# FISCAL LEAKAGES AND MEASURES TAKEN BY NT

Briefing to NCOP

PRESENTED BY: NT

**Date: 30 August 2022**

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

STAY SAFE
VACCINATE TO SAVE SOUTH AFRICA

# TAX LEAKAGES

Considering policy interventions for comprehensive and buoyant tax bases

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

STAY HOME
SAVE SOUTH AFRICA

# WHAT DO WE MEAN BY FISCAL LEAKAGES?

# TAX AVOIDANCE VS TAX EVASION

Tax avoidance is **legal**

Permissible action taken to reduce tax liability & maximise after-tax income

Under-reporting of income, claiming fake expenses, or deliberate under/non-payment of taxes

Tax evasion is **illegal**

# WHAT ROLES DO NT AND SARS PLAY IN ADDRESSING TAX AVOIDANCE AND TAX EVASION?

- With respect to **tax avoidance**, the Minister of Finance tables money bills each year which propose amendments to the legislation with the aim of minimising opportunities for tax avoidance
- South Africa has introduced a number of these measures over the years to reduce tax avoidance
- The success of curtailing tax avoidance requires a combined effort between NT and SARS
  - SARS are able to see what legal strategies are being used by taxpayers to minimize their tax burden. They can share how this is done with NT, and the MoF can then adjust the legislation to reduce these opportunities.
  - Requires close co-operation between NT and SARS – note that SARS does not (and cannot) share specific taxpayer information
- While the Minister of Finance can table anti-avoidance legislation, we rely on SARS to enforce the legislation
- SARS is primarily responsible for **tax evasion**, but NT can help by changing legislation to make it easier to catch or stop instances of illegal activity

# POTENTIAL FOR LEAKAGE (EITHER AVOIDANCE OR EVASION) IN EVERY STAGE OF "TAX CALCULATION"

Feedback loop: quality of expenditure (fiscal leakage beyond tax)

**GDP**

Structure of the economy ("tax handles")

**Informal economy** (partially tax compliant)

**Illicit economy**

**Illegal activities**

**Tax base**

Source vs residence; tax treaties

Exemptions / exclusions

Deductions

Tax preferred vehicles (tax expenditures and other deviations)

**Tax rate**

Rate arbitrage

Reclassification to attract lowest rate

**Tax revenue**

- Compliance / tax morale
- Administrative efficiency

Feedback loop: impact of policy (behavioural change)

# EXAMPLES OF TAX AVOIDANCE AND TAX EVASION

- Tax avoidance is defined as any **legal mechanism** used to reduce a tax liability. Examples could include:
  - Getting your company to pay for your motor vehicle or house or any other expenditure as it may be taxed at a lower rate than income
  - Placing a large amount of your income into a retirement fund to obtain the highest deduction possible
  - Moving a company into a special economic zone for the sole reason of achieving a lower corporate income tax rate
- Tax evasion is defined as **illegally** reducing the amount of tax that is paid. Examples could include:
  - Failing to declare income to SARS
  - Claiming personal expenses as business expenses
  - Over-declaring the level of expenses, which may include falsifying invoices

# WHAT HAS BEEN THE TAX POLICY APPROACH TO REDUCE FISCAL LEAKAGES?

# CREATE AS BROAD A TAX BASE AS POSSIBLE, WITH SIMILAR TAX RATES

- Since 1994 numerous changes to tax legislation have been made to try and reduce fiscal leakages by following a principled approach of aiming for a **broad tax base**, for both personal income taxes and corporate income taxes
- The objective is to **include all types of incomes** in the tax net, regardless of the type of income or whether the individual or company receives particular benefits instead of income
- The other aim is to try and keep the tax system as **neutral as possible**, by trying to tax different individuals and companies, as well as types of income, at similar tax rates
- There is a **constant tension with tax incentives**, which undermine these types of objectives and create opportunities for increased fiscal leakages, especially if the incentive is not meeting its intended objective

# WHY A BROAD-BASED TAX SYSTEM?

- Base broadening means increasing the portion of income (in the case of direct taxes) that is subject to taxation
- If we think of the tax base as a block of cheese...
  - the holes (incentives, exemptions, untaxed income types, etc. that are often for specific taxpayers/ activities/ sectors) reduce the size of the tax base and necessitate a higher tax rate to achieve a desired level of revenue
  - The more holes there are, the higher the rate required for the same level of revenue
- Evaluating and tweaking / removing the 'holes' is important policy analysis to minimise inequities and inefficiencies and any leakages in the tax system
- Expanding the base allows for lower tax rates

# DO BROAD BASES SUPPORT A PRINCIPLED TAX SYSTEM?

| | |
|---|---|
| Buoyancy | • Less exceptions mean that the fiscus is less exposed to downturns in specific sectors / activities |
| Efficiency | • Minimise distortions to decision making (e.g. structuring affairs to attract less tax).<br>• Main aim: broaden tax bases, to keep rates as low as possible |
| Equity | • VERTICAL: Higher income tax payers have more scope for diversification and tax planning<br>• HORIZONTAL: Tax favoured provisions tend to create lobbies for their continuation – at the expense of all other taxpayers who face higher rates to fund the "exceptions" |
| Simplicity | • Simple provisions that apply to everyone are easier to comply with and administer<br>• Easy to understand |
| Transparency & certainty | • Clear legal basis through general application |

# CHANGES TO THE PERSONAL INCOME TAX SYSTEM TO REDUCE LEAKAGES

# EFFORTS TO INCLUDE ALL TYPES OF INCOMES AND BENEFITS AND REDUCE RATE DIFFERENCES

- Main reforms were to include all incomes and benefits in the tax system. For example:
  - Before 2001, there was no capital gains tax which meant individuals could keep resources within a business and try to sell it at a higher price for a profit to reduce their tax liabilities (legal tax avoidance), instead of receiving income as wages or dividends which would be taxed. As a result, capital gains tax was introduced from 2001.
  - Individuals used to be able to receive benefits from their employers that were either not taxed, or taxed at a very low rate. Such as a reduced interest rate on a loan, or the ability to purchase a business asset at a low value. These are all benefits for the individual that would be taxed at a lower rate than income – a leakage. Over the years these benefits have all been included in the tax net and are taxed as closely to the actual benefit as possible.
  - Rate differences are also important, such as when the top personal income tax rate increased to 45%, the dividends tax rate was also increased to keep the effective tax rate between dividends and wages close together and stop individuals paying themselves through whichever form pays the lowest level of tax

# PIT reforms to limit leakages include:

| Major base expansions | Limit exemptions / deductions | Tax rate adjustments | Compliance and collection initiatives |
|---|---|---|---|
| • 2001: Residence base for taxation of worldwide incomes<br>• 2001: Include capital gains as taxable<br>• Annual expansions of fringe benefit taxation<br>• 2016: employee share-based schemes | • 2012: MTC (deduction to credit)<br>• 2017: Cap on Foreign income exemption<br>• 2016: Harmonised caps on pension contribution deductions<br>• 2019: Pension withdrawals on cessation of residence | • 2017: 45% bracket introduced<br>• 2017: Increase Dividend withholding tax rate<br>• Ongoing: Pre-retirement pension withdrawals (two pots) | • E-filing<br>• 3rd party information<br>• Auto assessments<br>• Rebuilding trust in SARS<br>• Recapacitating SARS (Budget allocation in 2021) |

# AMENDMENTS TO THE TAXATION OF TRUSTS: SECTION 7C

- Before 2017 taxpayers were able to grant interest free or low interest loans to trusts to which they were connected (as founder or through beneficiaries e.g. children). This enabled them to transfer wealth to trusts and avoid
  - Donations tax
  - Estate duty and
  - Income tax on interest (not) received on the loan repayment
- After recommendations from the Davis Tax Committee, in 2017 section 7C of the Income Tax Act was introduced whereby the difference between the interest charged on such loans to trusts and the official rate of interest is taxed as a donation.
- Initially this only applied to cases where natural persons granted the loan to a trust, but further amendments were made to also include:
  - Loans to companies where 20 percent or more of the company shares were held by connected trusts (2017) as well as
  - Cases where the loans were granted between connected trusts (2021)

# WHAT HAVE WE LEARNED IN OUR EFFORTS TO "PLUG THE LEAKS" IN THESE CASES?

- Rate hikes are not a fool-proof strategy to increase revenue
  - Base broadening is a powerful domestic revenue mobilization strategy
  - Many popular proposals for "new" taxes or higher rates want to add something on top of the existing tax system, rather than fixing the system
- Aim for broad and comprehensive bases, with as few as possible exceptions
  - Fragmentation of tax instruments complicate the tax system and open the door for avoidance and evasion – and the possibility of double taxation.
  - When there are lots of exceptions, exemption and carve outs there can even be double non-taxation
- Strong resistance from those who have much to lose from removing specific "tax breaks"
  - Rate hikes may in some cases be the fastest way to increase revenue in the short run, as they are easier to legislate

# CHANGES TO THE CORPORATE INCOME TAX SYSTEM TO REDUCE LEAKAGES

# CORPORATE INCOME TAX (CIT) BASE HAS...

... been broadened since the early 2000s and we continue to strive for a CIT system that is neutral (across sectors, activities and sources of finance), more efficient, simpler and offers more certainty, while ensuring that businesses contribute adequately to tax revenue.

- The tax system should be as neutral as possible and only deviate from a simple system in very limited circumstances.
- There are a large number of policy priorities, but we undermine the whole tax system and create vested interests if we have too many incentives
- Besides the legislated definition of the tax base, CIT revenue is driven by three main factors - the tax rate, profitability and the ability of SARS to enforce anti-avoidance legislation.

# EXPANSION HAS CONTINUED OVER TIME...

- A lot of effort to expand the tax base in the early 2000s
- Capital gains tax was introduced, and the tax system was changed from source-based taxation (where only income sourced in South Africa is taxable) to a residence-based system (where South African residents are taxed on their worldwide income)
- Controlled foreign corporation (CFC) rules were introduced in 2001 to prevent South African MNEs from accumulating profits and earning passive income in subsidiaries situated in low-tax countries
  - If the CFC does not constitute a foreign business establishment (a genuine, active business for a sustained period), or if tax payable by the CFC to a foreign government is less than 67,5% of the amount of tax that would be due in South Africa...
  - … South African residents with a qualifying interest in a CFC are required to include a proportionate share of the CFC's net income in their South African income
  - The design of our CFC rules were considered to be one of 3 best practices implemented in the OECD Base Erosion and Profit Shifting Project in 2014/15

# ANTI-AVOIDANCE LEGISLATION REDUCES LEAKAGES

- Since 2008/09, there has been a continual monitoring and tweaking of anti-avoidance (base protection) measures
- Thin-capitalisation and transfer pricing rules were merged in 2012
- Rules to address hybrid mismatches were introduced
  - An example of a hybrid mismatch is when a party in SA labels a financial instrument as debt so that it can deduct the interest payment and reduce its taxable income (payments on equity are not deductible), whereas the financial instrument actually has a set of equity features.
  - Rules were introduced that treat the payment as a dividend instead of interest and the taxpayer is denied a deduction for the "interest" payment
- In 2014/15, rules were introduced to restrict the ability of taxpayers to strip the SA tax base with excessive interest deductions
  - Most tax systems create an incentive to finance a company with debt rather than equity as interest payments on debt are deductible
  - This is exacerbated in the international context where a company in a low-tax country lends to a connected SA company and either extends more debt than is necessary or charges a high interest rate so as to shift profits from SA to the low-tax country and minimise the global tax burden

# INCLUDES REMOVING INEFFECTIVE INCENTIVES ...

... such as the venture capital company (VCC) incentive

- Section 12J of the Income Tax Act enabled investors in VCC companies to deduct the value of those investments (capped at R 2.5 million from July 2019, but uncapped before that) from their taxable income
- The VCC companies were essentially investment vehicles which would then on invest those funds into small businesses called qualifying companies
- The aim of the incentive was to encourage equity funding for small businesses and ultimately create more jobs and economic growth
- A survey done by National Treasury found the 12J incentive to be inefficient and that it mostly provided very wealthy taxpayers a significant tax advantage – which in this case would be considered a fiscal leakage
- Job creation was limited and investments were mostly in low-risk rental schemes with limited economic value
- As such the incentive was discontinued in 2021

# RACE TO THE BOTTOM…

- Over the years, global corporate tax rates began falling and companies could set up structures that enabled them to benefit from a network of bilateral treaties and negligible tax rates in some countries
- Countries realised that they needed to work together to address some of the activities leading to base erosion and profit shifting (BEPS)
- In 2013, the G20 Finance Ministers called on the OECD to find solutions to BEPS, which was negatively affecting corporate tax revenues
- In 2014 and 2015, the OECD led a 15-item action plan in response
- Developing countries rely more on CIT relative to developed countries, meaning they are disproportionately affected by BEPS
- Research shows that (as is the case for other developing countries) profit shifting responses to tax rate differentials by companies operating in South Africa are estimated to be double those in developed countries (based on tax administrative data up to 2016)

# INTERNATIONAL COLLABORATION...

- The G20/OECD BEPS Project culminated in a range of agreed-to minimum standards, recommendations and best practice approaches – most of which have been implemented by South Africa
  - Transfer pricing documentation has been enhanced and enables SARS to see a global picture of large South African MNEs' revenue, assets, employees, etc.
  - The excessive interest limitation rules were reviewed in line with the recommendations of the BEPS Project and have been strengthened in last year's tax laws amendment process
  - Interest payments to parties in a controlling relationship are potentially restricted to 30% of EBITDA to reduce the risk of BEPS using excessive debt and interest
- There were two remaining challenges that were not been appropriately addressed in the BEPS Project
  - How to tax the digital economy
  - The continuation of the “race to the bottom” (reduction in corporate tax rates)
  - Called for a continuation of work to find a solution...

