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# The financial relationship between national and provincial governments in South Africa

EDWARD ROBERTS *)

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## Introduction

1. This article is about the question: are the constitutional financial guarantees given to the Provinces in the Republic of South Africa congruent with the guarantees concerning their autonomous position under the Constitution. As the South African Provinces are for 96% of their income dependent on transfers from the national treasury in their 2001-2002 budgets, there seems ample reason to put the question.

In the first part of this article the relationship between central and provincial governments as elaborated in the Constitution will be described. In the second part the regulation of the division of total government income between the different layers of government will be looked into and a conclusion on the above question will be arrived at.

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I. National – Provincial relationship as established in the Constitution

2. The Republic of South Africa is a composite state. The component parts of the state are called Provinces. The 9 Provinces are enumerated in the Constitution (1996) of South Africa. The Constitution does not typify the relationship between central and provincial government in words like “federal” or “commonwealth”. It indicates this relationship quite neutrally with the word "sphere of Government”. So Section 40,1 reads: “In the Republic, government is constituted as national, provincial and local spheres of government which are distinctive, interdependent and interrelated.”.

The Constitution is the source of all authority in the Republic of South Africa. (S. 2) It may be amended by a majority of two thirds of the national parliament plus a two thirds majority in the senate, which is called the National Council of Provinces. A Constitutional Court may review every law on its consistency with the Constitution.

The Principles of 1993

3. The current Constitution of 1996 was preceded by the post-Apartheid Interim Constitution of 1993, which presents the political agreement of the South African population on the main characteristics of the constitutional design of the Republic. The 1993 Constitution was to be replaced by a new Constitution to be drafted by a Constitutional Assembly.

The characteristics are spelled out in 34 Constitutional Principles laid down in Annex 4 of the Interim Constitution.

The Constitutional Principles are of a lasting interest. Section 74 of the Interim Constitution of 1993 provides that no amendment or repeal of the Constitutional Principles shall be permissible. The new Constitution had to be certified by the Constitutional Court as complying with the Constitutional Principles before it might be signed into law by the President. (S. 72 of the 1993 Interim Constitution).

4. In the Principles democratic representation on all levels of government, national, provincial and local is prescribed.

More than a quarter of the 34 Principles deal with the powers of the Provinces in relation to the powers of the national government.

In the Principles the Constitutional Assembly is given the task of defining the powers and functions of national and provincial governments. Proposals for amendment of the powers of the provinces as defined in the new Constitution were only to be submitted after the provincial legislatures had been consulted. (Principle XVIII)

The national government of South Africa and the provincial governments were to have exclusive and concurring competences as well as the power to perform functions for other levels of government on a delegation or agency basis. (XIX)

The general Principle for allocating powers and functions is that each level of government is to function effectively. The allocation had also to be conducive to financial viability and an effective public administration which recognised the need for and promoted national unity and legitimate provincial autonomy and acknowledged cultural diversity. (XX)

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1 Act No. 108 of 1996
2 The nine provinces are: Eastern-Cape, Free State, Gauteng, KwaZulu-Natal, Mpumalanga, Northern-Cape, Northern Province, North West, Western-Cape. (see S. 103, 1)
3 Act No. 200 of 1993
As regards the allocation of powers between the national and provincial governments the following supplementary criteria were to apply. (XXI, 1 – 5) When the maintenance of economic union or of internal security is involved or when unreasonable action by one provincial government damages other provinces or the country as a whole the **national government is empowered** to intervene. Moreover the national government will act in matters of national economic policy, in the Republic's common market matter, in foreign affairs or where essential national standards are involved. Where uniformity across the nation is required for a particular function the legislative power over that function is to be allocated predominantly if not wholly to the national government. 

5. As regards *provincial powers*, the Constitutional Assembly got an either/or guideline in the Principles. The Provincial governments were to have powers allotted either exclusively or concurrently with the national government, inter alia

- for the purposes of provincial planning and development and the rendering of services; and
- in respect of aspects of government dealing with specific socio-economic and cultural needs and the general well-being of the inhabitants of the province (XXI, 6).

The regulation of local government is left to parliamentary statutes or provincial legislation or both. But a framework for local government powers was to be set out in the Constitution. (XXIV) 

So, the order to the Constitutional Assembly regarding the province's powers is rather vague: The provincial governments had to be empowered in matters concerning their town and country planning as well as concerning the well-being of their populations, but the possibility of the national government to step in had to be left open. However, Principle XXII mentions that the national government will not exercise its powers (be it exclusive or concurrent) so as to encroach upon the integrity of the provinces. The Principles provide expressly for co-operation between national and provincial governments by stating that where mutual co-operation is essential or desirable or where it is required to guarantee equality of opportunity or access to a government service, the powers should be allocated concurrently to the national government and the provincial governments. (XXI, 7)

The dominant position of the national government is underlined in Principle XXIII which mentions that in case of a dispute between the national and a provincial government about concurrent powers which cannot be resolved by a court on the basis of the Constitution, precedence is to be given to the powers of the national government. So, it seemed to be the intention that the reserve-powers would rest with the national government.

