# THE FINANCIAL AND FISCAL COMMISSION: TWO DECADES OF INSTITUONAL EVOLUTION

**ABSTRACT:**

This paper analyzes the Financial and Fiscal Commission (FFC) as a specific institutional response to the exigencies of the South African transition to democracy and the fiscal constitution of 1996, highlighting some key differences with other similar bodies internationally. As a creature of the constitution and an institution supporting democracy, the Commission's evolution is inextricably linked to the realisation of other transformative constitutional elements including the imperatives for creating a fiscally decentralised system, for public finance management reforms as well as the progressive realisation of socio-economic rights. The paper examines the role of the FFC's recommendations in shaping the intergovernmental fiscal relations (IGFR) trajectory over the past two decades. The Commission's role has responded to a maturing IGFR and public financial management system and a changing role of Parliament in the budget process. The paper concludes by exploring a few salient unresolved issues in the South African IGFR system, with which the FFC will continue to engage.

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# THE FINANCIAL AND FISCAL COMMISSION: TWO DECADES OF INSTITUTIONAL EVOLUTION

The aim of this paper is not a rigorous analytical exercise on the role, function and performance of the Financial and Fiscal Commission over the last 20 years. This has been amply covered by the FFC itself, as well as by domestic and international academic authors. Rather it intends to share a personal perspective of the author, reflecting on her decade long period in office as a Commissioner of the FFC, in a modest attempt to capture some of its rich institutional history and lessons learnt. She has been privileged to serve under all 4 chairpersons of FFC since its inception in 1994. This paper pre-supposes a knowledge of the South African IGFR system which has been well documented elsewhere (e.g. Ajam, 1999; Levy & Tapscott, 2001; Malan, 2005).

The first part of this paper presents a conceptual framework for analyzing the institutional evoluton fiscal commissions, and makes a cogent case for the existence of independent fiscal commissions, particularly in developing countries in transition or emerging from conflict. Using this conceptual approach, latter part of the paper focuses on the institutional growth and development of the FFC in the two decades since its inception.

Justiciable socio-economic rights coupled with a decentralised fiscal system are two of the most unique features of the South African constitutional dispensation. Appendix 1 considers the broad theoretical rationale for enshrining justiciable socio-economic rights and a decentralised fiscal system within a constitution. This provides useful insight into the context in which intergovernmental relations in South Africa plays itself out. With the broader institutional analysis of fiscal constitutions outlined in Appendix 1 as a backdrop, the following section examines fiscal commissions as a specific institutional response to these intergovernmental challenges.

## 1 INSTITUTIONS AND INTERGOVERNMENTAL FISCAL OUTCOMES: AN INTERNATIONAL PERSPECTIVE

There are a number of different institutional configurations underpinning intergovernmental fiscal relations in countries with decentralized systems with multi-level government, be they federal or unitary. These include: intergovernmental forums, independent commissions and combination of both (as in South Africa). This section outlines an approach to assessing the transaction costs and potential outcomes of each of these alternative institutional mechanisms for intergovernmental revenue sharing, with the aim of identifying an optimal institutional arrangement. This approach is then applied to evaluating intergovernmental revenue sharing institutions in South Africa: the Budget Council and the FFC in Section 1.3below.

### 1.1 Fiscal commissions: varying institutional responses to varying political economy contexts

There has been increasingly wide spread recognition in the both the academic and policy literature that budget institutions, as the "rules of the game", influence budget outcomes through shaping incentives faced various stakeholders (Campos & Pradhan, 1996; Horn, 1995, Poterba & von Hagen, 1999;Schick, 1998; Von Hagen, 2007).Here the term institution does not refer to organisations as per common parlance, but, in the institutional economics sense, to the "rules of the game" both formal (e.g. constitutional and legislative frameworks) and informal (e.g. social and professional norms, organisational culture, values and attitudes) which incentivise or discourage certain behaviours by roleplayers within the intergovernmental system.

Allen Schick emphasizes the impact of institutions in shaping incentives for aggregate fiscal discipline, allocative efficiency and operational efficiency in fiscal systems, in particular through (a) the budget rules, (b) roles and responsibilities of various stakeholders in the budget process and (c) flows of information (Schick, 1998). Developing appropriate and effective fiscal institutions is being recognised as critical for developing countries to ensure sustained, successful fiscal reform and improved fiscal outcomes (Andrews, 2013; Allen, 2009).

Many developing countries, including those in post-confict situations, are adopting constitutional democracies with some sort of federalist or decentralised unitary system of multi-level government as a peace building mechanism and to accommodate diversity. With the thrust towards decentralised and multi-level governments, intergovernmental fiscal relations systems (IGFR),and the institutions which support them, become increasingly prominent from both a political and administrative perspective. It is, therefore, not surprising that the intergovernmental arrangements underpinning effective fiscal and budgetary process across multiple tiers of government have recently attracted attentionnot only in the policy and academic domains (Choudhry & Perrin, 2007)but also aas practical organisational mechanisms being adopted by developing countries (such as Kenya and Sudan in the aftermath of their negotiated constitutional regimes). The experiences of the South African FFC may therefore have broader relevance, especially for developing countries contemplating or engaged in similar reform.

Institutional modalities for IGFR across different countries include:

1. central/national government agencies having sole or shared responsibility for policy and implementation of intergovernmental grants;

2. the national legislature models;

3. intergovernmental forums on which different tiers of government are represented

4. independent fiscal commissions.

Table 1below illustrates a range of institutional models employed by selected countries for intergovernmental revenue sharing and grant design.

**Table 1: Responsibility for Design of Intergovernmental Fiscal Transfer in Select Countries**

| Model | Responsibility |
|---|---|
| Central / National government agency model | ***Office of the President*** |
| | Kyrgyz Republic |
| | Tanzania (regional administration and local government Unit) |
| | ***Ministry of Finance*** |
| | China |
| | Italy (policy only) |
| | Kazakhstan |
| | Netherlands (Shared with the Ministry of Home Affairs) |
| | Poland |
| | Switzerland |
| | Ukraine |
| | ***Ministry of Home Affairs*** |
| | Italy (Distribution of funds only) |
| | Netherlands (with Ministry of Finance) |
| | Philippines (Ministry of Interior and Local Government) |
| | Republic of Korea (Ministry of Government Administration and Home Affairs) |
| | ***Ministry of Local Government*** |
| | Ghana (Ministry of Local Government and Rural Development) |
| | Zambia |
| | ***Planning Commission*** |
| | India (for plan and capital grants) |
| | ***Ministry of Public Administration*** |
| | Japan (Ministry of Finance is consulted) |
| National legislature model | Brazil: Senate<br>Ethiopia: House of Federation |
| Intergovernmental forum model | Canada:  Fiscal Arrangements Committee |
| | Germany:  Finance Planning Council |
| | Indonesia: Regional Autonomy Advisory Board |
| | Nigeria:  Revenue Mobilization, Allocation and Fiscal Commission |
| | Pakistan:  National Finance commission |
| Independent agency (grants commission) model | Australia:  Commonwealth Grants Commission |
| | India:  Finance Commission |
| | South Africa:  Financial and Fiscal Commission |
| | Kenya:  Commission for Revenue Allocation |
| | Uganda:  Local Government Finance Commission |

***Source: based on Shah, 2007: 295***

This diversity of institutional responses is also evident in Africa, where some countries such as Nigeria have opted for the intergovernmental forum model, Ethiopia through its House of Federation has chosen a national legislature model, while others such as Kenya, Uganda, Sudan, South Sudan and South Africa have adopted independent fiscal commissions.

It should be noted that the IGFR configuration of a country may include more than one of these institutional mechanism. In South Africa, for example, the Financial and Fiscal

Commission co-exists with intergovernmental fora (the Budget Council and Budget Forum) which are instrumental in determining intergovernmental allocations. Where both intergovernmental forums and independent commissions co-exist, Shah cautions that the "incremental value add provided by the independent agency must be rigorously examined" (Shah, 2007, p. 306). This is done later in this section in relation to the South African experience.

There are substantive variations in what fiscal commissions do and how they are structured. This paper does not attempt to conduct a detailed institutional comparison (see for example Shah, 2007). Appendix 2 however offers a brief comparison of the mandate and structure of independent fiscal commissions in South Africa, Australia, India, Uganda and Kenya to illustrate some of this diversity:

Given that the powers, functions and reporting lines of individual independent fiscal commissions differ so substantially, it is clear that these considerations should inform the evaluation of a Commission's performance. In practice however, the degree to which an independent commission's recommendations have been accepted by government tends to be the prime indicator of its effectiveness. For instance:

> The role of the Fiscal and Financial Commission of South Africa is constitutionally strong, but in practice this commission is weaker and less relevant in regional fiscal equity than the others. Neither the National Treasury nor the provinces have paid much attention to the Commission's recommendations (Shah, 2007:316).

In other words, the success of an independent Commission tends to be measured by the extent to which its technical recommendations supersede political values and considerations in intergovernmental revenue and grant allocations. But, as will be explored later in Section 2below, if the original intention in creating an independent commission was not to supplant but to inform political decision-making then a measure of institutional success based solely on this single indicator may not be appropriate.

Casual observation of the table in Appendix 2 which compares a few fiscal commissions (South African, Australia, India, Uganda and Kenya) would seem to suggest that broader ambits and self-definition of the terms of reference of independent commissions seem to be associated with less binding recommendations. Moreover it does not appear as if stronger constitutional status necessarily results in the convention that recommendations be accepted in general. Thesetentative inferences are merely suggestive and there is considerable scope for further more rigorous research based on a larger sample of commissions, especially as decentralisation and the need for effective intergovernmental institutions increases.

## 1.2 Fiscal commissions through an institutional economics lens

Drawing on an analytical framework grounded in institutional economics, Shah (2007) frames the optimal intergovernmental institution for intergovernmental grants as a principal-agent problem facing two challenges: (a) ensuring that the current agents act in the current principal's interests and (b) the pre-commitment problem to ensure that the preferences and agreements by the current principal is also honoured by future principals and agents. The latter is especially pertinent in relation to equalisation of public service funding and delivery outcomes, as these are likely to be realised gradually over a long time horizon.

Citizens, as the principal, conclude a national compact on equalization principles and standards, which however needs to be implemented by a various public agents (e.g. the legislature and executive at national level). The national compact may be an informal but universal consensus on fiscal equalization objectives, or may be more formally enshrined in a constitution or legislation. The national compact would typically require a substantial amount of time to be fully realised. The choice of embedding the compact in a constitutional framework helps ensure that future generations continue to implement the contact, since it is more difficult or costly to amend the constitution compared to legislation or other policy pronouncements. Constitutional provisions therefore mitigate, but do not entirely eliminate, the pre-commitment problem.

Public agents also may have different objectives from the principal (i.e. citizens) and they may elect to pursue their own self-interest at the expense of their principal’s. For example, the executive or legislature of a particular region may oppose redistribution of public resources away from their region. The citizens, as the principal, need to align their agents’ objectives with their own and need to ensure that public agents do indeed carry out the compact. Both principal and agents incur costs (e.g. time and effort) associated with participation, negotiation and decision-making which tend to be higher under circumstances of greater uncertainty, the greater the number of agents involved and the degree to which relevant information is available. In addition, principals also incur agency costs which are the costs associated with monitoring the agents in order to enforce compliance with the compact (in this case fiscal equalisation and equalisation of associated public service levels.

Using this principal-agent analytical framework outlined above, an optimal institutional arrangement would minimise agency costs, costs associated with uncertainty, as well as other transaction costs associated with participation, negotiation, decision-making and monitoring. An optimal institution would also create an appropriate incentive regime which would support equitable, durable and affordable intergovernmental allocation. These criteria permit the evaluation of alternative intergovernmental governance structures and administrative arrangements such as intergovernmental fora, legislatures and/or independent fiscal commissions. An implication of the framework is that greater transparency and access to information to civil society, the media and the legislatures, reduces information asymmetry between the principal (citizen) and the agents (e.g the executive), thereby reducing agency costs and enhancing accountability (Shah, 2007).

Formula based grant allocations with independent fiscal commissions are regarded often regarded as international good practice (Boex & Martinez-Vazquez, 2004; Choudhry & Perrin, 2007) because of the objectivity, transparency and technical expertise they bring to bear on the revenue sharing process, insulating it from political manipulation.

