



Intergovernmental Fiscal Relations in The Philippines

Perspectives from South Africa

POLICY BRIEF

**Prof. Jaap de Visser
Shireen de Visser**



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ABOUT THE AUTHORS

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Shireen de Visser (BIURIS, LLB, MPhil) has 17 years' experience in public finance, fiscal policy, integrated strategic planning, good governance and ethics. She started her career in Blaauwberg Municipality in 1999 (which subsequently merged into the City of Cape Town) during the transitional period in South Africa, Western Cape Treasury (Budget Office and Fiscal Policy) and more recently worked as the Senior Manager Governance and Strategy at Stellenbosch Municipality.

Shireen has worked extensively across different areas of expertise in South Africa including, intergovernmental relations, developing and analysing socio-economic profiles at provincial and local level, financial and performance monitoring and evaluation. Further research and practical work experience involves areas of energy and water sustainability, municipal tariffs, analysis of services across different spheres of government, risk and fraud management and ethics in government. More recently Shireen was appointed as a member to the Research and Ethics Committee of the Fiscal and Financial Commission of South Africa.



RECOMMENDATIONS

- When designing and allocating mandates to subnational governments, funding availability at that subnational level must be considered, both in the form of own revenue and intergovernmental grants.
- The autonomy of subnational governments must be respected in the design and in the implementation of intergovernmental fiscal relations.
- Intergovernmental fiscal relations must accommodate differentiation to encourage responsiveness to different regional need.
- A comparison between SA and BARMM reveals that, compared to South Africa's provinces, BARMM has significantly more fiscal autonomy. The calculation and utilisation of the block grant together with tax retention mechanisms for BARMM will be important determinants for the success of the autonomy of the region.
- Because BARMM's own revenue will eventually replace the block grant, much will depend on the development of own revenue-raising capability in BARMM.

1. INTRODUCTION

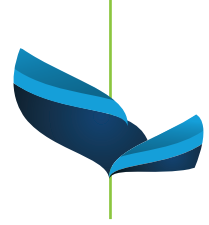
The following is a brief overview of intergovernmental fiscal relations in South Africa. The aim is to provide policymakers, researchers and other stakeholders in the Philippines, particularly in the Bangsamoro Autonomous Region for Muslim Mindanao (BARMM), with comparative insight into the system for financing subnational governments in South Africa.

A careful start of comparison is made on two occasions, namely with respect to the equitable share (para 4.5) and the perspective on own revenue (para 5.3).

This policy brief serves two purposes. First, to foster a greater understanding of the international comparative context in which the solutions for BARMM can be understood. Second, to foster informed debate in the Philippines on intergovernmental fiscal relations as they affect BARMM.

2. SOUTH AFRICA

South Africa has a national government, nine provinces, and 257 municipalities. The provincial and local spheres of government are constitutionally entrenched, and provinces and municipalities have powers listed in the Constitution. They each have their own locally elected provincial legislatures and municipal councils, which are led by indirectly elected premiers and mayors, respectively. The local government sphere consists of eight metropolitan municipalities, 44 district municipalities, and 205 local municipalities.



While the hallmarks of a federal structure are present, the majority of design elements, and certainly the federal practice, point towards a centralised or ‘quasi’-federal system. The constitutional arrangement is the product of negotiations held in the early 1990s between liberation movements (most notably the ANC) and the outgoing apartheid government, led by the National Party (NP). The compromise was a quasi-federal state with strong unitary elements that delegated significant powers to local government, eventually enshrined in the 1996 Constitution. The division of powers is briefly discussed below.

3. DIVISION OF POWERS

3.1. Central government’s exclusive powers

The central government may make and implement laws on any subject except for the matters reserved exclusively for provinces. The exclusive national powers are substantial and include issues such as land administration, policing, the judiciary, regulating the extractive industries, and the energy sector.

The national government also collects almost all of the taxes, such as income, corporate and value-added tax. It distributes national revenues across the three levels of government on an annual basis.

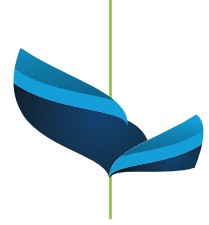
3.2. National and provincial government’s concurrent powers

The national and provincial governments have concurrent legislative and executive authority over housing, primary and secondary education, agriculture, environment, trade, and health services. This means they can both make and enforce laws in these areas. The Constitutional Court is ultimately responsible for resolving conflicts. This sounds like it empowers provinces with substantial autonomy. However, the practice of national-provincial concurrence is that the national government legislates, and the provincial governments implement. Provinces are responsible for implementing big social functions such as public health, housing, primary and secondary education, regulatory functions such as the environment, agriculture and disaster management. They do so following national law and pass very few provincial laws. The Constitution allocates certain powers exclusively to provinces, but these powers are generally insignificant.

