

FOREWORD

South Africa's constitution, which is generally thought of as one of the most liberal in the world, is a definite asset for the country's young democracy and needs to be carefully protected. The inclusive concept of the constitution, which can be attributed to the Codesa (Convention for a Democratic South Africa) process, commits the country's politicians to liberal values.

There are various multilevel government systems throughout the world; and whereas Germany is characterised by a strong federal system, the South African three-sphere system reflects the country's values of integration and cooperation. However, maintaining equilibrium among state institutions through a system of checks and balances poses a great challenge. The principles of the separation of powers and the rule of law are indispensable. Of similar significance is a decentralised state structure.

Part of the political dispute – and a key challenge to political decision-makers – is the degree of autonomy in particular of the provincial and local spheres of government. In this context the extent of financial autonomy is decisive for political competence. Only a fairly even distribution of state revenue can ensure efficient, good quality, collaborative and accountable service delivery. Since provinces and municipalities are diverse, especially in terms of their economic power, a financial equalisation system is necessary to balance the quality of life in the different regions of the country.

It is for these reasons that financial intergovernmental relations is the subject of intense political debate in decentralised states. Clearly defined competencies for each sphere and financial regulations are constitutive elements of a functioning multilevel system, which in turn makes real service delivery possible.

Minister of Provincial and Local Government Sidney Mufamadi has recently launched a review process of provincial and local government which aims to assess whether the government's objective to serve the people is being advanced through current provincial

and local government administration. Two factors will need to be looked at: first, capacity building at provincial and local level; and second, providing the two lower tiers of government with the necessary resources to deliver properly. The latter will prove to be significant, especially when financial responsibility is passed from national level downwards.

To prevent confusion between the national, provincial and local spheres of government, responsibility and accountability in financial intergovernmental relations must be clearly defined. Since local government is at the coalface in terms of practical implementation and delivery, this level of government must be properly resourced if the much lauded developmental state is to benefit.

In this policy paper, Dirk Brand analyses financial intergovernmental relations in South Africa. The paper presents and critically assesses the rules and regulations governing this topic and, where appropriate, makes comparisons with the German financial equalisation system. In addition the positions of the current political debate in South Africa are described and suggestions are made for future decision-making.

This policy paper is the first issue in a new Konrad-Adenauer-Stiftung South Africa series. Policy papers will be published at periodic intervals and will always strive to analyse and assess a particular topic of the current political debate. The series is therefore aimed at the 'quick reader' who is looking for information of good quality in a concise form.

Enjoy the first issue!



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FINANCIAL INTERGOVERNMENTAL RELATIONS IN SOUTH AFRICA

Dirk Brand

INTRODUCTION

South Africa is a young and developing democracy. Today, during the second decade of this new democratic order, one often hears questions and comments about problems in the functioning of South Africa's constitutional system.

As expected, there are diverse views across the political spectrum about the ways in which these problems should be addressed, and also about the nature of the constitutional system. There is, however, broad consensus that one of the major problems relating to the functioning of the system is a lack of sufficient and appropriate administrative, management and technical skills in all three spheres of government, although this is perhaps more serious at the sphere of local government.

An essential part of the constitutional system in South Africa is the system of financial intergovernmental relations, which not only describes the actual relations between the three spheres of government, but also includes a range of financial laws and relevant constitutional provisions governing the financial intergovernmental relations system. One could also refer to it as the 'financial constitution' of South Africa.

This policy paper provides an overview of financial intergovernmental relations in South Africa and aims to assist practitioners in improving their understanding of

South Africa's financial Constitution. In doing so, the paper aims to address some of the competency shortages referred to. After 10 years of democracy it is perhaps appropriate to review the functioning of the constitutional system, in particular financial intergovernmental relations, in order to make adjustments for improvement.

The political compromise that led to the development of the current constitutional order – and which made a peaceful transition possible – is a finely balanced compromise and one which should not easily be tampered with.

The Constitutional Court described the agreement on the Constitutional Principles, which paved the way forward in the constitutional negotiations, as a 'solemn pact' between the negotiating parties.¹ This is important to remember, in particular with reference to the nature and composition of the constitutional order and also with reference to the fundamental values underlying our constitutional system.

In reviewing the functioning of financial intergovernmental relations today one should therefore be slow to make radical changes to the system, but quick to 'fine-tune' the functional aspects of the system in order to enhance its accountability, efficiency and equity.

The key features of South Africa's constitutional order,

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which has the characteristics of an integrated federal system, are:

- a three sphere system of government, namely national, provincial and local government;²
- the constitutionally entrenched division of powers and functions among the three spheres of government, where the majority of powers and functions are allocated concurrently to national and provincial governments;³
- the division of fiscal resources, where the bulk of the taxing powers vests with the national government;⁴
- cooperative government as the overarching guiding principle;⁵
- supremacy of the Constitution;⁶ and
- a justiciable bill of rights.⁷

Financial constitutional law – still a new concept in South Africa – could be described as a distinct part of constitutional law, which includes a discussion of:

- economic considerations in the design of financial intergovernmental relations in decentralised systems of government;
- the constitutional allocation of financial resources and expenditure functions to the various levels of government;
- the financial equalisation method used to address the vertical and horizontal fiscal gaps in the system;
- the way in which the law (the Constitution as well as ordinary legislation) deals with policy issues pertaining to financial intergovernmental relations; and
- the justiciability of legal provisions dealing with financial intergovernmental relations.

Against this background the following sections will provide some detail about specific elements of the financial intergovernmental relations system in South Africa. This paper concludes with a discussion of some of the critical challenges relating to the further development of financial intergovernmental relations.

THE FINANCIAL INTERGOVERNMENTAL RELATIONS SYSTEM

Constitutional division of functions and financial resources

In describing the financial intergovernmental relations system in a multilevel system of government, the following questions could be asked: what is the scope of the legislative and executive jurisdiction of each level of government; what financial resources does each level of government have; what mechanisms for financial equalisation or sharing of financial resources are utilised; and how does the Constitution regulate all these matters?

