipalities and ESKOM. Furthermore, the REDS will have an impact on Local Government finances, in particular cash flow, credit rating and integrated development. This is due to the fact that the REDS will decide on new capital growth in the industry which would impact on the flexibility and consequently the growth potential of municipalities. A related matter in the area of delays in policy implementation leading to unwanted consequences in service delivery is the slow pace of the accreditation of municipalities with adequate capacity. In its 2009/10 Annual Submission on the Division of Revenue the Commission indicated that there were 18 municipalities that had applied for accreditation. At that time, none of the municipalities were at a stage where they had been accredited for all three levels of accreditation. According to the Department of

Housing, none of the municipalities were in a position to apply for Level 3 accreditation (allows municipality to undertake full financial administration). In a nutshell no municipality at this stage had been fully accredited. These issues may be stalling in part due to the uncertainty associated with the review process currently being undertaken by the Department of Provincial and Local Government. Government must put timelines to that process so that there can be certainty and movement on the policy implementation that has stalled. This review has implications on yet another area where some municipalities have raised issues of unfunded mandates. The unfunded mandates need to be clarified and addressed where they actually exist. Of particular relevance is in the area of health services which have been split, with Local Government being responsible for environmental health and provinces being responsible for primary health care. A number of municipalities still deliver primary health care without the resources necessarily flowing to them. This needs to be given attention in order to eliminate duplication and rationalise services as well as funding.

1.3.4 Government took a decision to extend a loan to the Gauteng Province to fund the Gautrain Rapid Rail Link Project, subject to an agreement being entered into between the Minister of Finance and the Premier of the Gauteng Province, and the Province's continued adherence to the loan agreement. While the decision was consistent with the Borrowing Powers of Provincial Government Act (1996), the Commission is of the view that the process would have required that the recommendations of the Commission are taken into consideration in line with the requirements of section 230 of the 1996 Constitution. The arrangement by national Government to borrow on behalf of a province potentially poses a high risk for the IGFR system and principles of no bail-outs to which the Government subscribes. The Commission raised this matter in its submission for the Division of Revenue Bill of 2007 when the matter first surfaced in the Bill. The Commission has recently received documentation around this matter from the National Treasury and will be submitting its recommendations to the Minister of Finance as required by the Constitution.

1.3.5 Designing capacity building grants that do not go through the DORA but through an agency type agreement is viewed with concern by the Commission. This is in specific reference to the Siyenza Manje capacity building programme that is situated at the Development Bank of Southern Africa (DBSA). While the Commission finds some merit in using the DBSA to assist with capacity building at the municipal level in particular, it is concerned that moving capacity building grants to an agency basis means that such initiatives are now out of the direct public scrutiny space and direct evaluation at the opportune time that other Government programs are being evaluated. Even though

DBSA does report to Parliament, this would be outside discussions of other relevant and related programs. There is thus a compromise in the systematic consolidated reporting on the outcomes of these grants to Parliament.

1.3.6 A final strategic issue that the Commission is concerned with pertains to the implementation of re-demarcations of provincial and municipal boundaries. The Commission made a supplementary Submission on this matter in 2006 following the 2005 demarcations and further in its submission on the Local Government Laws Amendment Bill in 2007. The Commission re-iterates its proposal for a full account of the fiscal spillovers associated with the transition phase of the demarcation process.

1.4 The rest of the submission is presented in four parts. The first part deals with general observations with respect to the amended clauses of the Bill. The second part provides comments on the allocations to sub national governments. The third part contains an assessment of the various schedules attached to the Bill that deal with different grants and the frameworks for different conditional grants. The fourth section contains the Commission's comments on the Government's response to the recommendations that it tabled in its submission for the 2009 Division of revenue.

2. General observations on the Bill

2.1 The Commission in general welcomes the Division of Revenue Bill as tabled. However, there are specific comments that the Commission raises in relation primarily to changes that have been introduced compared to what was contained in the 2008 Division of Revenue Act. The following are the specific comments of the Commission.

2.1.1 Section 15, Municipal infrastructure grant (Cities)

A differentiated approach is being proposed in respect of the Municipal Infrastructure Grant (MIG), with the metropolitan cities now receiving the Municipal Infrastructure Grant (Cities), which will be administered in terms of a separate framework, and have different requirements to those of the MIG which other municipalities will receive.

