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SUBMISSION ON THE 2019 DIVISION OF REVENUE BILL

Joint Meeting of the National Assembly and NCOP
Standing Committee on Appropriations and Select Committee on Appropriations

08 March 2019

For an Equitable Sharing of National Revenue

Outline

- 2019 Budget Overview
- Macroeconomic environment assessment
- FFC response to the DoR Bill
  - Government responses to FFC recommendations
  - Changes to the fiscal framework
  - Changes to the provincial fiscal framework
  - Changes to the local fiscal framework
  - Sector specific issues
  - Conclusion

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Budget and Macroeconomic Overview

2019 Budget Overview

- **Policy priorities**
  - Accelerating inclusive economic growth and job creation;
  - Improving the education system with a view to developing current and future skills required for national growth and development;
  - Improving the conditions of life for all South Africans, especially the poor;
  - Fighting corruption and state capture; and
  - Strengthening the capacity of the state to address the needs of the people
- **Macroeconomic overview**
  - Government has consistently had to revise its economic growth projections downward since 2009 as the economy has struggled to recover from the global and domestic financial crises
  - Muted economic growth forecasts, inflation remaining at the upper bound of the targeted 3% to 6% range, fragile domestic and export demand
- **Fiscal Framework and DoR**
  - Revenue shortfall of R16.3 billion over the next 3 years, necessitates significant expenditure reprioritisation
  - Growth in debt and debt service costs have grown consistently and significantly since 2009, and threaten to crowd out economic and social spending
  - Financially stressed state owned enterprises (SOEs) pose key risk to the fiscus

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Economic and Fiscal Outlook Underpinning the 2019 Division of Revenue

- South Africa’s economic prospects have deteriorated – despite this fiscal spending continues to exceed revenue:
  - Real, long-term growth continues to decelerate
  - Recessionary scares
  - Negative outlooks by credit rating agencies
  - Institutional deterioration due to governance failure
  - Uncertainty causing structural degeneration on both the demand and supply sides of the economy
  - Financial, operational and governance crises of key SOEs

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Underlying Growth Constraints

- Subdued current and expected demand
  - Private consumption growth contribution slowed from Q4 2017 at 1.7% to 0.8% in Q3 2018 due to a re-adjustment of the business cycle (economy overheated)
  - Government consumption growth contribution sustained at 0.3% for three quarters of the 2018 year
  - Public investment growth contribution slowed from 0.3% at the beginning of the same year to 0.1% in Q3
  - Private investment remained in the negative territory, declining at 0.1% due to the subdued economic outlook and expected future demand is falling
  - After the negative inventory carry in Q2 2018, firms began restocking again, adding 0.8% growth contribution in Q3 2018
  - And finally, external demand or net exports retreated significantly by -1.1% in Q3 2018

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Fiscal Constraint

- Since the 2008/09 financial crisis, national revenue and expenditure trends have departed into a distinct divergence
- Fiscal contractionary measures implemented over the years:
  - Imposing expenditure ceiling;
  - Consolidating spending through cost-containment measures;
  - Raising of the marginal income tax from 40% to 45% in the highest income bracket in 2017/18
  - Increasing value-added tax (VAT) from 14% to 15%
  - Cutting direct conditional grants

    these measures have been insufficient to close the widening gap between total revenue and expenditure
- With the economy locked into a low-growth spiral with rising deficits, it is evident that the current trajectory of expenditure will need further moderation