In terms of the Constitution, the provinces in South Africa have original legislative powers as well as assigned legislative powers.⁸ The residual legislative authority rests with parliament, which simply means that the competence to legislate on any functional area not listed in the Constitution lies with parliament.⁹

The Constitution allocates legislative jurisdiction to the various spheres of government in schedules 4 (concurrent legislative functional areas) and 5 (exclusive provincial legislative functional areas). The organisational scheme thus provides for both exclusive and concurrent legislative and executive jurisdiction to all three spheres of government.

It must be noted, however, that in reality the national sphere has dominated the policy-making and legislative field in concurrent matters, leaving provinces as 'executing agencies' of the national government.¹⁰ Provinces have so far not fully utilised the constitutional scope allocated to them as far as it relates to concurrent legislation.

Section 100 of the Constitution¹¹ provides for national intervention in provincial executive activities, and likewise provision is made in section 139 for provincial intervention in municipal executive activities. Such interventions, which are aimed at correcting problems in provinces or municipalities, should only be utilised in limited situations when there is a serious failure of government and must be done in accordance with the principles of cooperative government.¹²

The Constitution allocated legislative authority over the major taxes (personal and corporate income tax, value added tax and customs duties) to the national sphere, which is in line with economic theory on decentralised systems of government, while provinces have a limited

legislative scope on taxation. Provinces may impose taxes, levies and duties other than national and municipal taxes, and may impose flat-rate surcharges on certain nationally levied taxes, levies and duties.¹³ Provinces are also allowed to impose user fees. The right of provinces to legislate on taxes is further limited by the Constitution; namely, it may not be exercised in such a way that materially and unreasonably prejudices national economic policies, cross-provincial economic activities or the national mobility of goods, services, capital or labour. It must also be regulated by an act of parliament, and in 2001 the Provincial Tax Regulation Process Act, 53 of 2001, was adopted by parliament.¹⁴

The constitutionality of this legislation is, however, questionable since it goes further than mere regulation and in fact limits provinces' right to develop provincial taxes. Municipalities have the right to impose rates on property and surcharges on fees for services provided by or on behalf of a municipality.¹⁵ This right is also subject to regulation by national legislation. In general, municipalities create a substantial own tax base by imposing property rates and user fees.

There is thus a centralisation of the major financial resources in South Africa, while at the same time the expenditure jurisdiction for most of the government services are allocated to the provincial and local spheres of government. This creates a vertical fiscal gap which requires some form of financial equalisation or revenue-sharing mechanism. This is quite common in multilevel systems of government, and various countries have different ways of dealing with financial equalisation. In South Africa it is done by way of framework provisions in the Constitution which are augmented by specific national legislation.¹⁶

The Constitution in section 214 makes provision for the enactment of an Act of Parliament that provides for an equitable division of revenue raised nationally among the three spheres of government, the determination of each province's equitable share, and the determination of any other allocations to provinces, local government or municipalities from the national government's share of that revenue.¹⁷

The Constitution further requires that the Financial and Fiscal Commission (FFC) must make recommendations regarding this equitable division of revenue legislation and that a list of factors (for example, the fiscal capacity of provinces and municipalities) and the needs and interest of the national government must be taken

into account when enacting this law. This annual Act is called the Division of Revenue Act.¹⁸

In federal or multilevel systems of government one finds varying degrees of fiscal decentralisation or centralisation depending on the way one looks at it. Fiscal decentralisation has the potential to strengthen good governance values such as accountability and public participation, and to accommodate diversity if the respective provinces have sufficient administrative capacity to educate the citizens about their developmental needs and their preferences regarding the delivery of services.¹⁹ In a country such as South Africa with diverse needs in the various provinces and local communities, fiscal decentralisation could be quite beneficial, but it is dependent on the development of sufficient and appropriate administrative skills at provincial and local government level.

Intergovernmental structures and mechanisms

The FFC is an independent advisory body created by the Constitution; it plays a crucial role with regard to financial intergovernmental relations and public finance matters.²⁰ The members of the FFC are appointed by the state president and include a chairperson, a deputy chairperson and seven other persons.²¹

In addition, various intergovernmental structures have developed over time as part of the development of South Africa's financial intergovernmental relations. The Budget Council, which comprises the minister of finance as its chairperson and the nine provincial members of the executive council (MEC) responsible for finance, is perhaps the most important intergovernmental structure.²² This consultative body meets frequently to discuss matters pertaining to intergovernmental financial and fiscal relations. Although the Budget Council is seen as an effective intergovernmental forum, it is increasingly utilised as a 'management tool' for the minister of finance to ensure that national policies are carried out effectively in the provinces, and it is less of a consultative forum where provinces' views are accommodated.

The Budget Forum was established in addition to the Budget Council in order to include local government in a financial intergovernmental relations forum.²³ As part of the consultative process that leads to the enactment of the annual Division of Revenue Act, there is an important extended cabinet meeting which includes the nine premiers and the MECs responsible for finance.

This is the highest cooperative mechanism for finalising the annual division of revenue, and it creates an opportunity for Premiers to articulate specific provincial needs regarding the division of revenue.

It is not only political actors that play an important role in financial intergovernmental matters; a whole range of senior officials in the national and provincial treasuries play an equally important role. They are responsible for the hands-on implementation of financial legislation and the management of public finance, as well as for handling various policy matters relating to financial and fiscal issues. These officials must, among other things, ensure the effective development and implementation of the Medium Term Expenditure Framework (MTEF), which is an important multi-year planning instrument.

