FINANCIAL
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MEDIA STATEMENT

Submission for the 2019/20 Division of Revenue

Re-engineering the intergovernmental fiscal relations system for national development in a fiscally constrained environment

For an Equitable Sharing of National Revenue

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On 31 May 2018, the Financial and Fiscal Commission (the Commission) tabled its Annual Submission for the Division of Revenue in Parliament. 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 (1997) and Section 4(4c) of the Money Bills Amendment Procedure and Related Matters Act (2009). This Submission is an integral part of the Commission's constitutionally defined processes. The Commission advises Parliament and state organs on how the money collected by national government should be allocated fairly and equitably among the three spheres of government. Allocations should best enable them to carry out their respective constitutional and other legal mandates.

The Commission tables this Submission against the backdrop of an austere economic environment. South Africa is required to balance ongoing efforts of fiscal consolidation against the need to address the significant revenue shortfall without stifling the county's fragile growth recovery, or constraining the delivery of critical government services to its most disadvantaged citizens. The combined effects of muted economic growth and the budgetary pressures stemming from increased demand for the delivery of public services, for example to fund fee-free tertiary education, have precipitated the need for adjustments. These include expenditure cuts, revisions of planned government spending and a substantial adjustment in taxes, notably the increase in VAT to 15 percent.

From a fiscal policy standpoint, the persistently low and fragile economic growth South Africa has experienced since 2011 has adversely impacted government's ability to protect crucial frontline service delivery and successfully implement of the measures aimed at eliminating poverty and reducing inequality by 2030 as set by the National Development Plan (NDP). The success and sustainability of South Africa's intergovernmental fiscal relations system is built on the twin pillars of buoyant tax revenue collection and a stable fiscal framework supporting planned government spending allocations. For the Commission, an uncertain fiscal framework compromises the ability of subnational governments to carry out their mandated functions and address stubbornly high levels of unemployment, poverty and inequality.

Accordingly, the theme of the Commission's Submission for the 2019/20 Division of Revenue is ***Re-engineering the intergovernmental fiscal relations system for national development in***

a fiscally constrained environment. This Submission focus as on a fiscally constrained environment, continues the overarching theme of the intergovernmental fiscal relations system and national development, with the focus now on assessing of other public finance issues. This Submission is premised on the Commission's view that 'business as usual' policies and interventions will fail and will not achieve the poverty and inequality reduction targets set for 2030. The focus has to be on re-engineering incentives for interventions using intergovernmental fiscal relations instruments and not compromising public finances that are already severely constrained.

The Commission's articulates its recommendations in terms of the six chapters contained in the Submission. The past performance and prospects of the economy at national and subnational levels is investigated, as well as how linkages between various fiscal constraints place new limitations on the equitable sharing of nationally raised revenue and on policy formation. The focus on the anatomy of South Africa's fiscal crisis and implications for re-engineering intergovernmental fiscal instruments across provinces and municipalities.

The Commission examines whether recentralisation towards the national sphere poses a credible avenue for ensuring better value for money and improved service delivery during this period of heightened fiscal constraint. Using multiple research techniques, including case studies, the Commission finds that national government is not necessarily better at delivering sub-national services than subnational government itself. The Commission recommends that government should not automatically increase the role of national government. The nature and design of intergovernmental fiscal instruments should be aimed very specifically at improving service delivery in the attainment of national priorities, rather than as tools to support consolidation efforts during times of fiscal stress. Government must rather focus on supporting subnational programme implementers and on monitoring and evaluation. The chapter further recommends that when recentralising a function is necessary, a differentiated approach is required.

Given the ongoing fiscal constraint, what is the extent to which provinces are able to adjust their health care services and are the intergovernmental fiscal instruments responsive? The Commission finds that institutional arrangements largely prevent provinces from making discretionary fiscal adjustments. In addition, the research conducted reveals that budget adjustments tend to flow directly from national government through altering the composition and rate of growth in transfers to provinces. Non-fiscal adjustment measures are also imposed, most of which are rarely implemented. In selected cases, provinces actually use health delivery output reductions and accounting accruals to manage current expenditure pressures. The existence of provincial fiscal strain is not simply justified by incidents of fiscal imprudence and operational mismanagement in provinces. The offsetting of accounting accruals must be considered.

