A CRITICAL EVALUATION OF THE SOUTH AFRICAN INTERGOVERNMENTAL GRANT SYSTEM

by

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ABSTRACT

That there has been a revolution in intergovernmental fiscal relations system is undeniable. The political and constitutional transformation that took place in South Africa has not gone unnoticed in the civil society, and certainly not in the international world affairs.

After a period close to a decade of democratic system of governance in South Africa, the time is more than ripe to do a comprehensive review of intergovernmental fiscal relations. Given the variety of demands and pressures on the system, both from policy and from a constitutional point of view, it is important to reflect on the performance of the system in a manner that prepares it for future challenges.

Provinces are no longer merely spending agencies for central government. Instead, they have been empowered by the Constitution to fashion their own policy priorities in certain areas and to translate these into resource allocations that will support these policy objectives.

The focus of this study is to critically evaluate the South African intergovernmental grant system since 1994, noting the changes, successes and challenges that constitute future areas of improvement. The results can be used by other policy analysts, managers and can also constitute the basis for future research.

CHAPTER ONE

1. INTRODUCTION AND BACKGROUND TO THE STUDY

1.1. Problem Identification

The aim of this study is to give an overview of the rationale for fiscal federalism and the nature of intergovernmental fiscal relations in South Africa.

1.2. Background

One of the problems has been that provincial expenditure has never been balanced, i.e. there has never been a financial year in which expenditure has been the same (or at least close) as the budgeted revenue. In other words, expenditure has always registered either a deficit or a surplus. A deficit means that provincial spending overshot budgeted funds, while surplus outcomes refer to cases where spending was less than the budgeted amounts. This study endeavours to explain the reasons behind this dilemma, and to recommend steps to overcome this problem.

The new system of intergovernmental relations in South Africa implemented after 1994 differs fundamentally from the past system of government. Given the complexity of the three spheres system, (these spheres are *"distinctive, interdependent and interrelated"*); it is critical to develop some clear principles to guide the relationship between governments in the three spheres (National Treasury 2002: 1).

The South African Intergovernmental Fiscal Relations (IGFR) system is made up of nine provinces. The Intergovernmental Relations Division of the National Treasury coordinates fiscal relations between the national, provincial and local government spheres – a key role of South Africa's nascent intergovernmental fiscal system. The branch manages the Intergovernmental fiscal-relations framework, analyses and ensures oversight of provincial budgets and intergovernmental grants, and implements financial management reforms at the provincial level.

Provinces have registered surpluses for the past three years R1, 9 billion in 1999/00, R3, 2 billion and R1, 9 billion in 2001/02. Although the surpluses account for 1, 5 percent of the total provincial revenue, this varies considerably across provinces. Table 1 shows the surplus/deficit for three years from 1999/01 financial year up to 2005/06 financial year.

