FINANCIAL
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COMMISSION

Media Release

SUBMISSION FOR THE 2012-13 DIVISION OF REVENUE

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For an Equitable Sharing of National Revenue

[**30 May 2011**] On 27 May, the Financial and Fiscal Commission (the Commission) tabled at Parliament its Annual Submission for the Division of Revenue 2012/13. The Submission is made in terms of Section 214(1) of the Constitution of the Republic of South Africa (1996), Section 9 of the Intergovernmental Fiscal Relations Act (1998) and Section 4(4c) of the Money Bills Amendment Procedure and Related Matters Act (Act 9 of 2009).

The Submission based on research conducted by the Commission shows that South Africa's economic growth in real terms increased from -1.7% in 2009 to 2.8% in 2010 and is projected to be between 3.4% and 3.8% in 2011, an indication that the economy is recovering from the recession of the recent past. Despite the recovery, unemployment, poverty, inequality and relatively low growth persist. Poverty is still high especially among Black and female-headed households, despite an unprecedented extension of government social grants that have helped to reduce absolute poverty. Inadequate educational and health outcomes are similarly skewed against the poor. Distorted settlement patterns, which mean that the poor often locate at the peripheral urban and remote rural areas, further exacerbate the problems. The Commission is of the view that the intergovernmental fiscal relations system is a crucial instrument that government can use to tackle these pressing socioeconomic concerns. It is in this context that the Commission offers its recommendations, in pursuit of its overarching vision to enhance the developmental impact of public resources through the financial and fiscal system. The Submission is divided into three major focus areas as summarised below.

The first area focuses on the *Macroeconomic and Fiscal Outlook*. Similar to other countries, South Africa is dealing with complex issues when adjusting fiscal policy in an uncertain environment. The country has been implementing fiscal consolidation for a while and medium term forecasts still indicate a reduction in the fiscal deficit. Government is also proposing implementation of fiscal guidelines aimed at strengthening fiscal frameworks. The Commission's view is that over the medium term, government should continue with the gradual programme of fiscal consolidation that entails reducing moderately but consistently the budget deficit. In addition, recent government proposals on fiscal guidelines should be supported. However, there is more work to be done on the institutional arrangements for the implementation of such guidelines or rules. The Commission is of the view that while the implementation of fiscal guidelines can contribute to and complement existing fiscal policies, there is no "one size fits all" formula when it comes to the design, institutional arrangements, and implementation of such guidelines. Government should thus focus on these aspects of fiscal guidelines in the short to medium term. The Commission is also carrying out work in this regard and will be tabling further recommendations soon.

Although the country has made significant progress in achieving its social objectives, certain problems still require attention, such as inequality, poor educational attainment and child and maternal mortality. Looking ahead, a key issue for the country is to strike a balance around inclusive growth and job creation together with fiscal sustainability and low inflation. All this is compounded by structural challenges in infrastructure and public service delivery. To strike such a balance, the Commission re-emphasises the need for national, provincial and local government to further reprioritise expenditures in respect of the equitable share and conditional grants for 2012/13 to move towards attaining the Millennium Development Goals (MDGs). In particular it is recommended that government should further prioritise MDG 2 (universal education) and MDG 6 (HIV indicators) in the interim as their attainment will have positive impacts on other MDGs (positive spillovers). Furthermore, the existing intergovernmental fiscal transfer system should be strengthened so that it plays a supportive role in respect of the country's economic growth objectives. Finally, significant capital investment in public infrastructure that has a positive impact on total factor productivity and employment in the context of the New Growth Path should continue to be implemented. In all cases, fiscal policy needs to remain prudent and support anti-inflationary efforts.

