

IMPLICATIONS OF FISCAL LEAKAGES ON PROVINCIAL ECONOMY AND SERVICE DELIVERY IN THE FREE STATE PROVINCE

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Presentation Outline

- ❑ Synoptic Overview of Fiscal Leakage
- ❑ Notable sources of Fiscal Leakages in the Free State Province:
 - ✓ Expenditure perspective
 - ✓ Revenue perspective
- ❑ Some Implications (or costs) of Fiscal Leakage
- ❑ Remedial Strategies: *Fixing extant leakages*
- ❑ Conclusion



Synoptic overview of Fiscal Leakage

- ❑ Based on the widely accepted Keynesian model on the circular flow of income and expenditure in a domestic economy, the **non-consumption income such as savings, taxes and imports are viewed as leakages.**
- ❑ From a fiscal viewpoint, leakages can be attributed to the diversion of generated revenue and/or earmarked funds to finance, for example,
 - ✓ Unplanned budgetary allocations,
 - ✓ Unexpected financial obligations (e.g., natural disasters),
 - ✓ Project cost overruns,
 - ✓ Maintenance of '*white elephant projects*', incomplete projects
 - ✓ Litigation costs, and
 - ✓ Medical malpractice claims against public health officials etc.
 - ✓ Maintenance of dilapidated mines & closure of illegal mines

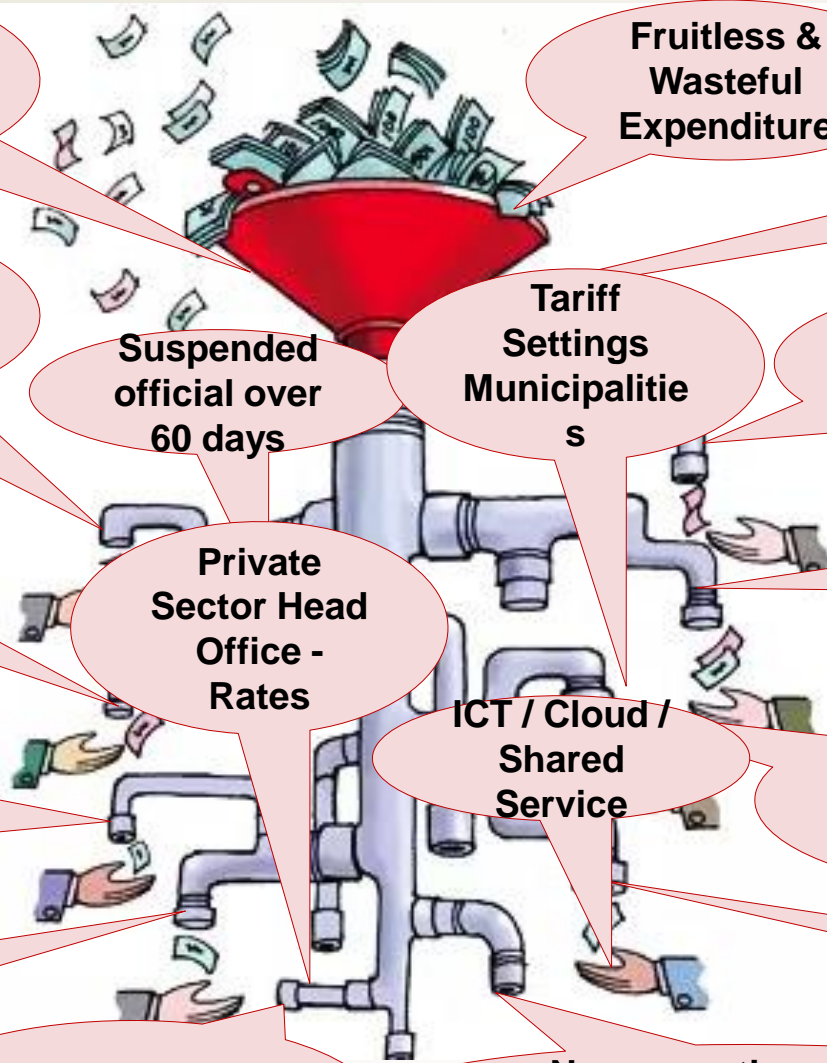


Notable sources of Fiscal Leakages in the Free State Province...