While the Commission welcomes this new approach, there are some concerns in respect of the strategic goals of the grant. Section 15 (1) (a) of the Bill indicates that the grant as set out in Schedule 4 supplements the funding of infrastructure programmes funded from the budgets of the municipalities to address municipal infrastructure backlogs as well as other investment requirements and built environment needs. The Commission is of the view that “other investment” be replaced by “support of” as this would tie down the objective towards the relevant investment in the built environment.

2.1.2 Section 23, Expanded Public Works Programme Incentive

A new type of conditional grant is introduced, which intends to enable and provide an incentive to provinces and municipalities to create additional employment through the Expanded Public Works Programme (EPWP). The Commission welcomes the Government’s attempt at addressing employment through Government expenditure programs. The availing of resources for purposes of employment creation goes a long way at addressing income poverty.

Indicative allocations are set for eligible provinces and municipalities, and incentive payments will be paid to provinces and municipalities on a quarterly basis, based on an assessment of their performance in comparison to the threshold and performance targets which are set for that province or municipality. The Commission is of the view that a more cautious approach is required in dealing with incentive issues as contained in this grant in relation to the EPWP of Government. The allocation of this grant will require significant growth in the capacity of Government to manage such a sophisticated conditional grant. The Commission is of the view that the actual skills that are developed with this grant as well as the types of jobs that are created should be monitored and evaluated to ensure sustainability.

2.1.3 Section 30 (c), Conversion of Schedule 7 to Schedule 6 allocation

A provision has been included to facilitate the conversion of a Schedule 7 allocation into a Schedule 6 allocation during the course of the financial year in order to prevent under-spending on the allocation.

2.1.3.1 This implies the conversion of an allocations-in-kind to municipalities for designated special programmes into specific-purpose allocations to Local Government.

2.1.3.2 The Commission welcomes the intention of clause 30 (1) because it is meant to prevent under-spending on allocations. However, the Commission would like to suggest that section 30 (3) be amended to read that any conversion done should comply with section 24 (2) (a) which says that “The National Treasury must publish in the *Gazette* any revisions of or amendments to the allocations or frameworks published in terms of subsection (1) authorised by an adjustment budget”.

2.1.4 Section 39, Implementation of re-demarcations of provincial and municipal boundaries

A provision has been included to provide for mechanisms to deal with the implementation of re-determinations of provincial and municipal boundaries which come into operation during the 2009/10 financial year. This provision will enable a smooth reincorporation of Merafong Local Municipality into Gauteng. The Commission supports this provision as it is in line with its previous recommendations.

2.1.5 Section 42, Duties relating to category C municipal budgets

Additional provisions have been added in order to ensure the proper flow of funds from category C municipalities to the category B municipalities. Currently this is managed through Memoranda of Understanding which are often not adhered to. The new clauses 42 (5) to (7) formalise and legislate the funding arrangements between the two levels. The Commission welcomes this provision as it will serve to improve transparency and certainty of funding. Furthermore this will assist municipalities to plan their expenditure.

2.1.6 Section 38, Approval of expenditure for emergencies

The Commission welcomes this clause as it will allow provinces to more flexibly respond to emergencies.

3. Comments on the allocations to sub national Governments

3.1 The 2009 Medium Term Expenditure Framework (MTEF) division of revenue is premised on five key policy priorities namely,

- Enhancement of the quality of education
- Improving the provision of health care, particularly for the poor, reduce infant, child and maternal mortality rates
- Reduction of levels of crime and enhancing citizen safety
- Expansion of the built environment to improve public transportation and meet universal access targets in housing, water, electricity and sanitation. Social infrastructure investment is prioritized to boost delivery and upgrading of informal settlements.
- Response to sharp increases in world food prices by allocating for food security.

These policy priorities are accommodated through a process of reprioritization and additions to the resource envelope to the three spheres of Government over the MTEF. The Commission notes that in arriving at the final allocations Government had to take drastic steps in trying to respond to the global economic crisis on the one hand, and the need to address social and developmental challenges on the other.

3.2 Provincial allocations

The national transfer to provinces increases from the revised R246 billion in 2008/09 to R336 billion in 2011/12. This represents an average increase of 11 per cent over the three years. The equitable share to provinces increases from a revised R204 billion in 2008/09 to R273 billion in 2011/12. The Commission notes the reduction of R7.5 billion in the equitable share to provinces compared to what was communicated in the Medium Term Budget Policy Statement (MTBPS). This reduces the addition to the revision on the equitable share to provinces to R47.8 billion over the MTEF if new additions post MTBPS are excluded. Even though the post MTBPS revision shows a further addition of R3.9 billion, the Commission notes a reduction of R62 million to the grant framework over the MTEF.