Shah however contends that independent agencies are likely to incur greater transaction costs and attain less favourable outcomes than intergovernmental forums: “In summary, the independent grant commission is a poor substitute for an intergovernmental forum. Its usefulness as a complementary institution forum is also limited, in view of high agency costs and its predisposition toward optimal as opposed to feasible reforms” (2007:309). His argument is summarised in Table 2below:

**Table 2: Transaction Costs and Potential Outcomes of Intergovernmental Forums and Independent Agencies (Grants Commissions)**

| Item | Intergovernmental forum | Independent agency |
|---|---|---|
| ***Transaction costs*** | | |
| Participation and monitoring costs | Low to medium | Low to high |
| Legislative and executive decisionmaking costs | High | High |
| Agency costs | Low | High |
| Uncertainty costs | Low | Medium |
| ***Potential outcomes*** | | |
| Political compact on equalization standard | Yes | No |
| Durability of the political compact | Yes | n/a |
| Pool determined by equalization standard | Yes for some, no for others | No |
| Allocation determined by equalization standard | Yes | No |
| Stability of allocation criteria | Yes | Maybe |

***Source: Shah, 2007: 309***

One of the main advantages of intergovernmental fora is that these bodies decide on both the vertical division of revenue (the pool of funds available for divisioin) as well as the division of resouces across subnational jurisdictions on the basis of the equalization standard. The equalization standard therefore may drive both the allocation across jurisdictions as well as the determination of the pool itself, and thereby ensure affordability of the equalization standard in absolute cost terms. In instances where the pool available for distribution is determined independently (i.e. the vertical division) and the independent commission only considers the horizontal division, then their focus will be on the relative share of individual jurisdictions. The allocation going to each jurisdiction would be a function of its relative share and the size of the total pool available for distribution.

Shah's conclusion that independent commissions incur greater transaction costs but yield inferior outcomes to intergovernmental fora, rests on four main premises:

1. *Differing political vis-à-vis techncial objectives*: Intergovernmental forums, as institutionalised bargaining forums tend to display pragmatic, "satisficing behaviours" aimed at achieving a political consensus which would balance competing intergovernmental interests and diffuse conflict in as simple a manner as possible, minimising the transaction cost of the nation as a whole. Shah also contests whether it is both possible and desirable to remove decisions on equalisation (e.g. the minimum per capita fiscal capacity) completely from the political domain and relegate them to purely technical processes. Furthermore, the more technical inclination of independent fiscal commissions, in contrast to intergovernmental fora, is seen as predisposing them towards the pursuit of over-complex ideal systems which diminish the transparency of the allocation process, undermine accountability and frustrate citizen oversight. Technical solutions create a derived demand for profession services both in the secretariats supporting fiscal commissioners as well as fromdomestic and foreign academics and other consultants. These professionals may favour increased complexity and theoretical purity in order to boost the "supplier-induced" demand for their services.
2. *Different orientations to consensus building for equalisation:* Conflicting interests and varying appetites for equalisation are represented in intergovernmental forums, within the parameters delimited by the constitution or legislation. Intergovernmental forums are characterised as being generally successful in concluding politically acceptable compacts due to peer pressure. Shah posits that the *in camera* nature of the forum's negotiations may facilitate politically difficult compromises being made by eliminating public "political grandstanding". He claims that "blameshifting is not possible" given that forum participants assume full responsibility for their decision and cannot blame an external party such as an independent fiscal commission (Shah, 2007). Furthermore, political agreements lend themselves to simplicity given the greater transaction costs associated with concluding, monitoring and enforcing agreements with complex criteria. It should be noted, however, that an assumption implicit in Shah's analysis seems to be that all parties have roughly equal powers, at least to veto outcomes which are unacceptable to them. While this may be probably in countries where subnational governments have substantial fiscal capacity and other forms of autonomy, it may not be the case in instances where there are large vertical fiscal imbalances and where subnational governments may be quite dependent on intergovernmental grants from national government. Under these circumstances, national government's preferences may be dominant and the quest for genuine consensus in intergovernmental forums considerably diluted, resulting in lipservice consultation in form but not in substance.
3. *Durability of the compromise reached*: Because of each party stands to lose should the compact fail and because of the transaction costs associated with concluding a new agreement, Shah (2007) envisages that the political consensus arrived at in intergovernmental forums would be fairly durable. In contrast, he anticipates that the

relentless search by independent fiscal commissions for the perfect equalisation formula using the most sophisticated techniques and latest data should result in more frequent revisions to grant arrangements, hence less durable outcomes.

4. *Susceptibility to other agency problems*: Here the argument is that intergovernmental forums typically do not have any incentive to justify their continued existence since the forum is merely a bargaining platform for the individual participants' interests. However, Shah notes that fiscal commissions, in contrast, face incentives to justify their continued existence through mission creep (i.e. seeking to expand their range of activities). Politicians may not curtail this creep due to unwillingness to be seen to be hindering the pursuit of "the holy grail - the ultimate formula for the equitable distribution of federal funds" (2007: 307).In addition to agency problems between the citizen principals and the independent commission as agent, he also hints at further agency problems between the fiscal commissioners and the professional research secretariats and consultants appointed to support them: "Outside academic experts typically clamor for further complexity to achieve more-precise justice. There is no escape from this circle, as part-time or term employment of members of the commission limits the oversight provided by them. It takes some time for term members to grasp the complexity of the allocation rules; by the time they can form their own judgment on their relative merits, it is usually time for them to leave. In any case, the staff would be resistant to any simplification, and recipient governments that benefit from the complexity and associated inequities of the system would likely block any reforms" (2007:308). It should be noted that a fiscal commission created by the constitution would face less pressure to justify its existence per se and mission creep would be constrained by the constitution and its founding legislation, which would be fairly costly to change.

Shah's analysis is insightful but incomplete. His calculus of the relative transaction costs of intergovernmental forums vis-à-vis independent commissionsdoes not explicitly factor in:

1. *the role of power relations among levels of government* (as noted above) as a result of which national government and the stronger subnational governments may impose their preferences on the others. The distribution of public resources tends to be conditioned by the underlying distribution of power.For example, subnational governments with the same governing party as the national level may be perceived to have more influence on allocations at the expense of subnational jurisdictions where opposition parties govern. Under such circumstances there may be a demand for an impartial pre-commitment device to ensure that the spirit of the original bargain is abided by and still build in sufficient flexibility to cater for the uncertain future. This is particularly true when fiscal decentralisation plays a peace and national building role and accompanies a complete regime shift, as in post-conflict situations.
2. *the role of trust (or lack thereof) in concluding and enforcing intergovernmental agreements*, especially in the absence of an independent judiciary (such as in post-conflict or developing country situations. Mistrust among the negotiating governments increases the transaction cost of concluding, monitoring and enforcing intergovernmental agreements. One example would be if a particular subnational government threatened secession for political reasons (such as the preservation of rights of minorities spatially concentrated in certain jurisdications) or because of divergent economic interests and solidarity with the other jurisdictions (e.g. concentrations of natural resources). Under these circumstances an independent commission may entail lower transaction costs than an intergovernmental forum and be more effective.
3. *The nascent nature of political institutions:* Political institutions of democracy may be in their infancy in developing countries (e.g. civil society may be ill-informed and uneducated and hence not able to exercise oversight over the executive, and the

media may not be free). Parliament and the judiciary may also be weak. All of this may mean that the executive is not held accountable. Independent experts may be seen to be less prone to corruption and capture by rentseeking interests.

4. *The need for deliberate institutional redundancy as a "fail safe mechanism"*: In their seminal work on fiscal system in poor countries, Caiden and Wildavsky (1970) note that in developed countries there tends to be a fair amount of planned redundancy and "slack"in the system to deal with uncertainty or institutional change. Examples would be a depth of skills which permit back up for key positions or contingency reserves. In poor countries in contrast, if the one skilled person (e.g. engineer or IT person) is ill or leaves the organisation, the entire system grinds to a halt. Institutional change e.g. public financial management reforms may require the new system to be piloted in parallel to the old, which would require additional resources. In developing countries where advanced economics and public finance skill sets are not being adequately produced by universities, fiscal commissions may represent a degree of insitutional redundancy by design and generate a skills pool which benefits the entire fiscal system.

At the end of the day, the complex calculus of costs vis-à-vis benefits must be context specific – no single institutional configuration is likely to be optimal under all circumstances. In stable developed countries where systems have evolved over long periods of time and dispay a large degree of continuity, where there is a high degree of trust and/or third party enforcers such as the the judiciary, strong legislative oversight, a political culture of cooperation, institutionalized mechanisms for conflict resolution and an informed active citizenry, intergovernmental forums may well be effective and entail lower costs than independent fiscal commissions.

As argued above, in transition and developing countries, a compelling case may well exist for an independent fiscal commission, as is the case in South Africa. As explored further later in this paper, much will depend on its mandate and the objectives it chooses to achieve, its organisational capability and its actual performance in achieving its objectives.

## 1.3 Assessing South African's revenue sharing institutional arrangements

Shah employs his analytical framework to into compare transactions costs and potential outcomes incurred by intergovernmental forums in Canada and Germany with independent grants commissions in Australia and India (see Appendix 3). He concludes that in these cases intergovernmental forums have yielded lower transaction costs and better outcomes than independent commissions and that there is little empirical support for the contention that grants commissions increase the transparency, equity and accountability of the IGF system.

In Shah's empirical analysis, he juxtaposes intergovernmental forums and independent commissions as alternative institutional forms but he does acknowledge that both may co-exist. This is the case in South Africa which has both the Budget Council and the FFC. The Budget Council, an intergovernmental forum established by the Intergovernmental Fiscal Relations Actof 1997, consists of the national Minister of Finance and his nine provincial counterparts (the Members of the Executive Council for Finance) and makes the decision on the vertical division of nationally collected revenue among national, provincial and local government spheres, and horizontal division of revenue across provinces and across municipalities within a particular sphere. The Budget Council decisions are ratified by Cabinet. The FFC makes its recommendations to Parliament and the provincial legislatures, and has observer status at Budget Council.

The table below attempts to summarise an institutional analysis of the Budget Council and the FFC:

**Table 3: Institutional analysis of the Budget Council and FFC**

| | Budget Council | Financial and Fiscal Commission |
|---|---|---|
| ***Transaction costs*** | | |
| Participation and monitoring costs | High. Proceedings are confidential and not in the public domain | Low. Everything relating to recommendations (e.g. technical reports) are on the FFC website. |
| Legislative and executive decision-making costs | High. Budget Council incurs transaction costs associated with building consensus. Proceedings in Budget Council are highly confidential and not in the public domain making direct citizen oversight difficult. | Low. Provision of evidence-based information and analysis complements and does not replace political decision making in the Budget Council. Parliamentary oversight is strengthened which reduces oversight costs. Executive and Parliamentary accountability is not undermined |
| Agency costs | Low. However power imbalances between national and subnational governments may mean that agreements achieved are not necessarily consensus driven. | Low to medium. Formula complexity is constrained by lack of data. Potential rent-seeking by Commissioners is constrained by externally determined salaries of Commissioners which are infrequently revised. Mandate creep is curtailed by the FFC's overall tight budget constraint. Higher agency costs are incurred when independence means technical proposals are totally insulated from the political process and consensus building. In the FFC case, technical insight augments the political process but does not displace it. |
| Uncertainty costs | Low | Low. The Commission's recommendations are not binding in future and can therefore the specifics can be adjusted in relation to circumstances annually, while still retaining the overall principles. |
| ***Intergovernmental fiscal outcomes*** | | |
| Political compact on equalization standard | Yes - equitable sharing of revenues as well as justiciable socio-economic rights in the Constitution | |
| Durability of the political compact | Yes | |
| Pool determined by equalization standard | No. The vertical division of revenue is a political decision, not directly related to the costs of the equalisation standard | |
| Allocation determined by equalization standard | No. A formula is used which generates each province's and municipality's relative share of the available pool. | |
| Stability of allocation criteria | Yes | |

The transaction costs incurred by both the Budget Council and the FFC are explored below:

1. *Participation and monitoring costs:*Budget Council proceedings are confidential, do not enter into public policy debates nor attract anymedia coverage. As a result, citizen oversight over the process is difficult. The culmination of the revenue sharing process, the annual Division of Revenue Act, is passed by Parliament and is however accompanied by a fair amount of publicly available information. . By contrast to the Budget Council, all the FFC's recommendations and the technical reports, data and analysis on which they were based are freely available to the public on the Commission's website. The Commission's public hearings, for example, the Local Government Fiscal Framework hearing, provide a rare public platform for technical discussion on revenue sharing related issues.
2. *Executive decision-making*: Because the FFC's recommendations are legally non-binding, they do not preclude the emergence of a political compact, but rather enrich the "rough justice" of political negotiations. Transaction costs of executive decision-making and consensus are not increased and may even be diminished by the infusion of policy advice based on high quality research. As a permanent body, the FFC has the incentive to look beyond the medium term planning horizon at the longer term sustainability and equity of the IGFR system. Unlike treasuries which are subject to the unremitting deadlines of the budget process and embroiled in the day

to day operations of the fiscal system, the FFC has the luxury reflecting on the longer term strategic evolution of the IGR system as well as immediate concerns.