The MTEF details three-year rolling expenditure and revenue plans for national and provincial departments. It is an integral part of the annual budget process and is designed to match the overall financial resource envelope, estimated through 'top-down' macro-economic and fiscal policy processes, with the bottom-up estimation of the current and medium-term cost of existing national and provincial departmental plans and expenditure programmes.²⁴ This is in line with the constitutional requirement that budgets and budgetary processes in all three spheres of government must promote transparency, accountability and the effective financial management of the economy, debt and the public sector.²⁵

Cooperative government

South Africa's constitutional system is characterised by its integrated and cooperative nature, in contrast to the competitive federal system which exists in countries such as Canada and the United States. Based on the principle of *Bundestreue* (federal loyalty and trust) found in the German constitutional system, a specific chapter (Chapter 3) on cooperative government was included in the South African Constitution.²⁶

The creation of three distinctive spheres of government suggests the recognition of some degree of constitutional autonomy of each sphere, which is confirmed by the principles of cooperative government. Chapter 3 specifically requires that each sphere of government must preserve the national unity and indivisibility of the country, and that they must cooperate with one another in mutual trust and good

faith by fostering friendly relations and by assisting and supporting one another. Cooperation is based on the premise that there is more than one entity, each with its own jurisdiction and institutional integrity.

When one considers the meaning of *Bundestreue*, it is evident that there must be mutual respect and trust between the cooperating partners; cooperative government does not mean that provinces and municipalities are just at the receiving end of a channel of national government policies. Unfortunately, however, it seems that in many intergovernmental forums 'cooperative government' is understood to mean that the relevant national minister must ensure that national policies are implemented by the provinces, resulting in the lack of a true spirit of cooperation.²⁷

The principles of cooperative government and inter-governmental relations contained in section 41(1) of the Constitution are as follows:

- All spheres of government and all organs of state within each sphere must –
- (a) preserve the peace, the national unity and the indivisibility of the Republic;
 - (b) secure the well-being of the people of the Republic;
 - (c) provide effective, transparent, accountable and coherent government for the Republic as a whole;
 - (d) be loyal to the Constitution, the Republic and its people;
 - (e) respect the Constitutional status, institutions, powers and functions of government in other spheres;
 - (f) not assume any power or function except those conferred on them in terms of the Constitution;
 - (g) exercise their powers and perform their functions in a manner that does not encroach on the geographical, functional or institutional integrity of government in another sphere; and
 - (h) co-operate with one another in mutual trust and good faith by –
 - (i) fostering friendly relations;
 - (ii) assisting and supporting one another;
 - (iii) informing one another of, and consulting one another on, matters of common interest;
 - (iv) co-ordinating their actions and legislation with one another;

- (v) adhering to agreed procedures; and
- (vi) avoiding legal proceedings against one another.

These principles are also of crucial importance in financial intergovernmental relations. In addition to the Constitutional prescripts in this respect, the intricate and interdependent nature of public finance in a federal or multilevel system of government requires that there must be a great deal of cooperation between the various government entities.

PROVINCIAL FINANCES

Budgets

Provinces and national departments all follow the same budget cycle and have their financial year ending on 31 March each year. In accordance with the multi-year planning approach as reflected by the MTEF, there is an integrated budget planning and preparation process. The National Treasury annually issues a set of guidelines for the MTEF. This includes a fairly rigid timetable which national departments and provinces must follow for assessing past expenditure performance, doing internal financial planning exercises, making their respective budget submissions and having the various intergovernmental meetings to discuss the MTEF in detail. These guidelines also provide information regarding the broad strategic objectives of the national government. For example, in the 2007 MTEF Guidelines, reference is made to 'growing the economy, expanding social development and achieving greater equity in society'.

Some of the crucial milestones in the budget planning cycle are: presentation by the minister of finance of the Medium Term Budget Policy Statement (MTBS), normally in October; cabinet approval of the MTEF in November; and the tabling of the budget in parliament by the minister of finance, normally in February each year.²⁸ The annual budget consists of the following pieces of legislation: the Division of Revenue Act, Appropriation Act and the Revenue Laws Amendment Act.

In accordance with the constitutional requirement in section 215(1) that budgets and budgetary processes must enhance transparency, accountability and effective financial management, the Public Finance Management Act (PFMA), 1 of 1999, contains detailed provisions about budgets for the national and provincial governments and organs of state within those spheres.

Provincial budgets must provide for capital and current expenditure as well as the sources of revenue; that is, own revenue as well as the equitable share of the province.

In view of the integrated nature of the constitutional system, the provincial budget cycle in all nine provinces follows a similar timeline and it forms part of the overall budget cycle for the country. The annual budget cycle normally starts with the medium term expenditure review early in the year, when the provincial cabinet has the opportunity to consider the new (own and national) expenditure priorities that arise from a review of the overall budget framework, and which include fiscal policy considerations and overall spending growth. Policy review is designed to assist departmental planning and budgeting and to guide the provincial treasury in the evaluation of budget proposals.²⁹

The various provincial technical committees have mid-year discussions with the respective provincial departments about the key spending priorities and pressures. By December, all the provinces must finish their planning and budget documentation for the next year to be in time for the presentation of the annual National Budget in February, and the respective provincial budgets shortly thereafter.

Financial management

Effective financial management in all spheres of government is constitutionally mandated.³⁰ The PFMA is a comprehensive law that was adopted by Parliament to promote good governance in the national and provincial spheres of government, and it came into effect on 1 April 2000. The main objectives of the Act are to:

- modernise financial management in the public sector;
- enable managers to manage better, but also to be more accountable;
- ensure the timely provision of quality information; and
- promote efficient utilisation of public assets and eliminate waste and corruption.