An addition of R23 billion to the provincial conditional grants revises the adjusted 2008/09 baseline of R41.6 billion to R63 billion in 2011/12. The conditional grants to provinces increase by an average of 15 per cent over the MTEF.

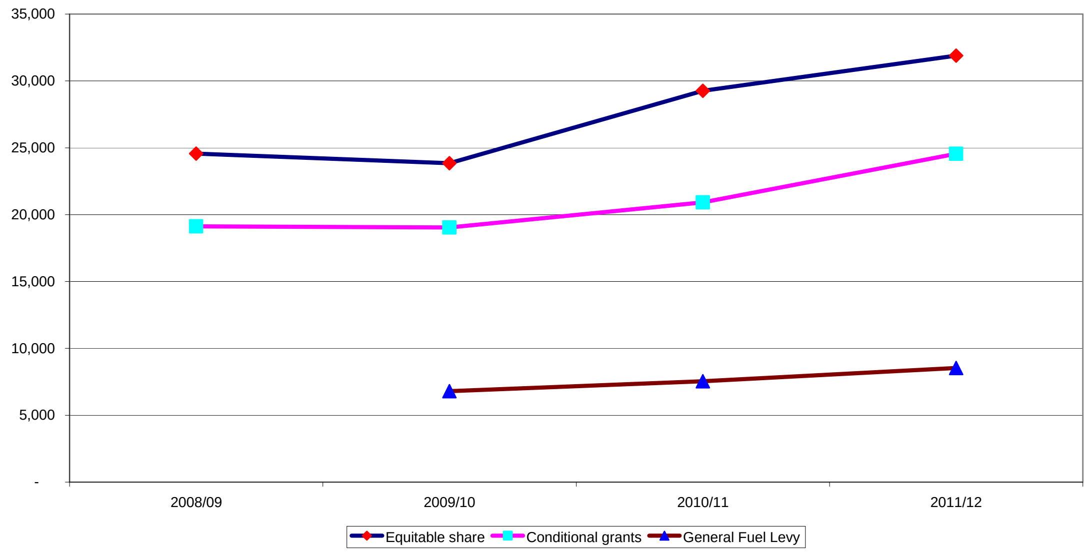
The change in the 2009 MTEF revisions to the provincial allocations baseline is an indication towards a movement to a very tight fiscal framework primarily due to a deteriorating economic outlook that is forecast.

3.3 Local Government allocations

The national transfers to Local Government increase from the revised R44.7 billion in 2008/09 to R56.4 billion in 2011/12, an increase of 8.5 per cent over the MTEF. The equitable share to Local Government represents a total increase of R2.9 billion over the MTEF.

In terms of comparing the two sources of transfer, Figure 1 shows that both the equitable share and conditional grants are declining by 2.9 and 0.4 per cent respectively. They are both projected to increase marginally over the MTEF.

Figure 1: 2009 MTEF Local Government Fiscal Transfers



With respect to the reductions effected at local government, there is a net upward revision of R57 million post the MTBPS as a result of the R69 million addition in 2009/10 and R54 million in 2010 but a reduction of R66 million in 2011/12.

Over and above the adjustment for economic pressures between the MTBPS and the tabling of the budget, the local government equitable share is adjusted down by a net of R1.8 billion. This reflects the variance between the R24.7 billion reduction to local government equitable and the addition of R22.9 billion to the Fuel Levy over the MTEF that is shared amongst the Metropolitan Cities.

3.4 Conditional grants in the Division of Revenue Bill

Even though this year sees the introduction of a number of conditional grants, the amount of money added through these grants to both the provincial and Local Government adds up to only R31 billion. This increase is not significantly higher than in the previous years wherein the additional grants added were small in number but large in terms of rand values added. As pointed out in the Commission's 2005 submission, the Commission does not support this kind of grant proliferation because it has the potential to undermine the autonomy and discretion of subnational Governments. On the other hand, this could also be a reflection of the growing tension between national and subnational Government priorities on concurrent functions.

The Commission is of the view that the choice between conditional and discretionary grant funding must among other things be informed by an objective assessment of the past performance of such grants. The Table below show that as at December 31 2008 many conditional grants had spent below 80 percent.