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FFC Response to DoR Bill

Overview And General Assessment of the 2019 DoR Bill

Adjustment to DoR Bill	FFC View
Clauses 9 (4) and 10 (11) have been added to ensure accountability within the transfer system. The 2018 DoR Act imposes responsibilities on the transferring and the receiving officers of the grant only, and imposes no responsibilities on other departments that are mentioned in the grant framework. The addition will ensure that other departments mentioned in the frameworks are also accountable	FFC welcomes this approach as it will ensure collaboration by all departments involved and affected, so that the grant can effectively be managed to achieve its purpose.
Clause 10(6)(b) is revised to require the transferring officer of a Schedule 5 or 6 allocation, as part of the reporting envisaged in section 40(4)(c) of the PFMA to submit information in the format determined by National Treasury within a period of 20 days after the end of the month in question, instead of 15 days	FFC welcomes this adjustment as it will give national departments enough time to prepare information for the reports to be submitted to National Treasury. This may also have positive effects on the quality of reported information
Clause 17(3) is added stating that for any transfer of grant funds to another organ of state, the receiving officer must submit a copy (written) of agreements envisaged in subsection 2 to the transferring officer and National Treasury before payment is made	FFC supports addition of this clause as it emphasises the use of service level agreements, which is important for accountability and will assist in eliminating issues of unfunded mandates and duplication

Overview And General Assessment of the 2019 DoR Bill [cont.]

Adjustment to DoR Bill	FFC View
Clause 26(3) is revised to state that the transferring officer may, with the approval of National Treasury, make one or more transfers of a Schedule 7 allocation to a province/municipality for a declared disaster within the period specified in the Disaster Management Act, 2002 (Act No. 57 of 2002)	FFC welcomes the change as it allows for a more immediate response to disaster situations however within the requirements of the Disaster Management Act
Clause 27 (2) (b) is added and requires the transferring officer of a conditional allocation to consult the department that has responsibilities listed in the grant framework before submitting the draft conditional grant framework to National Treasury.	FFC welcomes this clause, as it formalises the responsibilities of departments relative to transferring officers. Furthermore, this is in line with previous FFC recommendations that national and provincial departments should not neglect their leadership roles in monitoring and evaluating grants and should boost their capacity to support effective grant design, and monitor and evaluate grant implementation FFC Submission for the 2014/15 DoR
Clause 28 (1) is expanded to make reference to the Appropriations Act on transfers prior to the commencement of the DoR Act	The Commission welcomes the adjustment as it improves alignment and concurrence in the implementation of government legislation that is regulating the same function

Overview And General Assessment of the 2019 DoR Bill[cont.]

Adjustment to DoR Bill	FFC View
Clause 27(5)(c) is added to require the Department of Cooperative Governance (CoGTA) to seek National Treasury's approval for any additional qualifying municipalities for the Integrated Urban Development Grant (IUDG), and municipalities that have failed to continue to qualify	FFC is of the view that CoGTA should be allowed to manage the process without National Treasury approval. The Commission is of the view that CoGTA should be allowed to manage the process using the conditional grant framework to guide this process
Clause 29(2) is revised to state that the a district municipality providing a municipal service must, before implementing any capital project for water, electricity, roads or any other municipal service, consult the category B municipalities within whose area of jurisdiction the project shall be implemented, and agree in writing which municipality is responsible for the operational costs and maintenance the collection of user fees	FFC supports the changes made in this clause as it emphasises the importance of infrastructure maintenance. A service level agreement between districts and local municipalities will address the issues of accountability, as it will clarify both the funding and expenditure responsibilities

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Government Responses to FFC Recommendations

- The Annual Submission for the 2019/2020 Division of Revenue comprised six chapters with a total of twenty one recommendations
- Government has responded to twelve recommendations that have either a direct or indirect bearing on the DoR and the other recommendations are being considered by the relevant national departments
- Government agrees with most of the FFC recommendations
  - In some instances, government has indicated that processes that will be put in place to address the recommendations. For instance, government will explore the possibility of establishing a framework for evaluating the performance of provincial infrastructure grants to be implemented in the 2020 budget. In addition, government has indicated its desire to resume publication/reporting on Blue Drop Water status (see Annexure A of the FFC's Submission on the 2019 DoR for a list of all the Commission recommendations and government responses).

