Ensuring The Effective Participation Of Each Sphere Of Government In The Processes And Structures That Determine Intergovernmental Fiscal Arrangements

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Madame Chairperson, ladies and gentlemen,

It is, indeed, a pleasure to be able to address you at the 10-year anniversary of the FFC's existence, which coincides with the celebration of 10 years of democracy in South Africa. I, myself, have had the privilege of working as a Research Associate for the FFC in its early years.

South Africa is a unitary state with a decentralized system of three spheres of government – national, provincial and local – which are distinctive, interdependent and interrelated. In 1994, the democratic government restructured the intergovernmental system along non-racial lines with a view to providing equity and redressing the imbalances of the apartheid system. The former four provinces were restructured into nine. In 1995, municipalities were restructured and many parts of the rural areas, formerly outside municipal boundaries, were included. The number of municipalities was reduced from over 1,000 to 843 transitional local and rural councils. The system was, however, not workable as there were too many municipalities for the size of the country. The vast majority had little or no revenue base and was largely dependent on grants from national government. In order to address these challenges and to create financially viable and sustainable local government, the country was re-demarcated into 284 wall-to-wall municipalities in the year 2000. The creation of 284 municipalities allowed us to bring in those rural parts of the country that were still outside the system, and allowed us to achieve economies of scale in administration and service delivery.

[1] The views expressed in this paper are those of the author.

The Constitution provides the framework for intergovernmental relations and for some elements of the intergovernmental fiscal system. These provisions are, in turn, supported by legislation (including the Intergovernmental Fiscal Relations Act and the Financial and Fiscal Commission Act) and through the development of various forums. All three spheres of government have an important role to play under the Constitution; thus, they each have the power to determine their own budget. The Constitution, therefore, provides each sphere with specific revenue-raising powers but also complements these with a system of revenue-sharing that takes into account their functions and fiscal capacities.

National government's main role is policy-making, regulation and oversight. It sets policy priorities for the country and administers both exclusive (e.g. foreign affairs and defence) and concurrent (e.g. education, health and social welfare) functions. It retains the most significant revenue-raising powers. Provinces are mainly responsible for social delivery and have the largest budgets but limited revenue-raising powers. Most of their revenue comes from transfers from national government. Municipalities are mainly responsible for delivering basic services (e.g. water, sanitation, electricity, refuse removal) and other functions (such as firefighting, roads, stormwater drainage). They raise revenue mainly from property rates and tariffs. Transfers to both provinces and municipalities take the form of an unconditional constitutionally mandated equitable share of nationally-raised revenue and conditional grants to meet national policy objectives.

The intergovernmental fiscal system is suited for South Africa given the regional disparities in income and revenue raising capacity, as well as the different capacities that exist. It allows for a central collection of taxes, and thereby maximising revenue collection at minimum cost, while allowing for a decentralisation of expenditure responsibilities. This is important given the scarce capital resources that must be controlled by the central government to maximise returns. It also allows the national government to allocate fiscal resources to areas with least capacity as well as to services with national benefits and redistributive benefits.

One of the key tasks that the post 1994 set itself to do, which it did remarkably, was a major overhaul of the budget process. Underlying the reforms were the principles of predictability, accountability, responsibility, and measurable outcomes. A number of key initiatives were part of these reforms. The first was the introduction of three-year budgets, which are now being extended to the local sphere of government, including the three-year allocations per municipality published with the Annual Division of Revenue legislation.

The second was the promulgation of the Public Finance Management Act (1 of 1999) (PFMA) which, together with other reforms, establishes institutional mechanisms for strengthening financial management and fostering accountability. The promulgation of the Municipal Finance Management Act early in 2004 will extend these reforms to the local sphere of government.

The character of the intergovernmental fiscal system and the budgetary process has a major implication on planning and coordination. The budgetary process plays a critical role in determining and giving effect to government's policy priorities into plans and expenditure. The budget is a hard constraint - it forces policy priorities to be disciplined by fiscal and budgetary realities. On the one hand, the three year indicative allocations bring about certainty and predictability in funding, on the other hand they require every department or an organ of state to set priorities and plan expenditure programs within the parameter of the voted allocations. This does not allow for flexibility and forces trade-offs to be made to accommodate new priorities.