Table 1: Selected conditional grants spending rate as at 31 December 2008

	Number of provinces spent less than 60%	Number of provinces spent between 60% and 80% (inclusive)	Number of provinces spent more than 80%
Agriculture			
Land Care Programme: Poverty Relief and Infra	4 KZN, LIM, NC, WC	2 EC, NW,	3 FS, GT, MPU,
Arts and Culture			
Community Library Services Grant	6 EC, FS, MPU, NC, NW, WC	2 KZN, LIM,	1 GT,
Education			
Further Education And Training College Sector	2 EC, NC,		7 FS, GT, KZN, LIM, MPU, NW, WC
HIV and Aids (Life Skills Education)	2 LIM, NC,	4 EC, GT, MPU, WC	3 FS, KZN, NW,
National School Nutrition Programme	4 GT, KZN, NC, WC	5 EC, FS, LIM, MPU, NW,	
Health			
Comprehensive HIV and Aids	1 NW,	5 FS, GT, KZN, MPU, NC,	3 EC, LIM, WC
Forensic Pathology Services	2 NC, WC	5 EC, FS, LIM, MPU, NW,	2 GT, KZN,
Hospital Revitalisation	6 EC, KZN, LIM, MPU, NC, WC	2 FS, NW,	1 GT,
Housing			
Integrated Housing and Human Settlement Dev	1 EC,	4 KZN, LIM, NW, WC	4 FS, GT, MPU, NC,
Sport and Recreation South Africa			
Mass Sport and Recreation Participation Progra	4 EC, LIM, NW, WC	4 FS, GT, KZN, NC,	1 MPU,
Transport			
Gautrain Rapid Rail Link			1 GT,

Source: National Treasury 2008

In the past it has been observed that spending on a number of these grants does pick up quite rapidly in the last quarter. Such spending trajectories tend to stifle expenditure in the beginning of the financial year and lead to the infamous March spike. This trend impacts negatively on the quality of spending and even results in fiscal dumping. This implies poor coordination between grant programs. The Commission is of the view that grants showing such tendencies should ideally be reviewed or discontinued as they are not serving their intended purposes.

4. Introduction of new conditional grants to subnational Government

4.1 The Commission does acknowledge that the extension of infrastructure grant initiatives in the 2009 MTEF will help ensure that the provincial and local spheres of Government continue to develop infrastructure. It should be considered that investments in public infrastructure are an inherently long-term proposition, sometimes with 50-year time horizons. Investment in infrastructure must respond to pressures from inflation, population and economic growth. It is necessary that national transfers for the infrastructure funding strategy should be linked to long term objectives. There is also a need to examine the complementarity and efficient use of own revenues, infrastructure grant funding and borrowing arrangements. There are certain principles that should guide infrastructure allocations that the Commission would wish to emphasise as follows:

4.1.1 **Long-term infrastructure planning with funding commitments:** There is need for a long-term approach that aligns infrastructure planning and budgeting at each sphere of Government. To drive progress towards these longer term objectives is important that the components of this long-term strategy be designed in consultation with all spheres of Government and other important stakeholders. The strategy should respond to key principles consistent with effective infrastructure delivery.

4.1.2 **Differentiated approach and investment appraisals:** Before any infrastructure funding can be appropriated, appraisal should lie at the interface between technical work (engineering, planning, finance, and economics) and political decision-making. This approach should proceed with an assessment and understanding of the capacity of smaller urban, rural, and remote municipalities to absorb additional funding and deliver infrastructure. These municipalities require separate, specifically designed programmes that take into account their limited capacities to manage complex funding requirements.

4.1.3 **The need for a comprehensive infrastructure strategy:** Currently there are no comprehensive provincial-wide infrastructure strategies or similar municipal infrastructure strategies. To maximise economic, social and environmental benefits from the provision of infrastructure throughout South Africa, all spheres of Government must take a strategic and long-term approach to the determination of priorities that ensure timely supply of appropriate infrastructure capacity. Current and future needs for economic and social infrastructure must be identified and a plan for the optimal delivery of this infrastructure developed. The infrastructure strategy must also provide for appropriate contributions by the private sector. All spheres of Government should contribute to the development of new and replacement infrastructure that will support economic growth and development

4.2 New conditional grants to provinces

4.2.1 A total of 9 conditional grants valued at R18 billion have been added to the provincial framework. Three of these are disaster related, namely, Agriculture Disaster Grant (R60 million), Housing Disaster Grant (R150 million) and Health Disaster Grant (R50 million). The Commission is of the view that these grants will bring the much needed relief to the recent (natural) disaster in agriculture across provinces, the housing disaster in Kwa-Zulu Natal and the recent health outbreak of cholera in Limpopo and Mpumalanga. The fact that these are introduced as new grants of relatively small amounts indicates that there is a weakness in the way in which the country plans and response for disasters. There is a need for a comprehensive review of the disaster management framework. Such a review should ensure that responses to disasters do not necessarily have to depend on the conditional grant mechanism. There are some disasters that have become quite predictable such as floods and fires in the Western Cape.