6. The Principles contain three *prescriptions regarding finance*.
- National, provincial and local government shall have fiscal power. (XXV)
- Moreover each level of government shall have a constitutional right to an equitable share of revenue collected nationally, so as to ensure that provinces and local governments are able to provide basic services and execute the functions allocated to them. (XXVI)

So, equity is to be related to the provision of basic services plus the execution of functions allocated.
An advisory committee is to be established which will weigh the share each Province is to have in this division of nationally collected revenue taking into account a number of factors, that is to say the national interest, economic disparities between the provinces as well as the population and developmental needs, administrative responsibilities and other legitimate interests. (XXVII)

In this so-called Financial and Fiscal Commission each province is to be represented.

The 1996 Constitution and the Provinces

7. The Constitutional Assembly adopted a text for the new Constitution on 8 May 1996. This text was submitted to the Constitutional Court for certification. In its judgement of 14 September the Court concluded that the constitutional text could not be certified as complying fully with the Constitutional Principles. The main focus of its judgement was on provincial government matter, more specifically on the question whether the constitutional text provided for the required legitimate provincial autonomy. Consequently, the Constitutional Assembly amended the submitted text substantially and adopted the new version on 11 October 1996, which was then again laid before the Constitutional Court. Considering this amended text the Court found that the powers and functions of the Provinces were still less or inferior to those accorded in the Interim Constitution but that the disparity was not substantial. Therefore the Court concluded in its judgement of 4 December 1996 that the Constitution did indeed comply with the Constitutional Principles. The certification of the text thus being obtained the President of the Republic signed the new Constitution into law on the 11th of December 1996.

8. In the 1996 Constitution the concurrent and the exclusive powers of the provinces are enumerated in attached Schedules 4 and 5 respectively. The Schedules are amendable in the same way as the Constitution itself, that is by a two thirds majority in the national Parliament and in the National Council of Provinces. The powers of the national government are not put in an attachment. Section 44,1 ii of the Constitution provides that the national Parliament may legislate on any matter, including the matters allocated to the provinces under Schedule 4 but excluding those under Schedule 5. However, Parliament may even intervene in those exclusive provincial powers
- in order to maintain national security, economic unity, and essential national standards,
- in order to establish minimum standards required for the rendering of services, or
- to prevent unreasonable action taken by a province which is prejudicial to the interest of another province or to the country as a whole. (S. 44,2)

The first power of a province is to pass a constitution and to amend it. (S. 104,1) Amendments have to follow the same procedure as amendments of the national Constitution, that is by a 2/3 majority in the provincial legislature. A provincial constitution may not be inconsistent with the national constitution. (S. 143,1) A province is, however, expressly empowered to differ in its provincial legis-

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5 Ex parte Chairperson of the Constitutional Assembly: In re Certification of the amended text of the Constitution of the Republic of South Africa, 1996, 1997(2) SA 97 (CC)
lative or constitutional structures and processes from the ones in the national constitution. (S. 143,1a)
A provincial constitution may not confer on a province any power outside the powers
enumerated in Schedules 4 and 5 (S. 143,2)
The provincial constitution has moreover to be certified by the national Constitutional Court to be in conformity with the national Constitution before it may enter into
force. (S.144,2) As long as a province is without its own constitution it can manage
adequately on the default provisions for provincial governments provided in the national Constitution6.

*Provincial power over local government*

9. The Constitution allots provincial government the task to establish municipalities
and to provide by legislative or other measures for the monitoring and support of local
government. (S. 155,6a)
A South African Province shares its power over the local level of government in
many instances concurrently with the national government like for instance in re-
gional planning and development, in urban and rural development and welfare serv-
ices, in environment, health services and housing. Also some parts of chapters in
which the Constitution reserves exclusive competence for the national government,
some powers may be left to provincial government like police, language policy and
media services. Next to that the province has competence over a list of local govern-
ment matter over which it has the exclusive right to control (Schedule 5, part B). The
control of other local matter it has to share with the national Government (Schedule 4,
part B). The competence in any matter concerning local government not mentioned in
the Constitution rests with the national Government (S. 164).
The provincial government is empowered to intervene when a municipality cannot or
does not fulfil a obligation in terms of legislation (S. 139,1). However, the interven-
tion needs the approval of the member of the national Cabinet responsible for local
government within 14 days (S. 139,2a). Also the National Council of Provinces has to
approve the intervention within 30 days after its first sitting after the intervention (S.
139,2c).

*Conflict of laws*

10. The national Constitution (1996) provides for an extensive regulation concerning
conflict between national and provincial legislation.
It divides possible conflicts in two cases:
 a) the ones between national and provincial legislation in areas of concurrent power,
    and
 b) conflicts between national legislation and the provisions of provincial constitutions.

Ad a). In the case of conflict of existing legislation in the areas of concurrent
powers the effectiveness of regulation is the determining criterion for the prevalence
of national power over provincial. When uniformity is required as in the case of
norms and standards, frameworks or national policies the higher effectiveness of re-

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6 Only the province of the Western Cape succeeded in establishing a provincial constitution. It was
certified in an unanimous judgement by the Constitutional Court on 18 November 1997 and was signed
into law on 15 January 1998.
An attempt by KwaZulu-Natal to establish a provincial constitution was defeated in the Constitutional Court.
by judgement of 6 September 1996. The attempt has not been pursued. (KwaZulu-Natal Certifi-
cation Case 1996 (11)BCLR1419(CC))
national legislation is presumed by the Constitution (S. 146, 2 & 3). In other cases provincial law prevails. When the question is the necessity of a new national law instead of existing provincial law and that dispute is submitted to a court, the court has to have due regard to the rejection or approval of such legislation by the National Council of Provinces. If a court is not involved in the solution of the question the provincial power is made fully dependent on the position of the National Council of Provinces (S. 146,6). Ad b). As regards a conflict of law between existing national legislation and a provision of a provincial constitution national legislation prevails in general. (S. 147,1)

If a dispute cannot be resolved by a court the national legislation prevails over the provincial legislation or constitution (S. 148).

