ANNEXURE E:

MEMORANDUM TO ACCOMPANY THE DIVISION OF REVENUE BILL

INTRODUCTION

Section 10(5) of the Intergovernmental Fiscal Relations Act, 1997 (Act No 97 of 1997) requires the Division of Revenue Bill to be accompanied by an explanatory memorandum detailing how the Bill takes account of the following:

- each of the matters listed in section 214(2)(a) to (j) of the Constitution;
- any recommendations of the Financial and Fiscal Commission; and
- any assumptions and formulae used in arriving at the respective shares contained in schedules 1 and 2 of the Bill.

The 1998 Budget includes estimates covering the three years from 1998/99 to 2000/01, consistent with the medium term expenditure framework. The Division of Revenue Bill and this memorandum address only the 1998/99 financial year, as these are the amounts that Parliament will appropriate this year.

SECTION 214(2) OF THE CONSTITUTION

According to section 214(2) of the Constitution, the equitable division of revenue raised nationally and other allocations from the national share should give consideration to the following ten factors:

- the national interest;
- any provisions that must be made in respect of the national debt and other national obligations;
- the needs and interests of the national government, determined by objective criteria;

INTERGOVERNMENTAL FISCAL RELATIONS ACT

Intergovernmental financial and fiscal relations are critical for the smooth functioning of government in South Africa. The Constitution deals with a number of matters of importance to public finance: cooperative governance, the equitable division of revenue among the spheres of government, the setting of norms and standards for Schedules 4 and 5 functions, the regulation of budgets, treasury norms and standards, and monitoring and intervention mechanisms.

The Intergovernmental Fiscal Relations Act, 1997 (Act No 97 of 1997), which came into effect on 1 January 1998, establishes a process for considering intergovernmental budget issues. It regulates the budget process as outlined in section 214 of the Constitution. In addition, it promotes cooperative governance in the budget process, in line with section 41 of the Constitution.

The Act requires the Financial and Fiscal Commission (FFC) to make recommendations concerning the division of revenue between the three spheres of government – national, provincial and local – and to submit these recommendations ten months before the start of the financial year. It further requires the Minister of Finance to consult the provinces, local government and the FFC about these recommendations. The Act establishes intergovernmental bodies, such as the Budget Council and the Budget Forum, to facilitate such consultation. The Act specifies that the Minister must present a Division of Revenue Bill indicating the final allocations to the different spheres and the nine provinces and submit along with the Bill a memorandum of explanation.

The Division of Revenue Bill for the 1998/99 financial year, to be introduced by the Minister on Budget Day, gives effect to section 214 of the Constitution, which requires that an Act of Parliament must provide for:

- the equitable division of revenue raised nationally between the three spheres;
- the determination of each province’s equitable share; and
- any other allocations to the provinces, local government or municipalities from the national share and any conditions associated with these allocations.

Accordingly, the Division of Revenue Bill states the allocations to each of the three spheres as well as each province’s equitable share. It also provides details of other allocations from the national share to provinces, local government and municipalities. These allocations are assigned for a variety of particular purposes and often subject to specific conditions.

It should be noted that while the Constitution and the Act require details on the allocation of the provincial equitable share between the nine provinces, neither has a similar requirement with regard to the division of the local government equitable share between the various municipalities. For this reason, the Division of Revenue Bill only presents the total allocation going to local government as a sphere, not the specific allocations to municipalities. This information, however, will be published shortly after the release of the 1998 Budget.

- the need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them;
- the fiscal capacity and efficiency of the provinces and municipalities;
- developmental and other needs of provinces, local government and municipalities;
- economic disparities within and among the provinces;
- obligations of the provinces and municipalities in terms of national legislation;

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

The national interest

The fundamental objective of Government is to pursue the creation of a democratic, non-racial, non-sexist and prosperous society. To this end, it adopted the *Reconstruction and Development Programme* (RDP). The RDP provides a broad point of departure for social and economic development planning. There has been an extensive elaboration of detailed policies, strategies, plans and programmes to achieve Government's reconstruction and development goals.

One of the principal instruments for the realisation of the policy objectives of the RDP has been Government's macroeconomic strategy, known as the *Growth, Employment and Redistribution Strategy* (GEAR*)*. This integrated macroeconomic strategy was adopted to deliver job creation, improved export performance, more savings and investment in human and capital resources. It supports a redistribution of income and opportunities in favour of the poor. The fiscal framework outlined as part of the RDP and GEAR establishes the parameters for budget expenditure and the amounts available to allocate between the spheres.

The final budget allocations are the outcome of the medium term expenditure framework (MTEF), an expenditure planning process aimed at meeting the goals and objectives of the RDP. As a first step in this process, the national government and the nine provinces each received three-year indicative allocations consistent with the macroeconomic strategy. After developing preliminary budgets based on these allocations, and taking into account existing and new policy commitments, representatives of national and provincial treasuries and line departments prepared detailed analyses and reviews of the implications of these allocations. These analyses along with policy options were presented to an extended meeting of Cabinet, which included the provincial premiers. A summary of these findings was also published in the *Medium Term Budget Policy Statement* to ensure the broadest possible participation in the budget-making process.

In addition to the MTEF process, this year saw a marked expansion of consultation and coordination in intergovernmental financial relations. The Budget Council met ten times during the period leading up to the 1998 Budget. The Technical Committee on Finance, which includes national and provincial treasury officials and supports the work of the Budget Council, met seven times. The FFC were invited as participants in all of these meetings. There were also numerous bilateral meetings between national and provincial departments on budget-related issues.

Overall, this budget process was aimed at ensuring that all aspects of the national interest received due consideration. It also led to several specific budget reforms. The health conditional grant is such an example. Past inequities have resulted in a geographically distorted health care system, with the delivery of tertiary care and medical training functions concentrated in four provinces. These services are not restricted to the residents of these provinces, but these provinces must nonetheless bear the cost of these facilities. Recognising the importance of central referral hospitals and medical training facilities as national resources, conditional grants have been introduced to support these services and address the financial implications of cross-boundary flows.

National debt

Special provision is made in respect of the national debt when determining the allocations. The cost of servicing the national debt is set aside before making allocations to the three spheres in recognition of the obligatory nature of the payment. This approach demonstrates Government's commitment to meeting its debt servicing obligations, thereby allowing it to borrow at the lowest possible interest rates. Similarly, Government's statutory contributions to certain international organisations are also set aside as non-discretionary commitments.

