The Role of the Financial and Fiscal Commission within the Intergovernmental Fiscal Relations System in South Africa – Evolution, Key Successes and Challenges

1. Introduction

The origin of the Financial and Fiscal Commission (FFC) lies with Section 128 of the Republic of South Africa Act, 1993 (Act 200 of 1993). This Act provided for the Interim Constitution, which, in turn, contained the provisions for the establishment of the FFC. The Commission was appointed by President Mandela in August 1994 and by 1995 had produced its precedent-setting "Framework Report".

The FFC Framework document is remarkable. It expressed the clarity of mission and the vigorous manner in which the FFC began to fulfil its mandate. It noted that:

> *"1.2 The Interim Constitution establishes a unitary state with three levels of government, national, provincial and local…. In addition, the Interim Constitution creates a framework for intergovernmental relationships, including fiscal relationships. It is not only these governments which are part of the intergovernmental relationship, the FFC is intended to be a central component thereof too.*
>
> *1.3 The FFC is given a special role within the intergovernmental fiscal framework. This role is to be an independent and impartial statutory institution, accountable to the legislatures, with the objective of contributing towards the creation and maintenance of an effective, equitable and sustainable system of intergovernmental fiscal relations, rendering advice to legislatures regarding any financial and fiscal matter which has a bearing on intergovernmental fiscal relations."*

The FFC made an important contribution to the early years of the new Republic. Its role was further consolidated in the Constitution of 1996 and in legislation, including the Financial and Fiscal Commission Act and the Intergovernmental Fiscal Relations Act of 1997. By 1998, the National Budget Review noted that:

> *"4.2.2 Cooperative governance has been given effect through the enactment of legislation required by Chapter 13 and other sections of the Constitution.*
>
> *The Financial and Fiscal Commission Act gives purpose to the requirements relating to the FFC under section 220 of the Constitution. The FFC is an advisory body, accountable to Parliament, that makes recommendations*

and gives advice on financial and fiscal matters to organs of the state in the three spheres of government.

The FFC was originally established in terms of the Interim Constitution and has contributed significantly to the development of the intergovernmental system. Its recommendations for the division of resources between the three spheres of government form the basis of the current allocations…."

The following paper is divided into three Sections.

The first Section examines the early contributions of the FFC, through 1997/98. It analyses the underpinnings or foundations of the important recommendations of the Commission. Also, specific and significant components of recommendations are outlined, and the degree to which they appear to have been adopted. As well, there are areas which the FFC identified as requiring further or future work.

The second Section examines the consolidation phase of the FFC, from 1998 through to the present. During this period, the FFC sought to complete the essential elements of the system of equitable shares. It also began to investigate the means through which the system could revitalise itself, adjust to new priorities and adapt to provide greater effectiveness, efficiency and accountability.

The final Section is forward-looking. It examines current work underway at the FFC. It also considers essential elements or features within the FFC and in its interactions with the broader intergovernmental network, which will allow it to continue to be a valuable part of the Republic's intergovernmental fiscal system.

Review of the Reports of the Commission and the responses of the National government to its Reports is encouraged. A summary of these Reports and Responses has been prepared by the research staff of the FFC.

2. The First Years (1994 to 1998)

When the FFC was appointed in terms of the Interim Constitution by President Mandela, the democratic Republic of South Africa was in its infancy. The nation faced many institutional challenges and the legacy of apartheid needed to be overcome.

While the National Assembly was well-established and local governments continued to carry out their functions, there were nine new provinces in the place of the four old provinces and the numerous homeland governments which existed under the old regime. The second House of Parliament, the National Council of the Provinces (NCOP) was also new. The Interim Constitution provided for shared jurisdiction among the three orders of government, and emphasised the need to maintain the spirit of cooperative governance, but it did not clearly enunciate how this would be achieved. It was clear that the Interim Constitution envisaged a significant degree of decentralisation of service delivery through the provinces and the local government spheres. However, it was also clear that the new provinces were more than the "provincial administrations" that the old ones had been. They were to have elected legislatures with constitutional mandates that gave them more authority and independence, even if within a unitary state.

The establishment of the FFC provided a piece of the machinery through which important intergovernmental fiscal decisions could be examined in an independent, impartial and knowledgeable manner. Its basic functions were outlined in the (interim) Constitution, but to start with, the FFC existed in a legislative and procedural vacuum; its relationships with other organs of state, including Parliament and the Departments of Finance and State Expenditure (as they were then), still had to be established, generally on the basis of suggestions from the FFC. Developing these matters, for incorporation into the final Constitution and other legislation, formed an important part of the FFC's initial work.