4.2.2 The other six grants include the Public Transport Operations Grant (R11.5 billion), Expanded Public Works Programme Grant (R1.4 billion), Agriculture's ILima Letsema Grant (R650 million), Technical Secondary Schools Recapitalisation Grant (R280 million), Sani Pass Grant (R34 million) and Overload Control Grant (R21 million).

4.2.3 The Public Transport Operations Grant is aimed at assisting provinces to subsidise commuters using the public transport mode. The EPWP Incentive Grant incentivises provinces and municipalities for their increased spending on labour intensive programmes. The Illima Letsema Projects Grant aims to assist vulnerable South African farming communities with food production. The other two grants under the Transport Vote (Overload Control Grant and the Sani Pass Grant) are to assist provinces to reduce overloading practices and the promotion of regional integration with neighbouring countries.

4.2.4 The Commission notes that the increase in conditional grants has the potential to reduce the discretion of provinces in the execution of their budgets. While the grants may be of relatively insignificant amounts, a move towards increased conditional grants should not be encouraged unless such grants are entirely deemed necessary.

4.3 New conditional grants to municipalities

4.3.1 There are five new grants introduced in the 2009 Division of Revenue Bill, namely:

- Rural Transport Services and Infrastructure Grant
- Expanded Public Works Programme Incentive Grant for Local Government
- National Energy Efficiency and Demand Side Management (EEDSM) (Municipal)
- Municipal Infrastructure Grant (Cities)
- 2010 World Cup Host City Operating Grant

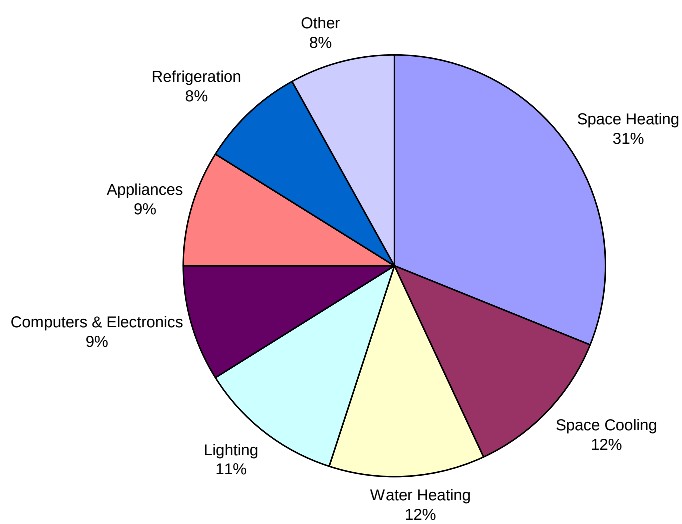
4.3.1.1 The *Rural Transport Services and Infrastructure Grant* is intended to improve mobility and access in rural municipalities in support of Integrated Development Plans. Projects must be in line with the Rural Transport Strategy for South Africa. The rural population in South Africa resides in villages and dense rural settlements. Investment on rural roads can assist a great deal to open up rural areas for economic development (corroborating evidence from elsewhere of the positive impact of such infrastructure can be found in Kilkenny (1995), Akee (2006) Shenggen and Chan-Kang (2005), Eskola (2005) and Warr (2005)). The ability to provide adequate access roads is limited by resources. This relates to technical issues such as lack of planning, funding and the lack of information on the state of the rural road network, including ownership. Most of the rural roads are not even proclaimed, and as such they are neglected. This grant can be used as a pilot to invest in rural and poor municipalities. The spill-over effects will be job creation and local economic development. Rural municipalities must be supported to absorb this grant.

