FINANCIAL AND FISCAL COMMISSION

SUPPLEMENTARY SUBMISSION
FOR THE DIVISION OF REVENUE
MTEF PERIOD 2005-2008
AND THE DIVISION OF
REVENUE BILL 2005-2006

FINANCIAL AND FISCAL COMMISSION

SUPPLEMENTARY SUBMISSION

THE FINANCIAL AND INSTITUTIONAL IMPLICATIONS OF SHIFTING THE SOCIAL SECURITY GRANTS ADMINISTRATION SYSTEM TO NATIONAL GOVERNMENT

January 2005

FINANCIAL
AND FISCAL
COMMISSION

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FOREWORD

Various sections of the Constitution (Sections 214, 218, 220, 228-230) provide for the FFC's role, mandate, and obligations with respect to the intergovernmental fiscal relations system. Two core parameters for the functioning of the Commission stand out, namely to act as an independent and impartial body and to make recommendations on the equitable vertical and horizontal division of revenue raised nationally among the three spheres of government. Legislation subsequent to the above provisions, namely the Intergovernmental Fiscal Relations Act, mandates the commission to submit to Parliament and Government, on an annual basis, recommendations on the Division of Revenue. In so doing, the commission is tasked with the responsibility of making such recommendations by taking into account factors listed in Section 214 (2) (a-j) of the Constitution.

In terms of the Intergovernmental Fiscal Relations Act the FFC entered into correspondence with the Minister of Finance with respect to the submission of its recommendations for the 2005/06 Division of Revenue (DOR) Bill. In this correspondence, among other issues, the FFC and the Minister of Finance agreed to the following:

1. That the FFC's Annual DOR recommendations for the 2005/08 MTEF period be processed for submission to Parliament and Government on, or before the 31 July 2004 to take account of delays in the appointments of FFC commissioners, Ministers and provincial MEC's following the elections held in April 2004.
2. That, where necessary, the Commission undertakes to provide Parliament and Government with a separate and supplementary submission dealing with any of the issues requiring further attention arising from the meetings with National Treasury.

In June 2004, the FFC submitted its annual recommendations for the 2005/08 Division of Revenue Bill. In addition, the Commission undertook to submit two supplementary recommendations at a later date relating to the FFC's recommendation on the allocations of infrastructure grants to provinces and, the financial and institutional implications of shifting the social security grants administration system to National Government. As these issues were an integral part of the work towards the review of the provincial fiscal framework and equitable share formulae, the FFC was required, following discussions with National Treasury, to revise some of its earlier recommendations and make supplementary recommendations on both issues for the 2005/06 Division of Revenue Bill.

In view of the preceding and as a supplement to its June 2004 submission, the FFC hereby presents to government and parliament, recommendations on the financial and institutional implications of shifting the social security grants administration system to national government.

As highlighted in the Foreword of the FFC's Submission for the Division of Revenue 2005/06, June, 2004;

"*over the last ten years, the work of the Commission not only related to the fiscal system per se, but was also an integral part of government-wide efforts to deal with the intricacies and modalities of a society and state undergoing a profound socio-economic, political, and cultural transition. Accordingly, the commission carefully tracked the exigencies of fiscal reforms undertaken within the ambit of wider development and socio-economic pressures. In keeping with such dynamics common to any transition, the trajectory of the development of the Commission's advice and recommendations over the last ten years was based on a core consideration, the goal of equity in the allocation of revenues to the three spheres of government such that they fulfill their obligations under the Constitution.*

As has been the case with many government institutions, the completion of ten years of democracy opened a window for reflection and the assessment of the fiscal system in order to enable the commission to chart the possibilities for further progress over the coming ten years."

The supplementary submission is made in response to a request from National Treasury for the FFC to comment on and make proposals for an appropriate transitional social security grant financing mechanism for the period leading up to the establishment of the South African Social Security Agency.

The research for these supplementary recommendations is the product of considerable collaboration. The Commissioners would like to thank the members of all provincial and national departments, non-governmental organizations, The Reserve Bank, intergovernmental forums and relevant Ministries that contributed to this document with their information, insights, and criticisms. The Commission is extremely grateful to AUSAID for their generous financial contribution to the funding of the research project on the infrastructure capital grant model. This submission would not have been possible were it not for the support of all those mentioned above.