The old Republic had had functional governments. Much of the government activity was under central government control. Furthermore, the legacy of apartheid meant that the majority of the population was not receiving the benefits of a modern state. The FFC saw itself as an instrument of transformation of the former system to one suited to the needs of the newly democratic regime.

A central element in the early reforms was developing a new budgetary process in terms of the (interim) Constitution. Previously, the Department of State Expenditure had largely treated the old provinces and various homeland authorities as government departments, with their budgets being allocated centrally. The concept of an equitable division of revenue collected nationally between the different levels of government (as opposed to administrations or departments) was initially foreign.

Flowing from the spirit of goodwill towards the new South Africa, the FFC was fortunate at this time to be able to consult with a wide range of international experts and agencies and visit countries facing similar challenges, usually at no cost to itself.

2.1 Guiding Norms and Objectives

In order to guide this work, the FFC examined and adopted a set of norms (some would ascribe the word "principles") for the intergovernmental fiscal system. The norms cited in its Framework document of 1995 included:

- Effective resource use to maximise the socio-economic benefits of the scarce resources available to the public sector
- Accountability to the electorate
- Nation-building and fiscal autonomy, in a manner which establishes a balance between the large degree of fiscal autonomy granted to provinces and local governments and the need to maintain national security, economic policy and essential national standards
- Transparency to promote credibility and stability.

In its May 1996 recommendations for the 1997/98 fiscal year, the FFC enunciated the following objectives:

- *"Equitable financial resources to perform assigned functions*
- *Predictable and objectively based allocations*
- *The provision of minimum levels of basic services, including administrative responsibilities*
- *Financing for so-called unique national services*
- *Reasonable fiscal autonomy at lower tiers*
- *The addressing of poverty, backlogs, developmental needs and economic disparities*
- *Long-term economic growth*
- *The development of democratic and accountable government*
- *Compensation for inadequate tax bases and*
- *A transparent budgeting process."*

Of course the FFC recognised that all of these could not be achieved to a satisfactory level in the immediate future.

2.2 Consultation

The FFC also committed itself to an extensive process of consultation. In 1995, the specific bodies cited were:

- The Intergovernmental Forum
- The provincial governments
- The National Department of Finance
- The National Department of State Expenditure
- The Joint Standing Committee of Finance of Parliament
- The Function committees (e.g. for Health and Education) and the MinMEC committees (Minister plus provincial MECs) which were established to work out and coordinate new budgetary processes
- Organised local government, and
- Other relevant structures

(The finance MinMEC was the forerunner of the Budget Council.)

Proceeding from its deliberations and consultations, and guided by the norms they had established, the FFC delivered its first set of recommendations. These recommendations were comprehensive, covering many of the key elements of intergovernmental fiscal issues which must be addressed in a nation with more than one tier or sphere of government.

2.3 Sub-national government revenues

The FFC recommendations were couched in terms of the constitutional requirements, and with respect to revenues, covered both:

- **Provincial government revenues**, including both an entitlement to an equitable share of nationally raised revenues and their competence (subsequent to an Act of authorisation by Parliament) to raise revenues, including the competence to determine the tax base, the tax rate and to administer the tax and to apply surcharges to nationally raised revenues

and

- **Local government revenues,** including an entitlement to an equitable allocation of nationally raised revenue and the competence to raise property taxes, levies, fees, taxes and tariffs.

As contemplated in the Constitution, with respect to own-source revenues for sub-national governments, the FFC proposed that there be:

- A modest surcharge on the personal income tax base (not on national income tax), to be levied by provinces
- No provincial surcharges on corporate income and no provincial VAT
- Provincial, and possibly local government, fuel levies administered separately or as surcharges on the national levy
- Replacement of the Regional Services Council Levy with payroll taxes.

Recommendations were made with respect to other provincial taxes and fees, including property transfer duties, and mining and mineral taxation. With respect to local governments, recommendations were made with respect to property taxes, user charges, and service fees, which were much in keeping with past and current revenue raising practices.

The conclusion can be drawn that the FFC envisaged a greater role for provinces in the raising of their own revenue and a speedier rationalisation of local government taxation than has occurred to date. This was prompted largely by the large shifts in the shares of nationally collected revenue that would result from dividing it according to the Constitutional guidelines and the desire of previously advantaged provinces (e.g. the Western Cape) to maintain the level of service delivery to which its citizens were accustomed. However, this had to be balanced by the fears of the national Department of Finance, both that the administrative capacities of the new provincial governments did not allow the introduction of new taxes, and that new taxes would lead to an overall increase in the tax burden, in contrast to the ideals of the GEAR macroeconomic policy.

