



Financial and Fiscal Commission

Five Year Research Strategy 2009/2014

Financial and Fiscal Commission

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Executive Summary

The Five Year Research Strategy sets out in broad terms how the Financial and Fiscal Commission will attain its stated 2008 vision of [enhancing the developmental impact of public resources through the financial and fiscal system in South Africa](#). How the Research Strategy is to be converted into practice will be set out in a separate document called the Operational Plan.

To be “pre-eminent and leading institution” implies the following outputs and outcomes from the Commission:

1. Better policy advice and recommendations which are more responsive to emerging issues of development to Parliament, provincial legislatures and to organised local government through the development of new as well as tailored and sharpened concepts and methodologies that better capture the nature, extent, and depth of the Commission’s legislative mandate
2. Enhanced capacity of researchers and practitioners in the modelling, measurement, analysis, and monitoring of the developmental impact of public resources;
3. Wider dissemination and greater policy influence of supported initiatives; and
4. Enhanced collaboration among researchers, experts, policymakers, and other stakeholders in achieving fiscal sustainability and related development agenda at the national and international level through its joint research initiatives.

Four goals or thematic areas have been determined to take the Plan forward. These are:

1. Policy Outcomes

This theme explores the contribution of government spheres in supporting developmental outcomes of government interventions within and across various government spheres. Monitoring and evaluation would play a key role in measuring expenditure outcomes.

2. Accountable Institutions

This theme centres on having accountable institutions in South Africa’s IGFR. This refers to accountability in (i) service delivery and (ii) policy making and planning. Accountability is a constitutional requirement for good governance. Transparency (for example in terms of section 215 and section 216 as well as constitutional provisions relating to procurement) is an important enabler of accountability.

3. Equitable Growth and Distribution of Resources

Under this theme the Commission wishes to see whether there is equitable growth and distribution of resources. There is a renewed need in respect of balancing the focus between equitable share transfers (allocations) and the efficiency with which such allocations are being spent (absorptive capacity/underspending etc). An important conceptual issue is the balance that needs to be struck on the trade-off between interventions that contribute to consolidating the progress to date in the fiscal arena and those that build pressure for additional changes.

4. Flexible Response

This thematic area involves anticipating political and economic changes that will significantly impact on the IGFR. This is also the area where the Commission deal with

those submissions and reports on which it has no control over any period of time. Some areas are already known where the commission will have to respond to. The Commission needs to factor these in and do background position papers. Other issues cannot be anticipated but the Commission will have to accept that it may be called upon to do high quality work at short notice in order to meet these stakeholder needs.

In line with the “Tinbergen Rule”, four areas of intervention or instruments have been identified to make an impact in the 4 thematic areas identified above as follows:

1. Expanding Public Services

This refers to assessments of how attempts by government to increase the quantum of public services are faring in attaining the goals set out in the key thematic areas identified. It also includes infrastructure financing.

2. Public Expenditure Management Systems

Public expenditure management refers to the ways in which public resources are allocated and managed in pursuit of fiscal discipline, strategic prioritisation and value for money. This analysis must take the budget process, policy process and institutional arrangements into account

3. Macro management and DOR

This refers to the institutions of economic and fiscal policy coordination within and among the three spheres of government that have impacts on service delivery.

4. Sustaining Public Service Delivery

A key and topical issue here is not expansion of public service but rather sustaining service delivery and holding public servants accountable. Key issues are job creation, improving the efficacy of government programmes and resuscitating/reviving existing ones.

Certain core principles must be in place to underpin this strategy. These are:

- 1) Research excellence and professionalism
- 2) Integrity
- 3) Creativity and Innovation
- 4) Independent and Objective
- 5) Impartial
- 6) Focus
- 7) Collaboration and engagement

Dissemination strategies are convened with local constituents and research partners to review the studies and research methods proposed to address each thematic area. The communication and dissemination strategy is organised around:

1. Direct contact (by regular mail, email, telephone, seminars or meetings (institutionalized (TCF, Budget Council, 10x10, Headcom, Emis etc) or at personal level or at Financial and Fiscal Commission corporate meetings).
2. Specific events such as national workshop/launch
3. Publication and media, including internet
4. Public hearings and other participatory activities

