# INTERGOVERNMENTAL FISCAL RELATIONS

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The three Women's Budget reports since 1996 have examined the sectoral allocations of the different departments at national and provincial level. They have also examined the cross-cutting issues of taxation, public sector employment, and budget reform. The discussions of different sectors have described how functions and budgets are divided between national and provincial governments. In Health, Education and Welfare, in particular, a large proportion of spending occurs at provincial rather than national level. Some of the chapters have referred, in passing, to intergovernmental fiscal relations. Intergovernmental fiscal relations refers to the allocation of responsibility for expenditure and powers to raise revenue to different spheres of government. A system of intergovernmental fiscal relations includes the design of a system of transfers to overcome the problem of "mismatch" between such responsibilities and powers.

This chapter takes that discussion further by describing the changing constitutional position as regards allocations and how this affects issues such as equity and efficiency. In particular, it focuses on the role of the Financial and Fiscal Commission in the system of intergovernmental fiscal relations. The discussion attempts to go further than other examinations of these topics by raising the question as to how equity and efficiency might be understood in gender terms. It also moves beyond previous Women's Budget analyses by extending the discussion to allocations at the local government level.

Both endeavours are made more difficult by the ongoing changes in the system. The nature and structure of the state created by the Constitution are different from that of the former regime. Past budgetary procedures - including rules as to raising revenue and allocation of that revenue between spheres - have therefore had to be changed. However, not all these changes have yet been implemented, or even formally decided.

There are two further factors compounding the confusion. Firstly, at the local government level the number of local governments and definition of boundaries have yet to be finalised. Secondly, we are still unsure as to the exact number of people in the different regions and their demographic profile in terms of age, gender and income. The first post-apartheid election was held in November 1996. The preliminary results of the census have already revealed that our picture of the country was very skewed. At the most obvious level, the results suggested that in 1996 we had 37,9 million people living in the country rather than the 42 million plus previously estimated.

From the gender perspective we can note that the proportion of women in the population is now estimated to be 52%, rather than the previous 50%. Further, the previous overestimation of the population was largely the result of apartheid demographers' assumption that black women were having babies far more rapidly than they actually were. At the more general level, the uncertainty about the population profile is important for intergovernmental relations as many of the inter-sphere allocations are based on demographic factors.

As with so many other aspects of the South African situation, the topics covered by this chapter are moving targets. In respect of gender analysis, in particular, most of our observations will be predictions of possible effects rather than reporting on past performance. These predictions will need to be tested against reality as the new systems come into effect.

The Constitution, which allocates functions and responsibilities, only became law in 1996. In many respects the Constitution left matters at a general level requiring further elaboration before they could be implemented. The national-provincial allocation system has developed fastest. But it was only in 1997/8 that the new system came into operation. In that year provinces were for the first time allocated block grants rather than separate allocations for each function.

At the local government level, the final form of the system is still a matter of debate. Firstly, the form of local government itself is still not decided. A Green Paper was issued only in October 1997 and a White Paper is planned for early 1998. Secondly, while the FFC released a discussion document on local government finances in mid-1997, the principles and approach adopted are here, too, still up for discussion. And the Green Paper suggests that the FFC's recommendations will not be accepted without much debate.

The first part of this chapter looks at the Constitutional framework for the division of powers and functions between the spheres of government and the allocation of resources to achieve these. The second part of the chapter discusses general principles of intergovernmental fiscal relations. The third and fourth parts then go on to examine the situation in respect of the provincial and local government spheres respectively. They also provide proposals for the future.

## 1. Part I: New Constitutional Provisions

### 1.2 Three spheres of government

The Constitution establishes a unitary state with three spheres of government - national, provincial and local. The term "spheres" is now preferred to "levels" so as to avoid any suggestion of a hierarchy. Schedules 4 and 5 of the Constitution assign each of the spheres certain powers and functions. National and provincial governments have some "exclusive" powers and functions for which they alone are responsible. They have other powers which are "concurrent", in that they share them with each other and/or with local government. For example, defence is an exclusive function for the national government while the provision of health services is shared by all three levels. Local government has executive authority to the extent that Section 156(1)(b) provides that a municipality may exercise authority and administer, in addition to the items listed in Schedules 4 and 5, "any other matter assigned to it by national or provincial legislation".

**All three spheres of government are responsible for health**

The health sector provides a stark illustration of the difficulties in ensuring equity – or even *understanding* financial flows – when responsibility for functions is split across spheres of government. The Constitution gives all three spheres – national, provincial and local – responsibility in respect of health. There are overlaps in the responsibilities of, and services offered by, different spheres. It is also not always clear what the division is meant to be. For example, Schedule 4 of the Constitution says that both provinces and local governments are responsible for municipal health services but there is, as yet, no final decision as to what these services are.

The post-apartheid Department of Health is moving towards a more locally controlled district-based health system. The districts are to bear the main responsibility for primary health care. This is, arguably, the most important level for women and poor people more generally. (See chapter by Marion Stevens in the *Second Women's Budget* (Stevens, 1997)).

By late 1997 eight of the provinces (all but KwaZulu-Natal) had been divided up into a total of 155 districts. The average population per district ranged between 124 000 in the underpopulated Northern Cape and 308 000 in the very densely settled Gauteng.

Theoretically such a local level system should allow for finer targeting to ensure equity within provinces, rather than simply between provinces. In practice, however, the division between the three levels makes this very difficult.

One problem is that the districts do not always match local government boundaries. In Gauteng, the Health Department has defined metropolitan local councils as districts. In other provinces, and particularly in rural areas, there is no neat match. Shan Naidoo describes the result as a "Swiss-Cheese phenomenon" (Naidoo, 1997:57).

Further problems arise because of the very uneven revenue bases of the different local governments, and the lack of information as to the level and flows of finances. Up until now there has been no tracking of expenditure at this disaggregated geographical basis. The current financial management systems and budget process do not allow such tracking. There are also as yet no minimum norms and standards for primary health care. Until the information, norms and standards are available, it will be very difficult to plan or monitor moves towards equity at the level of basic delivery.

The Constitution determines the ability of the different spheres of government to raise their own revenue separately from the allocation of powers and functions. But Section 214 introduces a revenue-sharing mechanism to close the gap between what a region can raise and the amount it needs to perform its functions.

The availability of resources - and in particular the availability of money - is central in determining what each of the spheres can deliver. The FFC calculates that in the 1996/7 financial year, just over three-quarters (76%) of government revenue was raised at the national level, 2% at the provincial and 22% by local government. In terms of expenditure, on the other hand, 43% was spent at national level, 36% at provincial and 21% at local.

The provinces thus have extensive responsibilities - in particular for primary and secondary education, health care and social security payments[1]. But they have very limited revenue-raising capability. They raise only 5% of the money they spend. For the rest, they are dependent on national government. This places South Africa's provinces among the most fiscally dependent of subregional governments anywhere in the world.

Local government fares a little better. Overall, it is able to finance 90% of expenditure from revenue it raises itself. But this overall average disguises significant variations. It is mainly large urban municipalities that can raise adequate revenue. Rural municipalities finance significantly less expenditures from own revenue. And a recent study by the National Electricity Regulator noted that the restructuring of local government had seen a "dramatic" increase in the costs of local government. This increase was due to increased responsibilities and staff, at the same time as a decrease in grants among the spheres of national, provincial and local (*Business Day*, 12.09.97). This discrepancy between funding and responsibilities has resulted in what have come to be termed "unfunded mandates". These occur when a sphere of government is given responsibility for performing a function but is not provided with the means to do so.

### 1.2.1 Constitutional provisions

There are several clauses of the Constitution which recognise and address the imbalance between revenue-raising powers and expenditure needs, at least in broad terms:

- Section 214 states that the provinces and local government are entitled to equitable shares of revenue collected nationally. This revenue comprises, firstly, percentages of personal income tax, value added tax (VAT) and the national fuel levy; secondly, duties on the transfer of properties in the particular province; and, thirdly, conditional and unconditional allocations;
- Section 213(2)(b) says that the amounts to which provinces are entitled in terms of section 214 will come out of the National Revenue Fund;
- Section 228 states that provinces are entitled to raise their own revenue, subject to certain conditions and approval by Parliament;
- Section 230 states that provinces and local government are entitled to borrow funds, subject to conditions that must be specified in an Act of the national Parliament;
- Section 126(3) states that provincial legislation takes precedence over national legislation with respect to Schedule 4 functions. This provision holds except to the extent that national legislation is necessary to establish national norms, promote the national economy, etc;
- Section 229 provides that local government can impose rates on property,

[1] There have been debates on where best to locate the provision of social security. The FFC has suggested that from an accountability point of view, financial and administrative responsibility should be located at the same sphere. In the case of social security the level of benefits, and who qualifies for them, are determined at the national level. The appropriate level for financial responsibility is therefore also national. However the transfer of personnel from the provincial level to the national level, the development of the systems and the management for monitoring and reporting still need to be established at national level. So while there is widespread agreement that the current system is illogical, the process of transferring responsibility will take some time to complete.