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Outstanding hospital patient fees

Fruitless & Wasteful Expenditure

Irregular Expenditure

Unpaid Traffic fines & Motor Vehicle licenses

Suspended official over 60 days

Tariff Settings Municipalities

Rising salaries for suspended employees over long period

High Infrastructure project cost overrun

Private Sector Head Office - Rates

Growing Contingent Liabilities

Delayed completion of infrastructure projects

ICT / Cloud / Shared Service

Medico-legal claims (incr. interest payment)

Property Leases

Litigations

Road Accident Funds

Non-operational SEZs (No tax incentives)



Sources of Fiscal Leakages: Expenditure (1)

Fig.1: Fruitless & Wasteful Expenditure

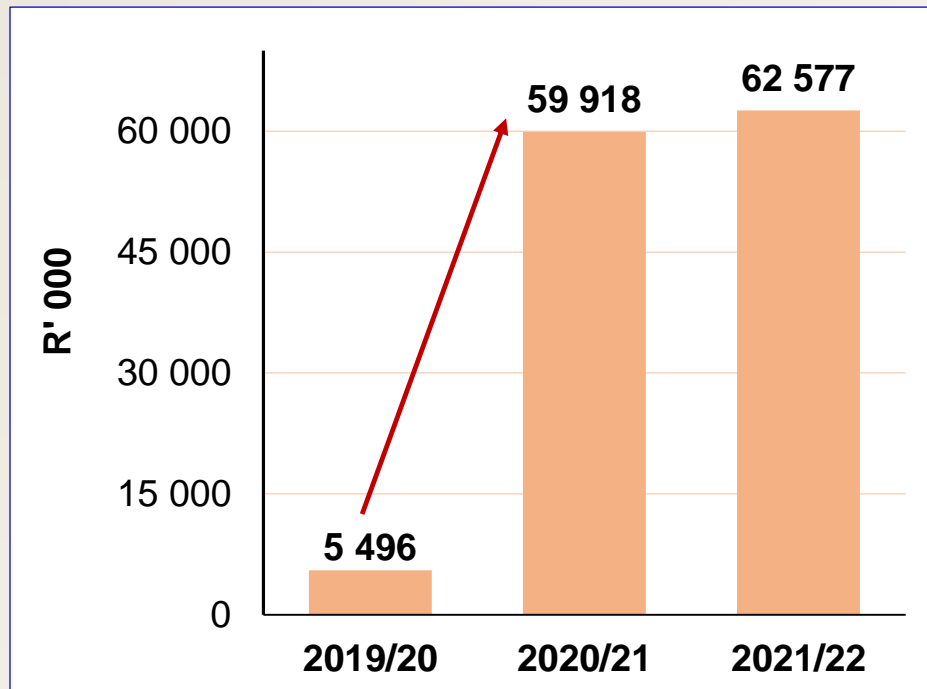
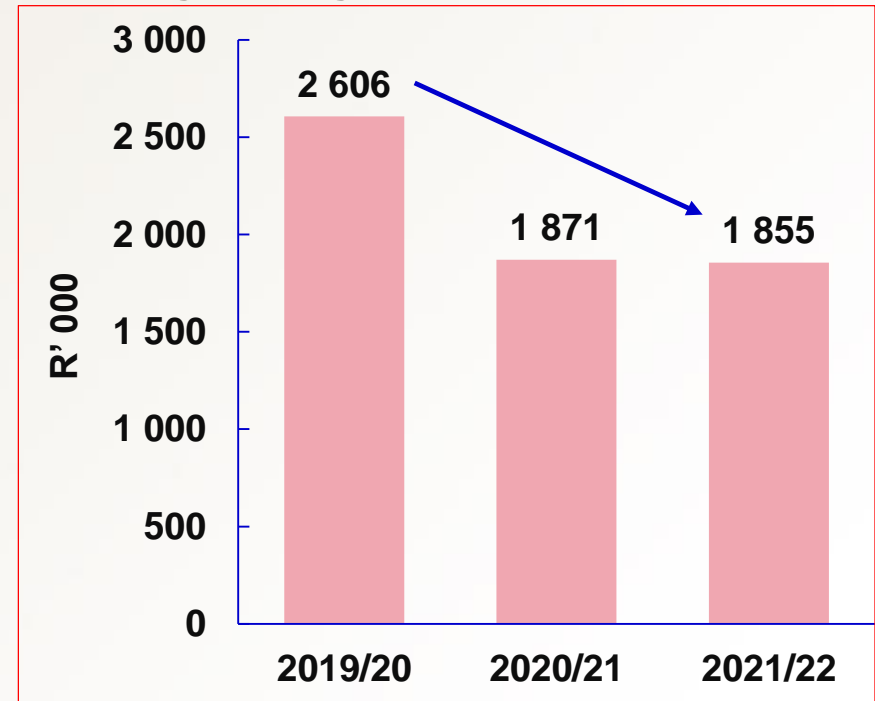