# TAXATION OF THE DIGITAL ECONOMY: PROFITS

- The G20 identified the taxation of the digital economy as a concern as new technologies enable companies without a physical presence in a country to make significant profits in that country without getting taxed
- In response, OECD started a process to find a solution
- On 8 October 2021 – 136 members of the OECD/G20 Inclusive Framework on BEPS (the Inclusive Framework) agreed to a Two-Pillar Solution to address the tax challenges arising from the digitalisation of the economy:
  - Pillar One: essentially a reallocation of taxing rights giving the country where the goods or services are consumed more taxing rights on profits made in their country, even if there is no physical presence
  - Pillar Two: a global minimum effective tax rate of 15%, to discourage profit shifting to low tax jurisdictions
- South Africa has been participating in this process and has representation on the Steering Committee of the Inclusive Framework, as well as other working parties

# A CIT PACKAGE…

… was introduced from 1 April 2022, which shows that by implementing base broadening measures, it is possible to reduce the CIT rate and not lose any CIT revenue as the expansion in the base offsets the revenue loss from decreasing the rate.

- There are a number of benefits to doing so:
  - The CIT system has less incentives that can result in windfall gains without any changes in behaviour (research shows that other factors such as access to markets, skills and infrastructure are often much more important I swaying investment decisions)
  - The tax base is adequately protected by anti-avoidance legislation (which rely on SARS' enforcement to be effective)
  - The CIT rate can be reduced, which reduces the incentive to shift profits away from South Africa and, in doing so, relieves some of the pressure on SARS to curtail this

# TRANSPARENCY HAS BEEN ENHANCED...

... through initiatives like the Automatic Exchange of Information and the Common Reporting Standard (CRS)

- The CRS calls on jurisdictions to obtain information from their financial institutions, and individuals, and automatically exchange that information with other jurisdictions annually
- A recent study by the OECD (in collaboration with NT) highlights how these initiatives swayed people to make use of the voluntary disclosure programmes offered by SARS
  - Thereby disclosing previously undisclosed assets/income and increasing the tax base going forward
  - Study available here

# TAXATION OF THE DIGITAL ECONOMY: INDIRECT TAXES

- As part of changes to the international tax system, the OECD proposed that digital platforms be subject to sales taxes such as VAT on sales made in that country, even if they are not physically present there
- South Africa was the second country to implement this proposal after Norway
- This implementation has not only generated additional tax revenues for South Africa, but also levels the playing field between local and international sales platforms

# CHANGES TO INDIRECT TAXES TO REDUCE LEAKAGES

# TAXATION OF THE DIGITAL ECONOMY: INDIRECT TAXES

- Before 2013, recipient/purchasers of online electronic services from non-resident, non-vendor suppliers were responsible for self-declaration of VAT on their purchases
- This resulted in low compliance and loss of revenue to the fiscus
- VAT legislation changed to require all non-resident suppliers of electronic services to customers in South Africa to register with SARS as VAT vendors (provided the registration requirements are met).
- This shifted the onus from the recipient to the supplier to pay the VAT to SARS.
- The 2014 Regulations (based on OECD Base Erosion and Profit Shifting (BEPS) recommendations for VAT) initially focused on a limited number of supplies such as educational services, games and games of chance, internet-based auction service, miscellaneous services (i.e. e-books, e-music, e-films, images, etc.), subscription services (i.e. magazine, newspaper, etc.)
- South Africa was the second country to implement the OECD recommendations after Norway
- In 2017, the Minister of Finance broadened the scope of electronic services to include software and other electronic services
- In 2019, the Revised Regulations were to apply to all “services” that are provided by means of an electronic agent, electronic communication or the internet
- **Revenue implications:**
  - Before base broadening: April 2018 to March 2019: raised **ZAR 1 billion**
  - After base broadening: April 2019 to March 2020: raised **ZAR 5.4 billion** and April 2020 to March 2021: **ZAR 6.7 billion**

# VAT REGULATIONS ON THE DOMESTIC REVERSE CHARGE RELATING TO VALUABLE METAL

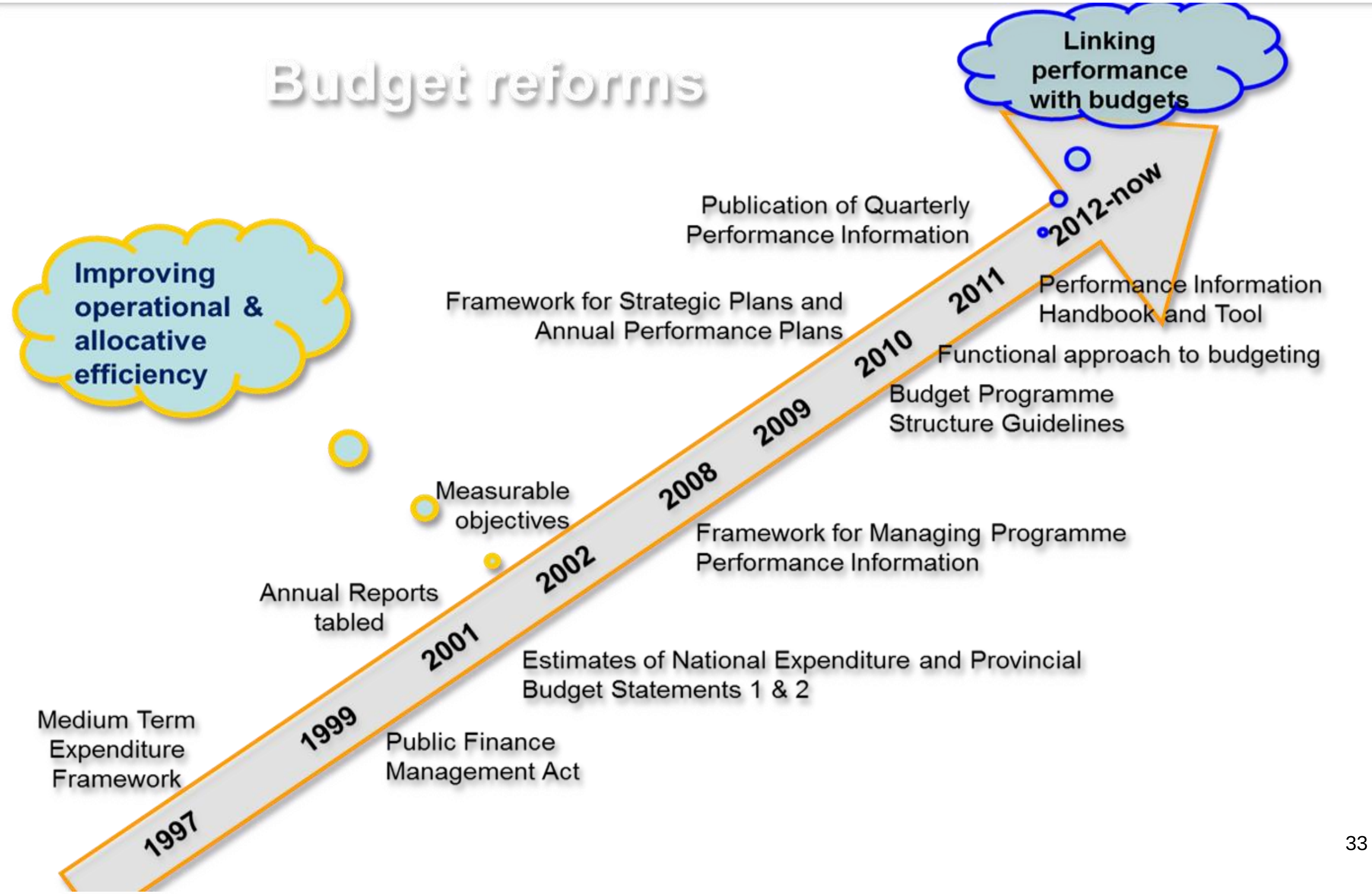
- VAT legislation requires VAT vendors (suppliers) to charge, collect and pay the VAT to government, and allows the vendor to determine its VAT liability or VAT refundable. Exports are zero rated for VAT purposes
- VAT on second-hand goods, particularly second-hand gold, was and still is a target of abusive and fraudulent activities
- Deduction of notional input tax (i.e. refund) on the acquisition of second-hand gold jewellery by VAT vendors from non-VAT vendors contributed to creating an enabling environment to obtain fraudulent VAT refunds, as jewellery is smelted along with gold coins and illegally acquired raw gold
- In 2014, changes were made to VAT legislation to put conditions for obtaining the notional input
- New modus operandi emerged where various fictitious businesses are registered for VAT and invoices are fabricated (i.e. “invoice-farms”)
- Melted gold are exported at the zero rate, whilst deducting input tax and claiming a VAT refund
- The overall scheme is therefore aimed at effectively capturing the VAT refund at the final stage of the production and distribution chain
- Effective from 1 July 2022, Regulations on Domestic Reverse Charge Mechanism was introduced to curb VAT fraud schemes.
- This shifts the onus of paying the VAT to SARS from the supplier to the recipient
- With this Regulations, VAT vendors (recipients) will only be allowed to deduct the input tax on the acquisition**, if the vendor has accounted for and paid VAT to SARS (and not just based on tax invoices)**

# FINAL THOUGHTS

- There are a multitude of taxpayers out there who would like to minimize their taxes as far as possible, and it is the role of the MoF, NT and SARS to ensure the system remains fair and generates sufficient revenue for government expenditure
- A simple tax system with as few exemptions, deductions and incentives as possible would be the best way to limit fiscal leakages through either tax avoidance or tax evasion
- Much progress has been made over the years in getting towards this ideal, however the tax system is often seen and used as another lever to achieve other governmental objectives
- The structure of the economy also continues to change at a rapid pace and the tax system needs to keep up, otherwise opportunities for avoidance will increase
- The country does require an efficient and effective SARS as the foundation for all revenue collection

# ACHIEVING SPENDING EFFICIENCY THROUGH SPENDING REVIEWS

# BACKGROUND



Budget reforms
Linking performance with budgets
Improving operational & allocative efficiency
2012-now
Publication of Quarterly Performance Information
2011
Performance Information Handbook and Tool
Framework for Strategic Plans and Annual Performance Plans
2010
Functional approach to budgeting
2009
Budget Programme Structure Guidelines
2008
Measurable objectives
Framework for Managing Programme Performance Information
2002
Annual Reports tabled
2001
Estimates of National Expenditure and Provincial Budget Statements 1 & 2
1999
Public Finance Management Act
Medium Term Expenditure Framework
1997

# BACKGROUND

- Since the above reforms have been implemented together with the traditional approach, the value for money that was envisaged has not been achieved.
- Since the 2008 financial crisis, government spending has been consistently higher than revenue, leading to substantially higher government debt.
- Government has since been reducing the growth of spending by focusing on underspending programmes and those which are growing much faster than consumer price inflation.
- Budget reductions were recently implemented, an across the board decrease approach in allocation for all programmes.
  - **The disadvantage of this approach is that some programmes become inefficient as a result of large reductions.**
- A more technical and strategic methodology is now needed. Cabinet has endorsed the implementation of zero-based budgeting

# BACKGROUND: WHY ZBB?

**Some of the benefits of using ZBB, as noted from the different case studies reviewed:**

- Greater involvement by managers in all stages of the budgeting process
- More effective dissemination of information on organisational operations;
- Addresses wasteful expenditure;
- Ensures a more rational allocation of resources;
- Ensures alignment of agency funding with the present level of effort and resources;
- Enables the realignment, discharge, transfer or redeployment of projects or resources; and
- ZBB provides a more flexible budget tool to facilitate policy review.