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CHANGES TO THE FISCAL FRAMEWORK

Overview of the 2019 DoR

R'billion	Outcome			Revised est.	Medium term estimates			Real Annual Average Growth 2019 MTEF
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	
National departments	**546.1**	**555.7**	**592.7**	**638.2**	**684.7**	**733.1**	**777.7**	**1.4%**
Provinces	**471.4**	**500.4**	**538.6**	**572.2**	**612.3**	**657.1**	**701.0**	**1.5%**
Equitable share	386.5	410.7	441.3	470.3	505.6	542.9	578.6	1.7%
Conditional grants	84.9	89.7	97.2	101.9	106.7	114.2	122.4	0.9%
Local government	**98.3**	**102.9**	**111.1**	**117.3**	**127.3**	**137.9**	**149.5**	**2.9%**
Equitable share	49.4	50.7	55.6	60.5	69.0	75.7	82.2	5.1%
Conditional grants	38.3	40.9	43.7	44.3	45.1	48.2	52.2	0.05%
General fuel levy sharing with metros	10.7	11.2	11.8	12.5	13.2	14.0	15.2	1.3%
Provisional allocation not assigned to votes	–	–	–	–	19.2	11.4	18.9	
Non-interest allocations	**1 115.8**	**1 159.0**	**1 242.3**	**1 327.6**	**1 443.5**	**1 539.5**	**1 647.1**	**2.0%**

- Non-interest allocations set to grow by real annual average of 2% p.a. over next 3 years
  - Commission welcomes real growth in the equitable share allocation, especially to municipalities – LES allocation projected to grow by real annual average of 5.1% p.a. over next 3 years
  - Conditional grant allocations to provinces and municipalities continue to bear the brunt of the need to cut and reprioritise spending over the next 3 years

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Changes to the Provincial Fiscal Framework

- The 2019 budget provides an estimated total provincial allocation of R1.9 trillion over the MTEF
  - The composition of unconditional transfers relative to conditional grants is expected to remain the same
- The Commission welcomes the incorporation of the substance abuse and social workers employment grant into the provincial equitable share (PES) allocation
  - The transition must be accompanied by greater oversight at inception to minimise crowding out

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Changes to the Provincial Fiscal Framework [cont.]

- The PES allocation is expected to maintain a nominal average growth rate of 7.2% over the MTEF, notwithstanding that it is inclusive if a baseline cut of R340 million in 2020/21
  - The Commission welcomes that new priorities are kept to a minimum
- Thorough expenditure management should be exercised to manage the impact of cost escalation on service delivery due to low real increases in PES
- Conditional grants continue to bear the largest burden of consolidation with a projected reduction of R5 billion over the 2019 MTEF
  - The Commission's stance is that funding should be reprioritised away from under-performing grants
  - Readjustment should not tamper with approved delivery plans

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PROVINCIAL CONDITIONAL GRANTS

- A number of provincial conditional grants have been reduced/reprioritised over the 2019 MTEF – these include grants in the agriculture, human settlements, public transport and health sectors
  - With respect to the agricultural sector, the Comprehensive Agricultural Support Programme (CASP) has been reduced by R887.4 million with this funding being reprioritised and transferred to the Land Bank for the implementation of a new blended finance mechanism
    - While the Commission supports that reprioritised funding remains within the sector, it recommends that Provincial Departments of Agriculture and Fisheries work with the Land Bank to the implement the new blended finance mechanism
  - Despite its good performance, the Human Settlements Development Grant (HSDG) has been reduced by R3 billion over the 2019 MTEF
    - The Commission is of the view that this reduction on the baseline will significantly affect outputs- number of housing units and serviced sites

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Provincial Conditional Grants [cont.]