11. The constitutional chapter on the regulation of conflicts of law finishes by laying down a rule of interpretation. It prescribes in Section 150 that every court when considering apparent conflicts of law between national and provincial law has to prefer any reasonable interpretation of the legislation or the Constitution that avoids a conflict over any alternative interpretation that results in a conflict.

From this chapter it may be clear that the drafters of the Constitution (1996) wanted to set borders to the legal process in favour of the political arena. This is also being made most clear in Section 41 in the Chapter on co-operative government where one may find the constitutional order to the courts to refer a dispute back to the organs of state involved when a court is not convinced that all other remedies are exhausted.

The role of the provinces in national legislation
12. The South African legislature is bi-cameral and consists of the National Assembly and the National Council of Provinces.

The National Assembly has 400 members elected on the basis of a national common voters roll and of proportional representation.

The National Council of Provinces is composed of a single delegation of ten delegates from each province, in total 90 members.

In a provincial delegation four delegates are special delegates and six are permanent delegates.

The special delegates are the premier of the province, or any member of the provincial legislature designated by the premier either generally or for any specific business before the National Council of Provinces, and three other special delegates (S. 60).

The introduction of special delegates in the composition of the provincial delegations allows for a measure of flexibility in the political decision making and for the mobilisation of a particular expertise when needed.

The political parties active in a province are entitled to be represented in the delegation of the province. The number of seats to be allotted to each party are to be calculated by a formula given in the Constitution itself. (Schedule 3 B of the Constitution)

The provincial legislature has then to decide how many of each party’s delegates are to be special delegates, and how many permanent delegates. It will also appoint the permanent delegates nominated by the parties. These decisions have to be taken within 30 days after the results of the election for the provincial legislature become public. Permanent representatives in the Council chosen from among the members of the provincial legislature may attend the meetings of that legislature but lose the right
to vote. They remain member of the Council until a new election for the province they represent is held.

The three special delegates are appointed, as and when required, by the legislature of the province from amongst its members. Their designation has to have the concurrence of the premier of the province and of the leaders of the political parties entitled to special delegates.

Participation of minority parties in the provincial delegations is to be ensured. (S. 61)

So, the members of the National Council of Provinces are not directly chosen by the population in the provinces, they are representatives of political parties.

All the political parties represented in the National Council of Provinces at the moment are also represented in the National Assembly. On both levels the African National Congress party (ANC) is in the majority. However, to attain a two thirds majority in decisionmaking the ANC needs the co-operation of an other political party.

13. The National Council of Provinces has to consider all national legislation and may amend or reject it. It may moreover initiate or prepare legislation falling within the functional area of Schedule 4 (= concurrent powers) or other legislation concerning institutional rules enumerated in Section 76 (3) 7 of the Constitution (S. 68). It may not initiate or prepare Money Bills 8.

The constitutional rules for the national legislation process provides for two separate procedures, one for an ordinary bill that does not affect the provinces and one for an ordinary bill that does affect provinces. The difference between the two procedures becomes visible in case of a disagreement between both houses about a submitted bill.

In the case of an ordinary bill not affecting provinces rejection by the Council only necessitates the National Assembly to reconsider the bill which it approved earlier. In these cases the National Council of Provinces acts as a consultative body.

Their "no" may only result in procedural delay. In these cases each delegate in a provincial delegation casts his/her vote as a separate member and questions are decided by simple majority in the house (S. 75).

As regards ordinary bills affecting provinces, each province has one vote and agreement is reached when at least five provinces vote in favour. A bill is supposed to affect provinces when it falls within the functional area of Schedule 4 (= concurrent powers) or concerns certain institutional or procedural matters (see footnote 7).

In the case of a conflict between the Council and the Assembly a Mediation Committee becomes involved.

The Committee consists of 9 Members elected by the National Assembly out of their midst, and 9 delegates of the Council each representing a Province.

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7 They are:
S. 65,2. Acts concerning the uniform procedure for the composition of provincial delegation
S. 163. Acts concerning organisations representing municipalities
S. 182. Acts concerning the function of the Public Protector
S. 195, 3 and 4. Acts concerning values and principles of the public service
S. 196. Acts concerning the Public Service Commission See
S. 197. Acts concerning terms and conditions of the Public Service

8 A Money Bill is a Bill that appropriates moneys or imposes levies or duties. A Money Bill may not deal with any other matter except a subordinate matter incidental to the appropriation of money or the imposition of taxes, levies and duties.
In this procedure the National Council of Provinces is able to stop the procedure and to torpedo a bill definitively when the Mediation Committee is not able to come to an agreement or the National Council of Provinces rejects the text agreed by the Mediation Committee, unless the Assembly is able to accept the agreed text or the original one by a two thirds majority. However in the case of a conflict between the Assembly and the Council while processing a bill initiated by the Council, the bill lapses if the Mediation Committee is unable to agree. Also when the Assembly rejects an other version of the bill drafted in the Mediation Committee, the bill lapses. (S. 76)