3. *Legislative decision-making*: The intergovernmental budget process in South Africa is long (about 18 months) and complex with many stakeholders. Without the requisite technical capacity in what is quite a specialised area, it would be impossible for the Parliament to exercise effective fiscal oversight over the executive (See Ajam, 2009). By providing evidence-based advice and recommendations to Parliament, the FFC has promoted information symmetry between the executive and legislature, thereby reduced the cost of legislative oversight and decision-making. For nearly all of the first two decades of democracy, Parliament did not have a budget office to inform its interactions with the executive in the division of revenue or the medium term expenditure framework more broadly[1]. Under these circumstances, the FFC's research based recommendations could enhance legislative oversight by putting on the table well-considered, feasible alternatives.
4. *Agency costs*: The Constitution created the FFC, therefore the FFC is not under much immediate pressure to justify its existence or legitimacy per se. Its challenge instead is in justifying its continued relevance and value-add to its stakeholders. The FFC's permanence means that it retains institutional memory which may otherwise be lost given the turnover of Parliamentarians after elections and the high turnover of senior officials in the executive (Kuye & Ajam, 2012). Tendencies for "mission creep" through assuming additional activities would be limited by the Commission's limited budget allocations and human resource constraints. Incentives to overly complicate the formula are constrained by the limited data available and the need to justify the costs of additional data in terms of their benefits, which encourages a simpler approach. Given the above factors, a strong case can be made that the agency costs associated with the FFC are low to medium.
5. *Uncertainty costs:* Because the FFC's recommendations are non-binding, they do not create rigidities or undermine flexibility in response to international and domestic economic shocks.

The additional transactions costs incurred by the FFC (over and above those of the Budget Council) need to be weighed up against the attainment of additional positive intergovernmental fiscal outcomes. These are discussed below.

1. *Transparency*: The Financial and Fiscal Commission has contributed substantially to increased transparency, not only in the sense of making data, analysis and policy advice freely available on its website, but also in trying to improve the user-friendliness of information through, for example, public hearings and plain language policy briefs. The National Treasury has been rate as one of the most transparent in the world. The degree of financial illiteracy is however so high not only in civil society but also in government itself that need for institutional capability to promote effective public engagement is enormous. This is especially true given the complexity of theIGFR system in shared concurrent functions such as education, health and basic services. Much more work is needed to go beyond transparency to active and meaningful participation by civil society in the intergovernmental budget process.

[1] In 2009 the Money Bills Procedures and Related Matters Act was passed which enabled Parliament to amend the budget and established a three stage budget process (consisting of the Medium Term Budget Policy Statement and fiscal framework, the division of revenue and individual appropriations to departments and public entities). The Act furthermore created a Parliamentary Budget Office and also required the FFC to provide advice at each of the key nodes of the three stage budget process. This seems to indicate a cooperative and complementary role was envisaged for the FFC and the PBO.

2. *Equity*: There is wide-spread political commitment to achieving equity, as enshrined in the constitution, and there has been in general considerable convergence to equity per capita funding over the last 2 decades. In some cases, however, the equalization standard in the form of input norms and service output standards are not well defined[2]. Furthermore, as pointed out by Shah (2007), the equalisation standard is not directly related to the total pool of funds available for revenue sharing nor to the individual allocations which go to the individual provinces which are based on relative equity. The Provincial Equitable Share generates a proportionate share per province on the basis of relative equity applied to a pre-determined pool emanating from the vertical division of revenue. This practice, rather than linking more closely with well-defined and costed equalisation standards as recommended in the FFC's costed norms (2000) is one of the major policy differences between the National Treasury and approach (which is further discussed later in this paper).
3. *Accountability*: One argument against independent commissions is that non-elected technical experts take binding allocation decisions for which they are not accountable to the electorate. In event of any problems, elected officials can simply shift the blame to the independent commission which dilutes accountability. This is not the case in relation to FFC recommendations, since the policy advice is non-binding. It is Parliament's role to hold government accountable, not the FFC's role. However, by providing research and advice to Parliament to improve legislative oversight the FFC contributes to creating a more accountable environment.
4. *Planned institutional redundancy and building institutional capacity:* Unlike their wealth country counterparts, poor countries often have limited financial reserves and human resource capacity to cushion against macroeconomic shocks to the system and other forms of uncertainty. In particular, reform of budgeting and expenditure management system may require some degree of spare capacity. For example, migration to a new financial management system may require both to run simultaneously (Caiden & Wildavsky, 1970). The FFC has created a pool of domestic specialist expertise in IGFR outside of government, thereby deepening the skills sets available to the country as a whole. In developed countries, the capacity developed by independent agencies may be superfluous, but in developing countries such as South Africa, a degree of planned institutional redundancy as a "fail safe" mechanism can add a lot of value. Although the FFC, like the National Treasury, has sought to draw on international technical expertise, judicious skills transfer has obviated dependency.

The FFC is still very much an institutional "work-in-progress" and there are no doubt many opportunities to improve its effectiveness and impact considerably. However, a cogent case can be made that FFC, as an institution supporting democracy, adds value over and above that of the Budget Council.

As discussed in the section below, the FFC played an influential role in establishing the system of intergovernmental fiscal relations in South Africa after the transition to democracy. As political dynamics mature, it may well be called upon to play more prominent role in intergovernmental disputes around intergovernmental transfers. Currently, the same governing party is dominant not only within the national sphere but also governs all of the provinces except the Western Cape which is run by an opposition party. If and when other dominant regional parties emerge, intergovernmental resource allocation processes may become much more contested. International experience such as India suggests that formal intergovernmental relations institutions may become much more prominent in

[2] An education NGO, Equal Education, has recently taken the Department of Basic Education to court in relation to school infrastructure norms and standards, for example.

intergovernmental bargaining and conflict resolution, rather than settling disputes informally through party caucuses.

In Canada, concerns about intergovernmental grant design are often settled through recourse to litigation in the courts. In South Africa however, in keeping with the imperative for cooperative government enshrined in chapter 3 of the constitution, the Constitutional Court (in the Uthukela District Municipality case around the local government equitable share[3]) has expressed a reluctance to be involved in intergovernmental decision-making unless all prior intergovernmental mechanisms have been exhausted.The FFC is obviously one such mechanism.

## 2 THE FFC OF SOUTH AFRICA: ITS CONSTITUTIONAL GENESIS AND ITS FIRST DECADE

This section sketches the trajectory of institutional development of the FFC in terms of the "rules of the game" set out in the South African constitution, its relationships with key stakeholders in the executive and legislature, the emergence of protocols for processing the FFC's recommendations and the availability of data and information on the basis of which makes its recommendations.

The FFC at its inception did not have the luxury of a pre-existing intergovernmental relations system within which to establish itself, but was required to help establish the IGFR system at the same time it was birthing and consolidating itself. An apt analogy is that of attempting to build an aeroplane while in mid-flight. As discussed further below, expectations of what the FFC should be shifted markedly between the 1993 interim constitution and the 1996 final constitution, resulting in some confusion as to whether the FFC was to be a consultative intergovernmental body on which each of the nine provinces would be directly represented (albeit composed of experts) or an independent expert commission.

### 2.1 Consultative or expert body?

The intergovernmental system outlined in the interim and final constitutions was a product of contestation and compromise during the negotiated settlement between the apartheid Nationalist Party (NP) and the African National Congress (ANC). The creation of the nine decentralised provincial governments within a unitary state was a concession by the centralist ANC to parties representing geographically concentrated racial or ethnic minorities which were pushing for a federal alternative, such as the NP in the Western Cape and the Inkatha Freedom Party in Natal. The NP, to protect minority political rights and culture and limit redistribution, were demanding significant devolution of both expenditure and taxing authority to provincial governments.

The ANC, as reflected in its 1993 *Regional Policy* document, favoured centralisation of the tax system to promote redistribution and overcome the racially-biased developmental deficits resulting from apartheid, but were forced to concede some degree of expenditure decentralisation for subnational governments based on the powers and functions assigned to them in the interim constitution of 1993 and the final constitution of 1996. This would create structurally a large vertical fiscal imbalance and require a system ofrevenue sharing and intergovernmental grants. The dependence of the provincial governments on an equitable share of revenue centralised in national government resulted in both substantive and procedural safeguards being built into the constitution. The former relate to s214 (a) –(j) of the constitution which delineate the substantive factors to be considered in determining the equitable share. These include: developmental needs of subnational governments and their ability to provide basic services and perform their allocated functions, economic

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[3]*Uthukela District Municipality and Others v The President of the Republic of South Africa and others* (CCT 7/02) Handed down by the Constitutional Court: 12 June 2002 2003 (1) SA 678 (CC); 2002 (11) BCLR (CC)

disparities, fiscal capacity and efficiency, the national interest, national debt, the needs and interest of national government, stability and predictability of revenue shares and the need for flexibility. In addition, procedural safeguards required that subnational governments be consulted and the FFC recommendations be considered before determining the equitable share.

The 1993 *ANC Regional Policy* made the argument that detail of the intergovernmental transfer mechanism should not be specified in the constitution itself as it was likely to be either too inflexible or too vague. Instead the *ANC Regional Policy*proposed the creation of an independent, permanent statutory Advisory Commission on Fiscal Decentralisation to:

> …..advise government how best to ensure that the allocation of taxes and transfers to the various levels of government takes place within guidelines laid down in the constitution. These guidelines must be consistent with the extent of political autonomy decentralised government is to have, and with the Bill of Rights. Such guidelines should ensure that transfers are made in such a way that lower levels of government are able to plan properly; that they are structured so as to enhance efficiency and local accountability and that they are open to clear and effective monitoring. The guidelines must seek, in a transparent and objective manner, to redress inequalities between regions.(African National Congress, 1993)

The Consultative Business Movement (CBM) also released a report in September 1993 entitled *Multi-tier Fiscal Relations: Financing Regions in South Africa* which also advocated the creation of an independent commission, which it called the Financial and Fiscal Commission. This report, aimed at political parties, interest groups and the general public, was an input into the Multi-Party Negotiating Process, based on the third draft of the interim constitution and aiming to support the formulation of the section on Finance in the draft constitution (Chapter 11) which was then still to be written[4].

At that time, there were huge uncertainties and a profound lack of information required to design the fiscal relations between the centre and the regions effectively. These included:

- "Difficulty of ensuring regional fiscal independence.
- Impossibility of knowing and specifying all possible and potential taxes (taxes are developing over time)
- Possible costs arising from duplication of revenue collection
- Possible undermining of regional tax base due to the inflexibility of the system (by default all new taxes accrue to the centre)
- Ignorance of the optimal form or regional taxation" (Consultative Business Movement, 1993: 20).

As a result, instead of a detailed intergovernmental fiscal design codified inflexibly in the constitution, a process and an institution(the FFC) were instead proposed to deal with these issues. The creation of an FFC "would obviate the need to **rigidly** define the precise fiscal powers of the various levels of government in the constitution, yet offer a level of objectivity to the ongoing dynamic process of the development of intergovernmental relations" (emphasis in the original) (Consultative Business Movement, 1993: 29).

The CBM document regarded developing and operationalizing the concept of equity in the intergovernmental system, balanced against other developmental and economic concerns, as the core role of the FFC. Here the FFC was not seen as usurping allocative decisions from elected representatives, but rather strengthening the political bargaining process:

[4] The facilitation team leader was Colin Coleman of the CBM and the team comprised a number of international and local experts, including Lieb Loots (University of the Western Cape), Phillip van Ryneveld (University f the Western Cape), Marius van Blerck (Anglo American Corporation), Renosi Mokate (Development Bank of South Africa).

“Essentially it is there to help define the parameters within which bargaining over resources between different parts of the state should take place” (Consultative Business Movement, 1993: 29). Similarly, the Constitutional Court, not the FFC, would remain the “the final arbiter of whether lower levels of government are being equitably treated from a fiscal point of view”. (Consultative Business Movement, 1993: 28).

The FFC was envisaged to promote equity and the development of the intergovernmental fiscal system through ongoing technical interaction with the relevant institutions charged with fiscal matters in the executive and the legislature. The modalities for accomplishing this could include: advice, objective benchmarks and criteria, generating a body of IGFR research, data and information, as well as technical proposals on the future evolution of the IGFR systems in relation to changing circumstances. To the extent that the FFC established a track record of independent objectivity and therefore legitimacy, it could “be of great assistance to politicians in legitimising political programmes which are necessary but politically difficult to implement (Consultative Business Movement, 1993: 28).

S198 of the 1993 interim constitution established the Fiscal and Financial Commission (FFC) as an independent body with the constitutional mandate to make recommendations to Parliament on equitable allocations to national, provincial and local government from nationally collected revenues. This initial conceptualisation of the FFC was along the lines of a “consultative forum” with each of the nine provinces nominating an expert in economics, public finance and related fields to represent their interests and nine experts nominated by national government (one of whom would have expertise in local government finance). S221(1) of the final 1996 constitution retained this ambiguous approach with elements both of a consultative and an expert body, as reflected in the representation on the Commission: 9 provincial nominees, 2 local government nominees and 11 from national government, each of whom with expertise in public finance, economics or related fields.

