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FEDERALISM AND PUBLIC FINANCE
SOUTH AFRICA'S EVOLVING INTERGOVERNMENTAL FINANCE REGIME
A Brief interlude

Presented By Murphy Morobe, Chairman, Financial and Fiscal Commission, South Africa
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South Africa has moved from a highly centralized system of governance to a post apartheid system characterized by three distinctive, interdependent and interrelated spheres of government.

Mindful of our immediate past history of racial segregation and conflict, and also informed a great deal by well documented conflicts over resources in many other countries, Chapter three of the south African constitution introduces the notion of cooperative government as constitutional imperative in the handling of all affairs of state. This constitutional injunction says that " all sphere of government must observe and adhere to the principles in this chapter and must conduct their activities within the parameters that the Chapter provides."

The following key principles set the parameters for all intergovernmental interactions:
All spheres of government and all organs of state within each sphere must-

a) preserve the peace, national unity and the indivisibility of the Republic;
b) secure the well-being of the people of the Republic;
c) provide effective, transparent, accountable and coherent government for the Republic and its people;
d) be loyal to the Constitution, the Republic and its people;
e) respect the constitutional status, institutions, powers and functions of government in the other spheres;
f) not assume any power or function except those conferred on them in terms of the Constitution;
g) exercise their powers and perform their functions in a manner that does not encroach on the geographical, functional or institutional integrity of government in another sphere; and
h) co-operate with one another in mutual trust and good faith by –
    - fostering friendly relations;
    - assisting and supporting one another;
    - informing one another of, and consulting one another on, matters of common interest;
    - co-ordinating their actions and legislation with one another;
    - adhering to agreed procedures; and
    - avoiding legal proceedings against one another.

Proceeding from this, the Constitution did not leave the important matter of budget resource allocations to be subjected to the vagaries of day-to-day political machination. As a consequence, written into the Constitution is the overarching and fundamental principle of **equity.**

To champion and to advise parliament accordingly, provision was made in the Constitution for the establishment of the Financial and Fiscal Commission. As a matter of fact, a key principle provided for by the Constitution in this regard, is for parliament to promulgate an act providing for the establishing for the establishment of structures and institutions to promote democracy and to facilitate intergovernmental relations. It is a requirement of the Constitution that in executing its mandate, the Commission must at all times be independent, and impartial. Its main objective is to ensure, through its recommendations to parliament, provincial legislatures and organized local government, that allocations to the national, provincial and local government are **equitable.**

In the South African case, attitudes to decentralization have naturally evolved as a function of history and particularly of the majority's experience of the way in which the previous white minority government had attempted to use decentralization to further its apartheid policies.

As could be imagined, some of the protagonists during the negotiations saw the emergence of strong regional government as a useful countervailing force against an anticipated strong central government. Those who came from the ranks of the liberation movement tended towards the view that strong regions would act as a fetter that would blunt the new government's ability to push through with much desired transformation programmes.

It is however my view that provinces or regions should be viewed as entities that could serve, rather than detract from any powers that are bestowed on central government by the Constitution. They can indeed be complimentary to and can even augment central government's capacity to govern.

Public finance in South Africa also has to occur with context of rights framework provided for in the "Bill of Rights." For example, some of the key rights that have a direct and immediate impact on the country's resource allocation decisions are:

- (26) the right to adequate housing
- (27) the right to have access to health care, food, water, and social security;
- (29) the right to basic education;
- (32) the right of access to any information held by the state, or that held by another person that is required for the exercise or protection of any rights.

In this respect, each sphere of government is assigned responsibilities by the Constitution with specific powers and functions defined therein. Education, health and welfare however are concurrent functions, with national government having the overall responsibility to determine the norms and standards associated with the delivery of the relevant services. This in itself has significant financial implications since e the level at which these norms will be or can be set is dependent primarily on the resources that are available to fund at that level.

As is typical in other federal systems, South Africa's public finance regime also has to deal with a significant vertical imbalance in that provinces, while assigned specific responsibilities, however have minimal to negligible own source revenues. This is a function of the way in which provinces were established. The political imperatives took precedence over any other.

One of the consequences of this design is that provinces in South Africa are much more dependent on the sharing of nationally collected revenue. Own revenue for provinces still account for no more than 5% of their total spending requirements. This compares with 70% or more for states / provinces in countries such as Brazil, Canada, Germany and the U.S.

This fiscal dependency has created a requirement, both for the establishment of clear principles to guide the sharing of revenue between spheres of government, and a mechanism to ensure that they are given appropriate consideration.

With respect to the local government sphere, the current situation stands in sharp contrast to that of provinces. Over 90% of local government revenue is own source revenue. However, taken at face value, a statistic such as this one could be misleading for at least three reasons:

I. One half of local government revenues received in the form of user fees, paid by residents for electricity, water, sanitation and other services;

II. It is generally recognized that in South Africa, given its history of preferential service provision to the white population, service delivery or access to basic services is still skewed in favor of that section of the population. As municipalities are increasingly compelled to fulfill responsibilities equitably to all South Africans, under funding due to lack of sufficient own source revenue arise and as such, results in increased reliance on the equitable share of nationally collected revenue.

III. Differences among municipalities are significant. While in some there would be adequate tax bases, for many others tax bases are insufficient to yield the required revenue.

