# Financial and Fiscal Commission's Recommendations for the Allocation of Financial Resources to the National and Provincial Governments for the 1996/97 Fiscal Year

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FINANCIAL
AND FISCAL
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Financial and Fiscal Commission For an Equitable Sharing of National Revenue

# Allocation of Financial Resources between the National and Provincial Governments for the 1996/97 Financial Year

**[8 September 1995]**

## Contents



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## EXECUTIVE SUMMARY

1. The Interim Constitution stipulates that provinces are entitled to an equitable share of revenue collected nationally and that the Financial and Fiscal Commission (FFC) should make recommendations to Parliament in this respect (Sections 155 and 199). This document contains the FFC's proposals for the 1996/97 fiscal year as well as projections for the following four years.

2. The proposals must be read against the background of the FFC's *Framework Document for Intergovernmental Fiscal Relations in South Africa,* which contains *inter alia* a detailed discussion of the norms applicable to this set of proposals. The conclusion contained in the *Framework Document* is that the division of fiscal resources between the provinces should be done by developing an objective formula. The goals of the formula should be to achieve: effective and efficient resource allocations; fiscal equity in the provision of services and the raising of provincial taxes; and the development of fiscally sound and democratically responsive provincial governments.

3. The total resources available to the public sector were estimated firstly by assuming that the country's GDP will grow at a moderately increasing rate from the base of 2.5 per cent in 1995/96. Provision is made also for a decrease in the budget deficit over the period under consideration.

4. The FFC's recommendations fall into two categories : a) the division of resources between national government and provincial governments (this addresses the problem of "vertical fiscal imbalance"); and b) the division of resources amongst the provincial governments (horizontal fiscal imbalance).

Back to Contents

5. The **vertical division** of the total available resources between the national and provincial governments is based on the constitutional allocation of functions, according to which the delivery of the major services to the public, such as education and health-care, is the responsibility of provincial governments. However, it recognises that both tiers of government have existing commitments which must be honoured in the short term.

6. As the services of only a limited number of **national departments** are related to the increase of the population (and some could be decreased over the period), the FFC recommends that the allocations to the national government be kept constant in real terms for the next three years; and that the additional resources derived from the growth of the economy in this period be allocated to the provinces. This will enable the current extremely unequal provision of public services to be corrected in the reasonably short period of five years.

7. The FFC recommends that the **total provincial allocation (G)** be divided among the provinces by means of a **provincial grants formula** comprising three major elements:

   - a **basic grant (B)** to enable provinces to establish and maintain the institutions necessary for the fulfilment of their constitutional obligations according to their own priorities;
   - a **national standards grant (S)** to enable the provinces specifically to provide primary and secondary education and primary health-care to their residents; and
   - a **tax capacity equalisation grant (T)** to encourage provinces to take responsibility for raising their own revenue. This component of the formula is an essential element in developing provincial accountability for expenditures.

   In addition, in recognition of the national role played by the academic hospitals, the FFC recommends that separate **conditional grants** (m) be given to those provinces having such institutions.

   The relationship between these components can be expressed in the form of an equation, namely:

   **G = B + S + T + m .**

8. The **tax capacity equalisation grant** will not be introduced until the provinces have been given the power to levy their own taxes by Act of Parliament according to Section 156 of the Interim Constitution.

9. The **basic grant** is determined on the basis of the weighted population figures for each province. A weight of 25 per cent is given to the number of rural people in each province, because "ruralness" is well-suited as a proxy for differences in wealth, is a good indicator of deprivation and presents relatively few data-related problems.

10. The **education** component of the national standards grant is determined by calculating the cost of providing an acceptable level of education to the residents of a province between 5 and 17 years of age, using the norm of one teacher for every thirty-eight pupils.

11. The value of the **health-care** component of the national standards grant is determined by calculating the cost of providing within eight years an average of 3.5 visits per year to a primary health-care clinic by people who do not have access to medical aid schemes, and 0.5 visits by those who do have access to such schemes.

Back to Contents

12. The FFC is of the opinion that the provincial grants formula must be reviewed after a period of two years. This will be necessary as improved population figures become available, as well as to accommodate provincial own revenue, (once the provinces have been given the powers to levy taxes) and to develop a procedure to allocate revenue to local governments.

13. The provincial grants formula does not address the issue of whether some provinces should be compensated for infrastructural backlogs, besides the higher weighting given to the rural population numbers. It is felt that this should be done by the RDP fund.

14. Given the lack of consensus amongst South African researchers on population data, the FFC, after careful examination of the various data sources, decided to make use of the figures of the Central Statistical Services (CSS) as adjusted by the Demographic Information Bureau, a group of independent demographers. The FFC has called for a workshop with the CSS and other interested parties to establish a sound basis for any revision that may be necessary for the 1997/98 cycle.

15. The FFC recommends that the formula be phased in over a period of five years, so as to ensure that those provinces which are projected to receive real cuts in their budgetary allocations, are given sufficient time to make the necessary adjustments, either to their expenditures or to their own revenues.

16. The four parts of Table 6 in the text of the main document show the total financial allocations per province for the next five years in the following ways: 6a - in terms of percentage shares; 6b - in terms of 1995 rand (millions) i.e. in real terms; 6c - as percentage changes; and 6d - as per capita allocations in 1995 rand.

17. The table below shows the recommended financial allocations per province for selected years.

**Financial allocations per province: Percentage Allocations for Selected Years**

| Province | 1995/96 Actual (base yr) | 1996/97 | 2000/01 |
|---|---|---|---|
| **Western Cape** | 11.26 | 10.50 | 7.96 |
| **Eastern Cape** | 17.58 | 17.12 | 15.58 |
| **Northern Cape** | 2.38 | 2.21 | 1.64 |
| **Kwazulu-Natal** | 20.04 | 20.30 | 21.18 |
| **Free State** | 7.08 | 7.07 | 7.05 |
| **North West** | 8.33 | 8.38 | 8.55 |
| **Gauteng** | 14.91 | 15.75 | 18.57 |
| **Mpumalanga** | 5.81 | 5.96 | 6.49 |
| **Northern Province** | 12.61 | 12.70 | 12.99 |
| **South Africa** | 100.00 | 100.00 | 100.00 |

## 1. Introduction

1.1 This document presents the recommendations of the Financial and Fiscal Commission (FFC) for the distribution of financial resources between the national and provincial governments for the 1996/97 fiscal year.

1.2 The recommendations of the FFC fall into two categories. The first relates to the issue of the distribution of resources between the national government and the provincial governments. In other words, an attempt is made at determining what global amounts should

be going respectively to the national and provincial governments on the basis of the division of functions specified in the Interim Constitution. This recommendation addresses the "vertical equity" question. Details are presented in Section 5 below.
1.3 The second set of recommendations relates to the distribution of resources among the provinces. These recommendations address the "horizontal equity" question. In developing these recommendations the FFC has devised a formula, termed the "Provincial Grants Formula". Details of this formula are presented in Section 6 below.