> and surcharges on fees for services provided by, or on behalf of, the municipality, Local government may also be authorised by national legislation to impose other taxes, levies and duties. It may not impose income tax, VAT or customs duty. Local taxes must also not “materially and unreasonably prejudice national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour”.

In sum, these sections of the Constitution indicate that provinces and local authorities should have a degree of fiscal autonomy, particularly with respect to Schedule 5 functions. However, they also indicate that substantial transfers to the provinces (and to a lesser extent local government) should occur. These are necessary because of the imbalances in revenue-raising capacities and expenditure responsibilities between the national, provincial and local spheres of government. These imbalances between the spheres are generally referred to as vertical imbalances.

### 1.2.2 Equity and other principles

The Constitution establishes the need for equality in opportunity or access to government services. This means that within each sphere each province and municipality must receive an equitable share of resources. This is referred to as horizontal balance.

The enormous differences between provinces make redistribution between them imperative. Gauteng, for example, produces 35% of GDP but contains only 7% of the population of the country. If each provincial government had to draw only on its own wealth, the people living in Gauteng would be enormously advantaged. Those in provinces like Northern Province and Eastern Cape would be hugely disadvantaged.

Different people, different provinces, and different municipalities have different ideas as to how to define equity. In fiscal discussions horizontal equity is usually understood as the requirement that comparable jurisdictions (or individuals or households) within a country should be able to provide (or have access to) comparable levels of public good provision at similar levels of taxation.

Ability to provide focuses on equity in inputs. Crudely, it says that provinces and local governments must receive equitable amounts of money. Access focuses more on outputs. It says that citizens within different localities must enjoy equitable levels of services. Ensuring equitable outputs is more difficult than ensuring equity in inputs. It is particularly difficult in a system where sub-national governments want to have autonomous decision-making powers. But a focus on output is more in line with our constitution. It says that citizens should receive equivalent services irrespective of where they live. The constitution is based on a notion of substantive equality rather than formal equality. Substantive equality says that it is not enough to ensure that all people are treated the same if their starting points are unequal. Instead, one might need to treat different groups and individuals differently in order to ensure that their finishing points are equal.

The South African Constitution puts the need for fiscal equity very strongly. The South African wording can be compared, for example, with the weaker Canadian Constitution Act which talks about "*reasonably* comparable levels of public services at *reasonable* comparable levels of taxation" (Wehner, 1997b:9; emphasis added). Our approach more closely matches that of Germany, which aims to create "equal living conditions throughout the country" (Wehner, 1997b:19).

Equity is not the only consideration. In trying to establish a credible, sustainable and flexible system of intergovernmental finance there are a number of sometimes conflicting considerations. These include:

- provision for the repayment of the national debt (At present approximately a fifth of the national budget each year is spent paying interest on the country's debt);
- the legitimate needs of national government;
- provincial and municipal fiscal capacity and performance;
- provincial and municipal developmental needs and disparities; and
- efficiency of revenue use in and within the different spheres.

If a system is to be successfully implemented, these criteria must be clearly defined, measurable, and continually re-evaluated.

Where resources are limited, the three-tier system with nine provinces and over 800 municipalities can easily result in competition rather than the cooperation and coordination required for national development. National government has tried to counter such competition through a number of mechanisms. These include:

- setting of norms and standards for essential and priority activities, such as teacher:student ratios (one way of addressing outputs as well as inputs);
- conditional grants which attempt to influence behaviour by only providing money if certain actions are undertaken by the other spheres;
- inter-provincial agreements, for example where one province pays another to provide certain services to its citizens; and
- national developmental strategies.

## 1.3 The Financial and Fiscal Commission (FFC)

The Constitution sets the broad parameters, but the "devil lies in the detail". The devil also lies in the fact that resource allocation will always generate tension and competition, particularly when resources are scarce and unmet needs are great. Both these conditions are certainly present in South Africa.

The Financial and Fiscal Commission (FFC) is intended to promote optimal decisions about these difficult questions. Section 220 of the Constitution provides for the establishment of the FFC as an independent and impartial statutory institution, accountable and reporting to the national and provincial legislatures. At the end of 1997 it consisted of 18 commissioners, appointed by the President and a secretariat (researchers and support staff) of 16 persons.

**Race and gender within the Financial & Fiscal Commission**

At the commissioner level the FFC is relatively balanced in racial terms, with twelve black commissioners out of a total of 18. It is very unbalanced in respect of gender. Only two of the eighteen commissioners are women. The racial breakdown is similar among staff, with eleven black and five white staff members. At this level women outnumber men. The single biggest colour-gender group is black women – at seven out of a total of /16.

**Race and gender composition of the FFC as at end 1997**

| | Black Women | White women | Black men | White men | Total |
|---|---|---|---|---|---|
| Commissioners | 2 | 0 | 10 | 6 | 18 |
| Staff | 7 | 3 | 4 | 2 | 16 |

The Constitution gives the FFC the task of advising the national and provincial parliaments regarding:

- criteria for equitable allocations from revenue collected nationally;
- the imposition by provincial and local governments of taxes, levies, rates, user fees and other charges, duties and surcharges;
- the raising of loans by provincial and local governments; and
- criteria to be used for determining the allocation of fiscal resources.

In respect of local government, the FFC is required to advise on both revenue-raising powers, and the nature and extent of any cross-subsidisation across municipalities. The FFC is not directly accountable to local government in the same way as to national and provincial legislatures. However, section 229(5) of the Constitution provides that national legislation in respect of local government finances can only be enacted after consultation with both the FFC and organised local government.

The FFC has been in operation since June 1995. During this time it has engaged in extensive research on the theory and practice of intergovernmental finances, as well as examining the specific conditions in South Africa. The FFC's detailed work and recommendations forms the basis of current allocations between the provinces. The recommendations were, however, amended before acceptance. The formula dividing the money between the provinces was slightly adjusted (see below). There was an even bigger change to the FFC recommendations as to how much should be allocated to the national sphere and how much left over to be divided among the provinces.

None of the proposals nor amendments was motivated, or even discussed, in terms of gender. In practical terms, however, the amendments could well have gender implications. For example, the province's cake is a smaller proportion of national revenue than recommended by the FFC. The provinces are responsible for delivery of basic services while national allocation is usually more concerned with policy. The provinces' smaller allocations will probably entail additional hardship for the many impoverished women (and men) who are too poor to afford private services and so depend on what government provides.

## 2. Part II: The Theory of Intergovernmental Fiscal Relations

## 2.1 Decentralised expenditure but centralised tax powers

In any country with decentralised functions, grants are the principal means through which the national government can influence provincial and local government decisions. The existence of intergovernmental grants raises questions regarding the costs and benefits, advantages and disadvantages, of decentralisation of government. Why should central government resort to indirect controls of local government decisions instead of assuming direct responsibility for provincial and local services? Furthermore, if the central government needs to control local decisions in this manner, why decentralise?

### 2.1.1 Advantages of decentralisation

Those in favour of decentralisation of government functions and decision-making argue that there are a number of advantages. The first advantage of decentralisation is the possibility of having regional variation in the mix and level of local public goods. The second advantage is that regionally placed governments are said to be in a better position to determine the preferences of the local population. In gender terms, in particular, it is often argued that local provision and decision-making is more likely to take note of the local concerns of women, who are assumed to be more concerned about day-to-day issues than grand political debates.

The third advantage is that competition between municipalities, proximity to beneficiaries, and transparency provide a strong motivation for local government to be more responsive to the desires of the local population. This is particularly the case where local constituencies have the power to elect or otherwise control who the decision-makers are and how they act. The fourth advantage stems from scale. This argument says that it is easier to administer smaller bureaucracies efficiently.