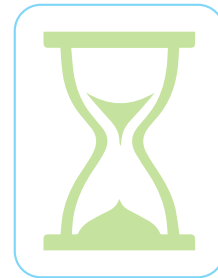
Provinces are almost entirely reliant on transfers from the national government. They receive those in the form of an annual, formula-based unconditional grant complemented by conditional grants.

3.3. Municipal powers

Municipalities have powers listed in the Constitution. They are responsible for delivering basic services such as water, sanitation, waste management, roads, and electricity to end-users. They are also responsible for environmental health services and town planning. National and provincial governments may regulate these local government matters but only with minimum standards.



The Constitution empowers municipalities to raise their own revenue by protecting their power to levy property taxes and service fees, which is the most significant expression of local government autonomy. Municipalities are expected to raise most of their own revenue through property taxes and service fees. However, they do receive intergovernmental funding in the form of an unconditional equitable share and limited conditional grants. Overall, cities and larger urban municipalities generally raise significant revenue, whereas rural municipalities experience a higher reliance on intergovernmental grants.



In summary, South Africa practices an 'hourglass' model of federalism; with a strong national government, relatively 'weak' provinces, and a mix of strong cities and weak rural municipalities in local government.

4 INTERGOVERNMENTAL FISCAL TRANSFERS

4.1. Introduction

The vast majority of intergovernmental fiscal transfers to provinces and municipalities emanate from the national government, which pursues two objectives with these transfers::

1. address fiscal imbalances and ensure fair distribution of resources across the country; and
2. drive policy priorities.

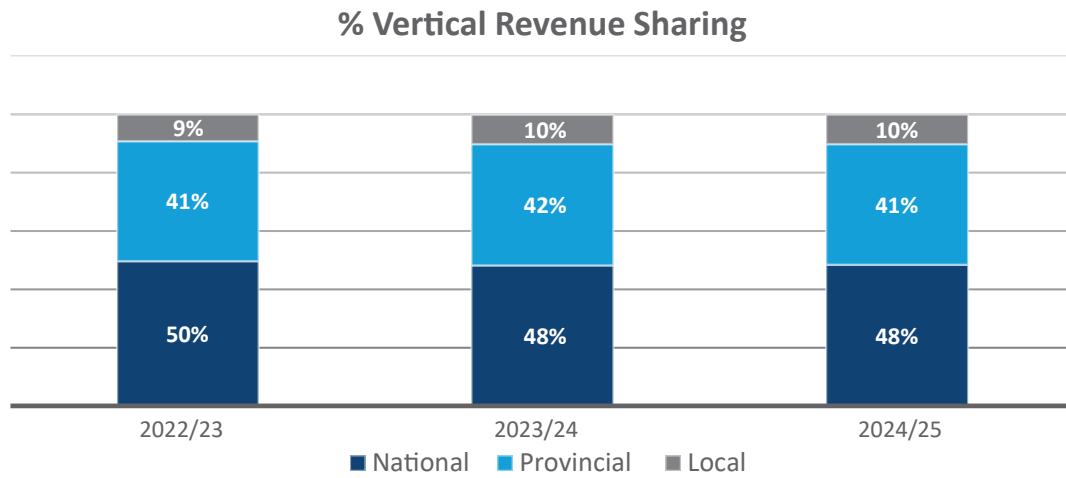
4.2. Division of revenue

Intergovernmental transfers are decided annually in the national Division of Revenue Act (DORA) which is passed as part of the annual budget. The Bill includes vertical and horizontal division determinations for three years. These are definite allocations for the first year. Years 2 and 3 are estimates that will be adjusted in the following years. However, the estimates are usually reasonably accurate.

The **vertical division of national revenue** determines how all revenue generated nationally is distributed between the national, provincial, and local spheres. There is no fixed percentage or formula for this: it is decided by the national government, guided by constitutional principles. Before determining allocations to provincial and national governments, the national government 'top slices' the National Revenue Fund, taking predetermined allocations such as debt service costs into account. After deducting those, the vertical split is decided and inserted into the Division of Revenue Bill. Figure 1 below shows that local governments receive approximately 10% of national revenue, provincial governments 40%, and national government 50%. Local government has a lower percentage than provinces because municipalities are expected to raise their own revenue while provinces are not.