2.4 Borrowing powers

The FFC was concerned that provincial and local governments, including their parastatals, should have the economic rights promised to them in the Constitution, but at the same time, not borrow excessively and jeopardise the creditworthiness of the nation as a whole. Within the new constitutional framework, in which sub-national governments have a degree of autonomy, it was considered important to allow them to raise capital for their priority projects. In an attempt to balance these various objective, the FFC concluded that:

- There should be a coordinating mechanism for the entire public sector borrowing activity
- National government guarantees for sub-national government debt should be given cautiously, and only for essential projects, so as subject sub-national governments to the discipline of the capital markets
- However, borrowing rules should not be so restrictive as to prevent the development of viable or essential projects
- The maximum use of private funding, subject to commercial discipline for viable projects, would reduce the need for public borrowing.

2.5 The Provincial Grants Formula

IN 1995, the FFC provided its first recommendations to Parliament concerning the equitable division of national revenue. Its focus was on the size and distribution of the provincial equitable share.

The first task was to rework the previous budgets in line with the Constitution to establish what the *de facto* division of revenue, both vertically and horizontally, was. Thereafter, the FFC proposed that, with respect to the vertical division of revenue, the national government share should be held to zero real growth for 1997/98 and three subsequent fiscal years, the reasons being that one had to begin from the *status quo,* so as to avoid destabilizing functions, and that the functions allocated to the provinces were those that would be influenced by future population growth. The growth in revenue should therefore go to the provinces. The proposal would have allowed national government to maintain its existing level of expenditure whilst simultaneously enabling the provision of services to the population to be expanded. [The fact that this recommendation was not accepted, is one of the reasons why it has become necessary to move social security expenditure from the provincial to the national sphere.]

The FFC also recommended that the total provincial allocation be divided among the provinces by means of a provincial grants formula. The basic structure of the formula adopted initially has been retained for all subsequent FFC recommendations with respect to the distribution of the provincial equitable share, though modifications and refinements were introduced.

This formula may be expressed as an equation:

$$\mathbf{G = B + S + T + m}$$

Where:

B represented a block grant to finance provincial programmes and was a determinant of a weighted demographic figures. Weighting was to provide a higher value for rural populations, in part as a proxy for poverty. An institutional component for establishing the provincial governance structures, **I,** was soon added to the formula and was provided on an equal per province basis. The Department of Finance had three components for this block, economic activity, basic and backlog components.

S represented the major component of the formula and was to enable provinces to provide basic public services to national standards. These services focussed on elementary and secondary education, health care and welfare services. Each of these services was represented in sub-components of the **S** grant, and each sub-component was to be calculated on a different basis which related to the demographic and service needs of the populations within each province;

T was to provide an equalization factor, to be activated as soon as provinces were raising a significant proportion of their own revenues.

m was a different category as it represented the transfer of a portion of the national equitable share, provided as a conditional grant to provinces for services delivered by provinces which served the national, rather than just the provincial population. The initial example of such a service was with respect to specialised national units in academic hospitals.

The issue of which functions to include in the formula was resolved with the simplicity of the formula in mind and the belief that the addition of many smaller factors would not change the overall division of revenue significantly.

The provincial formula encountered two significant difficulties with respect to the 1996/97 and 1997/98 fiscal years. First, the population data, which were a very significant element of the formula, was suspect and needed to be adjusted. Uncertainty also existed about the degree to which trans-border flows of citizens from one province to another, particularly with respect to health and education services, could or should be taken into account. Secondly, the formula resulted in significant shifts of resources as some provinces had enjoyed relatively larger *per capita* transfers than others as a result of the policies of the apartheid regime. The FFC recommended a five-year phasing-in of the shifts resulting from its formula.

2.6 Local Government Grants

The FFC specifically favoured the development of a local government grants formula, along the lines of that it had developed for provinces. However, it noted that local government boundaries were changing and that there was insufficient demographic and financial data available to develop such a formula. It nevertheless released a document outlining principles that the FFC believed should form the foundation of the formula in future, in the hope that a start would be made in collecting the necessary data.