The National Treasury and the Provincial Treasury in

each of the nine provinces are the key institutions that must ensure the effective implementation of the PFMA. Provincial treasuries are responsible for the preparation of provincial budgets, must manage the implementation of the provincial budget, promote and enforce transparency and effective financial management, and ensure that its fiscal policies do not materially and unreasonably prejudice national economic policies.³¹

The PFMA distinguishes between political responsibility and financial accountability. The political head of a department, that is the national minister or the provincial MEC, is responsible for policy matters and outcomes relating to the management of his or her allocated portfolio. The administrative head of department or director-general is responsible for the effective implementation of policies and the budget, and is accountable to parliament or the relevant provincial legislature, as the case may be. In terms of the PFMA the Minister or MEC is the executive authority, while the head of department is the accounting officer.³² Each accounting officer is in particular responsible for:

- the implementation of basic financial management systems, including risk management, an internal audit system, and an appropriate procurement and provisioning system;
- effective management of the budget;
- ensuring that there is regular (monthly and annual) reporting, including the timeous submission of annual financial statements; and
- the publication of annual reports, including performance reporting.³³

Failure to comply with the strict requirements of the Act and the financial regulations in terms of the Act could result in financial misconduct or even criminal action.³⁴

Sound financial management includes regular reporting, but also monitoring the budget against the strategic plan of a department to ensure the effective and efficient utilisation of the allocated resources. In this respect all nine provincial treasuries play a crucial role in ensuring that the provincial departments implement their budgets in line with their strategic plans. In year monitoring provides an opportunity for departments and provincial treasuries to take

corrective measures where necessary. The relevant portfolio committees in the provincial legislatures also have an important oversight function and must ensure that the provincial departments and organs of state provide them with regular and proper reports regarding their budgets.

Provincial taxes

In terms of section 228(1) of the Constitution, provinces are allowed to raise taxes, levies and duties other than personal and corporate income tax, value-added tax, general sales tax, property rates and customs duties. Provinces could also impose a flat-rate surcharge on certain nationally imposed taxes and may impose user fees. This provincial taxing power is limited in its scope by the Constitution since it may not be exercised in such a way that materially and unreasonably prejudices national economic policies, cross-provincial economic activities or the national mobility of goods, services, capital or labour.³⁵ It must also be regulated by an Act of Parliament, and such an Act, namely the Provincial Tax Regulation Process Act, 53 of 2001, was adopted by parliament in 2001 and is now in operation.³⁶ The already limited scope for provincial taxes has been further limited by the strict requirements of this Act, which appears to be unconstitutional since it encroaches on the provinces' constitutionally allocated taxing powers.³⁷

Despite these 'setbacks', some provinces have begun creating more own sources of revenue which could increase the discretionary part of their respective budgets and would also contribute to more accountability. The Western Cape has, for example, decided to introduce a fuel levy, but it will only be implemented after the adoption of a law on a Western Cape fuel levy, which will be done in 2008 at the earliest.³⁸

It is clear that as the demand for more financial resources grows, the imposition of new taxes could be explored further, such as a 'green tax' on carbon dioxide emissions, a transport tax on passengers arriving or departing by air, bus or rented car, or a tourism bed levy.³⁹

Provincial taxes such as the examples sited here are likely to have a limited effect on the total tax situation in the country. However, it will have a direct effect on the tax payers within the respective provinces as well as on the accountability and financial manoeuvrability

of such provincial governments. It is an issue that should be dealt with pragmatically, but with necessary caution. It should, however, not be treated in a way that inhibits provincial experimentation and innovation.

MUNICIPAL FINANCES

Budgets

The same constitutional requirement that applies to national and provincial budgets also applies to municipal budgets, namely that budgets and budgetary processes must promote transparency, accountability and effective financial management.⁴⁰ The Local Government: Municipal Finance Management Act, 56 of 2003 (MFMA), covers a wide range of issues relating to sound financial management of municipalities, including budgets and budgetary processes, in accordance with the constitutional requirements.

The financial year of all local authorities in South Africa is not the same as that for the national and provincial governments, since it ends on 30 June each year.⁴¹ The council of each municipality, whether it is a district or local municipality in terms of the Local Government: Municipal Systems Act, 32 of 2000, must approve an annual budget for that municipality before the start of each financial year.⁴²

In accordance with the format prescribed by the MFMA, annual municipal budgets must include:

- a capital and an operating budget;
- a clear indication of expected revenue;
- the appropriation of expenditure for the budget year for each municipal vote; and
- a statement on the actual revenue and expenditure of the previous financial year.⁴³

In the spirit of cooperative government prescribed by Chapter 3 of the Constitution, the MFMA also determines that there must be consultation between the mayor of a municipality and other relevant (local or district) municipalities, the relevant provincial treasury, and when requested the National Treasury, and any other national or provincial organ of state as may be prescribed. Furthermore, in preparation of the annual budget the mayor must take into account the integrated development plan of that municipality, the national budget, the provincial budget, the national

government's fiscal and macroeconomic policy, the annual Division of Revenue Act and any agreements reached in the Budget Forum.⁴⁴ The views of the local community should also be considered. These legal requirements lay the basis for a consultative and informed budgetary process. Budget documentation must be published immediately after an annual budget is tabled in a municipal council to ensure transparency.⁴⁵

Financial management

The MFMA contains detailed provisions regarding the financial management of municipalities. It determines that a municipal manager will be the accounting officer of a municipality.⁴⁶ It is evident that a municipal manager has a fiduciary relationship with a municipality, which implies that he or she must 'act with fidelity, honesty, integrity and in the best interests of the municipality'.⁴⁷ The financial management responsibilities of a municipality's accounting officer further includes:

- responsibility for efficient and effective utilisation of municipal resources;⁴⁸
- good record keeping;⁴⁹
- maintaining effective, efficient and transparent systems of risk management and internal audit;⁵⁰
- sound asset and liability management;⁵¹ and
- revenue and expenditure management.⁵²

An important part of a municipal manager's job is to assist the mayor in the preparation of the annual budget and to manage the implementation of the budget.⁵³ Similar to the situation in provinces and national departments, there is a duty on municipalities to provide regular reports on their financial affairs to the National Treasury, the relevant provincial treasury, the department of local government in the province, the auditor-general and the provincial legislature as may be required.⁵⁴ The provincial treasury and National Treasury are key institutions in the overall public financial management system and must both assist municipalities and monitor their performance.