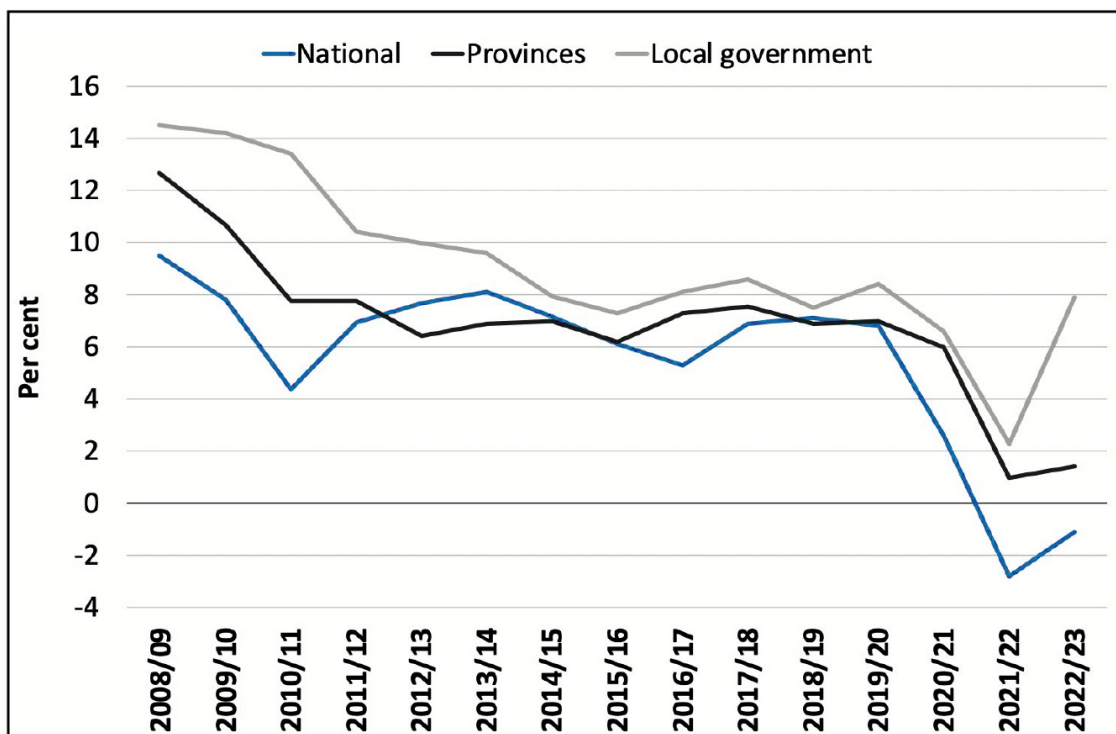
Figure 1: Vertical revenue sharing in South Africa



Source: Budget Review 2022, National Treasury, pg. 70¹

Year on year shrinkage in the vertical division between 2008 and 2023 is illustrated in graph below, which clearly illustrates fiscal constraints in the budget of the South African government.

Figure 2: Average annual growth rate of allocations to spheres of government



Source: National Treasury

¹ <http://www.treasury.gov.za/documents/national%20budget/2022/review/FullBR.pdf>



This decline in allocations, as illustrated, poses a risk to all levels of government from a fiscal sustainability perspective and the ability of each respective sphere to respond to the needs of citizens.

The **horizontal division** determines how much each province and each municipality receives. Intergovernmental fiscal transfers complement their own revenue but do not compensate for failures to collect revenue.

4.3. Equitable share for provinces

Each province receives an “equitable share” of the revenue raised by the national government. The equitable share is meant to enable provinces to perform their functions. It is an unconditional grant determined by a formula. Table 1 below shows the formula, as well as the indicators and data that were used.