**Some challenges which were experienced with the ZBB system:**

- Users of ZBB cited the time and paperwork required to be too much;
- Bridging the gap between the ‘theory and practice’ of ZBB was not easy
- There was resistance to change by some individuals working with the system (mainly budget advocates);
- There was little evidence that suggests that ZBB had improved the budget process; and
- There was no evidence that suggests that ZBB yielded huge spending reductions or cost savings

# BACKGROUND

**The lessons learned from the application of ZBB from different countries are as follows:**

- A proposal to adopt zero-base budgeting should be clear on whether it is expected to be an analysis of all government, a tool to respond to a fiscal crisis, or a periodic, revolving review of state agency operations and budgets
- Continued commitment from leadership and a commitment of time from all involved including legislators are essential for the successful application of ZBB
- Because in any of its forms, ZBB is likely to be an elaborate and time consuming process, and can add complexity to the current budget process (amongst other disadvantages), it is proposed that spending reviews be implemented shaped by the principles of ZBB

**A ZBB theoretical framework that will be used in shaping the spending reviews**

- ***<u>Step 1: identify "implementation programmes"</u>***
- ***<u>Step 2: Analyse each 'implementation programme' in a 'decision package'</u>***
- ***<u>Step 3: Evaluate and rank all the formulated decision packages to develop the appropriations request</u>***
- ***<u>Step 4: Prepare the detailed operating budget of the selected decision packages</u>***

# SPENDING REVIEWS: MAIN OBJECTIVES

**Improve spending efficiency over the medium term**

- Irregular government expenditure for the 2018/19 financial year rose to R32 billion, while fruitless and wasteful expenditure for the same period was R2 billion. This remains a perpetuating problem which results in misappropriation and wastage of scarce resources.

**Operational improvements leading to improved programme impact**

- Several programmes may be redundant to current priorities of government and may no longer warrant allocation of funds. Such programmes have remained in existence since they were launched.

**Short-term budget cuts to reduce the budget deficit**

- In 2019/20, the budget deficit amounted to 6.25 per cent of GDP and in the 2020/21 fiscal year forecast, the deficit is projected to amount to 15.7 per cent of GDP. If perennial growth in expenditure is not resolved, whilst revenue collection remains low, this will exacerbate the fiscal problem.

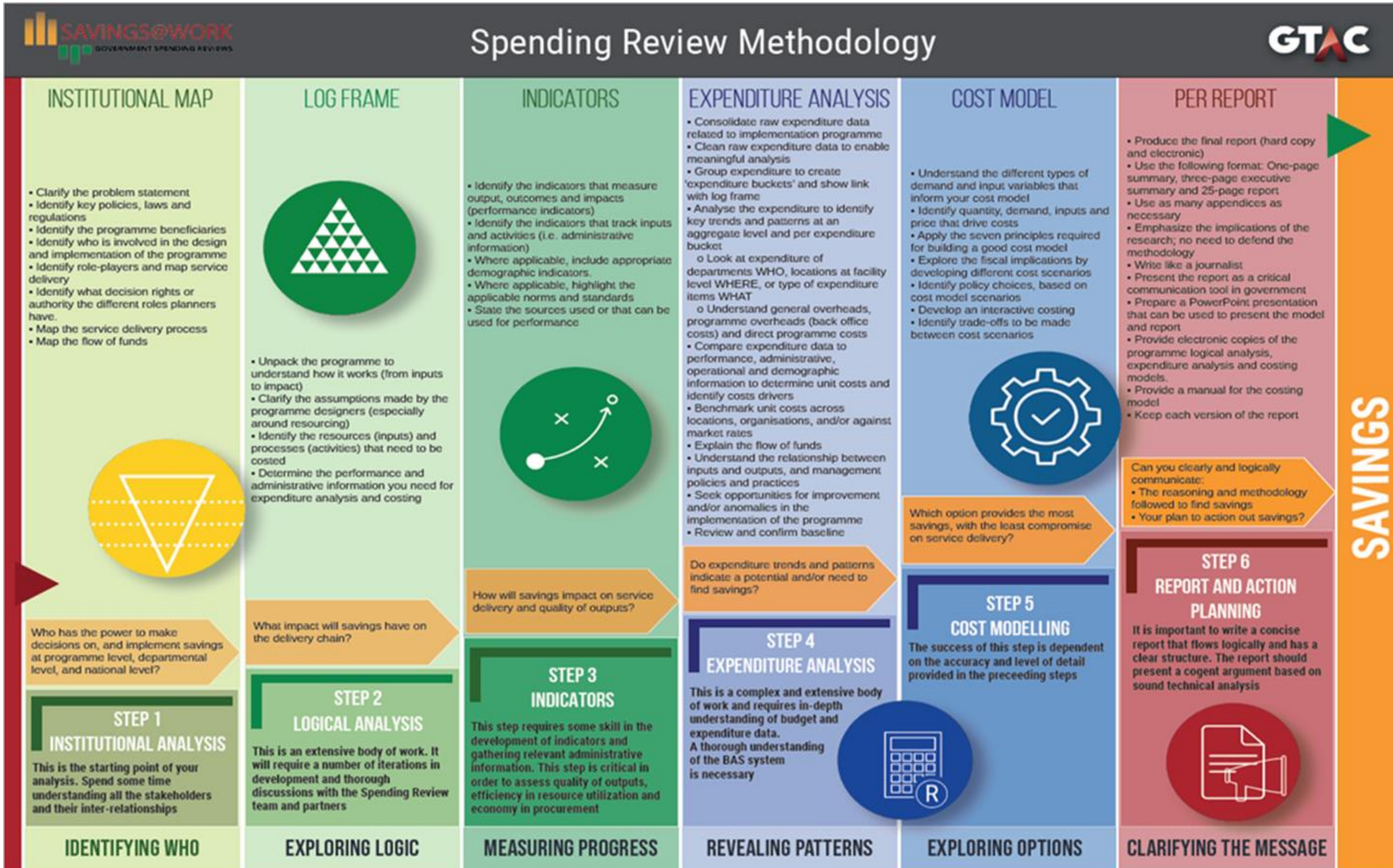
# SPENDING REVIEWS: MAIN TARGETS

- Reallocation of spending to match current government priorities
- Medium to long term improvements in spending efficiency
- Minimise the impact of spending reduction on service delivery while rapidly reducing the budget deficit
- Elimination of programmes that are no longer serving their intended purpose

**There are some challenges that arise in the implementation of spending reviews (both the technical work and the recommendations), including:**

- Availability and the quality of performance information
- Inattention and/or time constraints for implementation
- Political support both at an executive level and the legislature
- Capacity and skills set needed

# IMPLEMENTATION OF SPENDING REVIEWS



# SPENDING REVIEWS: IMPLEMENTATION

**Selection criteria**

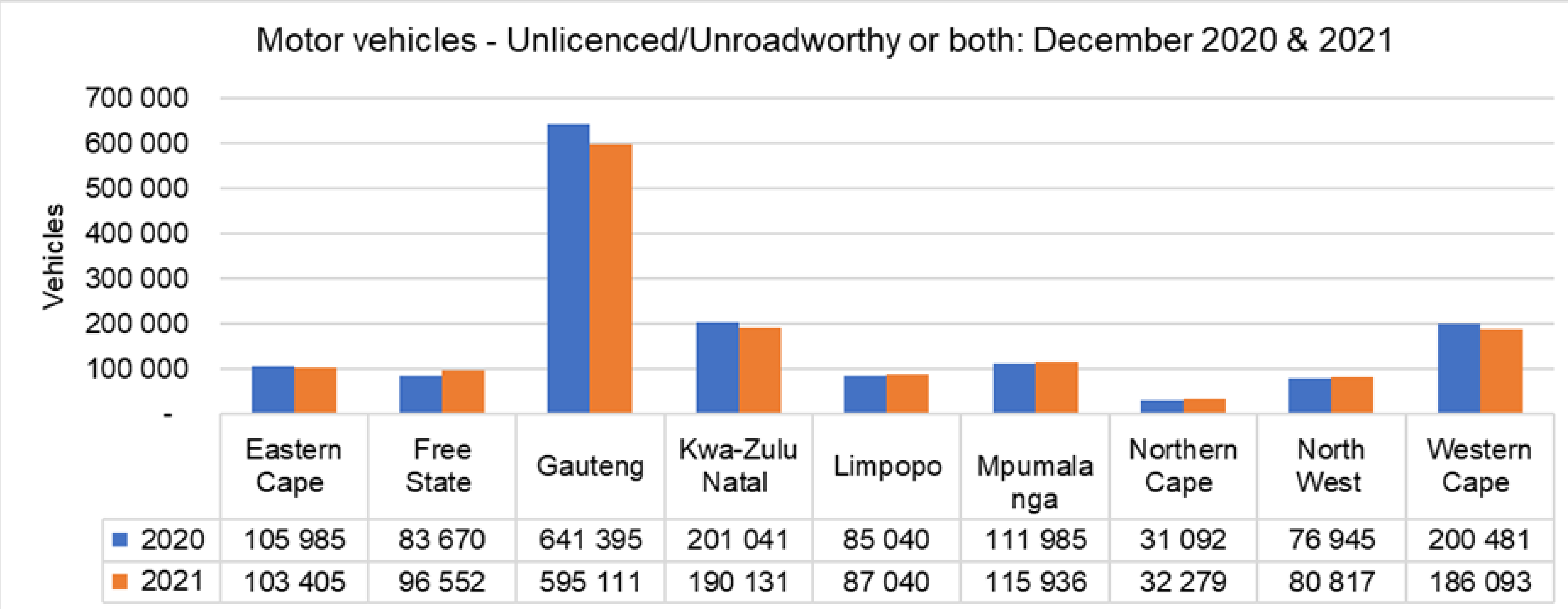
- Proportion of the implementation programme's budget relative to other programmes
- Composition of spending (compensation of employees should not account for majority of the programme's budget)
- Consistent underspending and or surplus as well as non-financial performance for the past three financial years
- Implementation programme no longer aligned to departmental mandate
- Provided there are multiple stakeholders - buy in should be obtained from all main stakeholders involved in the design for the programme, implementation, budgeting, funding, monitoring and evaluation that feeds into oversight and reporting
- All main stakeholders should agree on the implementation programme to be isolated for analysis and decision making

**Implementation**

- Departments, NT officials from Public Finance and GTAC did the main analytical work.
- Line departmental officials were involved in the process through bilateral and multilateral discussions, which include provincial representatives, and through MTEC
- The outcomes and the recommendations of these spending reviews to be presented in Cabinet for adoption and implementation

# FISCAL LEAKAGES - PROVINCIAL REVENUE & EXPENDITURE

# UNLICENSED/ UNROADWORTHY VEHICLES OR BOTH




| | Eastern Cape | Free State | Gauteng | Kwa-Zulu Natal | Limpopo | Mpumalanga | Northern Cape | North West | Western Cape |
|---|---|---|---|---|---|---|---|---|---|
| 2020 | 105 985 | 83 670 | 641 395 | 201 041 | 85 040 | 111 985 | 31 092 | 76 945 | 200 481 |
| 2021 | 103 405 | 96 552 | 595 111 | 190 131 | 87 040 | 115 936 | 32 279 | 80 817 | 186 093 |

- 1 487 364 unlicensed/ unroadworthy vehicles in SA in December 2021
- These vehicles have serious consequences on road safety and contribute to loss of revenue (motor vehicle license fees).
- Law enforcement measures to be strengthened to curb the lawlessness on our roads.

