

## **1. Introduction.**

Intergovernmental fiscal relations are product of a political process and continue to be shaped by that process. That process is in state of flux and will serious implications for today's discussion. In this response we have identified three areas of focus:

- a) Revenue assignment
- b) Infrastructure Backlogs
- c) Vertical imbalances

We have adopted this approach because we agree broadly with the thrust of the papers in so far as they a case expenditure need as determinant of resource allocation.

## **2. Revenue Assignment**

The theory of revenue assignment asserts that revenue sources should match expenditure responsibilities .This congruence between spending responsibility and revenue raising - powers is needed to exercise fiscal autonomy and improved accountability. There is no doubt that this is the dominant view in the public finance literature.

However most of the literature seems to be cautious. Boadway and others, for instance, argue that much of the discussion has been abstract and has been based on principles of fiscal federalism that have been conceived largely for industrialized countries. The 2001 IGFR also argues that match expenditure responsibility seldom occurs in practice .It further asserts that the devolution of tax sources offers autonomy but risks duplication of effort, the introduction of distortions and the accentuation of horizontal fiscal disparities. This view is reinforced by the OECD's argument that there are few taxing powers which can be transferred to subordinate levels of government without raising efficiency and/or distributional concerns.

In the South African context, a key constraint has been the government 's intention to maintain tax revenues at 25% of GDP as part of its macroeconomic policy .Any tax assigned to provinces has to be coupled with an offsetting reduction in national tax revenues . This will ultimately reduce the equitable share of national revenues accruing to provinces and affect the distribution of resources between provinces.

Govinda RAO and Bongani Kumalo's paper supports the FFC recommendations .The FFC has recommended a surcharge on the personal income tax .The surcharge would be matched by a 7% reduction in the national portion of the tax. Provinces would be allowed to choose rates within 5% point range. National Treasury's calculations shows that provincial own revenue would comprise between below 10% of total revenue in Limpompo and Eastern Cape, and over 40% in Gauteng.

In this arrangement, provinces such as the Eastern Cape and Limpompo would still face difficulties even if they were to impose 12 % point. It is clear that these provinces would be worse off with serious implications for the redistributive goals of this government. Higher taxes in these provinces would also give rise to other unintended consequences

.Higher taxes could be distortionary because people would migrate to lower tax jurisdictions.

Fiscal and political accountability can be achieved by other means. The World Bank, for instance, argues that certain institutional arrangements can influence expenditure outcomes and ensure accountability.

### **3. Infrastructure Backlogs**

We would agree with the rationale articulated in the paper that capital grants rests on three arguments viz

- i) State's constitutional obligation to provide basic services
- ii) Economic growth
- iii) and equity of access to basic services

It is important to note that the provinces that have huge infrastructure backlog are the ones in need of higher economic growth levels. It is precisely for this reason that would argue that the formula is not the appropriate instrument to deal with this particular problem. It is our contention that huge resource transfer to poor provinces need to be considered. The could take the form of a specific purpose grant. If this what the argues, then we concur.

### **4. Vertical imbalances**

Both papers have focused on horizontal equity and fail to deal with what is a major issue in fiscal intergovernmental relations. The distribution of resources between the different spheres of government is at the heart of intergovernmental fiscal relations.

Fjeldstad asserts that without exception countries assign more expenditure functions to sub national government than can be financed from the revenue sources allocated to the governments.

In the South African context, vertical imbalance is exacerbated by two other related problems. The first is what is called unfunded mandates or what Janice Mackinnon calls "offloading". The second one is that as national raised revenue increases. Provinces are getting less and less of that cake. The provincial split has declined from 58.6 % in 1999 to 56.4 % in 2001.

### **5. Conclusion**

The submission by the FFC is broadly supported .I do not agree that the costed norms approach must wait for new data. The available data is used to evaluate the performance of provinces but not for allocating resources. If we are serious about eradicating poverty we need to move significant resources in line with that objective. That is going to require the political courage and will to make trade-offs