In shaping the contents of this Submission, the FFC drew on the knowledge and insights of technical advisors. Their international experience greatly enriched the approach of the commission to the complex fiscal issues addressed in this Submission. In particular the Commission would like to thank Jeff Petchey and Gary Macdonald from Curtin Business School, Perth, Australia for their inputs on the capital grant model and, Andrew Reschovsky from the Unites States for advice on the social security grant project.

The Commission would also like to express its gratitude to the Secretariat of the FFC, namely Myron Peter (Executive Manager: Commission Co-ordination), Bongani Khumalo, (Manager; Fiscal Policy), Robert Mabunda (Researcher: Data and Information), Goodwill Dithlage (Researcher: Social Development); Rathipe

Nthite (Research Co-coordinator: Infrastructure) and Vincent Makinta (Statistical and Database Management). In addition, the logistical support from Annaleeze Prosee ensured that plans and processes to produce the document were kept on track.

This supplementary submission is made with the approval and in accordance with the resolution passed by the Commission Meeting held on the 24 and 25 November 2004 and under the authority of Commissioners listed hereunder:-

Commissioner Antonym Melck
Commissioner Kamalasen Chetty
Commissioner Tanja Ajam
Commissioner Gugu Moloi
Commissioner Risenga Buttler Maluleke
Commissioner Martin Kuscus
Commissioner Blake Keith Mosley-Lefatola

As the Executive commissioners of the Financial and Fiscal Commission, we the undersigned are pleased to submit this Supplementary Submission to Government and Parliament for consideration in accordance with the obligations placed upon us by the Constitution of the Republic of South Africa.

For and on behalf of the Commission:

Chairperson: Renosi Mokate

Deputy Chairperson: Jaya Josie

Date: December 2004

EXECUTIVE SUMMARY AND RECOMMENDATIONS

Supplementary Submission for the Division of Revenue 2005/06

Section 220 of the Constitution establishes the Financial and Fiscal commission as an independent and impartial body. The Constitution mandates the FFC to make recommendations on the vertical division of nationally raised revenue among the three spheres of government; the horizontal division of revenue among provinces and among municipalities; tax legislation; municipal fiscal powers and functions and, provincial and municipal borrowing powers (Sections 214, 218, and 228-230).

Based on Sections 214 and 222 of the Constitution; Section 9 of the Intergovernmental Fiscal relations Act of 1997 provides for the FFC to make annual recommendations to parliament and the provincial legislatures on the vertical and horizontal divisions of revenue. Section 10 of the same Act further requires that Government consult the Commission on the annual Division of Revenue Bill and outline its response to the Commission's recommendations. In performing its functions the Commission considers the Bill of Rights and the factors listed in Section 214 (2) (a-j) of the Constitution. The recommendations contained in this supplementary submission are presented following consultations with the Minister of Finance as required by the Intergovernmental Fiscal Relations Act. An executive summary of the recommendations and proposals mentioned in the Foreword are presented hereunder.

Recommendations and Proposals for a Transitional Financing Mechanism for Social Security Grants for the Period leading up to the Establishment of the National Social Security Agency.

- The most plausible method for financing social security payments through the provinces in the interim period leading up to the establishment of the national security agency is to separate the actual average expenditure on social security grants within the social development component. This specifically involves taking the latest actual average share of expenditure of all provinces on social security grants out of the social development component and using this quantum as the basis for social security allocations. The advantages of this method are:
    - An amount will remain for financing welfare services;
    - Provincial budgetary pressures will decrease and room will be created for funds to be spent on the delivery of other services.

- Once the actual average expenditure on social security grants has been determined and separated, any budgetary shortfalls that arise may now be considered by taking into account Section 214 (2) (a-j) of the Constitution. The Commission strongly recommends that taking into account Section 214 (2) should include:

    - An audit and review of the current status of all recipients of grants to ensure that only those deserving receive the grant and to create the basis for realistic projections in the growth of beneficiaries;[1] and

    - In view of its constitutional obligations to provide social development services, an assessment of the developmental sustainability and economic efficiency of the increasing demand for social security payments, given the macroeconomic and fiscal capacity limits to raising national revenue.

[1] . FFC Submission, 2003. "Towards a Review of the Intergovernmental Fiscal System", p. 88-93.