So, the National Council of Provinces is in the strongest position in the case of an ordinary bill affecting the provinces. The National Council of Provinces is less privileged when it concerns ordinary bills not affecting provinces. Money bills have to be dealt with as ordinary bills not affecting provinces. (S. 76,4)

Co-operative Government
14. In the regulation of the division of powers between national government and provincial governments the position of the Provinces is less clearly guaranteed because of the rather open-ended definitions of central government power. This fits in with the intention of the drafters of the Constitution (1996) to provide for co-operative government. In the Constitution a whole chapter - be it a short one - is dealing with this theme. (Chapter 3, Sections 40-41) In it the three "spheres of government" national, provincial and local are defined as distinctive, interdependent and interrelated.

As first principles of co-operation a few aims are mentioned which concern typical central government care, thereby binding the provinces to respect central government action. They are:

a. to preserve the peace, national unity and the indivisibility of the Republic;
b. to secure the well-being of the people of the Republic;
c. to provide effective, transparent, accountable and coherent government for the Republic as a whole.

Then a few general principles are mentioned underlining the distinctiveness of each sphere:

a. to respect the constitutional status, institutions, powers and functions of government in the other spheres;
b. not to assume any power or function except those conferred on them in terms of the Constitution;
c. to exercise their powers and perform their functions in a manner that does not encroach on the geographical, functional or institutional integrity of government in another sphere.

And, thirdly, general principles for intergovernmental relations, that is relations between provinces and central government and between provinces mutually

a. co-operate with one another in mutual trust and good faith by
b. i. fostering friendly relations;
ii. assisting and supporting one another;
iii. informing one another of, and consulting one another on, matters of common interest;
iv. co-ordinating their actions and legislation with one another;
v. adhering to agreed procedures; and avoiding legal proceedings against one another.
By Act of Parliament structures and institutions for the promotion and facilitation of intergovernmental relations have to be given. This has been done by amongst others the Intergovernmental Fiscal Relations Act. In the executive field (see para. 15) cooperative government is promoted by the many so-called MinMec Meetings. In such meetings Ministers consult their counterparts on the Provincial Executive Councils.

Executive powers

15. The President of the Republic of South Africa is the head of the national executive as well as the Head of State. In the latter capacity he signs the laws or may lay them before the Constitutional Court to check on their constitutionality. The President exercises his executive authority together with the other members of the Cabinet. He is chosen by the National Assembly from amongst its members in the first session after its election. He then ceases to be a member of the Assembly. He may be dismissed in case of serious violation of law or misconduct by a two thirds majority. The Ministers are appointed by the President. He assigns their functions and may dismiss them. The Constitution prescribes that a maximum of two Ministers may be selected from outside the Assembly, the others have to be members and stay member when they are functioning as a Minister. When the Assembly presents a vote of no confidence to the government the President has to appoint a new Cabinet, when the Assembly presents a vote of no confidence in the President the President and his cabinet has to resign and the Assembly has to appoint a new President.

In the Provinces similar constitutional rules apply as regards the executive function. The head of Government is called Premier and his cabinet consists of Members of the Executive Council (MEC’s). All MEC’s as well as the Premier have to be chosen by the provincial legislature out of its midst.

The Constitution allots expressly the supervision of provincial administration to the national executive. (S. 100)

If the national executive is of the opinion that a province does not fulfil an executive obligation it may state to it the steps required to meet that obligation. The national executive may also take over the responsibility to fulfil that obligation but only when essential national standards, economic unity or national security are at stake or the interests of another province or the country become into danger. Such intervention has to be brought to the notice of the National Council of Provinces which has to approve within 30 days of its first session after the intervention. After approval the National Council has to keep the situation under surveillance.

As regards the executive power of the province, the Constitution charges the provincial executive exclusively with the implementation of all provincial legislation. Moreover, the provincial executive is responsible for the implementation of all national legislation mentioned under the Schedules 4 and 5 (= concurrent and exclusive provincial legislative power, see para. 8). Outside areas mentioned in those schedules the executive power of the Province has to be specified in the relevant Act. The executive power of the Province however is dependent on an important proviso: a province has executive power only to the extent that the province has the administrative capacity to assume effective responsibility. The national government has to assist the provinces to develop administrative capacity required for the effective exe-
exercise of their powers. Terms and conditions of employment in the national as well provincial civil service are regulated by national legislation \(^\text{11}\). Disputes concerning the administrative capacity of provinces have to be referred to the National Council of Provinces and must be resolved 30 days after referral. (S. 125,4) This prescription makes the relationship between national and provincial administration to a high degree dependent on the effectiveness of the National Council of Provinces.

II . Intergovernmental financial relations

Introduction
16. In the second part of this article the regulation of the division of total government income between the different layers of government will be looked into in order to examine the constitutional and other legal guarantees for a sufficient income of the provinces which is congruent to their status under the constitution.