Table 1: Equitable Share Formula for Provinces

Weight	Factor	Indicator	Data Used
48%	education	public school enrolment (Gr R – 12)	Mid-Year Population Estimates 2020 age cohorts (new data) 2020 LURITS School Enrolment (new data)
27%	health	risk profile and health system case load	2020 Mid-Year Population Estimates (new data) Insured population (2018 GHS) (old data) Risk adjusted index Patient load data (DHIS 2018/19 - 2019/20) (new data)
16%	basic	share of population	2020 Mid-Year Population Estimates (new data)
3	poverty	share of country’s poor population, using income data	2020 Mid-Year Population Estimates (new data) Income and Expenditure Survey 2010/11
1	economic output	regional gross domestic product	GDP 2018 (new data)
5	institutional	equal division	Not applicable – distributed equally amongst provinces (data not used)

Source: National Treasury

4.4. Equitable share for municipalities

Every municipality has a constitutional right to an equitable share, which allows municipalities to deliver basic services. It is an unconditional grant determined by a formula. Table 2 below shows the five elements of the formula, together with the calculation.



Table 2: Equitable Share Formula for Local Government

Formula element	Calculation
Subsidy for free basic services (water, electricity, refuse removal etc) to poor households	subsidy x number of poor households
Subsidy for basic municipal administration (a contribution to running the municipal administration)	base allocation + allocation per council seat
Subsidy for non-trading services, i.e. services that municipalities cannot charge for	health and related services x number of households + other services X number of households
Adjustment for revenue capacity (incorporating the municipality's potential to raise revenue)	<ul style="list-style-type: none"> ▪ total income of individuals and households ▪ property values ▪ no of households on traditional land ▪ unemployment rate ▪ % of households that are poor
Correction and stabilisation	guaranteeing a certain percentage of the current allocation in year 2

Source: National Treasury

4.5. Comparing BARMM's Block grant with South Africa's Equitable Share

The Bangsamoro Organic Law (BOL) provides for a block grant to Bangsamoro. The context for the block grant is very different from the context for the equitable share in South Africa. The two countries' political histories, legal systems, and current challenges are vastly different. Nevertheless, it is a useful exercise to compare the two, even if it is to identify differences and raise questions about how either system work. How does BARMM's block grant compare to the equitable share for provinces in South Africa? Table 3 below provides a basic comparison of the key features of the two grants. The discussion of the BARMM block grant is based on a reading of the BOL. Inaccuracies are possible, and the table should be interpreted solely as a broad comparative exercise.

Table 3: SA's equitable share for provinces and BARMM's block grant compared

Question	SA's equitable share for provinces	BARMM's block grant
Is it envisaged that the grant will be a permanent feature?	Yes, the equitable share is a permanent feature and designed to be permanent. While the formula may change from time to time, the grant is expected to be permanent.	It is envisaged in the BOL that, after 20 years, certain deductions will be made of the block grant. This indicated that the block grant as it is defined in the BOL, will not necessarily be permanent but will be replaced by own revenue or both.
Is there a legal/constitutional entitlement to the grant?	Yes, but there is no fixed amount/percentage in the Constitution. The national government decides, guided by constitutional principles.	Yes, the BOL prescribes that the block grant must be 5% of net national revenue.



Is the grant unconditional?	<p>Yes, it is unconditional. However, the discretion for provinces is limited by, e.g. the fact that</p> <ul style="list-style-type: none"> provincial powers are limited in Constitution provinces implement national laws on social services salaries are centrally negotiated 	<p>Yes, but -</p> <ul style="list-style-type: none"> BOL demands priority to education, health & social services (and no arms) BOL caps salary expenditure at 45% of the budget <p>BARMM may regulate its own civil service but will be subject to national law.</p>
Is the spending of the grant subject to national public finance rules?	Yes, provinces are bound by the Public Finance Management Act and are audited by the Auditor-General.	Yes, BARMM is bound by national public finance legislation and is audited by one national auditing institution.
Is the grant dependent on the adoption of a subnational budget?	Yes, each provincial parliament adopts an Appropriation Act and an Annual Budget to operationalise the grant.	Yes, BARMM Parliament adopts Appropriation Act + annual budget
Are there objective criteria for the determination of the grant?	Yes, there are broad criteria in Constitution and a detailed formula for the horizontal division (not for vertical division).	Yes, the criteria for the grant are in the BOL
Is the grant reviewed regularly?	Yes, in principle, the equitable share is reviewed each year as it is decided and consulted on, each year. However, in practice it is kept constant and rarely changes.	The Intergovernmental Fiscal Board reviews the block grant at least every 5 years.
Is the determination of the grant subject to subnational and expert input and consultation?	Yes, there is an annual cycle of consultation in the Budget Council on the formula, and the expert Finance & Fiscal Commission gives input. The FFC is an expert body and does not represent provinces.	Yes, the IFB comprises representatives from BARMM
Is it transferred automatically and regularly?	Yes, the equitable share is paid in predetermined tranches (and may only be withheld if a province commits persistent gross financial mismanagement)	Yes (and the block grant may not be withheld)
Do the funds have to be returned to the national government if they remain unspent?	No	No