Table 1: Summary of (Surplus)-Deficits per province

	1999/00 Actual	2000/01 Actual	2001/02 Actual	2002/03 Estimated Actual	2003/04 Meduim Term estimates	2004/05	2005/06
Eastern Cape	*Rm*	*Rm*	*Rm*	*Rm*	*Rm*	*Rm*	*Rm*
Revenue	17,086	18,707	20,700	23,537	26,964	29,959	33,064
Expenditure	16,307	18,162	19,591	24,019	27,933	29,959	33,065
Surplus/ (deficit)	**779**	**545**	**1,109**	**-482**	**-969**	**-**	**-1**
Free State							
Revenue	7,037	7,749	8,656	9,654	11,056	12,248	13,363
Expenditure	6,692	7,431	8,227	10,054	11,056	12,248	13,363
Surplus/ (deficit)	***345***	***318***	***429***	***-400***	**-**	**-**	**-**
Gauteng							
Revenue	17,385	18,818	21,098	23,825	27,253	29,797	32,132
Expenditure	16,831	18,109	20,203	24,159	27,030	29,696	33,003
Surplus/ (deficit)	***554***	***709***	***895***	***-334***	***223***	***101***	***-871***
KwaZulu-Natal							
Revenue	20,273	22,629	24,998	28,337	32,908	36,434	39,808
Expenditure	19,389	21,799	25,061	29,043	32,908	36,434	39,808
Surplus/ (deficit)	***884***	***830***	***-63***	***-706***	**-**	**-**	**-**
Limpopo							
Revenue	12,807	14,565	16,189	18,405	21,373	23,477	25,721
Expenditure	12,745	14,485	15,656	18,455	21,373	23,477	25,721
Surplus/ (deficit)	***62***	***80***	***533***	***-50***	**-**	**-**	**-**
Mpumalanga							
Revenue	6,693	7,467	8,730	9,779	11,412	12,574	13,725
Expenditure	6,548	7,024	8,455	9,779	11,362	12,524	13,675
Surplus/ (deficit)	***145***	***443***	***275***	**-**	***50***	***50***	***50***
Northern Cape							
Revenue	2,507	2,622	2,965	3,357	3,934	4,326	4,699
Expenditure	2,524	2,667	2,947	3,424	3,932	4,326	4,699
Surplus/ (deficit)	***-17***	***-45***	***18***	***-67***	***2***	**-**	**-**
North West							
Revenue	8,484	9,289	9,963	11,310	13,203	14,682	16,069
Expenditure	8,241	9,216	9,906	11,349	13,203	14,682	16,069
Surplus/ (deficit)	***243***	***73***	***57***	***-39***	**-**	**-**	**-**
Western Cape							
Revenue	11,280	11,908	13,041	14,355	15,979	17,373	18,716
Expenditure	10,748	11,514	12,517	14,605	16,414	17,623	18,974
Surplus/ (deficit)	***532***	***394***	***524***	***-250***	***-435***	***-250***	***-258***
Total All provinces							
Revenue	103,552	113,754	126,340	142,559	164,082	180,870	197,297
Expenditure	100,025	110,407	122,563	144,887	165,211	180,969	198,377
Surplus/ (deficit)	3,527	3,347	3,777	-2,328	-1,129	-99	-1,080

Source: National Treasury, 2003 IGFR

Provinces are responsible for the delivery of social services such as social security grants, basic health care, school education and housing, and so receive the largest share of nationally raised revenue (about 56 percent) (National Treasury, 2002: 1).

1.3. Aim and Importance of the Study

Within the context of the aforementioned problems, the main objectives of the study are as follows:

- To explain why the sub-national governments exist at all.
- To describe the assignment of expenditure functions and revenue sources to national, provincial and local spheres of government.
- To give an overview of the types of intergovernmental grants.
- To discuss trends and issues in provincial government financing in South Africa.
- To highlight major developments and budget reforms that has taken place in the IGFR system since 1994.
- To assess what constitutes the strengths and weaknesses of the South African intergovernmental relations system, and lastly to
- To attempt to formulate recommendations that can contribute to improve the intergovernmental grants system of South Africa.

1.4. Postulated Hypotheses

Most of the surplus/deficit emanates from:

- Lack of adherence to spending plans by spending agencies in provinces;
- Low spending on conditional grants allocations; and
- The fact that provincial own revenue collections are not always the same as projected, thus either reducing projected revenue or inflating it.

1.5. APPROACH

1.5.1. Research Design and Methodology

The exploratory descriptive research method has been selected for this study. Mc Roy (1995: 2002) in De vos, *et al.*, (2002) argues that the qualitative method is concerned with non-statistical data and small samples are purposefully selected (De vos, *et al.*, 2002: 79). This exploratory study will be used to explain factors that contribute to the huge surplus or deficit in provincial spending patterns.

The most important feature in the study has been the utilization of secondary information, including, books, journal articles, magazines, policy documents, acts from relevant institutions, especially government departments and universities with experience and expertise in the field of study.

Sufficient literature is available on the challenges facing the Intergovernmental Relations system in South Africa. Research undertaken by Applied Fiscal Research Centre (AFReC) and other public sector finance management institutes like the IPFA (Institute for Public Finance), SAIPA (South African Institute for Public Administration) and other relevant published materials have been used to explore secondary data (literature review).

The National Treasury and Provincial Treasuries and the South African Reserve Bank (SARB) publish useful documents on this subject and attention shall be given to publications such as the Budget Review, Budget Speech, Intergovernmental and Fiscal Relations Act, Intergovernmental and Fiscal Relations Document, Division of Revenue Act, Public Finance management Act, etc.