## 2. The Interim Constitution and the FFC

2.1 The Interim Constitution provides for a decentralised system of government characterised by three tiers - (national, provincial, local) with an appropriate balance to be developed within such a system with regard to the coordination of functions. The Constitution furthermore specifies that all tiers are entitled to an equitable share of revenue.
2.2 Section 155 of the Interim Constitution states that the provinces are "entitled to an equitable share of revenue collected nationally to enable (them) to provide services and to exercise (their) powers and functions".
2.3 According to Section 155(2) this **equitable share of revenue** should consist of:

a. a percentage of personal income tax which is collected nationally;
b. a percentage of value-added tax which is collected nationally;
c. a percentage of any national levy on the sale of fuel;
d. transfer duties, collected nationally, on the sale or transfer of properties situated within the province concerned;
e. any other conditional or unconditional allocations out of national revenue to a province.

2.4 **Section 155 (3) requires the Financial and Fiscal Commission to make recommendations with regard to the percentages and the conditional and unconditional allocations referred to in Section 155 (2).**
2.5 As described in the text that follows, the FFC has chosen to specify the same percentage for each revenue source as referred to in Section 155 (2) (a) - (c). Therefore, these revenue sources are pooled effectively and divided according to the formula developed in this document, after which the percentages, referred to in the Interim Constitution can be calculated for each province. In addition, the FFC recommends, in terms of Section 155 (2) (e), a conditional allocation (the National Increase for Training, Education and Research - NITER) in the academic hospitals (See Section 9). In terms of Section 155 (2) (d) the amounts collected nationally as transfer duties are returned to the provinces from where they originate and are therefore not subject to the FFC's recommendations.
2.6 Section 178 (3) of the Interim Constitution states that a "local government shall be entitled to an equitable allocation by the provincial government of funds, and the Financial and Fiscal Commission shall make recommendations regarding criteria for such allocations..."

## 3. The FFC's Framework Document for Intergovernmental Fiscal Relations and the Allocation of Financial Resources

3.1 The FFC's draft *Framework Document for Intergovernmental Fiscal Relations in South Africa* (Part C3) states that the division of fiscal resources between the provinces should be done by developing a formula. Such a (provincial grants) formula will establish a procedure for dividing the available funds in an objective manner. Consequently, arbitrary allocations to the advantage of some provinces and at the expense of others will be eliminated. This document presents the FFC's proposals in this regard.
3.2 In designing a provincial grants formula one can distinguish between two polar cases, namely disaggregated and composite formulae. Disaggregated formulae are constructed by examining individual functions, deciding on the detail of the formula specifications of each function separately, and then combining these elements into a single equation or set of equations. On the other hand, a composite formula is based on the premise that it is not

Back to Contents

necessary to specify the elements of a formula individually, because it is only the total outcome which is ultimately of importance.
3.3 Attempting to construct a formula using the disaggregated approach may entail methodological problems, if the system to which it refers is as large and complex as the public sector. This is because, although the analysis of the individual components of the formula may be justifiable, their aggregation relies on a system of weighting, which in turn incorporates a set of value judgements. Value judgements are also unavoidable in considering the final outcome of a formula. Therefore, even if the weights used in the aggregation process are stated explicitly, which is not usually the case, it becomes clear that the individual process of evaluating separate functions is subordinate to the final outcome. And if this is the case, there is no reason why a formula that, with certain exceptions as will be illustrated below, concentrates attention on the final subsidy sum rather than on its components, should not be preferable.
3.4 In the FFC's recommended formula, the exceptions referred to in the previous paragraph, are school education and primary health-care. Their importance, both to individual residents and to the nation as a whole, make it essential to ensure that adequate funding is provided to meet national service standards. They are accordingly singled out in the formula.
3.5 The *Framework Document* (Part B) articulates a number of norms which are applicable to a system of intergovernmental relations. For the purpose of designing a grants formula these can be summarised as three goals: effective and efficient resource allocations; fiscal equity in the provision of services and the raising of provincial taxes; and the development of fiscally sound and democratically responsive provincial governments. The mechanisms for the allocation of resources to the provinces developed in this document are driven by the constitutional requirements embodied in Section 155 and by these three goals.
3.6 In summary, the Framework Document emphasises four principles as key features of intergovernmental fiscal relations, namely equity, democracy, fiscal accountability and economic efficiency.
Horizontal **equity** can be promoted through the development of mechanisms for redistributing financial resources amongst provinces that recognise historical and current imbalances. **Democracy** means that provinces must be able to excercise a degree of budgetary control over spending on Schedule 6 functions. **Fiscal Accountability** requires own revenue generation. Finally, **economic efficiency** can be enhanced when the lowest capable tier is given the responsibility for the delivery of services.

## 4. The Macroeconomic Framework

4.1 The resources available for government expenditure, at both national and provincial levels, are constrained by a number of factors, notably the economic growth rate and government economic policy, particularly with respect to the commitment to reducing the budget deficit and servicing the national debt.
4.2 Various government and private sector institutions have made projections of the GDP growth rate for the next three to five years. In most of these predictions the average annual growth rate of GDP is estimated to be around 3 per cent up to the year 2000. The FFC model commences from a more conservative position by assuming a growth rate of 2.5 per cent for 1995/96 and extrapolating by 0.1 percentage points for each of the next five years. This caution is due to the uncertainty of the transitional period.
4.3 In recent months concern has been expressed in various quarters about the high degree of indebtedness of the public sector. The Government of National Unity is committed to reducing the budget deficit. In the FFC model, therefore, the budget deficit is projected to fall from 5.8 percent of GDP in 1995/96 to 4.5 percent in 2000/01.
This is again a conservative projection with several analysts predicting the budget deficit to fall to around 3.5 - 4.0 per cent of GDP by the year 2000.
4.4 The projected moderate GDP growth rates and the commitment to reducing the budget deficit over the medium term impose serious budget constraints for policy-makers. These two economic factors have particularly important implications for the division of resources between the national and provincial governments. However, it should be remembered that the actual rate of economic growth may differ from that assumed in this document. If it is higher, more opportunities for adjustment will arise.