### 2.1.2 Disadvantages of decentralisation

The above advantages are not necessarily always applicable. For example, the transparency argument only holds if the decentralised bodies provide greater information to citizens. And decentralisation will work against transparency to the extent that different provinces or municipalities structure and frame their budgets in different ways. In particular, the lack of uniformity makes comparisons difficult across the different localities.

The advantages must also be weighed up against a number of disadvantages. Firstly, the potential gains from decentralisation depend on the size of the country in terms of geographical area, population, and so on. They also depend on the diversity of the population. In terms of diversity, the potential benefits will differ according to whether the most important differences in need and preference are between people living in different areas, or rather between groups - race, class, gender, and so on - within each of the areas. Where intra-regional differences which predominate, a national system could provide the opportunity, for example, for women across provinces to unite to fight for certain services. In this case, decentralisation could weaken the strength of the women by multiplying the fora in which they must organise.

Secondly, at the simple level of representation, South Africa is similar to many other countries in having higher proportions of women among decision-makers at the national level than at other levels. Within legislative bodies, 27% of national parliamentarians are women. This must be compared to the overall average of 24% at provincial level, and only 19% at local. Within the executive, both the national Deputy Minister of Finance and the national Director General are women, while none of the provincial Finance MECs or deputy director generals are women. Further, the electoral system for provincial parliaments does not ensure any direct links to resident populations. The system therefore diminishes the likelihood of direct response to local needs and preferences.

Thirdly, decentralisation can increase the scope for corruption within government since the number of officials in a position to benefit from corruption increases with the number of points of control.

Finally, decentralisation tends to increase the demand for skilled administrators by the government sector since each autonomous regional and local authority requires its own administrative staff. A greater degree of centralisation could conserve scarce public management resources and so promote efficiency in the spending of public funds.

#### 2.1.3 Taxing powers and collection

Even those who argue for decentralised decision-making around allocations and spending, often support central taxing powers and central collection of certain taxes. These would usually include personal and corporate income tax, but not property taxes.

In most cases, central collection is more efficient than decentralised collection. Centralised tax collection is often less costly for informational reasons. A centralised system requires only one file on each economic entity, while a decentralised system could lead to mutilple agencies collecting essentially the same information.

It is also more difficult to assess taxable income with decentralised tax collection. Many residents and companies earn income in multiple regions. In particular, it is the richer people (usually men) who are most able to pay tax, who are likely to earn income across regions. A sub-national government is always at a relative disadvantage in collecting data outside of its jurisdiction. All these factors mean that central collection will usually result in higher amounts being collected as it is more difficult for those who are liable to avoid and evade tax.

Centralised tax systems promote uniformity in taxation between areas. This brings its own benefits. If different regions impose different levels of taxes, companies and wealthier individuals might relocate away from a high tax region. (Conversely, tax holidays and other tax benefits in apartheid growth points and post-apartheid spatial development initiatives aim to lure investors to target areas through lowering effective taxes.) When the company moves away, the high tax region loses in terms of tax revenue, as well as employment and other benefits. When the wealthy individual moves away, the region also loses out on tax revenue. In the end, the poorer regions - those most in need of government services and often those with a higher proportion of women - become those with the smallest tax bases and lowest ability to provide the services. This obviously only applies to tax bases that are relatively mobile.

More generally a South African system must be designed to cope with the current large disparities in wealth and levels of services in different regions. Decentralisation of both taxation and spending will strengthen opposition to redistribution and equity. Wealthier regions will argue that they should have the full benefit of the revenue which they raise. In most countries, deficit financing is the prerogative of the centralised authority i.e. regions are not permitted to spend more than they receive and so incur budget deficits. In most countries, bond financing - another way of spending more than one has - is restricted to the funding of capital projects. If a region cannot spend more than it receives, and its receipts are restricted to those it collects itself, then existing inequalities between regions will continue, or even increase.

Centralised taxing powers and collection accompanied by grants to regional authorities addresses the problem of inequity, in that it allows for easier redistribution between different regions. Grants also allow a country to rely on an efficient centralised tax collection agency while still availing itself of the advantages of decentralised expenditure decisions. Additionally, grants afford the centralised authority the ability to influence local expenditure decisions to ensure that, when appropriate, such decisions take account of national interests.

## 2.2 Grants

Grants are one form of intergovernmental transfers between different spheres. There are three main types of grants:

### 2.2.1 Block grants

A block, or “general purpose”, grant is the principal means of increasing the funds available to sub-national governments. It provides a “block” or lump sum to the sub-national government. That government then decides how to allocate the money amongst functions.

Block grants are normally calculated according to a formula based on the goals of central government. For instance, the grants will normally be inversely proportional to the per capita income of a region and positively correlated with population size. In South Africa, rural areas generally suffer from disproportionate levels of poverty and need. The FFC’s provincial allocation formula has added a further pro-poor bias in that the rural population is weighted by an additional 25%. In effect, because women predominate in impoverished rural areas, this weighting also implies redistribution in favour of women.

Block grants in South Africa are thus a means of both providing general revenues to sub-national governments to fund local public services and redistributing funds in favour of more needy sub-national governments. They are calculated according to a formula which takes account of the overall need for delivery. They do not, however, specify how the total amount should be distributed between the different functions, programmes and services for which the sub-national government is responsible. Those decisions are made by the sub-national governments themselves.

**The numbers**

The table below provides some of the provincial demographic numbers which influence the size of the block grants. The first two columns of figures show the proportion of the population found in each province. The first column gives the proportions based on the 1991 census. This was the basis of the figures used for the FFC's calculations until late 1997. The second column gives the proportions suggested by the preliminary results of the 1996 census.

The biggest proportional gain is in the two wealthier and more urban provinces – Western Cape and Gauteng. The very rural Northern Province, on the other hand, shows the largest proportional loss. In real terms Northern Province "loses" nearly 1,5 million people and KwaZulu-Natal just over a million. The population weighting in the new figures is thus better for the wealthier provinces and worse for the poorer.

**Table 1: Provincial demographics**

| | **Precensus** | **Census** | **%fem 91** | **%fem 96** | **%non-urb** | **GGP p.c.*** |
|---|---|---|---|---|---|---|
| W Cape | 9.0 | 10.9 | 50.0 | 51.9 | 10.1 | 14764 |
| E Cape | 15.7 | 15.5 | 52.5 | 53.9 | 62.7 | 4539 |
| N Cape | 1.8 | 2.0 | 49.5 | 50.9 | 28.3 | 10848 |
| KZN | 21.1 | 20.3 | 52.5 | 53.3 | 56.5 | 6681 |
| F State | 6.7 | 6.5 | 47.6 | 50.7 | 30.4 | 8647 |
| N West | 8.2 | 8.0 | 49.3 | 50.9 | 65.2 | 6428 |
| Gauteng | 17.1 | 18.9 | 46.8 | 49.1 | 3.6 | 20893 |
| Mpum | 7.3 | 7.0 | 49.4 | 51.3 | 61.7 | 10625 |
| N Prov | 13.1 | 10.9 | 54.3 | 54.5 | 88.1 | 2709 |
| **Total** | **100** | **100** | **50.5** | **52.0** | **44.6** | **9461** |

*Gross Geographic Product per capita
*Sources: Central Statistics (1997a; 1997b; 1998)*

The next two columns show what proportion of the population of each province is female according to the 1991 and 1996 censi. The final row shows that, overall, the proportion of women has increased. The different provincial figures suggest that there is less of a difference between the provinces than previously thought. In 1991 the province with the highest proportion of females (Northern Province) was 6,7 percentage points higher than the province with the lowest (Free State). In 1996 the difference between the highest (again Northern Province) and the lowest (Gauteng) was 5,4 percentage points. The retrenchments on the mines have probably resulted in more men returning to rural areas, while easier movement post-apartheid between homeland and other areas have allowed women to move more easily to towns. But the pattern still shows women predominating in the poorer rural provinces – Northern Province, KwaZulu-Natal and Eastern Cape.

The second from last column shows the proportion of the population in non-urban (or rural) areas according to the 1996 preliminary results. In Northern Province close to nine out of every ten people live in rural areas. Rural weighting will be to the advantage of this province, as well as to the North-West, Eastern Cape, Mpumalanga and, to a slightly lesser extent, KwaZulu-Natal. Comparing this and the previous column, we see a fairly close match between rurality and the proportion of women. A rural weighting in the formula will, then, tend to be women-friendly.