National government needs and interests

The Constitution assigns specific functions to the three different spheres of government. The needs and interests of the national government are defined by this assignment of responsibility as well as by the policy goals presented in Government's *Reconstruction and Development Programme*. Numerous pieces of national legislation have been promulgated to establish specific objectives to guide the operations of national departments. These objectives are taken into account in compiling budget submissions and during the ensuing budget process. Departmental policies, strategies, plans and programmes informed the MTEF analyses of the policy implications of budget allocations presented to Cabinet and published in the *Medium Term Budget Policy Statement.* The availability of this information ensured that the needs and interests of the national government, based on objective criteria, were considered fully when the final budget allocations were made.

The national budget includes provisions for general administration, representation of South Africa's interests internationally, the protection of law and order, support for an extensive set of reconstruction and development initiatives and growing allocations for higher education, skills development, housing and other social development objectives. The national budget also includes provision for specific needs, such as the forthcoming elections, labour-based poverty relief projects and improved management information and financial administration in government.

Conditional grants to provincial and local governments are also means by which the needs and interests of the national government are taken into account. In the new intergovernmental system, broad policy guidelines and norms and standards are set at the national level but, in many cases, the policies are actually implemented by the provinces and local government. Conditional grants are funds on the budget of national departments that are allocated to provincial and local governments. They provide a vehicle to ensure that the objectives of a national department are supported at the level where the service is actually provided.

Provincial and local basic services

The allocations to the provinces and local government are also informed by the functions assigned to them under the Constitution and the analysis provided through the MTEF process. MTEF teams, which included representatives from both national and provincial departments, were assigned to analyse the three major provincial services – education, health and welfare. In addition, task teams led by the Departments of Finance and State Expenditure have worked with provinces to review the funding needs associated with these core services and other provincial functions. The findings of these various teams informed the final allocations to the provinces in the Division of Revenue Bill.

The division of the provincial equitable share between the provinces – known as the *horizontal division* – is informed by the need of provinces to provide basic services. The equitable shares formula includes components directly related to the demand for education, health and welfare services in each province. For instance, the education component takes into account the number of school-age children and the number of those actually enrolled. Similarly, the health component is based on the proportion of the population without private health insurance and weighted in favour of women, children and the elderly – in keeping with the patterns of demand for public health care services.

The elements of the equitable division formula are not indicative budgets. The education, health or social security shares, for instance, are not conditionally allocated to these functions. Provinces budget for these functions within their overall resource constraints, informed by their own processes of prioritising spending within the context of national policies. This ensures that each province has both the budgetary responsibility and flexibility to provide basic services and perform the functions allocated to it. On the other hand, it is important for a province to make sure that adequate funds are provided for these basic services within its total allocation. A conditional grant of R2,8 billion is available to the provinces in 1998/99 to guard against shortfalls in the provision of basic services. The R2,8 billion is allocated by an equitable formula, but a province can only receive its share after it has enacted a credible budget, particularly as regards funding of education personnel, health personnel and welfare grants. The role of the national Departments of Finance and State Expenditure in this respect is to provide assistance and capacity building in line with section 125(3) of the Constitution.

This year marks the introduction of the equitable share for local government. This will replace the existing patchwork of grants for the operating costs of local government. Funds are allocated based on a formula aimed at providing support for the extension of basic services to low-income communities. The new system will be phased in gradually over five to seven years, with existing allocations replaced incrementally. To further guard against any disruption of basic municipal services, the Division of Revenue Bill includes conditional grants to the provinces to support local government operating costs, particularly personnel in R293 (former homeland) towns. Capital transfers to local government, such as the consolidated municipal infrastructure programme and the rural water supply and sanitation programme, are also financed as conditional grants from the national share.

Fiscal capacity

The size of the equitable shares takes into account the ability of each sphere to raise its own revenue. This ability to raise revenue, known as fiscal capacity, differs across the spheres. The national government raises more revenue than it needs to fulfil its obligations, and thus transfers funds to the other two spheres. Provinces have only limited sources of own-revenue available to them, and thus receive a far larger share of national revenue than local government, which is largely self-supporting. It is in this sense that each sphere’s “equitable” (rather than “equal”) share takes into account their relative fiscal capacity.

The revenue sharing formula used to calculate the horizontal division between provinces is equity-enhancing in its principal demographic components. In addition, it includes an economic output component that directs a portion of nationally collected revenue back to the provinces where the revenues are generated. This serves as a proxy for the provincial own-revenue that would be raised if provinces were to introduce their own taxes.

Section 228 of the Constitution envisages expanded tax-raising powers for the provinces, which would in part reflect a transfer of existing tax capacity to the provinces. This would reduce the nationally raised revenue available for redistribution to the provinces as part of their equitable share. Because of this link between provincial own-revenues and the equitable share, it will be necessary to change the quantum of the tax shares component as provincial revenue-raising powers expand. At some point, it may become appropriate to transform the tax shares component into a fiscal capacity equalisation grant, as proposed by the Financial and Fiscal Commission.

Efficiency

Efficiency considerations enter the revenue sharing formula in several ways. Taking into account the dynamics of economic growth and development, both the provincial and local government equitable shares will be phased in over a period of five to seven years. The provincial and local government budget allocations start from current spending trends, which capture the relative efficiencies and inefficiencies in the system. The phase-in period allows for provinces and municipalities to adjust as the system moves toward purely formula-based, equity-driven allocations and inefficiencies are systematically removed.

In addition, the economic output component of the provincial formula recognises that the demand for infrastructure and public services is positively associated with economic output, independent of demographic factors. The health conditional grants allow for the consolidation of expensive referral and clinical training functions in a limited number of central hospitals.

Overall, Government recognises the importance of efficient service delivery in all spheres, and has established special initiatives to promote improved financial management and expanded capacity in the public sector. The 1998 Budget includes R100 million to improve financial management in the public sector. The Department of Education vote also includes R200 million to address management and quality concerns in the education sector. Similarly, R100 million is on the vote of the national Department of Welfare for social security management and information systems.

Developmental needs

The allocations to provinces and local government address developmental needs both indirectly through the equitable shares formulae as well as directly through conditional grants. For instance, the distribution of the basic shares component of the provincial revenue sharing formula reflects each province's share of total population, adjusted so that people living in rural areas are given an extra 50 percent weighting. This directs additional funds to provinces with large rural populations to help address the special developmental needs and backlogs that exist in rural areas.