Back to Contents

## 5. The Vertical Division of Resources (i.e. the division of resources between the national and provincial governments)

5.1 In making recommendations on the budget, the FFC has to ensure both vertical equity (in this case between national and provincial governments) and horizontal equity (i.e. between provinces) in the distribution of resources as emphasised in the *Framework Document* (Part B7). Moreover, Section 199 of the Constitution requires the FFC to make recommendations with respect to the division of resources between the national, provincial and local governments.
The first of these functions arises because the vertical relationships between national, provincial and local governments are usually such that an imbalance exists between tax bases (revenue sources) and the obligation to deliver services. The financial resources required by the provinces and local governments to deliver these services are usually greater than the resources available from their own revenue sources. It is therefore necessary for revenue to be distributed to sub-national governments to enable them to fulfil their functions.
5.2 A prior step to constructing a provincial formula is to recommend what the division of revenue between the national and sub-national governments should be, and consequently the amount that is available for division with the provincial grants formula. This depends upon a number of factors, the most important of which is the allocation of functions between the different tiers of government.
5.3 In terms of the Interim Constitution (Schedule 6) the delivery of the major services to the public, such as education, health and welfare, is the responsibility of the provincial governments. It is also these functions that must be expanded as the population increases. Additional resources that become available as the economy grows should in the FFC view, therefore be directed towards the provinces, certainly for the short term period. (i.e. the next 1-3 years)
5.4 At the national level many departments are engaged in activities that are not directly related to the size of the population. Examples of these are Defence, Foreign Affairs, Parliament, Finance and State Expenditure. In these departments, the recommendation is that budgetary increases should be restricted to nominal amounts.
5.5 A second category of government departments at the national level comprises functions that do vary according to changes in population. Examples from this group include (tertiary) Education, Water Affairs and Correctional Services. Clearly, the activities of these departments must expand as the numbers of people making use of their services increase.
5.6 Given the obligations of the provinces with respect to their Schedule 6 functions, the FFC recommends that the vertical division of resources should be such that the proportion going to the national government should not grow in real terms for three years beginning with the 1996/97 fiscal year.
This does not mean that expenditure in all national departments should remain constant in real terms. It should be possible to effect savings by not allowing any of the first category of functions to increase in real terms and by planning real decreases in some of them (e.g. Defence) to enable more resources to be devoted to the second category (e.g. Higher Education).
5.7 The consequence of the recommendation that the proportion of revenue allocated to the national government grow at 0% for the first three years in real terms means that the provinces will absorb the total real growth in resources during this period. It may be necessary to review this recommendation on an annual basis if unforeseen economic circumstances raise the cost to the national department of servicing the national debt, or if the national Government is saddled with other unforeseen expenditure.

## 6. The Provincial Grants Formula

6.1 Appropriately designed intergovernmental grants can contribute to each objective described in Section 3.5 above. Accordingly, the FFC recommends that a grants formula consisting of three major elements be implemented. The relationship between these elements can be expressed in the following equation:

$$\mathbf{G = B + S + T}$$

where:

**G** is the **total financial allocation** received by a province in a fiscal year;

**B** is the **basic grant** received by a province in a fiscal year; this basic grant being determined by population figures appropriately weighted. (B can be referred to as the basic grant component of the grants formula);

**S** is the **national standards grant** received by a province in a fiscal year; (S can be referred to as the national standards component of the grants formula); and

**T** is the **tax capacity equalisation grant** received by a province, that is unable to raise sufficient own revenues because its tax base is inadequate compared to the national average, in a fiscal year. (T can be referred to as the tax-base equalisation component of the grants formula.)

6.2 In recognition of the current debate over the special position and the funding of academic health centres, a separate fourth grant for medical training is proposed for those provinces having such institutions (m). (See Section 9.) The equation therefore becomes:

**G = B + S + T + (m).**

6.3 The advantages of using a formula funding mechanism should be stressed. The first advantage is its relative objectivity compared to other funding mechanisms or processes that are open to manipulation by politicians, civil servants and other policy makers. Second, and most importantly, having a funding formula which is set for particular periods (say 2-3 years) ensures "certainty of revenue" for governments. Such predictability in revenue flows is vital to any development planning such governments may wish to undertake.

6.4 **Basic grant (B***)*

a. This component of the formula provides each province with a basic amount of money to undertake the various functions assigned to it in the Interim Constitution. How this money should be used is not stated specifically so as to emphasise the extent of fiscal independence provinces have in managing their own affairs.

b. As explained in the FFC's *Framework Document* lower-tier governments are often able to spend public money more efficiently than higher-tier governments, because they are more responsive to the needs and preferences of their constituents. If the formula were to be totally prescriptive as to how provinces should spend their resources, this important advantage would be lost.

c. Accordingly, within the broad national development framework each provincial government should decide what its particular priorities are, which institutions need to be developed to suit its circumstances, and which set of services will satisfy its citizens' needs most effectively.

d. In short, the basic grant is designed to enable each province to develop as provincial entities in the full sense as envisaged by the Interim Constitution, through taking its own decisions and accepting responsibility for them.

e. Because services are used by people, the demand for them will rise as the number of people in an area increases; it is therefore natural that the total amount of the basic grant should be related to the size of the population of the particular jurisdiction. The amount of financial resources available for distribution under this part of the formula (see Table 4) is accordingly shared in proportion to the weighted provincial population numbers using the best demographic estimates available. (see (g) below)

f. Estimating the current South African population is subject to numerous problems which primarily stem from the general lack of confidence in the 1991 Census data. In addition, since 1991, considerable urbanisation and immigration, besides normal demographic movements, have taken place and have further complicated the picture. It was therefore necessary for the official figures to be adjusted in an attempt to

Back to Contents

compensate for these factors. Once the Central Statistical Services (CSS) has completed the next population census, unadjusted official figures will be used in the formula. As population figures are updated the latest figures will be used for each budget.

g. As mentioned above, the population figures used in the formula have been weighted. After considering the available options, the FFC recommends that the number of people living in rural areas be used for this purpose and that a weight of 25 per cent be attached to this factor. This in effect means that in each province a rural person would "count as 1.25 persons" in the basic grant formula. (or in other words, for every R1 spent on an urban person, the government spends R1,25 on a rural person).

h. The reasons for doing so are the following. Section 155(4)(b) of the Interim Constitution, read in conjunction with section 199(2), states *inter alia* that the FFC should take into account the "...needs and economic disparities within and between provinces, as well as the development needs ... of the provinces..." when making its recommendations on the equitable shares of revenue collected nationally, to which each province is entitled.

i. The number of rural people in a province is well-suited as a proxy for differences in wealth, is a good indicator of deprivation and presents relatively few data-related problems. On the whole, the greater number of poor people live in rural areas; the severity of poverty is considerably higher in the rural districts; rural people have higher unemployment rates; access to services such as housing, water, electricity, sanitation and transport, is much lower in rural than in urban areas; and the provision of education and health-care to rural people is inferior to that of the urban population. This picture would remain unchanged if the definition of ‘rural’ were to exclude the ‘functionally urban’ living on the fringes of many urban areas.

j. It should be noted that other socio-economic indicators such as poverty levels and the Human Development Index (HDI) were considered for weighting. In the end it was felt that "ruralness" of the population would be the most appropriate and least contentious of the indicators for weighting given the nature of the data in this country.

k. The weighting of 25 per cent is essentially a value judgement made by the FFC in the absence of reliable data on poverty and income, the higher costs of service delivery, of providing infrastructure and to a lesser extent of reducing backlogs in rural areas.