2.7 The Early Years – Summary and Conclusion

The FFC recommendations provided a solid foundation for the financing of the new provinces, with their extensive responsibilities for the delivery of major public services. Perhaps the most important achievement was the establishment of an objective and equitable formula for the division of national revenue. Thus the National Treasury was moved to acknowledge the central role played by the FFC in the development of the initial patterns for the division of revenue and stated in its 1998 Budget Review:

> *The FFC was originally established in terms of the Interim Constitution and has contributed significantly to the development of the intergovernmental system. Its recommendations for the division of resources between the three spheres of government form the basis of the current allocations….”*

However, this perhaps overstates the case and does not give a balanced view of the work that remained unfinished. Without taking anything away from the importance of the contributions of the FFC during these early years, the following should also be noted:

- The National Treasury continued to use a different formula than that recommended by the FFC, though it did yield results which, for the most part, were close approximations to that recommended by the FFC.
- FFC recommendations with respect to revenue-raising powers for provinces had not been implemented.
- The FFC acknowledged the demographic and other data inadequacies in arriving at results of its formula.
- Backlogs resulting from apartheid and other policies were a major issue which was not yet being addressed.

- The vertical division was being addressed on an ad hoc basis through the recommendation that the national equitable share be held to zero real growth, with additional revenue growth being available to the provinces.
- A formula for the establishment and division of the local government equitable share had been addressed in principle only, but its data requirements had not been addressed.

3. Consolidation and Revitalisation (1999 through 2004)

The FFC structured their 1996 recommendations for the 1997/98 fiscal year as also applicable to a three year planning horizon, extending through the subsequent fiscal years. Thus recommendations and advisories in the years 1997 through 1999, tended to reiterate and refine the earlier work and sought to make progress on outstanding issues.

During this phase, the FFC also had to deal with a changing environment. National and provincial governments were gaining in strength and competence. New institutions, such as the Budget Council and Budget Forum were beginning to play a more substantial role. New legislation, including the Intergovernmental Fiscal Relations Act, the Financial and Fiscal Commission Act and the Financial Administration Act were introduced and passed by Parliament. There was a need to develop appropriate protocols for dealing with Parliament, the legislatures and organised local governments.

At the same time, the FFC needed to deal with internal issues. After the initial period of intensive activity and solid achievement, it was perhaps inevitable that both FFC Commissioners and FFC staff would be sought after for other roles within both the public and private sectors. Indeed, several Commissioners and staff members went on to important positions within the national, provincial and local governments, including the Offices of the President and/or Vice President, and elsewhere. It was necessary for the FFC to recruit and immerse new staff in its work. Between 1996 and 1999, virtually the entire research and senior administration staff, with the exception of the Chairman, were new or in new roles.

In 1999, the FFC began an intensive focus on the preparation of its recommendations for the next three-year cycle. These recommendations would be made early in 2000, for the 2001/02 and subsequent fiscal years. The FFC process leading up to the presentation of these recommendations was known within the FFC as Project 2001.

3.1 Project 2001 and the Costed Norms Approach

Project 2001 was the collaborative effort of a team which consisted of FFC Commissioners, FFC staff, contracted staff from South Africa and a number of international academics and practitioners from Australia, Canada, India, Italy and the United States. They produced preliminary recommendations published in February 2000. The FFC, after consultation on these recommendations, produced its recommendations for the 2001-2004 Medium Term Expenditure Framework (MTEF) Cycle in May 2000.

The principal recommendations were made around the development of a "costed norms" approach to establishing the provincial governments' equitable shares, both in terms of the vertical division of revenue amongst spheres of government and the horizontal division among the provinces. The focus was on the social services sector – education, health and welfare. As noted by the FFC in its May 2000 Recommendations:

> *"The recommendations contained in this Report are made against the backdrop of an evolving intergovernmental fiscal framework and are aimed at advancing the FFC's initial recommendations for revenue sharing submitted in 1996. The Commission believes that the costed norms approach elucidated in the Report will give substance to the recent developments in public finance management as contained in the Public Finance Management Act of 2000, particularly with respect to facilitating the development of an outcomes-based and cost-sensitive budgeting regime."*

Thus Project 2001 represented continuity, but introduced major refinements of the original recommendations of 1996. Importantly, this work within the FFC began a process of examining how to match financing regimes better with policies, norms and standards and outcomes-based budgeting practices. In 2000, the proposals were centred around costing of norms. In the next few years, the FFC continued the refinement of these concepts and emphasised funding for the provision of constitutionally mandated basic services and outputs and outcomes-based budgeting. These are a natural fit with the overriding concept of a costed norms approach for a financing formula.

Other sections of the May 2000 Report presented recommendations and observations with respect to the capital element of financing arrangements and principles and best practices for intergovernmental fiscal relations.