# FISCAL LEAKAGES - PROVINCIAL EXPENDITURE

# MEDICO-LEGAL PAYMENTS

**Table: Payment trend on claims against health departments between 2013/14 and 2021/22**

| R'000 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 |
|---|---|---|---|---|---|---|---|---|---|---|
| Eastern Cape | 63 359 | 74 775 | 74 868 | 255 561 | 208 503 | 423 263 | 797 434 | 766 399 | 920 981 | 38 683 |
| Free State | 440 | 700 | 196 | 1 728 | 1 560 | 376 | 3 600 | 22 655 | 3 484 | 41 397 |
| Gauteng | 145 071 | 181 802 | 241 085 | 572 815 | 751 082 | 358 230 | 586 453 | 502 148 | 392 126 | 369 697 |
| KwaZulu-Natal | 20 679 | 97 433 | 103 536 | 90 367 | 251 278 | 461 919 | 438 819 | 180 444 | 115 933 | 293 588 |
| Limpopo | 8 040 | 25 022 | 35 073 | 9 622 | 74 830 | 26 773 | 7 045 | 83 572 | 79 233 | 106 305 |
| Mpumalanga | 13 918 | 44 080 | 7 628 | 15 211 | 34 255 | 67 782 | 39 268 | 45 534 | 18 632 | 40 081 |
| Northern Cape | 1 437 | 10 705 | 3 828 | 4 844 | 823 | 9 493 | 3550 | 40 735 | 34 327 | 23 447 |
| North West | 5 502 | 10 896 | 13 246 | 6 422 | 29 539 | 33 274 | 14 450 | 18 912 | 44 479 | 18 538 |
| Wetern Cape | 6 928 | 23 015 | 19 272 | 28 073 | 38 381 | 86 984 | 62 140 | 60 140 | 131 729 | 64 433 |
| **Total** | **265 374** | **468 428** | **498 732** | **984 643** | **1 390 251** | **1 468 094** | **1 952 759** | **1 720 539** | **1 740 924** | **996 169** |

- State Liability Amendment Bill should help provinces to make periodic payments and provide future medical care at state facilities

## FRUITLESS AND WASTEFUL EXPENDITURE SUMMARY

| Department | 2021/22 | | | | | |
|---|---|---|---|---|---|---|
| | Opening Balance | Fruitless and wasteful expenditure – relating to prior year | Fruitless and wasteful expenditure – relating to current year | Less: Amounts Recoverable | Less: Amounts written-off | Closing Balance |
| Eastern Cape | 350 484 | 23 221 | 28 997 | -19 242 | -14 017 | 369 443 |
| Free State | 200 700 | 125 760 | 12 644 | -291 | -181 | 338 632 |
| Gauteng | 483 390 | 239 272 | 73 894 | -484 | -46 263 | 749 809 |
| KwaZulu-Natal | 216 064 | 2 998 | 1 045 | 11 | -5 490 | 214 628 |
| Limpopo | 574 658 | 425 | 2 036 | -80 | -92 202 | 484 837 |
| Mpumalanga | 53 543 | - | 339 | -1 | -10 181 | 43 700 |
| Northern Cape | 159 590 | 7 | 14 608 | - | -74 | 174 131 |
| North West | 183 501 | - | 9 286 | -6 | -2 489 | 190 292 |
| Western Cape | 251 | 63 | 112 | -13 | -301 | 112 |
| **Total** | **2 222 181** | **391 746** | **142 961** | **-20 106** | **-171 198** | **2 565 584** |

# FRUITLESS AND WASTEFUL EXPENDITURE - PROVINCES

**FRUITLESS AND WASTEFUL EXPENDITURE SUMMARY**

| Department | 2021/22 | | | | | |
|---|---|---|---|---|---|---|
| | Opening Balance | Fruitless and wasteful expenditure – relating to prior year | Fruitless and wasteful expenditure – relating to current year | Less: Amounts Recoverable | Less: Amounts written-off | Closing Balance |
| Eastern Cape | 350 484 | 23 221 | 28 997 | -19 242 | -14 017 | 369 443 |
| Free State | 200 700 | 125 760 | 12 644 | -291 | -181 | 338 632 |
| Gauteng | 483 390 | 239 272 | 73 894 | -484 | -46 263 | 749 809 |
| KwaZulu-Natal | 216 064 | 2 998 | 1 045 | 11 | -5 490 | 214 628 |
| Limpopo | 574 658 | 425 | 2 036 | -80 | -92 202 | 484 837 |
| Mpumalanga | 53 543 | - | 339 | -1 | -10 181 | 43 700 |
| Northern Cape | 159 590 | 7 | 14 608 | - | -74 | 174 131 |
| North West | 183 501 | - | 9 286 | -6 | -2 489 | 190 292 |
| Western Cape | 251 | 63 | 112 | -13 | -301 | 112 |
| **Total** | **2 222 181** | **391 746** | **142 961** | **-20 106** | **-171 198** | **2 565 584** |

# INTEREST PAID – FRUITLESS AND WASTEFUL EXPENDITURE

**Accruals and Fruitless and wasteful expenditure: Interest paid (R thousands)**

| Province | Accruals and payables: 2021/22 | | | Interest paid | |
|---|---|---|---|---|---|
| | 30 Days | +30 Days | Total | 2020/21 | 2021/22 |
| Eastern Cape | 2 844 554 | 4 216 456 | 7 061 010 | 56 874 | 6 187 |
| Free State | 678 015 | 396 584 | 1 074 599 | 22 527 | 11 801 |
| Gauteng | 3 249 887 | 4 503 417 | 7 753 304 | 1 714 | 65 472 |
| KwaZulu-Natal | 2 132 715 | 283 609 | 2 416 324 | 1 058 | 2 245 |
| Limpopo | 734 546 | 72 723 | 807 269 | 999 | 207 |
| Mpumalanga | 922 572 | 157 946 | 1 080 518 | 11 | 272 |
| Northern Cape | 318 904 | 1 181 040 | 1 499 944 | 6 906 | 17 057 |
| North West | 970 246 | 925 296 | 1 895 542 | 14 883 | 8 517 |
| Western Cape | 844 544 | 73 044 | 917 588 | 8 | 2 |
| **Total** | **12 695 983** | **11 810 115** | **24 506 098** | **104 980** | **111 760** |

Source: Accruals - pre-audited AFS. Interest paid - Vulindlela

Interest paid on water and electricity; overdue accounts, bank overdraft, arrear salaries

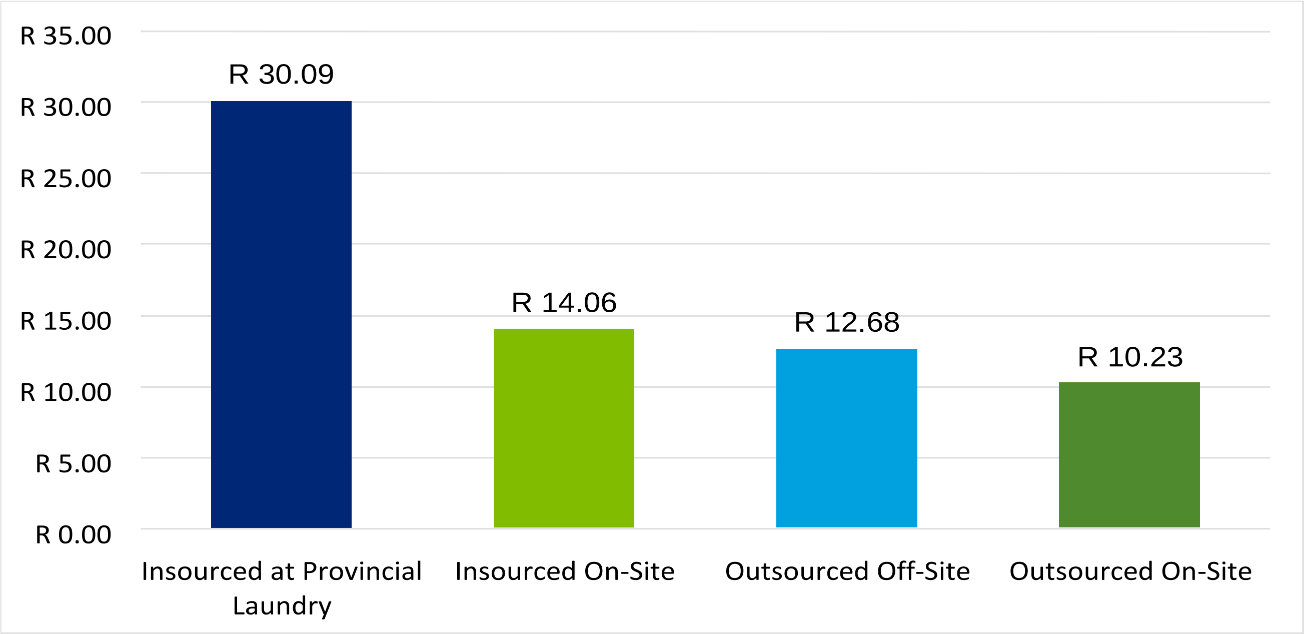
- All payments due to creditors to be settled within 30 days (Treasury Regulation 8.2.3)
- Provincial unpaid invoiced for 2021/22 amounted to R24.5 billion
- R11.8 billion was due for more than 30 days. Accruals are largely not cash backed.
- Provinces paid interest of R105 million in 2020/21 and R111.8 million in 2021/22 due to late payment of invoices.
- This is fruitless and wasteful expenditure.

# COMMUTED OVERTIME

| Level of care | Basic condition work (40*52) | Average (hourly) at 1 times (normal) and 1.3times (overtime) 1 | 1.3 | Overtime (2018/19) | Analysis (overtime/1) | overtime/1.3) | Difference | Cost of need at normal rate | Waste |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | e | f (real need) | g | h | i |
| | a | b | c | d | d/b | d/c | e-f | f*b | h-d |
| **District** | **2 080** | **381** | **495** | **415 698 826** | **2 729 660** | **2 099 739** | **629 922** | **319 768 328** | **95 930 498** |
| *Doctors* | 2 080 | 616 | 801 | 23 831 032 | 38 691 | 29 763 | 8 929 | 18 331 563 | 5 499 469 |
| *Nurses* | 2 080 | 146 | 189 | 391 867 794 | 2 690 969 | 2 069 976 | 620 993 | 301 436 765 | 90 431 029 |
| **Provincial** | **2 080** | **381** | **495** | **278 343 311** | **1 752 185** | **1 347 834** | **404 350** | **214 110 239** | **64 233 072** |
| *Doctors* | 2 080 | 616 | 801 | 30 363 123 | 49 297 | 37 921 | 11 376 | 23 356 248 | 7 006 874 |
| *Nurses* | 2 080 | 146 | 189 | 247 980 188 | 1 702 888 | 1 309 914 | 392 974 | 190 753 991 | 57 226 197 |
| **Central** | **2 080** | **381** | **495** | **333 711 858** | **2 232 675** | **1 717 442** | **515 233** | **256 701 429** | **77 010 429** |
| *Doctors* | 2 080 | 616 | 801 | 11 239 817 | 18 249 | 14 037 | 4 211 | 8 646 013 | 2 593 804 |
| *Nurses* | 2 080 | 146 | 189 | 322 472 041 | 2 214 426 | 1 703 405 | 511 021 | 248 055 417 | 74 416 625 |
| Total sector | 2 080 | 381 | 495 | 1 027 753 995 | 6 714 519 | 5 165 015 | 1 549 504 | 790 579 996 | 237 173 999 |

- The sector spent R237.2 million more than what could have been spent if the capacity was obtained through the appointment of additional staff.
- There is a need to carefully assess the trade-off and decide if is still prudent to continue with the overtime route or capacitate the health facilities.
- The National Department of Health needs to consider the development of norms to guide overtime at facilities level.