- With specific reference to institutional, administrative and personnel budgets, the shifting of the social security function must be implemented in a manner that does not compromise the delivery of welfare services and other constitutional obligations, especially where these services are complementary to provincial delivery obligations. Furthermore, legislation and regulations for the assignment, budgeting, and delivery of the social security function must be aligned with other relevant legislation.

- Measures should be instituted in order to ensure that:

  - The provincial and national information systems are consistent with each other, such that the link between those benefiting from grants and welfare services is not entirely lost, e.g. foster care, care dependency.
  - The integrity and constitutionality of the program is maintained, and an incentive system that mitigates the provincial propensity to over- or under-spend is put in place.
  - The continuity and minimal disruption of existing programs, and, if possible, a seamless transition from current to interim arrangements and final take-over by the national agency.
  - The accountability, oversight, legal compliance and transparency of responsibility of program spending.
  - Predictability and stability of allocations, and
  - The effective management of risks by national government

As an interim payment mechanism, the Commission recommends that a specific-purpose agency agreement between National government and provinces is put in place. Such an agreement will engage provinces to disburse social security grants on behalf of National Government for the interim period and in conformity with the principles set out above.

B. The Financial and Institutional Implications of Shifting the Social Security Grants Administration System to National Government

1. Introduction

This submission is made in response to National Treasury's request for the FFC to comment on and make proposals for an appropriate transitional social security grant financing mechanism for the period leading up to the establishment of the South African Social Security Agency. The proposals and comments deal with the challenges that need to be addressed in shifting the social security service function from provinces to national government. Among the issues examined are the following:

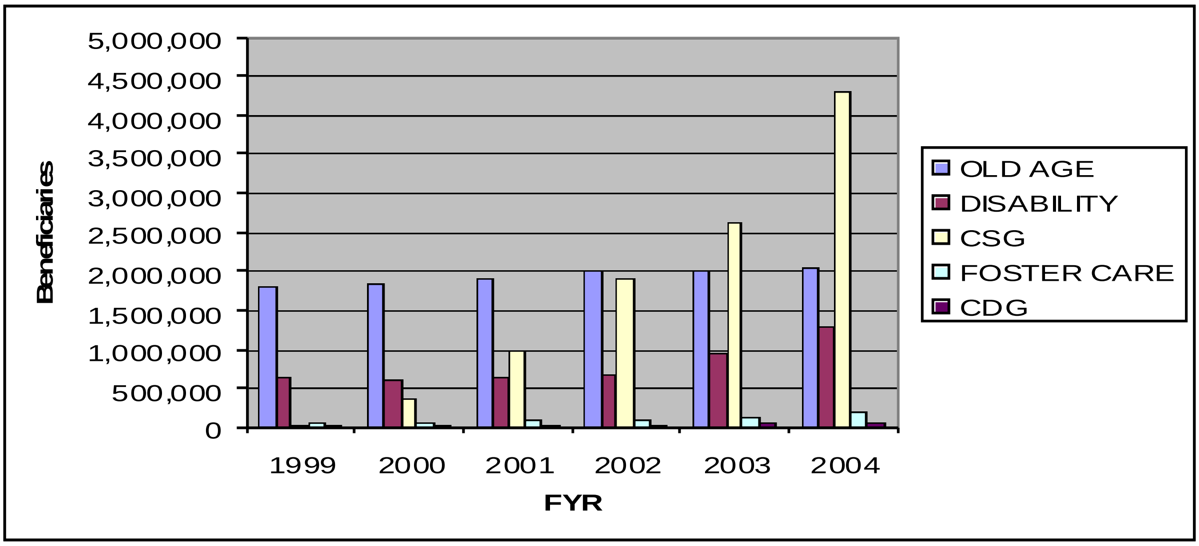
- The trend in beneficiary numbers;
- Provincial expenditure trends relative to the equitable share allocations for social development grants;
- The possible funding options for shifting social security grants in the interim period;
- The possible impact on the provincial equitable share, other social development programs and institutions;
- The transitional funding mechanism that should be adopted as the agency is being established.

The submission concludes with a set of recommendations and proposals.

1. **Trends in beneficiary numbers**

As at April 2004, there were about 7.9 million individuals receiving social security grants across the whole of South Africa. In April 1998, the number of social grant beneficiaries stood at 2.4 million. Figure 1 shows that beneficiaries of the child support grant have grown significantly over the period. The rapid growth in the take-up of the child support grant is attributed to increased awareness campaigns and the extension of the grant to children up to 14 years. Beneficiaries receiving the old age grant have also increased beyond the 2 million mark.