It is not only the municipal manager that carries the responsibility for the effective financial management of a municipality. The Act also stipulates that the top

management of a municipality, consisting of the chief financial officer, all senior managers responsible for managing municipal votes and any other designated senior official, must assist the accounting officer to manage the financial administration of a municipality.⁵⁵

A municipality is a government entity and cannot function without an appropriately constructed and staffed budget and treasury office, similar to the national and provincial treasuries. The Act thus makes provision for the establishment and functioning of such budget and treasury offices.⁵⁶

These legislative measures regarding financial management are aimed at promoting good governance and are supported by provisions in the Local Government Municipal Systems Act, 32 of 2000, which determine that all municipalities must create appropriate and effective administrations to enable them to fulfil their constitutional mandates.⁵⁷

If there are serious financial problems within a municipality, section 139(1) of the Constitution allows for provincial intervention to address the problem. The MFMA deals with these intervention measures in detail and provides for both discretionary and compulsory provincial interventions in case of a financial crisis in a municipality.⁵⁸

Intervention from one sphere of government in the affairs of another is a serious matter that must be dealt with accordingly and in a way that adheres to the principles of cooperative government. When such an intervention takes place, the MFMA allows for the development of financial recovery plans to ensure that a municipality is enabled to meet its obligations to provide basic services or its financial commitments.⁵⁹

Municipal taxes

Municipalities are entitled to raise property rates, impose user fees and surcharges on fees for services provided by or on behalf of the municipality. If authorised by national legislation, a municipality could also impose other taxes, levies and duties appropriate to local government.⁶⁰ The Constitution limits this tax raising power of municipalities by stating that it may not be used 'in a way that materially and unreasonably prejudices national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour'. It may also be regulated by national legislation.⁶¹ Such

regulatory legislation, namely the Local Government: Municipal Property Rates Act, 6 of 2004, took effect on 2 July 2005 and is being implemented by all municipalities over a four-year period. This Act creates a new property rating system based on transparency and fairness, that provides for fair and equitable valuation methods of property, and which makes provision for municipalities to allow exemptions, reductions and rebates through their rating policies.

The bulk of income of municipalities comes from user charges, mainly for water and electricity, property rates and other locally raised revenue, and account on average for more than 93% of municipal income. Municipalities should thus be financially self-sufficient, but there are various factors that impact on their financial autonomy, such as the lack of sufficient revenue collection by many municipalities and the increasing scope of implementation of nationally determined basic services.⁶² Municipalities also receive transfers from the National Treasury in terms of the annual equitable division of revenue, which have experienced a steady increase over the past few years.⁶³

The National Treasury is busy with further local government fiscal reform measures to enhance the ability of municipalities to perform their constitutional mandate to develop local communities and to provide basic services. These reform measures follow on the Local Government Municipal Finance Management Act, 2003, and the Local Government Municipal Property Rates Act, 2004, which are two important laws that shape the fiscal and financial architecture of local government in South Africa. These reform measures will include arrangements to replace funding from the repealed Regional Services Council levies (referred to as Joint Services Board levies in KwaZulu-Natal) as well as the restructuring of the water and electricity distribution services.⁶⁴

ROLE OF THE COURTS

In addition to a vertical division of powers between the national, provincial and local spheres of government in South Africa there is a horizontal division of powers between the executive, legislative and judicial branches of government.

Judicial review, the doctrine of separation of powers and the principle of supremacy of the Constitution are fundamental to the constitutional order in South Africa.

The Constitution stipulates clearly that it is the supreme law of South Africa and that all law or conduct inconsistent with it is invalid.⁶⁵

The courts, in particular the Constitutional Court, play an important role in upholding this principle of constitutional supremacy. The importance of an independent judiciary in applying the separation of powers doctrine in South Africa was confirmed by the Constitutional Court in *Executive Council of the Western Cape Legislature v President of the Republic of South Africa*.⁶⁶ The judgement made it clear that the Court will not interfere in the realm of the executive or legislative branches of government, but that it will fulfil its role to interpret the Constitution and to uphold the principle of supremacy of the Constitution. The Court described its role as follows:

Our duty is to declare legislative and executive action which is inconsistent with the Constitution to be invalid, and then to deal with the consequences of the invalidity in accordance with the provisions of the Constitution.⁶⁷

The Constitutional Court is the highest court on constitutional matters, and this authority includes being the final adjudicator in constitutional disputes between organs of state in the national or provincial sphere of government concerning their constitutional status, powers and functions,⁶⁸ as well as having the final say in disputes about the constitutionality of a parliamentary or provincial bill and any provincial or national Act.⁶⁹

The Constitution provides that organs of state involved in intergovernmental disputes should make an effort to settle such dispute by other means before going to court.⁷⁰ This clearly does not mean that intergovernmental disputes should never go to court. The Constitutional Court has an important role to play as adjudicator of such disputes and it is necessary that the Court, being an independent judicial institution, interpret the Constitution and the law to give clarity and to uphold the supremacy of the Constitution. There were in fact quite a few important judgements by the Constitutional Court regarding the division of powers between the national and provincial governments.⁷¹

The issue of concurrency, which forms the basis of most of the provincial powers, is not clearly defined in the Constitution and is open to judicial interpretation. In this respect the Constitutional Court holds the view

that 'where two legislatures have concurrent powers to make laws in respect of the same functional area, the only reasonable way in which these powers can be implemented is through co-operation'.⁷² This confirms the constitutional requirement that all governments and organs of state should interact with one another in the spirit of cooperative government, but it does not bring clarity about the constitutional demarcation of powers.⁷³

Provinces have an allocated constitutional space which has not been explored fully. Concurrent jurisdiction over a range of functions is central to this constitutional space. In the last judgement on such an issue, *Mashavha v President of the RSA* 2004 12 BCLR 1243 (CC), the Constitutional Court somewhat surprisingly found that 'social assistance' is a function that should be dealt with by the national government despite the fact that 'welfare services' is a concurrent function.⁷⁴

This judgement gives the impression that the Court will rather lean towards centralisation when deciding matters relating to the demarcation of functions, which is clearly not the way the Constitution has been designed. Whether this would in fact be the case in future judgements of this nature remains to be seen. Hopefully this will not deter any organ of state or individual to test matters relating to concurrency before the Court, which is in the ideal position to give a thorough analysis of the applicable law and to give content to the meaning of concurrency in practice.