Fig.2: Irregular Expenditure



- **Significant growth in fruitless & wasteful (F&W) expenditure** from R5.49 million in 2019/20 FY to 62.57 million in 2021/22FY. **But, F&W only grew by 4.4% between 2020/21 and 2021/22.**
- Although a source of fiscal leakage, there is a **notable decline in irregular expenditure** from 2.60 million in 2019/20FY to 1.85 million in 2021/22FY, **reflecting a decline of 28.8%!**



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Sources Fiscal Leakages: Expenditure (2)

Fig.3: Litigation—Interest payment on ENGO cases

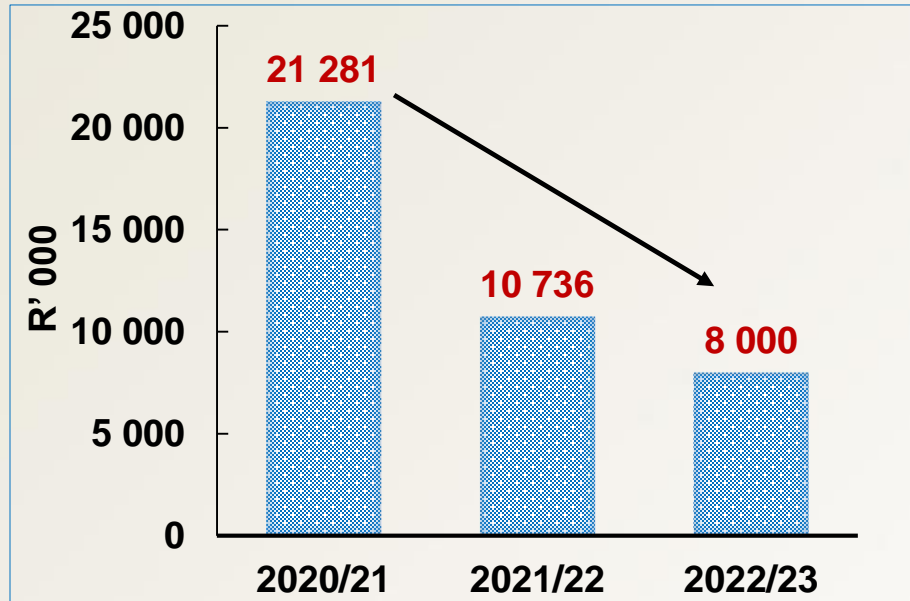
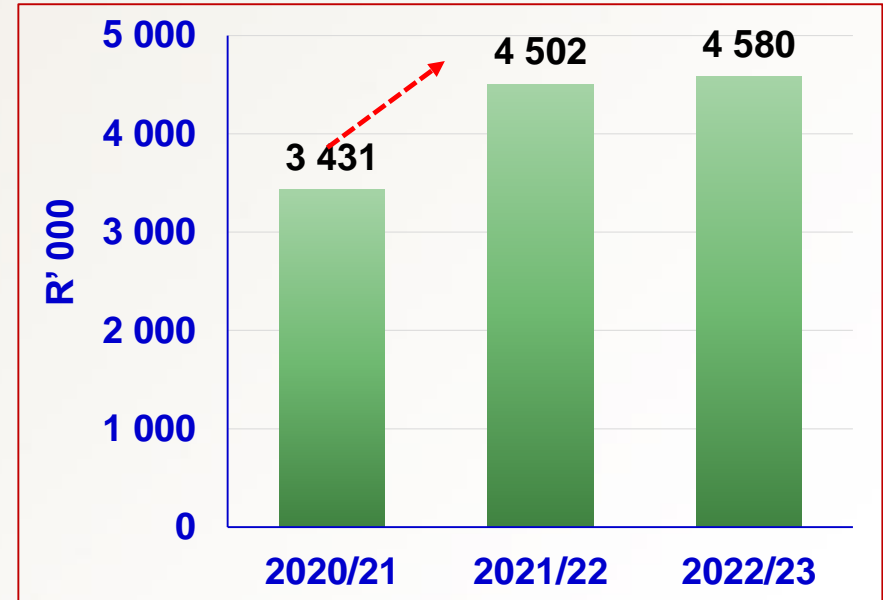