The result of this state of affairs is that the budgetary process approves the priorities, plans and expenditures of <u>each department or organ of state</u>. This is because public funds are voted to a department or organ of state to perform functions it is mandated to perform through programs that give effect to political priorities. This further undermines all efforts aimed at coordinating government's policies.

A single budget process for the country, embedded in political and administrative practices, permits Government to decide upon the right mix of restraint and flexibility when deciding priority areas of expenditure. International experience shows that "the failure to link policy, planning and budgeting may be the single most important factor contributing to poor budgeting outcomes at the macro, strategic and operational levels in developing countries."[2]

Although intergovernmental fiscal relations is primarily an executive function, legislatures also play an important role. They formally adopt the laws that confer powers on the executive and oversee their implementation.

The core business of government consists of three main activities commonly referred to as the Policy Cycle of Government: 1) setting; 2) planning; and 3) implementation of priorities. All three spheres determine priorities subject to budget constraints. Cabinet determines national priorities, provincial executive councils and municipal councils determine priorities for their jurisdictions. The four main priority setting systems at national level are: 1) Cabinet Lekgotla – sets high-level medium-term priorities in July and January each year after recommendations from Cabinet clusters; 2) Medium Term Expenditure Framework (MTEF) – a three-year projection of Government expenditure on priorities with annual budget appropriations and a division of revenue between and within spheres of government (currently done at national and provincial level and will be extended to local); 3) Medium Term Strategic Framework (MTSF - not yet adopted by Cabinet) – a proposed three-year set of strategic priorities informing the MTEF and annual departmental budgets, strategic plans and expenditures; and 4) Spatial Development Instruments (that inform spatial development planning) – National Spatial Development Perspective (NSDP), Provincial Growth and Development Strategies (PGDSs) and municipal Integrated Development Plans (IDPs).

[2] The World Bank, Public Expenditure Management Handbook, 1998, p31.

There are several intergovernmental forums that play an important role in shaping policy and resources allocation decisions. The Extended Cabinet, comprising the national executive, nine premiers and the chairperson of the South African Local Government Association (SALGA), is the highest cooperative mechanism advising the national Cabinet when finalizing the fiscal framework and division of revenue on which MTEF budgets are based. The Budget Council is constituted of the Minister of Finance and the nine Members of the Executive Council responsible for finance in the provinces. The Budget Forum is made up of the Budget Council and local government representatives. MinMECs are sectoral policy forums of the Ministers and their provincial counterparts. There are also several intergovernmental forums comprising senior officials who provide technical support to the political forums.

Although the basic foundation for intergovernmental fiscal relations exists, the processes and structures that determine it are not without their weaknesses. These include:

1) Lack of a shared focus on key national development priorities: Although the MTSF was endorsed by Cabinet in principle, it has not yet been prepared. There is a need for a national strategic development framework of priorities for the country that is informed by provincial and municipal priorities and objectives – a bottom-up developmental approach to national planning. This essentially means that the Integrated Development Plans (IDPs) of municipalities should form the basis for informing PGDSs and the MTSF.
2) Lack of coordination between policy making and the budget: policy making is done by the various line ministries in accordance with policy priorities set at the Cabinet Lekgotlas. In order to implement these priorities, line ministries need to ensure that the budget provides them with a sufficient budget envelope. It is here where there appears to be a disjuncture. There is a real danger of policy making through the budget. [3] It is policy priorities which should drive the budget and not the other way around. There are signs that

[3] Pillay, Pundy (2002). "Governance for Sustainable Development: Policy Integration and Coherence in South Africa. Report prepared for the United Nations Development Programme, South Africa.

the latter is happening. There is a need for a mechanism that systematically links the policy-making process to the budgetary process. While structures, such as Cabinet Committees, Cabinet Clusters, the Forum of South African Directors-General (FOSAD), and the Cabinet Office and the Policy Unit within the Presidency, exist, their role is not well defined in Treasury and other budgeting processes.