Financial intergovernmental relations have not been tested properly before the Constitutional Court. The only case before the Court dealing with aspects of the annual division of revenue is *Uthukela District Municipality and Others v The President of the RSA and Others* 2002 11BCLR 1220 (CC).

In this case the question was whether category C municipalities (district municipalities) are entitled to an equitable share of nationally raised revenue, but the matter was settled out of court before the Constitutional Court could address the Constitutional questions relating to the scope of sections 214 and 227 of the Constitution.

Disputes about financial matters often contain both legal and policy issues due to their nature. For example, a dispute about a minister's decision to increase spending at some schools to the detriment of

other schools in a particular province. The Constitutional Court in this respect would not question specific budget preferences or the desirability of specific measures taken by the state. It would, however, assess the reasonableness of legislative or other measures taken by the state.⁷⁵

Financial intergovernmental relations – in particular financial equalisation or the equitable division of revenue – remain a complex field in which the Constitutional Court could also give further meaning to this developing part of constitutional law.

CHALLENGES AND SUGGESTIONS

South Africa is a young democracy, and democracy should be dynamic and growing – it should never stagnate. This implies that there should be introspection from time to time to review the system in order to make adjustments that would contribute to strengthening the democracy.

South Africa is confronted by various challenges, some of which relate directly to the functioning of financial intergovernmental relations or the performance of various governments in South Africa. Although there are serious socio-economic challenges, such as the eradication of severe poverty and the fight against HIV/Aids, this discussion will focus only on some of the key challenges relating to the functioning of financial intergovernmental relations in South Africa.

These challenges are:

- the lack of sufficient administrative and management capacity within government; and
- finding a 'suitable' degree of fiscal autonomy or decentralisation needed to strengthen service delivery.

Administrative and management capacity

Although there are shortages of appropriately qualified personnel in all three spheres of government, it is perhaps more acute within local government where there is a more direct link between citizens and government than in any other sphere of government. This situation is aggravated by the serious under-performance of various municipalities, which is evidenced by a lack of service delivery within the respective communities.

The seriousness of the situation in some communities has even led to public protests by residents because they are not receiving the services that a municipality should provide. There is also a lack of sufficient technical skills, for example in engineering, which is crucial for maintaining existing and developing new infrastructure such as roads, water distribution and sewerage systems.

Within the provincial sphere of government, some provinces are struggling due to a lack of sufficient administrative and management capacity required to execute their constitutional mandate as governments. Underspending due to poor planning, poor management or a combination of both also occurs at provincial level, in particular in relation to capital projects. The situation is, however, improving, as reported by the National Treasury in its Budget Review 2007.⁷⁶

There are various reasons for the capacity deficit at local and provincial level. An initial problem when the new provinces and municipalities were created was the very quick transfer of responsibilities to them, with the relevant capacity having to be developed.⁷⁷ However, after more than a decade of democracy this should no longer be a problem. Another reason is the particular way in which affirmative action targets are chased within government, which has unfortunately resulted in a huge loss of management and technical skills at various provincial and local governments.

While the pressure for quick transformation is high, the reality is that it takes time to develop new managers and to obtain scarce technical skills, irrespective of a person's ethnic background. A more pragmatic approach to employment equity is thus required in order to achieve a more representative workforce, and at the same time to develop the required capacity. In a growing economy like South Africa's, it is crucial to utilise all available technical and management skills.

Special provision is made in the 2007 budget to deal with the capacity deficit in order to improve good governance and service delivery, which is a positive development. There is, for example, a specific programme, the Siyenza Manje initiative, which utilises expertise provided by the Development Bank of Southern Africa in partnership with various municipal and provincial governments to improve the planning, project management and technical capacity in municipalities.⁷⁸

Sound public financial management and effective administration are the basis of good governance. In addition, an effective financial intergovernmental relations system would support good governance and improved service delivery.

Good foundations have been laid for sound public financial management at all three spheres of government with the implementation of the Public Finance Management Act, 1999, and the Local Government Municipal Finance Management Act, 2003. The system has been functioning reasonably well for a few years now at national and provincial government level, and the challenge is to ensure that the MFMA is implemented with the same degree of success in all municipalities throughout South Africa.

It is not only the strengthening of capacity of managers and financial administrative staff that is important; the checks and balances provided by the various institutions in terms of this legislation make an equally important contribution to sound public financial management.

Decentralisation and service delivery

There is often debate in multilevel systems of government about the degree of centralisation or decentralisation suitable for that particular country. The process of constitutional reform in Spain, for example, centres on the issue of decentralisation of functions and more fiscal autonomy for the communities (provinces).⁷⁹ In Brazil, where huge regional inequalities exist, there is growing pressure for fiscal reform to provide more fiscal autonomy to the cities and the provinces, and thus to support an equitable fiscal relationship among the three levels of government.⁸⁰

Such a discussion is inherent in multilevel systems of government and there is no specific model that could be applicable in all cases. Although political ideas and ideology could drive such discussions, it is often a case of practical concerns, such as the need for more efficient service delivery at local and provincial government level, that influence these debates.

In the case of South Africa the debate is mainly a politically driven one, but practical concerns such as the lack of proper and efficient service delivery by many local and provincial governments also influence the debate. There is a widely supported view within the

African National Congress that there should be more centralisation of functions to ensure an effective redistribution of resources and to coordinate policy development and service delivery throughout the country. More fiscal decentralisation and more powers to the provinces are viewed with scepticism by supporters of this view and are seen as a way to perpetuate economic inequalities that could potentially fragment the country.⁸¹

There is also an opposite view, supported by economic theory and developments in various other multilevel systems of government such as Germany and Spain, that large countries would benefit from more decentralisation and fiscal autonomy due to the fact that provinces and municipalities are closer to the people and should be able to respond to their particular needs more effectively.⁸² Provinces and municipalities are in a better position than the national government to experiment and innovate regarding the services they provide to their respective communities and to respond directly to their needs, but to do that they need a reasonable degree of autonomy.