3.2 Recommendations of the 2001 and 2002 Reports: Addressing Local Government Finance

The 2001 Report, with recommendations for the 2002/03 and subsequent fiscal years, continued to advance the work of Project 2001 with respect to the foundations for the equitable division of national revenue amongst the three spheres. It addressed certain issues to fill out its proposals of the previous year, including recommendations with respect to provincial revenues, borrowing, the use of conditional grants and the capital grants model.

The central feature of the 2001 Report was related to its work with respect to developing a formula for the local government equitable share. As noted in the Report:

> *"While the local government restructuring process is still ongoing, it is important to articulate a vision for the final system of local government finance and then to develop a "road map" for moving toward such a system over time."*
>
> *In this submission, the FFC proposes a framework for local government finance which included:*

- *A formula for the local government equitable share*
- *The identification of municipal basic services*
- *The financing of municipal services*
- *Own revenue (including the borrowing framework)*
- *Infrastructure financing issues"*

Local government issues were also a major theme in the 2002 Report. That report extensively discussed municipal borrowing, The Municipal Finance Management Bill, the division of powers between district and local municipalities, remuneration of municipal councillors and implications of the restructuring of the electricity distribution industry.

The 2002 Report also addressed some emerging issues with respect to the provincial government sphere. The Provincial Tax Regulation Bill and funding for early childhood development and for HIV/AIDS were specifically addressed. Furthermore, the FFC provided some guidelines which could be used to evaluate the Comprehensive Social Security Review Report. It more extensively discussed the matter of providing funding for the progressive realisation of constitutionally mandated basic services. It also discussed disaster management funding and the central contingency reserve.

Examining the records of these two years, it is clear that the FFC was moving ahead on an agenda which was both reactive to current issues within the intergovernmental fiscal system and also forward-looking – seeking to manage change within the system in a consistent, logical and managed fashion. In this, its status as an independent, impartial, informed, knowledgeable and competent component of the intergovernmental system continued to be of value, just as it had in the democratic nation's first formative years.

3.3 The 2003 and 2004 Reports: Review of the Intergovernmental Relations System

The mission of the FFC was reiterated at the beginning of the 2003 Report:

> *"Taking into account the relevant provisions of the Constitution, the Financial and Fiscal Commission's (FFC) responsibility is to make recommendations that inform the intergovernmental policy-making process. The FFC has noted in the past that it remains the role of the three spheres of government and their legislatures to determine fundamental policy objectives and priorities. The Commission continues to maintain this approach."*

Nevertheless, the FFC began to look ahead and proposed new approaches and perspectives for consideration.

In Part A of its 2003 Report, the FFC:

- Proposed that a comprehensive poverty alleviation package be designed
- Reaffirmed the provincial role as the primary provider of many constitutionally mandated basic services
- Recommended that a National Social Security Agency be established to administer cash grants, and that the provision of welfare cash grants be from the national equitable share, rather than the provincial share, once this agency was functional
- Recommended rationalisation of governments' role in the provision of water and housing services.

It also proposed specific indicators for policy outcomes, delivery outputs and financial inputs which could prove useful in examination of the progressive realisation of constitutionally mandated basic services within the constraints facing governments. It continued to advocate for the development of clear norms and standards and for the collection of data which could measure performance against those norms and standards. It also advocated for a system of budgeting and of cooperative governance which could give effect to policy direction in an effective manner.

Part B of the 2003 Report continued to refine and advance its formula for the equitable division of revenue to and amongst the national, provincial and local governments.

Prior to the dissolution of Parliament in 2004 in advance of the general elections, the FFC presented a Report to Parliament. This Report provided an extensive overview of government spending and financing trends and projections and data on indicators of poverty reduction and the progressive realisation of constitutionally mandated basic services.

3.4 1999 through 2004: Summary and Conclusions

Beginning in 1999 with Project 2001, the FFC sought to advance the work it had begun after being appointed in 1994. The objective was at first to complete sections of the formula for equitable sharing which had not been complete or satisfactory in its earlier Reports. Later Reports during this period began to explore issues with respect to change, adaptation and accountability for results.

The “road map” for developing the local government fiscal framework together with the detailed discussion of specific issues or elements was a major element of the work of the FFC throughout this period.

The costed norms approach was not very well received at first by the National Treasury. It was viewed as, perhaps, a check against the decisions of the traditional budgeting processes, rather than as a viable alternative to development of an appropriate formula for the equitable division of revenue. However, as the issues of poverty alleviation and the progressive realisation of constitutionally mandated basic services were advanced, the merits of costing norms and standards necessary to achieve those goals, by whichever name it was implemented, became increasingly accepted.