# *LAUNDRY*




- Data on laundry costs was collected from 385 hospitals in 9 provinces.
- Emphasis of report was placed on outsourced vs. insourced services and onsite vs. offsite costs

- There are 21 provincial laundries in South Africa, which service 32 per cent of all hospitals nationwide. - expensive model of delivery
- Outsourced on-site model is the most cost-effective, at R 10.23 per item laundered
- Outsourcing, whether off-site or on-site is more cost-effective than insourcing.
- The cost of maintaining overheads and the cost of procuring consumables are for the outsourced contractor’s cost
- Require initial infrastructure investment, but the cost become low in a long run

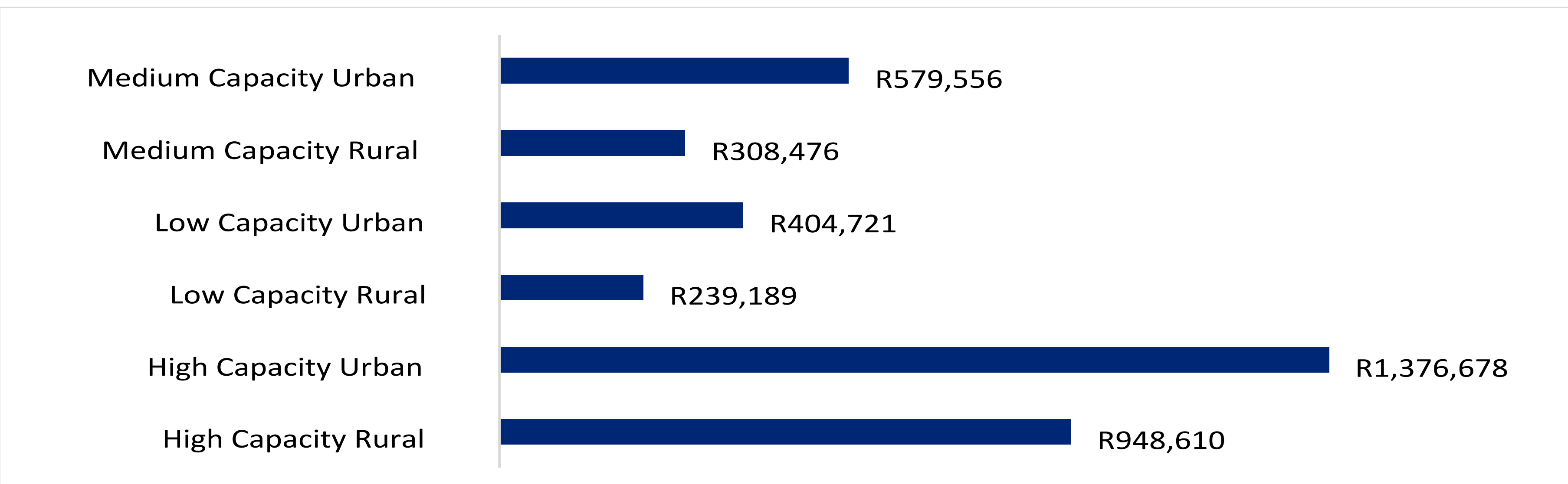
# SECURITY

Total Projected Cost per Bed of Providing Security Services per Cluster and Model of Operation

| Cluster | Insourced | Outsourced |
|---|---|---|
| **High Capacity Rural** | R40 965.72 | R13 262.91 |
| **High Capacity Urban** | R22 949.96 | R16 504.00 |
| **Medium Capacity Rural** | R957.35 | R13 122.39 |
| **Medium Capacity Urban** | R4 882.29 | R19 098.02 |
| **Low Capacity Rural** | R12 787.79 | R14 453.43 |
| **Low Capacity Urban** | R11 839.55 | R14 100.66 |
| **Average** | **R13 380.71** | **R16 202.10** |

- Outsourced security services were found to be cheaper only in large facilities
- This is likely due to the size of the staff complement required at large facilities
- It would be cheaper to outsource for facilities in the high-capacity clusters.

**Security Services: Potential Savings for an Average Hospital in Each Cluster**

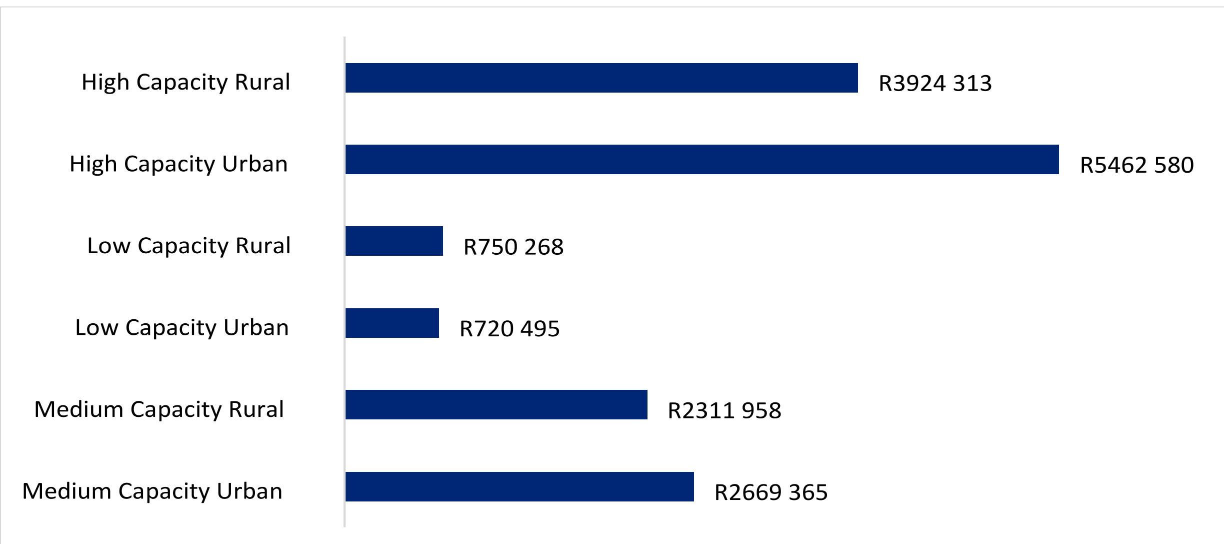


# FOOD

**Total Projected Cost per PDE of Providing Food Services per Cluster and Model of Operation**

| Cluster | Insourced | Outsourced |
|---|---|---|
| High Capacity Rural | R51.93 | R52.72 |
| High Capacity Urban | R62.27 | R58.59 |
| Medium Capacity Rural | R74.39 | R78.01 |
| Medium Capacity Urban | R89.33 | R74.18 |
| Low Capacity Rural | R96.18 | R85.51 |
| Low Capacity Urban | R98.51 | R105.77 |
| **Average** | **R91.64** | **R81.78** |

**Food Services: Potential Savings for an Average Hospital in Each Cluster**




- It is more cost-effective on average to outsource food services in high and medium capacity urban facilities.
- This is likely due to the proximity to catering companies in urban areas and the economies of scale achievable in high and medium-capacity facilities
- Low-capacity urban facilities, which account for just under half of all hospitals, are projected to incur lower costs for insourcing.

# DETERIORATING PROVINCIAL ROAD NETWORK

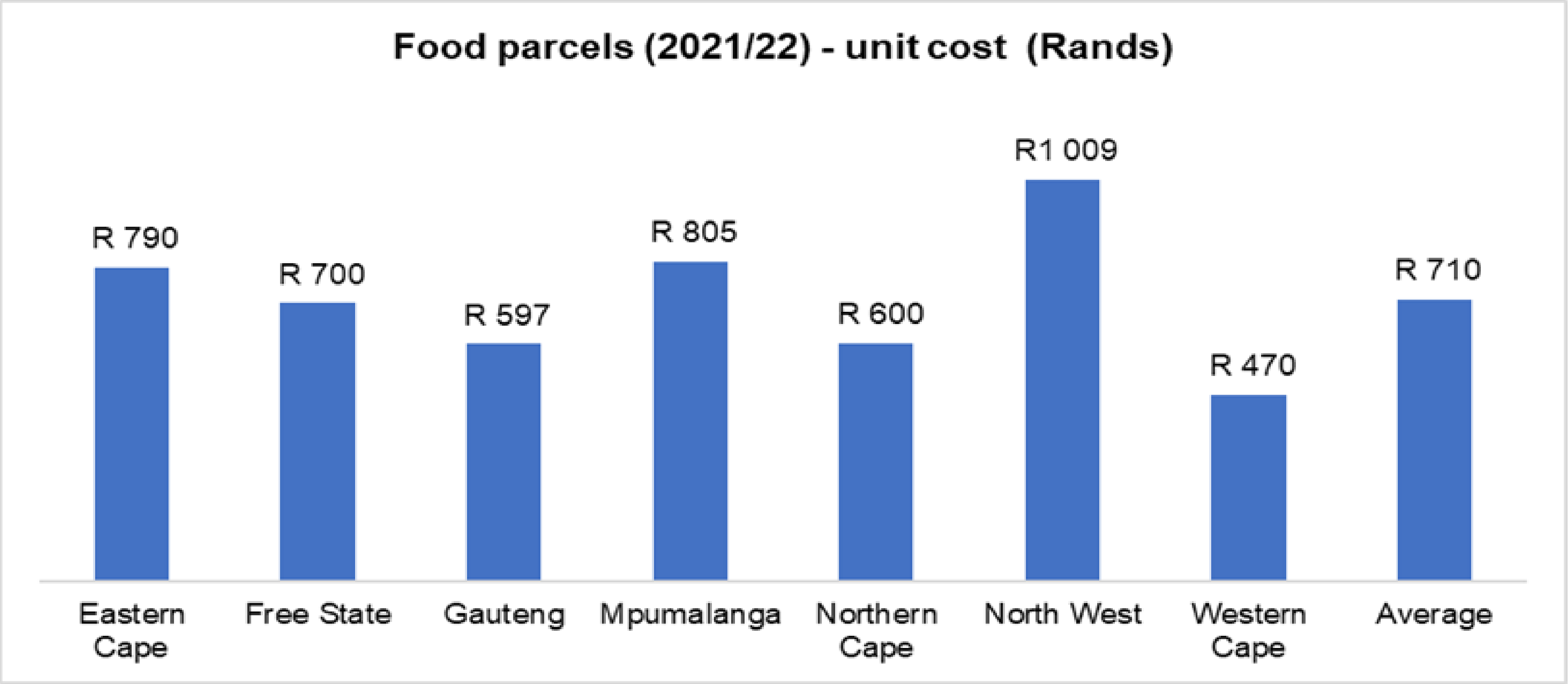
**Provincial roads network, conditions and maintenance backlog**

| Province | *Surfaced (paved)* | Gravel (unpaved) | Total network | Very good | Good | Fair | Poor | Very poor | Maintenance backlog - 2021/22 (R thousands) |
|---|---|---|---|---|---|---|---|---|---|
| Eastern Cape | 3 808 | 36 345 | **40 153** | 0,2% | 21,8% | 36,3% | 35,7% | 6,0% | 30 500 000 |
| Free State | 6 370 | 39 149 | **45 519** | 1,0% | 6,0% | 27,0% | 33,0% | 33,0% | 42 500 000 |
| Gauteng | 4 284 | 1 356 | **5 640** | 30,0% | 26,0% | 34,0% | 9,0% | 1,0% | 9 500 000 |
| KwaZulu-Natal | 8 084 | 23 254 | **31 338** | 14,0% | 16,0% | 34,0% | 29,0% | 7,0% | 69 800 000 |
| Limpopo | 7 583 | 13 473 | **21 056** | 42,1% | 26,8% | 18,0% | 10,6% | 2,5% | 5 700 000 |
| Mpumalanga | 5 453 | 8 373 | **13 826** | 10,0% | 21,0% | 35,0% | 28,0% | 6,0% | 34 000 000 |
| Northern Cape | 4 987 | 23 963 | **28 950** | 22,0% | 32,0% | 32,0% | 13,0% | 1,0% | 14 400 000 |
| North West | 4 929 | 14 550 | **19 479** | 12,0% | 21,2% | 15,6% | 11,5% | 39,6% | 2 400 000 |
| Western Cape | 6 616 | 10 374 | **16 990** | 27,7% | 35,6% | 25,8% | 8,3% | 2,6% | 26 500 000 |
| **Total** | **52 114** | **170 837** | **222 951** | **17,7%** | **22,9%** | **28,7%** | **19,8%** | **11,0%** | **235 300 000** |

*Source: National Department of Transport, Roads Asset Management System, September 2017 & 2021/22*