The centralisation of taxation powers more than what is required to meet the national expenditure needs strengthens political control over sub-national governments and could even weaken their accountability.⁸³ According to economic theory, with respect to fiscal federalism the allocation of expenditure responsibilities should match the allocation of revenue sources as close as possible to strengthen accountability and efficiency. This implies that provinces and municipalities should have more autonomy to decide about their income as well as their expenditure responsibilities and how they deliver their services. This does not detract from the need for centralisation of certain functions such as macroeconomic stability and redistribution policies, which is in line with economic theory.

The debate in all multi-level systems of government is really about finding the right balance between centralisation and decentralisation within the context of a particular country. In the case of South Africa the principles of cooperative government characterise the relations between the various spheres of government. This implies a balanced approach, giving proper recognition to the constitutional mandates and needs of all constituent governments, and does not mean that there should be a centralisation of decision-making under the guise of cooperative government structures,

for example within the various Minmeccs (the line function intergovernmental forums between the national and provincial executives). Provinces should utilise these structures, in particular on financial intergovernmental issues, more effectively to lobby and discuss their particular provincial needs, and to provide constructive input into the development of national policies and legislation.⁸⁴

The decentralisation question is not limited to the functioning of intergovernmental structures. It is in the first place about the degree of constitutionally allocated responsibility to provinces and municipalities. In this respect provincial autonomy could, for example, be strengthened by giving more recognition to provinces' constitutional authority regarding concurrent functional areas. The effective exercise of such authority in turn depends on the actual administrative and management capacity within each province and municipality. Greater autonomy is thus not only a political or constitutional question but also a practical one.

In order for provinces and municipalities to enjoy more autonomy, they need to be equipped to do so. It is

primarily the task of each government to ensure that it builds the necessary capacity to effectively discharge its constitutional mandate. There is, however, also a constitutional duty on the national government to strengthen the capacity within provinces, and a similar duty on provinces to promote the development of local government capacity.⁸⁵ These constitutional provisions should be taken more seriously and given effect before questions are raised about reducing the number of provinces or further limiting provincial powers. If this is approached in a constructive way, it would go a long way in strengthening service delivery throughout the country, while recognising that there are different needs and strengths within the different areas of South Africa.

Taking stock of how the constitutional system has developed requires an honest and objective approach that gives recognition to the political compromise which cemented the South African Constitution, while also looking at the future in order to strengthen the system in such a way that it would be better equipped to deal with local challenges, as well as to compete within the global economy. ■

ENDNOTES

- 1 *In Re: Certification of the Constitution of the Republic of South Africa*, 1996 1996 4 SA 744 (CC); 1996 10 BCLR 1253 (CC) (*First Certification case*) para 15.
- 2 Sec 40 of the Constitution (Constitution of the Republic of South Africa, 1996).
- 3 This is dealt with in various provisions in the 1996 Constitution, eg sec 44 (legislative authority of parliament); sec 104 (legislative authority of provincial legislatures); sec 156 (powers and functions of municipalities); Schedule 4 (functional areas of concurrent legislative jurisdiction) and Schedule 5 (functional areas of exclusive provincial legislative competence).
- 4 Sec 228 of the Constitution.

- 5 Sec 41 of the Constitution.
- 6 Sec 1,2 of the Constitution.
- 7 Ch 2 of the Constitution.
- 8 Sec 104(1)(b) of the Constitution; *First Certification Case* paras 258-259; Currie I & De Waal J, *The New Constitutional & Administrative Law, Vol 1 Constitutional Law*, Juta, Cape Town, 2001, p 201; Malherbe EFJ & Brand DJ, South Africa – Sub-national Constitutional Law, in Alen A et al (eds), *International Encyclopaedia of Laws – Sub-national Constitutional Law*, Kluwer Law International, The Hague, 2001, pp 49-56; Rautenbach IM & Malherbe EFJ, *Constitutional Law*, 3rd ed., Butterworths, Durban, 1999, p 278 et seq.