4.3.1.2 The *Expanded Public Works Programme Incentive Grant for Local Government* aims to incentivise municipalities to increase labour intensive employment through programmes that maximise job creation and skills development as encapsulated in the EPWP guidelines. According to the existing EPWP guidelines, provinces and municipalities must institutionalise a process of identifying the EPWP projects and a recruitment procedure. Local municipalities can also, using their capital budgets, decide to construct their infrastructure and other projects in a labour intensive manner. They can then apply for guidance from the National Public Works Programme, and link up with the Department of Labour on training for participants. Where new plans are being made in terms of Integrated Development Plans (IDP) or Local Economic Development (LED) programmes, projects that use local labour and skills of unemployed people should be prioritized. There is a need therefore for an alignment between this grant and

EPWP guidelines. The role of the Department of Public Works in this regard is to find out plans and projects that will be implemented and this should be done before the financial year starts. The other challenge is to link the financial year and reporting cycles of municipalities with those of national Government.

4.3.1.3 The *National Energy Efficiency and Demand Side Management (EEDSM)* aims to implement the EEDSM programme by providing capital subsidies to licensed distributors to address the EEDSM in residential dwellings, community and commercial buildings in order to mitigate the risk of load shedding and supply interruptions. The Grant also aims to assist municipalities with the development of capacity to deliver on EEDSM. Initiatives aimed at enhancing energy efficiency are to be commended. The first step to taking an energy efficiency approach though is to find out which parts of the energy-utilising 'instruments' are consuming most energy. Usually heating accounts for the biggest chunk of a typical utility bill (Figure 2).

Figure 2: Energy Demand Components



Source: Building Energy Data Book, 2007

Before any financial instruments are used as incentives to encourage energy efficiency, it is therefore, important first to identify areas wasting energy, and then assign priorities by asking a few important questions such as (i) where are the greatest energy losses? and (ii) How long will it take for an investment in energy efficiency to pay for itself in energy cost savings The Commission submits that investment in energy efficient equipment and operational behaviour is recognised as an important element in achieving energy efficiency targets. The grant framework as it stands needs to be reworked in the following areas:

- There is a need to clarify the role of resellers of electricity to multi-tenanted premises where municipalities only provide a bulk electricity supply to the perimeter.
- The role of consumers is very unclear and needs further clarification.
- Other measurable outputs such as EPWP jobs created and carbon emission replaced by Megawatt hours saved overload the grant framework unnecessarily.

4.3.1.4 The *Municipal Infrastructure Grant (Cities)* aims to supplement the capital revenues of selected large urban municipalities in order to support their infrastructure investment programmes.The framework postulate that "…the IGC differs from other infrastructure grants in that it seeks to regulate all outputs and outcomes of municipal capital expenditure programmes, through multi-year IGC Performance Agreements that allow municipalities to allocate grant resources in an integrated manner across their capital budgets." It is commendable that a differentiated approach to supplement Metropolitan Councils' funding for cities infrastructure has been budgeted for. This will assist cities to deal with an increasing need for infrastructure services. In as much as the grant does not prioritise sectoral investments in its framework, it is important that the money is spent on infrastructure that enhances access to constitutionally mandated basic services. Both financial and non-financial data on the performance of the grant needs to be institutionalised and reported on a regular basis.

4.3.1.5 The *2010 World Cup Host City Operating Grant* aims to assist host cities with the operational response associated with the hosting of the 2009 Confederations Cup and the 2010 FIFA World Cup (operations of the Confederations Cup and 2010 FIFA World Cup competitions, recruitment and installation of appropriate signage for the competition). The Commission's view is that performance indicators for this grant need to be developed on achievability and outcomes.

4.3.1.6 The *Capacity Development Grants in Local Government (*Local Government Financial Management Grant) managed by National Treasury and Municipal Systems Improvement Grant managed by the Department of Provincial and Local Government) are aimed at improving the capacity and ability of municipalities to plan, budget and manage their finances properly as well as to perform their functions and stabilise institutional and governance systems as required in the Local Government Municipal Systems Act of 2000 and related legislation and policies. The Commission submits that section 154(1) of the Constitution obliges national and provincial Governments to build the capacity of Local Government. There is a need, therefore, to tailor-make capacity interventions to focus on diagnosed delivery constraints and strengthening the delivery capacity of Local Government by:

- Assessing the impact of these grants against improvements suggested in the Auditor-General's report for municipalities;
- Aggressively expand these grants to poorer and weaker municipalities with need.
- Mainstreaming practical hands-on support to Local Government to improve municipal governance, performance and accountability;
- Focus on institutional and human capacity needs, including broad-based civic engagement;
- Strengthening capacity for planning, implementation, monitoring and evaluation.