6.5 **National standards grant (S)**

a. To ensure that each province will have sufficient resources to meet nationally established service standards in the important areas of primary and secondary education and primary health-care, **as may be set by the respective national departments in terms of section 126 of the Interim Constitution**, the FFC recommends that each province be entitled to a national standards grant.

b. This grant comprises two elements: **a national standards grant for education and a national standards grant for health.**

c. The national standards grant not only recognises the importance of education and health-care to each resident’s immediate and future quality of life, but also to the national goal of obtaining the maximum possible growth in society’s resources over time. Investments in human capital, through public expenditure on education and health-care, have long been recognised as governments’ single most important way of achieving sustained long-term economic growth. Furthermore, this process will enable the earnings of the majority of residents to rise because of increasing productivity, thus facilitating a more equal future distribution of income.

Back to Contents

d. The **education grant** provides funds to the provinces to meet national education standards for residents between 5 and 17 years of age.

e. The **health-care grant** likewise provides specific funds to the provinces to meet national primary health-care standards for the residents of the particular province. This is in line with the stated policy of the Government of National Unity, which aims to concentrate an increasing share of its resources for health-care at the primary level so as to ensure the greatest benefit for the maximum number of people. However, each province is entitled to spend as much of its basic grant on additional health-care as it sees fit.

f. The calculation of the national standards grants for primary and secondary education and primary health-care is based on estimates of the expenditures thought to be necessary for providing those services. This implies that a portion of the revenue available for division between the provinces will be allocated for these purposes first. What is left of the total is the amount which can be distributed as basic grants as described above.

6.6 **Tax capacity equalisation grant (T)**

a. This grant, which is the third major element of the formula, has two functions, both of which relate to the provinces' capacity to raise own revenues through taxing their residents.

b. In the first place, this grant supplements the revenue of those provinces that wish to raise own revenue but are unable to do so because of limited tax bases. In such cases, the grant will fill the revenue gap between what the province would have raised, if it had the national taxing capacity, and what it actually raises from its own taxing capacity.

c. The second function of this grant is to encourage provinces to raise their own revenues, because if they do not do so, they will not only forfeit own revenue but also not be reimbursed by the national government for whatever relative tax base disadvantage they may have. It is vitally important that this should be the case. If it were to become possible for a province to rely almost exclusively on revenue from the national government, the benefits of coupling of own revenue and expenditures, necessary for fiscal accountability, would be lost.

d. In the FFC's *Framework Document* (Part B3) accountability was regarded as one of the most important elements of a system of intergovernmental fiscal relations. Its absence could be seen as an invitation to spend recklessly, because the provincial government would be absolved from having to justify its expenditure programme to its constituents, while the total obligation to raise taxes would rest on the national government.

e. Despite its importance, this element of the total grant formula cannot be introduced immediately, because this must be done in conjunction with the granting of powers to the provinces to levy own taxes in terms of Section 156 of the Interim Constitution. Section 156 stipulates that this competency must be conferred by an Act of Parliament that has been passed by the National Assembly and the Senate sitting separately, after consideration has been given to the recommendations of the FFC. Furthermore, as discussed in Part D5 of the *Framework Document,* the introduction of provincial taxes must be done with the potential effects upon the national total tax burden in mind. The specific recommendations of the Commission on provincial powers to levy taxes and the specification of the tax capacity equalisation grant therefore will be made together at a later stage.

6.7 **Grant for Medical Training**

Section 155 (2e) of the Interim Constitution requires the FFC to recommend conditional and unconditional allocations to provinces. Only one recommendation is made with respect to

Back to Contents

conditional grants and that relates to the issue of National Education and Research in the health sector. This is the "m" component of the formula and is addressed in Section 9 below.

## 7. The Interim Nature of the Provincial Grants Formula

The FFC view is that the provincial grants formula must be reviewed after a period of two years. While the basic structure of the formula will remain, it will be necessary to modify it in the light of at least three factors.
7.1 **Population**: A major part of the formula is population-driven. However, official CSS data are regarded in many quarters as having been historically unreliable. For instance, the 1991 Census conducted by the CSS was not an accurate count of the population. For a number of reasons there was a serious undercount of the African population.
Given the lack of consensus amongst South African researchers on population data, the FFC after careful examination of the various data sources, decided to make use of CSS figures adjusted by the Demographic Information Bureau, a group of independent demographers. The DIB data set has the advantage in that it caters for the undercount of the African population as well as increased rates of urbanisation.
However the 1996 Census promises to be a reliable measure of the country’s population. It is vital that these figures are incorporated in the formula as soon as they become available.
7.2 **Provincial Own Revenue**: An essential component of the provincial grants formula is the tax capacity equalisation grant ("T" in the formula). This has been "put on hold" by the FFC as the provinces develop their tax capacity. However, it is vital that this part of the formula should be implemented as soon as possible so that provinces are provided with incentives to increase their accountability by levying their own taxes.
7.3 **Local Government:** The distribution of resources to local governments is not addressed explicitly in the formula for reasons outlined in Section 8.1 below, except in so far as the existing earmarked transfers to local governments have been included in the 1995/96 base year provincial pool and should be passed on to local governments in each province. However, Section 178 of the Constitution requires the FFC to develop criteria for the allocation of resources to this tier of government. Thus the provincial grants formula will have to be revisited to include the local government financing issue.

## 8. What the Current Provincial Grants Formula does not Address

8.1 **Local Government:** According to Section 178 (3) of the Interim Constitution, "(a) local government shall be entitled to an equitable allocation by the provincial government of funds and the Financial and Fiscal Commission shall make recommendations regarding criteria for such allocations taking into account the different categories of local government...."
The FFC believes that the current inter-governmental transfers from the national government to local authorities which are included in the global amounts going to the provinces, are unsatisfactory because the criteria on which such grants are made are subject to doubt.
The FFC is of the view that equity between the second and third levels of government can be promoted only in a dispensation where no finance is made available on an ad hoc basis as currently happens. This practice transgresses many of the norms specified in Part B of the *Framework Document*. Rather the FFC favours a mechanism for transfers to local government that is based on similar considerations to those used in the provincial grants formula.
Given the new local government boundaries, and the current lack of demographic and financial information at this level of government, the FFC believes that the question of resource allocation to local governments should be seriously examined for the 1997/98 financial year.
8.2 **Backlogs:** The issue of whether the provincial grants formula should compensate provinces which have large infrastructural backlogs relating to schools, clinics, roads, etc. has been raised.
After careful consideration of the relevant issues the FFC has come to the conclusion that backlogs should not be explicitly built into the formula. The current formula does to an extent compensate for backlogs through the increased weighting given to the rural population, but it is felt that the elimination of additional backlogs falls largely within the ambit of the RDP fund.