Chapter 13 of the Constitution of South Africa lays down the rules for an equitable division of revenue raised nationally between national, provincial and local spheres of government in order to provide basic services and exercise the functions allocated to each sphere. (S. 214,2d)

The Constitution also prescribes that the provincial governments have to be involved in the procedure for the division or revenue (S. 214,2) and establishes the guidelines for that division(S. 214, 2 a – j)

In the same chapter of the Constitution the general policy and the administrative requirements for the annual budgeting on the national and the provincial levels are laid down and Treasury-control on the implementation of these rules is established.

The Fiscal and Financial Commission
17. In the decision making process concerning all these aspects of intergovernmental financial relations an important role – albeit a consultative one - is reserved for the Fiscal and Financial Commission (FFC).

The Commission is established by the Constitution itself. (S. 220)

Its members are appointed by the President of the Republic of South Africa for a term of 5 years. They may be removed by the President on grounds of misconduct, incapacity or incompetence.

The Commission exists of a chairman and a vice-chairman who are full members, plus nine persons each representing a province and nominated by the Executive Council of a Province, and two persons nominated by organised local government plus nine other persons. The members need to have the appropriate expertise.

The Commission is independent, only subject to the Constitution and the law, and has to be impartial.

It is to make recommendations and advise the three spheres of government on issues that affect intergovernmental fiscal relations. Its main task is to advise on the requirements for each level of government in the division of national income and thus contribute to the system of allocation.

\(^{11}\) S. 197,2
The income position of the Province

18. The income of a province consists of its own resources, and transfers from the national government. Provincial government is moreover allowed to raise loans in accordance with reasonable conditions determined by national legislation. (S. 230,1) This legislation has not been established up to now. The provinces have a certain leeway in this respect as the Constitution allows them loans for current expenditure for bridging purposes during the current fiscal year and to be repaid within 12 months. In practice all intergovernmental cash is co-ordinated through a national instance, the Corporation for Public Deposits which results in lower borrowing costs.

As regards own resources: the South African Constitution empowers the Provinces to impose taxes. This taxing power is however rather limited. A provincial Government may not impose income tax, value added tax, general sales tax, rates on property or customs duties, it may impose flat rate surcharges on taxes nationally imposed except for the corporate income tax, value added tax, rates on property or customs duties. (S. 228) So only minor tax sources are constitutionally allotted to the Provinces. The use of the provincial taxing power may not prejudice national economic policies, inter-provincial economic activity or the national common market. Therefore a provincial tax has to be regulated by an Act of the National Assembly. (S. 228,2)

At the moment the provincial governments in the Republic of South Africa only raise 4% of their expenditure out of provincial taxes. They are dependent on transfers from the national government for 96% of their expenditure\(^1\). It is the intention to increase the own resources of the provinces in the course of time. An Act which regulates an intergovernmental process that must be followed by provinces in the exercise of their taxing power has entered into force on 10 December 2001\(^1\).

In the meantime the rules concerning the division of revenue nationally raised are the basis of financial security for the South African Provinces.

The Division of Revenue

19. As ordered by the Principles (see para. 6) the Constitution guarantees the Provinces an equal share of the revenue nationally raised (S. 214). This relates to all monies raised on the basis of national legislation. The Constitution guarantees in an equal way shares to the national and local spheres of government.

As regards the Provinces and the local sphere of government the Constitution adds the possibility (S. 214,1) of other, extra allocations from the national governments' share which might be made under conditions. It thus created a constitutional basis for providing (conditional) grants to the provinces next to their annual equitable share. The national government has to take the initiative in the division of the money. The division is to be performed by an Act of Parliament. In that Act the equitable shares for the 3 spheres of Government (= vertical division) have to be inscribed as well as the division of the provincial share over the 9 Provinces (= horizontal division) plus the special grants to the provinces.

The Constitution adds that provincial government, organised local government and the Financial and Fiscal Commission have to be consulted before the Bill is lodged. The Bill, being a money bill, has to follow the procedure of Section. 75 which requires the approval of the National Council of Provinces. In the case of disapproval a

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\(^1\) Intergovernmental fiscal review 2001, p. 15

\(^1\) Provincial Tax Regulation Process Act (Act No. 53, 2001)
conciliation procedure sets in which is in the end dominated by the national government. (see para. 12)

The Bill leads to the so-called Division of Revenue Act which is annually adopted by National Assembly at the same time as the annual Appropriation Act. The division of revenue is thus part of the adoption of the annual state budget.

20. The Constitution defines the criteria which have to be taken account of when deciding on the vertical and horizontal division of national revenue. Among the first are the needs and interests of the national government, determined by objective criteria; the next is: to ensure that the provinces and municipalities are able to provide basic services and exercise the functions allocated to them. (S. 214, 2d)

The following specific criteria are to be used for the horizontal division over the provinces:

- fiscal capacity and efficiency of a province and its developmental and other needs,
- economic disparities within and between provinces,
- obligations in terms of national legislation,
- the need for predictable and stable allocations, and
- the need for flexibility in responding to emergencies.

The criteria have to be applied in an objective way.