By the end of the period, the emphasis on indicators and relevant data provided a focal point for the work of the FFC. Measuring outputs and outcomes against financial inputs was increasingly becoming the means through which the FFC informed the intergovernmental fiscal decision-making process.

As at the end of the FFC’s first decade, work remained incomplete. The local government grants formula was still being structured. Capital and backlog issues were just beginning to be addressed within the intergovernmental fiscal formula. The new work on measuring outputs and outcomes had uncovered new needs with respect to data availability and reliability. Technical capacity constraints were evident.

However, over the decade, valuable work had been done. Knowledge and understanding had increased and the FFC was poised to play an important role in the intergovernmental financial processes in the years ahead.

4. Developing the Intergovernmental Fiscal System: Roles for the FFC

4.1 The Intergovernmental Context

The FFC is in a unique and strong position to play a vital role in the continuing development of the intergovernmental fiscal arrangements. The Constitution envisaged a special role for the FFC. The Intergovernmental Fiscal Arrangements Act and the Financial and Fiscal Commission Act give practical effect to the provisions of the Constitution.

There are few other nations of the world with a similar authoritative body. The Australian Grants Commission is the most obvious comparable institution, with the Indian Financial Commission, which is reconstituted every four years, as the second. Most other nations must rely on other means for the conduct of intergovernmental fiscal relations, often with very mixed success.

Another mechanism for resolution of intergovernmental fiscal issues is the role of Parliament, sometimes operating in a bi-cameral format with one House structured around representation from the states, provinces or regions. The United States Senate is a primary example.

A third mechanism for the conduct of intergovernmental fiscal relations involves negotiations among the First Ministers (and usually the Ministers of Finance and several committees of senior officials) of the states, provinces or regions with their national counterpart. In Canada, this practice has taken on the name of "executive federalism".

In addition to the FFC, the Republic of South Africa also has a bi-cameral Parliament, with the NCOP as the second House. The nation also has formalised "executive" collaboration through the legislative establishment of the Budget Council and Budget Forum (Team Finance), as well as through an elaborate array of less formal structures involving senior elected and appointed officials.

Given this array of very useful mechanisms for the conduct of intergovernmental fiscal arrangements, the FFC role should both draw upon and support these other institutions. Effective participation of the FFC within the system will be enhanced through the continuing development of protocols for interaction with Parliament, provincial legislatures and local governments. As well, effective functional relationships with the Budget Council, the Budget Forum, the national Minister and Director General of Finance, other ministries, provincial EXCOs, SALGA and other such structures should be maintained.

The real power of the FFC within this framework lies with its ability under the Constitution and legislation to place its research and recommendations before Parliament and the other spheres of government, <u>together with the requirement for the National Government to respond to the FFC recommendations</u>. Therefore, the Government must adopt the FFC recommendations or provide the reasons for declining to do so. In the later case, this opens up the possibility of constructive national debate around pertinent issues.

4.2 Effective FFC Participation

The exercise of this power will be more effective if the FFC plays a constructive role in its functional relationships with the other players in the system. Also, the role of the FFC will be further enhanced if the FFC is able to inform and enhance the public debate in a manner which clarifies the linkages between fiscal decisions and the policy decisions adopted by or required of government. Examples of necessary linkages are with respect to the progressive realisation of constitutionally mandated basic public services, human rights and initiatives with respect to poverty reduction.

4.2.1 Functional relationships

Through the provisions of the Constitution and legislation, key relationships between the FFC and certain other parts of the intergovernmental system are mandated. These include the relationship directly with Parliament, provincial legislatures and organised local government. As well, the participation of the FFC within the Budget Council and Budget Forum are established. The manner in which the FFC is to interact with these bodies is prescribed in part. This involves the annual FFC Submission to Parliament and the legislatures which is a key part of the early schedule for budget preparation and commentary on the Draft Division of Revenue Bill. It includes the role of the FFC within the Budget Council and Forum as a non-voting participant and observer. It also includes the expectation that the FFC will respond to legislation which impacts on intergovernmental fiscal issues as well as responding to other issues which are referred to the FFC. Protocols for these interactions have been developed over the years and they should continue to evolve to meet the needs of governments, while providing for the effective participation of the FFC.

Other relationships are not prescribed in legislation, but are ongoing and essential. These include the relationships of the FFC with the national executive, ministries, commissions and interdepartmental committees, provincial Executive Councils (EXCOs), and organised local government, including SALGA. As well, it can be foreseen that the FFC could and should liaise with bodies such as the Human Rights Commission, and the proposed National Social Security Agency.