- 9 Sec 44 of the Constitution; *First Certification Case* para 239.
- 10 Malherbe EFJ, Centralisation of power in education: Have provinces become national agents?, *TSAR*, 2006, p 237.
- 11 It was amended by the Constitution of the Republic of South Africa Second Amendment Act, 2003 (Act 3 of 2003).
- 12 *First Certification Case* paras 263-266; Murray C, Municipal integrity and effective government: The Butterworth intervention, *SAPR/PL* 14, 1999, pp 332-342; Malherbe EFJ, Die Drankwetsontwerp: vooraf kontrole en grondwetlike gesagsverdeling verder omlin, *THRHR*, 63, 2000, pp 321-331.
- 13 Sec 228 (1) of the Constitution.
- 14 13 Sec 228 (2) of the Constitution. This Act was assented to on 4 December 2001 and published in *Government Gazette* No 22918 of 10 December 2001.
- 15 Sec 229 (1) of the Constitution.
- 16 For a detail discussion of financial equalisation in South Africa see Brand D, *Financial Constitutional Law*, Konrad-Adenauer-Stiftung Occasional Paper, Johannesburg, 2006, pp 183-222; see also Murray C & Simeon R, South Africa's financial constitution: Towards better delivery?, *SAPR/PL* 15, 2000, pp 477-504.
- 17 Sec 214 (1) and 227 of the Constitution.
- 18 See for example the Division of Revenue Act, 1 of 2007.
- 19 Ajam T, The evolution of devolution: Fiscal decentralization in South Africa, in Abedian I & Biggs M (eds), *Economic Globalisation and Fiscal Policy*, 1998, pp 54-94.
- 20 Sec 220 of the Constitution. The constitutional provisions are supplemented by the Financial and Fiscal Commission Act, 99 of 1997.
- 21 Initially the FFC included nine persons nominated by the provinces, two persons nominated by organised local government and nine other persons, but the Constitution was amended in 2001 (Act 61 of 2001) in order to have a smaller commission.
- 22 Sec 2 of Act 97 of 1997. These persons together with the top officials in the National Treasury and the nine provincial treasuries refer to themselves as 'Team Finance'. See Ajam, op cit.
- 23 Sec 5 of the Intergovernmental Fiscal Relations Act, 97 of 1997 makes provision for the establishment of the Budget Forum, which consists of the minister of finance, the nine MECs for finance and representatives of organised local government.
- 24 *MTEF Treasury Guidelines 2005*, National Treasury.
- 25 Sec 215 (1) of the Constitution.
- 26 *First Certification Case* para 289; Brand, op cit, pp 60-65; Haysom N, Federal features of the final Constitution, in Andrews & Ellmann (eds), *The Post-Apartheid Constitutions*, 2001, pp 504-514.
- 27 Malherbe, Centralisation of power in education, op cit, pp 237-252.
- 28 *MTEF Treasury Guidelines: Preparing budget proposals for the 2007 MTEF*, National Treasury, July 2006, p 4.
- 29 Ibid, p 30.
- 30 Sec 215 (1) of the Constitution.
- 31 Sec 18 (1) of Act 1 of 1999.
- 32 Sec 1 of Act 1 of 1999.
- 33 Sec 38 of Act 1 of 1999.
- 34 Sec 81-86 of Act 1 of 1999.
- 35 Sec 228 (2) of the Constitution.
- 36 This Act was assented to on 4 December 2001 and published in *Government Gazette* No 22918 of 10 December 2001.
- 37 Brand, op cit, p 125; Murray & Simeon, op cit, pp 477-482.
- 38 *2007 Budget Overview*, Western Cape Provincial Treasury, February 2007, p 48.
- 39 Ibid, p 49.
- 40 Sec 215 (1) of the Constitution.
- 41 Sec 1 of Act 56 of 2003.
- 42 Sec 16 read with sec 24 of Act 56 of 2003.
- 43 Sec 17 read with sec 18 and 20 of Act 56 of 2003.
- 44 Sec 21 and 23 of Act 56 of 2003.
- 45 Sec 22 of Act 56 of 2003.
- 46 Sec 60 of Act 56 of 2003.
- 47 Sec 61(1) of Act 56 of 2003.
- 48 Sec 62(1)(a) of Act 56 of 2003.
- 49 Sec 62(1)(b) of Act 56 of 2003.
- 50 Sec 62(1)(c) of Act 56 of 2003.
- 51 Sec 63 of Act 56 of 2003.
- 52 Sec 64 and 65 of Act 56 of 2003.
- 53 Sec 68 and 69 of Act 56 of 2003.
- 54 Sec 71-74, 132 of Act 56 of 2003, read with sec 46 of Act 32 of 2000.
- 55 Sec 77-79 of Act 56 of 2003.
- 56 Sec 80-83 of Act 56 of 2003.
- 57 Sec 51, 55-57 of Act 32 of 2000.
- 58 Sec 136-140, read with sec 148-149 of Act 56 of 2003; Steytler N, Local government in South Africa: Entrenching decentralised government, in Steytler N (ed), *The Place and Role of Local Government in Federal Systems*, KAS Occasional Paper, Johannesburg, November 2005, p 203.
- 59 Sec 141-146 of Act 56 of 2003.
- 60 Sec 229 (1) of the Constitution.
- 61 Sec 229 (2) of the Constitution.
- 62 Steytler, op cit, p 201.
- 63 Local government percentage share of equitable revenue is 6.5% for the 2006/07 financial year and a slow but steady increase is expected for the next three financial years.
- 64 *Budget Review 2007*, National Treasury, 21 February 2007, p 258.

- 65 Sec 1, 2 of the Constitution.
- 66 1995 4 SA 877 (CC) paras 55- 60. See also sec 165 of the Constitution; Currie & De Waal, op cit, p 92; Rautenbach & Malherbe, op cit, pp 86-92.
- 67 *Western Cape-case* para 100. See also *President of the RSA v United Democratic Movement* 2003 1 SA 472 (CC) para 31.
- 68 Sec 167(4)(a) of the Constitution.
- 69 Sec 167(4)(b) and (c) of the Constitution. See also Malherbe & Brand, op cit, p 71; Venter F, *Constitutional Comparison – Japan, Germany, Canada & South Africa as Constitutional States*, Juta, Cape Town, 2000, p 101; Rautenbach & Malherbe, op cit, p 256; Sarkin J, The political role of the South African Constitutional Court, *SALJ* 114, 1997, pp 134 145; Claassen CJ, The functioning and structure of the Constitutional Court, *THRHR* 57, 1994, p 419.
- 70 Sec 41 (3) of the Constitution.
- 71 See for example *In re: National Education Policy Bill, No. 83 of 1995*, 1996 4 BCLR 518 (CC); *Executive Council of the Western Cape Legislature v President of the Republic of South Africa* 1995 4 SA 877 (CC); *Ex Parte Western Cape Provincial Government: In re DVB Behuising (Pty) Ltd v North West Provincial Government* 2000 4 BCLR 347 (CC); *Ex parte President of the Republic of South Africa: In re Constitutionality of the Liquor Bill* 2000 1 SA 732 (CC); Malherbe, Centralisation of power in education, op cit, p 237.
- 72 *In re: National Education Policy Bill, No 83 of 1995* 1996 4 BCLR 518 (CC) para 34.
- 73 Malherbe, Centralisation of power in education, op cit, pp 237-242.
- 74 See discussion of judgement by Malherbe EFJ, Grondwetlike bevoegdheidsverdeling: 'n Stap agteruit vir Provinsiale Regering?, *TSAR*, 2005, p 862.
- 75 *Khosa and Others v Minister of Social Development and Others, Mahlaule and Another v Minister of Social Development and Others* 2004 6 BCLR 569 (CC).
- 76 *Budget Review 2007*, op cit, p 119.
- 77 Murray & Simeon, op cit, p 499.
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