The final column gives the gross geographic product (GGP) per capita for each province in 1994. This is a proxy for income per capita. Gauteng is clearly the wealthiest province, followed by Western Cape and Mpumalanga. Northern Province and Eastern Cape are the poorest. Again there is some correlation between the wealth of a province, its degree of rurality, and the proportion of women. But there are some provinces – such as Mpumalanga – which do not fit neatly into the pattern.

One of the reasons for the mismatch is that GGP per capita is an average measure. It does not say anything about inequalities within a province. These inequalities could be along gender lines, but also according to race, area and other characteristics. These intra-provincial inequities mean that an equitable system of intergovernmental fiscal relations cannot stop after dividing up the available resources between the provinces. The system must also ensure that within each province the resources, goods and services reach those who need them most.

Block grants give the sub-national governments maximum discretion as to how they spend the allocations. The other two types of grants restrict the discretion of the recipient governments.

### 2.2.2 Matching grants

A matching grant is normally related to a specific functional category of expenditure. Typical examples are primary education or health clinics. The size of the grant depends on the level of local expenditure on the given programme. The purpose of these grants is to encourage sub-national governments to spend more on a targeted service. They do so both by providing funds and by providing the sub-national government with an incentive to use more of its own resources for this purpose.

Matching grants have not been used in South Africa to date. The national Department of Finance is currently considering a matching grant mechanism between national and provincial governments to fund Curriculum 2005 (Department of Finance, 1997). The Department does not, however, spell out what this will mean in terms of a formula for the matching grant

### 2.2.3 Conditional grants

These “special purpose” grants are restricted-use funds offered to sub-national governments. The sub-national government must use the funds for the specifically designated purpose prescribed by the national government in order to qualify.

In some cases, such grants can be inefficient or ineffective. For example, when a conditional grant pays for a programme that the sub-national government would have instituted anyway, they are equivalent to block grants. Also, if a specific purpose grant is provided for a programme that the sub-national government did not intend to fund or does not consider desirable, the sub-national government might not apply for the grant.

Conditional grants provide an incentive, or “carrot”, to a sub-national government to provide a service. In the South African context there is no corresponding “stick” to enforce provision of the service, as national government does not have the capacity to monitor the expenditure effectively. Another argument against conditional grants is that the smaller the degree of discretion enjoyed by a sub-national legislature, the less the electorate can hold them accountable for what and how they deliver.

The national Department of Finance intends implementing several conditional grants in the 1998/99 budget. For the most part they involve projects that were part of the Reconstruction and Development Programme. These include the Primary School Nutrition Programme, the outstanding commitments on the school classroom building projects which are part of the Culture of Learning and Teaching Campaign, and the Kwazulu Peace Initiative Task Team. Other conditional grants to the provinces are in Health (for the delivery of tertiary health care and the medical training function); the transitional conditional grant for so-called R293 (ex-homeland) towns; and water services transfers from the Department of Water Affairs and Forestry.

The Department of Finance is also considering further conditional grants. These include grants to support capital spending in the provinces, in particular to address health and education infrastructure needs (Department of Finance, 1997). At this stage the Department of Finance has not spelt out the detail of any of the grants.

In gender terms conditional grants are likely to be blunt instruments for accelerating the development of more gender sensitive programmes/projects, unless gender criteria are explicitly included in the "conditions".

## 2.3 Equity

Equity in the allocation of public resources can be judged from both a vertical and a horizontal perspective. The vertical perspective focuses on the relationship between the national, provincial and local governments. It looks at the imbalance between tax bases and the obligation to deliver services. The former are insufficient to cover the latter at the provincial level, and - to a lesser extent at least in global terms - at local level. It is therefore necessary for revenue to be distributed to these two spheres of government if they are to perform their functions adequately.

The allocation of resources must also be equitable from a horizontal perspective. Neither economic activity nor population are evenly spread geographically. Further, some areas provide services which benefit people from other areas. For example, only a few provinces have academic hospitals and these treat patients from other provinces as well as their own. On the other hand, some areas impose costs on those living in other areas. For example, a company situated in one local area might pollute the water that flows into another. Similarly, ill-health in one area because of poor services might pose a health danger to those living in a neighbouring area. Both the ability to provide services from own revenues and the need for those services vary between areas. Equity requires that comparable levels of basic public services should be available in all areas within a country.

Equity has many dimensions. It refers amongst other things to income distribution, economic development, and equal opportunities. At the level of intergovernmental fiscal relations, these characteristics are compared across provinces or local governments. This comparison precludes looking at differences in these characteristics between individuals of different races, genders, etc within the provinces or local governments. Nevertheless, the individual characteristics of the inhabitants of a particular region will influence that region’s overall profile. For example, the low proportion of African people in the Western Cape partly explains that province’s relatively favourable profile. Similarly, the high proportion of rural women in the Northern Province accounts for its unfavourable one.

On the fiscal terrain, several dimensions are usually distinguished in discussing equity. Firstly, tax equity requires that the burden of maintaining public expenditure should be borne by the taxable entities of a country or region in proportion to their ability to pay.

Here again one can distinguish between vertical and horizontal equity. Vertical equity refers to the relationship between tax incidence and differences in income levels. In South Africa, as in most countries, the basic principle is progressivity. The progressivity principle states that those who are richer should pay a higher proportion of their income in tax than those who are poorer. This is equitable because the additional rand is less crucial - of less real value - to the wealthier person than to the poorer. As Trudi Hartzenberg discussed in the first Women’s Budget, the extent to which progressivity is imposed and achieved is often less than supposed. For example, the increasing relative importance of VAT - a regressive tax - in the overall taxation scheme means that our system is far less progressive than two decades ago.

Horizontal equity refers to the equal treatment by the fiscal system of individuals or households in equal positions. So, for example, the first element in respect of provision of public services to households is that each should have equal access to publicly provided services such as education, health care, sanitation, water, etc. A second element of intergovernmental fairness requires that citizens have access to equal or similar public services for equivalent tax or fiscal effort, i.e. a poor community making comparable fiscal effort should not be disadvantaged relative to those who can provide more because they are wealthier, but at no greater effort.

While these definitions may seem simple, implementation is less easy. “Equal” can be open to different interpretations. In order to discuss what fiscal equity means, it is useful to distinguish between fiscal capacity, fiscal effort, fiscal need and fiscal performance.

- *Fiscal capacity* is a measure of the amount of revenue a province or local government would raise if a nationally uniform set of tax rates were applied to commonly defined tax bases. It represents the potential ability of a jurisdiction to raise revenue from its own sources.
- *Fiscal effort* is a measure of the extent to which a government's taxable capacity is actually used. It implies that a province or local government applying a tax rate above the national average could be rewarded. On the other hand a region following the opposite strategy should not be able to rely upon assistance from the national level.

- *Fiscal need* refers to the outlay needed in a province or local government area to secure a standard level of performance or service. It acknowledges, for example, that providing piped water in every dwelling will be more expensive in rural areas than in more densely populated ones. It recognises that achieving adult literacy in an area with a high illiteracy rate will require more resources than in a more highly educated area.
- *Fiscal performance* is the ratio of actual outlay by the jurisdiction to that required to meet the standard level.

The other important distinction in discussing equity is that between inputs and outputs. As noted above, the South African Constitution stresses output equity i.e. that all citizens should have access to similar services wherever they live. In practice, most systems involve a mix of input and output equity. For example the South African formula uses population figures as one basis of allocations. Allocations on the basis of population ensure input equity. In South Africa these allocations are then adapted to take account of need, for example with the rural weighting. The sub-national governments are also subject to minimum norms and standards in how they allocate the money over which they have control. Such amendments are based on output equity.

## 2.4 The formula approach

The FFC's position is that effective and equitable allocations will best be achieved by means of objective formulae. A formula approach will also minimise opportunities for manipulation. To facilitate planning by all spheres, the FFC recommends that the formula, once adopted by Parliament, should remain constant for periods of, say, three years at a time. This differs from the previous one-year budget cycle of the government. It is nearer if not identical to the new Medium-Term Expenditure Framework (MTEF) approach. The latter allows for annual changes to a multi-year, rolling, budget.

Actual amounts allocated by the formula, and even relative shares, will change even within a three-year period. Formulae consist of a combination of parameters (e.g. the weights) and independent variables (e.g. the provincial and municipal populations) which give the dependent variables (i.e. the amounts of the provincial and municipal transfers). Independent variables will need to be updated annually. Thus the relative provincial and municipal shares will vary within a three-year period even though the formula itself will remain unchanged.