Specific conditional grants are targeted at developmental needs. The allocation to the provinces includes conditional grants for the completion of RDP primary school nutrition and school building programmes. The provincial health grant includes funds to promote the development of tertiary care services in those provinces that currently lack such facilities. The Division of Revenue Bill also refers to the R2,9 billion that is to be allocated to provincial housing authorities to subsidise the construction of housing for low-income households.

For local government, funds have been set aside in the national share for the consolidated municipal infrastructure programme and rural water supply and sanitation programme, both of which address developmental needs through the extension of basic infrastructure to poor communities. The local government equitable share supports the operating costs of these infrastructure projects.

Economic disparities

The Constitution also requires that the allocations give consideration to economic disparities within and among the provinces. As noted above, recognising these disparities among the provinces is at the heart of the equitable share formula, which relies on the demographic and economic profiles of the provinces to calculate the allocation of funds. Special factors – such as rural weighting and tax shares – have been included in the formula to capture these disparities and the needs that arise from them. Only by allocating funds on an equitable basis will it be possible to overcome these economic disparities.

Addressing economic disparities within provinces is largely the responsibility of the provincial governments themselves. But the national budget supports the process of reducing economic disparities within a province through, for instance, funding the consolidated municipal infrastructure programme. A province allocates this grant to municipalities according to the province's planning and developmental priorities.

The redistribution of fiscal resources is essential to addressing economic disparities and achieving equity in the provision of basic services. To fulfill the goals of the RDP, the economy must grow and create jobs. The expansion of the economy in a manner that yields rising living standards for all is a cornerstone of the macroeconomic framework supporting these allocations.

Obligations in terms of national legislation

Both the equitable share and other allocations are intended to allow provinces and municipalities to meet obligations imposed by national legislation, while retaining responsibility for budgetary management and programme implementation. Ensuring that sufficient funds are available to meet these obligations is crucial to the success of the intergovernmental system. Task teams comprising the national Departments of State Expenditure, Finance, Public Service and Administration, Education, Welfare, and Health have worked closely with the provinces throughout the year to align available resources with obligations. Within each sector, intergovernmental meetings of Ministers and provincial MECs review these issues. The Budget Council and the Budget Forum serve to resolve spending pressures within a framework of cooperative government.

The provincial revenue sharing formula takes into account obligations in terms of national legislation in at least two ways. First, the division of resources between the national and provincial spheres reflects the latest information concerning the assignment of functions. The guiding principle concerning the treatment of function shifts is that funds must follow responsibilities. For instance, beginning in 1997/98 the national government assumed responsibility for the approximately R2 billion cost of servicing the debts of former homelands. These costs had been borne by the provinces. As a result, the division of funds between the two spheres shifted in favour of the national government to reflect the reduction in the obligations of the provinces.

Second, some of the specific components of the revenue sharing formula are designed to reflect the requirements of national legislation. For instance, the welfare component relies on demographic data consistent with the population eligible for social security payments. It reflects children up to age six, who are eligible for the new child welfare grant, and women over age 60 and men over age 65, who are the eligible population for old-age pensions. The base for all other social security grants, including disabilities, is the population as a whole. In addition, it includes an income-related adjustment intended to capture the impact of the qualifying means-test on the number of beneficiaries.

Obligations that demand resources beyond those available represent unfunded mandates, and must be avoided. Provinces and municipalities must have some flexibility in the way in which they meet national obligations. On the other hand, they must act in terms of national norms and standards, as prescribed by the Constitution. Intergovernmental institutions are crucial to the success of the system. Substantial progress has been made in clarifying the roles and responsibilities of these institutions.

Stable allocations

The need for stable and predictable allocations of revenue shares is essential to improve planning, particularly during this period of significant transformation. It is for this reason that the equitable shares formulae for both provincial and local government are phased in. Although it is the intention to break from the funding policies of the past, sufficient time has to elapse to enable provinces and municipalities to adapt to the new funding arrangements. A phase-in period of five to seven years, consistent with the recommendations of the Financial and Fiscal Commission, is therefore used.

The introduction of the medium term expenditure framework (MTEF) will also increase stability and predictability in allocations and thus improve planning. As part of the MTEF, allocations were presented for three years. National and provincial departments prepared three-year budgets consistent with these allocations. These budgets will be the base for next year’s budget process, and any changes will have to be justified in terms of revised macroeconomic assumptions or specific policy changes. Moreover, stability is further promoted by the publication of these budgets, which increases transparency and commitment.

Finally, Government has resolved that the equitable shares for a given financial year are to be based on estimates of nationally collected revenues announced in the budget for that year. Allocations will not be affected if actual revenue collections deviate from the anticipated amounts. Thus provinces and local government will know their allocations at the beginning of the financial year. Moreover, the Bill calls for the Director General: Finance to determine a payment schedule setting out the amounts to be transferred to provinces on a weekly basis. Similarly, the Bill requires the Director

General: Finance, after consultation with the Director General: Constitutional Development, to determine a payment schedule for local government.

Need for flexibility

The Constitution recognises the need to retain some flexibility to respond to emergencies or other temporary needs. As in past years, the 1998 Budget includes a contingency reserve to address these issues. Moreover, the size of this reserve is larger in the outer years, recognising that expenditure projections over the medium-term are inherently more uncertain. Over the course of the next three years there are likely to be changes to macroeconomic conditions and Government's policy priorities as well as unforeseen emergencies and expenditure pressures. To the extent that these can be accommodated within the contingency reserve, disruptions to existing plans are mitigated.

The Intergovernmental Fiscal Relations Act envisages a budget process with an appropriate degree of flexibility to respond to changing circumstances. The planning process begins ten months before the start of the fiscal year, allowing ample time for adjustments and consultation. Intergovernmental forums are established to keep the relevant parties aware of changing circumstances that may have financial repercussions and to facilitate consultation, both before the financial year begins and after it gets underway. Indeed, cooperative governance as represented by these institutions is the centre-piece of an intergovernmental system that will promote the requisite stability and flexibility to ensure the realisation of Government's reconstruction and development goals.