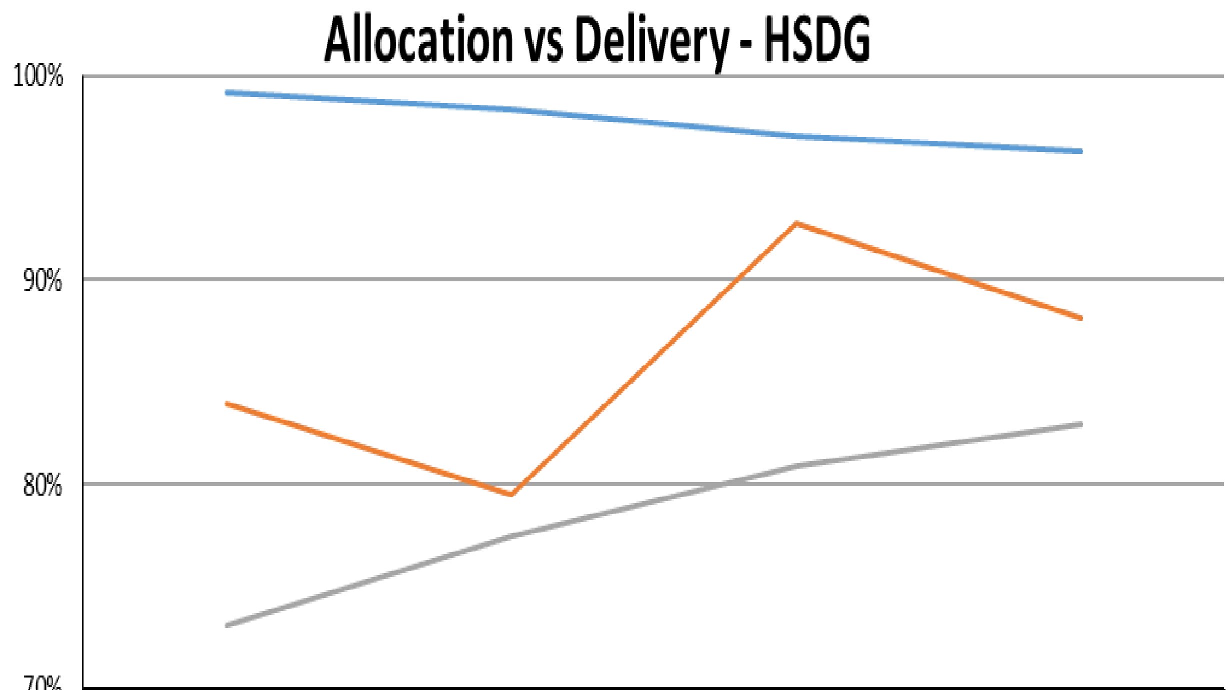
- Provincial road network: 222 951 kilometres (77% gravel and 33% surfaced)
- 31% of the network is in poor to very poor conditions.
- SAICE 2017 report: road condition in most provinces remain precarious/ deteriorating
- Contributing factors: vehicle overloading, poor maintenance and the reduction of skilled personnel in provincial departments.
- R24 billion annual spending on transport infrastructure, but conditions not improving.
- Maintenance backlog: R235.3 billion in 2021 (was R185.9 billion in 2017)
- DoT planning to take over the grant (PRMG) to fix potholes.
- Delaying maintenance increases funding requirements drastically

# FOOD PARCELS UNIT COST




- Food parcel: Average cost R710
- Eastern Cape, Mpumalanga and North West are paying above average
- Cost of food parcel influenced by: Location, contents, and items procured
- Standard items covered: maize meal, rice, sugar, cooking oil, salt, peanut butter, tea bags, baked beans, sunlight soap, soup, vegetables and canned fish
- Provincial Treasuries to investigate high costs.
- Other affordable options include - cooked meals and soup kitchens

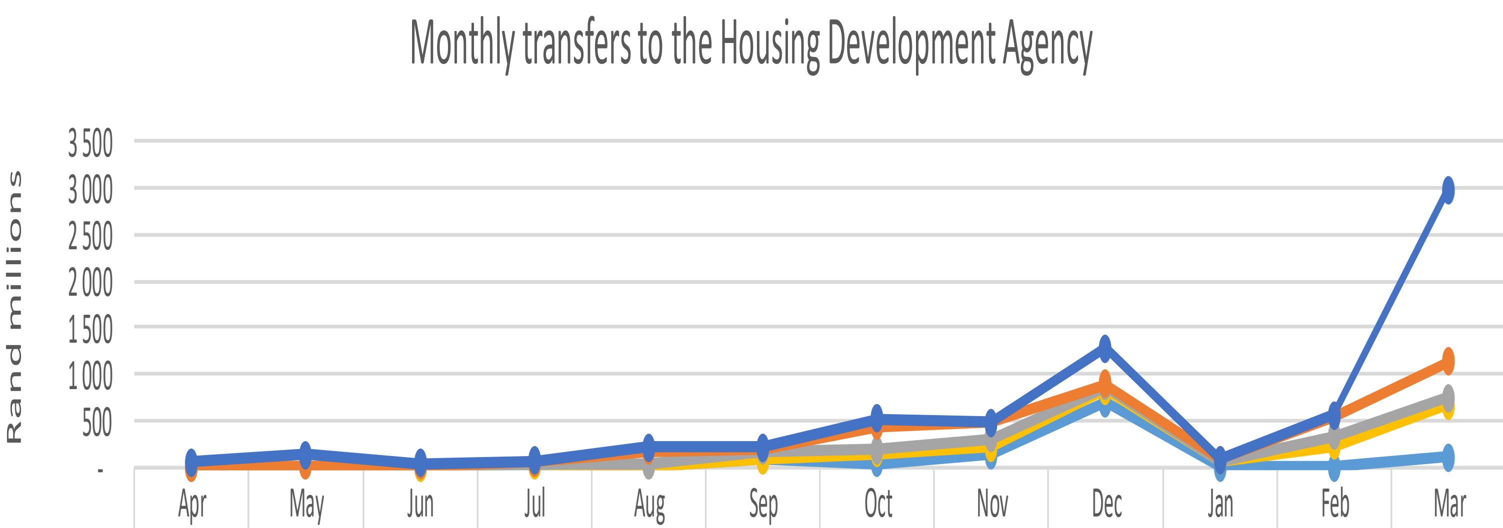
# HUMAN SETTLEMENTS – MISMATCH BETWEEN SPENDING AND DELIVERY




| | 2017-18 | 2018-19 | 2019-20 | 2020-21 |
|---|---|---|---|---|
| Expenditure | 99% | 98% | 97% | 96% |
| Sites | 84% | 80% | 93% | 88% |
| Units | 73% | 77% | 81% | 83% |

- Disparity between spending and the delivery of outputs in the human settlements
- Outputs consistently lower than spending performance
- Average units delivered over four years at 78 per cent
- Inefficiencies in the delivery chain – large transfers to agencies

# HUMAN SETTLEMENTS – TRANSFERS TO ENTITIES TOWARDS END OF YEAR




| | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2017-18 | 51 | 128 | 26 | 15 | 36 | 16 | 73 | 10 | 385 | - | 10 | 1 853 |
| 2018-19 | - | - | 1 | 13 | 150 | 20 | 256 | 163 | 25 | 6 | 214 | 378 |
| 2019-20 | 2 | 1 | 7 | 8 | 17 | 98 | 38 | 105 | 34 | 9 | 107 | 76 |
| 2020-21 | 3 | - | - | 12 | 2 | 0 | 107 | 75 | 143 | 60 | 222 | 561 |
| 2021-22 | - | 8 | - | 18 | 8 | 78 | 41 | 131 | 688 | - | 0 | 110 |

Transfers to the HDA and other agencies classified as spending

Transfers to the HDA follow a clear pattern – spiking in the last quarter

Part of transfers that transfers that remain unspent returned to the NRF

# EXPENDITURE REVIEW ON LEASING OFFICE ACCOMMODATION BY PROVINCIAL DEPARTMENTS, 2018

- Government Technical Advisory Centre (GTAC) in collaboration with National Treasury (IGR) and National Department of Public Works conducted a comparative review on Provincial Office Rental Accommodation in 2018.
- The purpose of the review was to assess potential savings in leasing commercial office accommodation from private land lords by provincial departments.
- About **645 active leases** were analysed, the Provincial Government monthly office rental expenditure was approximately **R151 million per month as at July 2016, this translate to R1.8 billion** spent on renting office accommodation by provincial departments for the 2016/17 financial year.
    - *Sample contained current and expired leases running month to month basis.*
- Assumption was that, **Potential savings** can be realised by reverting leases above market rates reverting to market rate.
- The review revealed that approximately **R48 million** of the **R151 million** monthly rental expenditure above market.
- Therefore, if provincial department were to consider negotiating leases and revert to the market, potential savings could amount to **R576 million per year** when using 2016/17 information.
- The data from the review have been used as baseline to encourage provincial departments to renegotiate lease contracts to align with market rate.

# FISCAL LEAKAGES - 3D PUBLIC ENTITIES

# SUSTAINABILITY OF 3D PUBLIC ENTITIES

| Province | Total number of provincial entities | Number of 3C entities | Number of 3D entities | Number of 3D's still dependant on the fiscus |
|---|---|---|---|---|
| Eastern Cape | 5 | 3 | 2 | 2 |
| Free State | 2 | 1 | 1 | 0 |
| Gauteng | 3 | 3 | 0 | 0 |
| Kwa-Zulu Natal | 10 | 8 | 2 | 2 |
| Limpopo | 3 | 2 | 1 | 1 |
| Mpumalanga | 3 | 1 | 2 | 1 |
| Northern Cape | 4 | 4 | 0 | 0 |
| North West | 4 | 3 | 1 | 1 |
| Western Cape | 3 | 1 | 2 | 2 |
| **Total** | **37** | **26** | **11** | **9** |

- The table above herein reflect 37 provincial entities under the economic development sector, of which 26 are listed as Schedule 3C entities (reliant on the fiscus), while about 11 are Schedule 3D entities (business enterprises).

- 3D entities are expected to be fiscally sustainable, however about 9 of the 11 business enterprises are still dependent on the fiscus to manage their operations.

# PROVINCIAL DEVELOPMENT FINANCE INSTITUTIONS (PDFIS)

| PDFIs R'000 | Loan receivables | | Impairment amount | | Impairment rate | |
|---|---|---|---|---|---|---|
| | 2021/22 – Pre-Audited Numbers | 2020/21 – Audited numbers | 2021/22 – Pre-Audited Numbers | 2020/21 – Audited numbers | 2021/22 – Pre-Audited Numbers | 2020/21 – Audited numbers |
| Eastern Cape Development Corporation (ECDC) | 183 423 | 183 209 | 152 968 | 147 881 | 83.4% | 80.7% |
| Eastern Cape Rural Development Agency (ECRDA) | 143 058 | 139 929 | 130 376 | 122 843 | 91.1% | 87.8% |
| Free State Development Corporation (FDC) | 347 628 | 349 943 | 322 022 | 324 045 | 92.6% | 92.6% |
| Gauteng Enterprise Propeller (GEP) | 86 428 | 79 080 | 41 773 | 49 416 | 48.3% | 62.5% |
| Ithala Development Finance Corporation (IDFC) | 2 826 319 | 2 881 126 | 433 863 | 447 995 | 15.4% | 15.5% |
| Limpopo Economic Development Agency (LEDA) | 630 017 | 838 042 | - | 141 528 | - | 16.9% |
| Mpumalanga Economic Growth Agency (MEGA) | 177 697 | 181 000 | 139 518 | 135 970 | 78.5% | 75.1% |
| North West Development Corporation (NWDC) | 104 074 | 96 144 | 88 438 | 83 637 | 85.0% | 87.0% |
| **Total** | **4 498 644** | **4 748 473** | **1 308 958** | **1 453 315** | **29.1%** | **30.6%** |

- By the end of 2021/22, PDFIs had total loan book (loans issued) of R4 499 million, a slight decrease of 5.3% from R4 748 million in 2020/21.
- IDFC has the largest loan book of the PDFIs, accounting for approximately 62.8% of the total loans issued by PDFIs but can still manage to curb the impairment rate at lowest (15 per cent) in these both years.
- The overall impairment rate is standing at 29.1% in 2021/22. The impairment rate shows slight improvement between these financial years.
- FDC reported the highest impairment rate, and the increases on impairment rate are observed in ECDC, ECRDA and MEGA.
- LEDA didn't report on any impairment loss on their loan receivables in the 2021/22 financial year, though reported 16.9% in the prior year.

