

THE EVOLUTION INTERGOVERNMENTAL FISCAL RELATIONS (IGFR) IN SOUTH AFRICA (SA)

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INTRODUCTION

- **The Legacy of Apartheid**
- **1994 – Change to a democratic state**
- **One Republic, One Nation State**
- **Negotiated Constitution – Transformation of the IGFR System**
- **Socio-Economic disparities between provinces and municipalities and between communities**
- **Challenges faced by the new government**
- **Globalization**

ASSESSING IGFR IN SA

- **Policy Frameworks**
- **The Revenue Assignment**
- **The Expenditure Assignment**
- **Dealing with fiscal imbalances**
- **Processes to adjust fiscal imbalances i.t.o.conditions**
- **Fiscal Management**
- **Coordination for IGFR Reforms**
- **Stabilization Policy**
- **Simplification - Modernization**

FEDERALISM, FISCAL FEDERALISM AND DECENTRALIZATION

SOME QUESTIONS TO CONSIDER

- **Federalism often accompanied by decentralization but it is not a condition for decentralization nor is decentralization a sufficient condition for federalism?**
- **Does a federal system facilitate decentralization and development better than unitary systems? Or is success independent of government structure?**
- **For decentralizing unitary systems is federalism the logical step?**
- **Is political federalism the same as fiscal federalism? What is the correlation?**

THE SOUTH AFRICAN CONSTITUTION

- Three spheres of government
- Division of Powers and Functions
- Chapter 13 of the Constitution – FFC, the South African Reserve Bank (SARB) and the Equitable Sharing of National Revenue (ES)
- Bill of Rights – Constitutionally Mandated Basic Services (CMBS) and progressive realization
- Co-operative governance – Chapter 3
- Nine provinces
- 284 local governments
- National, Provincial legislature and municipal councils
- Forums, Institutions and Processes

KEY STATUTORY AND POLICY FRAMEWORKS AND LEGISLATION

- Section 214 (1) – provides for a Division of Revenue Act (DORA)
- Section 214 (2) (a-j) – factors for the division of revenue
 - National interest, provision for debt, needs of national government, emergencies, to ensure that provincial government provide CMBS, developmental and other needs of provincial and local government, the reduction of economic disparities, promotion of stability and predictability, providing for obligations to national legislation, efficiencies and fiscal capacities.
- Policy Frameworks
 - GEAR
 - Growth and Development Summit (GDS)
 - Ten Year Review by the Office of the President
 - Fiscal Frameworks

KEY STATUTORY AND POLICY FRAMEWORKS AND LEGISLATION

- The Intergovernmental Fiscal Relations Act, 1997 – a process of IG consultation for enacting the DORA
 - Establishes a Budget Council (BC) & Budget Forum (BF)
 - Consultation with the FFC
 - DOR Bill to be accompanied by government's response to the FFC's recommendations
 - Organized Local Government (Act)
- Other Key Legislation
 - The Public Finance Management Act
 - Provincial Borrowing Powers Act
 - Municipal Finance Management Act
 - Municipal Systems Act
 - Provincial Tax Regulation Process Act

THE REVENUE ASSIGNMENT

Revenues are assigned to

■ National government

- Examples : Trade Taxes, Excise, Corporate Tax, PIT, Fuel Levy, VAT, Road Accident Fund Levy

■ Provincial government

- Examples : Gambling taxes, Horse racing taxes, Business license fees

■ Local government

- Examples : Property Rates, User Charges, RSC levies
Charges and fees for other services

THE EXPENDITURE RESPONSIBILITIES

■ National government

- Health, Education, Welfare and Social Services, Housing, Infrastructure, Protection Services, Economic Services, Trade and Industry, Foreign Affairs, Defense, Justice, Sport and Recreation, Arts – Science – Technology, Water, Land, Transport, Environmental Services, Agriculture, Contractual and statutory commitments, policy and legislation.

■ Provincial government

- Health, Education, Welfare and Social Services, Housing, Provincial infrastructure and roads, Sport and Recreation, Local government support, Agriculture, Regional Economic Development.

■ Local government – 3 tiers, a, b, c

- Basic services – water, sanitation, electricity, municipal roads, amenities, abattoirs and markets, municipal infrastructure.

TRENDS IN THE VERTICAL DIVISION OF REVENUE AND EXPENDITURE

% of General Government Revenue or Spending	Revenue		Expenditure	
	1994	2002	1994	2002
National	84.9%	83.5%	56.8%	42.8%
Provincial	4.9%	1.6%	32.2%	39.5%
Municipal	10.2%	14.9%	11%	17.7%

THE NATIONAL FISCAL FRAMEWORK

■ Trends in Nationally Raised Revenue:

% of Nationally Raised Tax Revenue	Personal Income Taxes	Corporate Income Taxes	Sales Taxes	Inter-national Trade Taxes	Payroll & Property Taxes
1994	40%	13%	39%	5%	3%
2002	33%	20%	35%	3%	9%

THE NATIONAL FISCAL FRAMEWORK

■ Trends in National Government Spending:

- The proportion of nationally raised revenue transferred to provinces (47%) and municipalities (3%) has remained constant between FY 1996 and 2002.