5. Comments on Government's response to the Commission's recommendations

5.1 The Financial and Fiscal Commission tabled its submission for the Division of Revenue 2009/10 to Parliament in May 2008. The submission covered a wide range of issues affecting provincial and Local Government. Section 10(5) of the Intergovernmental Fiscal Relations Act provides for an explanatory memorandum outlining Government's response to the Commission's recommendations to be set out in the Division of Revenue Bill when determining the division of revenue for the 2009 MTEF. This section gives the Commission's response to Government's response to its recommendations.

5.2 The Commission in general welcomes the in-depth response to its recommendations by Government. It is also pleasing that Government has responded to everything that the Commission proposed. While the Commission welcomes that most of the recommendations have been appropriately responded to and accepted by Government, there would be more value added to the process if Government would in future provide details around implementation of recommendations both for the previous year and progress over the medium term expenditure period. The rest of the discussion in this section dwells only on those responses to its recommendations by the Government where the Commission feels there is a need for follow up.

5.2.1. Learner transport

5.2.1.1 The Commission recommended that national norms and standards for the provision of learner transport should be established. At the stage when it was recommended the location of this function had not been clearly demarcated between the national Departments of Education and of Transport. The responsibility had to be clarified as a matter of urgency.

5.2.1.2 Government agreed with the recommendation of the Commission and stipulated that the Department of Education is responsible for the functional provision of scholar transport while the Department of Transport is responsible for regulatory requirements with respect to such transport. Although the Council of Education Ministers decided that the function should reside with the Department of Education and regulations should be with the Department of Transport, all the issues have not been clarified and resolved. The Commission would want to re-emphasise that this matter should be finalized as a matter of urgency. It is important, however, that the matter of learner transport is adequately addressed in the provincial budgets. The Commission will continue to evaluate the program in this regard.

5.2.2 Augmenting Local Government Revenue

5.2.2.1 The Commission recommended that in light of the disestablishment of the Regional Services Council (RSC) Levy, which formed a significant source of municipal revenue, the replacement revenue source for municipalities should be a tax that (a) enhances the fiscal autonomy and discretion of Local Governments; (b) strengthens the accountability of Local Government regarding the administration and use of the proposed tax base; (c) yields an adequate and buoyant revenue stream for municipalities in the face of cyclical instability; and (d) does not disturb macroeconomic balance.

5.2.2.2 Government agreed that it is important that reforms to the fiscal framework for Local Government should ensure that the fiscal autonomy of municipalities is not compromised but enhanced and supports the principles proposed to underpin the choice(s) for replacement sources of revenue for the RSC levy.

5.2.2.3 Government proposed as part of a package of reforms, the VAT zero-rating of municipal property rates and other VAT reforms from 1 July 2006. Further reforms contained in the 2009 Division of Revenue Bill include the sharing of the general fuel levy. While the sharing of the fuel levy is a stop-gap measure which improves revenue adequacy, the Commission notes that it falls far short of the criteria of a good local tax delineated above, and agreed to by Government. The Commission is of the view that municipalities should continue the pursuit of appropriate revenue sources. The proposed fuel levy tax sharing package does not comply with all of the proposed criteria since municipalities have no discretion over the base and rate of the tax. Furthermore, the link between the agents who bear the incidence of the fuel levy and the beneficiaries of the services funded by fuel levy revenue sharing is tenuous. This means that accountability at the margin is not enhanced.

5.2.2.4 More importantly, in terms of Section 229(5) of the Constitution, national legislation on municipal fiscal powers and functions may be enacted only after Local Government and the Financial and Fiscal Commission have been consulted, and any recommendations of the Commission have been considered. The Financial and Fiscal Commission has not yet had access to documentation about the proposed fuel levy reform package and yet it is already in the Bill. The Commission would therefore require the necessary documentation about the package of reforms planned.

5.2.3 Electricity Sector Investments

5.2.3.1 The Commission had made a recommendation with regard to investments in the electricity sector. It recommended that for greater efficiency of resource allocation, technological innovation and increased investment in renewable energy sources, Government would need to increase funding resources set aside for such purposes and incentives with a view to establishing and implementing a framework that:

- Encourages new forms of electricity generation technologies to enter the market;
- Expands opportunities to consumers to access such forms of energy;
- Allows non-utility developers equal market opportunity to compete with established providers; and
- Incorporates financial incentives to expand production and distribution capacity, and effect savings through improving end-user efficiency.