Section 227, 2 expressly forbids to deduct additional revenue raised by the provinces from their share of revenue raised nationally. A province is obliged to raise for itself any resources that it requires - commensurate with its fiscal capacity and tax base - and provide for such activity by a provision in its Constitution. (S. 227,4)

The Constitution also provides that a province has to receive its equal share of revenue promptly and without reduction (S. 227,3) except in the case of serious or persistent material breaches of the prescribed measures to ensure transparency and expenditure control. (S. 216,2) In that case the Treasury, backed by the member of Cabinet, may stop transfers. This refers to the requirements imposed on the provincial governments in the Public Finance Management Act regarding sound financial governance and budgeting). The Act has been implemented for the first time in the 2000/2001 fiscal year.

21. The actual division of revenue is achieved in a process of consultation before the Division of Revenue Bill is introduced by the national government. The national government rounds this process of consultation off by deciding on the amounts which will be inscribed in the Bill.

The process is regulated by the Intergovernmental Fiscal Relations Act which is designed to facilitate and guarantee the system of consultation to promote a fair budgeting process.

The Act has institutional aspects and procedural ones. It established a Budget Council in which the national government and the provincial governments consult on fiscal, budgetary and other matters affecting the financial position of the provinces. It is chaired by the national Treasurer and each province is represented in it by its Member of the Executive Council for finance. The Act also established a local Budget Forum in which national government, the provinces plus organised local government are represented.

14 Act No. 1, 1999 as amended by Act No. 29, 1999
15 Act No. 97, 1997
The recommendations of the Financial and Fiscal Commission - which have to be delivered ten months before the start of each financial year – are the basis for the deliberations in the Budget Council on the division of national revenue. The recommendations are also sent to both houses of Parliament and to the provincial legislatures. After the consultations and deliberations in the Budget Council have taken place the Treasurer introduces the Division of Revenue Bill in the National Assembly. The Bill is to be accompanied by a memorandum explaining how the constitutional criteria have been taken into account, how the recommendations of the FFC have been followed up, and which criteria and assumptions were used by the national government in arriving at the proposed shares. This memorandum is part of the Review of the Budget which accompanies the Appropriations Bill. The policy followed in the division of revenue in the year under consideration is set out in the Intergovernmental Fiscal Review, which complements the Budget Review.

The 2001 Budget

22. The preceding paragraphs 16 – 22 deal with the constitutional and other legal rules concerning the intergovernmental financial relationship in South Africa. This description is "illustrated" in the following paragraphs by an analysis of the state budget for the fiscal year 2001 – 2002 with an accent on the Division of Revenue Act 200116.

23. From the explanatory notes accompanying the budget, that is the Budget Review and the Intergovernmental Fiscal Review, it becomes clear that the Republic of South Africa is very much a country in development. The main policy target of the national 2001 -2002 budget is to spread in an equal way the delivery of social and basic services so as to give S.A. citizens access to education, health care, social development, housing, roads and the basics like water, electricity and refuse removal, and thus to repair the inequalities of the foregoing period under the "Apartheids regime".

The elaboration and implementation of this policy is very much the task of the provinces as well as of local government.

24. As regards statistics: South Africa and is a middle-sized economy with an estimated GDP in 2001 of R965,2 billion and has a population of 43,3 million. Estimated total national expenditure amounts in the fiscal year 2001/2002 to R258,3 billion, or 26,2% GDP. The deficit is supposed to amount to R24,9 billion or 2,5 % GDP.

Total debt service costs in 2001/2002 are estimated to be R48,1 billion or 4,9% GDP, that is 18,6 % of total government expenditure in 2001/2002. A large imbalance of the income/expenditure ratio exists between the national and the provincial governments. National government income is 2,3 times larger than its own expenditure. Total provincial own income is 27 times smaller than total provincial expenditure.

25. Income raised by the national government consists for 98% out of tax-revenues. Total resources shared between the three spheres of government include the proceeds of borrowing by the national government.

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16 Act No. 1, 2001
From the total resources to be shared the costs of national debts is firstly deducted on the basis of S. 214, 2a of the Constitution. To that, a general national reserve of a R2 billion. is added, which leaves an amount of R208,2 billion for division in the fiscal year 2001 – 2002.

The Division of Revenue Act 2001 allotted 40,2% of this amount to the national government, 56,6 % to the provincial governments and 3,1% to the local governments. The large provincial allocation is explained by the provincial responsibility for the implementation of major social services, including school education, health (primary care and hospitals), social grants and welfare services, housing and provincial roads.

The transfers to the provinces will for 11,3 % consist of conditional grants and for 88,7 % of equitable shares17.

**Conditional grants**

26. Conditional grants have been introduced into the intergovernmental financial system by the 1998-1999 state budget. Their aim is to provide for national priorities in provincial budgets, to promote national norms and standards, to compensate for cross province externalities and to support capacity building and structural adjustment. Sometimes the conditions include matching requirements.

The grants are made under the responsibility of the relevant national department and the amounts are included in the expenditure side of its budget. Being part of the Division of Revenue Act the allotment of conditional grants and their horizontal division is covered by the recommendations of the Fiscal and Financial Commission and is subject of deliberation in the Budget Council.

By far the biggest portion of conditional grants relates to health (42%), followed by Housing, Finance, Education and Social development. About 10% of the expenditure of the national Health department in its 2001/2002 budget is to be spent on conditional grants to provincial governments.

27. Conditional grants may be divided in 2 classes:

- **Block grants**
- Specific grants

**Block grants** are large allocations to complement equitable share allocations. They are not earmarked for particular projects or spending programs. They are allotted to fund functions assigned to provinces. Sometimes they are allotted because provinces are not compensated adequately for spill-over effects through their equitable share.