% of National Government Spending	Admin & Finance	Integrated Justice Sector	Economic & Infrastructure	Others
1996	11.2%	29.1%	26.7%	33.0%
2002	13.2%	31.5%	20.3%	35.0%

THE PROVINCIAL FISCAL FRAMEWORK

- Trends in Provincial Government Revenue:

% of Provincial Revenue	Own Revenue	Unconditional	Conditional Grants
1994	12.9%	87.1%	
1997	3.7%	90.8%	5.5%
2002	4.0%	86.5%	9.5%

THE PROVINCIAL FISCAL FRAMEWORK

■ Trends in Provincial Government Spending:

% of Provincial Spending	Education	Health	Social Dev't.	Economic & Infra-structure
1996	39.8%	22.5%	17.3%	20.4%
2002	36.4%	22.8%	21.4%	19.4%

- The take-up of the child support grant and more recently disability grants, is the most significant trend in general government finances. These grants are government's primary tool of poverty alleviation.
- All social assistance grants are to be shifted to the national sphere during the forthcoming medium-term budget planning cycle.

THE PROVINCIAL FISCAL FRAMEWORK

- Intergovernmental Transfers to Provinces: The P.E.S.
 - P.E.S. determines horizontal division between provinces.
 - 7 components weighted on basis of inherited functional breakdown and subsequently on national policy priorities. But provincial policy priorities are not necessarily congruent:
 - Education share increased from 39% to 41% (but actual decline to 36% by 2002). Health share increased from 18% to 19% (but provinces spend 22.5%). Welfare increased from 16% to 18% (vs. actual increase to 21.5%). Institutional component at 5% (vs. 4% actual).
 - Backlog component for new infrastructure, Economic Activity component for maintenance of existing infrastructure + Basic
 - Funds divided on basis of eligible / target populations from Census, rather than actual beneficiaries. More equitable? Less subject to data manipulation in budget game?

THE PROVINCIAL FISCAL FRAMEWORK

- Intergovernmental Transfers to Provinces: The P.E.S.
 - Formula introduced in 1998 and based on 1996 Census figures. 5 year phase in period. Similarly for impact of 2001 Census.
 - Shares of Eastern Cape, Western Cape, North West and Free State declined between 1996 and 2002, whilst the shares for the other provinces, notably Gauteng increased.
 - Rapid urban migration between the 1996 and 2001 Censuses suggest further declining shares for the Eastern Cape & Free State as well as for the Northern Cape and Limpopo due to significant out-migration. By contrast, Gauteng and the Western Cape should receive higher shares due to in-migration.
- Conditional Grants to Provinces:
 - Conditional grants are made by national department budgets and are primarily used to encourage spending on infrastructure (which is being crowded out) and institutional capacity building (which is transitional).

THE PROVINCIAL FISCAL FRAMEWORK

■ Horizontal Fiscal Imbalance:

- PES second to urban migration in reducing socio-economic disparities. If PES defined eligible population as poor, equalizing impact would be greater.

% of national average	GDP per capita		Provincial Govt Spending per Capita	
	1996	2001	1996	2001
Gauteng	174%	159%	78.5%	80%
Limpopo / North West	44%	54%	122%	118%
Highest: Lowest	4 x	3 x	1.55 x	1.47 x

THE MUNICIPAL FISCAL FRAMEWORK

■ Municipal Revenue Trends:

% of Municipal Revenue	Own Revenue	Inter Governmental Grants	L.E.S.	Conditional Grants	From Provinces
1997	87.6%	12.4%	4.8%	7.6%	n/k
2002	84.8%	15.2%	5.4%	5.8%	4.0%

■ Municipal Expenditure Trends:

- The two-stage municipal demarcation and restructuring process over the past 10 years has made trend or time series analysis of comparable budget programs difficult to track.

THE MUNICIPAL FISCAL FRAMEWORK

■ Horizontal Fiscal Imbalance:

- In 1996, GDP per capita in the metropolitan municipalities was 5.1 times that of mainly rural municipalities. By 2001, the gap had narrowed to 4.8 times. This is primarily due to urbanization of the poor.
- Municipal spending per capita in 2003 in metropolitan municipalities was between R 3 200 and R 3 800 (vs) between R 400 and R 800 in rural municipalities. The gap is between 4 and 9.5 times indicating that municipal spending contributes little to spatial equalization.
- In 2002, metropolitan municipalities received between 3% and 8% of their revenue from intergovernmental grants (vs) between 60% and 90% for rural municipalities.

THE MUNICIPAL FISCAL FRAMEWORK

- Intergovernmental Transfers to Provinces: The L.E.S.
 - L.E.S. formula introduced in 1998 and based on Census population and poverty data. Updating in response to the 2001 Census results requires a transition path in which 70% of previous allocations are guaranteed. L.E.S. has developed ad hoc in response to claims of un-funded mandates. 6 funding windows:
 - Basic municipal services (S) component which allocated an affordable per household amount to cover operating costs of water, sanitation, waste removal and electricity.
 - Institutional component which, like the PES, allowed for a fixed cost of administering a municipality but added a population-driven component.
 - Transitional window to enable transfer of former R 293 Bantustan townships from provinces to municipalities.
 - In FY 2002, an additional funding window was opened for municipalities in which rural and urban development nodes were allocated.
 - In FY 2003, Free Basic and Free Electricity Services components were introduced to supplement the S-grant but targeting poor households.