### 2.4.1 The process

The FFC is required to make recommendations on the vertical division. The resulting formula should determine the percentage of total revenue to be allocated to each sphere of government. The next step is to divide the available pool of resources within a sphere between the nine provinces or hundred municipalities. There are further formulae for these horizontal divisions.

Section 149 of the Constitution states that Parliament must make the final decision as to the acceptability or otherwise of the different formulae. Before being approved by Parliament, there is an attempt to reach consensus as to equity and objectives amongst those directly affected. In terms of the vertical division amongst the three spheres of government, the forum for this is the Budget Council. This Council brings together the provincial MECs for Finance, the national Minister and Deputy Minister of Finance and their respective technical advisors[2]. Any agreement reached at the Budget Council can be ratified subsequently at a meeting of the provincial premiers and relevant national ministers. In the case of Local Government, a Budget Forum[3] has been established for discussion of the allocation to local government.

Once both houses of Parliament have given their approval, the formulae are used at an annual meeting of the Budget Council to determine the shares of the revenue collected nationally which will accrue to each province for the coming year. (For local government this will happen for the first time in the 1998/9 financial year). Thereafter the Department of State Expenditure compiles the expenditure budget of the national government departments, and each provincial treasury does the same for its province. These budgets must be compiled within the limits defined by the allocation and other constraints (i.e. possible other grants, loans and own income). Finally, the Budget Council meets again to review the macro-economic consequences of the consolidated national and provincial budgets.

#### 2.4.2 Why is a formula needed?

Long-term fiscal planning highlights the necessity for coordination between the short-term budget and the longer-term allocation process. To avoid allocations being made in an *ad hoc* manner one must identify the nature and extent of programmes and activities which should be undertaken by the public sector, who should undertake them, and the key indicators by which these activities can be measured. Formulae provide a situation of "certainty of revenue". This certainty allows the different players to plan effectively and realistically. An allocation formula defines a procedure for dividing the available funds, eliminating arbitrary allocations and day-to-day fluctuations in influence and power, and reducing the debate to matters of principle.

This does not imply that either the allocations or the formula itself should be static. The allocations will vary according to changes in the independent variables in the formula. For example, in the FFC formula the allocations for education are based upon the number of children of school-going age. The allocated funds will thus increase or decrease as that part of the population grows or shrinks, or if the age for compulsory school-going changes. The allocations will also vary if and when the data on which the formula is based is improved. If, for example, the new census results change the age distribution of the country, allocations based on the number of children of school-going age will be affected.

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[2] Special arrangements have been made for a representative(s) of the FFC to attend as observers. The Budget Council can invite other parties like the Minister of Constitutional Development to attend as well.

[3] This consists of the Minster and Deputy Minister of Finance, the provincial MEC, five representatives of the South African Local Government Association and one representative of each of the provincial organised local government associations.

Similarly, the parameters of the formula itself should not be inflexible. They should be the subject of review to enable new circumstances and new priorities to be taken into account. If, for example, the government decides to give greater priority to adult education, the formula would need to change to take into account the size of the adult population previously denied adequate education. In this example, we would get a shift in favour of those areas where poor African women predominate, as the incidence of illiteracy is highest among Africans, and higher among African women than African men.

The important point is that changes to the formula, and thus to allocations, should not be the result of short-term expediency. Instead, they should be objectively justifiable. Further, the choice of parameters or independent variables should enable everyone to see more clearly the priorities of government. This will facilitate their participation in the debate as to the basis on which allocations are being made.

A formula is a mathematical expression of certain relationships. Its cryptic yet precise form may conceal its aims and underlying assumptions by concentrating attention on its final outcome. Where many of those who are affected have limited mathematical skills, a formula can also intimidate and prevent debate by implying that it is “scientific” and unquestionable. It is therefore essential that the assumptions should be stated specifically and that everyone is clear that these assumptions incorporate particular views, interests and values.

#### 2.4.3 Criticisms of the formula approach in the South African context

Some people argue that formula funding, at least in its present form, does not allow for detailed planning. The main problem is seen as the broad and aggregated, approach which is necessary if the formula is to be relatively simple and predictable.

Firstly, opponents argue, although the formula is based on measures such as the number of children of school-going age, it does not address the more detailed norms and standards agreed upon within sectors or national priorities. The problem is that this can only happen if and when systems are more clearly defined and there is much closer coordination between structures.

Planning is required if government is to meet the needs determined by both horizontal and vertical equity. The formula should allow, through predictable and transparent flows, for better planning. It should allow, for example, for the training of personnel. Money is only one of the important resources needed for effective delivery. Equally important are human resources. A large and timeous human resource development plan should be on the immediate agenda of all spheres of government. An inability to create viable plans in this regard will jeopardise the ability of all spheres to spend and implement effectively. It will mean that the formula is based on input equity, but does not achieve output equity. The formula should play an interactive role in that it should suggest where trained people are required.

A second criticism relates to the fact that formulae which are based on per capita distribution, such as those of the FFC, are driven by needs. The needs-driven approach means that formulae contain a strong equalising component. This is strengthened in the case of the provincial formula in that it contains an additional weighting for rurality, as a proxy for deprivation. Those who criticise the formula are unhappy with this approach. They would prefer a per capita allocation weighted by allocative efficiency (a measure of the ability to spend the money efficiently) as well as by a revenue generation capacity (a measure that adjusts for where revenue gets generated regionally). This approach will see Gauteng and the Western Cape receive a much higher allocation than those suggested by the FFC. It will be anti-poor people and anti-women in that there are relatively fewer poor people and women in these provinces.

Some people have argued that the current formula is anti-urban and anti-growth. They say that by focusing only on redistribution, there are “disproportionate” allocations to rural, and less “productive”, areas. They argue that it is inefficient to continue to provide compensation for the ‘natural’ disadvantages of an area.

### 2.4.4 Defence of a formula approach

In defence of the formula, it is important to note, firstly, that the formula is intended to be both interim and flexible. The current formula aims to shift expenditure away from apartheid anomalies so as to achieve equity in public expenditure. Over time it will be supplemented and refocused. In particular, it will place greater emphasis on the revenue side and performance measures.

The growth arguments of the opponents of the FFC formula do not recognise the inter-relationships between different regions of our country. Access to improved health care and education for people living in deprived areas has growth-related benefits for the areas in which people live. It also has spillover benefits for other areas. A more literate, healthy and productive human resource base will increase overall productivity. This, in turn, affects growth rates, at local, provincial and national level. Similarly, the absence or presence of services as well as employment opportunities affects migration patterns. Underdevelopment in one area will force people to move to other, wealthier areas. That will place strain on the services of the area to which they migrate.

More generally, a focus on growth can be dangerous in other ways. At its crudest level, the argument against a formula which excludes a measure of growth states that it is wasteful to put resources in poor areas which will never “succeed” economically. Instead, the argument says, resources should be poured into areas with more prospects, and those in poorer areas should then migrate to those where their life-chances would be better. This argument is clearly inequitable and unrealistic. In particular, it disregards the fact that certain groups will be less able than others to move easily. Many women, for example, will be constrained both by money and by their domestic and caring duties from moving from the poor areas in which they live.

At a more subtle level, the argument has a narrow view of economic activity and economic potential. It disregards the fact that in many areas there will be subsistence activity that is not reflected in economic statistics because no cash changes hands. In all areas there will be reproductive activity that is also not measured. These activities have no apparent cash value, but they certainly add to human welfare. Appropriate provision of services in an area will increase the productivity of such services, and so increase their contribution to welfare. Of course, the bulk of these activities are provided by women.

#### 2.4.5 Beyond the present formula

The FFC formulae attempt to meet the constitutional provisions quoted above. They are designed in the hope of achieving an equitable allocation of public resources. But a formula is only one of a number of public finance tools. It should not be used to address problems outside the scope of its powers - in particular more "once-off" problems. For example, backlogs and indivisible projects, projects on a national level, restructuring to address past inefficiencies and so on, are not appropriately dealt with by a formula. Instead more once-off mechanisms are required. These include mechanisms such as the RDP fund, municipal infrastructure allocations such as those described by Lindiwe Ndlela and Deevy Holcomb in their chapter on the Development of Constitutional Development, and conditional and matching grants. Section 146(3) of the Constitution explicitly allows for conditional allocations from national to provincial level. These should be used in addition to the basic formula to ensure the integrity of development and resource planning.

