FINANCIAL AND FISCAL COMMISSION

For an Equitable Sharing of National Revenue

How Provinces are Funded to Fulfil Rural Development Mandates

EXECUTIVE SUMMARY

Provincial rural development mandates straddle many concurrent functions, but how each sphere perceives its role is not always clear. Provinces in South Africa have very different levels of tax effort, reflecting the different tax bases. Between 2005 and 2014, tax effort increased across all provinces, with some provinces relatively optimising their collection of own revenue, but the scope to increase revenue collection from current provincial tax sources is limited. Provinces therefore rely heavily on transfers from national government, especially the provincial equitable share (PES), which is criticised for perpetuating regional imbalances. The Financial and Fiscal Commission (the Commission) found that the PES formula is not responsive to rurality, whereas infrastructure conditional grants are responsive to rural needs because the largest share of the main infrastructure grants goes to the three most rural provinces. Many conditional grants are targeted at the agricultural sector, although agriculture is not the dominant economic activity in all rural areas. The Western Cape has the second highest (after KwaZulu-Natal) agriculture output, whereas the Northern Cape contributes the least to national agriculture output and yet receives the largest share of agricultural grants. The Commission recommends that departmental reports be disaggregated in accordance with municipal boundaries, and that national government ensure that grant conditions take into account spending efficiency and performance. A comprehensive review of infrastructure conditional grants to rural areas should be carried out, to assess the reduction of backlogs and spending efficiency.

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BACKGROUND

According to the Constitution, rural development is a concurrent responsibility of national and provincial governments, but how activities should be shared between the two spheres is not explicitly described. This lack of specificity is central to the uncertainties over how different spheres perceive their respective roles. Provincial responsibilities include regional planning, schooling and health facilities, housing, roads and agriculture. These functions potentially constitute rural development, as they reduce poverty and improve living standards. Yet provinces do not always perceive their education and health spending as rural development, partly because sector policies are mostly driven from the centre, and partly because sectoral allocations and investments are not space-based, i.e. outcomes are not physically confined to a rural space (as in the case of investments in roads and agriculture).

The Constitution does not make any spatial distinctions when assigning functions but requires fiscal and developmental disparities between and within provinces to be taken into account when determining the provincial equitable share (PES). Therefore, the PES and various conditional grants include variables that directly and indirectly compensate for "ruralness". However, without a clear framework of provincial rural development functions and coordinated spending, the transformation of the rural landscape will remain an elusive ideal. The Financial and Fiscal Commission (the Commission) looked at how responsive provincial funding is to rural challenges.

RESEARCH FINDINGS

The research highlighted the intricacies of provincial rural development mandates, which straddle many concurrent functions and lead to duplication.

Own revenue mobilisation

The "tax effort" is the revenue a province collects relative to its tax base. It indicates the extent to which provinces are maximising the potential revenue from current revenue sources. Provinces have very different levels of tax effort, which implies that provinces have very different tax bases. Rural provinces, such as the North West and Eastern Cape, generally have the highest level, whereas the urban provinces of Western Cape and Gauteng have the lowest level of tax effort. This peculiar phenomenon is possibly because rural provinces charge higher tax rates than urban provinces for (e.g.) vehicle licences.

Between 2005 and 2014, the tax effort drastically increased across all provinces. The difference between potential and actual tax revenues suggests that some provinces (including Gauteng, Western Cape and KwaZulu-Natal) are relatively optimising their collection of own revenue from selected tax sources and, in some instances, are "overtaxing" their tax bases. This implies that the scope to increase revenue collection from current provincial tax sources is limited.

PES and rural development

Provinces rely heavily on transfers from national government, especially the PES that represents 81% of national transfers. Over the years, the PES formula has undergone several reforms but continues to be criticised for perpetuating regional imbalances. A statistical test was done on the different components (or variables) of the PES, to determine their impact on rural development. The results overwhelmingly support the perception that the PES formula is not responsive to rurality, as the per capita PES allocations do not differ across provinces (with the exception of Gauteng).

The task of channelling the PES towards priority areas rests entirely with provinces, albeit within the bounds of national policies, norms and standards. Provinces perceived generally as rural (with the exception of the Eastern Cape) were found to allocate very little of their own discretionary funding to rural development. However, the research was unable to indicate conclusively whether or not provinces are prioritising rural development. This is because the extent of rural development needs in each province is unknown, and provincial expenditure reports do not distinguish spatially where health and education funds are spent.