FINANCIAL AND FISCAL COMMISSION RECOMMENDATIONS

The Intergovernmental Fiscal Relations Act requires the Financial and Fiscal Commission (FFC) to make recommendations regarding the equitable division of revenues collected nationally. The recommendations must cover all the allocations envisaged in section 214(1) of the Constitution and take into account all the requirements in section 214(2). Under the Act, the FFC must submit its recommendations to the Minister of Finance, Parliament and provincial legislatures at least ten months before the start of the financial year.

1998 Budget process

The preparation of the 1998 Budget began well before this Act was enacted, and thus followed a different route. The Budget Council and Cabinet accepted initial recommendations concerning the equitable division in May 1997. These indicative allocations took account of previous FFC recommendations. At the request of the Budget Council, the FFC provided comments on these proposals. Revised recommendations were submitted to the Budget Council and Cabinet in November 1997, and they were subsequently published in the *Medium Term Budget Policy Statement.* The FFC responded in terms of the Intergovernmental Fiscal Relations Act on 9 January 1998. By agreement, these recommendations reflected a summary of FFC proposals submitted in previous years and comments on the proposals that appeared in the *Medium Term Budget Policy Statement.* Beginning with the 1999 Budget process, however, the FFC is expected to submit detailed recommendations on the equitable division at an earlier stage, consistent with the Act.

Agree on principles

The final allocations in the Division of Revenue Bill incorporate the recommendations of the FFC in two ways. First, they adhere to the broad principles promoted by the FFC in its reports. The FFC has consistently advocated an objective formula based on demographic data as the proper method for calculating each province's equitable share. The final provincial equitable allocations are derived from a formula similar in design to that proposed by the FFC.

Second, the final allocations reflect specific proposals made by the FFC. The FFC was consulted before the revised allocations were submitted to Cabinet in November, and several specific changes to the formula suggested by the FFC were incorporated. In particular, the FFC provided extensive assistance in revising the health and welfare components of the equitable shares formula. Another FFC recommendation, which involved adjusting the formula to take into account expenditure outcomes in earlier years, was adopted for purposes of the final allocations.

Recommendations not taken into account

Although Government found the advice of the FFC valuable in finalising the 1998 Budget, certain recommendations were not accepted. In particular, the FFC expressed certain concerns regarding this year's budget process and the sequencing of decisions. These issues will be addressed in the budget process for 1999/2000. Some of the FFC recommendations have resulted in further investigation, such as the proposed surcharge on the personal income tax. Indeed, the FFC notes in its report that "some of these problems do not have simple solutions." To this end, Government agrees with the FFC suggestion that "the dialogue between the Commission, the Department of Finance and other relevant players (including provincial treasuries and local government) becomes a dynamic source of debate and improvement in the system."

Equitable shares formula

The provincial equitable shares formula takes as its point of departure the recommendations of the FFC, particularly as they are presented in the *Framework Document for Intergovernmental Fiscal Relations in South Africa* (June 1995) and *Recommendations for the Allocation of Financial Resources to the National and Provincial Governments for 1997/98* (May 1996). Consistent with the FFC proposal, this formula is also phased in over a five-year period. The final allocations in the Division of Revenue Bill, however, reflect five notable departures from the FFC approach presented in these documents.

Census data

First, the FFC relied on estimates of population and population growth based on data provided by the Demographic Information Bureau and the Development Bank of Southern Africa. This was prior to the availability of the new census data, and the FFC noted that it would adopt the official statistics after the census was completed. The final allocations reflected in the Division of Revenue Bill use the preliminary results of the 1996 census, including estimates of the age distribution by province prepared by the Department of Finance in consultation with the Central Statistical Service. The full census results will become available during 1998. Once firm evidence of inter-provincial migration trends become available, it will also be possible to adjust provincial allocations for variations in population growth.

Weighting of equitable shares components

Second, although the two formulas have many of the same components, they rely on somewhat different methods for calculating the provincial shares. The FFC approach involves estimating the costs of achieving certain minimum standards implicit in Government policies. This has the disadvantage that the different components of the equitable shares would adjust over time toward cost-raising reforms and unfavourably to efficiency-enhancing policies. Cost-based calculations also tend to be erroneously read as indicative budgets or spending targets for the provinces. To avoid this problem, each component was assigned a specific weight as a way of dividing the total pool of resources available to the provinces. The FFC notes in its report that it "recognises the need to shift from a cost based norm." While supporting the proposed changes, the FFC also raises concerns about assigning weights to the various components of the formula. Government agrees with the FFC conclusion that further research is needed to establish an agreed basis for assigning these weights.

Local government

Third, the final allocations reflect the establishment of the local government equitable share, as required by the Constitution. The May 1996 recommendations of the FFC were consistent with the Interim Constitution, which did not call for an equitable share for local government. The FFC supports the establishment of a local government equitable share and has stated that Government's proposal should be "seen as a definitive start." During the formulation of this proposal, the Department of Finance consulted the FFC and took account of its report *Local Government in a System of Intergovernmental Fiscal Relations in South Africa* (July 1997). There is agreement on the need for a transparent, equitable, formula-driven approach to allocating subsidies to local government. The details of the division of the local government equitable share between municipalities will be published shortly after the release of the 1998 Budget.

Conditional grants

Fourth, the final allocations incorporate the introduction of certain conditional grants. In its May 1996 recommendations, the FFC did not include detailed proposals concerning conditional grants. In its most recent report, the FFC welcomed the proposed introduction of conditional grants, noting that the "general concept of conditional grants is desirable for reasons relating to equity, national development and policy priorities." The FFC, however, raised concerns about the possible administrative costs associated with monitoring and enforcement.

The largest of the conditional grants is the health grant to support central hospitals, introduced in recognition of the limited number of hospitals that provide specialised referral services. The FFC expressed reservations about this grant in its report, but did not offer specific alternatives. Rather the FFC has undertaken to review the nature and conditions of this grant, and hopes to complete the research in time for the 1999 Budget process. Government believes the introduction of conditional grants represents a new and innovative step in the intergovernmental financial system, and refinements in the design of these grants will necessarily occur over time.

Provincial surcharges

A fifth area where Government's approach to the provincial equitable shares departs from the FFC's is in the treatment of provincial taxing powers. In its recent report, the FFC repeats its May 1996 proposal, which called for a provincial surcharge on the personal income tax. The FFC called for a reduction in the national government's share of personal income tax revenues to create the "tax room" to accommodate a provincial surcharge. The FFC suggested that tax room equal to 7 percent of the personal income tax base be phased in over six years. Finally, because the surcharge would benefit those provinces with a larger tax base to the detriment of those with smaller tax bases, the FFC formula included a "fiscal capacity equalisation" component.

