Description : OPENING COMMENTS ON THE DIVISION OF REVENUE BILL BY MR T A MANUEL, MINISTER OF FINANCE
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Speaker : MINISTER TREVOR MANUEL

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Madam Speaker, Honourable Members

The Division of Revenue Bill which serves before this House today was tabled alongside the Budget on 11 March. This Bill is a great leap forward in the implementation of the Constitution.

In complying with Section 214, this Bill is at the heart of the new budgeting process, which empowers provinces and local governments to pass their own budgets. For this reason, the National Budget no longer budgets for provincial functions like school education, health services and social pensions. These are now budgeted for in provincial budgets.

Section 214(2)(a) to (j) of the Constitution lists matters that must be taken into account in establishing the equitable division between the three spheres of government. This is generally known as the vertical division of Revenue. In addition, it sets out the matters that must be considered in determining each province's equitable share of the total provincial allocation and any other allocations made from the national share. Conditions can be attached to the latter allocations from the national share, while the equitable shares are distributed without conditions.

The Constitution and the Intergovernmental Fiscal Relations Act require the Financial and Fiscal Commission (FFC) to make recommendations regarding the equitable division of revenues raised nationally a few months before the start of the financial year, and for government to consider these recommendations before deciding on any allocation.

The government has followed this approach in both letter and spirit. It has not only given consideration to the recommendations of the FFC, but engaged in a proactive process of discussion with the FFC before finalising the basis for allocations. There has also been broad consultation with provincial governments through forums like the Budget Council, and with organised local government.

Before determining the vertical division of nationally-raised revenue, Cabinet took into account the national interest as reflected in the Government's Reconstruction and Development Programme (RDP) and the macroeconomic framework GEAR. In determining the total resource envelop available for expenditure, government makes a number of macroeconomic assumptions. For the 1998/99 Budget these assumptions are a GDP growth of 3%, CPI inflation of 5.5%, deficit as a percentage of GDP of 3.5% and a tax to GDP ratio of 26.4%.

On the basis of these assumptions a total revenue envelope of R 200.3 billion was determined.

The first charge against nationally raised revenue is debt service costs. Amounts for standing appropriations and a reserve to cope with uncertainties is also set aside. In summary, it is national revenue, plus the deficit, less the cost of debt servicing, standing appropriations and the contingency reserves that represents the total pool of resources available for the equitable devision of revenue between the three spheres.

The vertical division takes into account the functions allocated to each sphere, as well as the the fiscal capacity of that sphere. Provinces have only limited sources of own-revenue, and thus receive a far larger share of national revenue than local government, which is largely self-supporting. In order to minimise any adverse shocks resulting from the implementation of the new system, the actual expenditure levels of each sphere in the last two financial years have also been taken into account. Schedule 1 of the Bill therefore allocates R79 billion to the provincial sphere, and R1 billion to the local government sphere.

After determining the provincial equitable share, a formula is used to effect the horizontal division, or the allocation of the equitable share between the 9 provinces. This formula takes as its point of departure the recommendations of the FFC, particularly as they are presented in the FFC's framework document (June 1995) and its recommendations for 1997/98 (May 1996).

The final provincial allocations in the Division of Revenue Bill take into account the recommendations of the FFC in two ways. First, they adhere to the broad principles advocated by the FFC and are based on a formula similar in design to that proposed by the FFC. Second, the final allocations reflect specific comments made(by the FFC) regarding the social services components of the equitable shares formula and adjustments to the formula to address expenditure outcomes in earlier years. In some cases, however, an FFC recommendation was noted but not accepted pending further investigation of the issue, such as with the proposed surcharge on the personal income tax.

The provincial equitable shares formula relies on the preliminary 1996 census and other demographic and economic statistics to direct funds to provinces consistent with the level demand for basic services. The formula is comprised of the following six weighted components:

- An education share, based on the average of the size of the school-age population and number of learners actually enrolled;
- A health share, based on the proportion of the population without private health insurance and weighted in favour of women, children and the elderly;
- A social security component, based on the estimated numbers of people entitled to social security grants (elderly, disabled, and children);
- A basic share, based on total population with a 50 per cent weighting in favour of rural communities;
- An economic output share, based on the estimated distribution of gross geographic product (GGP); and
- An institutional grant, equally divided among the provinces.

Schedule 2 provides the breakdown of the R79 billion between the 9 provinces. In addition to the equitable share allocation to the provinces,certain conditional and other grants totalling R9 billion are made from the national share of R78.4 billion to the provinces and local government spheres. Conditional grants are a critical component of the new budgeting system, as they provide a mechanism for the national government to encourage provincial and local governments to promote national objectives through their spending programmes. The most important conditional grants introduced this year are the health grants totalling R4.4 billion, local government grants for, R293 towns etc., totalling R1.1 billion , as well as a R2.8 allocation supplementary allocation for provinces that budget adequately for education, health and welfare. Schedule 3 provides the details of all the conditional grants.

