2027 POLICY BRIEF

FINANCIAL AND FISCAL COMMISSION
For an Equitable Sharing of National Revenue

POLICY BRIEF NO. 9
Budget & Fiscal Federalism Series

Strengthening governance in intergovernmental fiscal transfers for effective local service delivery

Executive Summary

The policy brief examines whether intergovernmental fiscal transfers translate into improved service delivery and governance outcomes at a municipal level. It draws on empirical evidence from regression models examining the relationship between Water Services Infrastructure Grant (WSIG) allocations, service delivery, and governance indicators. Evidence shows that fiscal transfers alone are insufficient to drive service delivery improvements or strengthen governance systems. Instead, the effectiveness of transfers depends on broader institutional factors, including municipal technical capacity and the alignment of roles across the three spheres of government. Evidence points to a fundamental governance constraint within the intergovernmental fiscal system, where financing addresses resource gaps, not institutional gaps. Weak integration between national funding, provincial oversight, and municipal implementation limits the ability of transfers to translate into measurable outcomes.

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FOCUS AREA: Intergovernmental fiscal transfers & governance
RELATED: Water Services Infrastructure Grant (WSIG); Division of Revenue Bill

THE FINANCIAL AND FISCAL COMMISSION

The Financial and Fiscal Commission is a constitutional institution that makes recommendations to organs of state on financial and fiscal matters. As an institution created in the Constitution of the Republic of South Africa, it is an independent juristic person subject only to the Constitution itself, the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997) (as amended) and relevant legislative prescripts. It may perform its functions on its own initiative or at the request of an organ of state.

The vision of the Commission is to provide influential advice for equitable, efficient and sustainable intergovernmental fiscal relations between national, provincial and local spheres of government. This relates to the equitable division of government revenue among three spheres of government and to the related service delivery of public services to South Africans.

Through focused research, the Commission aims to provide proactive, expert and independent advice on promoting the intergovernmental fiscal relations system using evidence-based policy analysis to ensure the realisation of constitutional values. The Commission reports directly to both Parliament and the provincial legislatures, who hold government institutions to account. Government must respond to the Commission's recommendations and the extent to which they will be implemented at the tabling of the annual national budget in February each year.

The Commission consists of commissioners appointed by the President: the Chairperson and Deputy Chairperson, three representatives of provinces, two representatives of organised local government and two other persons. The Commission pledges its commitment to the betterment of South Africa and South Africans in the execution of its duties.

Strengthening governance in intergovernmental fiscal transfers for effective local service delivery

Background

The intergovernmental fiscal system in South Africa is based on the principles of equity, predictability, and efficiency in how resources are allocated, which requires coordination across the three spheres of government. Infrastructure grants such as the WSIG are designed to support water and sanitation delivery. Municipalities, however, face a critical challenge in achieving developmental outcomes, partly due to systemic weaknesses in fiscal coordination.

Research Findings

The key findings are as follows:

Service Delivery Efficiency

Regarding service delivery efficiency, regression models reveal no statistically significant relationship between WSIG allocations and service delivery indicators. This indicates that infrastructure grant allocations alone are insufficient to improve operational performance, pointing instead to coordination failures, weak technical capacity, and governance deficits as more decisive constraints.

Governance Outcomes

Concerning governance outcomes, multinomial logit and logistic regression models show that WSIG allocations do not significantly influence audit results. Municipalities receiving larger transfers are not more likely to obtain clean or unqualified audits. Diagnostic tests further confirm that funding levels do not vary systematically across audit categories or provinces. Collectively, the evidence demonstrates that while fiscal transfers address vertical fiscal imbalances, they do not correct institutional imbalances – governance quality, oversight, and intergovernmental coordination remain the missing link between funding and performance.

Table 1: Regression Models on Water Losses and WSIG Allocations

Model Specification	R-Squared Value
OLS: Water losses – WSIG per indigent	0.04
OLS: Water losses – WSIG per beneficiary	0.08
OLS: Water losses – WSIG per beneficiary	0.22

Source: Financial and Fiscal Commission's calculations

The regression models in Table 1 show low explanatory power, with R-squared values ranging from 0.04 to 0.22 and no statistically significant predictors. Increasing infrastructure grants does not automatically increase service delivery, an indication that budget allocation levels alone are insufficient to justify service delivery outcomes. This points to governance and coordination failures and weak municipal technical capacity as more decisive factors in successfully managing water systems, rather than financing shortages.

Table 2: Regression Models on Audit Outcomes and Fiscal Transfers

Model Specification	Pseudo R-Squared Value
Logistic Regression (Binary: Clean/Unqualified vs. Others)	0.134
Multinomial Logistic Regression (Multiple Audit Categories)	0.32

Source: Financial and Fiscal Commission's calculations

Table 2 shows logistic regression produced an R-squared of 0.134 with no significant predictors, while multinomial logit models yielded a Pseudo R-squared of approximately 0.32 but again failed to yield statistically significant results. Municipalities with clean audits did not receive different funding than those with qualified or adverse opinions, indicating that institutional compliance and accountability mechanisms are more important drivers of audit performance than fiscal inputs.

Table 3: Statistical Test Results

Statistical Test	P-Value Range
Chi-square Test of Independence	0.325
Kruskal–Wallis Test	0.40–0.82

Source: Financial and Fiscal Commission's calculations

While the Chi-square test highlights governance challenges across government spheres, where uneven allocation patterns do not translate into measurable differences in outcomes, the Kruskal–Wallis test demonstrates that funding levels do not distinguish municipalities with clean audits from those with qualified or adverse opinions, supporting the conclusion that governance quality, oversight, and coordination mechanisms are the missing links.

Conclusion

Based on the empirical evidence, fiscal transfers alone are insufficient to drive improvements in either service delivery efficiency or governance outcomes. Evidence shows no statistically significant relationship between WSIG allocations and service delivery indicators or governance outcomes. The findings suggest that the intergovernmental fiscal framework effectively addresses vertical imbalances by providing resources to district municipalities, but it fails to resolve deeper institutional imbalances. Specifically, the disconnect between financial inputs and performance outcomes stems from weak governance and coordination among national, provincial, and local governments, inadequate technical capacity at the municipal level, and the absence of governance mechanisms. Therefore, increasing infrastructure grants without immediate investments in institutional capacity and oversight alignment is unlikely to yield measurable improvements in service delivery. Policy efforts should therefore shift from a focus on allocation levels towards strengthening the governance and institutional mechanisms through which fiscal transfers operate.

The Commission Recommends That:

1. The National Treasury should embed the institutionalisation of governance and coordinated planning and budgeting across the three spheres of government in the Division of Revenue Bill clauses and the Intergovernmental Fiscal Relations Act, as the findings show that misaligned planning cycles and weak communication between national, provincial, and local government significantly undermine the effectiveness of fiscal transfers.

2. National Treasury should redesign conditional grants, in collaboration with the Department of Cooperative Governance and Traditional Affairs and sector departments such as Water and Sanitation, to be simpler and more flexible in the Division of Revenue Bill clauses and grant framework conditions, to better reflect and respond to differentials in municipal capacity, governance, and coordination requirements.

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