The version of the FFC formula used for the 1997 Budget included a "transitionally assigned surcharge" as a proxy to estimate the impact of the surcharge until it was officially introduced. The transitionally assigned surcharge is a crucial component of the FFC's formula, as it boosts the total revenues allocated to those provinces that have higher levels of economic activity. Those more developed provinces tend to receive less from other components of the formula, which have a strong equity bias in favour of the rural, poorer provinces, and would be unable to meet the demand for services without these additional revenues.

Tax shares

The formula used to calculate the final allocations in the Division of Revenue Bill includes an economic output or tax shares component, which is based on the level of economic activity in a province. Like the transitionally assigned surcharge, it acts as a proxy for provincial own revenues and has the similar effect of redistributing funds to provinces with larger tax bases. However, the tax shares component is a more static approach than the one proposed by the FFC, and is applicable in its current form only under the present circumstances where the provinces have limited taxing powers.

Review of provincial tax issue

In a presentation to the Budget Council, the Commissioner of the South African Revenue Service indicated that it would be impossible to implement a provincial surcharge on personal income tax in the near future. The proposal poses significant administration problems since adequate information concerning the residence of taxpayers is often not available. The Budget Council subsequently requested the Commission of Inquiry into the Tax Structure of South Africa to review the provincial tax issue. Its findings will inform the 1999 Budget. Consequently, the simpler tax shares approach was retained, pending more progress on the larger issue of provincial taxing powers.

In advocating its proposal for a provincial surcharge on personal income tax, the FFC has pointed to the need for expanding provincial taxing powers as a means of promoting democratic and accountable government at the provincial level. The FFC supports the notion that entities, such as the provinces, having significant expenditure responsibilities but limited revenue-raising powers, have little incentive to be fiscally accountable. The FFC has identified an important issue affecting the present South African fiscal structure. However, Government is of the view that it would be premature to build a provincial revenue-sharing formula around a surcharge on the personal income tax until the question of the appropriate tax base has been resolved.

Other challenges

While the tax issue is under review, Government has chosen to focus its attention on addressing other challenges facing the intergovernmental system. The FFC highlights several such problems in its recent report, most relating to provincial over-expenditure. Government has taken steps to address the four main reasons for provincial over-expenditure cited by the FFC:

- the original base is wrong;
- provinces have unfunded mandates;
- "budget gaming" by the provinces; and

- poor financial management in the provinces.

Base adjustment

Until now, budget figures from previous years have been used to determine the starting point, or base, for phasing in the provincial equitable shares allocations. In periods of overspending, however, actual spending may depart from budgeted levels.

In its recent report, the FFC states: "To solve problems of large-scale persistent overspending, it is recommended that a once-off adjustment to the base figures needs to be made to take into account the actual level of expenditure (and to ensure that future budgets and actual spending coincide)." The base should reflect actual spending to ensure that the transition to "equitable shares" has a realistic starting point. But one of the difficulties of incorporating actual expenditure into the base is that a complete set of financial statements reflecting actual spending is only available 12 months or more after the year-end.

The final allocations to the provinces included in the Division of Revenue Bill make provision for this FFC recommendation by incorporating actual 1996/97 spending into the base figures. These 1996/97 actual spending totals have not been audited, but were provided by provincial treasuries as part of recent task team exercises. The figures have been adjusted to exclude provincial own revenues and debt-related costs that are no longer a provincial responsibility. The "base year" was then adjusted to reflect 25 per cent of 1996/97 actual spending in the provinces and 75 per cent of 1997/98 budgeted amounts. This weighting establishes a balance between the distribution across provinces of spending outcomes and the budgeted amounts guiding 1997/98 expenditure.

This base adjustment was made with available information. A further review of actual expenditure in 1996/97, particularly after the figures have been officially audited, and actual expenditure in 1997/98 will shed more light on the nature of provincial spending.

Financial management

To address the problems of poor financial management in the provinces, the FFC notes in its report that it may be necessary for the 1998 Budget to invest additional resources in this area. The final allocations make provision on the vote of the Department of State Expenditure for R100 million for financial management. In addition, the Education Department budget includes R200 million to address management and capacity issues in provincial education, while R100 million has been reserved on the vote of the national Department of Welfare for social security management and information systems.

Unfunded mandates and budget gaming

The problems of unfunded mandates and "budget gaming" are quite complex. In some respects they are linked. Facing what it believes to be an unfunded mandate from the national government, a province may chose to under-budget in the hope of receiving additional funds from the national government. They also highlight some of the difficulties that arise with the implementation of a new intergovernmental system. Playing budget games is a way for provinces to test national government's resolve to uphold the rules of the new system, which require provinces to live within their budgets. Unfunded mandates result from flaws in the intergovernmental planning and budgeting process.

Addressing these issues must be part of the broader evolution of roles, responsibilities and accountability in the intergovernmental financial system. Improved information flows will increase transparency in the system and reduce the incentives for budget games. Mandates must be identified and the associated costs properly estimated. Intergovernmental forums must work to clarify the functional responsibilities between the three spheres and focus on achieving greater coordination between policy and budgeting. The medium term expenditure framework also offers an important means for identifying the expenditure implications of policies and promoting sound budget planning.

Task teams led by the Departments of Finance and State Expenditure, but also including the national Departments of Education, Health and Welfare, have worked extensively during the second half of the 1997/98 financial year to review provincial budgets. Based in part on their recommendations, the final allocations include a conditional grant of R2,8 billion in 1998/99 for the provinces. These funds are intended to guard against shortfalls in the provision of basic services. But a province can only receive the additional funds if its budget is credible – that is, it has not deliberately underbudgeted in the key sectors of health, education and welfare.

Although this conditional grant is intended to create incentives for provinces to avoid underbudgeting, the Department of Finance will continue to work with other national departments to address the links between national policies and provincial spending commitments. Areas in need of reform include provision for personnel cost, education and health norms and social security grants. The FFC has commented on these matters in its report, and the Department of Finance will work closely with the FFC on further resolving these issues in preparation for the 1999 Budget.