Source: National Treasury



4.6. Conditional grants in South Africa

South Africa's national government uses **conditional grants** for a number of reasons, namely to –

- address historical legacies of underdevelopment in parts of the country
- implement national policy priorities
- build governance capacity
- fund infrastructure

Every conditional grant is published with a grant framework that sets out the goal of the grant, which department will transfer it, which government outcome the grant contributes to, the criteria for allocation, the application process, how much funds are available, and the payment schedule, etc.

4.7. Process towards the annual division of revenue

The **process** toward the annual DORA starts at least 10 months before the start of the financial year with a report by the Finance and Fiscal Commission (FFC). The FFC is an independent national constitutional body tasked with advising the government on intergovernmental fiscal relations. The FFC makes recommendations on the vertical and the horizontal division of revenue. The National Treasury then prepares the DORA in consultation with the provinces and local governments. The National Treasury must respond to the recommendations of the FFC, which it usually does when it tables the Division of Revenue Bill in Parliament.

5 OWN REVENUE FOR SUBNATIONAL GOVERNMENTS

5.1. Introduction

In general, provincial and local governments in South Africa have the following own revenue sources: taxes, user charges, surcharges, licensing fees, debt financing (borrowing), agency and contract fees.

South Africa's Constitution reserves almost all taxing powers for the national government. This choice was informed by the –

- outcome of the constitutional negotiations in which the ANC pushed back against provincial autonomy;
- need for macro-economic stability and economic unity;
- need for redistribution of resources and address service delivery backlogs featured prominently; and
- distribution of functions to provinces and municipalities.



5.2. Provincial functions and own revenue

As explained earlier, the majority of provincial functions are held concurrently with the national government. This supports the notion that the national government raises the revenue for these functions. For the majority of provincial functions (public health care, public education, public housing), limited cost-recovery is possible. On the other hand, many municipal functions are trading services where cost recovery is possible. Municipalities may charge individual users of electricity, water, wastewater management and waste management.

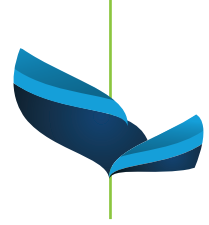
Provincial governments may not impose taxes unless authorized by legislation. Furthermore, they may not impose an income tax, value added tax, sales tax, property tax, or customs duty. One general limitation is that they may not use their taxing powers to prejudice economic unity. There is no 'original', constitutional power for provinces to tax. Provincial governments may apply for permission to impose a provincial tax. In practice, provincial governments raise little revenue. Gambling licenses and vehicle licenses are two areas where provincial governments raise their own revenue. It typically accounts for no more than 4 to 6 percent of the provincial budget. Provinces generally focus on managing expenditure rather than raising revenue.

5.3. Own revenue in BARMM compared with provincial own revenue in South Africa

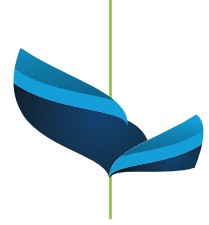
Similar to what is stated in para 4.5 regarding the equitable share and the block grant, it is possible to compare the South African perspective on provincial own revenue with the Philippines' perspective on its own revenue for BARMM. Table 4 below shows some of the key comparisons. Again, the South African context, history, and reality are very different from that in the Philippines, and the content on the BARMM is based on a reading of the BOL, which may contain inaccuracies in the interpretation of the provisions. The purpose is to compare broadly rather than to present definite interpretations.

Table 4: Own revenue for SA provinces and BARMM compared

Question	SA provinces	BARMM
Does the law envisage self-sufficiency in the long term?	No, the constitutional design does not envisage provinces to be self-sufficient or to even have significant fiscal autonomy.	Yes, the BOL speaks very clearly of the "... end view of attaining economic self-sufficiency" (sec XII-1).
Is there any mechanism for subnational governments to retain national taxes collected within their region.	No, all national taxes are collected and appropriated by the national government. The provinces only benefit from those taxes by receiving grants.	The BOL provides for revenue retention: <ul style="list-style-type: none"> ■ 75% of all tax revenue (except customs and tariffs) collected in BARMM ■ 25% for first 10 years, can be extended?