Fig.4: Medico-legal Claims (Health)



- FSPG has proactively mitigated the fiscal leakages from litigation costs, by halving the interest payment on ENGO cases to 10.73 million in 2021/22FY, with a further reduction to R8 million projected for 2022/23FY to produce a 62.4% cut on 3-yr growth rate basis!
- A steady rise in Medico-legal claims, with expected increase from 3.43 million in 2020/21 to 4.58 million in 2022/23, reflecting a 33.5% growth based on 3-yr growth rate analysis.



Sources of Fiscal Leakages: Expenditure

(3)

Fig.5: Contingent Liabilities (incl. medico-legal)

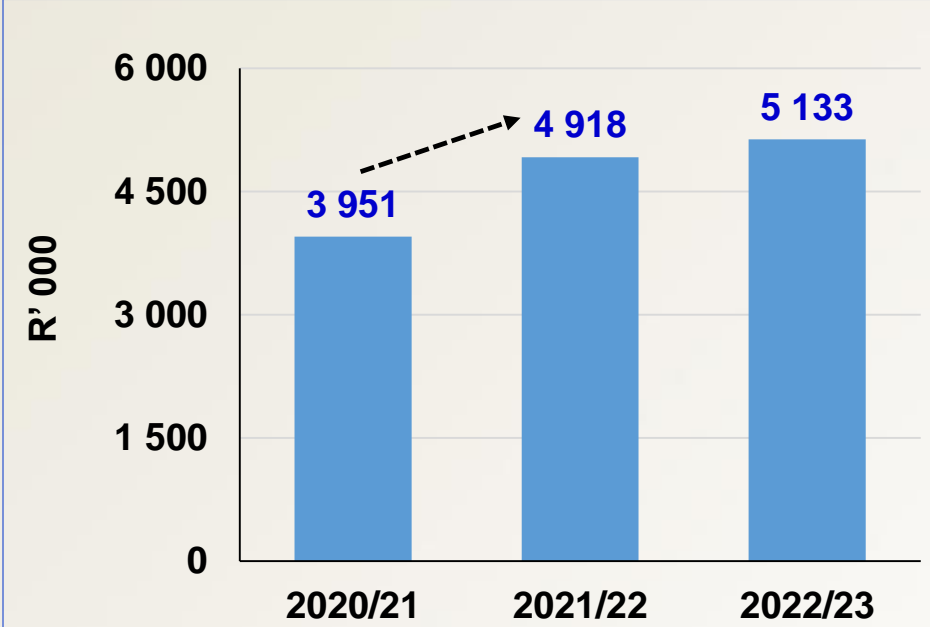
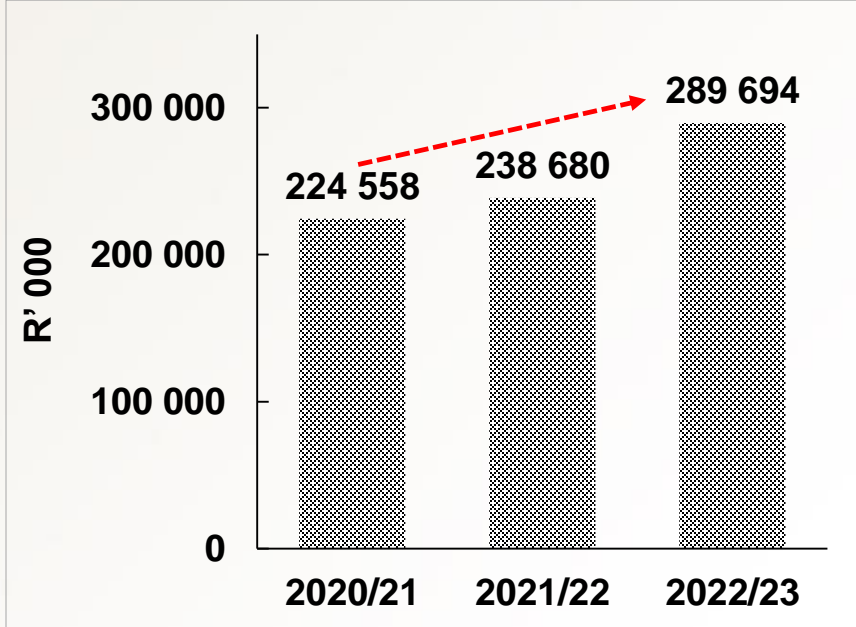