Primary data has been collected by means of questionnaires and telephone interviews. The questionnaires have been sent to managers in provincial treasuries. A good balance of close -ended and open-ended questions will be asked to respondents to solicit more data. To avoid language as an entry barrier, English has been used as a mode of communication as more that 98 percent of the provincial treasuries use it in their daily operations.

1.5.2. Sample design and size

In this study, the population was made up of managers in the Provincial Treasuries in each of the nine provinces. Bless and Higson-Smith (2000: 85) points out that population is the set of elements that the research focuses on and to which the obtained results should be generalised. It is a totality of persons or units that the research problem is concerned with.

The functions of a Provincial Treasury are set out in Section 18 of the Public Finance Management Act (PFMA): to prepare the provincial budgets, exercise control over the implementation of the provincial budget, promote transparency and effective management of revenue and expenditure, as well as ensuring that the province's fiscal policies do not materially and unreasonably prejudice economic policies. The Act also authorise the provincial treasury powers to do anything further to fulfill its responsibilities effectively.

1.5.3. Telephone interviews

Structured telephone interviews (person to person) were also used to acquire data from the respondents.

1.5.4. Questionnaires (see Annexure "A")

Questionnaires were mailed electronically to acquire data from the respondents.

1.5.5. Field workers and field work dates

The study has not utilised the services of a private consulting firm. The researcher has conducted all aspects of the research.

1.6. DEFINITION OF CONCEPTS

The following concepts have been used frequently throughout the paper, and requires some explanations/definitions. The Budget Review, Public Finance Management Act, and Annual Division of Revenue Act articulate the definitions of these concepts as follows (alphabetically arranged):

a) ***Accounting Officer*** - the civil servant in a department who is accountable to Parliament for financial management, usually the Director-general or head of the department.

b) ***Accrual accounting*** - an accounting system by which payments and receipts are recorded as they occur, even if no cash flow takes place. (the opposite system is the cash based accounting system, in terms of which the recording of transactions takes place only when cash flow takes place).

c) ***Adjusted budget***- the funds allocated for spending during the course of the financial year to cover the costs of unforeseen expenditures, or expenditure that came during the course of the year and was not planned for. For example, funds to cover higher than inflation costs, higher than expected personnel cost, etc.

d) ***Agency payments*** - payments made by one government department to another (in the same or different sphere of government) to pay for services administered by the department receiving the payment. Agency payments do not form part of the budget of the department receiving the payment, but is reflected at transfer payment of the books of the receiving department/sphere.

e) ***Budget Council*** - a body established to coordinate the financial relations between national and provincial government, comprising the Minister and Deputy Minister of Finance and the nine provincial Member of Executive Council (MEC's) for finance.

f) ***Budget deficit/surplus*** - the difference between budgeted expenditure and budgeted revenue.

g) ***Capital expenditure*** - government expenditure on assets that last for a year or more, such as buildings, land, infrastructure and equipment.

h) ***Conditional grants*** - allocations of money from one sphere of government to another, conditional on certain services being delivered or on compliance with specified requirements.

i) ***Contingency reserve*** - an amount that is not allocated for specific purpose in advance in order to accommodate changes to the economic environment and to meet unforeseen and unavoidable spending pressures.

j) ***Current expenditure*** - government expenditure on goods and services, such as salaries, rent, maintenance, and interest payments.

k) ***Division of Revenue*** - the allocation of funds between spheres of government as required by Section 214 of the Constitution.

l) ***Equitable share*** - the allocation of revenue to national, provincial and local spheres of government as required by Section 214 of the Constitution.

m) ***Financial year*** - the 12 months period according to which companies and organisations budget and account for expenditure.

n) ***Fiscal policy*** - policy on tax, spending and borrowing by the government.

o) ***Fiscal year*** - the 12-month period on which government budgets are based, beginning 1 April and ending 31 March of the subsequent calendar year.

p) ***Government debt*** - the total amount of money owed by government as a consequence of its borrowing in the past.