THE MUNICIPAL FISCAL FRAMEWORK

- Conditional Grants to Municipalities:
 - Conditional grants for capital and institutional capacity building and an operating subsidy for water provision.
 - Capital grants have been progressively consolidated into the Municipal Infrastructure Grant of FY 2004. The M.I.G. has components for residential (weighted at 75%), bulk connector (15%) and SME (5%) infrastructure plus additional funding windows for development nodes and a performance bonus. The residential B-component currently prioritizes water & sanitation followed by roads.

THE MACRO-ECONOMIC FRAMEWORK

■ Trends in Debt Management:

% of GDP	1994	2002	% of GDP	1994	2002
General Government					
Spending	34.9%	32.9%	Deficit	5.8%	1.1%
Revenue	29.1%	31.8%	Investment	2.4%	2.2%
(Nationally Raised) Revenue	23.5%	25%	Credit Rating (Std & Poors)	BB	BBB
Debt	48.4%	41.1%	Loan Guarantees	10.7% (1997)	6.3%

THE MACRO-ECONOMIC FRAMEWORK

■ Challenges in Debt Management:

% of General Govt Deficit	National	Provincial	Municipal
1994	91.3%	5.4%	3.3%
2002	69.7%	25.1%	5.2%

- Deficit financing has been increasing since 2002 and is officially projected to rise further over the 2004 medium-term budget cycle. Shifting social assistance grants to an independent national agency may contain this trend.
- The challenges to the health sector may generate a similar set of deficit financing pressures over the next 5 to 10 years.

PROCESSES, IG COORDINATION, & MANAGING FISCAL RELATIONS

- **Constitutional provisions for cooperative governance**
- **Processes legislated**
- **Formal Process for Budget Management**
 - TCF, Budget Council, Budget Forum, Mincombud, 4X4s, Organized Local Government, Cabinet, Parliament, Provincial Legislatures, Minmecs, Bi-laterals, Stakeholder consultation, PCC, PCAS, Joint Minmecs and Budget Council meetings
 - Annual Budget Cycle: Medium Term Budget Policy Statement (MTBPS) Budget Speech, Budget Review, Estimates of National Expenditure, Division of Revenue Act, Adjustment Budget Estimates
 - Institutions : FFC, Loans Borrowing Committee, South African Reserve Bank (SARB)

PROCESSES, IG COORDINATION, & MANAGING FISCAL RELATIONS

■ Key fiscal adjustment initiatives and issues

- Revenue Sharing Formulae under review
- Data and information problems
- Policy pressures
- Inter-governmental and inter-departmental pressures
- Costing disabilities
- Performance of sub-national government
- Developmental imperatives
- Uncertainty as to where best to place expenditure responsibilities
- Systemic reform issues

PROCESSES, IG COORDINATION, & MANAGING FISCAL RELATIONS

■ Key fiscal adjustment initiatives and issues

- Poverty reduction
- Refinements to vertical and horizontal equalization measures
- The issue of capacity at sub-national and local government
- Adjustment for a progressively expansionary fiscal stance
- International economic outlook and its impact on IGFR issues/relations/systems
- Centralization – decentralization issues not yet resolved
- Simplicity vs complexity in the construction of revenue sharing formulae
- Differentiation in the application of policy frameworks and regulations

PROCESSES, IG COORDINATION, & MANAGING FISCAL RELATIONS

- **The impact of effective coordination in the first ten years of democracy**
 - Introduction of three-year rolling budgets that bring together budgets and national policies
 - Strategic planning, financial management and reporting, publication of performance information into the PFMA
 - Move to greater coordination among three spheres of government on development planning
 - Municipal Finance Management Act
 - An objective and re-distributive revenue sharing formula
Refinements to vertical and horizontal equalization measures
 - Statistical data gathering to improve
 - Increased accountability
 - Consolidated national and provincial accounts
 - Procurement reform

SIMPLIFICATION

- **Key question- what do we mean by IGFR and simplification**
- **Aggregation vs the special conditions at local and sub-regional level**
- **State simplification problematic for national policy –ex ante policy intentions don't necessarily result in ex post outcomes**
- **Simplification and the management of IGFR systems**
- **State simplification to be complemented by political and public participation and consultation**

SOME CHALLENGES FOR THE NEXT TEN YEARS

- Deficit targeting vs expansionary budget
- Centralization – decentralization – and appropriate assignment of expenditure responsibilities
- Vertical and horizontal imbalances
- No “one size fits all” policy approach
- Information/knowledge management of IGFR systems
- Synergy between policy coordination, diverse state structures & mechanisms for the delivery of services
- Spatial economy and revenue base of sub-national governments

THANK YOU