Figure 1: Growth in beneficiary numbers (1999-2004)



The disability grant has the third highest number of beneficiaries. The number of beneficiaries to this grant has increased from just over 500,000 to around 1,200,000 between 1999 and 2004. Some of the reasons that have been offered for this rapid increase in the take-up rate of this grant are:

- Changes in regulations
    - Medical officers were replaced by community based panels in some provinces

- Corrupt practices in the issuing of medical certificates where these are still used
- Weak application of the means test
- Treatment of HIV/AIDS sufferers as disabled persons
- Failure to distinguish between temporary and permanent disability

While the disability grant is an entitlement, it is clear from recent trends that the systems surrounding the determination of legal beneficiaries of this grant need to be reviewed.

The FFC noted in its submission of 2003 that the foster care grant had a potential to increase very rapidly and indicated that the impact of HIV/AIDS would have significant implications for the grant. Indeed, there has been an upward trend in the take up rates of this grant since 2001.

Any ambiguity in defining the recipients of foster care and care dependency grants needs to be clarified especially given the possible impact of HIV/AIDS on these categories of grantees. The number of beneficiaries receiving the care dependency grant remained fairly steady between 1999 and 2001 and began growing slightly from 2002. It is obvious from the above that as the number of grantees increase so too will the funding requirement increase. Although, in terms of the Bill of Rights, genuine recipients of all grants are entitled to these benefits, there is a need for an audit of the current status of the recipients in the system to ensure that only those deserving receive the grant. Such an audit should also review the fiscal capacity, economic efficiency and developmental impact [Chapter 13, S214(2), (e) and (f)] of the current system, as the way it currently operates will have serious consequences and funding implications given that the equitable shares of nationally raised revenues have to also finance the provision of other constitutionally mandated basic services within macroeconomic and fiscal constraints.

3. Social Development Expenditure and the Equitable Share

The provincial equitable share (PES) allocates 18 percent to provinces for spending on social development. The weighting of the social development component of the PES formula is determined by past expenditure allocation decisions and is supposed to reflect the need for this service in provinces.[2] It must be noted that the equitable share allocation through the formula does not in practice represent the budget allocation in any province. Provinces have the final decision on budget allocations that may reflect their specific priorities.

Historical allocation patterns show that the portion of funds going to provinces for social development out of the equitable share formula has never matched the actual expenditure share of provincial social development. It must be noted that this component incorporates allocations for welfare services and social security grants. Table 4 shows that the allocation from the formula has been less than the actual expenditure on social development. The allocation from the formula trailed behind by 3 percent in 1998/99, 2 percent between 1999/00 and 2001/02 and almost 7 percent in 2003/04.

It is important to note that past expenditure trends that have been used as an indicator for the weighting have not taken into account increased beneficiary numbers for different grants. If these numbers were to be considered the increase would show a significant impact on provincial expenditure and would have necessitated an adjustment in the provincial equitable share in the vertical division of revenue, other things being equal.

[2]. See FFC Submission for the Division of Revenue 2003-04 for a fuller discussion on how the social development component is calculated.

Table 4: Equitable Share Allocations v/s Actual Expenditure Share

Financial Year	98/'99	99/'00	00/'01	01/'02	02/'03	03/'04
S. Development Expenditure	18,440,660	19,373,697	20,897,175	23,836,934	32,423,800	42,444,247
Total Provincial Expenditure	97,132,694	100,153,143	110,043,297	122,563,387	144,868,760	170,867,416
Actual Share	19.0%	19.3%	19.0%	19.4%	22.4%	24.8%
Formula Share	16%	17%	17%	17%	18%	18%

4. Options for Shifting the Social Security Portion

While a national agency to administer grants is in the process of being established, it is not clear what portion of funds needs to be shifted and what the impact of this will be on the provincial equitable share. A number of options may be considered, and they should be assessed according to the extent to which they are equitable and promote fiscal stability.