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SECTION 1: OVERVIEW

The Financial and Fiscal Commission makes recommendations and gives advice to organs of the state in the national, provincial and local spheres of government on financial and fiscal matters. The Vision of the Commission is to be a pre-eminent and leading institution influencing the Intergovernmental Fiscal Relations System in South Africa. Its mission is to enhance South Africa's development by providing independent, impartial advice and recommendations on Intergovernmental Fiscal Relations to legislative authorities and organs of state. This vision and mission is pursued by the Commission through its support and promotion of high quality and policy relevant research resulting in:

1. Better policy advice and recommendations which are more responsive to emerging issues of development to Parliament, provincial legislatures and to organised local government through the development of new as well as tailored and sharpened concepts and methodologies that better capture the nature, extent, and depth of the Commission's legislative mandate
2. Enhanced capacity of researchers and practitioners in the modelling, measurement, analysis, and monitoring of the developmental impact of public resources;
3. Wider dissemination and greater policy influence of supported initiatives; and
4. Enhanced collaboration among researchers, experts, policymakers, and other stakeholders in achieving fiscal sustainability and related development agenda at the national and international level through its joint research initiatives.

The Commission has played a central role in the development of the intergovernmental fiscal relations (IGFR) system in South Africa since it was established in 1994. It has played this role through a long-standing and broad-based research program focused on the many challenges of equitably distributing nationally raised revenue. It is recognized as one of the foremost contributors to the provincial equitable share formulae used by government. It has also made notable contributions on issues of expenditure assignments and financing issues with respect to local government, developed a "costed norms approach" and carried out a comprehensive review of the intergovernmental fiscal relations system and conditional grants. The capacity of the Financial and Fiscal Commission to continue its productive history is now challenged by many of the forces faced by many other public institutions including declining real budgets, the changing nature of important research questions, and shifts in

stakeholders and their expectations for research products. This document presents a five year research strategy for the Financial and Fiscal Commission that prepares the organisation to address today's questions and positions the organisation for research leadership into the next five years.

SECTION 2: THE CONTEXT

South Africa has a reputation for sound fiscal management, financial markets that are opening progressively over time, and prudent regulatory regime. However, there is a growing awareness of the big challenges that lie ahead. These include, at the macroeconomic level; maintaining a reasonable deficit to gross domestic product ratio, an inflation rate that is within acceptable targeted limits, an economic growth rate sufficient to make inroads into high unemployment and poverty levels as well as an acceptable balance of payments deficit. At a sub-national level, the challenges include sub national borrowing and poverty alleviation, and improved access to basic services.

The necessity for the Financial and Fiscal Commission to transform its research performance has national and international drivers. At the national level, the Constitution clearly sets the expectation that the Commission must contribute more significantly to the Intergovernmental Fiscal Relations (IGFR) system and revenue sharing among spheres of government. The emergent Intergovernmental Fiscal Relations (IGFR) system is a relatively new initiative in South Africa and is enshrined in the Constitution. In this regard, the system continues to have issues that must still be addressed in the course of its evolution and implementation. While it has been relatively straight forward to deal with funding of own responsibilities at national, provincial and local government levels, the challenge for devising effective approaches for funding concurrent functions (education, health, social development, and housing) remains. A misalignment between national priorities and provincial budgets has been often identified that compromises service delivery. This problem continues to persist despite the establishment of technical and intergovernmental forums tasked with the responsibility to improve intergovernmental coordination in the spirit of cooperative governance stated in Chapter Three of the Constitution.