q) ***Measurable objective*** - quantifiable impact, results or outcomes of public services that can be achieved over three years of the medium-term framework. As required by the Public Finance Management Act.

r) ***Medium-Term Expenditure Committee (MTEC)*** - the technical committee responsible for evaluating the Medium Term Expenditure Framework budget submissions of national (and provincial) departments (or any spending agency receiving funds from the government budget) and making recommendations to the Minister of Finance regarding Medium Term Expenditure Framework budget allocations to national departments.

s) ***Medium-term Expenditure Framework*** - the three year spending plans of national and provincial governments, published at the time of the budget.

t) ***Ministers' Committee on the Budget (Mincombud)*** - the political committee that considers key policy and budgetary issues that pertain to the budget process before they are tabled in Cabinet.

u) ***MinMec***- a political forum where national and provincial departments in the same sector (e.g. Housing, Health, Education, Agriculture, etc) discuss policy issues. It consists of the national Minister and the nine provincial MEC's, supported by key departmental officials.

v) ***Overspending*** - when expenditure under a vote exceeds the amount appropriated for that vote.

w) ***Public sector*** - national government, provincial government, local government, extra budgetary government institutions, social security funds and non-financial public enterprises.

x) ***Rollovers***- monies/funds not spend in one financial year is allocated/appropriated into the next ensuing financial year, so that the purpose for which it was initially allocated could not be defeated.

y) ***Saving*** - the difference between income and expenditure.

z) ***Unauthorised expenditure*** - expenditure that is not in accordance with the purpose of a vote, or purpose of the main division within a vote.

aa) **Vertical division of revenue** - the division of revenue between 3 spheres of government.

bb) ***Virement*** - the transfer of resources from one programme to another within the same department during the financial year.

1.7. DIVISION OF CHAPTERS

Chapter 1 demarcates the research field and research methodology. This chapter sets out parameters within which the scope of the research falls.

In **Chapter 2,** the background to the South African Intergovernmental Relations system is discussed. This constitutes an overview of provincial demographics and the socio economic profiles of the nine provinces, and legislation upon which the intergovernmental fiscal relations in South Africa are based.

Chapter 3 refers to the literature review. This discusses the nature and character of the South African intergovernmental relations system, with attention focused on what constitutes the strengths and weaknesses in the system. Attention has also been focused on topical issues on provincial budgets and their impact on service delivery.

Chapter 4 gives a systematic analysis of the reforms that took place in the South African Intergovernmental System since 1994.

Chapter 5 gives an analysis of the information acquired through the questionnaires and or interviews (findings).

Chapter 6 refers to conclusions and recommendations emanating from the study.

CHAPTER TWO

2. BACKGROUND ON THE SOUTH AFRICAN INTERGOVERNMENTAL FISCAL RELATIONS SYSTEM

"The needs of the community are in most cases more than the available resources at the disposal of government. The demand for goods and services is usually more than their supply."

T A Mufamadi, MEC of Finance: Limpopo Province, 2003 Budget Speech

2.1. PURPOSE

The purpose of this chapter is to give background to the South African Intergovernmental Relations system. This chapter gives an overview of provincial demographics and the socio economic profiles of the nine provinces. Furthermore, the chapter defines the concepts relating to the research theme, as well as highlighting some of the key legislation upon which the intergovernmental fiscal relations in South Africa is based.

2.2. INTRODUCTION

The South African Intergovernmental Relations System is found upon seven principles as enunciated in Chapter 3 of the Constitution Act (Act 108 of 1996). These principles provide that: *"all spheres of government and all organs of state within each sphere must -*

(a) Preserve the peace, 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 the 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 -

a. Fostering friendly relations;

b. Assisting and supporting one another;

c. Informing one another of, and consulting one another on, matters of common interest;