The Constitution Amendment Act of 2001 (elaborated on in the current FFC Act of 1997 as amended in 2003[5]) signalled a clear departure from a consultative model to an unambiguously expert independent commission. Only 3 persons were to be appointed in consultation with the nine provincial governments, a further 2 would be nominated by organised local government and 4 would be appointed at national level. Both reducing the size of the Commission from 18 to 9 and dispensing with individual provincial nominees who could be duly mandated to represent their province’s interests directly has eliminated the consultative dimension and reinforced the technical expertise dimensions.

While individual commissioners do not represent the interests of specific spheres of government, the Commission’s recommendations must be in the best interests of all three spheres and the intergovernmental system as a whole. One of the major drivers behind streamlining the Commission from 22 to 9 persons was as a result of a large number of Commissioner vacancies. Only 14 Commissioners were in office at the time of submission of the June 2001 recommendations, with obvious difficulties in relation to the quoracy of the Commission. The issue of vacancies is one which plagues the Commission to this day, including the position of Commission chair which has not been filled for about two years.

Section 2(A) of the FFC Amendment Act of 2003 also clarified the procedure for consulting the FFC when functions are shifted among spheres of government. Despite this, the FFC is often not consulted about function shifts and their impact on the revenue sharing until the tail end of the process.

[5] Financial and Fiscal Commission Amendment Act, no 25 of 2003

## 2.2 Institutionalizing the FFC: teething problems

The period between the interim constitution in 1993 and the final constitution in 1996 saw the creation of the nine provincial governments out of the amalgamation of the four provincial administrations of White South Africa (the Cape, Free State, Transvaal and Natal) and the plethora of black homelands: the four “independent states” of Transkei, Boputhutswana, Venda and the Ciskei and the six “self-governing” territories of Gazankulu, Kangwane, KwaNdebele, KwaZulu, Lebowa and QwaQwa. Each of these systems had, at least on paper, a legislative assembly, a political executive and an administration of public servants. These public services had to be merged, consolidated and then rationalised, while at the same time avoiding breakdowns in service delivery. Therefore there was a strategy of centralising to permit later decentralisation in line with the Constitution. This process was overseen by the Public Service Commission, established in terms of the 1993 Interim Constitution, and the Commission on Provincial Government.

The Government of National Unity assumed office in May 1994, followed soon after by the election of the provincial Premiers and the appointment of provincial executive councils. The need to establish the new public service as speedily as possible lead to the normal parliamentary procedures being by-passed . The basic framework legislation necessary for the establishment of the new public service was promulgated by proclamation by the President on 3 June 1994. The Public Service Act, 1994 included a time-limit for the Public Service Commission to establish uniformity in the terms and conditions of employment of civil servants within one year. The new Act also brought into existence a new structure of 35 national departments, offices and services, and nine new provincial governments, and the post of Director-General to head each of the national departments and provinces.

For 1995/96 and1996/97, the legislative framework for the financing of provinces was not yet put in place, and provincial budgeting was really just an extension of the national budget process, with transfer payments to the provinces shown as global amounts on the budget vote of the Department of Finance. The function committees were the key players in the budget process during the period in which the interim Constitution was in force.

The various function committees made recommendations for the division between provinces of guideline amounts for agriculture, education, health, nature conservation, roads, welfare etc. As their name suggests, function committees were charged with the responsibility of co-ordinating budget proposals for each area of government’s functional expenditure (e.g. health, education, defence). They received proposals for funding for all departments engaged in a function and prioritised them.

The functional committee for health, for instance, would allocate the health budget between provincial and national health departments. Each province was expected to spend exactly that amount on health. So initially, provincial budgets were just the sum of pre-determined functional allocations from the Department of State Expenditure and functional committees, with provincial legislatures having very little influence in shaping budget priorities. The functional committees were, however, disbanded after 1996/97 budget cycle.

The challenge at this early stage was to ensure that the provincial governments were not merely administrative extensions of the national government, but governments in their own right as envisaged by the Constitution. Furthermore, the pre-1994 budget process had to be completely transformed to align with the interim and final constitutions. In July 1995, the FFC submitted its seminal *Framework Document for Intergovernmental Fiscal Relations in South Africa* and its first recommendations in September 1995, *The Allocation of Financial Resources between the National and Provincial Governments: Recommendations for the Fiscal Year 1996-97.* The timing of these recommendations was unfortunate since it was too late in the budget process for them to have much impact. Secondly, the recipients of the

Commission's recommendations did not have established protocols for processing and responding to them. The FFC was able to time its submissions much better in subsequent years to feed into the critical milestones in the intergovernmental budgeting process. The fact that the FFC is legislatively required to submit its recommendation at least 10 months prior to the start of the fiscal year remains a critical factor to be managed, given that the research to support recommendations commences as least a year prior to submission.

In trying to take up the niche envisaged by the constitution the FFC initially encountered significant teething problems in defining its role in the budget process. Academic commentators noted:

> It might be argued that the FFC is far too young, has too little resources, and that the prerequisite statistical database for its role is not available. True as some of these might be, the real problem lies in the fact that the existing budget process is not designed to accommodate an entity such as the FFC (Abedian et al 1995: 14).

In the FFC's 1998-99 Annual Report, Murphy Morobe, the then Chairperson, expressed a concern that the Ministry of Finance had still not developed protocols for responding to the FFC's recommendations and opined that:

> It would serve the systemwell were bodies like the FFC not left at times with the feeling (real or imagined) that in the absence of clear protocols to facilitate its interactions with either the executive or legislative branch of government, derives from a political expediency which renders the institutions(s) irrelevant, The Commission should not have to fight for its place in the sun. Being born of the Constitution of the Republic, its role should be understood, welcomed and even facilitated so as to enhance the critical role it has of contributing theintegrity of the revenue-sharing regime in South Africa (FFC Annual Report 1998-1999 2000, 4-5)

These frustrations were significantly alleviated by the Intergovernmental Fiscal Relations Act of 2007 (IGFR Act) which formalized the phases and stakeholders in the intergovernmental budget process (i.e. the rules of the game), and the emergence of protocols and procedure between the FFC and its stakeholder in regard to processing its recommendations (clarifying roles).

The IGFR Act confirmed the FFC's observer status in the Budget Council which would allow it to be privy to the intergovernmental bargaining process while retaining its independence. The IGFR Act requires that the FFC submits its recommendations at least 10 months before the start of the financial year to Parliament and the provincial legislatures. This ensures sufficient time for the recommendations to be fully considered, but places significant pressure on the FFC since its research cycle would have to commence about 20 months (nearly 2 years) before the year to which the recommendations would apply. The IGFR Act also requires that Minister of Finance responds to FFC recommendations when the annual Division of Revenue Act is tabled, explaining the extent to which they had been taken into account. This ensures that a debate takes place not only at technical level (at Budget Council) but also within the public domain (as part of the Parliamentary and Legislature budget hearings).

Other challenges to the FFC as a nascent institution was to attract and retain the necessary specialised research and policy analysis skills, given their short supply in the entire South African economy as a whole. As a result of both Commissioner and secretariat staff turnover between 1996 and 1999, Melck and Van Gass (2004:9) observe that "virtually the entire research and senioradministration staff, with the exception of the Chairman, were new or in newroles. (Melck & Van Gass, 2004)

Wehner notes these other factors but also contends that through focussing primarily on the National Treasury, the Commission's failure to establish close links with Parliament, its primary stakeholder, was a lost opportunity to support legislative oversight over the budget process and gain support for FFC recommendations.

> The discussion highlights some key factorsthat contributed to the sidelining of the FFC: the uncertainty surroundingthe future of the provincial system, the Commission's negligence of itsmandate to support legislatures, poorly timed inputs, increased capacity inthe executive to manage intergovernmental relations, as well as internalissues. It is within the FFC's powers and ability to remove several of thesestumbling blocks, especially managerial issues relating to the timing ofinputs, and staff management. This indicates that it should be possible forthe Commission to reclaim practical influence by initiating appropriate steps. (2003:15)

Wehner did however concede that the Commission's decision to create an office in Cape Town in 1999had signalled a commitment to move in this direction. However, at that stage Parliament itself could not amend the budget (since it had not yet passed the enabling legislation required by the constitution) and had been accused of being a "rubber stamp" in the budget process. Until Parliament itself mustered the political will to pass the enabling legislation which would allow it to take up the role intended by the constitution, it could be argued that demand from Parliament for the FFC advice on intergovernmental matters was unlikely to materialise at that early stage.

## 2.3 Early responses to FFC recommendations

At the Commission's inception, and indeed throughout its existence to date, its recommendations have only been partially accepted. In its first set of recommendations for the 1996/97 fiscal year and later amplified its recommendations for the 1997/98 fiscal year, the Commission advocated that in splitting the pool of available funds among national and provincial government[6] (the "vertical" division) should keep national government's share constant over the next three years of the Medium Term Expenditure Framework (MTEF), accompanied by a real growth in the provincial share over the MTEF to fund elimination of service backlogs and attain parity in service provision across provinces. In regard to the division of provincial pool of resources among the individual provinces ("the horizontal division), instead of the ad-hoc allocations from national government departments to the provinces, which had been the previous practice, the Commission recommended the use of a transparent formula based on provincial demographics (which proxied for expenditure need), tax capacity and national minimum norms and standards for the delivery of constitutionally mandated services.

Instead of the commitment to bias the vertical division of revenue towards provincial governments, the Department of Finance[7] insisted (and has so to date) that the vertical division remain a "political judgment" made by Cabinet (South Africa. Department of Finance, 1999:258). The Department of Finance did indeed adopt a largely demographically driven formula based approach based on the variables suggested by the FFC. The formula would generate a global allocation which would be transferred to the provincial governments, and the provincial executive councils would then allocated these funds across provincial departments. The components of the formula were therefore not meant to be indicative budgets.

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[6] At that stage the demarcation and transformation of the local government sphere had not yet begun and conditional allocations from national government were made on an ad hoc basis. Local government was, therefore, omitted from the revenue sharing process at that early stage.
[7] The Department of Finance and the Department of State Expenditure, both departments inherited from the National Party regime would be merged in 2000 to establish the National Treasury in the form in which it currently operates.

However, the actual provincial equitable share (PES) formula adopted by the Department of Finance in the 1998/99 generated a relative distribution of the politically determined provincial pool. In other words, based on a provinces share of total population and other variables, the formula would generate the percentage of the total provincial pool going to that particular province.

This type of formula did indeed realised relative equity of provincial shares, as well as ensuring fiscal discipline (as noted by Wehner, 2003). Furthermore, the PES formula was, and remains, fairly simple. A major problem however was that the share of the pool which each province received was not directly related to, and therefore may not have covered the full cost of delivering minimum norms and standards of services as required by total sum of all the costs for the constitutional progressive realisation of justiciable socio-economic rights (such as education, health etc).

The Department of Finance's response was that a cost-based approach that explicitly linked allocations to provinces with the costs of minimum norms and standards would have the perverse incentive to escalate costs:

> The FFC approach involves estimating the costs of achieving certain minimum standards implicit in government policies. This has the disadvantage that the different components of the equitable shares would adjust over time towards cost-raising reforms and unfavourably towards efficiency enhancing policies. Cost-based calculations also tend to be erroneously read as indicative budgets or spending targets for the provinces. To avoid this problem, each component was assigned a weight as a way of dividing the total pool of resources available to the provinces. (South Africa. Department of Finance, 1998: E10)

The weights used in the formula were also quite arbitrary, linked to previous year's provincial spending patterns in education, health, welfare and other formula components.

Under the Department of Finance's PES revenue sharing regime (which has subsequently undergone several incarnations but retained these essential characteristics to the present day), the equalisation standard was not clear, the provincial pool of funds available for sharing among the provinces were not directly linked to the equalisation standard and nether were the allocations going to individual provinces. In 2000, the FFC reiterated the need to link provincial allocations with the minimum efficient cost (not actual cost) of providing a minimum level of constitutionally mandated services, in its *Costed Norms* approach.The costed norms approach depended on the existence of minimum norms and standards for various constitutionally mandated services, from which the minimum cost of determining these services would be derived, contingent on the structure of the provincial population. Provincial allocations would then be derived as the aggregate of the cost estimates across the constitutionally mandated services in the provincial budgets.The *Costed Norms* approach was envisaged to inform both the vertical and horizontal division of revenue.