- If 18 percent is taken to reflect the expenditure need for social development within provinces, then shifting 18 percent of provincial expenditure to national government is an option to consider. But it is unsustainable because:
  - The actual average share of expenditure on social development within provinces has grown from 19 to 24.8 percent between 1998/99 and 2003/04. Thus 18 percent is not relevant anymore;
  - This option will leave the national sphere with a funding gap of 6.8 percent.
- The second option may be to adjust the 18 percent formula allocation by 6.8 percent to reflect the actual expenditure share of provinces on social development. This option is also fraught with difficulties:
  - The majority of provinces are already spending a share of their provincial expenditure that is either equal to or greater than this share. Most provinces would therefore be adversely affected by any attempt to shift the adjusted formula allocation;
  - Another downside to the two options above is that they represent average shares for the entire social development function within

provinces. Other welfare services within provincial social development will be left without funding.

- The third option requires that the actual average expenditure on social security grants be first separated within the social development component. This specifically involves taking the latest actual average share of expenditure of all provinces on social security grants out of the social development component and using this quantum as the basis for social security allocations. The advantages in this method are:
    - An amount will remain for other welfare services;
    - Provincial budgetary pressures will decrease and room will be created for funds to be spent on the delivery of other services.

Once the actual average expenditure on social security grants has been determined and separated, any budgetary shortfalls that arise may now be considered by taking into account Section 214 (2) (a-j) of the Constitution.

The Commission strongly recommends that taking into account Section 214 (2) should include:

- An audit and review of the current status of all recipients of grants to ensure only those deserving receive the grant and to create the basis for realistic projections in the growth of beneficiaries;[3] and
- In view of government's constitutional obligations to provide social development services, an assessment of the developmental sustainability and economic efficiency of the increasing demand for social security payments given the macroeconomic and fiscal capacity limits to raising national revenue needs to be undertaken.

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[3] . FFC Submission, 2003. "Towards a Review of the Intergovernmental Fiscal System", pp. 88-93.

Table 7 shows the shares of expenditure going to social security grants within provincial social development. As already argued above, taking only the average actual percentage share spent on social security grants of all provinces will ensure that other programs within social development are not left without a budget. The shifting of social security must therefore be implemented in a manner that does not compromise other services.

Table 7: Social Security Share of Social Development

Province	98/'99	99/'00	00/'01	01/'02	02/'03	03/'04
Eastern Cape	94%	94%	94%	93%	94%	94%
Free State	88%	88%	87%	89%	89%	90%
Gauteng	82%	82%	82%	82%	85%	87%
KwaZulu-Natal	94%	93%	94%	93%	94%	94%
Mpumalanga	94%	94%	94%	93%	92%	94%
Northern Cape	90%	88%	89%	88%	89%	89%
Limpopo	97%	96%	96%	96%	96%	95%
North West	90%	92%	95%	89%	88%	90%
Western Cape	81%	81%	82%	82%	87%	85%

5. Institutional and Programmatic Impact

The shifting of the social security grants component will also involve the shifting of personnel. The physical movement of personnel involved in the administration of social security grants on its own may pose problems. In particular, how is foster care, which involves both elements of social welfare services and social security grants, to be dealt with?

Another difficulty is the delineation of assets related to this function within provincial departments. Experience within provincial departments shows that some of the assets are actually used for a host of other functions not related to the administration of social security grants. If these assets are moved as part of the shifting of social security grants, how will other services that also rely on these assets be affected? It is a complex process to delineate or divide assets, the use of which depends on practical considerations and the daily workings of provincial departments. Provincial departments of social development are best suited to make this judgment. This submission confines itself to the envisaged institutional reconfigurations that will arise out of the shifting of the function.

Institutionally, the shifting of social security grants from provinces to national government will affect all personnel that administer grants at provincial level. Legislation for the establishment of the national social security agency already provides room for the agency to engage any provincial department in building its capacity. The movement of personnel from provincial social development departments is implicit in the legislation. Table 8 shows that within the majority of provincial social development departments, personnel are concentrated in the social welfare services programme. Therefore no major interference will be experienced in the delivery of services. Social security grants personnel constitute the second highest portion of all personnel within most provinces. Thus, the majority of provincial social development department personnel will remain with provinces.