Conditional grants and rural development

Conditional grants are used to fund specific regional expenditure that is not covered by general transfers. Many of the conditional grants aimed at addressing rural development challenges are controlled by national government, either through stringent, nationally determined conditions or outright central management of the grants. These centrally controlled grants were found to be associated with poor spending performance and insufficient reporting on expenditure outcomes.

Between 2000 and 2015, over half (52%) of the Provincial Infrastructure Grant and just under half (46%) of the Health Facility Revitalisation Grant were allocated to South Africa's three most rural provinces (Eastern Cape, KwaZulu-Natal and Limpopo). (Although over the 15 years, Gauteng received the largest share, i.e. 25%, of the Health Facility Revitalisation Grant.) These three provinces also accounted for nearly two-thirds (63%) of the relatively new Education Infrastructure Grant. This shows that infrastructure conditional grants are responsive to rural needs.

The current provincial fiscal framework consists of many conditional grants targeted at agriculture, despite agriculture not being a dominant economic activity in rural areas. For instance, the Northern Cape receives the largest share of the Comprehensive Agricultural Support Programme (CASP) (34%) and Illima (19%) grants but contributes the least of all provinces to total national agriculture output. Conversely, the Western Cape, which is commonly regarded as an urban province, has the second highest agriculture output after KwaZulu-Natal, ahead of the other provinces perceived as rural. These findings dispel the view that rural areas have a strong agricultural base, and so rural development strategies should have an agrarian focus.

CONCLUSION

The provincial rural development mandates straddle many concurrent functions and lead to duplication. Rural provinces are optimising revenue collection on their current tax base and, in certain instances, are exerting higher-than-average tax effort. Some provinces (e.g. Gauteng, Western Cape and KwaZulu-Natal) may be "over-taxing" their tax bases, which implies that the potential to increase revenue from current provincial tax sources is limited. Thus provinces continue to rely heavily on transfers from national government, in particular the PES. However, the PES was found not to be responsive to rural challenges, as the per capita PES allocations do not differ across provinces (with the exception of Gauteng).

Provinces perceived generally as rural (with the exception of the Eastern Cape) allocate little of their own funding to rural development, but this does not mean that provinces do not prioritise rural development – this cannot be established because provincial expenditure on health and education is not reported spatially. Infrastructure conditional grants are responsive to rural needs, as South Africa's three most rural provinces (Eastern Cape, KwaZulu-Natal and Limpopo) receive about half of the Provincial Infrastructure Grant and Health Facility Revitalisation Grant, and two-thirds of the Education Infrastructure Grant. Yet questions remain regarding the extent to which these funds have been used to address rural infrastructure backlogs and how infrastructure investments contribute to better expenditure outcomes. The misalignment is evident between the allocation formulae of agriculture grants and the policy objectives for promoting agriculture output and food security.

With respect to enhancing the efficacy of provincial fiscal transfers and own revenues in funding rural development mandates, the Commission recommends that:

- In each province, the Provincial Office of the Premier, in consultation with the provincial departments of basic education, health, agriculture and rural development and roads, identify the rural development needs in the province and set annual delivery targets against which PES allocations will be assessed by oversight bodies. Departmental budgets and expenditure reports should be disaggregated in accordance with municipal boundaries to help ascertain the extent to which PES allocations are targeted to rural areas' needs.

- The National Treasury, in collaboration with the departments of basic education and health and those responsible for provincial roads, ensure that the criteria for allocating infrastructure conditional grants take into account spending efficiency, delivery targets and performance, as well as the applicable national norms and standards. This should assist with monitoring of provinces in meeting their developmental goals and facilitate targeted intervention where a province consistently fails to meet delivery targets.

- The Department of Agriculture, Forestry and Fisheries and National Treasury review the framework for allocating agriculture conditional grants to reduce the weighting of agriculture land size and poverty relief and to incorporate factors that are closely aligned to the objectives of the grant, in particular the promotion of emerging farmers or agriculture production in the rural areas, as stipulated in the Agriculture Policy Action Plan.

- The Department of Planning, Monitoring and Evaluation conduct a comprehensive review of expenditure outcomes associated with infrastructure conditional grants targeted at the rural provinces, to ascertain the extent to which infrastructure backlogs have been reduced and the efficacy of the spend. The outcome of the review should be used to form the basis of any adjustments to infrastructure grants earmarked for rural development.

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