Block grants amount to 50% of conditional grants.

There are 3 such block grants.

Two block grants are administered by the national department of health providing general funding for hospitals in provinces in which central and/or academic hospitals are located, and also for funding professional training in health.

The third block grant is the Supplementary Allocation Grant administered by the national Treasury. This grant is general budget support grant to encourage good budgeting and financial management practices. This grant has also been used to consolidate various small grants and thus effected a streamlining in grant administration.

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17 Budget Review 201, p. 242
Specific grants support specific priorities and interventions by the national government. They require monitoring. Payment may be withheld on failure to comply with the conditions attached.

There are two categories of specific grants:

- Infrastructural grants
- Recurrent grants

Infrastructural grants are allotted to assist provinces address infrastructure backlogs in education, health, roads and rural infrastructure and to repair flood damage.

These specific grants are administered by the national departments of Health and of Housing together with the national Treasury. The greater part of these specific grants (61%) concerns Housing.

Other specific grants fund recurrent spending. The major grants in this category target improvement of financial management.

- The grants are administered by the national departments of Education, Health and Social Development plus the national Treasury.
- The Department of Provincial and Local Government allocates grants to provinces to enable them to support municipalities in financial difficulties.
- Other recurrent grants provide for direct support for service delivery. Among these grants is a grant for implementation of an integrated strategy for the prevention of HIV/AIDS.

Development of the conditional grants-system

The South African grants-system is still in development. It is part of the restructuring of the state, which started under the Interim Constitution after the “Apartheidsregime”. The provincial governments needed time to become operational after 1994 when they had to merge 17 different administrations into 9 new ones. Moreover, since the budget-process was fully centralised before 1994, provinces had to develop capacity and expertise, and set up their data-collecting which is still not fully harmonised.

The money transferred under the conditional grants-system is being paid in accordance with the payments schedules agreed between the national and provincial authorities. Neither national nor provincial authorities monitored actual spending. Provinces have only recently set up their systems so that they can report more accurately on grants spending.

The task of developing a system of public finance, which provides transparency and accountability, falls on the national government which brought about the Public Finance Management Act in force since April 2000 (see also para 20). The Public Finance Management Act introduced accountability and formulates a framework for the management of cash. It also established a system of internal audit. The Act sets reporting requirements for conditional grants thereby improving planning and management. Provinces will have to prepare implementation plans based on a policy framework which has to be provided by the national authorities. This policy-framework has to include objectives as well as criteria for allocations between provinces. The Act is applicable to the national and provincial governments and the public entities under their ownership.

The main emphasis in the first year of implementation has been on developing the capacity of national and provincial authorities to implement the Act.
Equitable shares

29. In the National Budget for 2001/2002 the equitable share for the provinces is inscribed under the heading Standing and Statutory appropriations. In the triennial estimate the amount rises from R104.1 bill. in 2001/2002 to R120.2 bill in 2003/2004, which represents a rise of 15% over a three-year period.

This amount is part of the vertical distribution of total national government revenue over the three spheres of government. The total provincial share reflects a political decision on the priority of provincial functions amongst those of national and local government. The total provincial share is about 25% larger than the national government's share, local government got an allocation which amounted to 2½ % of the provincial share.

The equitable shares are allocated between the provinces (horizontal distribution) in accordance with a formula based on the recommendations of the Financial and Fiscal Commission of 1996 and first practised in the Fiscal year 1997/1998.

The formula is a proportional distribution formula and attempts to capture the relative demand for services between provinces and to adjust for particular provincial circumstances. The formula is updated every year taking into account changes in statistical data and is reviewed every 5 years.

In accordance with the formula as implemented for the 2001/2002 fiscal year, the total of the provincial equitable share for the provinces has to be divided in 7 components:

- 7% of the amount is set aside and divided over the provinces taking into account each province's share in population
- 5% is set aside and divided taking into account the institutional costs of running the government of the province
- 41% of the amount is allotted to the provinces for education purposes and shared on the basis of average school age populations and the number of pupils
- 19% is a health share and is to be divided in proportion to the population without access to medical aid funding
- 17% is the social security component to be divided over the provinces based on the estimated number of people entitled to social security grants, weighted by using a poverty index derived from the latest income and expenditure survey
- 3% is a backlog component based on the distribution of capital needs for schools and hospitals and of a share in rural population
- 8% is the so-called economic output component based on each province's share in total remuneration in the Republic of South Africa.

The amounts allotted to each province under each of the seven components are added, and their total is the equitable share of that province. The provincial governments are free to spend the money allotted to them as their equitable share.

The result of the formula is that more funds per capita are allocated to the poorer, rural provinces. Four of the nine provinces have an equitable share per capita, which is below the average. The province of Northern Cape receives the largest share per capita, whilst the lowest equitable share per capita is allotted to Gauteng. The difference between the shares of the two provinces is R. 13.3 billion, which is 12% of the total equitable share allotted to the provinces in the vertical distribution.