- With respect to earmarking of funds within HSDG: R7.4 billion will be reprioritised over the MTEF for the implementation of informal settlements upgrade program and the title deeds grant will be phrased back into the HSDG in 2020/21
  - FFC has a concern with the earmarking of conditional grants as it limits provincial discretion over the implementation of housing projects
  - While FFC supports the phasing back of title deeds grant into the HSDG in 2020/21, it is recommended that in future a comprehensive evaluation of whether earmarked funding has achieved its goals and challenges encountered has to be undertaken instead of terminating a grant simply because its predetermined life span has been reached

– As part of the devolution process, it is anticipated that public transport contracting and regulatory functions could be assigned to metropolitan municipalities during 2019/20 – as a result, R20.2 billion will be transferred directly to the affected municipalities

- The Commission supports the anticipated assignment of the function as it is in line with previous FFC recommendations on the devolution of the public transport function. Further the Commission recommends that a decision on devolution should be taken without further delay as this could effect planning and performance in those municipalities

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PROVINCIAL CONDITIONAL GRANTS [CONT.]

- New developments in the health sector include the introduction of a Human Resources Capacitation Grant to assist provincial departments of health to address critical vacant posts in health facilities
  - The Commission supports the introduction of this grant as human resources are key to the functioning of health facilities and this will address shortages of staff in the sector which in turn could improve the effectiveness of the National Health Insurance (NHI)
- The Commission notes the additional R2.8 billion allocated to the School Infrastructure Backlogs Grant (SIBG) for the replacement of pit latrines as well as to provide water in schools
  - Given the historical poor spending and service delivery performance of this grant, the FFC emphasises the need for effective and efficient expenditure of the additional funds
  - The analysis of the infrastructure value-chain reveals that a lack of oversight at key delivery points is increasing incentives to engage in fiscal misappropriation; the status quo mode of delivering most provincial infrastructure projects weakens the accountability chain