Back to Contents

8.3 **Special Circumstances:** Every province is able to point to special circumstances that require additional funding. These include: low population densities in rural areas that raise the costs of service delivery; high population densities in metropolitan areas that likewise raise the costs of service delivery; high levels of crime; particular topographical and climatic circumstances; not inheriting an administration; inheriting more than one administration; etc. The FFC is of the view that no "special pleading" provisions should be introduced into the formula. Setting a precedent with one province will encourage other provinces to design their own pleas, thus over time seriously undermining the credibility of any new revenue sharing system.
8.4 **Monitoring:** No provision has been made in this set of recommendations for monitoring expenditure in the provinces. The FFC is of the view that this must be an essential feature of future recommendations especially where grants are linked to the delivery of services in such sectors as Education and Health.

## 9. National Increase for Training, Education and Research (NITER) in the Academic Hospitals

9.1 Given the slow growth of the health budget in real terms and the national commitment to improving access to primary health care, it is generally acknowledged that the academic hospitals in Gauteng, Free State, Kwazulu-Natal and Western Cape are experiencing a serious financial crisis.
9.2 These academic hospitals fulfil both national and provincial functions. They provide the national service of training medical doctors (tertiary education is a national function) and they provide services to residents of provinces where they are situated as well as to residents of other provinces.
9.3 The FFC proposes that the expenditures on national and provincial functions within academic hospitals be separated as far as possible. The revenue associated with the national function is therefore taken from the provincial pool and a Section 155 (2) (e) grant is allocated to the province where the hospital is located.
9.4 It is recommended that this grant be made with the following provisos:

a. Given the national and provincial commitment to primary health care, it is proposed that spending on academic complexes should not grow for the next few years. Nevertheless the training of doctors remains a priority. The proposal here is to allow for the training of a fixed number of doctors every year equal to the current intake of students at medical schools. In expenditure terms, this will mean that the grant for medical training will remain constant in real terms.

b. In order to promote equity it is proposed that in future, once adequate cost calculations have been made, such grants be based on the actual numbers of students being trained.

9.5 It is currently impossible to make an accurate determination of the respective resource allocation between national and provincial functions within academic hospitals. As an interim measure the FFC proposes that the grant to academic hospitals be equal to 30% of the 1994/95 spending in academic hospitals adjusted for inflation. (Based on international experience 25-30% of actual expenditure represents a good approximation of the additional costs imposed on an academic hospital for the training of doctors. The higher figure is recommended to compensate in part for the inter-provincial flow of patients to these hospitals.) The provincial allocations from this grant are given in Table 5. It is difficult at this stage, because of the lack of data, to allocate a grant to the academic hospital associated with the University of Transkei. This will be done as soon as such data becomes available.

## 10. Phasing-in the FFC's Recommendations

10.1 The FFC's recommendations with respect to the provincial grants imply that some provinces would receive less than they had done with previous allocation mechanisms. The primary reason for this is that, in the formula, population distribution within provinces is the

Back to Contents

major determinant of resource allocation. Consequently, provinces which have been historically under-funded with respect to their population composition will receive greater funding with the FFC's provincial grants formula. Moreover, provinces which have a higher proportion of their population in the 5-17 age group, relatively more people who use the public health care system and a higher distribution of rural people will be advantaged by the formula.
10.2 The FFC's recommendation is that the outcomes predicted by the provincial grants formula should be phased in over a five-year period. In other words there should be a five-year adjustment period towards equity as defined by the formula. This is in line with international experience which suggests that there should not be a decrease of more than 3 - 4% per annum ('floor") on provincial revenue from the central government in real terms. This will ensure that such provinces can embark on the restructuring and rationalisation process while still having the necessary resources to meet most of their contractual obligations.
10.3 Similarly, provinces receiving additional resources should be restricted, as far as possible, to 5-6% annual increases in their revenues from the central government. Such a "ceiling" would ensure that additional expenditure is efficient and that provinces are not provided with resources that their human and institutional capacity cannot handle.

## 11. Provincial Grants: The FFC Recommendations

11.1 As described in section 6, the financial allocations to the provinces are determined using the provincial grants formula.
For the 1996/97 fiscal year the FFC recommendation is that the total financial allocation to a province should comprise two of the major components, namely the Basic Grant (B) and the National Standards Grant (S).
To these two components must be added the NITER component (m) in those provinces where academic hospital complexes are located. Thus each province's grant will have the following components:

**Basic Grant (B) + Standards Grant (S) + NITER (m)**

(Note: m is applicable only to Free State, Gauteng, Kwazulu-Natal and Western Cape)

11.2 Tables 1-6 illustrate how these grant components and the total financial allocation to provinces are derived.
Table 1 shows some of the base data used in the provincial grants formula, namely, total population, rural population, the population in poverty, the Human Development Index, Income per capita and the percentage of population aged 5-17, by province.

**TABLE 1: Base data**

| [1] | [2] | [3] | [4] | [5] | [6] | [7] |
|---|---|---|---|---|---|---|
| **Province** | **Total population** | **Rural population %** | **Population in poverty %** | **Human development index** | **Per capita income (Rand)** | **% of Population aged 5-17** |
| **Western Cape** | 3,828,242 | 14.29 | 18.40 | 0.826 | 11,203 | 26.02 |
| **Eastern Cape** | 7,141,290 | 64.85 | 63.88 | 0.507 | 2,401 | 31.18 |
| **Northern Cape** | 786,374 | 26.73 | 37.77 | 0.698 | 7,092 | 26.25 |
| **Kwazulu-Natal** | 9,079,536 | 62.99 | 51.47 | 0.602 | 6,657 | 31.42 |
| **Free State** | 2,950,928 | 46.45 | 50.02 | 0.657 | 4,958 | 25.94 |
| **North West** | 3,719,949 | 72.41 | 37.21 | 0.543 | 3,326 | 28.58 |
| **Gauteng** | 8,040,094 | 5.62 | 19.90 | 0.818 | 15,094 | 23.84 |
| **Mpumalanga** | 2,895,956 | 67.47 | 48.82 | 0.694 | 5,066 | 29.13 |

Back to Contents

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|---|---|---|---|---|---|---|
| **Northern Province** | 5,456,918 | 91.17 | 72.42 | 0.470 | 2,158 | 35.71 |
| **South Africa** | 43,899,287 | 51.37 | 45.70 | 0.677 | 6,517 | 29.20 |

11.3 **Standards Grant**

As stated earlier the standards grant has two components: an education grant and a health grant.