<p>Are there 'original' revenue raising powers, provided for?</p>	<p>No, virtually none.</p> <p>The Constitution permits provinces small own revenue sources such as car licensing, hospital fees and gambling fees. But they are minimal.</p>	<p>Yes, BARMM's own revenue sources as per the BOL include (amongst other things):</p> <ul style="list-style-type: none"> ■ revenue from natural resources, fees and charges, dividends from BARMM companies, income from BARMM utilities ■ certain parts of quarry resources tax ■ capital gains, documents stamp tax, donor's tax, estate tax as per BOL if BARMM collects it (sec xii-9)
<p>Can the subnational government exercise additional revenue raising power, over and above those set out in the Constitution/ organic law?</p>	<p>Yes, but only if approved by national govt. and no income tax, VAT, general sales tax, property tax, or customs duties. In practice, no such taxing powers have been granted.</p>	<p>The BARMM "Shall have the power to create its owns sources of revenue, subject to BOL". The IFB may recommend additional fiscal powers, but (1) no income, customs, small scale agricultural tax, excise, VAT, internal mobility tariffs, pioneer business etc. (2) no double taxation.</p>
<p>Is additional revenue deducted from the equitable share/block grant?</p>	<p>No, additional revenue is not deducted.</p>	<p>Yes, after 20 years, the national government will deduct revenue from capital gains, documents stamp, donor's tax, estate tax and BARMM's share of natural resources.</p>
<p>Is there national support for creating revenue raising capability at subnational level?</p>	<p>Not applicable (because it is not envisaged that provinces will raise own revenue).</p>	<p>Yes, national assistance on tax administration and financial management (sec XII-5).</p>



5.4. Local own revenue

The situation is different for municipalities in terms of their own revenue. The Constitution provides the municipalities authority to impose property taxes and charge fees for services. This aligns with their constitutional powers. Municipalities may charge individual users of electricity, water, wastewater management, and waste management. The right of municipalities to collect property taxes and charge fees for services is constitutionally guaranteed. However, the national government regulates how municipalities exercise these powers. Municipalities may apply to the national government for additional taxing powers. In practice, the extent to which municipalities raise their own revenue varies greatly from municipality to municipality. The revenue base and tax effort differ substantially, resulting in a wide variation. In fact, most of the local government revenue is generated in the eight metros, accounting for almost two-thirds of the total aggregated revenue raised by local government.

5.5. Borrowing

Provincial **borrowing** is limited to capital expenditure. Borrowing for current expenditure (e.g., running a bank overdraft) is only permitted if the loan is repaid within the same financial year. The national Minister of Finance must approve provincial loans. In practice, provinces rarely borrow because of their inability to provide adequate security for the debt. Their main source of revenue is intergovernmental grants, which the national government determines. In practice, the provincial debt thus becomes a national debt.

Municipal borrowing is permitted only for capital expenditure. Borrowing for current expenditure is only allowed if the loan is repaid within the same financial year. Municipalities are given more discretion to borrow than provinces, and borrowing is much more common in local government than provincial government. This is partly because (many) municipalities can offer a revenue stream (property taxes, service fees) as security for the debt. They are thus more attractive to financial institutions. Some cities have explored bonds, including green bonds and other financial instruments to finance capital expenditure.

6. CONCLUSION

In summary, South Africa has developed a system of revenue sharing across spheres of government that works reasonably well for its context. While it remains a contested issue, the distribution of centrally raised revenue is formula-based, objective, and consultative. Compared to South Africa's provinces, BARMM has significantly more fiscal autonomy. Much will depend on the exact calculation of the block grant and its use by BARMM. In addition, implementing the tax retention mechanisms in the BOL will be key. Given that it is envisaged that own revenue will eventually replace the block grant, much will depend on the development of own revenue-raising capability in BARMM.

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The Forum of Federations is the world's premier network for expertise on federalism and multilevel governance. It develops and shares comparative expertise on the practice of federal and decentralized governance through a global network. The mission of the Forum is to strengthen inclusive and responsive governance, including pluralism and gender equality, in federal, decentralized, and transitioning countries.

As a learning network, the Forum builds and shares knowledge about governance challenges in multilevel democracies. Its mandate is straightforward and practical: "Learning from one another" – sharing experiences, challenges and lessons learned among partners -- federal countries, those undergoing devolution and their subnational units. This is significant as it offers peer exchange and understanding to help improve the laws, policies and programs each nation provides its citizens.

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