South Africa: Fiscal Federalism in Transition

Renosi Mokate

South Africa is one of the most recent entrants to the group of nations which have a system of intergovernmental fiscal relations (IGFR). The system was instituted with the advent of democracy in 1994 and is entrenched in the Constitution. South Africa's IGFR system is the result of political compromise, which was reached following a multi-party negotiation process. The constitutional provision aims to recognise South Africa's regional, economic, and ethnic diversity, and provide expression to that diversity without undermining the attainment of national unity and the creation of an equitable society.

With a population of 44.8 million people, South Africa's Gross Domestic Product was US$212.8 billion in 2004, and the per capita Gross National Income was US$3,630. It has a stable macroeconomic environment characterised by moderate growth rates and low inflation and interest rates.

South Africa's intergovernmental system can be characterized as a unitary but decentralised system in which government comprises three spheres – national, provincial, and local. From a practical perspective, the relationship between the national and provincial spheres is one in which the national sphere determines policy –and the norms and standards guiding functions – with provinces acting as the implementing authority. The expenditure responsibilities of the provincial sphere are financed from the centre through a revenue-sharing model. The centre allocates a portion of nationally-raised revenues to provinces through the formula-driven Provincial Equitable Share (PES), as well as through conditional and specific purpose grants.

Unlike the national and provincial spheres, municipalities, especially the large metropolitan ones, have sufficient revenue-raising capacity to meet their expenditures, and additional resources are provided via the formula-driven Local Government Equitable Share (LES). Nonetheless, there are great disparities between the amount of revenue that the metropolitan municipalities and smaller municipalities can raise. Generally, urban municipalities have strong revenue bases and, as a result, are minimally dependent on transfers from the national sphere. This contrasts sharply with many rural and smaller urban municipalities that have very weak fiscal capacity and are heavily reliant on transfers from national government.

All spheres of government have the power to raise their own revenues. However, provinces neither impose nor collect levies on broad base taxes, such as corporate income and profits, personal income, and consumption and trade taxes. Most of the taxes available to provinces are narrowly based and relate to fees levied on motor vehicle licenses, gambling, liquor, hospital fees, and tourism. Local municipalities have access to property rates and fees for garbage collection and water use. The collection of user fees remains a significant challenge for both spheres of government for a number of reasons. The main reasons are:

- the lack of effective billing, collection and credit control systems, particularly at the local sphere,
- affordability, and
- a legacy of using non-payment for services as a form of voice to indicate lack of satisfaction with service delivery. The Constitution does grant provinces the power, subject to national legislation and national economic policy objectives, to impose a surcharge on personal income tax and the fuel levy.

South Africa's intergovernmental fiscal relations are thus characterized by relative centralization on the revenue side with highly decentralised expenditure responsibilities. Although expenditure on social services constitutes about 89 percent of total provincial spending, these services generate very little in terms of revenue. However, unable to raise adequate revenue from their assigned taxes and in order to achieve their constitutional mandate, provinces have come to rely heavily on intergovernmental transfers or grants, which make up 95 percent of total revenue utilized at the provincial order.

Nonetheless, government has embarked on various strategies to address these challenges, namely: capacity building, the introduction of more effective financial management and control systems, improved budgeting systems, more effective financial auditing in order to address collection deficiencies, and improved service delivery. In addition, the national government has introduced universal free basic services for water, electricity, water, and sanitation to address affordability issues. The latter strategy entails the provision of a minimum service level for all citizens and a scaled pricing mechanism for any service level utilised above that minimum. With respect to hospital services at the provincial order, a minimum fee is charged based on a means test. In this regard, more effective and reliable means testing mechanisms have been introduced in order to improve revenue collection.

The Constitution requires that the allocation of funds from nationally collected revenue should be divided on an equitable basis among the three spheres of government. This vertical division is in addition to the horizontal equitable division of revenue among the nine provinces and 284 municipalities with both conditional and unconditional grants. The vertical division of revenue among the three spheres of government is a policy made by the national government that reflects the relative priority functions assigned to each sphere of government. The horizontal division of revenue is formula-based, taking into account the specific factors of demographics and economic activity. Fiscal disparities are very great – corresponding to the differences in costs and capacity in providing public services.

The Constitution enables the national and provincial spheres to temporarily intervene in the affairs and the administration of a province or a municipality (in the case of provinces) where there is evidence of failure to deliver on mandates. The approach that has been taken by the upper spheres of government in this instance has been to take measures early in the process in order to avoid outright administrative take over. This has allowed the opportunity to develop more appropriate solutions, focus on improving conditions as opposed to punishing the relevant sphere of government, and leverage the scarce human and financial resources required to solve the problem. The underlying philosophy is to intervene in a manner that improves service delivery in the immediate term and builds the capacity of the province or municipality to perform better in the future.

South Africa's system of intergovernmental relations is still evolving, as the country is still a young democracy. The clarity with which powers and functions are defined in the Constitution safeguards the country against arbitrary reallocations of functions. Nonetheless, there have been some function shifts in the past ten years, such as the transfer of responsibility for social security grants from provincial to national government and the reallocation of primary health care from local to provincial governments. A framework has been formulated for the effective assignment of functions, and it ensures that assignment remains true to the spirit of the Constitution.