Further, the formula at present only makes recommendations for ensuring inter-provincial equity over the medium term. It makes no recommendations about intra-provincial equity. A similar problem exists in the allocation for local government. The development of appropriate national norms and standards could greatly assist in addressing the problem of intra-provincial inequity.

## 3. Part III: The Provincial Formula

### 3.1 The FFC's provincial formula

The provincial grants formula attempts to address the problem of inter-jurisdictional inequality and poverty. It does so by allocating resources more favourably to provinces that are poorer, more populous, have a disproportionately larger rural population, more children and more citizens that use the public health care system. This has a definite bias toward women as they form the majority in the rural areas and among the poor.

The FFC's provincial grants formula comprises the following major elements:

- a minimum national standards grant (S) to enable the provinces to provide primary and secondary education and primary and district healthcare to their residents;

- a fiscal capacity equalisation grant (T) to ensure that provincial functions are financed from an equitable provincial taxing capacity;

- a basic grant (B) to enable provinces to establish and maintain the institutions – such as provincial legislatures - necessary for the fulfillment of their constitutional obligations.

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

The healthcare component of the grant is determined in two parts. The first part is based on the costs of providing within ten years an average of 3,5 visits per year to a primary healthcare clinic by people who do not have access to medical aid schemes, and 0,5 visits by those who do have access to such schemes. The second part is based on the cost of providing services by district hospitals. This part of the formula is very biased toward women, and especially poor women.

In terms of fiscal capacity equalisation, a zero-sum system of grants has been proposed. Zero-sum means that adding all the provincial amounts together gives a zero total. This implies that for some provinces the amount will be greater than zero, but for others it will be less than zero. In the latter cases, the negative amount will be subtracted from other parts of the grant. This part of the formula tries to compensate for differences in the taxable capacity of the provinces. The grant is not, however, dependent on the provincial tax rate actually chosen (or on other grants it receives). Thus, by levying a tax at a higher or lower rate than the one used for these calculations, a particular province can have a higher or lower level own revenue and hence a higher or lower level of public services.

The basic grant is determined on the basis of the weighted population figures for each province. An additional weight of 25 per cent is given to the number of rural people in each province. Because “ruralness” is a good proxy for differences in wealth, it is a good indicator of deprivation. Because the rural population is disproportionately rural, the grant is women-friendly.

The FFC recommended that the formula be phased in over a period of six years. This is to ensure that provinces which will receive real cuts in their budgetary allocations are given sufficient time to make the necessary adjustments. They will need to do so either by cutting expenditures or by increasing their own revenues.

In 1997/8 the government deviated from the FFC recommendations. Firstly, it “top-sliced” an amount from the total available for national and provincial functions. The “top-slice” was reserved to cover interest on government debt, improvement in wages and conditions of service of public servants, increases in social pensions and RDP projects. Secondly, while the FFC had recommended an annual increase in the proportion going to the provinces, the government divided the money remaining after the top-slice in the same proportions between national and provincial as in 1996/7. The provincial portion was then, however, distributed among provinces according to the FFC formula.

The deviation from the FFC recommendations as to the national-provincial split resulted in an overall decrease for each province in the amount available for delivery of services. The provinces are responsible for most basic education, health and welfare services. These are all services with particular significance for poor women and girls. The decrease in the overall amount allocated to the provinces almost certainly had negative consequences for the quantity and quality of services delivered to those who needed them. The deviation also had implicit gender implications in terms of public service employment. A very high proportion of provincial expenditure goes on salaries. Within education, around 90c in every R1 is spent on salaries. The proportion of women is much higher in the provinces than at the national level because of the dominance of teachers and health personnel in the provinces and the dominance of defence and policy within the national sphere. By reducing the size of the cake available to provinces, the deviation from the FFC formula reduced the amount of available employment in many female-dominated jobs. Given the difficulty and unpalatability of cutting the number of nurses and teachers, to date it seems that fiscal constraints have mainly affected capital rather than current expenditure (Adelzadeh and Lethale, 1997).

The FFC proposes that the formula should be reviewed periodically - ideally every three years. The need for flexibility must be weighed up against the need for predictability. This balance is of particular importance during a period of transition since it involves change, the collection of new and better information as well as the development of new priorities.

In particular, there is the need to update the demographic and economic data. In the absence of a reliable census, the FFC formula has up to now used demographic data of the Demographic Information Bureau (DIB). The provisional estimates of the 1996 census suggest that the DIB figures are too high overall, that they overestimate the number of children in the population, and that they overestimate the relative size of provinces which incorporate large sections of the previous homelands. The economic data also need to be updated on a yearly basis and growth rates from the previous year included.

**Provincial formulae: The FFC and the Department of Finance**

The Department of Finance's Medium Term Budget Policy Statement of November 1997 shows ongoing deviations from the FFC's proposed formula. The basic framework is very similar. One change is an increase in the rural weighting from 25% to 50%. However, this component of the Department's formula is smaller than the FFC's basic grant, which constitutes half the provincial share. The 50% is therefore a higher proportion on a lower base. A second is that the educational component takes account of the large number of over age children in school by using an average of the school age population and the number of learners enrolled.

The Department of Finance's formula has six components:

- An education share – based on the average of the size of the school age population and the number of enrolled learners;
- A health share – based on the proportion of the population without private health insurance, giving a bias in favour of women, children and the elderly;
- A social security component - based on the number entitled to grants;
- A basic share – based on total population but weighted for rurality;
- An economic output share – based on the distribution of gross geographic output;
- An institutional component – with equal amounts for each province (Department of Finance, 1997:41).

It is difficult to judge the equity and gender implications of the Department's changes. Some of the changes to the components should increase equity. By taking overage enrolments into account the revised education component will provide for provinces still suffering from the legacy of poor apartheid provision. By taking the number of young children (0-4 years) and elderly people (those over 65 years) into account, the health share now acknowledges the increased health vulnerability and needs of the very old and very young. By taking the number of women of child-bearing age (15-44 years) into account, the calculation acknowledges that women in this age group have additional reproductive health needs as well as needs shared by other people. These changes, too, should increase equity.

By increasing the rural weight, the revised basic share should benefit poorer, rural people and the women who predominate in such areas. However, the contribution of the basic share to the overall provincial slice is now smaller. This will make the increased bias in favour of rural areas less significant.

A definitive judgment as to whether the Department's formula is more equitable is difficult because we do not have full information. The Department of Finance sees the province's share of overall revenue increasing by only 0,1% in each year between 1997/8 and 2000/01. So the interprovincial formula will be calculated on the basis of a smaller cake than that proposed by the FFC. The Department says that these calculations do not include conditional and unconditional grants to the provinces that may be allocated from the policy reserve portion of the national share. At this stage it is impossible to say how this will change the growth in the provincial share over the coming years.

Like the FFC, the Department of Finance proposes that redistribution between the provinces be phased in over the years between now and 2002/3. The table shows the proposed provincial shares for 1998/9 and 2000/1 (i.e. the endpoints of the three-year period of the MTEF) for each province according to the formulae of the FFC and Department (FFC, 1998:8).

**Provincial allocations: FFC and Department of Finance**

| | FFC 98/9 | FFC 00/01 | DoF 98/9 | DoF 00/01 |
|---|---|---|---|---|
| W Cape | 10.3 | 9.5 | 9.9 | 9.7 |
| E Cape | 17.2 | 16.6 | 17.7 | 17.3 |
| N Cape | 2.1 | 1.9 | 2.5 | 2.4 |
| KZN | 19.8 | 20.1 | 19.4 | 19.8 |
| F State | 6.8 | 6.7 | 6.9 | 6.7 |
| N West | 8.6 | 8.5 | 8.7 | 8.5 |
| Gauteng | 16.5 | 17.8 | 15.0 | 15.6 |
| Mpum | 6.1 | 6.3 | 6.5 | 7.1 |
| N Prov | 12.6 | 12.6 | 13.4 | 12.9 |
| **Total** | **100** | **100** | **100** | **100** |

Looking at the two richest provinces, Gauteng will fare worse under the Department's formula than under the FFC's but Western Cape will fare somewhat better. Looking at the poorest provinces, Northern Province and Eastern Cape do better under the

Department’s formula, but KwaZulu-Natal does worse. This pattern suggests that the Department’s formula is slightly more pro-poor than that of the FFC in disadvantaging the richest province and favouring the two poorest. Nevertheless, the difference is not large.