At the international level, global trends show the growing importance of decentralisation, at least amongst democratising African countries. Global shocks such as the recent sub-prime crisis, rising oil and food prices and volatile commodity prices also have important consequences for South Africa that the Commission must be able to anticipate through its research and work out consequences for the country's IGFR system. For instance, the poorest people will be hit the hardest by the oil and food price

crisis and the Financial and Fiscal Commission's research should help the country manage this downturn through research that assists government in designing supportive policies to help minimize the negative effects of oil and food price crisis on poor households. International experience also highlights increasing importance of collaboration between institutions for the processes of research in order to obtain synergies of expertise, facilities, data access, and knowledge generalization in the field. For the Commission to be respected and its advice taken seriously, it is essential to have a research profile that is nationally and internationally recognized and competitive and takes cognizance of developments in IGFR taking place nationally and internationally. Such research needs to be relevant and right at the forefront and cutting edge of what government is implementing. Currently government seems to only serve to comply with the requirement to respond to the Commission's recommendations without immediate or high impact on the work they do. This should position the Commission as an automatic reference body of knowledge for various government departments. It is within this context that a new long term research strategy needs to be couched.

SECTION 3: THE STRATEGY

The Financial and Fiscal Commission has not used an explicit strategic approach to research in the past. Although very useful contributions have been made especially in the areas of development of formulas for equitable allocation of revenues, the implications of not having an explicit research strategy have been that research projects have tended to be ad hoc and severely affected whenever there is staff turnover. An explicit strategic approach to research will be adopted to tackle these imposing issues and this constitutes a major break from the past where there was no explicit strategic approach to research.

In terms of content, research in the past has emphasised first generation issues of equitable division of the provincial and local equitable share, expenditure assignments and development of relevant research tools. Recently, research work has become more forward looking, seeking to manage change within the system in a consistent, logical and managed fashion. Most of the work in this period has been developmental, focusing on building credible tools (e.g., costed norms approach, CAPEX model, CGE Models, Econometric Models). Emphasis on indicators and relevant data has been increasingly becoming the means through which the Commission informed the intergovernmental fiscal decision-making process. Despite these important contributions, it has become increasingly clear that the issue at stake is no longer so much about the quantum of public funds and its allocation only, but rather whether these financial resources can be translated into service delivery outputs which actually have an impact on communities.

The main focus of the new research strategy is therefore on these second generation issues of how much the quantum of public funds and its allocation can be translated into service delivery outputs which actually have an impact on communities. The focus will be on outcomes and impact of government interventions, premised on seeking to identify a broader set of institutional and governing arrangements that are capable of achieving positive public expenditure outcomes. This is a significant realignment from the thrust of research in the past.

SECTION 4: RESEARCH THEMES AND INTERVENTIONS

The ultimate objective of the 5 year research strategy is thus to contribute to coherent government policy and effective participation of institutions and communities in the IGFR system. The strategy seeks to achieve this objective through targeting 4 themes or areas of impact that are listed below and followed by a description.

- a. Expenditure Outcomes
- b. Accountable Institutions
- c. Equitable Growth and Redistribution of Resources
- d. Flexible Response

1. *Expenditure Outcomes*

This theme addresses whether the government policies are contributing to the intended outcomes. As pointed out in Schick (1998), these outcomes pertain to (a) total revenue and expenditure, (b) the allocation of resources among sectors and programs, and (c) the efficiency with which government institutions operate. Specifically, the theme is to explore:

- The contribution of government spheres in supporting developmental outcomes. There is a clear focus on what the outcomes and impact of policy interventions are. A number of questions become pertinent such as whether national and subnational budgets are allocating funds in line with agreed development priorities? Are municipalities for instance playing their role with regards to encouraging economic growth and poverty reduction?
- The extent to which service targets are being met. Research should show where government spheres have allocated and spent public money and answer whether budgets are buying the planned outputs?

Monitoring and evaluation would play a key role in measuring expenditure outcomes. With a shift in focus towards outcomes evaluation, emphasis will be placed on the national spheres to not only provide policy direction, but to have increased monitoring capability. In itself an outcome based approach will imply that there is a need to increase reporting on non-financial data.