Table 8: Provincial Personnel Distribution by Programme

Province	Administration	Social Assistance Grants	Social Welfare Services	Development and Support Services	Population Development and Demographic Trends
Eastern Cape	20%	25%	51%	4%	0.1%
Free State	12%	27%	52%	9%	0.1%
Gauteng	57%	2%	40%	1%	0.3%
KwaZulu/Natal	13%	35%	50%	1%	0.2%
Limpopo	13%	27%	38%	22%	1%
Northern Cape	14%	19%	58%	8%	1%
Western Cape	95%	1%	3%	0.1%	1%

Institutionally, it is also possible that the establishment of the agency may attract the attention of personnel employed in other programs within provincial social development and they may, as part of their career advancement, indicate a desire to move. Where this occurs in great numbers, it may act to incapacitate provincial social development departments in other areas. The case of foster care services, that draw personnel from both social security grants and social welfare services, raises the need to continue viewing the two programs as complementary to each other.

6. Transitional Arrangements

The phasing in of the national social security agency is expected to be a three to five year project operational by 2006/07. Legislation regarding the assignment of the function of social security is still under consideration. As a result, the establishment and full shifting of the function can only happen once the relevant legislation has been passed. This presents a significant challenge given the scenario painted above. The budgeting, financing and delivery of social security grants needs to be aligned with the relevant legislation.

Currently provinces will continue to administer and pay social security grants. Taking into account the FFC's past recommendations and, subsequently, Cabinet's decision in 2003 to shift the function of social security to national government, it is crucial that the delivery of grants continues smoothly without interruption whilst the other processes are addressed. An appropriate transitional financing mechanism is required to relieve the pressure on provincial budgets and to facilitate the eventual handover of the function to the agency. Some of the issues that must be taken into account in deciding on such a mechanism include:

- *The integrity of the program in terms of meeting the constitutional mandate, including incentives for delivering social security to all entitled citizens:* This means incentives for both take-up and proper targeting. There are two ways in which incentives come into play, and these work in opposite directions. One is that provinces must have an incentive to contain spending according to the rules and regulations established by national government. An absence of this incentive will lead to over-spending. The second is to ensure that the take-up of eligible recipients is as high as possible. Failure of this incentive will lead to under-spending relative to the size of the target population. Thus, the provision of incentives to provinces is a delicate balancing act.

- *Continuity of existing programs:* This includes the need to make a seamless transition from current arrangements to transitional arrangements to final delivery by a national agency.
- *Accountability and oversight of program spending:* These must be evaluated in light of meeting constitutional objectives, including transparency of responsibility.
- *Predictability,* and
- *Management of risks:* Given the current trends in social security, risk is better borne by national government rather than provincial governments.

Presently, national government and provinces are jointly responsible for the adequate delivery of social security, which is a crucial constitutionally, mandated basic service**.** Program parameters are determined nationally, but delivery by the provinces involves some discretion. It is important that provinces have incentives to deliver grants both efficiently and fairly. These goals seem more likely to be achieved, especially on a transitional basis, by a system that involves some decentralized responsibility and discretion. Provincial accountability will also be enhanced when provinces have some discretion over how funds are allocated and how much is spent.

The FFC in its submission for 2005 proposed two options for consideration, namely that social security may be funded via a conditional grant mechanism or any other appropriate funding mechanisms determined on a case by case assessment of a province's capacity and experience in the administration and payments of such grants. In principle it is not necessary to use a conditional grant to fund social security since this is currently a provincial mandate. However, taking into consideration Cabinet's decision, the payment of grants is a national priority founded on serving the national interest and therefore, theoretically, a conditional grant may be used. The existing legislation, however, makes the payment of social security a provincial mandate and therefore, calling the funding mechanism a conditional grant is not entirely appropriate.

Should provinces be used as agents of national government in the delivery of social grants, prior to the establishment of a national agency, a principal-agent relationship will occur. The risks associated with a principal-agent relationship will then need to be managed. The key risks include problems of moral hazard, information asymmetry, uncertainty regarding the cost implications of acting as national government's agent, and lack of clearly defined contracts between the principal and the agent (namely national and provincial government). Political accountability would be relatively clear-cut since national government is responsible for budgeting and financing the program while provinces are responsible for delivery. Furthermore, national government takes responsibility for creating the correct incentives for provinces to perform effectively and efficiently in the delivery of social grants.

Managing the above risks will require:

- Accurate forecasting of potential grant recipients per province
- Mechanisms for adjusting budgets, should there be unforeseen cost increases that are beyond the province's control
- Clear articulation of the costs associated with the delivery of the service and who is accountable for providing funding to meet them
- Mechanisms to reduce the problems associated with information asymmetry which could lead to a situation where in instances of non-delivery the principal cannot ascertain if it is the agent's fault or other factors that caused it.