Fig.6: Property Lease (Infrastructure)



- **Contingent liabilities** would have grown by 29.9% at the end of 2022/23FY, as a cost of R5.13 billion is projected, compared to 3.95 billion spent in 2020/21.
- A continued rise in spending on **property lease** (--savings that could be directed to government own building), which **grew by 21.3% (y-o-y growth rate)** from 224.5 billion in 2020/21 to R238.6 billion in 2021/23.



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Fiscal Leakages: Variation Orders, cost overruns & escalation (Infrastructure)

Department	No of Projects with Variation Orders	Total Project Cost R' 000	Total Variation Order R' 000	Escalation (%)
Education	10	290 473	16 012	5.51
Agriculture & Rural Development	1	4 560	907	19.89
Police, Roads & Transport *	15	2 283 399	162 414	7.11
Sport, Arts, Culture & Recreation **	5	108 306	37 646	34.75
Public Works & Infrastructure	1	11 928	2 415	20.25
Human Settlement ***	8	239 716	27 134	11.31

Note: *, **, *** denote financial figures for 2022:Q3, 2022:Q2, 2021:Q4 respectively

- Fiscal leakages emanate from delayed completion of infrastructure projects, which causes high-cost overruns, escalation costs, pervasive project backlogs and poor service delivery



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Fiscal Leakages: Loss of Revenue

(1)

Fig. 7: Unlicensed Vehicles (DPRT)