3) Confusion about the roles of each sphere in key aspects of intergovernmental relations: There is considerable variation and uncertainty in provincial conceptions of the role of the Office of the Premier, the provincial treasury, and the MEC for Local Government in strategic planning. The relationship between intergovernmental forums as well as the relationship between these forums and executive decisions is also unclear.
4) Insufficient sharing of information: Very few departments are able to provide information regarding priorities, budget allocation and expenditure per municipality or have associated information about each municipality.
5) Lack of capacity in key areas or functions: Despite several years experience with program-based budgeting, effective medium term planning at departmental level cannot be taken for granted. In many cases, measurable objectives are either not measurable or not objective or rolled over and are mainly de-linked from cluster priorities.

Other problems include inadequate monitoring, evaluation, enforcement and performance management, erratic and unfocused participation in intergovernmental forums and other coordination structures.

While substantial progress has been made in overhauling the budgetary process, initiatives that have been introduced to improve coordination across the three spheres of government have yet to bear fruits. The above issues need to be urgently addressed in order to successfully combat the massive developmental challenges that exist in the country; there is also a need to focus on institutional transformation. In addition, the following need to be attended to:

1. **dplg** must take the lead in implementing the PCC's resolution that municipal IDPs form the basis for engaging the priorities, plans and expenditures of all spheres of government. This will require some form of planning process to coordinate municipal priorities, and feed them into the provincial and national priorities into a coherent government wide programme for discussion by Cabinet.
2. Provinces must prepare Provincial and Growth Development Strategies as the key development plans for provinces reflecting a province wide developmental perspective. Similar to the IDPs, sectoral plans should be part of the PGDS.
3. Provinces must establish structures which include organised local government and in some instances certain mayors, to coordinate and align provincial priorities.
4. The role and the nature of the existing intergovernmental fiscal structures should be reviewed and clarified. The proposed Intergovernmental Relations Bill provides an opportunity to review and align the policy setting and budget processes.
5. The role of organised local government, and the other coordinating departments, that is, **dplg,** DPSA and the Presidency, should be clarified in the budget process. These departments should participate in the intergovernmental fiscal structures, the Budget council and the Budget forum. Similarly, the role of the clusters in the budget process should be clarified. Currently, local government, through SALGA, participates only marginally in the budget process. National Treasury consults SALGA with regard to the local government equitable share but this consultation appears to be more procedural than substantive. Thus, there is a need for local government to be more strongly represented in the budget process.
6. Improved coordination across the three spheres of government would be greatly enhanced by the provision of budget and other information per municipal area, including capital expenditure. The various government

departments, both national and provincial, must over time strive to make such information available to facilitate inter-sphere planning and implementation.

In addition to the above, the other issue that need to be flagged in order to ensure that all three spheres participate effectively in intergovernmental fiscal relations is the vertical distribution of nationally-collected revenues. Thus far, this has always been a political decision taken at the national level. What is required is some level of objectivity in decision-making on this issue. Some countries even have a formula, determined by national government and implemented by independent commissions (similar in nature and function to the FFC), that determines this vertical division. The FFC has advocated a costed norms approach to determining both the provincial and local government equitable share. This will go a long way towards reducing the fiscal gap (between expenditure need and revenue-raising capacity) that exists in both the provincial and local spheres.

Thus far, I have talked about the role of government in intergovernmental fiscal relations. No democracy is ever complete without considering the role of civil society. In many countries, lip service is paid to public participation but in South Africa, community participation is a key feature in legislation and in budget processes and actually works. A prime example is seen in the Property Rates legislation that was recently signed into law by the President on 11 May, 2004. The legislation went through a thorough consultative process within government before it went to Cabinet and through careful public scrutiny throughout the Parliamentary process.

The Property Rates legislation requires municipalities to consult communities when formulating their rates policies that will inform decisions on the treatment of different categories of property. Examples of other legislation that deal with community participation include the Municipal Systems Act and the Municipal Finance Management Act. These acts require municipalities to go through a process of community participation before councils can approve their budgets.

Another important forum that government must engage with is NEDLAC. This forum largely represents the interests of business and labour in the community.

Both government and communities, including the private sector and civil society formations, must forge the partnerships to make sure that legislation gets implemented in the way it was visualised. They have a responsibility to collectively make determinations about budgets and to make decisions about how the resources raised would be used in the pursuit of development objectives in their localities. Civil society must make full use of the legislative rights granted to it in order to ensure that intergovernmental fiscal arrangements benefit the citizens of South Africa.