The financing mechanism will merely represent an extension of the existing system. It will build on the existing experience and expertise of the provinces in delivering social security grants. The incentives for efficient and fair program delivery, though not perfect, are likely to be enhanced by having provinces continue to deliver grants to their own citizens. National oversight will continue to be maintained through the clear definition of norms and standards. However, provincial incentives would be weakened to the extent that the funding mechanism is purely transitional, as there would be no long-run consequences for poor delivery. Unless this is addressed at the outset, this is likely to be a problem no matter what transitional mechanism is adopted.

Other alternative mechanisms have their own disadvantages and here we consider three types. The first is to keep social security funding as an element of provincial equitable shares. This may serve continuity well, but it will perpetuate the current system whereby provincial social security obligations crowd out other Constitutionally Mandated Basic Services (CMBS) funding. The second mechanism is a non-matching bloc grant which will make provinces responsible and accountable for program delivery. This mechanism will impose some risks on provincial budgets. It is therefore not desirable. Lastly, instead of non-matching bloc funding, a matching grant system may be imposed. If the matching rates are high, there would be relatively little risk imposed on provincial finances. However, provinces currently have little revenue raising capacity and therefore little capability for providing matching funds. Its adoption will be counter to the whole objective of eventually shifting the social security administration system.

An agency payment to provinces (as has already been indicated above) for the delivery of grants will, in the interim, represent a positive step towards the eventual handover of the social security grants system to the national social security agency.

As already alluded to above, the challenge is to manage the principal-agent problems that may arise, such as information asymmetries and conflicting objectives between national and provincial governments. This will require the national department to strengthen its capacity to monitor the performance of provinces and induce them to act positively on its behalf. It also requires the national department to strengthen its information management systems and address all the weaknesses that currently plague the access to grants to ensure that the current problems faced by the provinces are not transferred to the agency. Redress may also be necessary if the performance of provinces is not meeting agreed standards.

7. Recommendations and Proposals

- The most effective method for financing social security payments through the provinces in the interim period leading up to the establishment of the national security agency is to separate the actual average expenditure on social security grants within the social development component. This specifically involves taking the latest actual average share of expenditure of all provinces on social security grants out of the social development component and using this quantum as the basis for social security allocations. The advantages of this method are:
    - An amount will remain for financing welfare services;
    - Provincial budgetary pressures will decrease and room will be created for funds to be spent on the delivery of other services.

- Once the actual average expenditure on social security grants has been determined and separated, any budgetary shortfalls that arise may now be considered by taking into account Section 214 (2) (a-j) of the Constitution. The Commission strongly recommends that taking into account Section 214 (2) should include:

- An audit and review of the current status of all recipients of grants to ensure that only those deserving receive the grant and to create the basis for realistic projections in the growth of beneficiaries;[4] and

- In view of its constitutional obligations to provide social development services, an assessment of the developmental sustainability and economic efficiency of the increasing demand for social security payments, given the macroeconomic and fiscal capacity limits to raising national revenue needs to be undertaken.

▪ With specific reference to institutional, administrative and personnel budgets, the shifting of the social security function must be implemented in a manner that does not compromise the delivery of welfare services and other constitutional obligations, especially where these services are complementary to provincial delivery obligations. Furthermore, legislation and regulations for the assignment, budgeting, and delivery of the social security function must be aligned with other relevant legislation.

▪ Measures should be instituted in order to ensure:

- The provincial and national information systems are consistent with each other, such that the link between those benefiting from grants and welfare services is not entirely lost, e.g. foster care and care dependency.
- The integrity and constitutionality of the program is maintained, and an incentive system that mitigates the provincial propensity to over- or under-spend is put in place.
- The continuity and minimal disruption of existing programs, and, if possible, a seamless transition from current to interim arrangements and final take-over by the national agency.

[4] . FFC Submission, 2003. "Towards a Review of the Intergovernmental Fiscal System", p. 88-93.

- The accountability, oversight, legal compliance, transparency and responsibility of program spending.
- Predictability and stability of allocations.
- The effective management of risks by national government.

▪ As an interim payment mechanism, the Commission recommends that a specific-purpose agency agreement between National government and provinces is put in place. Such an agreement will engage provinces to disburse social security grants on behalf of National Government for the interim period and in conformity with the principles set out above.