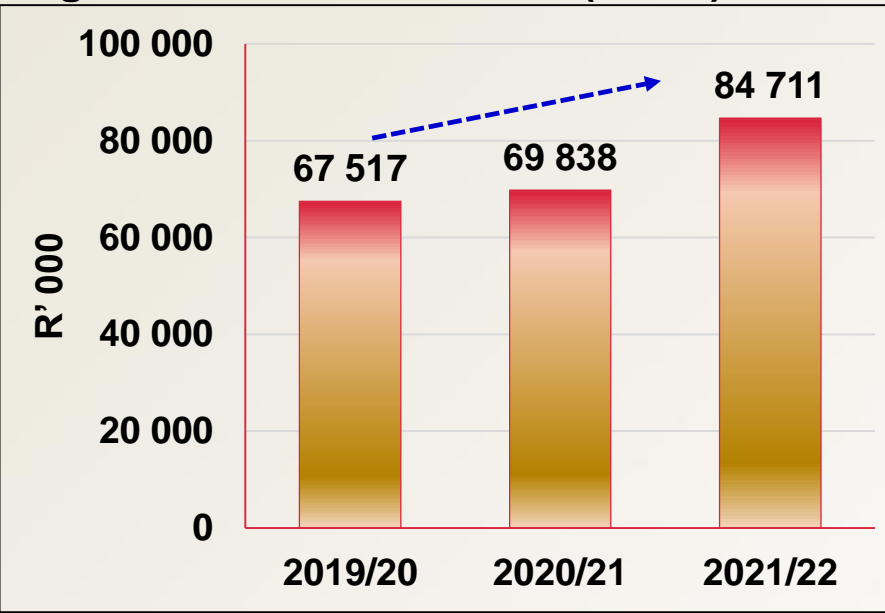
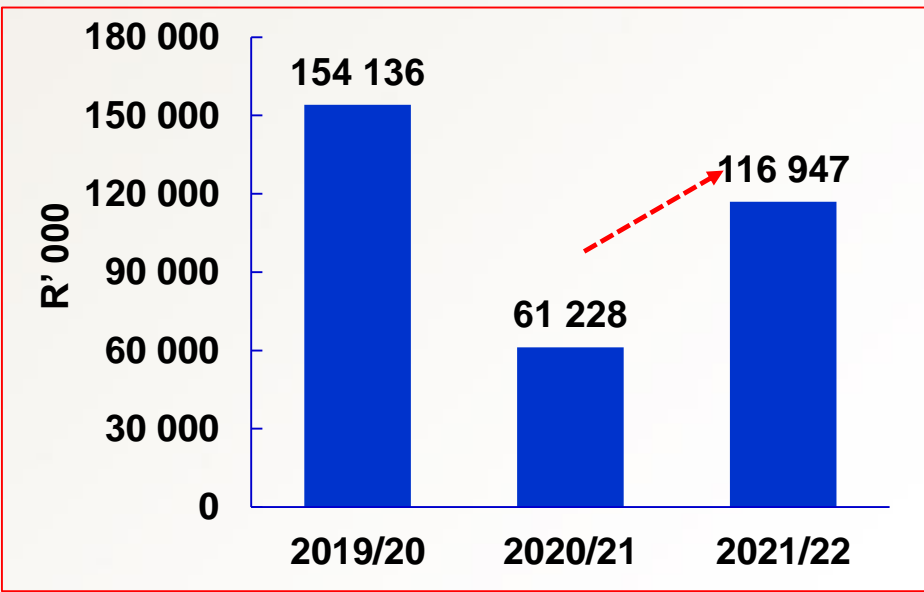


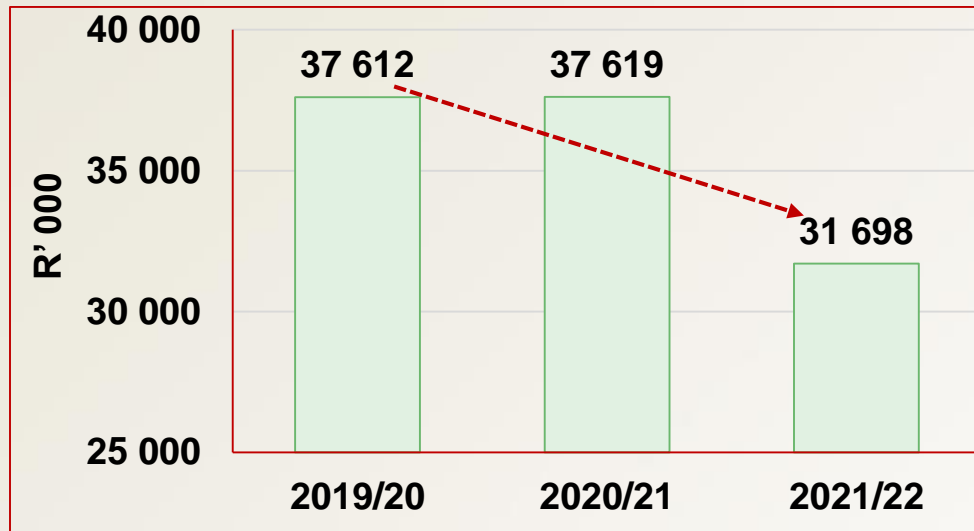
Fig.8: Outstanding Hospital Patient Fees



- Non-payment of traffic infringement fines by unlicensed vehicles remains a notable source of fiscal leakage due to loss of 'own' revenue, which has grown from R67.5 million in 2019/20 to R84.7 million in 2021/22, **depicting a 25.5% growth rate!!!**.
- Another source of fiscal 'revenue' leakage for FS is the large outstanding debt owed by Lesotho Government for the treatment of refereed patients. R63 million and R60 million was received during the 2019/20 and 2021/22 FY, respectively partial payments from Lesotho Government.