It should be noted that the national standards in Education and Health will be set by the respective national departments in consultation with the provinces. The role of the FFC is to determine the level of resources necessary for the implementation of these national standards.

In the absence of such norms the FFC has used examples below for the purpose of illustrating how the formula would work.

11.3.1 **Education Grant**

a. The purpose of this grant is to provide financial resources to provinces to ensure provision of national standards in primary and secondary education, as defined by the national department.

b. The formula for this grant has three components; a **demographic** component, a **policy** component and a **cost** component.

   The demographic component is the age cohort 5-17; the policy component is a teacher-pupil ratio of 1:38 (derived from an average of 1:40 for primary schools and 1:35 for secondary schools); the cost component is determined by the product of the number of teachers required and the average salary and non-salary costs.

| $S_{ED}$ : NATIONAL STANDARDS FOR EDUCATION | | |
|---|---|---|
| **Demographic** | **Policy Component** | **Cost Component** |
| Children aged<br><br>5-17 | Teacher : pupil ratios<br><br>Primary 1:40<br><br>Secondary 1:35<br><br>Weighted average 1:38 | Teachers required x<br><br>average salary<br><br>+ Non-teacher costs<br><br>(=41% of salary) |

c. The value of the education grant is determined by calculating the average cost of providing an acceptable level of education to those in the 5-17 age cohort, based on the norm of one teacher for every thirty-eight pupils and using a cost unit comprising the national average teacher salary plus an amount for operating and other expenditures.

d. The ratio of salaries to other costs in the cost unit was determined empirically, using current national expenditure figures, and equals 71 : 29.

e. The amount accruing to a particular province is determined by multiplying the average grant per pupil by the number of residents in the 5-17 cohort in that province.

f. Table 2 illustrates this process. Column 2 contains the population numbers of the provincial residents of school-going age; column 3 indicates that the amount per eligible child is equal (to R2 076 in 1995/96), irrespective of province, thereby ensuring equity even though the amount per capita differs between the provinces (as shown in column 5). Column 4 gives the total education grants per province for 1995/6.

Back to Contents

g. It is recognised that some children aged 18 and over are also in school but are not considered in the formula. Similarly most children aged 5 years are not in school. The intention was to choose the cohorts that most closely approximated the school-going age population. Furthermore an advantage of using the age cohort and not school enrolments is that this process caters also for children who should be in school but for a variety of reasons are not.

**TABLE 2: $S_{ED}$ formula component: National standards grant for education, 1995/6, children 5-17 years**

| [1] | [2] | [3] | [4] | [5] |
|---|---|---|---|---|
| **Province** | **No. of Children aged 5-17** | **Grant per eligible child (Rand)** | **National standards amount (R 000s)** | **Grant per resident (Rand)** |
| **Western Cape** | 996,122 | 2,076 | 2,067,562 | 540 |
| **Eastern Cape** | 2,226,664 | 2,076 | 4,621,690 | 647 |
| **Northern Cape** | 206,444 | 2,076 | 428,498 | 545 |
| **Kwazulu - Natal** | 2,852,432 | 2,076 | 5,920,541 | 652 |
| **Free State** | 765,489 | 2,076 | 1,588,858 | 538 |
| **North West** | 1,063,161 | 2,076 | 2,206,709 | 593 |
| **Gauteng** | 1,916,684 | 2,076 | 3,978,291 | 495 |
| **Mpumalanga** | 843,547 | 2,076 | 1,750,876 | 605 |
| **Northern Province** | 1,948,754 | 2,076 | 4,044,856 | 741 |
| **South Africa** | 12,819,297 | 2,076 | 26,607,881 | 606 |

11.3.2 **Health Grant**

a. The purpose of this grant is to provide financial resources to provinces to ensure provision of national standards in primary health care as defined by the national department.

b. As with the education grant, the primary health care grant has 3 components : demographic, policy and cost. The demographic component defines the "qualifying population" described further in (d) below; the policy component is a projected target of visits to public clinics; and the cost component is derived from a National Health Insurance (NHI) model designed by the national department of health.

c. The value of the health grant is determined by calculating the number of residents in each province that qualify for the grant and multiplying this number by an average cost per person.

   To determine the first of these numbers it is necessary to distinguish between those who have access to private medical care, through membership of medical aid schemes, and the remainder who rely on the public clinic system. It has been found that it is usual for members of private medical aid schemes to visit public health clinics once in two years on average, whereas other persons do so on average 1.82 times every year. Once the proposed new system of incentives has been introduced that will encourage patients to visit clinics first, and to go to hospitals only if referred there from a clinic, it is expected that the average clinic usage of the latter group will increase to 3.5 per year. This figure can be regarded as the target clinic usage rate. The

Back to Contents

target is expected to be reached in eight years time, whereas the clinic usage by medical aid patients is assumed to remain constant at 0.5 visits per year.

Using these factors, one is able to calculate the ‘qualifying population’ in terms of the health grant for each province by applying the weights of 0.5 to the number of people in the private system and annually increasing the weights (between 1.82 and 3.5) to the number of people in the public system for each year. The sum of these two calculations equals the total number of clinic visits estimated for a particular year; and dividing this number by the target usage rate determines the ‘qualifying population’ of the province for that year.

d. The final steps in the process are, firstly, to estimate the average cost per year of a visit to a primary health clinic and, secondly, to multiply this by the qualifying population to arrive at the amount of the grant being made to a province. The estimate of costs was derived from the NHI input-output model which projects the average cost per visit to a clinic.

| $S_H$ : NATIONAL STANDARDS FOR PRIMARY HEALTH | | |
|---|---|---|
| **Demographic** | **Policy component** | **Cost Component** |
| Qualified population weighted<br><br>for differential use by individuals with medical aid/benefit cover for use of public, primary care facilities | Development of the primary health care approach. Average clinic visits per annum to increase from 1.82 to 3.5 over 8 years | NHI model estimates of average cost per clinic visit |

e. Table 3 contains the results of the FFC’s calculations with respect to the grant for primary health-care. Column 2 lists the numbers of qualifying persons in terms of the definition given above. The third column contains the grant amount per qualifying person. As was the case with education, these amounts are equal, irrespective of the province to which they refer. Column 4 contains the total grant amounts for the different provinces and Column 5 the grant per capita or grant per resident.