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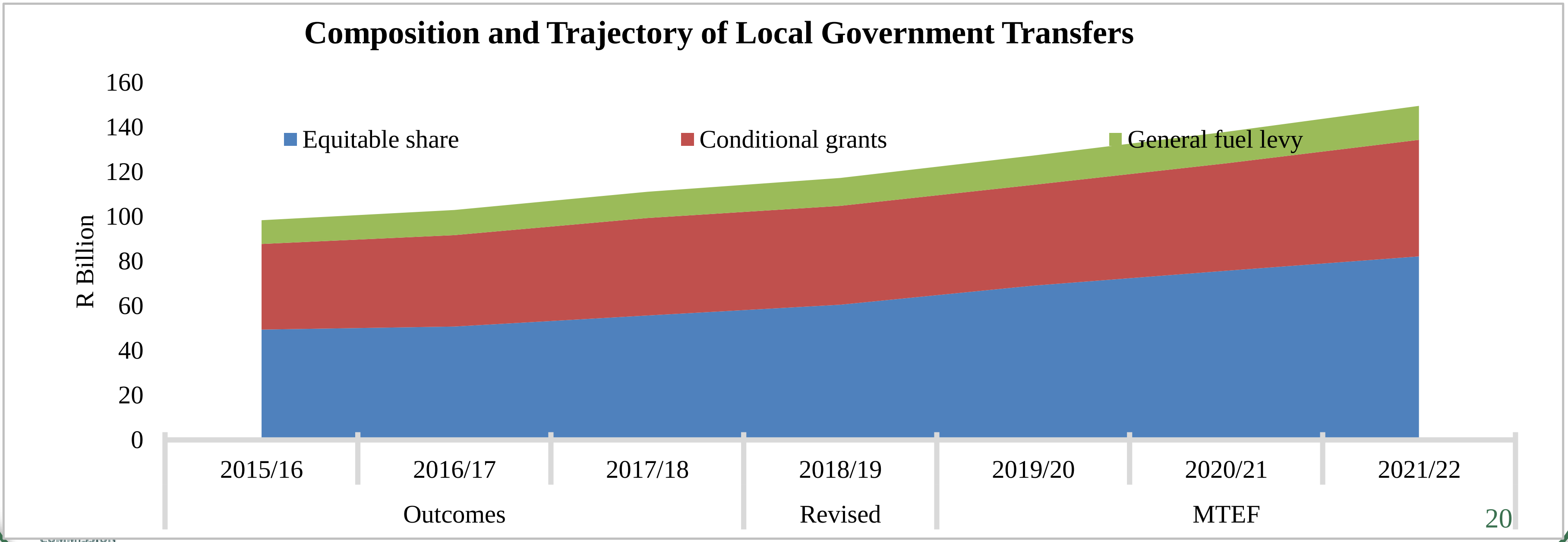
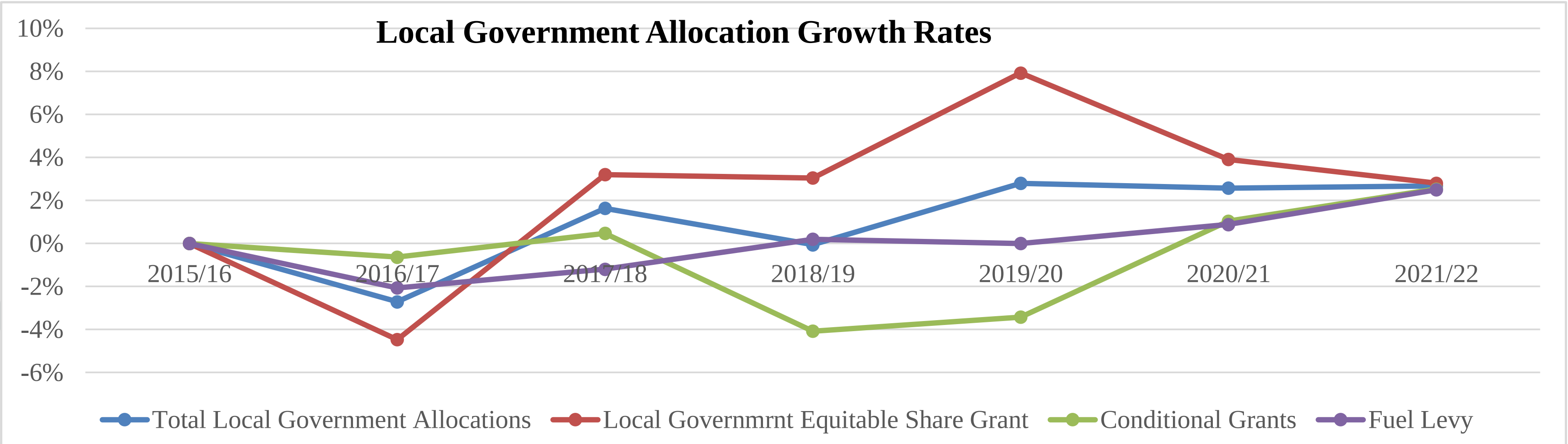
LOCAL GOVERNMENT FISCAL FRAMEWORK

- The local government fiscal framework is allocated R414.7 billion over the 2019 MTEF
  - Of this amount, R227 billion will be added to the local government equitable share (LGES), R146 to conditional grants, and R42 billion in the form of the fuel levy
  - In nominal terms, the local government allocations will grow modestly: by 8.4% over the MTEF, however well above the projected average MTEF inflation rate of 5.4%



Local Government Fiscal Framework [cont.]