It was thus in recognition of this vertical fiscal imbalance, and the attendant horizontal fiscal disparities that the drafters of the constitution established the Financial and Fiscal Commission to play the role of an independent and impartial arbiter in the resolution of inevitable competing claims on nationally collected revenue.

As a starting point, the Commission had argued that it is of paramount importance that "sound fiscal arrangements must rest on sound principles," and these would have to be spelt out very clearly. Some of these have of course been extensively written about in literature on fiscal transfers. However, experience the world over has shown that these can never be repeated enough!

After all, "it is an essential feature of all multi-level government systems, federal and otherwise, that tensions exist and compromises must be made. These involve among other things the resolution of the balance between truly decentralized provincial responsibility for fiscal decision on the one hand, and the achievement of national equity and efficiency objectives on the other. Although decentralizing basic public service provision to provincial or local levels of government can enhance efficiency, these basic public services are at the same time among the most important policy instruments for achieving national equity goals. These goals, explicitly stated or not, include the aim that citizens ought to have equal access to educational opportunities, health care and socio-economic security regardless of where they reside."

The Commission recognizes that 'it is the role of the grant structure, and national-provincial-local fiscal arrangements more generally, to facilitate the decentralization of fiscal responsibilities in a way that leads to efficient and responsible sub-national government decision-making, while at the same time respecting national goals and objectives.

Of course different nations resolve these tensions in very different ways. Some more successfully than others. Success in this respect would mean, " that decentralization of public service provision achieves two objectives. First, it gives provincial governments responsible legislative authority to meet their own constituents' particular needs effectively. Second, it ensures that citizens are provided with comparable access to basic services regardless of their province of residence.

Let me then outline the following principles for best practice for intergovernmental fiscal relations, which the Commission accepted as applicable to South Africa:

1. Fiscal autonomy of provincial governments

In the South African case, autonomy is limited by a constitutional injunction, which defines South Africa as "one sovereign, democratic state". The Commission however was of the view that efficient and politically accountable provision of public services by provincial governments is facilitated if provinces are allowed to exercise their responsibilities within the limits provided in the Constitution. It should be expected of provinces to be better informed about the detailed needs of their residents and be best placed to micro-manage their own programs. But then in the cut and thrust of politics it is always tempting to want to argue that the capacity for responsible expenditure decisions at the provincial level simply does not exist. The unfortunate consequence of this argument is indeed the perpetuation of that very same lack of capacity rather than allowing the capacity to develop through experience.

2. Sharing Resources for fiscal equity

Sharing has to entail the affording of sub-national governments sufficient resources, such that each can provide comparable levels of public services for similar revenue raising effort. This notion of fiscal equity, to be meaningful must reflect the common rights of citizenship that all citizens should enjoy.

3. Formula driven rather than discretionary grants

In South Africa we have recognized and accepted the perspective that grant systems whose amounts are determined by a well specified formula have a number of advantages over those that are determined on a year by year discretionary basis by national government. These tend to be more transparent, reliable and predictable.

4. Transparency in setting grants

The importance of transparency in the determination of grant formulae and amounts cannot be overemphasized. To this extent we've taken a leaf from the role of similar bodies in India and in Australia. These bodies have over time proven to be effective structures for consulting with sub-national governments.

5. Unconditionality of major grants

Notwithstanding the unconditional nature of say the equitable share grant that provinces receive, their delivery of important social programs could be subject to nationally set norms and standards. This is especially the case in South Africa where national government and provinces bear joint responsibility for ensuring that public services in areas of education, welfare, and health satisfy national equity criteria.

6. Provincial accountability

The Commission's refrain on this subject has been that "political accountability is important for ensuring that public services are delivered in efficient ways and that they meet the needs of citizens. The Commission argues that explicit and unambiguous delineation of accountability relationships between the different spheres of government is critical.

7. Avoidance of bailouts

One of the benefits of formula-driven unconditional grants arises from the fact that sub-national governments bear responsibility for the consequences of their expenditure. This of course will also depend on a country's electoral system. The irresponsible behavior of some levels of government, where a possibility of bailouts exists is well documented.

8. Norms and costs as elements of grants

Historical inequality in levels of development, including critical capital backlogs, is a major determinant of provincial disparities. These are typically much more difficult to measure and very few countries do so in a detailed way, except of course Australia where the equalization system incorporates needs in a sophisticated way to determine the horizontal allocation of grants among states.

In the South African context, the problem is made more challenging by the requirement that the norms and costs of providing basic services should inform not only the horizontal division of funds across provinces, but also the vertical division of equitable shares. Notwithstanding the fact that it is in the final analysis the prerogative of national government to determine the vertical division of revenue, it has nevertheless to do so in a way that satisfies the requirements of the constitution. One of the pre-eminent constitutional requirements is that the division of revenue has to ensure that provinces can provide basic services up to the nationally established norms and standards.

9. Macro-economic management

National government in terms of the South African Constitution is ultimately responsible for macro-economic management and hence, the implementation of fiscal and monetary policies. The perpetual dilemma however is how the actions of national, provincial and local spheres of government can be coordinated so as to achieve national re-distributive objectives.

10. Provincial revenue raising

Having made the point that a strong case exists for decentralizing expenditure functions than for decentralizing taxation functions, the Commission nonetheless recognizes that the advantages for provincial levels of government having reasonable revenue-raising responsibilities are compelling.