In the context of constrains, national and provincial treasuries must develop clear, measurable financial and non-financial frameworks to assist provincial admininstrations and entities in tackling issues related to serious financial strain, especially given demand-induced expenditure pressures from the poor. One of the biggest threats to fiscal sustainability, fiscal governance, public goods and service-delivery management is fraud and corruption. As such, the Commission believes that all spheres of government and administrations, including within institutions, entities and agencies of state, must consciously fight and solidify systems to eradicate error, fraud and corruption within the supply management systems. This should be done irrespective of how small or large insourcing and outsourcing of public good and services are. Consequential decision-making in all systems practices, especially the value chain of procurement and in the behaviour of civil servants in administrations, other institutions and state-owned entities goes hand-in-hand with consequential responsibility and accountability.

Fiscal rebalancing, impacts municipalities by reducing the intergovernmental transfers from national government. The Commission sought to determine whether this facilitates reduced dependency on grant transfers and spurs innovation in using local autonomy to raise its own revenue. Or conversely, whether it worsens service delivery capacity and regional disparities. This is particularly important because municipalities are expected to use their assigned functions as the main revenue raising tool to address significant historical inequities and to equitably distribute socio-economic infrastructure and resources.

The Commission research finds reduced dependency on transfers as the main driver of expenditure and revenue for municipalities particularly in metropolitan areas and secondary cities. However, for smaller and rural municipalities, reductions in transfers significantly correlate with less financing of capital and operating budgets. The Commission recommends that intergovernmental transfers strike a balance between the need to enhance fiscal autonomy through reduced transfers on the one hand, and the important stimulus that increasing conditional grants provides for funding capital expenditure in fiscally vulnerable municipalities on the other. More flexibility must be built into the grants for vulnerable municipalities. Grants should also incentivise municipal effort to increase their revenue.

The Commission further considered how conditional grants, their framework and general environment can be re-engineered during this period of austerity. Widespread inefficiencies in infrastructure delivery across the three main infrastructure sectors of health, education and road maintenance exist. While the 2018 Budget cut infrastructure grants, owing to underspending and relative ease of rescheduling spending to outer years, the Commission calls for strengthened oversight and consequential accountability over consultants and contractors, especially noting the SASSA Constitutional Court Judgment that private companies and by extension not-for-profit organisations delivering public goods and services on behalf of the government and state institutions are not only agents of the state, but also an extension of the state.

So, in addressing the potential for fiscal misappropriation during the procurement and implementation stages of infrastructure delivery, the Commission recommends that a clear, measurable evaluation framework be added to conditional grants frameworks in the Division of Revenue Bill. Holding the implementing agent accountable for funds spent will more closely align to sector department objectives. Particular scrutiny must be exercised over contract variation orders.

Providing water services is one of the most important social and economic functions of local government. The Constitution mandates municipalities to exercise this responsibility and empowers national government to regulate and guide municipal performance of the functions. Considerable progress has been made in expanding water service infrastructure and ensuring that affordability does not prevent people from accessing basic water services. However, research indicates that while water supply infrastructure reaches 95 percent of the population, its reliability is declining. The Commission finds that fiscal constraints may be aggravating this, however the performance of inter-governmental financial instruments can be enhanced. Measures to monitor and control operations and maintenance budgets for water services are necessary - as are a review of affordable service delivery standards and the use of conditional grant transfers.

The central message of the Commission, that underly the various recommendations made, is that in the context of the country’s intergovernmental fiscal system, three key issues must be faced:

- First, there is an urgent need to properly understand the country's economic challenges and to address them specifically and directly,
- Second, is the need to establish a balanced fiscal position that can be sustained over the long term, and
- Third, the efficiency of all government activity must be sharpened so that residents receive the best possible value for money from the taxes they pay.

THANK YOU