2. *Accountable Institutions*

Accountability is a constitutional requirement for good governance. Transparency (for example in terms of section 215 and section 216 as well as constitutional provisions relating to procurement) is an important enabler of accountability. Accountable institutions can be analysed within Schick (1998)'s broad paradigm of rules, roles and incentives. Relevant questions to address for example would be whether there are any laws or regulations which undermine accountability of public sector institutions (for example separating policy, budgeting and implementation across spheres of government)? Are roles clarified or does uncertainty create a lack of accountability (e.g. accountability by whom, for what to whom)? Are perverse incentives being created? The concept of perverse incentives can be expanded to capture moral hazard, where diffuse accountability can result in choices being made without reference to their ultimate consequences, because incentives are poorly aligned. This reinforces the importance of clear delineation of responsibilities. Additionally, accountability is made more complex in intergovernmental systems as central oversight often attempts to replace rather than complement citizen oversight (or direct accountability), despite the information asymmetry facing national actors. Strengthening direct citizen oversight would be a critical challenge for the Financial and Fiscal Commission. Information relates to the ability to monitor and evaluate decisions and actions taken, to enforce accountability and responsiveness in public institutions. There is also the need for managing both formal and informal institutions as well as linkages between public and private sectors. In the face of an outcomes based approach a need exists for a more regular reporting on progress made against set targets, using means most accessible to the constituencies/citizens.

3. *Equitable Growth and Distribution of Resources*

This theme arises out of ongoing work and the Commission would wish to see equitable growth and distribution of resources following implementation of its recommendations. There is a renewed need in respect of balancing the focus between equitable share transfers (allocations) and the efficiency with which such allocations are being spent (absorptive capacity/underspending etc). An important conceptual issue is the balance that the Commission's recommendations would need to strike between its research objectives in (a) deepening the understanding (interpretation) of the implications of expenditure assignments across spheres, and (b) reviewing fiscal performance within

and across spheres within existing interpretations of assignments. The balancing act implies that there may be a trade-off between recommendations that contribute to consolidating the progress to date in the fiscal arena rather than building pressure for additional changes. The challenge in the South African context is a need to be vigilant about accumulated backlogs overtime. In an equalizing system, how does one ensure that one does not only set a long term policy, but one subsets it per province such that under achievement by one province (due to accrued absorptive capacity) does not lead to reduced funding for progressive provinces. The more there is under spending in one province the more their backlogs increases and thus claiming a bigger share of the finite national pool of resources.

Specific research topics will provide a survey of the governance structure and fiscal relationships between and among spheres of government. They will detail the macro distribution of revenue and expenditure responsibilities/authority between spheres as required by the Constitution. Major revenue issues to be considered include: (i) adequacy of revenue assignment and discretion over own source revenue; (ii) obstacles to effective revenue administration/mobilization; (iii) internal revenue allocation, including issues of adequacy, dependency and effectiveness in achieving vertical and horizontal fiscal balance; and (iv) local political will in revenue mobilization and collection. Expenditure issues include: (i) range of effective local budgetary autonomy; (ii) adequacy of compensating transfers for devolved functions; (iii) central government budgetary mandates without compensating fiscal transfers; (iv) nationally raised revenue sharing mechanisms and their reforms. Finally, there would be analysis of fiscal transfers – impact on efficiency and equity of service delivery and inter-governmental equity.

4. Flexible Response

This is the area where the Commission deal with those submissions and reports on which it has no control over any period of time. The Commission needs to meet its legislative mandate in terms of the Division Of Revenue Act for instance as well as pursuing its own proactive research which asks whether the Intergovernmental Relations system is a support or an impediment to the use of public funds to achieve policy impact. At the same time, the Commission needs to realise that it will on occasion have to respond rapidly to stakeholder requests which it may not be able to predict in advance. Some areas that are already known where the commission will have to

respond to sometime include engaging in the appropriation process after the Money Bills Amendment Act and relationship with the Parliamentary Budget Office, Department of Provincial and Local Government's process to restructure provinces and local government, complying with legislative requirements in such legislation as the MFMA, FFC Act, PTRPA, MSA. The Commission needs to start factoring these in and do background position papers. Other issues cannot be anticipated but the Commission will have to accept that it may be called upon to do high quality work at short notice in order to meet these stakeholder needs.

We need a flexible, coordinated and fast response to these issues. A more flexible and broadly representative research team will be needed to coordinate the rapid response. The critical challenges here are related to (a) capacity and process of anticipating demand; and (b) management of the delivery process within firm timelines and budgets, with an emphasis on a rapid and coherent response.