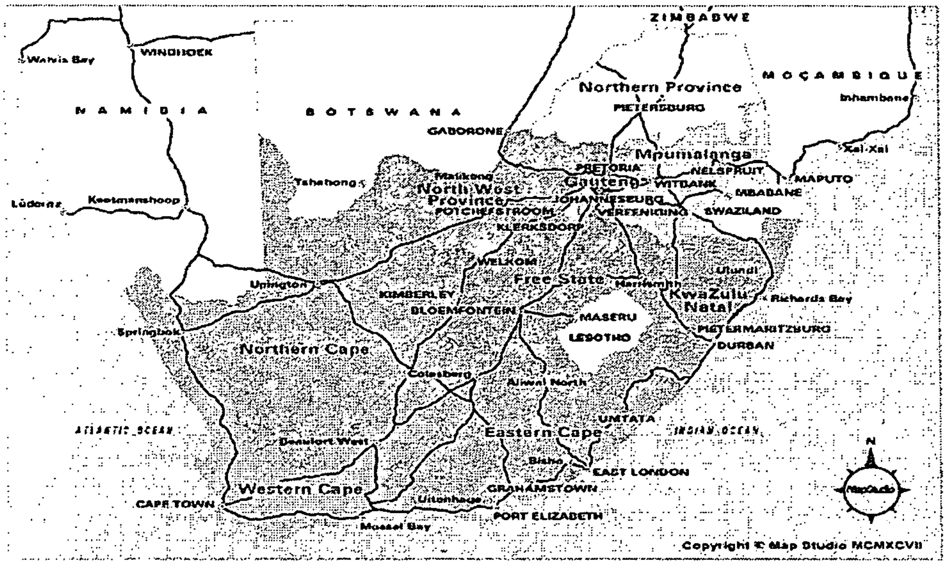
d. Co-ordinating their actions and legislation with one another;

e. Adhering to agreed procedures; and

f. Avoiding legal proceedings against one another.

2.3. OVERVIEW OF PROVINCIAL PROFILES

The provincial sphere of the South African Intergovernmental Relations consists of nine provinces as is set out in Chapter 6 of the Constitution Act (Act 106 0f 1996): Eastern Cape, Free State, Gauteng, KwaZulu-Natal, Mpumalanga, Northern Cape, Northern Province (now Limpopo), North West and Western Cape (Constitution Act, 1996:60). Figure 1 shows a map of South Africa, and its nine provinces:



Source: 2003 Intergovernmental Fiscal Review, National Treasury

South Africa's nine provinces vary considerably in terms of their socio-economic profiles. The socio-economic composition of the provinces is a starting point to understand the budget allocations and expenditure trends. The following is a brief synopsis of the demographic and socio-economic profiles of the nine provinces:

2.3.1. Eastern Cape Province

With the estimated total population of around 6.7 million in 1996, the overall population density in the Eastern Cape Province is very low, at around 40 persons per sq km. The province is highly rural (62.9 percent vs. 44.2 percent nationally), and the unemployment rate in 1996 was also higher than the national percentage (48.4 percent vs. 33.8). Despite this, the literacy rate stands at 73, 1 percent, lower than 82, 8 percent nationally. The province contribution to national Gross Domestic Product (GDP) is 8, 4 percent (Eastern Cape 2003/04 Budget Statement: 11).

2.3.2. Free State Province

The Free State Province covers an area of 129 464 km^2, and has a population of 2, 8 million, which accounts for 6, 4 percent of the national population. With the GGP per capita at R5 871 per annum, (contributing 5.5 percent to national GDP) the province has about 71 percent of the population (2 million) living in urban settlements and 34 percent of the population is unemployed. The province has the fourth highest Human Development Index (0,671), representing a medium level of human development (Free State 2003/04 Budget Statement: 10).

2.3.3. Gauteng Province

In spite of being the smallest province, geographically, the province is the dominant economic region of South Africa, contributing 33, 9 percent of the GDP. This is more than double the contribution of the next highest provincial GDP contribution, that of KwaZulu-Natal at 15, 5 percent (Gauteng 2003/04 Budget Statement: 12). Gauteng is the second province (KwaZulu-Natal leads at 8, 8 million) with the highest population in the country at 7, 8 million (1996 Census).

