

Speech: Submission for the Division of Revenue 2010/11

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Background and Mandate

The Financial and Fiscal Commission (FFC) is a statutory institution. It is a permanent expert Commission with a constitutionally defined mandate, set of generic responsibilities and institutional processes, dealing with intergovernmental fiscal relations in South Africa. The advice and recommendations that the FFC provides is defined by the Constitutional and legislative mandate. The remit of the FFC at its conception was to contribute towards reducing spatial distortions inherited from the apartheid rule, backlogs and many other related problems. According to the 1996 Constitution this was done in the context of established spheres of government that were distinctive, interdependent and interrelated. Section 214 of the Constitution obliges the FFC to consider factors such as economic disparities, national interest, the funding of basic services and other developmental needs in making recommendations on the division of revenue between and among the three spheres of government. The implication here is that recommendations made by the FFC must be developmental in orientation.

In order to address these issues and the dynamically changing intergovernmental relations environment, the Commission has developed a new research strategy to inform its recommendations. The primary focus of the new strategy is on outcomes of government interventions within and across various government spheres.

The FFC has its own conceptual challenges. Some may interpret its recommendations as federalist while others may think of them as too centrist. There are even some that may perceive the FFC to be encroaching on policy matters. What business does the FFC have with policy? This is a purview of elected officials. Others may even go further and say oversight work is the responsibility of elected parliamentarians. Yet stakeholders, especially in the provinces, call for the FFC to track the impact of its recommendations. While considering these concerns, the FFC maintains its independence, objectivity and impartiality. Thus, the FFC takes its mandate directly from the Constitution and related legislation. However, while the mandate of the FFC is clear and fixed, its interpretation needs to change over time in response to the significant challenges that come with change in government every five years and the changing international environment. What is evident in our intergovernmental system is that, not only must the FFC focus on the distribution of nationally collected revenue, but recently, it has had to focus on developmental impacts; that is, how do mobilized resources impact on the people's lives?

Intergovernmental Fiscal Relations and Macroeconomic Environment

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 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 often been identified as an obstacle 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.

Put simply, the problem is to ensure that the government and Ministers at national level have an influence on the funding of national priorities in provincial budgets. On the other hand, provincial and local governments are concerned that their discretion to reflect local priorities will be curtailed. In other words there are perceptions that (whether genuine or not) national government is encroaching in the arena of sub-national government responsibility. To address this issue with specific reference to provinces, in this Submission for 2010 Division of Revenue document, the FFC recommends that expenditure assignments between provinces and national government should distinguish between delegated and own responsibilities; that clear separation of instruments in the transfer system and the Provincial Equitable Share be introduced; that more revenue autonomy for provinces be provided for and that the provinces be encouraged to utilise the revenue sources assigned to them through the constitution so that they are able to even leverage further resources through borrowing.

In the short term, the FFC recommends that the current structure of the Provincial Equitable Share formula should be retained and brought closer to an equalization grant. This means that the grant should be framed such that expenditure needs minus revenue raising capacity equal the grant. This is where our hard choices that come with our IGFR system become evident. Hard choices in that we must now look the IGFR system in the face, and say, despite resource constraints, money must be found. Put simply, each sphere of government must be made responsible and accountable for the choices it makes.

The FFC further recommends that in the medium term, government should consider separating education and health from the Provincial Equitable Share formula and that the constituent components should be converted into distinct block grants. The Equalization Grant should be implemented fully in the medium term.

Under block grants, the provincial government will have an obligation to spend the grant in a particular expenditure area such as primary education, but will also be free to determine how the funds are used within that area. In a reformed expenditure assignment system, these services will be recognized as fully delegated by national to provinces. Under this arrangement, the national departments will have full responsibility to secure funds for this function. However, the provinces will have the discretion to augment funding through more effective exploitation of their existing revenue sources as provided for

through the Provincial Tax Regulation Process Act (2003) and Section 228 of the Constitution. The national government should set the norms and standards as well as determine the minimum expenditure needs for both education and health.

The Commission is aware that the transition from the status quo to the new dispensation can be expensive and potentially disruptive to service delivery if not managed expeditiously. Consequently, it is further recommended that a dedicated intergovernmental committee be established to manage the transition process.

Strategic Issues for the Short to Medium Term

As part of its response to the 2009 Division of Revenue, the Commission identified the following strategic issues as areas requiring a significant amount of focus for the government in the short to medium term. These are issues that the Commission will be following very closely in the next year.

The Commission notes with concern that there is an increased proliferation of conditional grants. This concern was initially raised by the Commission in its 2006 Division of Revenue. This was particularly pointed at an increase in small grants. The government indicated that it would attend to this issue with the objective of consolidating these grants and incorporating them into the equitable share. An examination of the 2009 Medium Term Expenditure Framework (MTEF), the Commission observes that these conditional grants are small and are mainly once off. The Commission is of the view that this tendency might be revealing tensions between national and sub-national governments on concurrent functions.

What is of note here firstly is that a large number of small conditional grants tend to obscure the major policy priorities of government in favor of often changing sector priorities. That is, in this case, the national government may think that it is controlling through these small grants when in fact it is not. Secondly, historically these small grants have tended to be poorly managed with low expenditure levels and limited impacts, and more so, because they tend to ignore self funded initiatives in these sectors by sub-nationals.

The Commission is concerned about the number of instances where policy implementation stalls for protracted periods, resulting in negative impacts on the intergovernmental fiscal system. Areas where policy has stalled include the Regional Electricity Distributors (REDs), primary health care and process formulation of a White Paper for Provincial government and the review of the White Paper on Local government by the former Department of Provincial and Local Government. It is very important that the White Paper process is finalized sooner than later as there is great expectation from stakeholders that part of the outcome would be to address the perennial problems associated with powers and functions of the different spheres of government. Past stalling has had severe negative effects on quality of service (due to municipal uncertainty and thus underinvestment), to the point at which the full cost of now implementing (including cost of delays, impacts on Local Government finance, transition costs, etc) most likely outweighs any benefits they may deliver. The proposed reforms may thus be no longer a priority and need substantial re-evaluation. Times have changed and new ideas are needed!

As always, the Commission thanks the staff at the FFC, our stakeholders in government for the support they have provided over the current research cycle. Special thanks go to the former Minister of Finance Hon. Trevor R Manuel for the support he has given to the FFC over the years. The Commission wishes him well in his new undertaking. The Financial and Fiscal Commission further welcomes the new Minister of Finance, Hononourable Pravin Gordhan and expresses the hope that the robust engagement that has characterized interaction between the two institutions will continue.