- In real terms, the growth of local government allocations over the next 3 years is positive: i.e. 3% on average over the 2019 MTEF period
  - This real growth will be driven by the LGES which is envisaged to average 5%
  - But growth is weighed down by the poor growth of conditional grants (due to baseline cuts in the previous budget) and of fuel levy grants - envisaged to grow by 0.05% and 1% in real terms over the 2019 MTEF
  - The Commission welcomes efforts by government to protect the LGES as it will go a long way in cushioning the poor against the negative effects of limited economic growth



Local Government Conditional Grants

- During 2019, the MTEF local government conditional grant framework will be restructured by introducing a new grant, reprioritising funds and consolidating some grants
- A new Integrated Urban Development grant (IUDG) to be introduced for non-metro cities with the purpose of promoting (a) spatial integration, and (b) greater leveraging of non-grant financing
  - The Commission supports the introduction of this grant as it is in line with previous FFC recommendations that grants should follow a differentiated allocation system
- The structure of the public transport network grant (PTNG) is revised by introducing an incentive element in the grant
  - The Commission welcomes the introduction of the incentive component as it is in line with the Commission's 2014/15 recommendation which urged government to introduce performance based incentives in the grant framework. The Commission believes the introduction of the incentive component will enhance the performance of the PTNG grant
- The Urban Settlement Development grant (USDG) will be revised to ring fence 20% of the grant to fund the upgrading of informal human settlements

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LOCAL GOVERNMENT CONDITIONAL GRANTS [CONT.]

- Prioritising the upgrading of urban informal settlements in the grant framework has been long overdue and is a step in the right direction
- However, the basis and adequacy of the 20% is unclear. Also, the Commission is of the view that the proposed 1-year testing period for this funding window before it becomes a stand-alone grant may not be time enough to make conclusions on its performance and efficacy

- The USDG will also be revised to incorporate the integrated national electrification programme (INEP) grant for metros
  - The Commission welcomes the merger of the two grants as it will provide a basis for a holistic approach to building human settlements
- The municipal emergency housing grant (which is meant to assist with the provision of temporary housing in line with the emergency housing programme) will have its scope expanded to include repairs of houses damaged in a disaster
  - The Commission supports the expansion in the scope of this grant, but emphasises the need to ensure that there is a link between the increased scope and the funding

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SECTOR SPECIFIC ISSUES

Social, Economic and Protection Functions

- The Commission welcomes the 7.4% average growth in social protection expenditure because cushioning social assistance beneficiaries is critical in compensating the poor for the adverse effects emanating from both government spending constraints in general and the consolidation fiscal adjustment effects
- The social protection programme therefore plays a pivotal role in alleviating poverty and inequality through the provision of social grants and social welfare services for the most vulnerable groups – i.e. the provision of a social wage
- The Commission supports government in introducing new service providers in the delivery of grants aimed at minimising intermediation costs and enhancing efficiency in social spending

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Infrastructure and Economic Development

- The Commission commends government for the contribution of R100 billion to a blended-finance infrastructure fund over the next 10 years because more reliable, modern, and affordable infrastructure will greatly enhance South Africa's competitiveness and benefit both businesses and citizens, including the poor
- The Commission also welcomes the additional allocation of R3.5 billion between 2019/20 and 2021/22 for non-toll national roads to resurface an additional 3 300 km of national roads and strengthen 1 500 km, as it will improve the connectivity between primary and secondary road networks and enhance the mobility for goods and people, which is critical in accessing key markets and boosting trade facilitation

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Conclusion

- In the context of the above Response Remarks on the 2019 DoR Bill, the Commission agrees with the new measures introduced to improve governance and performance of conditional grants, and the general thrust of the 2019 DoR Bill given the tight macroeconomic and fiscal environment
  - The Commission recognises that government has managed to maintain real growth in the allocation of resources to the three spheres under difficult economic circumstances
  - The Commission reiterates the need for greater oversight over provincial and municipal spending
  - The Commission has noted the reduction in the funding of provincial conditional grants as well as their restructuring but accepts that this partly a function of the fiscal crisis

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CONCLUSION

- In local government, it is recognised that allocations are expected to grow modestly. Here attention should be paid to greater efficiency of spending
- The Commission applauds the government's continuing efforts to reduce poverty through maintaining the increase in social grants
- In the same vein, the allocations for economic development are welcomed

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