It is the combination of the equitable share allocations and all the conditional and unconditional allocations that comprise the total allocation to provinces and local government. If all these allocations including ICS are taken into account, provinces receive R90 billion, and local government R5 billion.

Adding on another R4 billion of own revenue, total provincial expenditure rises to R94 billion. However, this total does not include amounts such as R2.8 billion for provincial housing authorities that fund activities performed by the provinces on an agency bases for national departments.

The local government allocation of R5 billion is composed of R1 billion equitable share which replaces the old intergovernmental grants, R 583 million for consolidated municipal infrastructure programmes, R716 as capital grants, R1,189 billion for bus subsidies, R419 million for urban renewal, R130 million for settlement of outstanding debts, and at least R79 million for other subsidies from various national departments. The provincial share of R90 billion includes R1,132 billion for local government

Local governments budgets totalled R52 billion in 1997/98, financed overwhelmingly by own revenue. The Division of Revenue Bill does not spell out the allocation of the local government share between the various municipalities, as this is not required by the Constitution. A new formula for the division of the R1 billion share was announced recently - this formula is targetted at poor households and poor local authorities. It will be phased in over the next 5 to 7 years.

This new system of intergovernmental transfers to local governments will be governed by four main principles, namely

- All municipalities will be treated in an equitable manner in order to ensure that all municipalities are able to deliver a basic package of services to all poor households in their areas at affordable costs. This is the primary objective of the new system.
- Competition between municipalities will be on the bases of their fiscal performance to promote allocative efficiency.
- Spillover effects by one municipality to a neighouring one will be catered for, and
- A minimum level of institutional and administrative infrastructure will be required for municipalities to fulfil their obligations

The allocations in the Division of Revenue Bill take into account the constitutional requirements as follows:

- The national interest is reflected in the Government's Reconstruction and Development Programme (RDP) and the macroeconomic framework GEAR.
- Special provision is made in respect of the national debt by setting aside the costs of servicing that debt before allocations are made to the spheres.
- The needs and interests of the national government are defined by the assignment of responsibility in the Constitution and the RDP. These were taken into account during the MTEF process and are reflected in the final allocations to national departments as well as in some of the conditional grants to provinces and local government that are made in terms of national government policies.
- The allocations meet the needs of provinces and local government to provide basic services and other functions. The provincial equitable share formula directs funds to provinces based on their demographic and economic profiles, as these provide an indication of the demand for basic services within each province. In addition, the Budget includes a conditional grant of R2,8 billion for provinces to ensure that their budgets are credible and to guard against shortfalls in the provision of basic services.
- The allocations take into account efficiency in several ways. The equitable shares formulae for provinces and local government are phased in over a number of years, allowing for an adjustment period. The Budget also includes several special initiatives to promote improved financial management and expanded capacity in the public sector.
- The basic shares component of the provincial equitable shares formula directs additional funds to provinces with large rural populations to help address the special developmental needs and backlogs that exist in rural areas. The Budget also includes specific grants, such as municipal infrastructure and housing subsidies, targeted at developmental needs.
- Recognising economic disparities among the provinces is at the heart of the equitable shares formula, which relies on provinces' demographic and economic profiles. In addition, national government supports the process of reducing economic disparities through certain grants, such as the consolidated municipal infrastructure programme
- The allocations are intended to allow provinces and municipalities to meet obligations imposed by national legislation, while retaining responsibility for budgetary management and programme implementation. Task teams have worked closely with provinces in the preparation of their budgets to ensure that available resources are aligned with obligations.
- The requirement for stable and predictable allocations is taken into account through the phasing of formulae and the multi-year planning framework of the MTEF. Also the Division of Revenue Bill requires that a schedule of payments be determined for making the equitable share transfers to the provinces and municipalities.
- The Budget reflects the need for flexibility by retaining a R1 billion contingency reserve in 1998/99 to respond to emergencies or other temporary needs.

Section 10(5) of the Intergovernmental Fiscal Relations Act, 1997 (Act No 97 of 1997) requires the Division of Revenue Bill to be accompanied by an explanatory memorandum detailing how the Bill takes account of the following:

- each of the matters listed in section 214(2)(a) to (j) of the Constitution;
- any recommendations of the Financial and Fiscal Commission; and
- any assumptions and formulae used in arriving at the respective shares contained in schedules 1 and 2 of the Bill.

This is done in Annexure E in the Budget Review tabled as part of the Budget documentation.

The new constitution imposes a tremendous responsibility on provincial and local governments to deliver on basic services. They are expected to table Provinces are expected to table balanced budgets, and local governments cannot budget for operational deficits. The challenge we all face with national, provincial and local governments is to prioritise and reprioritise expenditure and spend the revenues allocated to each sphere of government in a way that promotes the objectives of the RDP. The cooperative and transparent process pursued by Government in determining the division of revenue helps to widen and deepen the debate on how to allocate the nation's resources.

Madam Speaker, I move.