Fig.9: Revenue from Property Disposal



- **Delayed disposal of non-strategic government property** (with extra cost burden for rates and taxes, maintenance, utility & electricity bills). Receipts markedly declined to R31.6 million in 2021/22 from 37.6 million in 2019/20, indicating a **15.7% reduction in revenue!!!**
- **Road Accident Fund** remain a source of fiscal 'revenue' leakage for FS. As at end of July 2022, payment of R78 million is expected from the RAF.

□ Compensation of employee's on indefinite suspension

- ✓ R2.79 million spent on 5 suspended officials over the prescribed 60 days

□ Non-performing Maluti-A-Phofoung SEZ

- ✓ Allocated R20 million—large proportion of expenditure on CoE & Goods and Services
- ✓ Lack of tax incentive to investors—**do not attract private (external) investors** to provide the much needed external financing to support adequate operation.
- ✓ Experiencing **severe structural problems** (for the past 5 years), HR issues, **unreliable water and electricity supply**
- ✓ **Institutional governance failure**—non-adherence to SEZs Act.



Some Implications (or costs) of Fiscal Leakages

- ❑ Exerts undue fiscal pressures and risks
- ❑ Threatens budget sustainability and credibility
- ❑ Diversion of earmarked funds towards financing, e.g., (i) growing debt service cost (e.g., interest rate repayment on loans), (ii) contingent liabilities (e.g., financial support to poor performing provincial departments and/or municipalities), and (iii) litigation costs.
- ❑ Significant adverse effect on public service delivery, infrastructure investment, adequate provision of basic amenities (e.g., road network, construction of schools and health centers), and private investment.
- ❑ Weakens institutional governance and proliferate corrupt practices
- ❑ Dampens economic growth and constrain sectoral productivity, **lowering the contribution of provincial economy to the national GDP.**



Some Implications of Fiscal Leakages (2)

- ❑ Increased maintenance backlogs and project cost overruns
- ❑ Loss of capital investment--accumulation of dilapidated assets with low value
- ❑ Insufficient generation of 'own' revenue---unable to fund identified provincial priorities
- ❑ Deepens social exclusion, and exacerbate social unrest
- ❑ Entrench the degree of rurality---poorly developed rural area
- ❑ Widens income inequality, and poverty gap
- ❑ Create significant fiscal burden---large budgetary allocation for social protection due to growing dependants (i.e. those earning below the nationally approved food poverty line of R561, the lower-bound poverty line of R810, or the upper-poverty line of R1 227 (April 2019 prices, Stats SA)



Remedial Strategies: Fixing Extant Leakages

- ❑ The province has appointed service provide who assisted in reducing irregular expenditure in various provincial departments.
- ❑ The province has initiated revenue enhancement strategy with a view to enhance revenue controls as well as to optimize revenue. (Case managers were appointed to assist with revenue recoveries in Health as well as revenue administration)
- ❑ Bulk of irregular expenditure relates to interest charged on overdrawn accounts and ENGO Court ruling outstanding payments (*Through normal budget process, the province has allocated funds to deal with this matter though not sufficient*)
- ❑ The province has appointed a task team that considers the disposal of assets and land parcel.
- ❑ Impose a non-negotiable adherence to IDMS guidelines on contractors to ensure efficient infrastructure delivery
- ❑ Utilize conservative contract management measures to compel service providers to adhere to stipulated contract terms and conditions.
- ❑ Blacklist service providers for poor contract performance and avoid future reappointment where feasible.
- ❑ The province is participating in the Budget Facility for Infrastructure with a view to source external funding through ISA in order to attend to some of mega projects in the province, this will in turn unlock funding for other projects such as; provincial government building.
- ❑ The province participates in the National Task Team for Medico Legal Claims, furthermore, the Department of Health is strengthening clinical, revenue and legal service units with a view to minimize medico litigations.



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Conclusion: Way forward

- ❑ The Free State Provincial government (FSPG) remains resolute and committed to the implemented fiscal consolidation process, ongoing performance monitoring process, and consequence management to address most of the fiscal leakages.



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