ASSUMPTIONS AND FORMULAE

This section discusses the assumptions and formalue used in arriving at the *vertical division* – the allocation of resources between the national, provincial and local government spheres – and the *horizontal division* of the provincial equitable share between the nine provinces. The approach taken to arrive at these two divisions is quite different. The vertical division between the spheres reflects the outcome of a process, while the horizontal division between provinces is the product of a formula.

Objective criteria

Although the two divisions used different approaches, both rely on objective criteria. Decisions by Government concerning the vertical division were informed by the detailed analyses of the medium term expenditure framework. These analyses assessed the extent to which the nation's programme for reconstruction and development was supported by initial budget proposals. The provincial revenue sharing formula draws on census data, provincial budgets and other departmental statistics selected to offer an accurate profile of the demand for basic services within provinces, so that funds would flow equitably in support of these services and other provincial functions.

Informed judgements

Government cannot achieve all its transformation goals immediately, because there are constraints on the capacity to deliver and on resources available. It is the responsibility of Government to determine priorities from among the nation's goals and the allocation of responsibility between the three spheres, consistent with the Constitution. Allocation formulae also reflect certain policy judgements. As with setting policy priorities, Government's choices regarding allocation formulae ultimately reflect informed judgements based on analysis of the best available information

The Constitution requires an equitable division of revenue between the three spheres and between the nine provinces. It is the outcome of the processes and formulae used to reach the allocations that has to be judged to have fulfilled this requirement. While budgeting requires a certain level of confidentiality, Government has taken significant steps to expand consultation and cooperation between the spheres and increase transparency with the publication in December 1997 of the *Medium Term Budget Policy Statement* and the documentation accompanying the 1998 Budget. These steps are intended to widen and deepen the debate on how the nation's resources are allocated.

Economic assumptions

A key assumption in the allocation process is the macroeconomic framework, which ultimately defines the level of resources available for expenditure. Table 1 presents projections of how the economy will perform over the medium term. Government remains committed to reducing the budget deficit to 3 per cent of gross domestic product by the end of the decade and lowering the overall tax burden. These fiscal goals are reflected in the macroeconomic framework.

Table 1: Medium term macroeconomic assumptions

R billion	1997/98	1998/99	1999/00	2000/01
GDP	**613,0**	**669,3**	**734,3**	**809,6**
Real growth	1,5%	3,0%	4,0%	5,0%
GDP inflation	8,5%	6,0%	5,5%	5,0%
Revenue	**162,6**	**177,6**	**193,4**	**210,5**
- per cent of GDP	26,5%	26,5%	26,3%	26,0%
Expenditure	**189,2**	**201,3**	**215,7**	**235,0**
- per cent of GDP	30,8%	30,1%	29,4%	29,0%
Budget deficit	**26,6**	**23,7**	**22,3**	**24,5**
- per cent of GDP	4,3%	3,5%	3,0%	3,0%

Division of resources

The Constitution requires that all revenue raised nationally be divided equitably between the three spheres of government. In addition to collecting revenue, government currently borrows to meet its expenditure requirements. Debt service and repayment obligations arise from this and previous borrowing. In dividing nationally raised revenues, the size of the budget deficit is taken into account. Moreover, amounts are set aside for the cost of debt service and standing appropriations, which are mandatory obligations, and a reserve to cope with uncertainties. As a consequence, it is national revenue plus the deficit, less the cost of debt service, standing appropriations and the reserve, that represents the total pool of resources available for sharing.

In line with constitutional requirements, provincial and local government own-revenues are not included in the equitable division calculation. Nor is borrowing by either of these spheres included. Within the total revenues raised nationally, there are departmental receipts that are collected to fund specific activities. In the future, it may be appropriate to exclude these national own-revenues from the pool of resources available for sharing.

Expenditure levels in previous years influence the division of resources between the spheres, given the funding requirements of existing commitments. In both 1996/97 and 1997/98, about 60 per cent of non-interest funds were allocated to the provinces, with the remainder allocated to national departments. A similar proportion is allocated to the provinces in 1998/99, if the ratio is calculated on the same basis as in previous years. But, as Tables 2 and 3 show, the division of resources in 1998/99 now reflects the introduction of the local government equitable share and several major conditional grants to the provinces. This should be taken into account when comparing the allocations over time.

Table 2: Division of revenue in 1998/99

R million	1998/99
National share	78 457
- national departments[1]	*69 434*
- identified conditional grants to provinces	*9 023*
Provincial equitable share	79 117
Local government equitable share	1 024
Debt service and standing appropriations	42 570
Contingency reserve	1 000
Total	**202 169**
less: recovery from pension funds	-870
Total expenditure	**201 299**

1. Includes conditional grants to local government, allocations such as improvements in conditions of service and other grants where the provincial or local government shares have not yet been finalised and funds are to be transferred on an agency basis.

Conditional grants

Conditional grants are consistent with the Constitution, and were introduced to address policy concerns that are inter-provincial in nature. The health conditional grant to support medical training and central hospitals is the most notable in this regard. Provinces had funded these activities from their budgets until this year. But having established these grants, amounts were shifted from the provinces to be included on the votes of national departments. These funds will nevertheless flow to the provinces, albeit with the attachment of certain conditions. The purposes and conditions associated with these allocations are presented in schedule 3 of the Division of Revenue Bill.

Table 3: Provincial allocations for 1998/99

R million	Equitable share	Conditional grants: Supplementary allocation	Health[1]	Local Government[2]	Other	Total
Eastern Cape	14 073	503	148	173	119	15 016
Free State	5 432	189	308	39	36	6 003
Gauteng	11 701	408	1 910	27	49	14 095
KwaZulu Natal	15 508	562	729	592	238	17 628
Mpumalanga	5 213	192	21	45	36	5 507
Northern Cape	1 964	64	21	6	9	2 064
Northern Province	10 424	378	21	135	108	11 066
North West	6 837	236	21	86	36	7 216
Western Cape	7 965	270	1 202	30	26	9 492
Unallocated	0	0	53	0	0	53
Total	**79 117**	**2 800**	**4 434**	**1 132**	**657**	**88 140**

1. *Includes R200 million that will be voted as part of the supplementary estimate.*
2. *Includes R951 million allocated to R293 towns in Eastern Cape, Free State, KwaZulu-Natal, Mpumalanga, Northern Province and North West and R181 million to all provinces for allocation to local authorities to adjust to the new local government equitable share formula. These amounts will form part of the equitable share for local government beginning in 1999/2000.*

Note: Total excludes improvements of conditions of service and other conditional grants where the provincial allocation has not yet been finalised. Also excludes agency payments.