5.2.3.2 In its response, Government has acknowledged the need to promote greater efficiency of resource allocation, technological innovation and increased investment in renewable energy sources. Government also responded that tax incentives to encourage the uptake and development of renewable energy, such as accelerated depreciation allowances, are already in place. Government has in the *2008 Budget Review* proposed the imposition of a 2c/kWh tax on the sale of electricity generated from non-renewable sources, to be collected at source by the producers/generators of electricity. The *2008 Medium Term Budget Policy Statement* pointed out that the electricity levy should be seen as the first step towards the introduction of a more comprehensive emissions-based carbon tax. Implementation of the levy has been postponed to 1 July 2009 to coincide with the commencement of the next municipal financial year.

5.2.3.3 From the Commission’s perspective, diversifying electricity supply towards sustainable development is encouraging. However, there must be creation of an enabling environment through the introduction of further fiscal and regulatory instruments to allow renewable energy technologies to compete with fossil based technologies. Government must set proper boundaries with time limits within which the renewable energy industry can operate and develop.

5.2.3.4 Municipalities have a constitutional right to the reticulation of electricity distribution. The fact of the matter is that not all municipalities have the capacity to provide the service. Some are not financially viable because of diseconomies of scale issues. Infrastructure in most municipalities is in dire need of rehabilitation and this leads to distribution losses. Government must still commit itself to rationalizing and restructuring of the electricity distribution sector as a matter of priority.

5.2.4 World Cup 2010 Transport Infrastructure

5.2.4.1 The Commission recommended that spending on public transport infrastructure for 2010 should be linked to broader city development plans. A more resourced Public Transport Infrastructure and Systems (PTIS) Grant must continue after the 2010 FIFA World Cup. Projects that are funded under this arrangement should be selected based on full appraisal of economic, environmental and social costs/benefits. Funding mechanisms to cover maintenance costs of constructed 2010 FIFA World Cup facilities should be developed.

5.2.4.2 Government responded that the PTIS funded projects should be selected based on full appraisal of economic, environment and social costs/ benefits. The existing PTIS will continue post 2010 as outlined in the 2008 Budget Review. PTIS is aligned to the Public Transport Strategy which provides guidance on the creation of integrated public transport networks for the whole country up to 2020. Moreover, PTIS projects are part of the integrated transport plans contained in integrated development plans (IDPs) of municipalities. As concerns maintenance of built infrastructure, Government is of the view that the costs relating to maintenance of constructed 2010 FIFA World Cup facilities should be covered by municipalities

5.2.4.3 The Commission welcomes this response by Government. Even though this grant is targeted at municipalities, the focus should be inter-modal in nature, inclusive of rail and minibus taxis as well. For equity purposes, this grant should be extended to other municipalities that are not host cities but provide valuable public transport. The Commission notes Government’s suggestion for how maintenance of built facilities for the event should be funded and will reserve comment on the proposal until after researching the proposal further.

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6. Conclusion

6.1 The Financial and Fiscal Commission notes and welcomes most of the changes that have been introduced through the 2009 Division of Revenue Bill. Unlike in previous submissions, this year the Commission has raised broader strategic issues critical for future evolution of the Division of Revenue Bill. The issues raised pertain to (a) simplifying and refocusing the Division of Revenue Bill to its core essence (ii) refraining from tendencies leading to proliferation of conditional grants, (iii) Intergovernmental Loan Agreements, (iv) guarding against dangers of delays in policy implementation, (v) ensuring that capacity building grants remain part of DORA and (vi) re-demarcations and addressing the fiscal and financial impacts thereof. These issues do not pertain only to this year's Division of Revenue Bill but are issues that the Commission would wish to see addressed in the future Bills.

6.2 As in previous years, the Commission's submission makes observations on certain clauses of the Bill with a view at enhancing clarity and transparency in the Bill. It recommends the streamlining of certain specific frameworks. The submission then focuses on changes to conditional grants for provinces and Local Government. It calls for a move away from proliferation of conditional grants and towards more consolidation. It points out that financing of disaster management requires detailed work to come up with a long term and flexible financing arrangement. The Commission agrees with the basic principles behind most of the new conditional grants but raises problematic areas to do with implementation and how the grants will be rolled out. In this regard it recommends that certain of the grants be run on a pilot basis. Finally the submission assesses Government's response to the Commission's recommendations on the 2009 Division of Revenue. Generally the Commission welcomes the in-depth response to its recommendations by Government and notes that there is agreement between itself and Government on most of the recommendations. The Commission suggests that Government should in future provide details around implementation of recommendations and progress over the medium term expenditure period.

6.3 Subject to highlighted changes, the Commission supports the Division of Revenue Bill for 2009.