While acknowledging the use of the *Costed Norms* approach as an analytical tool for assessing sectoral budgets ex post,  the National Treasury did not accept the *Costed Norms* approach as an revenue allocation formula on the grounds that:

1. Data, particular on costs was not available. The output measures on the basis of which to base minimum norms and standards and cost estimates where then not available (This is further discussed in the section on budget and financial management reforms below).
2. Provincial fiscal discretion would be undermined by endorsing "the notion that provincial education, health and welfare budgets can be calculated at the national level by formula. This undermines the principle of provincial budgetary autonomy, and limits the role of provincial executive committees in making trade-offs,

addressing provincial priorities and achieving efficiencies. In addition, such an approach would weaken accountability." (South Africa. National Treasury, 2001:234)

3. Even though the FFC prescribed that the formula should include only cost factors outside provincial government's control, Treasury contended that cost related formulae "unavoidably reflects cost factors over which provinces do or should have discretion" and therefore create perverse incentives for provinces to distort funding levels.
4. More research was required to ensure that norms across sectors reflected true minima rather than broader policy goals, since this seems to vary across sectors.
5. Norms and standards would tend to be ambitious rather than minimal, and hence unaffordable. They would create an expectation for securing more funds rather than the more efficient use of existing allocations, and "reinforce cost-raising tendencies in public services, while undermining political responsibility for budget priorities and choice"(South Africa. National Treasury, 2001:234)
6. Government did not believe that the FFC's process for the vertical division would yield outcomes superior to that of the current politically based decision, and
7. Basing provincial government's allocation on cost estimates of selected provincial functions (i.e. constitionally mandated basic services) only would bias against other provincial functions which did not appear in the formula, as well as local and national functions. Moreover it would create a bias towards functions and outputs more amenable to costing.

From the above it is clear that the rejecton of the costed norms approach was based not only on technical constraints (data) but also on political preferences. This is not a surprising outcome given that FFC recommendations by constitutional design were meant to enrich, but not necessarily displace, political values in intergovernmental fiscal decision-making. The issue of costed norms is revisited later in Section3, in the context of progressive realisation of socio-economic rights.

The other area in which the FFC recommendation have been rejected relates to provincial taxation. Section 228 of the Constitution permits provincial taxes, levies and duties other than an income tax, a value added tax, general sales tax, rates on property or customs duties. It also authorises provinces to impose a flat-rate surcharge on the tax bases of any tax levy or duty imposed by national legislation other than the tax bases of corporate income tax, value added tax, rates on property or customs duties. In the interest of greater fiscal accountability and discretion, the FFC recommended the enactment of legislation to enable such a provincial surcharge on the national personal income tax (collected by the South African Revenue Services).

A number of objections to a surcharge on personal income tax were raised by National Treasury, both in relation to policy and tax administration (the capacity of the South African Revenue Services to admnister the surcharge), For instance, it was contended that the narrowness of the personal income tax base would lessen its attractiveness as a provincial-level tax, where taxes with a wider revenue base that reflect a large cross-section of the population are more desirable. Furthermore at that stage there were concerns that such a surcharge may hinder Government's equity and redistribution goals as well as foreclose or complicate other tax reform efforts.

The Katz Commission report on provincial taxation also expressed a number of reservations about a provincial income tax surcharge (Commission of Inquiry, 1998). As noted earlier, Section 228(1)(b) of the constitution specifies that any provincial surcharge must be levied at a flat rate on the base of a national tax. In other words, the surcharge must be levied as a percentage of taxable income or activity within the province, not as an additional rate on each taxpayer's national tax liability. The complexity of this requirement, given that a rebate system is used in South Africa, means that personal income tax surcharge will not be easy to implement. For instance, a provincial surcharge, which must be imposed at a flat rate for all income classes, may require provisions for low-income protection (exemptions, tax thresholds, credits, etc.) to ensure it does not fall unreasonably on the poor. In addition, under the PAYE system, the residence of taxpayers is not required information. A major problem is lack of data on a taxpayer's province of residence, which is required to properly attribute income for provincial tax purposes. The Katz Commission also warned that other developing countries have encountered significant difficulties in attempting to apply regional or local surcharges on national income taxes, due to the burden on tax administration. Accordingly the Katz Commission cautioned against a surcharge on the personal income tax at that stage.

Subsequently however is a procedural vehicle for provincial governments to propose new taxes was promulgated: the *Provincial Tax Process Regulation Act of 2001*. A province may, in terms of this Act, propose any tax not strictly prohibited by the Constitution. This process legislation, however, has not really yielded any buoyant new revenue sources for provincial governments which remain largely dependent on nationally collected revenue rather than own revenue sources.

As the demarcation of wall to wall local government was finalised, the emphasis shifted to include the local government fiscal framework. In July 1997 the Commission released a discussion document, *Local Government in a System of Intergovernmental Fiscal Relations in South Africa,* which informed its 1998/1999 recommendations which included recommendations on revenue sharing to the local sphere as well as the provincial sphere. Here too the actual formula adopted by the National Treasury only incorporated certain dimensions of the FFC's recommendations.

The issues raised by the FFC in its early recommendations still remain the "unfinished business" of the IGFR system development trajectory and may well regain prominence in future. This is explored further later in Section 4: THE UNFINISHED BUSINESS OF THE IGFR SYSTEM DEVELOPMENT.

Other recommendations made by the FFC in its first decade were indeed accepted by Government e.g. the creation of national social security agency and shifting this function from provincial governments to the national sphere (2002/3), on Early Childhood Development funding (2003/4).

## 2.4 Budget reform and IGFR: data and information

As discussed above, one of the reasons afforded for FFC's costed norms approach not being accepted as an allocation formula was the absence of data on costs of producing particular service delivery outputs. From an institutional perspective, the more decentralised a governance system, the greater its complexity and the number of decision-makers and other roleplayers, and the more information is required to ensure effective coordination, planning, budgeting, monitoring, evaluation and legislative oversight.

In decentralised government arrangements, especially where there are concurrent (i.e. shared) competences in which, for instance, national government may set policy and subnational governments implement this policy or where subnational governments have substantial revenue and borrowing powers and/or expenditure responsibilities, coordination of budgetary policy and implementation becomes crucial. Coordination can ensure that the fiscal policies of the various tiers of government are mutually reinforcing in contributing to national, provincial and local goals, or at least not contradictory.

Furthermore in unitary states like South Africa where the central government has a supervisory role over subnational counterparts, monitoring of both aggregate revenues and expenditures is crucial, as is monitoring whether subnational governments are achieving value-for-money and are minimising unproductive expenditures and corruption. Monitoring of the progressive realisation of socio-economic rights across provinces and municipalities in the interests of interpersonal equity, is also critical. In the South African context, public finance management and monitoring and evaluation reform are key enablers of effective IGFR.

Potter (1997) describes some of the mechanisms to promote coordination in intergovernmental budget processes:

1. Common assumptions by all governments of the macroeconomic variables underpinning the budget (e.g. economic growth rates, inflation rates, exchange rates etc);
2. Uniform revenue and expenditure classifications, budget programme structures and other treasury norms and standards;
3. Identical financial years across all spheres of government;
4. Medium term expenditure frameworks (i.e. three to five year rolling budgets);
5. Budget monitoring, reporting and evaluation systems which are accurate, timely and consistent;
6. Consistent service delivery performance indicators;
7. Fiscal rules which limit subnational governments ability to raise revenue, spend or run deficits;
8. Strong supreme audit institutions (such as the Auditor General);
9. Contingency reserves at national and subnational level to deal with exogenous shocks (i.e. out of the control of the national or subnational governments).
10. Conditional intergovernmental grants to incentivise subnational governments to spend on national priorities or to deal with spillover effects;
11. Management of the interface of national and subnational governments with international capital markets in the interest of minimising costs of borrowing and preserving macroeconomic balance.
12. Management of guarantees and other forms of contingent liabilities (i.e liabilities that may or may not be incurred by an entity depending on the outcome of a future event such as a court case).

All 12 mechanisms outlines above feature prominently in the South African intergovernmental system by constitutional design. Sections 215 and 216 of the Constitution for example create a National Treasury with the ability to enforce uniform norms and standards of financial management across subnational governments, such as uniform expenditure classifications. The adoption of the Medium Term Expenditure Framework in 1998 which encompassed national government and all nine provinces, the *Public Finance Management Act* in 1999 and the *Municipal Finance Management Act of 2003* and which gave operational substance to sections 215 and 216 of the constitution were key milestones of a long term, and still ongoing, budget reform initiative aimed at realising the constitutional ideals of efficiency, effectiveness, equity and development orientation.

With a common constitutional genesis, the sequence and phasing of the South African public financial management reform project is inextricably linked to the evolution of the intergovernmental fiscal system, as well as intergovernmental planning and government-wide monitoring and evaluation systems. From its inception, as reflected in the seminal 1995 *Framework Document for Intergovernmental Fiscal Relations in South Africa,* the FFC has grappled with the conundrum of crafting an intergovernmental budgeting process which reconciles fiscal decentralisation mandated by the Constitution with the Bill of Rights which requires progressive realisation of justiciable socio-economic rights. In other words a fiscal system which not only focuses on grant allocations, but also ultimately service delivery outputs and outcomes, not just regional equity but interpersonal equity. The FFC's *Costed*

*Norms* Approach, through its emphasis on delivery norms and standards, had attempted to do just this.

As noted earlierat the time the FFC first mooted the *Costed Norms* approach, neither the minimum norms and standards required by the Constitution were in place, nor were their associated costs known. Public finance management at that stage placed emphasis on managing expenditure (inputs rather than service delivery outputs or outcomes), and accurate data on the unit costs of services was virtually non-existent.

However, since then there has been a plethora of initiatives under the rubric of the Public Finance Management Act of 1999 implementation, aimed at standardising planning formats across provinces in concurrent functions, integrating planning and budgeting, standardising performance indicators and a move towards accrual accounting. Initially lead by Treasury, the Department of Performance Monitoring and Evaluation in the Presidency has supplemented this through its outcomes approach monitoring and evaluation (Engela &Ajam, 2010). Despite ongoing reforms since 1999, however, norms and standards often remain undefined, and when they exist are not specific enough to cost. Moreover costing information remains weak. This means that even now there would be gaps in operationalising a costed norms approach. Legislation is seldom accurately costed, and the fiscal consequences of function shifts across spheres and re-demarcation across municipalities are often not determined in advance.

# 3 FFC: THE SECOND DECADE

While the previous chapter explores the Commission's first decade of existence, this section reviews the Commission's role in shaping the IGFR system over the last ten years. This is followed by a final section which explores the debates in IGFR which remain unresolved to date, and to which the FFC may contribute in future.

## 3.1 Towards institutional maturity

In the second decade of its existence, the FFC's identity was clearly defined as a technical body of experts rather than an intergovernmental forum. Crucially, it had built much stronger relationships with Parliament, one of its primary stakeholders. In the 2007 an ad hoc Parliamentary Committee under Kader Asmal was tasked with reviewing Chapter 9 and other institutions supporting democracy, including the FFC.

The ad hoc Committee accepted that FFC is "an important advisory body that strengthens the fabric of our institutional arrangements" by playing a crucial role in 'the strategic evolution of the intergovernmental relations as well as in assisting in maintaining the balance between fiscal decentralisation and the unitary state". Citing its seminal work in the early design and implementation of the intergovernmental fiscal system and the creation of a national social security agency as instances of influential recommendations, the ad hoc Committee opined that its work may assume even more relevance in future..

Thead hoc Committee noted that the Commission's recommendations "enjoyed a high degree of acceptance". Furthermore In respect of the FFC recommendations on the*Costed Norms* approach as "an alternative to the present transfer system that does not take into account all relevant factors in determining normative expenditure", the ad hoc Committee noted that these had engendered widespread debate even though they were ultimately not accepted (Parliament of the Republic of South Africa, 2007: 57-58).

The ad hoc Committee concluded that the FFC had "performed commendably"in discharging its revenue sharing roles and responsibilities and that there was "a strong argument for the Commission's continued existence accepted" (Parliament of the Republic of South Africa, 2007: 63). The Committee reasoned that while the current intergovernmental system was stable, as the system matures, political tensions regarding equitable sharing of nationally collected revenues may arise which the FFC would be in a unique position to mediate, given its consitutional obligation to consider the interests of all three spheres when making its independent and impartial recommendations to Parliament.

The ad hoc Committee did however suggest certain institutional enhancements to improve the effectiveness and efficiency of the FFC, which would entail constitutional amendment in some instance. The mot salient recommendations were that:

1. *The appointment procedure of Commissioners be reviewed:* In particular, the Committee recommended that Parliament should nominate Commissioners to the President in contrast to the existing process in which the national Minister of Finance and his/her provincial Member of the Exexutive Council (MEC)for finance counterparts play the dominant role. The exclusion of Parliamentary involvement was found by the Committee to be "inconsistent with the principle of independence".
2. *The number of Commissioners be reduced* from nine to 3 to 5 full time Commissioners to facilitate decision-making and streamline the institution and that there should be greater legislative clarity on whether Comissioners are being appointed on a part-time or full time basis.
3. *Determination of Commissioner salaries:* The existing procedure whereby the Presidency reviews Commissioner salaries has been very lengthy and resulted in infrequent revisions over many years. To better institutionalise this process, the Committee recommended that the framework legislation envisaged in section 219(5) of the Constitution be enacted.
4. *Mechanisms be introduced to strengthen the relationship with Parliament*such as finalisation by Parliament of formal protocols that had already been drafted by the FFC and creation in Parliament for a separate unit dealing with all of the institutions supporting democracy, including the FFC.
5. *Better collaboration with other Chapter 9 institutions supporting democracy be fostered.* These would include the Public Service Commission, the Human Rights Commission and the Gender Commission.
6. *Initiatives to raise public awareness of the FFC be intensified:* The Committee felt that the FFC should do more to foster civil society input into its recommendations and that a "visible public presence may lend additional weight in the eyes of policymakers to the Commission's recommendations.
7. *Various governance and HR weaknesses be addressed*: including the need for the need to review the FFC's governance model (e.g. a singe Chair who is also the CEO which is contrary to the PFMA and King III ggod governance practice), conflict resolution mechanisms among Commissioners, better procedures for the disclosure of FFC Commissioner and staff interests, and a staff retention policy and strategy.
8. *The budget process and the location of the FFC budget be reviewed to enhance its independence:* The FFC does not have a budget vote of its own, but falls under the National Treasury. Although the Committee acknowledged that this arrangement had not been operationally problematic and that the FFC had always obtained reasonable budget allocations, its opinion was that the current location could comprmise perceptions of the FFC's independence. (accepted (Parliament of the Republic of South Africa, 2007: 63-64).