In a third category of necessary functional relationships, are those institutions, which are needed for the effectiveness of FFC research and the development of recommendations. Within government, agencies such as Statistics South Africa and the South African Development Bank should provide valuable information for FFC decision-making.

Functional relationships should extend to the various elements of society - academic, non-governmental organisations (NGOs), social and policy advocates – which may be playing important roles in informing the democratic debate on issues of relevance. It may prove beneficial to the FFC both to draw from and to support these elements of civil society. Objectives of such a strategy would include the enrichment the research programme of the FFC, building human capacity within the nation for the conduct of intergovernmental fiscal relations and encouraging a broader debate within society on these fiscal issues, which ultimately are amongst the most important decisions of governments.

4.2.2 Key policy areas to inform fiscal recommendations

As noted, the work of the FFC has focussed on the size and the equitable division of the provincial share of national revenue. More recently, financing of local government has received similar attention. While formulas for the equitable shares of these two spheres could be expected to dominate the future work of the FFC, there are **cross-cutting policies** which must be addressed by all three spheres.

Most importantly, the work of the FFC has increasingly been focussed on establishing the financial underpinnings necessary to fulfil the constitutional mandate of **progressive realisation of rights** outlined in the Bill of Rights and achieved through the provision of **constitutionally mandated basic services**. Secondly, the related issue of **poverty reduction** will remain a focus of policies to overcome the unfortunate legacy of the apartheid era, which impacted on the fortunes and opportunities of the majority of the South African population. All three spheres are expected to play important roles with respect to achievement of these policy goals. The equitable division of national revenue must consider the evolutionary roles with respect to delivery of public services being played by each of the spheres.

The FFC must continue to have a heavy engagement with respect to the issues of **local government finance**. For the foreseeable future, local government development and its fiscal dimensions will be undergoing change, consolidation and refinement. Many decisions with respect to local government service delivery remain to be made. What are the local government responsibilities for certain programmes, such as primary health care and housing, as compared with provincial and national roles? Are district or local municipal governments responsible for delivery of certain services? What revenues will be available to municipal governments after the restructuring of utilities and other services, and what will be the distributional pattern of these revenues? Will cross-subsidisation be expected to provide for limited free basic services or should these be funded through the local government portion of the equitable share? This is only a partial list of the questions which have implications for the further development of the size and distribution of the local government equitable share.

Infrastructure expenditure, the addressing of **backlogs** with respect to capital expenditure, including further enabling and control mechanisms for sub-national **borrowing**, may be expected to continue as one of the major cross-cutting issues.

Finally, the FFC is expected to respond to policy and legislation referred to it, because of fiscal dimensions involved. These **referrals** may be of significant or comprehensive scope, with implications for many aspects of the financing of the three spheres. An example would be with respect to comprehensive social security reform. Alternatively, a referral may have much more limited scope, such as the issue of financing disaster relief.

4.2 Opportunities and Constraints

There is a great opportunity for the FFC to produce useful research and recommendations, both in the immediate future and in the very long run. Intergovernmental fiscal relations issues will remain in the forefront of government decision-making at all times. Budgets reflect the key policy and administrative decisions of governments.

The core of the FFC work will continue to be the equitable division of revenue to enable public policy goals to be achieved. Some dimensions of this work are described below.

The vertical division: The vertical division of national revenue is a complex task. The lack of a generally accepted theoretical approach to these issues led the FFC to propose in its early recommendations that a pragmatic, iterative process should be implemented. Thereby the real growth in national revenue would have been channelled to sub-national governments, because it is the services provided at sub-national level that increase in line with population growth.
The FFC has been mindful of the provisions of Section 214(2)(a-j) of the Constitution which requires the following to be taken into account:

a) *the national interest;*

b) *any provision that must be made in respect of the national debt and other national obligations;*

c) *the needs and interests of the national government determined by objective criteria;*

d) *the need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them;*

e) *the fiscal capacity and efficiency of the provinces and the municipalities;*

f) *development and other needs of provinces, local governments and municipalities;*

g) *economic disparities within and among the provinces;*

h) *obligations of the provinces and municipalities in terms of national legislation;*

i) *the desirability of stable and predictable allocations of revenue shares; and* *j) the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria.*

A more sophisticated and comprehensive approach by the FFC to the vertical division will be necessary in the future. Some elements, which may play into FFC recommendations with respect to the vertical division, include:

- examination and projection of the macro-economic and fiscal environment
- costing services, using a costed norms or similar approach
- charting the pace of progressive realisation of constitutionally mandated basic services
- addressing backlogs and infrastructure requirements
- adapting to changes in responsibilities, such as the placement of responsibilities for welfare grants.