**TABLE 3: $S_H$ formula component:** National standards grant for primary health, 1995/6

| [1] | [2] | [3] | [4] | [5] |
|---|---|---|---|---|
| **Province** | **Qualifiying population** | **Grant per qualifiying resident (Rand)** | **National standards amount (R000s)** | **Grant per resident (Rand)** |
| **Western Cape** | 2,870,340 | 124.38 | 357,021 | 93.26 |
| **Eastern Cape** | 6,701,041 | 124.38 | 833,495 | 116.71 |
| **Northern Cape** | 676,869 | 124.38 | 84,191 | 107.06 |
| **Kwazulu-Natal** | 8,045,666 | 124.38 | 1,000,744 | 110.22 |
| **Free State** | 2,623,472 | 124.38 | 326,315 | 110.58 |
| **North West** | 3,342,231 | 124.38 | 415,717 | 111.75 |
| **Gauteng** | 5,760,065 | 124.38 | 716,454 | 89.11 |
| **Mpumalanga** | 2,564,099 | 124.38 | 318,930 | 110.13 |

Back to Contents

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|---|---|---|---|---|
| **Northern Province** | 5,009,691 | 124.38 | 623,120 | 114.19 |
| **South Africa** | 37,593,474 | 124.38 | 4,675,987 | 106.52 |

11.4 **Basic Grant**

a. The total amount of financial resources for the basic grant is determined after the total allocation for the standards grant.
b. Table 4 illustrates how the basic grant is derived for each province.

**TABLE 4: 'B' formula component:** Basic grants to provinces, 1995/6, 25% rural weighting

| [1] | [2] | [3] | [4] | [5] |
|---|---|---|---|---|
| **Province** | **Weighted population** | **Basic grant per weighted resident (Rand)** | **Basic grant total (R000s)** | **Basic grant per resident (Rand)** |
| **Western Cape** | 3,965,030 | 695.35 | 2,757,097 | 720.20 |
| **Eastern Cape** | 8,299,080 | 695.35 | 5,770,794 | 808.09 |
| **Northern Cape** | 838,928 | 695.35 | 583,351 | 741.82 |
| **Kwazulu-Natal** | 10,509,292 | 695.35 | 7,307,673 | 804.85 |
| **Free State** | 3,293,641 | 695.35 | 2,290,244 | 776.11 |
| **North West** | 4,393,334 | 695.35 | 3,054,920 | 821.23 |
| **Gauteng** | 8,152,990 | 695.35 | 5,669,210 | 705.12 |
| **Mpumalanga** | 3,384,406 | 695.35 | 2,353,358 | 812.64 |
| **Northern Province** | 6,700,749 | 695.35 | 4,659,389 | 853.85 |
| **Total** | 49,537,448 | 695.35 | 34,446,038 | 784.66 |

c. Column 2 shows the "weighted population". As stated earlier a 25% weighting was given to rural persons.
d. Column 3 shows the grant provided per weighted person. Note that each weighted person gets an equal grant.
e. The total basic grant for each province is shown in Column 4. The figure for each province is obtained by multiplying the relevant figures in Columns 2 and 3.
f. Column 5 shows the basic grant per capita or per resident in each province. This figure is obtained by dividing the figure in Column 4 by the total population in the province.

11.5 **NITER**

a. Table 5 shows the grant for medical training allocated to the academic hospitals in four provinces ("m" in the formula).

**TABLE 5:'m' formula component:** Allocation for the NITER, 1995/6

| [1] | [2] |
|---|---|
| **Province** | **NITER (R000s)** |
| **Western Cape** | 280,734 |
| **Kwazulu-Natal** | 73,494 |
| **Free State** | 111,073 |
| **Gauteng** | 519,512 |

Back to Contents

| Total | 984,813 |
|---|---|

11.6 **Total financial allocations to the provinces**

a. Tables 6a - 6d illustrate the total financial allocation to each province.
b. Table 6a shows the provincial shares of the total financial allocation.

**TABLE 6a) Financial allocations per province (percentage share)**

| [1] | [2] | [3] | [4] | [5] | [6] | [7] |
|---|---|---|---|---|---|---|
| **Province** | **1995/96 Actual (base yr)** | **1996/97** | **1997/98** | **1998/99** | **1999/00** | **2000/01** |
| **Western Cape** | 11.26 | 10.50 | 9.80 | 9.14 | 8.53 | 7.96 |
| **Eastern Cape** | 17.58 | 17.12 | 16.69 | 16.30 | 15.92 | 15.58 |
| **Northern Cape** | 2.38 | 2.21 | 2.05 | 1.91 | 1.77 | 1.64 |
| **Kwazulu-Natal** | 20.04 | 20.30 | 20.54 | 20.77 | 20.98 | 21.18 |
| **Free State** | 7.08 | 7.07 | 7.06 | 7.06 | 7.05 | 7.05 |
| **North West** | 8.33 | 8.38 | 8.43 | 8.47 | 8.51 | 8.55 |
| **Gauteng** | 14.91 | 15.75 | 16.53 | 17.25 | 17.93 | 18.57 |
| **Mpumalanga** | 5.81 | 5.96 | 6.11 | 6.24 | 6.37 | 6.49 |
| **Northern Province** | 12.61 | 12.70 | 12.78 | 12.86 | 12.93 | 12.99 |
| **South Africa** | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |

Note:
1. The FFC's recommendations are calculated to phase in over a five year period;
2. Provinces with declining shares over the five year period: Western Cape, Eastern Cape, Northern Cape, and Free State.
3. Provinces with increasing shares: North West, Gauteng, Kwazulu-Natal, Mpumalanga and Northern Province.

c. Table 6b shows the total financial allocations to provinces in 1995 rand and Table 6c the annual percentage change in these allocations.

**TABLE 6b) Financial allocations per province in 1995 rand (million)**

| [1] | [2] | [3] | [4] | [5] | [6] | [7] |
|---|---|---|---|---|---|---|
| **Province** | **1995/96 Actual (base yr)** | **1996/97** | **1997/98** | **1998/99** | **1999/00** | **2000/01** |
| **Western Cape** | 7,510 | 7,270 | 7,031 | 6,791 | 6,552 | 6,313 |
| **Eastern Cape** | 11,728 | 11,854 | 11,980 | 12,105 | 12,231 | 12,357 |
| **Northern Cape** | 1,585 | 1,529 | 1,472 | 1,416 | 1,359 | 1,302 |
| **Kwazulu-Natal** | 13,370 | 14,056 | 14,742 | 15,428 | 16,115 | 16,801 |
| **Free State** | 4,722 | 4,895 | 5,069 | 5,242 | 5,416 | 5,589 |
| **North West** | 5,560 | 5,805 | 6,050 | 6,295 | 6,539 | 6,784 |
| **Gauteng** | 9,950 | 10,905 | 11,861 | 12,817 | 13,773 | 14,728 |