Six years later, considerable progress has been made in many of these areas, although issues in other areas still await resolution. Appointments of Commissioners remains problematic, especially the prolonged delay in appointing the Chair of Commission(more than two years), resulting in an extended period during which the Deputy Chair has acted in that capacity.

The governance issues regarding the conflation of the Chairperson function from the CEO function requires legislative amendment to rectify, and passing of an amendment to the FFC Act. This would also occasion an opportunity to review other key strategic decisions such as the optimal number of Commissioners, with a view to enhancing effectiveness of the FFC's organisational configuration. Attracting and retaining high quality research skills continues to be a challenge to the FFC given the country-wide shortage of economics and finance skills, exacerbated by the prolonged dysfunction of the South African education system.

In contrast there have been a number of visible improvements in the FFC's ability to add value to its stakeholders, although there is still room for improvement. The Commission's focus in its second decade has increasingly been on the development impact of the intergovernmental fiscal system in addition to the "first generation" issues such as devising allocation formulae. To support this thrust through evidenced-based recommendations, the FFC has considerably enhanced its research capacity over the last decade, in particular, its econometric modelling capacity and its budget analysis capacity.

This has been reinforced by the appointment of a research and recommendations director within the secretariat tasked with generating research which is both policy relevant and methodologically sound enough to merit publication in local and international economic journals. The increase in FFC researcher publications in domestic and international journals is an indication that this approach is bearing fruit. While the research director is charged with the quality assurance of individual projects, the research committee of the FFC has given much more attention to the strategic portfolio of research projects which the FFC undertakes, and the key themes/messages which emerge from research insights and inform recommendations.

Increasingly, the FFC has pursued collaborative research, entering into Memoranda of Understanding with other reputable research institutions (such as the Human Science Research Council) and other institutions supporting democracy with a complementary focus (such as the Public Service Commission). This not only enables the FFC to access specialist skills and leverage its finite research budget, but also increase the visibility and policy impact of the ultimate recommendations. Collaborating with local academics and judiciously drawing on international expertise where appropriate, the FFC has contributed to building a body of knowledge on intergovernmental relations.

Given the high turnover of senior management staff within the public sector, the importance of this repository of institutional memory should not be underrated. It is surprising that there is more material on intergovernmental fiscal relations in the public domain in South Africa rather than on economic analysis of tax policy. There is no institution (outside of National Treasury and the South African Revenue Services) with a long term research strategy focussing on the economic analysis of taxes (as opposed to legal, auditing or tax practitioner expertise), as the Davis Tax Committee has recently discovered. Some of the FFC research capacity is also located in Cape Town which can facilitate rapid response to ad hoc requests by parliamentary committees.

Even more importantly, the FFC has recognised that despite the inherent technical complexity of its mandate domain, it needs to tailor the dissemination of its research to its various stakeholder audiences. As a result, for example, the Commission has supplemented its Annual Submission document with specialised technical reports which cater for practitioners in the Executive, and 2 to 3 page policy briefs in plain language, which are more user-friendly for parliamentary committees and other oversight bodies.

The FFC has also significantly enhanced its relationship with Parliament, the provincial Legislatures and organised local government (SALGA). Initially the FFC had interacted mainly with the finance and appropriations committees, but over the last decade it has extended its engagement to other parliamentary committees, especially in relation to concurrent functions which have an intergovernmental finance dimension. These would include the committees on local government, on basic education, on human settlements and social development to name but a few.The FFC's annual visits to each of the nine legislatures have also helped cement relationships within the provincial sphere.

But the most crucial development in the last decade has been the enactment of the Money Bills Amendment Procedures and Related Matters Act (MBPRMA) of 2009, which formalises a four stage budget process consisting of the Medium Term Budget Policy Statement (MTBPS), the fiscal framework which delineates revenue and expenditure aggregates, the Division of Revenue Act and individual Departmental appropriations considered by the various portfolio committees. In this critical piece of legislation, provision has been made for input from the FFC to finance committee cluster on the MTBPS andthe fiscal framework.

Moreover, when the portfolio committees draft their Budget Review and Recommendations (BRR) reports, they are obliged to consider the FFC's recommendations. This provides an excellent platform for institutionalizing FFC recommendations within the cycle of legislative action on the budget and oversight of budget execution. It enables regular interaction as the accountability cycle for the previous year's audited financial statements concludes, oversight over the implementation of the current budget is exercised and preparations for the following year's budget is initiated. The FFC has also responded to ad hoc requests from various committees where these fall within its mandate as well as other organs of state (e.g. in relation to function shifts).

Another exciting development is the establishment of the Parliamentary Budget Office (PBO) under the auspices of the MBPRMA. The PBO has a much wider remit than the FFC encompassing tax policy, debt and deficit management, individual appropriations of national Departments as well as intergovernmental relations. Given that the PBO is still in its infancy and that its initial structure is very small relative to the breadth and complexity of its mandate, it is likely to focus – at least in the medium term – primarily on the finance and appropriations committees. There is much potential for collaboration and creative tension between these two institutions and the FFC has done all it can to support the development of PBO institutional capability.

The other mechanism which has facilitated the FFC's institutional interaction with Parliament is the creation of an Office for Institutions Supporting Democracy in 2010 in the Office of the Speaker of Parliament. This institution not only has facilitated the interface of the FFC with Parliament but has also constituted another institutional mechanism with which to strengthen its interactions with other institutions supporting democracy.

Visits to the nine provincial legislatures in relation to Division of Revenue recommendations have also strengthened engagement with the legislative sector in the provincial sphere. Some of the provincial legislature finance committees also invite their provincial treasuries to participate in this interaction, as well as other portfolio committees and provincial departments in areas where the FFC has made recommendations (such as health, basic education, provincial roads etc).

With an increased focus on municipal finances, the FFC has forged relationships with the South African Local Government Association (SALGA), the Municipal Demarcation Board Individual metros e.g. Ethekwini in relation to its proposal for a local business tax and and City of Cape Town in relation to devolution of transport functions to cities.

Another recent innovation has been the FFC's focus on public hearings on various themes outside the division of revenue cycle. The aim of these public hearings has been to validate FFC understanding of problems and its subsequent research, solicit the views of a spectrum of stakeholders and inform the FFC's medium term research strategy. Participants in public hearings have included not just the executive from all three spheres of government, but also portfolio committee members in Parliament and the legislatures, state owned enterprises, the private sector and NGOs. These public hearings have created a public platform to debate fairly complex technical issues usually discussed only in executive intergovernmental fora.

Public hearings to date have included: (a) the local government fiscal framework in 2012, (b) housing finance in 2012 and (b) funding of child welfare services which most often delivered by non-profit organisations (NPOs) and partially subsidised by government. So for example, the local government public hearing allowed individual municipalities such as the small rural Emakhazeni Local Municipality made a presentation to illustrate that despite being a municipality with sound financial management, as evidenced by their clean audit, the municipality still faced severe financial challenges emanating from exogenous socio-economic factors. Given that much of the division of revenue discussions tend to focus on aggregates across the local government sphere as a whole, this provided a much more nuanced understanding of the unique pressures faced by rural municipalities. Disconcertingly, the finance managers ofsome municipalitiesindicated that they did not understand the local government equitable share formula. As a result, the National Treasury made a spreadsheet and the underlying formula easily available on its website[8].

As a result of its closer interaction with various portfolio committees which have meetings open to the public and well attended by journalists and the Parliamentary Monitoring Group, an NGO, its public hearings and opinion pieces in major newspapers, the FFC has strengthened its media presence and hence it's public visibility. A rough proxy for increased media visibility is the increase in the number of articles featuring the FFC from 9 in 2004 and 1 in 2005, to 20 in 2011 and 26 in 2013[9].

### 3.2 FFC recommendations in its second decade

In its second decade of existence, the FFC has made a wide array of recommendations not only on the provincial and local equitable share formulae and conditional grants but also on other crucial intergovernmental financing including: basic education, health, social development, the provincial wage blll, infrastructure development and maintenance, funding of basic services such as water, electricity and sanitation, human settlements, public transport including scholar transport, the fiscal cost of poor land use planning, climate change, fiscal consolidation, intergovernmental financing of rural development, local government rates and tariffs, funding of libraries and museums, funding capacity building.

In general these recommendations have been met with a high degree of acceptance by government. However it is extremely difficult to gauge the Commission's effectiveness by this single indicator alone. For instance, there are cases with which government concurred with FFC recommendations (e.g. in respect of housing accreditation which would devolve provincial functions to municipalities), but the actual implementation was completed only after prolonged delays, or the case of gender budgeting within municipalities to which government agreed but has not become institutionalised yet.

In the South African context, concerns about equity encompass not only equity in allocations, but – even more crucially - also equity in quality and access to public services and developmental impacts. Despite increasing convergence to equity in budget allocations

[8]http://mfma.treasury.gov.za/Media_Releases/LGESDiscussions/Documents/2014%20LGES%20Summary%20Data%20and%20Formula.xls
[9]These articles can be found on the Commission's website http://www.ffc.co.za/index.php/library-ffc-storage/ffc-in-the-news)

per capita in the provincial equitable share and improved access to services, substantial variances remain in relation to the quality of services such as health and education (South Africa. Presidency, 2009). In some areas, there remain huge variations in provincial budgets and actual spending (e.g. in child welfare services as highlighted by the FFC's public hearings). Moreover, as evidenced by successive Auditor-General reports showing high levels of fruitless and wasteful expenditures as well as outright corruption, the efficiency of public spending in the IGFR system needs to be improved markedly.

Equity in developmental outcomes fostered by the IGFR system and progress with realization of socio-economic rights therefore constitute a major thematic leitmotif underpinning FFC recommendations in its second decade. In doing so the FFC provided an independent and impartial view on balancing a decentralised fiscal system with the progressive realization of socio-economic rights (inter-personal equity as opposed to justregional equity), which requires that our intergovernmental system be not just input focussed but output focussed.

The creation of an intergovernmental budget system which gives effect to the Bill of Rights is very much work in progress. Sometimes norms and standards for public services do not exist (e.g. inclusive education of intellectually disabled children on which the FFC has made recommendations). Where norms and standards exist, they are often not costed and hence adequately budgeted for, especially at the lowest institutional level delivering service such as school and hospital level. A good example would be e-education on which government had a policy with norms but these were not adequately funded in poorer provinces such as Limpopo and Mpumalanga. More than three quarters of the schools in the poorer provinces did not even have access to a single email address, unlike provinces such as Western Cape which at least had 100% of schools with email access. Most schools across the country fell far short of the broadband access required for effective e-education. The FFC made a recommendation in this regard for the 2013/14 Division of Revenue cycle.

Government's reluctance to define and cost minimum standards for basic services may be based on the fear that they will be unaffordable and create contingent liabilities for government as citizens take government to court when norms and standards are not adhered to. However, whether norms and standards are explicitly defined or not, these contingent liabilities were in fact created by the adoption of the Bill of Rights. Because of the Executive and Parliament's reluctance to enter this domain, the courts have had to compel greater definition and funding of norms and standards.

One crucial instance is that of the non-government organisation, Equal Education, against the Department of Basic Education focusing on the prolonged absence of **school** infrastructure norms and standards and textbook non-delivery. Another prominent instance is the 2010 NAWONGA vs Free State Premier court case[10], which clarify that non-profit organisations (NPOs) are providing a service on behalf of government and therefore should be adequately funded. Recourse to the courts to enforce socio-economic rights and their financing could intensify unless government can demonstrate that it has a reasonable system to employ available resources to meet socio-economic rights. The FFC's costed norms approach may, in some modified form, assume future greater relevance.