# LOCAL GOVERNMENT FISCAL LEAKAGES

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

STAY HOME
SAVE SOUTH AFRICA

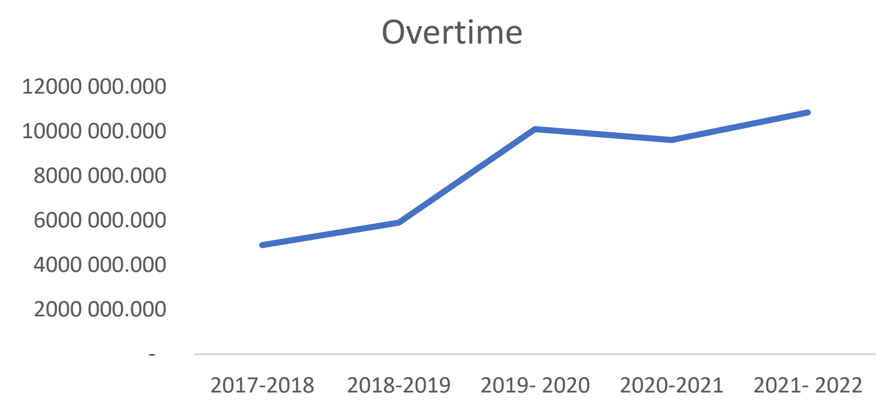
# SIGNIFICANT FISCAL LEAKAGES - LG

- On 30 June 2020, 50 per cent of municipalities showed indications of severe financial strain – this situation since worsened.
- The most significant is the **dismal recovery of property rates and service charges,** with the major contributors thereto being**:**
  - A consumer culture to not pay.
  - A municipal political leadership culture that does not enforce credit control and debt collection.
  - The paying public deteriorated in the face of substandard/ absence of reliable municipal services, deteriorating public roads, and perceptions of public money waste, etc.

**In conjunction with other challenges, this culminated in municipalities owing Waterboards more than R11 billion and Eskom R45 billion as at 31 March 2022**

# CRITICAL INEFFICIENCIES IN SERVICE DELIVERY

- Municipalities that are ***not able to accurately measure*** consumer and their own ***consumption*** of services in large areas across the country.
- An ***unlimited supply*** of municipal services to indigent households.
- Spending on ***bloated non-core organisational structures*** with disproportionate numbers of non-core (support as opposed to frontline) staff.
- ***Revenue forgone*** - several properties in municipalities are not billed resulting in significant revenue forgone.
- High water and electricity losses above the expected norms translate into a significant drain of municipalities' cash generating ability i.e. 36 per cent water losses (2019/20) at an estimated cost of R6.56 billion to the local economy
- R10 million ***overtime*** (2019/20)
  - too few technical staff coupled with a culture to increase salaries by delaying critical technical work to after hours



# CRITICAL INEFFICIENCIES IN SERVICE DELIVERY (2)

- ***Fraud, theft, etc. –*** More municipalities are being investigated by the SIU, 2019/20 municipalities spent R1.2 billion on legal wees and R26.5 million to undertake 160 forensic investigations.
- Massive ***indirect fiscal drains*** –
  - LG ***revenue generating assets are grossly under maintained*** – LG only undertook 3.4 per cent (R15.9 billion) repairs and maintenance vs. a budget of R26.3 billion.
  - Over the past 5 audited financial years, approximately R21 billion local government ***direct conditional grants*** have been returned to the national fiscus as ***"unspent"***
  - Most of the 43 municipalities in crisis are ***not generating adequate funding from their operations*** to sustain the municipality.
  - ***Tariffs do not recover cost*** to provide services + do not know what services cost.
  - ***Ineffective and correct budgeting + cashflow management***.
  - ***Organs of state year-on-year*** not paying and ***owing LG more***.
  - ***Inappropriate implementation*** of the supply chain management process, management of contracts, performance of service providers and lack of value obtained from public spending.
  - ***Unauthorised, irregular, fruitless-and wasteful expenditure (UIFW): consolidated R216 billion*** ***(2020/21, AG Report)***

Integrated, all these challenges contribute to the increasing cost to provide FBS beyond what is affordable to most consumers – universal access progressively remains out of reach as a result.

# CRITICAL INEFFICIENCIES IN SERVICE DELIVERY (3)

The cost municipalities incur to provide FBS is consistently significantly lower than the LGES - FBS subsidy:

| | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 |
|---|---|---|---|---|---|---|
| | LGES FBS subsidies | | | | | |
| Water | 11 838 535 157 | 13 369 415 794 | 14 761 228 573 | 16 362 142 168 | 18 010 545 838 | 19 055 277 013 |
| Sanitation | 9 402 933 726 | 10 364 206 283 | 11 269 052 262 | 12 292 246 063 | 13 290 324 084 | 13 616 322 297 |
| Eletricity | 7 829 630 088 | 8 725 347 868 | 9 603 894 745 | 10 612 123 113 | 11 645 119 423 | 12 214 863 798 |
| Refuse | 7 882 313 397 | 8 688 131 217 | 9 446 647 633 | 10 304 372 939 | 11 141 044 129 | 11 414 322 678 |
| FBS costs incurred by municipallities | | | | | | |
| Water | 2 849 008 162 | 3 487 236 804 | 3 325 512 184 | 4 285 354 413 | 4 649 272 301 | 4 318 676 650 |
| Sanitation | 1 348 970 539 | 1 683 944 672 | 1 746 298 993 | 1 960 627 872 | 2 068 883 929 | 2 286 897 730 |
| Eletricity | 4 806 929 897 | 3 706 762 832 | 3 886 106 127 | 5 568 103 596 | 4 563 528 585 | 6 110 624 116 |
| Refuse | 1 174 858 609 | 1 361 644 044 | 1 351 536 787 | 2 281 818 692 | 1 745 276 090 | 2 254 777 594 |
| | FBS costs incurred as % of LGES subsidies | | | | | |
| Water | 24% | 26% | 23% | 26% | 26% | 23% |
| Sanitation | 14% | 16% | 15% | 16% | 16% | 17% |
| Eletricity | 61% | 42% | 40% | 52% | 39% | 50% |
| Refuse | 15% | 16% | 14% | 22% | 16% | 20% |

# CRITICAL INEFFICIENCIES IN SERVICE DELIVERY (4)

- The poor targeting of indigents for FBS (municipal discretions to set indigency levels) means many households cannot afford their municipal bills:

| | 2017/18 | | | 2018/19 | | | 2019/20 | | | 2020/21 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Poor households funded from the LGES '000 | Households receiving FBS '000 | No. of households receiving FBS as a % of LGES funded poor HH | Poor households funded from the LGES '000 | Households receiving FBS '000 | No. of households receiving FBS as a % of LGES funded poor HH | Poor households funded from the LGES '000 | Households receiving FBS '000 | No. of households receiving FBS as a % of LGES funded poor HH | Poor households funded from the LGES '000 | Households receiving FBS '000 | No. of households receiving FBS as a % of LGES funded poor HH |
| Water | 9 544 | 4 750 | 50% | 9 806 | 4 066 | 41% | 10 110 | 3 438 | 34% | 10 361 | 3 378 | 33% |
| Electricity | 9 544 | 2 563 | 27% | 9 806 | 2 180 | 22% | 10 110 | 2 368 | 23% | 10 361 | 2 374 | 23% |
| Sanitation | 9 544 | 3 590 | 38% | 9 806 | 2 978 | 30% | 10 110 | 2 880 | 28% | 10 361 | 2 816 | 27% |
| Refuse | 9 544 | 2 770 | 29% | 9 806 | 2 598 | 26% | 10 110 | 2 790 | 28% | 10 361 | 2 734 | 26% |

Comparing the cost municipalities incur on FBS vs. the number of poor households actually receiving LGES: FBS indicates that LGES: FBS funds are lost/ diverted and ***funds meant to support core functions and provide FBS to the poor are diverted in municipalities and not used for purpose.***

# MITIGATING FISCAL LEAKAGES (1)

| | |
|---|---|
| Multi-disciplinary integration of support | • Multi-disciplinary Revenue Committee (M*d*RC) as an organs of state consultation platform drive integrated solutions for municipalities' non-payment of bulk suppliers. |
| Tariffs | •DCoG: Water and electricity cost of supply studies in selected municipalities.<br>•City Support Programme: similar cost of supply studies + analysis of the pricing framework and related capacity building.<br>•NT: Socio-economic profiling of all 257 municipalities.<br>•NT: Economic- and Financial Viability Studies in 4 provinces<br>•*m*SCOA Regulations, a Costing Segment that facilitates improved costing of municipal services<br>•NT: issued a tariff setting methodology |

# MITIGATING FISCAL LEAKAGES (2)

Revenue Collection

- **Tools to assess whether budgets of municipalities are funded** (assisting creditor payment):
- Tariff setting methodology and tool (mentioned above) (2019); and
- Property rates to billing system reconciliation tool (2020).
- NT: OCPO/ DMRE/ DTI: exploring a **SMART transversal solution**
- A coordinated resolution is underway to **correct the ownership of 80 000 government properties** preventing numerous organs of state to pay the respective municipalities.
- DCoG facilitated a ***'Pay for Services Used'- campaign*** in 20 municipalities (2021) to change the consumer culture.
- MdRC **research into the impact of the consumer debt write-off** to explore a similar government approach to the current huge arrears owed to municipalities; etc.

# MITIGATING FISCAL LEAKAGES (3)

| | |
|---|---|
| Active Partnering Support to municipalities in crisis | • Further work needed for a national position on the concept of Active Partnering for electricity |
| Deep Dive Assessment of Water Services Business | • Multi-stakeholder assessments to be undertaken in the 9 top bulk water defaulter-municipalities to diagnose the root causes preventing sustainability and identify solutions. |
| Dispute Mediation/ Facilitation | • Strengthening the respective annual legislation to facilitate personal liability for the institution of unnecessary litigation without attempting the available dispute resolution mechanisms.<br>• NT strengthening its own capacity to facilitate the resolution of MFMA s.44 envisaged disputes.<br>• DCoG panel of facilitators to fast track the resolve of any payment disputes between municipalities, bulk suppliers, and NERSA. |

# MITIGATING FISCAL LEAKAGES (4)

## Mandatory and Discretionary Interventions

- Premiers need to intervene in the 43 municipalities that are in crisis beyond normal day-to-day support.

## Procurement and UIFW expenditure related support & reforms

- Advancing ethical behaviour and good governance in public finance management
- Regulations, guidelines, and Circular(s) parallel with tools and training.
- Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings in 2014 – accountability for financial misconduct.
- Consequence Management and Accountability (CMA) Framework for local government.
- Roll-out of automated, electronic, and web-enabled audit action plans and a financial management capability maturity model.
- Municipal Public Account Committee (MPAC) Guide and Toolkit, and training.
- Roll-out of a web-based monitoring and evaluation tool to assist municipalities comply with the MFMA.

# IN CONCLUSION

- The inability of local government to collect revenue is the most significant fiscal leakage facing the sphere - this is a complex national challenge with various contributors.
- Leakages in the provision of FBS and in the conditional grant system are disturbing – this undermines government's policy objectives of supporting the poor and eliminating the backlog towards achieving universal coverage that is affordable.
- There are significant indirect fiscal leakages in the form of revenue forgone and inability to grow the municipal revenue base due to inadequate repairs and maintenance of the critical related assets underpinning municipal services.
- A culture shift in accountability is needed to address the high levels of UIFW and implementation of consequence management - both political and administrative leadership must set the tone, including respect for laws and regulations and key role players performing their oversight.
- The various work underway will address these fiscal leakages over the medium to long term. Many of these initiatives require legislative changes and unfortunately there is no tangible immediate or short-term results at this point.
- It is urgently necessary to universally restore normal credit control measures by strengthening the integration of systems across government to facilitate and enforce payment for government's services.

# MEASURES TO CURB FISCAL LEAKAGES PROCUREMENT

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

STAY HOME
SAVE SOUTH AFRICA

# WHAT CAUSED THE PROBLEMS?

SOUTH AFRICAN ECONOMIC RECONSTRUCTION AND RECOVERY
BUILDING A NEW ECONOMY

The South African public procurement system is complex. It is operated by over a thousand organs of state that delegate to tens of thousands of divisions, field offices, schools, hospitals, and so on, with hundreds of thousands of registered suppliers entering into over two million transactions annually. The causes of its problems can, however, be reduced to the following five broad areas:

1. **Increased corruption levels and lack of enforcement**.
2. **A lack of capacity** at both regulatory and operational levels. Lack of sufficiently skilled public procurement personnel employed within poorly designed organisational structures.
3. **Complicated, fragmented, and inconsistent legal prescripts** that results in operational inefficiency, non-compliance and confusion in the application thereof.
4. **Inflexible, incoherent and rigid prescripts** that hamper development and service delivery.
5. **An overburdened procurement system** that causes a mismatch between applying the rules of procurement law and achieving government's commitment to **social and developmental objectives**.