Back to Contents

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|---|---|---|---|---|---|---|
| **Mpumalanga** | 3,874 | 4,129 | 4,383 | 4,638 | 4,892 | 5,147 |
| **Northern Province** | 8,415 | 8,794 | 9,172 | 9,550 | 9,928 | 10,306 |
| **Provincial government** | 66,715 | 69,237 | 71,759 | 74,282 | 76,804 | 79,327 |
| **National government** | 86,534 | 86,534 | 86,534 | 86,534 | 86,534 | 86,534 |

**TABLE 6c) Percentage change in financial allocations per province (based on table 6b)**

| [1] | [2] | [3] | [4] | [5] | [6] | [7] |
|---|---|---|---|---|---|---|
| **Provincial** | **1995/96-1996/97 Actual** | **1996/97-1997/98** | **1997/98-1998/99** | **1998/99-1999/00** | **1999/00-2000/01** | **Period Average** |
| **Western Cape** | -3.19 | -3.29 | -3.41 | -3.53 | -3.65 | -3.41 |
| **Eastern Cape** | 1.07 | 1.06 | 1.05 | 1.04 | 1.03 | 1.05 |
| **Northern Cape** | -3.57 | -3.70 | -3.84 | -3.99 | -4.16 | -3.85 |
| **Kwazulu-Natal** | 5.13 | 4.88 | 4.65 | 4.45 | 4.26 | 4.67 |
| **Free State** | 3.67 | 3.54 | 3.42 | 3.31 | 3.20 | 3.43 |
| **North West** | 4.40 | 4.22 | 4.05 | 3.89 | 3.74 | 4.06 |
| **Gauteng** | 9.61 | 8.76 | 8.06 | 7.46 | 6.94 | 8.16 |
| **Mpumalanga** | 6.57 | 6.16 | 5.81 | 5.49 | 5.20 | 5.85 |
| **Northern Province** | 4.49 | 4.30 | 4.12 | 3.96 | 3.81 | 4.14 |
| **Provincial government** | 3.78 | 3.64 | 3.52 | 3.40 | 3.28 | 3.52 |
| **National government** | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

d. Finally, Table 6d shows the financial allocation per capita for each province. Note that while Gauteng receives the highest percentage growth in the total provincial allocation (Table 6c), its per capita allocation is still the lowest at the end of the five year period under consideration (Table 6d).

**TABLE 6d) Financial allocations per province in per capita 1995 rand**

| [1] | [2] | [3] | [4] | [5] | [6] | [7] |
|---|---|---|---|---|---|---|
| **Provinces** | **1995/96 Actual (base yr)** | **1996/97** | **1997/98** | **1998/99** | **1999/00** | **2000/01** |
| **Western Cape** | 1,962 | 1,864 | 1,770 | 1,678 | 1,589 | 1,503 |
| **Eastern Cape** | 1,642 | 1,649 | 1,656 | 1,662 | 1,669 | 1,675 |
| **Northern Cape** | 2,016 | 1,902 | 1,793 | 1,687 | 1,585 | 1,486 |
| **Kwazulu-Natal** | 1,473 | 1,517 | 1,560 | 1,600 | 1,638 | 1,673 |
| **Free State** | 1,600 | 1,594 | 1,587 | 1,577 | 1,566 | 1,553 |
| **North West** | 1,495 | 1,525 | 1,554 | 1,580 | 1,605 | 1,627 |
| **Gauteng** | 1,238 | 1,289 | 1,332 | 1,367 | 1,396 | 1,418 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Mpumalanga** | 1,338 | 1,401 | 1,461 | 1,519 | 1,574 | 1,627 |
| **Northern Province** | 1,542 | 1,598 | 1,654 | 1,708 | 1,761 | 1,814 |
| **Provincial government** | 1,520 | 1,541 | 1,559 | 1,576 | 1,590 | 1,603 |
| **National government** | 1,971 | 1,925 | 1,880 | 1,836 | 1,792 | 1,748 |

## 12. Conclusion

12.1 The Interim Constitution stipulates that provinces are entitled to an equitable share of revenue collected nationally and that the FFC should make recommendations to Parliament in this respect (Sections 155 and 199). This document contains the FFC's proposals for the 1996/97 fiscal year as well as projections for the following four years.
12.2 The total resources available to the public sector were estimated firstly by assuming that the country's GDP will grow at a moderately increasing rate from the base of 2.5 per cent in 1995/96. Provision is made also for a decrease in the budget deficit over the period under consideration.
12.3 The vertical division of the total available resources between the national and lower-tier governments is based on the constitutional allocation of functions, according to which the delivery of the major services to the public, such as education and health-care, is the responsibility of provincial governments. However, it recognises that both tiers of government have existing commitments which must be honoured in the short-term.
12.4 As the services of only a limited number of national departments are related to the increase of the population (and some could be decreased over the period), the FFC recommends that the allocations to the national government be kept constant in real terms for the next three years; and that the additional resources derived from the growth of the economy in this period be allocated to the provinces. This will enable the current extremely unequal provision of public services to be corrected in the reasonably short period of five years.
12.5 The FFC recommends that the total financial allocation to the provinces be determined by means of a provincial grants formula comprising three major elements: a basic (population-based) grant, a national standards grant (for school education and primary health) and a tax capacity equalisation grant.
In addition, in recognition of the national role played by academic hospitals, the FFC recommends that separate conditional grants (m) be given to those provinces having such institutions.
12.6 The tax capacity equalisation grant will not be introduced until the provinces have been given the power to levy their own taxes by Act of Parliament according to Section 156 of the Interim Constitution.
12.7 In the total financial allocations to the provinces, determined according to the grants formula, for 1996/97, the percentage shares of four provinces (Western Cape, Eastern Cape, Northern Cape and Free State) decrease relative to their allocation in the 1995/96 budget while the shares of the other five provinces increase. This pattern is projected to continue during the following four years until a greater degree of equity in the allocation of financial resources is attained with respect to population distribution and basic needs in the provinces.
**Notes:**

1. All monetary values in this document are expressed in 1995 rand.

2. Provinces are listed in the table from the south of the country northward.

3. Notes for Table 1:

   [2] CSS data adjusted by DIB (1995)
   [3] CSS data adjusted by DIB (1995)
   [4] HSRC (1994), based on SALDRU (1993)
   [5] CSS (1991)

[6] CSS October household income and expenditure survey 1994, adjusted to 1995 rand
[7] CSS data adjusted by DIB (1995)

4. Abbreviations:

DIB - Demographic Information Bureau
HSRC - Human Sciences Research Council
SALDRU - Southern African Labour and Development Research Unit

5. Publications:
    1. HSRC, 1995: Poverty, Inequality and Human Development in South Africa.
    2. SALDRU, 1994: South Africans Rich and Poor - Baseline Statistics from the 1993 Project for Statistics on Living Standards and Development.