### 3.2 Cross-provincial coordination

Section 146 of the Constitution allows national departments, in consultation with the FFC, to formulate national standards. These standards must then be embodied in Acts of Parliament, and are funded as part of the formula allocations. National standards as well as some other issues require regulation and coordination nationally across all provinces. For example, national and provincial economic planning and the delivery of infrastructure often involve more than one province.

Cross-provincial coordination takes place through sectoral technical committees. These come under the auspices of the MinMec committees, which consist of representatives of the provincial MECs and national Minister of a particular sector or department. Political and technical consensus is thus obtained before parliamentary approval is sought.

For proper coordination and equitable allocations to work, the Department of State Expenditure and the Office of the Auditor-General will need to establish uniform information, accounting and auditing standards across all national departments and provinces. At present, many provinces lack financial, accounting and planning capacity. All too often it is the poorest provinces which are the weakest. Yet these are the provinces whose residents are most in need of competent and cost-effective expenditures, and in which women predominate. In the transitional period it may be necessary for the Department of State Expenditure (with the help of Department of Finance and the Department of Public Service and Administration) to assist provincial treasuries to fulfill their budgetary function until they have the capacity to do so unassisted.

### 3.3 Taxation

Provinces currently have extremely limited taxation powers. The FFC has recommended that these be slightly increased. The Commission recommended that the proportion of tax raised at the national level be decreased slightly for each of the next few years, and that each province at the same time be given discretion to take up this slack by imposing a surcharge on personal tax.

The FFC proposal will promote inequity between provinces. The ability of a particular province to raise additional tax is directly related to the wealth of its inhabitants. So richer provinces will be able to raise additional revenue, and provide even better services than they currently have. The fiscal capacity equalisation grant will counteract this to some extent in that it compensates those provinces that have a lower than average ability to raise revenue from the surcharge.

## 4. Part IV: Local Government

## 4.1 The current (non-)system

Local government finances, like the current structure of local government, are complicated and diverse. They are also at present in a state of extreme flux. There is as yet no decision as to the best way to raise and allocate funds either vertically (between national, provincial and local spheres) or horizontally (between different local authorities). In the interim many local governments are in financial crisis. In June 1997 the Department of Constitutional Development reported that the estimated municipal debt was almost R26 billion (Department of Constitutional Development, 1997). In some areas, local government employees were not paid at various times because the local authorities said they did not have the necessary funds (*Worker's News*, September 1997).

In many areas payment for services - one of the sources of income for local government - is at a very low level. The Masakhane Campaign of the government is intended to increase payments. It is part of a larger process of building local democracy and promoting local economic development. Yet when, in October 1996, government surveyed the 878 local authorities as to rates of payment, just over half responded. Those who responded reported that, overall, only 25% of the total amount for rates and services charges was being paid. One third of the accounts was either being totally ignored or paid late. The situation has probably worsened since then (Infrastructure Research Team, 1997:16). And while media reports often blamed apartheid-era township boycotts, the recent cut-offs in Gauteng proved that the private sector and semi-government institutions were often as guilty of non-payment as ordinary citizens. And they usually owed larger amounts.

The current situation in respect of local government finance is still largely shaped by pre-1994 patterns and practices in that it is different for different types of area. In urban areas local government takes the form of metropolitan councils (MCs), metropolitan local councils (MLCs), and local councils (LCs). In rural areas, on the other hand, there are district councils (DCs), rural councils (RCs), representative councils (REPCs), and local area councils (LACs).

MCs and DCs receive revenue in the form of Regional Service Council (RSC) levies, MLCs and LCs collect property rates, MLCs and LCS generally have trading surpluses, MCs receive contributions from their MLCs, and MLCs and LCs receive revenue in the form of licenses and fees (FFC, 1997:55). Local government levies taxes on property, taxes on land, and receives income related to motor vehicles, rates for services, and so on.

If we look at the comparative yields of these different sources, a recent survey by the National Electricity Regulator found that electricity payments account for over 40% of local government revenue, rates a further 20%, water payments 12%, sewerage and refuse collection 8% and subsidies 6% (*Business Day*, 12.09.97). Overall, therefore, property rates and surpluses on trading accounts are the most important sources of revenue. This already puts rural and poorer urban areas at a disadvantage. These areas have no property rates. They also receive limited trading income because of the limited services.

Even in better-off areas trading account income is under threat because of non-payment, and because local government is now less likely than in the past to be responsible for electricity distribution. Further, there is a strong likelihood that other services - such as water - could follow the same privatisation path. Many have predicted a serious financial crisis as well as an administrative one for municipalities when they no longer supply these services themselves. The administration will be endangered because much of the technical capacity now resides in electricity departments (FFC, 1997:55).

In the apartheid era national government gave grants to some black local authorities to cover operating expenditure. Provincial government gave subsidies to some local governments to perform agency functions such as libraries, health, and fire fighting services. They also allocated money to so-called R293 towns - those which had very limited tax bases. Some national departments gave grants for capital expenditure.

Most of the capital expenditure grants have now been incorporated into the Municipal Infrastructure Programme of the new government (see chapter on Constitutional Development). Many of the other transfers are still in place until local government financing policy is decided. The Department of Constitutional Development itself acknowledges that the current infrastructure subsidies “make little sense in rural areas” (Department of Constitutional Development, 1997:13).

## 4.2 Proposals for local government finances

A number of possibilities exist for determining the equitable share that goes to local government. These range from the quantification of the present transfers to municipalities to a detailed calculation of municipalities’ expenditure needs. Each of the possibilities has political, financial and data implications. At the political level, overall financial constraints and the requirements of the other spheres of government make it impossible to effect rapid increases to the total amount flowing to the local government sphere. On the other hand, there will be serious political consequences if there are long delays in delivering basic services to those to whom they have been promised.

The FFC discussion document recommends that, as an initial step, the horizontal formula ensures that the total annual transfer equals the amount of the present transfer. The second step is to determine the time period for eliminating backlogs in the provision of basic services to all citizens. The third step is to consider the implications of increasing the transfers to the local government sphere. Such an increase would decrease the time required to eliminate the backlogs. The Department of Finance’s current proposal is that local government’s share increase from 0,8% of the total in 1997/98 to 1,4% in 2000/01 (Department of Finance, 1997:39).

The FFC's proposals for the funding of municipalities are based on the use of a formula for the horizontal division between the metropolitan councils and district councils. As with the provincial allocation, the use of a formula will ensure both revenue stability and objective allocations. The proposed formula takes into consideration indicators of need, tax capacity for operating transfers and infrastructure backlogs for capital grants.

The transfers are based on a two-part formula with three components:

- a conditional capital grant;
- an unconditional operating transfer; and
- a related tax capacity equalisation component.

Both the capital and operating grants are designed to address the basic needs of the poorest section of the population. The capital grant is aimed at eliminating backlogs in the provision of basic municipal services. The operating transfer is to enable poor residents in the different localities to purchase the minimum quantities of certain essential services, such as clean water, adequate sanitation, suitable roads and electricity.

The government is keen that in future local government raises a significant portion of its own revenue. The FFC Discussion Document argues that this will increase efficiency and the accountability of municipalities to local people, because they will have to justify the taxes and charges they impose in terms of the services they deliver. The document also argues that consumers will not waste resources if they have to pay for them.

The FFC discussion document acknowledges that if local government only gets money from local people, poorer areas will suffer because their inhabitants are less able to contribute. The document therefore states that people in different local government areas "should receive *reasonably* comparable levels of public services at *reasonably* comparable levels of tax effort" (1997:4, emphasis added). The document does not define how reasonableness will be measured. It does, however, say that "where disparities are severe, intergovernmental transfers are also required". Further, as noted above, the Constitution entitles local government to an "equitable" share of the revenue collected at the national level. And sections 214 and 227 of the Constitution speak of "basic services". The latter are usually understood in respect of services provided by local government as access to clean water within a certain distance from the dwelling, basic sanitation, and perhaps access to electricity and decent roads.

Intergovernmental transfers imply cross-subsidisation. This means that those who are richer, or who live in wealthier areas, pay part of the cost of provision for those who are less well off. In crude terms, it addresses the extent to which the former white areas will be expected to finance former black areas. These black areas have always been under-serviced in terms of provision, but their residents are also less able to pay. Cross-subsidisation is one of the fundamental principles of the FFC discussion document, although it is suggested that the equalisation will probably happen “only to a certain proportion” (1997:42).