2.3.4. KwaZulu-Natal Province

In terms of land mass, KwaZulu-Natal (KZN) is the third smallest province in South Africa. The province has the highest population numbers in the country, estimated at 8, 8 million in terms of 1996 Census. In terms of racial distribution, about 82, 5 percent of the population is Black, 9, 1 percent is Asian, 6, 9 percent is White and only 1, 4 percent is Coloured. KZN has some 62 percent of the population living in rural areas. With regard to Human Development Index (HDI) KZN had an HDI of 0, 53 in 1996. The contribution of the province's GGP to GDP increased steadily from 15 percent to an estimated 15, 5 percent in 2002, (KwaZulu-Natal 2003/04 Budget Statement: 4).

2.3.5. Mpumalanga Province

Occupying a geographical area of 79 338 km^2 square km (6 percent of South Africa's land), the Mpumalanga province's population was 3,2 million in 2001, according to information released by Econometrix and DRI WEFA, and was projected to grow a the rate between 1,3 percent to 1,8 percent in 2002. The 1996 population census reveals that only 26,5 percent of the households in Mpumalanga have access to piped water in their dwelling and 17, 8 percent of the households still have no access to basic water. This means that the only sources of water are informal sources such as tanks, rivers or dams. The province contributes 7, 5 percent of South Africa's GDP, while the province's GGP is 74, percent (Mpumalanga 2003/04 Budget Statement: 11).

2.3.6. Northern Cape Province

According to the 1996 Census, the total population of the Northern Cape Province is estimated at 840 thousand, the smallest province in South Africa. The majority of Northern Cape's people (70 percent) reside in urban areas, while about one third (30 percent) reside in rural areas. The province's population density is also one of the smallest at 2, 3 people per km^2. In terms of gender, the province's population is fairly evenly distributed, with 50, 9 percent female and 50, 1 percent male. The province's weaker education profile (only 6 percent with tertiary qualifications) contribute to its total contribution to national GDP at 2, 1 percent, in terms of the 1996 Census (Northern Cape 2003/04 Budget Statement).

2.3.7. Limpopo Province

The estimated total population in Limpopo province (formerly known as Northern province) is 5, 1 million in 1996 (Statistics South Africa, 1996 Census). The province is highly rural (62.9 percent vs. 44.2 percent nationally), and unemployment rate in 1996 was also higher than the national percentage (48.4 percent vs. 33.8). Despite this, the literacy rate stands at 42, 7 percent, lower than 82, 8 percent nationally. The province contribution to national Gross Domestic Product (GDP) is 6, 1 percent (Limpopo 2003/04 Budget Statement: 8).

2.3.8. North West

The North West Province consists of an area of approximately 118,710 square kilometres (9, 7 percent of South Africa), with a population of approximately 3, 5 million, or 8, 3 percent of the South African population. With the distribution of population between urban and rural at 13:7, or 63 percent rural and 37 percent urban, compared to a distribution of 46 percent and 54 percent rural and urban for South Africa, North West province can be regarded as one of the rural provinces. The access to basic services in the province in 1999 (access to refuse removal: 55 percent, access to telephone services: 34, 9 percent, access to health care: 69, 4 percent and access to sanitation: 55, 8 percent) confirms the reports that the North West Province is one of South Africa's most rural provinces, where service delivery efforts should be intensified (North West 2003/04 Budget Statement: 10).

2.3.9. Western Cape

According to the Census 1996 results, the Western Cape province's total population was 3, 9 million (and projected at 4, 2 million in 1999). Indications are that about 48 000 (net figure) people migrate to the province per annum. According to the 1999 projections, the population composition of the province will remain Coloured dominated (55, 2 percent) while the other racial denominations share the 44, 8 percent remainder (Blacks: 20, 9 percent), White (20, 8 percent) and (Other 3, 1 percent).

2.4. LEGISLATION IMPACTING ON INTERGOVERNMENTAL FISCAL RELATIONS IN SOUTH AFRICA.

The following are some of the key legislations and policy documents providing a generic legislative framework within which intergovernmental fiscal relations' role players interact in the South African context:

2.4.1. Division of Revenue Act (DoRA)

The Division of Revenue Act gives effect to section 214 (1) of the Constitution of the Republic of South Africa, 1996 (Act No.108 of 1996), which requires that an Act of Parliament be passed to provide for (a) the equitable division of revenue raised nationally among the national, provincial and local spheres of government; (b) the determination of each province's equitable share of the provincial share of that revenue; and (c) any other allocations to provinces or local government from the national government's share of that revenue, and any conditions under which those allocations may be made (National Treasury, 2003:1).