The basic components of the programme to assist the Commission make an impact in the 4 thematic areas identified above are listed next, followed by a general explanation of the main features of each component/intervention:

1. Expanding Public Services;
2. Public Expenditure Management Systems;
3. Macro management and Division of Revenue;
4. Sustaining Public Service Delivery.

1. Expanding Public Services

This refers to assessments of how attempts by government to increase the quantum of public services are faring in attaining the goals set out in the key thematic areas identified. It also includes infrastructure financing. The key issues in the assessment boil down to how capital is financed, what the dominant mode is and why issues surrounding the credit market access such as rules, restraints and assistance from higher order government, rules and restraints on foreign borrowing and bond financing will be tackled.

2. Public Expenditure Management Systems

Public expenditure management (PEM) refers to the ways in which public resources are allocated and managed in pursuit of fiscal discipline, strategic prioritisation and value for money. Any analysis of a PEM system must take the budget process, policy process and institutional arrangements into account

The outcomes of the PEM system will depend on the institutional environment in which the budget and policy process operates. (See Schick (1998) for a discussion for the institutional rules, roles and information that contribute to the achievement of the three PEM objectives). The “institutional structure” is the framework of rules, customs, and incentives, which influence how expenditure decisions are made and people behave. Some of the rules are contained in formal laws or regulations. A well-performing public sector will have a clearly defined system of authority delegation. However, there are also usually many unwritten customs and habits that may, for example, dictate the extent to which the written rules are actually enforced. Assessing a public expenditure management system, and developing solutions, should be informed by a good understanding of the informal rules by which the system actually operates, as well as the formal regulations that are supposed to apply.

A number of institutions mediate government’s abilities to turn budget allocations into the necessary inputs for service delivery (personnel policies, supply chain management processes, central bargaining issues). A further set of institutions relating to PEM also come into play when converting inputs into service delivery outputs through a range of service delivery modalities and funding instruments. Effective PEM requires articulation between the policy making, strategic planning, operational planning for programmes and projects, budgeting, implementation, financial management in executing the appropriate budget, the control environment, in year reporting and annual reporting. A breakdown in any of these linkages undermines a public sector institutions ability to achieve its policy objectives. So for instance looking at performance budgeting in the public sector would be relevant here, looking at immoveable asset management and budgeting for maintenance, looking at measuring government outputs in national accounts and so on. The centrality of citizen oversight and the difficulty in achieving it are important research areas.

3. Macro management and DOR

This refers to macroeconomic management institutions that have impacts on service delivery. We will wish to identify the institutions of economic and fiscal policy coordination within and among the three spheres. Another important aspect will be the institutional framework for monetary policy (and relations to the government). Issues of central bank independence, its mandate and concerns regarding monetary policy will be studied. The institutional setting for fiscal policy will also come to the fore, including the coordination of fiscal policy, issues of fiscal rules for fiscal discipline and coordination, framework for debt management and other concerns regarding fiscal discipline and fiscal policy coordination.

4. Sustaining Public Service Delivery

Key and topical issues here are job creation, improving the efficacy of government programmes and resuscitating/reviving existing ones. There is a need to develop norms and standards and enforcement of such .e.g. a road constructed in one province should be equal in quality to the one done by the other province. Once such road is constructed, how often it is maintained should be made part of such norms. If this is not done, government may be creating more backlogs in the process of dealing with the current new ones (there are more rural areas with non-functional taps even though these worked once before). Therefore the issue here is not expansion of public service but rather improvement in service delivery and holding public servants accountable.

SECTION 5: CORE RESEARCH PRINCIPLES

The Commission holds itself to certain core principles that underpin this strategy. These are:

- 1) Research excellence and professionalism
- 2) Integrity
- 3) Creativity and Innovation
- 4) Independent and Objective
- 5) Impartial
- 6) Focus
- 7) Collaboration and engagement

SECTION 6: DISSEMINATION STRATEGY

Dissemination strategies are convened with local constituents and research partners to review the studies and research methods proposed to address each thematic area. The communication and dissemination strategy is organised around:

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6. Specific events such as national workshop/launch
7. Publication and media, including internet
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