The use of the words “reasonably” and “certain proportion” suggest that the FFC is less forceful on equity at the local government level than at the provincial. The discussion document at times also argues the cross-subsidisation point quite narrowly. Instead of focusing on equity, it appeals to self-interest. It talks about the “spillover” effects i.e. the bad consequences for wealthier areas if poorer areas are not adequately serviced. It refers, for example, to the spread of infection, or of pollution, from an under-serviced area to an adjacent wealthier area.

The danger of the focus on self-interest is that it does not cover poorer areas which are not adjacent - and thus “dangerous” - to wealthier areas. Most importantly, it does not cover the majority of rural areas. Because women predominate in most rural areas, there is a danger that a narrow interpretation of the discussion document will allow for provision in some poorer areas, but not those in which the neediest women congregate.

The FFC also conceptualises “spillover” only in area terms. It discusses how under-provision in one area might affect residents of another. But there is another “spillover” that occurs at a much more micro level. Where there is inadequate sanitation and water, for example, it is women who will bear the brunt. It is women who will have to spend extra time and energy collecting water, cleaning up, and looking after those who become ill as a result of the inadequate services.

The FFC’s discussion document proposes that intergovernmental redistributive transfers be made to the metropolitan or district council rather than to the primary level. Firstly, it says that national government does not have adequate information about the primary level. Secondly, it says that the secondary level will then be able to redistribute from wealthier to less wealthy sub-structures.

The second argument is valid. The first argument is also valid to the extent that the secondary level might have better judgment than the primary. However this judgment will still be impaired because the secondary level is not likely to have any better data than the primary. The discussion of the horizontal division at provincial level noted the problem of data deficiency. These are even more serious at the more disaggregated local government level. The 1996 census results, when released, should improve the situation to some extent. But there will still be problems such as aligning enumerator areas and local government boundaries, updating of statistics between censi, and a range of issues which are not captured by the census.

In terms of both arguments, then, redistribution will rely, at least to some extent, on how well each of the primary structures can argue at the secondary level. The discussion document itself notes that a related disadvantage with the current grants for capital expenditure. It notes that where local government must apply to the provincial level, “often there is an inverse relationship between the capacity of a municipality to prepare an application and its need for funding, which places poorer jurisdictions at a disadvantage” (1997:18). The proposed mechanism in the FFC’s proposal is different in that the decision-makers will be local level politicians who can lobby for their constituencies. Nevertheless, capacity constraints and differences in ‘ability’ could still influence outcomes.

The document also acknowledges elsewhere that: “Stringent criteria need to be applied to ensure that the funds are equitably distributed by the MCs and DCs. An effective monitoring system also needs to be put in place to ensure that conditional funding is appropriately applied by the spending agencies” (1997:40). Given the weaknesses in data and capacity weaknesses in local government administrations more generally, gender-sensitive councillors will need to draw up their own criteria and constitute themselves as monitors.

The discussion document argues that all services must be charged for so that people do not waste resources and scarce resources are used efficiently. Thus, “(e)ven though the requirements of the poor must always be kept in mind, care must be taken that the grant system does not result in inefficiencies by creating incorrect incentives” (1997:24). The document argues further that, because a price is charged for local level goods and services, they will usually be better provided by private producers than by public sector monopolies. It therefore favours privatisation. But it notes that special care must be taken to ensure that where the benefit of goods and services are shared - for example in the case of roads, communal land or public facilities - all those who benefit pay in some way for their usage, and don’t become free riders.

Unfortunately, the discussion does not seem to extend to those goods and services which do not have a monetary price. In particular, it does not extend to unpaid labour. This narrow approach disregards, for example, the time that women spend in collecting water and fuelwood where there are not adequate supplies; or in taking those they care for to seek health care and waiting for that service; or in waiting for public transport. Yet this time, too, has a “price” or “opportunity cost” for women for whom time itself is a scarce resource.

#### 4.2.1 The FFC formula and arrangements in terms of provision of infrastructure

As with the provincial/national allocation of finances, the FFC has proposed a formula for allocation of finances to cover recurrent expenditures of local governments. The discussion document acknowledges the lack of accurate available data and has thus tailored the formula to what is reasonably possible to calculate.

One part of the formula is based on guaranteeing basic levels of service to all citizens. The idea of basic levels of service has been most developed in respect of water and sanitation. The formula therefore uses these two utilities. The FFC calculates an operating grant on the basis of the cost of providing a minimum amount of water to a household and a basic level of sanitation to a household below the poverty line. At this stage the formula does not seem to take account of different household sizes. This is a problem to the extent that poorer households are generally larger than wealthier, and rural larger than urban.

Additional grants are available for non-recurrent costs outside of the formula. In terms of capital infrastructure, the Department of Constitutional Development is responsible for the Municipal Infrastructure Programme (MIP). The aim of the MIP is to provide basic municipal services for all within 10 years. R500m has been allocated in the 1997/8 financial year for intergovernmental transfers. It is not yet clear whether allocations will be made on the basis of the socio-economic profile of an area, or on the basis of infrastructural backlogs.

The Rural Administrative Infrastructure Development Programme (RAID) is intended to build both the physical infrastructure and administrative capacity of the rural District and Regional Councils to enable them to deliver services. The national Department of Constitutional Affairs has allocated R170 million towards the programme. Distribution of this amount between the provinces is based on the size of the rural population, the number of rural local government structures, and surface area. Thus Eastern Cape, for example, has received R36,5m compared to R13 million of Mpumalanga. Funds are disbursed in the form of once-off grants by Provincial Programme Managers on the basis of applications from primary level rural municipalities. To succeed, municipalities must demonstrate that they have made adequate budgetary provision to cover the operation and maintenance of the infrastructure. It is not clear what plans there are for municipalities which are simply too poor to do so.

## 5. Conclusion

This chapter has discussed the emerging system of intergovernmental fiscal relations. These relations comprise the systems and rules that determine which spheres of government can collect different types of revenue, and how the total amount of revenue is distributed between spheres and within spheres.

The South African Constitution envisages a set of intergovernmental fiscal relations with a clear foundation in principles of equity. The notion of equity is a strong one. It focuses on equality of output or result, rather than equality of input. It thus takes account of the severe historical inequalities in the country both between provinces and within provinces.

There are several factors which make it difficult to analyse the gender impact of the system. Firstly, the system is still very much in flux. Discussion of the local government allocations has not yet reached the White Paper stage. The provincial system has been in place for just over a year. The system is also still in flux because of improvements in information and because of refinements in the approach. The new information – and particularly the census results – mean that more money should be available per citizen as there are fewer people in the country than expected. But the census showed not only fewer people overall, but also a different demographic profile, with fewer young people and fewer people in rural areas. The form of the provincial allocation formula implies that there will now be a smaller proportionate share for the poorer provinces and a bigger one for the wealthier.

The second factor which makes gender analysis difficult is that intergovernmental relations focuses on equity between areas, whereas gender is an individual characteristic. At the broad level we can say that there are proportionately more women in rural areas and in poorer provinces. So to some extent a system which favours poorer areas will favour women. But this is at a very broad level of generalisation.

The third factor is that the system currently evolving consists mainly of block grants. The amounts to be allocated are in some cases based on the types of services to be provided. For example, the provincial grant is partly based on the expected numbers of schoolchildren and people using public health facilities. But these numbers are used to calculate the division between the provinces and local governments. They are not intended as prescriptions as to how much of the money should be spent on different functions. Apart from a few conditional grants, the provinces and local governments receive the money as one block. It is then up to them to decide how to divide the amount between education, health and the other functions for which they are responsible.

This does not go far enough in ensuring gender equity. We cannot ensure gender equity by looking only at the level of intergovernmental fiscal relations. Provincial and local governments are responsible for many of the goods and services of greatest importance to poor women and men. They are responsible for the core areas of education and health. They are also responsible for the basic infrastructure which can relieve the daily burden of reproductive and productive tasks. The system of intergovernmental fiscal relations provides the different spheres of government with money to perform their functions. To judge gender equity, we need to know how the national government, provinces and local governments allocate their share of the money between sectors and between services that serve the interests of different groups of women and men. In a decentralised system like our own, we need detailed examination of provincial and local government budgets as well as the national budgetary allocations.

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