In the first decade, the overwhelming focus was on convergence to equity in funding. Increasingly, the FFC's recommendations have focussed not only on equity, but also on how the intergovernmental finances can stimulate economic growth and job creation. Given the concentrations of poverty and wealth as a legacy of the apartheid past, the FFC has also begun to look more closely at the geospatial dimensions of access to services and

[10]National Association of Welfare Organisations and Non-Governmental Organisations and Others v MEC of Social Development, Free State and Others (1719/2010) [2010] ZAFSHC 73 (5 August 2010)

stimulating growth. Climate change and environmental considerations have also featured much more prominently as well

In relation to grant design and implementation, the FFC has had to grapple with the need to infuse greater incentives for performance, while not compromising equity within and across spheres of government and accountability. For example, sanctioning a province or municipality for not spending conditional grant allocations by re-allocating unspent funds to other beneficiaries may end up compromising equity and access to basic services by the residents of that province or municipality. The capacity of the recipients of intergovernmental grant recipients to spend them effectively is a crucial consideration. Despite a steady and significantly large flow of conditional grant capacity building funding to the weaker provinces and municipalities, capacity building outcomes have been highly disappointing and chronic lack of capacity appears to have become a structural (rather than transient) feature of our intergovernmental system. Furthermore, lack of consequences for poor performance and outright maladministration have lead to a culture of mediocrity where lack of capacity is often used as an excuse for lack of accountability.

# 4 THE UNFINISHED BUSINESS OF THE IGFR SYSTEM DEVELOPMENT

The issue of creating and intergovernmental budgeting system that would balance fiscal decentralisation (and regional equity of funding) with the progressive realisation of justiciable socio-economic rights (and interpersonal equity in developmental outcomes) has been raised earlier in this paper. The challenges around capacity have also been alluded to earlier. There are, however, a number of issues which remain to be resolved and to which the FFC is in a good position to make insightful contributions. A few salient ones are explored below

## 4.1 Prolonged uncertainty about the future of the IGR system

In 2007, the then Department of Provincial and Local Government (DPLG) initiated a policy process to review the provincial and local government system which was to culminate in a White Paper on Provinces and a revision of the Local Government White Paper (South Africa. Department of Provincial and Local Government, 2007). Seven years, three ministers and two departmental name changes later (from DPSA to COGTA to DCOG, the Department of Cooperative Government), there has still been no resolution to this policy process, exacerbating the IGR policy vacuum.

Key questions such as to the number and role of provinces and whether to continue with two tier local government outside of the metros remain unanswered. Without certainty on the functional framework, it is not possible to devise an appropriate fiscal framework for either sphere.This challenge has also been noted in the National Development Plan 2030:

> South Africa has struggled to achieve constructive relations between local, provincial and national government. A lack of clarity about the division of responsibilities together with a reluctance to manage the system has created tension and instability across the three spheres of government. There is no consensus on how this is going to be resolved and there is a lack of leadership in finding appropriate solutions.(South Africa. National Planning Commission, 2012)

## 4.2 The hollowing out of provincial governments

In the absence of clear, well conceptualised overarching IGR policy, there have been a number of sector-specific policy decisions by national sector departments which have had a cumulative effect of "hollowing out" the role and sphere of influence of provincial governments. Some of these include:

1. *Shifting certain functions to national level*: here for instance is the relocation of Further Education and Training (FET) function to national level. The new National

Health Insurance may exacerbate this trend, leaving provinces as little more than glorified basic education administrators.

2. *Devolving other provincial functions to cities and other municipalities:* These would include accreditation of housing functions, public transport and land use planning
3. *Restrictions on the input side of the budget*: Centralised procurement at national level of large tenders such as school books have been introduced to overcome supply chain management weaknesses and corruption within the provincial sphere. Similarly there have been increases in indirect grants (i.e. grants in-kind) where national government delivers infrastructure, for example, on behalf of under-capacitated provinces and municipalities. Intergovernmental fora such as the President's Coordination Council proposed by the 2013 Infrastructure Development Billmay restrict the discretion of subnational governments in giving expression to local priorities. While the original aim of public financial management reforms such as the Public Finance Management Act of 1999 was to hold accounting officers accountable for outputs but give them greater managerial discretion over inputs, there has recently been a trend towards input controls and expenditure ceilings,

While the rationale for each of the decisions outlined above may be cogent in terms of sectoral policy or specific policy objectives, they are unlikely to have systemic coherence for provinces as governments in themselves (as intended by the constitution) rather than the ad hoc incidental by-product of discrete, unrelated sector policy decisions. Tinkering with organisational arrangements around the location of functions or grants is neither necessary nor sufficient to solve underlying delivery problems. Shifting functions from one sphere to another or conditional grants from one national Department to another are ultimately a form of displacement activity. It may give a semblance of decisive action but actually distracts from the real underlying issues which are much more intractable and managerially and politically unpalatable to resolve. The National Development Plan has candidly diagnosed the underlying causes of the pervasive unevenness of capacity which has led to stark disparities in service delivery performance:

> This is caused by a complex set of factors, including tensions in the political-administrative interface, instability of the administrative leadership, skills deficits, the erosion of accountability and authority, poor organisational design and low staff morale….A deficit in skills and professionalism affects all elements of the public service. At senior levels, reporting and recruitment structures have allowed for too much political interference in selecting and managing senior staff. The result has been unnecessary turbulence in senior posts, which has undermined the morale of public servants and citizens' confidence in the state.(South Africa. National Planning Commission, 2012, p. 408)

## 4.3 The tension between centralised wage bargaining and decentralised provincial budgeting

There is a tension between conditions of service of provincial public servants which are negotiated at national level and budgeting for personnel which takes place at provincial level. Personnel spending constitutes the lion's share of provincial budgets and as a result there are significant rigidities in provincial budgets. Provinces control over their personnel budgets are, by and large, limited to their control over the head count of provincial employees, exacerbated by a complex labour law environment and poorly implemented initiatives such as the Occupation Specific Dispensation (OSD)[11]. Over the last 20 years, there have been

[11] Introduced in 2007 after a personnel expenditure review by the Department of Public Service and Administration, the OSD aimed at providing differentiated remuneration dispensations at certain targeted occupations such as nurses, doctors and engineers, in order to attract scare skills and make provision for rural allowances.

episodes of provincial over-spending driven mainly by the personnel budget, followed by National Treasury enforced fiscal discipline. While aggregate spending has been contained in general, personnel spending has tended to crowd out complementary inputs such as textbooks and medicines, to the detriment of the progressive realisation of socio-economic rights.The issue of the single public service encompassing all three spheres, as envisaged by the Constitution, looms large as an unresolved issue.

## 4.4 Provincialand local revenue raising powers

South Africa has one of the largest vertical fiscal imbalances in the world. If the intention is to reduce provinces to administrative arms of the national government through constitutional amendment, then the question is moot. But if provincial governments are to play a meaningful role and accountability at the margin is to be fostered within the provincial sphere, this question may have to be revisited in future. This will depend on the political dynamic which emerges as the South African polity matures. International experience in countries such as India suggest that the rise of regional majority parties which are different from the dominant party at the centre, may in future foster a formalisation of intergovernmental fiscal relations (rather than informal negotiations in the ruling party caucus) and a demand for increased revenue raising powers.

A similar situation obtains within the local government sphere. The Regional Services Council (RSC) levy was phased out and an RSC replacement grant introduced to cover the consequent funding shortfall. Metropolitan councils were subsequently granted part of the fuel levy. They however have not control over either the base or the rates set. The issue of finding further buoyant revenue sources over which municipalities have some degree of control remains an outstanding issue in determining a sustainable long term local government fiscal framework.

## 4.5 A sustainable, differentiated local government fiscal framework

As noted earlier, the absence of a clearly articulated policy on the structure of the local sphere and a functional framework makes crafting a local government fiscal framework very difficult, as explored in the FFC public hearings on the local government fiscal framework LGFF (Financial and Fiscal Commission, 2012). There is a huge variation in the fiscal capacity, expenditure needs, cost disabilities and socio-economic profiles across municipalities. The challenge is to devise a LGFF that takes into consideration the differing capacity and performance of rural municipalities, metros, secondary cities etc. in a way which achieves equity but does not compromise growth.

The focus has predominantly been on the rollout of infrastructure to extend access to basic services to unserved communities, but rehabilitation and maintenance backlogs have accumulated. The FFC has noted that addressing the funding of these backlogs as well as the ability of municipalities to spend maintenance budgets effectively (e.g. given constraints on the number of engineers, for instance) would be critical. There is also a tendency to indulge in organizational tinkering such as re-demarcation as a displacement activity (similar to provinces). The results of the recent 2014 elections indicate that the forthcoming local elections is likely to be fiercely contested in metropolitan areas. This may generate greater urgency around issues relating to the LGFF and the quality of service delivery.

## 4.6 Low value for money and low developmental impact of public spending through the IGFR system

In the medium term the global economic environment is likely to be austere with continued pressure for prolonged fiscal consolidation with little room for increasing taxes. Sustaining the social grants system and other existing forms of social safety net and promoting the progressive realisation of socio-economic rights will require that the application of existing public resources be much more productive and impactful. Public financial management reforms to date have yielded good macroeconomic stability, fiscal discipline and allocative efficiency, domains which can, and have, been influenced by the National Treasury. Reforms have however been singularly unsuccessful at increasing operational efficiency, policy effectiveness and eliminating waste and corruption – microeconomic reforms which are largely the preserve of individual accounting and executing officers, not treasuries per se.

As the discussion of the pivotal issues delineated above indicates, while much has been achieved in institutionalising the IGR system, much more work needs to be done to mediate the tensions inherent in South Africa's constitutional dispensation, and forge a budget system which is capable of supporting the aspirations of progressive realisation of socio-economic rights.

## 5 CONCLUDING REMARKS

In this paper, the compelling point is made that the role of a fiscal commission in developed country with a stable macro and public finance management system in a federal system is vastly different from that of a fiscal commission in a developing country, particularly in a decentralised but unitary state.

As each public sector context is different, so are the institutional lessons learnt. The FFC has learnt that independence and impartiality does not mean disengagement from key stakeholdersnor irrelevance. It has learnt that policy impact must be earned by demonstrated value add to Parliament and other stakeholders rather thanby constitutional fiat. It has learnt that policy change takes time to perculate in strange and nonlinear ways, and that policy implementation through the intergovernmental system takes even more time.

In charting the way forward for the coming decade – especially in the context of the National Development Plan, Commissioners, Parliament and the Executive need to grasp the opportunity to make the FFC even more effective. Equally important is strengthening the role of other inter-related role players and their interface with the IGFR system. The FFC is unlikely to be effective without: (1) policy certainty on the future development trajectory of the IGFR system; (2) continued stability of the macro and fiscal framework, (3) strong provinces, organized local governmentand municipalities, (4) a vibrant Parliament and (5) deepening budget reforms, especially in relation to value-for-money and accountability.

In the interim, as articulated by the first chair of the FFC,"Just because it is not raining, don't throw away your raincoat". The FFC is an institutional innovation not just to help address the conundrums of the present, but also to assist the system in its dynamic evolutionary response to complex and emergent issues. I have no doubt that the FFC will continue to rise to the challenge articulated by Trevor Manual, the then Minister of Finance, a decade ago at the FFC's 10th anniversary conference in 2004:

> "Our invitation to the FFC is to act decisively both as participant and conscience to government… We have much to be proud of, yet sufficient undone to compel us to be humble."

## APPENDIX 1: FISCAL CONSTITUTIONS AND JUSTICIABLE SOCIOECONOMIC RIGHTS AS PRECOMMITMENT DEVICES

To understand the economic role of the constitution itself, it is important to first explore why a fiscal constitution was deemed by the framers of the South African constitution to be necessary in the first place. Most other countries have not considered it necessary to craft a specific fiscal constitution, and fiscal policy is generally governed mainly by ordinary budget laws and regulation .The broader design choices (involving a largely Westminster model of parliamentary/cabinet government overlaid on a system of constitutionally entrenched multi-level government) contributed to the level of detail in the South African constitution. The centralization of revenue raising powers in the national sphere (for both tax administration efficiency and redistribution/equalisation reasons) coupled with the decentralisation of expenditure functions to provinces and municipalities necessitated a fairly high degree of constitutional clarity. The fiscal constitution itself (as outlined in Chapter 13 of the South African constitution) thus provides the context for analysing the interaction between the executive, legislature and the courts within a democratic decentralised intergovernmental system, and for analyzing the role of fiscal commissions in particular.

Bednar et al (2001) and De Figueiredo and Weingast (2005) identify two fundamental institutional design dilemmas which fiscally decentralised constitutions must resolve simultaneously: (1) “What prevents the national government from destroying federalism by over-awing its constituent units?” (the “commitment dilemma” and (2) “What prevents the constituent units from undermining federalism by free-riding and other forms of failure to cooperate?” (the “self-enforcement dilemma”).