Local government equitable share

The local government equitable share fulfils a specific requirement of the Constitution, and also achieves the desirable goal of replacing the present cumbersome, discretionary and *ad hoc* system of operating grants and subsidies. The goal of the equitable share is to enable municipalities to subsidise the operating costs of a basic level of services to low-income households. The Department of Finance undertook studies to establish the level of funds needed to fulfil this objective. It found that the present flow of funds to local government from the other two spheres was, in fact, sufficient to support the provision of these basic services, given existing capacity constraints and other policy demands.

Table 4 shows amounts for the recurrent transfers to local government in 1997/98 budgets. Capital transfers financed by conditional grants from the national share are not reflected in the table, as they are excluded from the equitable share. The equitable share for local government was therefore based on the amounts shown in Table 4, increased consistent with the level of growth in non-interest expenditure.

The actual equitable share for 1998/99, however, reflects several transitional steps that are being taken to smooth the adjustment from the current system to a formula-driven equitable shares approach. First, the Department of Water Affairs will continue to subsidise water schemes directly in rural municipal areas, and the Department of Constitutional Development will make payments in 1998/99 for the settlement of local authority debt. Second, provinces that are still meeting the costs of provincial and municipal staff for so-called R293 (former homeland) towns will receive a grant to meet the cost of these employees and services. Legislation to be introduced by the Department of Constitutional Development will facilitate the transfer of these staff from the provinces to the municipalities. Third, a small transitional fund will be allocated as a conditional grant to provinces. The fund is intended to address transitional problems, particularly where there is a sharp decline in the allocation to a municipality.

Table 4: Current expenditure transfers to local government in 1997/98

R million	IGGs	R293 towns	Other subsidies[1]	Total
Provincial transfers:				
Eastern Cape	125	121	139	384
Free State	66	25	8	99
Gauteng	156	0	10	166
KwaZulu Natal	151	523	21	695
Mpumalanga	69	30	9	108
Northern Cape	22	0	13	35
Northern Province	74	114	1	190
North West	68	69	2	139
Western Cape	173	0	10	183
Subtotal	*903*	*882*	*214*	*1 999*
National transfers:				
Department of Water Affairs			493	493
Department of Constitutional Development			129	129
Disaster fund			20	20
Subtotal			*642*	*642*
Total current transfers	**903**	**882**	**856**	**2 641**

1. Includes service of loans, sport & recreation, subsidies to former white municipalities, settlement assistance, land tenure rights, resorts, and financial assistance from own budget.

Provincial formula

As noted, the provincial equitable shares formula is intended to direct funds to provinces based on their demographic and economic profiles, as these offer an indication of the demand for basic services within the provinces. The formula is comprised of the following six components:

- *An education share*, based on the average of the size of the school-age population and number of learners actually enrolled;
- *A health share*, based on the proportion of the population without private health insurance and weighted in favour of women, children and the elderly;
- *A social security component*, based on the estimated numbers of people entitled to social security grants (elderly, disabled and children);
- *A basic share*, based on total population with a 50 per cent weighting in favour of rural communities;

- *An economic output share*, based on the estimated distribution of gross geographic product (GGP); and
- *An institutional grant*, equally divided among the provinces.

Each of these components was assigned a specific weight. For the education, health, and social welfare components, the weighting correspond to their relative size in provincial budgets. According to the province's initial MTEF submissions, education represents about 39 per cent of provincial spending, primary and secondary health services about 18 per cent, and social security about 16 per cent over five years, 1996/97 to 2000/01.

The remaining three components – basic, tax and institutional – do not represent specific items in provincial budgets. Rather they are intended to capture other pressures on provincial budgets arising from administrative, governance and capacity needs and the level of economic development. Together, these components comprise just over one-quarter of the formula.

Census data

The results of the 1996 census are used in the revenue sharing formula because they are the most reliable and up-to-date demographic statistics. The new data show large changes in the population distribution across the provinces. As a consequence, they have a significant impact on the allocation to certain provinces.

The preliminary census estimates released by the Central Statistical Services (CSS) provided total population figures for each province, with additional detail on gender and the urban-rural split. Although the CSS publication included some information on the age distribution for the total population, CSS is not expected to release the details by province until April 1998. Due to the importance of age-related information in the revenue sharing model, the Department of Finance prepared, in consultation with CSS, age distribution estimates consistent with the 1996 census.

Tables 5 to 7 contain census data, including estimates prepared by the Department of Finance, and other statistics that are relevant to the revenue sharing formula.

Table 5: Census data

000's	Total population	Rural	Urban	Women	Men
Eastern Cape	**5 865**	3 677	2 188	3 162	2 703
Free State	**2 470**	752	1 718	1 251	1 219
Gauteng	**7 171**	260	6 911	3 520	3 651
KwaZulu Natal	**7 672**	4 331	3 341	4 089	3 583
Mpumalanga	**2 646**	1 632	1 014	1 357	1 289
Northern Cape	**746**	211	535	380	366
Northern Province	**4 128**	3 638	490	2 250	1 878
North West	**3 043**	1 983	1 060	1 550	1 493
Western Cape	**4 118**	415	3 703	2 135	1 983
Total	**37 859**	**16 899**	**20 960**	**19 694**	**18 165**

Source: Central Statistics

Table 6: Age-specific data

000's	Total Age 0-6	Total Age 5-19	Women Age 5-59	Women Age 60+	Men Age 65+
Eastern Cape	962	2 338	2 572	241	146
Free State	381	818	1 026	95	66
Gauteng	895	2 114	2 976	203	145
KwaZulu Natal	1 093	2 819	3 400	250	146
Mpumalanga	377	981	1 142	72	54
Northern Cape	111	249	308	28	19
Northern Province	676	1 665	1 888	126	83
North West	479	1 105	1 278	98	59
Western Cape	554	1 310	1 775	146	98
Total	**5 528**	**13 399**	**16 366**	**1 261**	**817**

Source: Department of Finance

Table 7: Other data

	School enrolment 1995	Persons on medical aid 1995	Gross geographic product 1994
	000's	*000's*	*R million*
Eastern Cape	2 333	474	29 049
Free State	780	438	23 688
Gauteng	1 414	2 887	144 359
KwaZulu Natal	2 572	1 006	57 007
Mpumalanga	915	370	31 175
Northern Cape	204	156	8 000
Northern Province	1 918	315	14 158
North West	916	415	21 251
Western Cape	857	1 173	53 874
Total	**11 909**	**7 233**	**382 562**

Source: Education Department, Central Statistics

Education component

The education component of the revenue sharing formula targets school education, which is a provincial responsibility. Education is the largest component of expenditure at the provincial level.