2.4.2. The Constitution of the Republic of South Africa

The Constitution provides for a division of functions between national, provincial and local government and serves as a point of departure for cooperative arrangements between the three spheres of government (2003 Budget Review, National Treasury: 2).

Chapter 13 of the Constitution Act (Act No.108 of 1996) provides a broad legislative framework for public finances in South Africa. Section 214 of the Constitution sets out the National Revenue Fund, into which all money received by the national government must be paid. Sections 216 and 220 of the Act provide for the establishment of National Treasury and the Financial and Fiscal Commission respectively, playing crucial (but distinct) roles the allocation and appropriation of public funds. Section 215 sets out broad provisions with respect to the budgets in the three spheres of government (Constitution, 1996:120).

2.4.3. The Public Finance Management Act (PFMA)

The PFMA is one of the most important pieces of legislation passed by the first democratic government in South Africa. The fundamental aim of the Act is to modernise financial management in the public sector. It represents a fundamental break from the pre 1994 era characterised by obscure, hierarchical systems of management, poor information and weak accountability. The Act seeks not only to improve financial management, but also provides the basis for a more effective governance framework for the public sector (National Treasury, PFMA, 1999:1).

2.4.4. Treasury Regulations (TR)

These regulations (TR) are passed in terms of the Public Finance Management Act. Treasury Regulations, apply to all local, national and provincial departments/institutions and constitutional institutions in matters pertaining to budgets and generic financial matters (National Treasury, Treasury Regulations, 2001: 3).

2.4.5. The Intergovernmental Fiscal Relations Act

The Intergovernmental Fiscal Relations Act, 1997 (Act No. 97 of 1997), provides that each year when the annual budget is introduced, the Minister of Finance must introduce in the National Assembly a Division of Revenue Bill for the financial year to which that budget relates (Intergovernmental Fiscal Relations Act, 1997:1 National Treasury).

2.5. FEATURES OF THE SOUTH AFRICAN INTERGOVERNMENTAL AND FISCAL RELATIONS SYSTEM

The 1994 post-apartheid system aims to democratize state institutions, redress inequality and extend services to the broader population. In summary, the new system has the following key features:

- A unitary system of government with three distinctive, interrelated and interdependent spheres, with significant decentralization of powers, functions and budgeting.
- National Parliament comprising two houses: a national assembly and a national council of provinces, representing provincial legislatures and organized local government.
- Each of the nine provinces has its own legislature and executive committee, as well as administrative structures.
- There are 284 municipalities, categorised as metropolitan, district wide or local structures, which comprises of political and administrative components.
- Provinces are accountable to provincial legislatures, and local governments are accountable to councils.
- The system of election at the national and provincial level is proportional representation, while at the local level it is a mix of directly elected and proportional representation.
- The constitution entrenches 'co-operative governance', thus obligating the three spheres of Government to co-operate and negotiate political and budgeting issues between them.
- Numerous intergovernmental forums (e.g. the Budget Council and Budget Forum) facilitate the co-operation and consultation in the budget process.

- Public servants employed by national and provincial governments comprise one single public service (with similar remuneration for similar rankings, irrespective of function).

Some government functions are shared (concurrent) amongst the spheres, others are exclusive. The provincial sphere performs functions like school education, health and social grants, which account for a substantial proportion of public spending. The large concurrent functions shared between national and provincial governments include school education, health services, social security and welfare services, housing and agriculture.

National Government is largely responsible for providing leadership, formulating policy, determining the regulatory framework, including setting minimum norms and standards, and monitoring overall implementation by provincial governments. Given these different responsibilities, provincial departments have large budgets for implementing services, while the national departments have a relatively small share.

On the other hand, the exclusive functions are the sole responsibility of the relevant sphere only. In the case of national Government, large exclusive functions include national defence, criminal justice, higher education, water and energy resources and administrative functions such as home affairs, and the collection of national taxes. These exclusive functions absorb a substantial proportion of the national Government's budget. Exclusive functions, for provinces, include provincial roads, ambulance services, and provincial planning.