There should be a credible commitment by all parties to refrain generally from infringing on the rights of their federal counterparts (the “commitment dilemma”). In the interests of sustainability, the rules underpinning a federation must therefore be self-enforcing for all stakeholders at all levels of government (i.e. all political officials should have an incentive to abide by the rules). If the choice of institutional authority for all levels of government is not self-enforcing, the federation would ultimately fail. Resolving this quandary, requires a trade-off: institutional configurations designed to mitigate the former could exacerbate the latter and vice versa . For example, institutional fragmentation of national power can constrain national encroachment on subnational government powers and functions. It simultaneously, however, undermines national government’s ability to regulated subnational government cheating on the decentralised constitutional compact. This trade-off is made particularly trenchant by the tension inherent in the South African constitution between (a) devolved power, functions and expenditure responsibilities to provincial governments but limited revenue responsibilities (which intensifies the “commitment dilemma”) and (b) justiciable socio-economic rights in shared concurrent functions such as education and health which complicate the self-enforcement dilemma.

The “commitment dilemma” alluded to above thus also has intertemporal dimensions. Changes in the holders of political power could hinder the implementation of pareto efficient institutional investment. Policymakers today may fear that the policies and institutions created in the present will be at the disposal of an opponent’s coalition in the future. If they want to ensure that current decisions provide benefit flows in the future they may want to insulate their effects by designing institutions which will survive in the future. This pre-commitment exercise could create deviations from an optimal institutional design from a purely “technical” perspective (Iaryczower et al, 2000: 16). The rigidity introduced by pre-commitment to avoid future opportunism could entail significant cost in terms of loss of flexibility and efficiency in the present.

From this perspective, a Bill of Rights can also be regarded as a commitment designed to eliminate dynamic or time inconsistency. Ferejohn (2002) points out that the widespread acceptance of constitutional adjudication in Italy and elsewhere in Europe was influenced by the expansion of the set of rights to be protected by the proposed constitutional court:

> The need to ensure that ordinary lawmaking would be regulated by fundamental values was especially felt in Italy and Germany. The ordinary lawmaking processes in those countries had completely failed to respect human rights during the fascist and nazi periods. Not only was the legislature suspect as a defender of fundamental human rights, so too were the ordinary courts, which had done little to control or limit the impact of authoritarian legislation. The institution of new constitutional courts, which would have the power to overturn legislation but be independent from the judiciary itself, were part of this double circumstance of distrust – of the legislature and the court system.

This finds resonance in the South African situation, where the Bill of Rights, and the transformative tenor of the constitution as a whole, can be regarded as commitment devices. As Albie Sachs, a constitutional court judge) presciently observes in his motivation for justiciable socio-economic rights:

> The danger exists in our country as in any other, that a new elite will emerge which will use its official position to accumulate wealth, power and status for itself. The poor will remain poor and the oppressed. The only difference will be that the poor and the powerless will no longer be disenfranchised, that they will only be poor and powerless and that instead of racial oppression we will have non-racial oppression."(1990:2)

While ensuring commitment, the Bill of Rights could also, conceivably, limit flexibility (for example in respect to programme design and budgets) and thus introduce inefficiencies. The challenge for the executive would be to design an intergovernmental fiscal system consonant with both justiciable socio-economic rights., The extent to which deviations from efficiency are minimised would also depend on how the courts choose to interpret both the formal rules as well as the informal norms in crafting their socio-economic rights jurisprudence.

## APPENDIX 2: COMPARISON OF THE MANDATE AND STRUCTURE OF VARIOUS FISCAL COMMISSIONS

| | SOUTH AFRICA | AUSTRALIA | INDIA | UGANDA | KENYA |
|---|---|---|---|---|---|
| ***Commission Name*** | *Financial and Fiscal Commission* | *Commonwealth Grants Commission* | *Finance Commission* | *Local Government Finance Commission* | *Commission on Revenue Allocation* |
| ***Type of system*** | *Unitary* | *Federal* | *Federal* | *Unitary* | *Unitary* |
| ***Established in*** | *1993 under the interim constitution and reflected in the final constitution of 1996* | *1933* | *1951 but reconstituted every 5 years with a new terms of reference and disbanded after submission of recommendations. Curently 14th Commission* | *1995* | *2010* |
| ***Legislative framework*** | *1996 Constitution, Intergovernmental Fiscal Relations Act of 1997, Financial and Fiscal Commission Act, annual Division of Revenue Act, Money Bills Procedures and Related Matters Act of 2009* | *Intergovernmental Agreement (IIGA) on Federal Financial Arrangements. Federal Financial Relations Act provides legislative authority for transfers in terms of the IGA.* | *Article 280 of the Constitution of India, Finance Commission Act of 1951* | *Article 194 of the 1995 constitution , elaborated on by s7 of the Local Governments Act of 1997, Local Government Finance Commission Act of 2003* | *Article 215 of the Constitution of Kenya* |
| ***Levels covered*** | *Provincial and local government* | *States (regional) not local governments (which are done by state commissions)* | *State and to a limited extent panchayats (regional councils) and municipalities, on the basis of recommendations of the Finance Commission of each state* | *Local government* | *Counties (local government)* |

| | SOUTH AFRICA | AUSTRALIA | INDIA | UGANDA | KENYA |
|---|---|---|---|---|---|
| ***Composition*** | *Nine members including a Chair and Deputy Chair, 3 of whom are nominated by the provincial Premiers, 2 nominated by organised local government and 2 other person by national government.* | *Part-time Chair and 5 part-time members* | *Expertise in financial administration, accounts and economics* | *7 Commissioners for a period of 4 years renewable: A full time chair and deputy chair appointed by the President and 5 other part time commissioners. 3 are nominated by district councils through the Urban Local Authorities Association, 1 commissioner nominated by urban councils through the Ugandan Urban Authorities Association of Uganda and 3 by the national Minister of Local Government in consultation with the Minister of finance, planning and economic development* | *Nine commissioners: a chairperson nominated by the President and approved by the National Assembly; two persons nominated by the political parties represented in the National Assembly according to their proportion of members in the Assembly; five persons nominated by the political parties represented in the Senate according to their proportion of members in the Senate; and the Principal Secretary in the Ministry responsible for finance. Commissioners to have expertise in finance and economics* |

| | SOUTH AFRICA | AUSTRALIA | INDIA | UGANDA | KENYA |
|---|---|---|---|---|---|
| ***Secretariat*** | *31 staff members in the secretariat with 5 vacant posts, thus a total establishment of 36* | *Permanent, 60 staff members. There is a secretary to whom corporate services reports as well as 2 assistant secretaries to whom Branch A and Branch B report. Branch A has 3 subcomponents: (1) Revenue and Business Manager, (2) Education, justice and Economic Development and (3) Health and Roads. Branch B comprises: (1) Welfare and transport, (2) Demography, (3) capital and PTEs and (4) Data Management* | *Temporary secretariat managed by a secretary, usually from the Planning Commission* | *Permanent secretariat of 28 staff members in 2 departments: (1) administration and (2) central grants and local revenue (comprising economists and statisticians)* | *The Divisions of the secretariat include Research and Policy, Country Fiscal Affairs, Communications, Corporate Services, Legal Affairs* |
| ***Commissioners appointed by*** | *President* | *Federal government in consultation with the states* | *President* | *President* | *President* |

| | SOUTH AFRICA | AUSTRALIA | INDIA | UGANDA | KENYA |
|---|---|---|---|---|---|
| ***Mandate*** | *Makes recommendations on the equitable division of revenue raised nationally among the national, provincial and local spheres of government; the determination of each province's equitable share of the provincial share of that revenue; and any other allocations to provinces, local government or municipalities from the national government's share of that revenue, and any conditions on which those allocations may be made. Its primary role is to support the creation and maintenance of an effective, equitable and sustainable system of IGFR in South Africa.* | *Works only within the terms of reference provided by the federal minister of finance and administration e.g. per capita relativities for distributing among states and territories the pool of general assistance made available by the Commonwealth. Commonwealth and state treasuries negotiate the terms of reference through the Heads of Australian Territories Forum. Review of relativities occurs every 5 years with annual updates* | *Distribution of the net proceeds of taxes between the union and states, and of shares to individual states, principles governing grants-in-aid of the revenues of the states from the consolidated India Fund, measures needed to augment the consolidated fund of a state to supplement the resources of panchayats (regional councils) and municipalities on the basis of the recommendations by the Finance Commission of the State, Any other matter referred by the President* | *Advice to national government on all matters relating to transfer of resources to local governments and advice on the appropriate level of local revenues to local governments* | *Recommendations on the basis for equitable sharing of revenues raised nationally between the national and country governments, and among the county governments. The Commission is also required to make recommendations on financing and financial management by county government as well as recommendations to Parliament on appropriations from the Equalisation* |
| ***Authority to initiate own independent inquiries*** | *Yes* | *No* | *No* | *Yes* | *Yes* |

| | SOUTH AFRICA | AUSTRALIA | INDIA | UGANDA | KENYA |
|---|---|---|---|---|---|
| **Recommendations submitted to** | *Parliament and the Provincial Legislatures* | *to the Commonwealth Government and immediately thereafter to the states* | *to the union government* | *President and national Minister of Local Government* | *the Senate, the National Assembly, the national executive, county assemblies and county executives. Once every five years, the Senate shall by resolution, determine the basis for allocating among the counties the share of national revenue that is annually allocated to the county level of government.* |
| **Status of recommendations** | *Non-binding. Most have been accepted but not all (e.g. costed norms approach, provincial taxes)* | *Non binding but Almost always accepted* | *Not formally legally binding, but the convention has been that they are accepted. Under article 28 of the constitution, the recommendations and government's responses to each of them must be presented to both houses of Parliament* | *The recommendations are submitted to the President and are not legally binding. Government is not legally required to comment or respond to them.* | *RA's recommendations to Parliament and Executive are advisory. In the case of Annual Division of Revenue Bill, where the National Treasury position is different to CRA recommendations, they must explain why they differ with the CRA recommendation. Parliament in making the final decision has to consider both CRA recommendations and explanations given where the recommendations are not followed. CRA has mandate for determining which counties are marginalised for purposes of receiving equalization fund. The CRA decision on this is final. However, extensive prior consultations are however held with stakeholders* |

| | SOUTH AFRICA | AUSTRALIA | INDIA | UGANDA | KENYA |
|---|---|---|---|---|---|
| ***Public access to information*** | *Extensive material is available to the public on the Commission's website* | *Recommendations on relativities are defended by the Commission in open adversarial proceedings in all states before submission. There is extensive material regarding recommendations on the Commission's website.* | *Extensive material on recommendations is available to the public on the Commission's website* | *There is extensive material regarding recommendations on the Commission's website easily accessible to the public* | *Extensive information on formulae etc. on Commission website easily accessible to the public* |
| ***Do other subnational finance commissions exist?*** | *No* | *Since 1975 state grants commissions make allocations to municipalities* | *Each state has a Finance Commission to make recommendations on the allocation of resources to municipalities* | *No other commissions. There is a National Planning Authority with which the Local Government Finance Commission is required by law to consult* | *No* |

*Source: Shah (2007: 293), Kenyan Commission on Revenue Allocation http://www.crakenya.org, Ugandan Local Government Finance Commission http://www.lgfc.go.ug*

## APPENDIX 3: COMPARING TRANSACTION COSTS AND OUTCOMES OF INTERGOVERNMENTAL FORUMS AND INDEPENDENT COMMISSIONS IN SELECTED COUNTRIES

**Table 4: Transaction costs and potential outcomes of Intergovernmental Forums and Independent grants commissions in selected countries**

| | INTERGOVERNMENTAL FORUM | | INDEPENDENT AGENCY | |
|---|---|---|---|---|
| **Item** | **CANADA** | **GERMANY** | **AUSTRALIA** | **INDIA** |
| **Transaction costs** | | | | |
| *Citizen participation and monitoring costs* | Low | Medium | High | High |
| *Legislative costs* | Low | Low | Low | Low |
| *Executive decision-making costs* | Medium | Medium | Medium | Medium |
| *Agency costs* | Low | Low | High | Medium |
| *Uncertainty costs* | Low | Low | Medium | Medium |
| **Potential outcomes** | | | | |
| *Political consensus on equalization* | Yes, constitution | Yes, consitution | Yes, federal law | No |
| *Durability of consensus* | Yes | Yes | Yes | No |
| *Political compact on equalization standard* | Yes, constitution | Yes, solidarity pact | No | No |
| *Type of equalization program* | Paternal | Fraternal | Paternal | Paternal |
| *Pool determined by equalization standard* | Yes | Yes | No | No |
| *Allocation determined by equalization standard* | Yes | Yes | No, but formula | No |
| *Fiscal capacity equalization* | Yes, representative tax system | Yes, actual revenues | Yes, representative tax system | No |
| *Fiscal need equalization* | No | No | Yes | Yes, come |
| *Stability of allocation criteria* | Yes | Yes | No | No |
| *Sunset clause* | Yes | No | No | No |
| *Dispute resolution* | Supreme Court | Constitutional Court | Supreme Court | Supreme Court |
| *Program equity* | Yes | Yes | Maybe | Maybe |
| *Program complexity* | Low | Low | High | High |

***Source: Shah (2007:311)***

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