The second area of focus addresses local government issues, paying specific attention to the role and conduct of municipalities in their unique spatial environments, under the theme of *Vibrant Urban Economies*. Sustainable development is anchored in a well-functioning local government sector and vibrant urban economies in particular. Vibrant urban economies spur robust development in all spheres of the economy, including rural areas. In turn, such vibrancy is based on using scarce resources in an effective, efficient and sustainable manner. Like most other aspects of the South African society, municipalities are diverse and operate in unique social, demographic and economic spaces. These unique characteristics have a significant impact on municipal performance and strategies required to ensure a well- functioning local government sphere. Vibrant urban economies can be promoted if, *inter alia*, budgetary resources are used efficiently and productively. In this respect, national and provincial treasuries' efforts to improve the credibility of municipal budgets through annual benchmarking exercises should continue to be supported and results of such evaluations made public. In addition, national and provincial government should develop and support peer learning and support programmes that assist poorly performing municipalities to leverage experience and best practices of well-performing municipalities, particularly in relation to spending performance, efficiency in using resources, proper debt management and achievement of desired developmental outcomes. It is important to strengthen the coordination of programs aimed at supporting municipalities from different spheres of government and other organs of state. Provisions set out in S74 (2) of Municipal Systems Act should be enforced to ensure that municipalities are adequately repairing and maintaining infrastructure. Municipalities should be required to identify primary causes of poor performance in billing and revenue collection functions and the information used to design appropriate remedial strategies. Data available at local government level should be reviewed to ensure appropriate surveys or alternatives are available to account accurately for changes in demographics and other factors at municipal level.

By international standards South African cities are inefficient, as measured by low-density development, high travel costs and long distances to and from places of work, and high carbon footprints. While all income groups are worse off financially because of an inefficient urban form, low-income households are most adversely affected by the urban sprawl, having to pay significantly more for transport. The Commission recommends that government should pursue development of a more spatially compact urban form actively by formulating and adopting appropriate policies and financing instruments. Specific fiscal instruments that can support these objectives include the wider use of development charges in financing infrastructure associated with the land development process, public transport subsidies that specifically target high density low-income areas, and fiscal incentives for urban land development projects located within the existing urban form. To address environmental problems in cities, government is called upon to consider providing municipalities with a performance-based conditional grant, which incentivises actions that are environmentally efficient and responsive to adaptation and mitigation challenges of climate change.

The third and final area of focus looks at *Improving Development Outcomes of South Africa's Intergovernmental Fiscal Relations System*. National government, provinces and municipalities need to exercise increased fiscal responsibility in the context of government's overall fiscal consolidation stance which entails slower growing medium-term expenditure framework allocations, coupled with cost pressures (e.g. for occupation specific dispensation) as well as a rising demand for services. In this regard, improving the quality and efficiency of services in education, health and rural development are central. Government should protect such services within existing medium-term allocations so as to cushion the effects of the fiscal consolidation on the most vulnerable as well as to assist in building human and social capital critical for future growth development. The Commission is of the view that government should finalise implementation of Occupation Specific Dispensation and formalise the performance evaluation system across government. Increases in education spending should be directed towards investments that will have biggest impact on quality – this includes learner and teacher support materials and scholar transport. Government should improve quality and should develop the capacity to evaluate the academic performance of learners throughout their academic careers, ensure that the requisite amount of time is spent on teaching and learning through relieving teachers of administrative duties and ensuring that they actually teach. In the area of health, ongoing efforts to reform health fiscal frameworks should be deepened and take into account the burden of disease giving rise to budget pressures (includes reviewing funding for HIV/AIDS, opportunistic and other infectious diseases through a regular review of usage costs for chronic disease services in HIV/AIDS, tuberculosis, maternal and child health to inform resource allocations in public sector health care system; Institutionalisation of a budget process that forces provincial health budgets to be based on estimations of needs of health care service users and holds provincial governments accountable for underfunding of hospitals and clinics). Finally, certain functions such as procurement, human resources and financial management, should be devolved to hospital management to boost efficiencies and better performance.

The Commission has also provided with this submission progress reports on the matter of rural development and food security and also on the matter of unfunded/unfunded mandates together with a number of advisories for consideration by government. These are attached as appendices to the Submission.

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