A key challenge will be to find the "objective criteria" to determine the funds necessary to meet the needs of the national government, particularly in view of the national government's reluctance to embrace the costed norms approach.

The provincial equitable share: While the size and distribution of the provincial equitable share has been at the core of the work of the FFC since its inception, the evolution and maintenance of a provincial equitable share formula will continue as a primary task of the FFC. The basic formula must develop to accommodate the full range of provincial government activity, not only education, health and welfare services. In addition, practical means of incorporating financing for capital expenditure, infrastructure and backlogs are required. The formula must respond to shifting roles and responsibilities with both the national and local government spheres.

Though little progress has been made to date, basic principles of intergovernmental fiscal relations and best practices suggest the need to have some significant revenue raising responsibilities for sub-national governments with extensive programme delivery responsibilities. It is a question of promoting accountability and efficiency. Should greater revenue-raising capacity be allowed and exercised in the provincial sphere, an appropriate equalisation formula ("t" grant) will need to be developed.

A key challenge will be to obtain better data for the formula. Demographic data must be accurate and more current, given the significant migration patterns in South Africa. Fiscal data must be complete and also current. The FFC has already enjoyed substantial improvement in the demographic and fiscal data available to it.

A second major challenge will be to relate the formula and monitor results based on outcomes and outputs, rather than on inputs. The FFC has begun the work necessary to chart progress toward the provision of constitutionally mandated basic services and poverty reduction. This work must be expanded and refined.

One further ongoing issue will be the use of conditional grants. Most public services are shared responsibilities of the national and provincial governments. Therefore, it is legitimate for the national government to wish to establish and promote its policies. However, excessive use of conditionality in financing mechanisms results in a loss of transparency and accountability concerning the roles of the two spheres of government.

The local equitable share: The list of issues with respect to local government finance has been discussed in Sections 3.2 and 4.2 and will not be repeated here.

Key challenges in the development of a local grants formula include:

- keeping pace with the placement and redistribution of responsibilities of district and local governments;
- obtaining demographic and fiscal data of sufficient quality, pertinence and detail;
- as with respect to the national government, developing sufficient "objective criteria" to establish financing to meet needs and obligations being addressed by municipal governments; and
- giving fiscal effect to decisions, such as those with respect to the financing of free basic services.

Other constraints: As in the past, the FFC will be faced with human and other resource constraints. Human constraints may be addressed through proactive training programmes and linkages to academic, NGO and other organisations. It may prove useful to continue to draw on international resources to provide insight into principles and best practices being used elsewhere.

The establishment of extensive data bases is much more feasible with current technology. The FFC, in partnership with other government departments and agencies, Statistics South Africa, academic institutions and relevant NGOs, should build its data bases. However, this is a major task which requires significant resources to build and maintain. Furthermore, the FFC will be hostage to the willingness and ability of its data partners to continue to develop data banks.

Perhaps most important of all will be the ability of the FFC to make its positions heard and to evoke responsiveness. A challenge will be to maintain effective relationships with other players in the sphere of intergovernmental fiscal relations, including Parliament, the legislatures and organised local government, as well as national, provincial and local officials. The FFC should encourage transparency, accountability and public debate which will strengthen the role of the FFC.

5. Conclusion

The FFC has successfully charted a course through its first ten years, which has enabled it to play a significant role within the intergovernmental fiscal relations system of the democratic Republic of South Africa. Yet, this role is evolving and, as noted, faces both opportunities and constraints. It must keep its bearings and adhere to sound practices. Confidence in the FFC should be strong, given its past record.

In its June 2001 Submission on the Division of Revenue, the FFC outlined the following set of operational guidelines.

"In making its recommendations, the FFC:

- *Respects the constitutional status of each sphere of government*
- *Adheres to constitutional principles*
- *Is mindful of the fact that the Constitution's Bill of Rights mandates the provision of basic services*
- *Considers other principles of good intergovernmental relations*
- *Undertakes extensive research to inform the basis of its recommendations*
- *Considers stated government programme objectives and priorities."*

With these as its fixed star and a good reading of the evolving forces within the intergovernmental system, the FFC can chart a course for the future, which will provide the nation with the means to maintain equity and efficiency in the conduct of its intergovernmental fiscal relations.