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18 Budget Review 2001, p. 146/147
19 Budget Review 2001, p. 147
30. By using the above formula the South Africa Government deviated from the recommendations put before her by the FFC for the 2001 – 2002 fiscal year. In those recommendations the FFC introduced a costed norm approach for the distribution of the equal shares over the provinces. The costed norm approach would have to be implemented on funds needed by each provincial government to provide for basic levels of service in primary health and social security services and in basic education. Moreover, institutional costs had to be separated form the "net" costs and had to remain at the lowest possible level. The national government was only prepared to accept the costed norm approach as an analytical tool, where sufficient data were available. It rejected – in accordance with a resolution adopted by the Budget Council - the approach as a criterion for decision on the amounts of the equal shares. Their main objection was that the costed norm approach would destabilise patterns in a slowly growing experience in financial governance. Moreover this approach seemed less appropriate to determine budgetary priorities which require political judgement in making difficult trade-offs. The use of the costed norm approach would undermine the principle of provincial budgetary autonomy and would weaken accountability. The difficulty of setting the standards, which would have to be implemented on a national scale, would arise and the difficulty of equating policy goals and standards. The national government also found that the process would create a bias in favour of the services that could be more easily costed over the ones that could not. A very practical objection was that the crucial data required for developing cost estimates were not available.

Final Conclusion
31. The 1996 Constitution presents the possibility for the Republic of South Africa to develop into a federal state.

In the division of powers the Constitution seems on first sight to favour the national government by its accent on national programs and the necessary uniformity of legislation. However, the rather broadly worded definitions of the powers allotted to each of the three spheres of government may work out in favour of the provinces as well as in favour of central government. Much depends in this respect on the activity deployed by the provinces and on the effectiveness of the National Council of Provinces acting on behalf of the provinces and their autonomy. Especially the possibility that national law and provincial law may exist next to each other as long as inconsistency between both laws is avoided gives provincial legislatures scope. The constitutional prescription that legislation with regard to a matter which is reasonably necessary for or accidental to the effective exercise of a power concerning any matter in the area of concurrent power is for all purposes legislation with regard to that matter, also offers the provinces leeway. In the national legislation procedure the provinces find guarantees to hold their own in the national legislature.

However, federation-building does not seem to be one of the main policy targets in South African politics. The lack of enthusiasm in most provinces to make use of the possibility offered by the Constitution to adopt a provincial constitution is one indica-

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20 Budget Review 2001, p. 235
21 Sections 44,3 and 104,4.
tion of this. The provinces lack the political environment of their own to make this a natural ambition. The provincial legislatures are dominated by the same political parties which dominate the national Assembly and which have mainly their sights on national policy targets.

This situation is scarcely surprising as the Republic of South Africa was very much organised as a unitary state with strong central powers until the adoption of the introduction of the 1993 interim Constitution. The legal and administrative framework for a federal-like state has still only partly been elaborated.

The constitutional regulation of the financial relations between the national and provincial governments does not contribute to a budding out of the South African provinces into federal states. The Constitution favours the central government by guaranteeing it the revenues of the main tax-sources, the provinces only got the broad guarantee that the central government is to share its income with them. As regards the criteria for this sharing the national financial needs are underlined as first priority. The fact that already 70% of the expenditure of the provinces is on social security benefits and public service salaries, which are all detailed in national legislation, indicates the very restricted financial leeway provinces have, whilst the push that the national government showed in developing the grants system indicates its willingness to use its financial superiority.

As regards the horizontal distribution over the 9 provinces, the disparity of fiscal and economic capacity within and between provinces and the needs for stable and predictable allocations supporting development are formulated as determining criteria. However, no fine-tuning of the equalisation concept is undertaken in the Constitution or the law.

Equalisation is mainly pursued by the national programs on health, education, housing etc. which are elaborated by the national government.

The actual decision on the amounts allocated in the horizontal distribution is left to the national cabinet. Effectiveness as general principle for the sharing of power (see para. 4) is thus easily made into an important guideline for the vertical and horizontal division of revenue by the national government. Arbitrariness is, however, somewhat checked by the transparency of the division of revenue process brought about by all the explanations which have to be given in accordance with the Intergovernmental Fiscal Relations Act.

As regards institutional aspects in the field of public finance the Constitution created the Fiscal and Financial Commission (FFC) which could - in co-operation with the National Council of Provinces - create for itself a consultative but authoritative role in the annual division of revenue. It seems too early to conclude on the success of this formula. The FFC devised indeed the method which is used for the horizontal division of income but its standing in future is still an open question. The national legislature created a counterbalance by the Act which established the Budget Council. In this body the division of revenue is actually negotiated between the national and provincial treasurers before the decision is taken in the national cabinet (see para. 22).

In short, the constitutional regulation of the financial relations between the South African provincial and central governments leaves the central government ample opportunity to limit provincial power and does not seem supportive for a development of the Republic of South Africa into a federal state.

Official documents:
Constitution of the Republic of South Africa Act No. 200, 1993
Public Finance Management Act No. 1, 1999
Provincial Tax Regulation Process Act No. 53, 2001
Division of Revenue Act No. 1, 2001
Appropriation Act No. 18, 2001
South Africa Yearbook 2001/02
ABSTRACT

The financial relationship between national and provincial governments in South Africa

by Edward Roberts (May 2002)

The article is about the position of the South African provinces under the Constitution of South Africa, and more especially about the question does the Constitution guarantee them sufficient revenue as well as powers.

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