# MEASURES IN PLACE TO CURB FISCAL LEAKAGES

- **Implementation of a single procurement framework & authority-** Implementation of the Public Procurement Bill
- **Implementation of strategic sourcing** as an enabler in this process is critical and it is instrumental to success of institutions. Through the strategic sourcing costs are managed, leakages and wastages are prevented, continuity, and quality so that the institution can focus on the core competencies of their service delivery mandate.
- **Stakeholder support** –support to institution on Audit Outcomes (Major themes National/Provincial and Local) .
- **Acceleration of digital transformation-** standardization of systems.
- **Transparency-** Modernization of procurement processes- publication and maintenance of government spend through reporting dashboard for the covid-19 expenditure,tender opportunities, awards, cancellation, procurement plans and contract registers.
- **Transversal contracting**

# TRANSVERSAL CONTRACTING

## BENEFITS OF TRANSVERSAL CONTRACTING

- **Standardisation or consolidation of state requirements**
  - Common products
  - Similar specifications and pricing

- **Benefit from Economies of scale**
  - High Volumes

- **Reduce duplication of procurement efforts**
  - Single centre of procurement

# TRANSVERSAL CONTRACTING- CONTRACTS / COMMODITIES

| Agriculture, Textiles and professional services<br>10 Contracts | ICT and Security Services<br>12 Contracts | Education Sector<br>6 Contracts | Medical and Pharmaceuticals<br>20 Contracts | Fleet Management<br>11 Contracts |
|---|---|---|---|---|
| • RT10- Veterinary Remedies<br>• RT- Animal Feed<br>• RT12 Agricultural remedies<br>• RT14 Toilet paper and paper towels<br>• RT26 Blankets and household textiles<br>• RT27 Provision of debt Collection<br>• RT28 Sterilization related items<br>• RT59 Footwear<br>• RT60 Fabric<br>• RT64 Clothing | • RT2 Medical equipment<br>• RT3 Office automation solutions<br>• RT13 Respiratory aids<br>• RT24 Hospital furniture<br>• RT31 Administration accessories<br>• RT40 Crutches and walking aids<br>• RT54 Mental Health Equipment<br>• RT55 Therapeutic Rehabilitation Equipment | • RT5 Courier services<br>• RT6M learning material and apparatus for mathematics<br>• RT7 LTSM: Distribution of School Textbooks<br>• RT8 Transportation of cargo<br>• RT17 LTSM: Distribution of School Stationery | • RT4 Ambulance rescue<br>• RT35 Medical male circumcision (MMC)<br>• RT41 Rapid HIV test kits<br>• RT50 Medical & industrial gases<br>• RT75 Condoms and lubrication<br>• RT76 Surgical and exam gloves<br>• RT252 Surgical instruments<br>• RT284 Hypodermic syringes<br>• 8 RT287 Dental Instruments | • RT23 Lubricating oil<br>• RT46 Fleet Vehicle maintenance (Pool)<br>• RT51 LPG Gases<br>• RT58 Insurance for subsidized vehicles<br>• RT62 Subsidized vehicle fleet<br>• RT68 Financing of subsidized vehicles<br>• RT69 Tyres and tubes<br>• RT57 Vehicles<br>• RT70 Petrol and diesel<br>• RT61 Rental of aircraft and helicopters |

# STRATEGIC PROCUREMENT

Strategic procurement is a differentiated approach to procurement aimed at leveraging sourcing benefits for all parties involved; it includes proper planning, research, consultation and finally the development of a sourcing strategy which can either be a tender, policy directive, commodity guidelines etc.

- ✓Collaborative approach with all stakeholders in the procurement chain to develop the best suitable strategy for a particular commodity (i.e. the establishment of governance structures such as **Project Team, Steering Committee and Cross Functional Sourcing Team**.

- ✓In a strategic sourcing process, the role of the **end-users** (for correct need identification) and that of the **suppliers/ industry** (to ensure that the identified need is not biased towards certain suppliers, there's availability of the product and market response readiness) are extremely important.

# DIFFERENTIATED APPROACH TO PROCUREMENT COMMODITY POSITIONING

To identify **smarter ways of procuring** commodities and services that are **relevant** to the client base and in line with industry dynamics. This is done through a **differentiated approach** to procurement where different sourcing approaches are employed for different commodities and services.

High

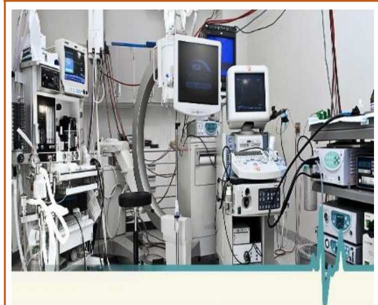
Business & TCO impact

Low

### LEVERAGE (Food and Cleaning)

**Focus on Short Term Relationship:** Use competitive tendering to reduce cost and consolidate volume

### STRATEGIC (Med Equip)



**Focus on Long Term Relationship:** Ensure availability of supply, focus on relationship building, process integration and innovation

### ROUTINE (Surgical Sundries)

**Focus on Short Term Quick Wins: Simplify** and streamline purchasing process, reduce number of suppliers and simplify ordering

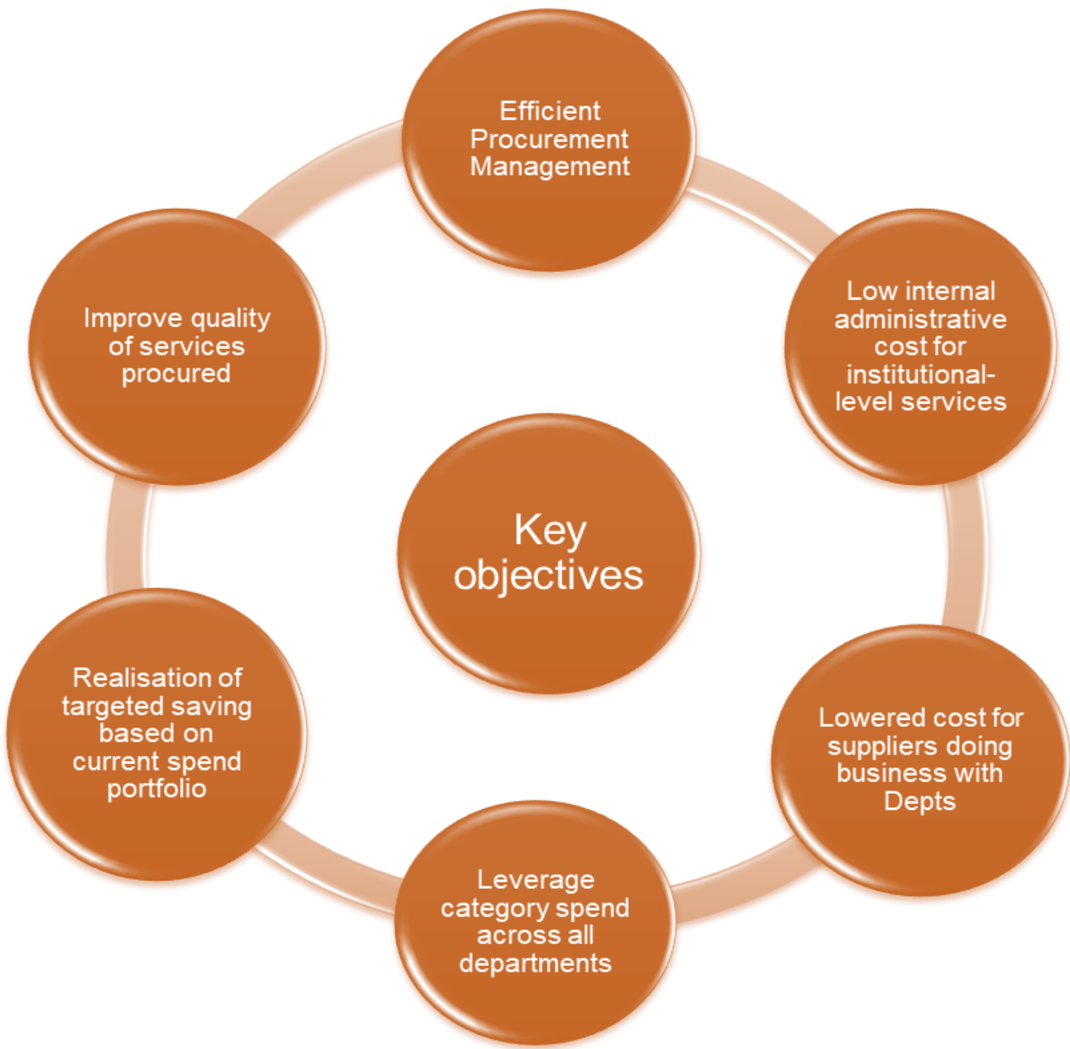
### BOTTLENECK (Med Gas)

**Focus on Long Term Security of Supply:** Search for alternatives, seek new suppliers, reduce dependency on current supplier

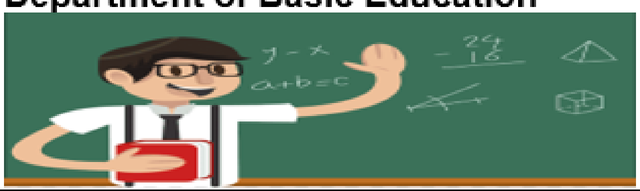
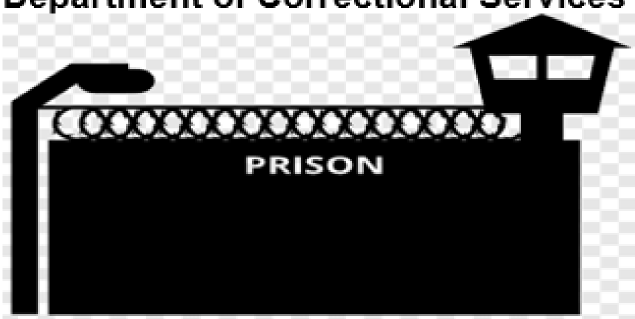
Low — High

Supply Market Complexity

# STRATEGIC PROCUREMENT OBJECTIVES



# PREVIOUS STRATEGIC PROCUREMENT INITIATIVES

| | |
|---|---|
| **Department of Health, Correctional Services and South African Military Health Services**   | ✓ Hospital Linen and Laundry<br>✓ Hospital Patient Food Services<br>✓ Hospital Waste Management<br>✓ Hospital Cleaning Services<br>✓ Expanded Programme on Immunisation Vaccines<br>✓ Electro Medical Equipment – RT2<br>✓ Mental Health Equipment – RT54<br>✓ Rehabilitation Equipment – RT55<br>✓ Dental Equipment- RT286<br>✓ Picture Archiving & Communication System (PACS) |
| **Department of Basic Education**  | eEducation Procurement Delivery Management Guide |
| **Department of Correctional Services**   | Prison Catering Services |

# PROCUREMENT AUTOMATION INITIATIVES

## *Central Supplier Database (CSD)*

- The establishment and implementation of the central supplier database (CSD) enables service providers to register once off on a supplier portal. It automatically performs all compliance checks required by SCM regulations (tax compliance status, bank account verifications, directorships, state employee checks, etc). The CSD simplifies doing business with government. It is an enabler for further automation and simplification of procurement processes. It enables organs of state to find suppliers and issue Requests for quotations directly from the platform and manages supplier restrictions.
- Institutions should utilize available tool for managing Requests for Quotations and improving competition which will drive down costs
- Employees of the state doing business with the .state

# PROCUREMENT AUTOMATION INITIATIVES

***E-Tender platform***

- Portal that is used for submission of procurement plans, procurement opportunities, tender awards, cancellations, deviations, and contracts reporting – FREE OF CHARGE.
- Transparency in tender awards, cancellations, reporting on deviations – this enables better oversight and accountability.
- Online tender submissions will be introduced to enable recording and oversight of tendering processes.

***Procurement Data***

- Reporting on procurement data to be made mandatory to enable compliance monitoring and available procurement data is made available to procuring entities
- Data to be used in when doing procurement planning and decision making (what was bought, prices, by location, suppler type, etc).

# FISCAL LEAKAGES AND MEASURES TAKEN BY NT

Briefing to NCOP

PRESENTED BY: NT

**Date: 30 August 2022**

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

STAY SAFE
VACCINATE TO SAVE SOUTH AFRICA