An average of two demographic distributions – school enrolment and school-age populations – is used to calculate the education component. Using school enrolment on its own has the advantage of funding the exact number of pupils in government funded schools. The disadvantage is that it penalises provinces that still need to expand access to schooling. It also fails to establish an incentive for provinces to reduce repeater rates. Indeed, in some provinces the number of enrolled pupils is actually larger than the estimated school-age population. Averaging these two figures attempts to address these concerns.

School enrolment figures for public as well as independent schools are used, as both categories are funded to varying degrees by the provinces. School enrolment figures provided by the Department of Education for the tenth school day of 1995 are used in the calculations.

Health component

The health component of the revenue sharing formula focuses on the provincial responsibility to deliver primary and secondary health services to the public.

Provincial population is the basis of this needs-based formula. These figures are adjusted to reflect the proportion of the population with access to private medical-aid derived from 1995 October Household Survey data. Those with private insurance are removed from the base population to create an initial estimate of the demand for public-sector health services. This estimate is then further adjusted for utilisation differences due to age and gender. That is, the population is weighted for women, children, and the elderly, who make greater use of health care services. The three weightings are applied equally.

The provision of specialised health care and academic health training is not directly captured in this formula. These costs are addressed through the health conditional grant.

Welfare component

The welfare component of the unconditional grant follows a similar methodology, relying on population shares for each province to determine the initial proportions.

The population is weighted according to the recipients of social security. The base population for the old-age pensions includes all males over age 65 and females over age 60. The estimated number of children aged 0-6 is also incorporated in the calculation as these children are the intended recipients of the new child grant. The base for all other social security grants, including disabilities, is the population as a whole.

These three components are then weighted to reflect the relative size of the different social security grants. The 1997 Budget and estimates of actual expenditure show that the old-age pension absorbs approximately 65 per cent of the social security budget, child and family care a little over 10 per cent, and disabilities and other grants about 25 per cent. It is important to note that in the longer term, the size of the child grant component will increase as the new child benefit programme expands.

Finally, provinces with an above average proportion of high-income individuals get a lower weighting than those with relatively more poor individuals. This adjustment is intended to capture the impact of the means test for the old-age pension and the new child support grant. Research is required to refine this adjustment in line with the improved application of the means test and once there is clarity over the functioning of the child support grant.

Other components

The economic output component of the formula directs a proportion of nationally collected revenue back to the provinces where the revenues are generated. This serves as a proxy for the provincial own-revenue that would be raised were provinces to raise additional taxes themselves. This component acknowledges the link between investment and infrastructure needs and related economic services, and the level of economic output in a province.

The institutional component, which is divided equally among the provinces, provides for the cost of maintaining public administration, building essential capacity, and participating in intergovernmental forums. These costs, unlike those associated with basic services, are not directly related to a province's demographic profile but represent fixed costs that are borne equally by all the provinces. This definition of the institutional component is somewhat broader than the one applied by the FFC.

The basic component reflects each province's share of the total population, adjusted so that people living in rural areas are given an extra 50 per cent weighting. This provides compensation for provinces with large rural populations for the special developmental needs and backlogs that exist in rural areas. The FFC proposed "ruralness" as a proxy for poverty given the lack of appropriate data on developmental needs.

Table 8 includes the weighting and provincial distribution associated with each of the six components.

Table 8: Distribution of equitable share components

	Education	Health	Social welfare	Basic	Economic activity	Institutional	Weighted average
weighting	*39,0%*	*18,0%*	*16,0%*	*15,0%*	*8,0%*	*4,0%*	*100,0%*
Eastern Cape	18,5%	17,3%	18,7%	16,6%	7,6%	11,1%	16,9%
Free State	6,3%	6,7%	6,6%	6,1%	6,2%	11,1%	6,6%
Gauteng	13,8%	15,6%	13,3%	15,8%	37,7%	11,1%	16,2%
KwaZulu Natal	21,3%	21,1%	21,0%	21,2%	14,9%	11,1%	20,3%
Mpumalanga	7,5%	7,0%	7,2%	7,5%	8,1%	11,1%	7,6%
Northern Cape	1,8%	2,0%	2,0%	1,8%	2,1%	11,1%	2,3%
Northern Province	14,3%	11,8%	13,2%	12,8%	3,7%	11,1%	12,5%
North West	8,0%	8,3%	8,8%	8,7%	5,6%	11,1%	8,2%
Western Cape	8,5%	10,3%	9,1%	9,3%	14,1%	11,1%	9,6%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

Phasing

The revenue sharing formula yields a distribution across the provinces that differs somewhat from the current distribution of funds. Government has agreed that the new shares will be phased in over five years – that is, by 2002/03 – to avoid dislocations. During the transition period, each province's portion of the overall provincial equitable share will increasingly reflect the distribution envisaged by the revenue sharing formula.

The starting point for this phasing-in process is a base distribution that combines the distribution of actual spending in 1996/97 and budgeted expenditure for 1997/98, with weightings of 25 per cent and 75 per cent, respectively. Table 9 summarises the relevant data.

Table 9: Distribution of base year components

	Shares of provincial expenditure		
	Actual 1996/97	**Budget 1997/98**	**Weighted average**
weighting	25,0%	75,0%	100,0%
Eastern Cape	18,2%	17,9%	18,0%
Free State	7,2%	6,9%	7,0%
Gauteng	13,7%	14,8%	14,5%
KwaZulu Natal	20,3%	19,1%	19,4%
Mpumalanga	6,4%	6,3%	6,3%
Northern Cape	2,4%	2,6%	2,5%
Northern Province	12,5%	13,6%	13,3%
North West	8,6%	8,7%	8,7%
Western Cape	10,7%	10,1%	10,2%
Total	**100,0%**	**100,0%**	**100,0%**

Total allocations

It is the combination of the equitable share allocations and all the conditional and unconditional allocations that comprise the total allocation to provinces. These grants play an essential role in meeting the requirements contained in section 214(2) of the Constitution.