Municipalities also have responsibilities for both concurrent and exclusive functions, like the provision of water, electricity, refuse-removal, municipal infrastructure and emergency services.

2.6. FINANCING ISSUES IN THE SOUTH AFRICAN IGFR SYSTEM

The provinces receive their revenue from three sources, that is, their equitable share, conditional grants and provincially raised revenue. The provincial sphere receives the largest allocation of the nationally raised revenue, called equitable share (about 56% on average annually), followed by the national Government (about 39% on average annually) and the local sphere (about an average of 5 percent annually).

Provinces only raise about 4 percent of their own revenue. Municipalities in contrast, have significant revenue-raising powers and collect between 60 to 95 percent of their own revenue, as two thirds of activities such as water, electricity and refuse-removal are income generating.

2.7. PROVINCIAL BUDGETS AND EXPENDITURE

Until 1997, provinces were only spending agencies for the national government, disbursing funds according to the policies and priorities determined at national level. In the past, provinces were treated as mere administrations. They were concerned mainly with implementation of policy. The budgetary arrangements for 1997/98 fiscal year for the first time permitted provinces to determine their own provincial budgets according to their own social and economic priorities, with the national framework serving as a guideline (Abedian, Ajam & Walker, 19997:55).

The 2003 provincial budgets reinforce focus on pro-poor programmes. Provinces reaffirm their commitment to deliver more and better quality services that ensure the progressive realization of improved quality life. Building on the strong and stable financial and fiscal environment created through prudent budget and expenditure management over the past years, provincial budgets reflect strong real growth in spending of 7,7 percent in 2003/04, and a real average annual growth rate of 5,3 percent over the Medium Term Expenditure Framework (National Treasury, 2002: 14).

Table 2 shows spending per province, from 1999/00 and projected expenditure until 2005/06.

Table 2: actual spending per province

	1999/00 Actual	2000/01 Actual	2001/02 Actual	2002/03 Estimated Actual	2003/04 Meduim Term estimates	2004/05	2005/06
Eastern Cape	16,307	18,162	19,591	24,019	27,933	29,959	33,065
Free State	6,692	7,431	8,227	10,054	11,056	12,248	13,363
Gauteng	16,831	18,109	20,203	24,159	27,030	29,696	33,003
KwaZulu-Natal	19,389	21,799	25,061	29,043	32,908	36,434	39,808
Limpopo	12,807	14,485	15,656	18,455	21,373	23,477	25,721
Mpumalanga	6,548	7,024	8,455	9,779	11,362	12,524	13,675
Northern Cape	2,524	2,667	2,947	3,424	3,932	4,326	4,699
North West	8,241	9,216	9,906	11,349	13,203	14,682	16,069
Western Cape	10,748	11,514	12,517	14,605	16,414	17,623	18,974
Total	**100,087**	**110,407**	**122,563**	**144,887**	**165,211**	**180,969**	**198,377**
Percentage growth							
Eastern Cape		11.4%	7.9%	22.6%	16.3%	7.3%	10.4%
Free State		11.0%	10.7%	22.2%	10.0%	10.8%	9.1%
Gauteng		7.6%	11.6%	19.6%	11.9%	9.9%	11.1%
KwaZulu-Natal		12.4%	15.0%	15.9%	13.3%	10.7%	9.3%
Limpopo		13.1%	8.1%	17.9%	15.8%	9.8%	9.6%
Mpumalanga		7.3%	20.4%	15.7%	16.2%	10.2%	9.2%
Northern Cape		5.7%	10.5%	16.2%	14.8%	10.0%	8.6%
North West		11.8%	7.5%	14.6%	16.3%	11.2%	9.4%
Western Cape		7.1%	8.7%	16.7%	12.4%	7.4%	7.7%
Total		**10.3%**	**11.0%**	**18.2%**	**14.0%**	**9.5%**	**9.6%**

Source: National Treasury, 2003 IGFR

2.8. CONCLUSION

Provincial spending has been growing remarkably, varying across provinces, ranging from 5,7 percent in Northern Cape to 14,8 percent in 2003/04, to reach a projected level of 8,6 percent in 2005/06. Generally all provinces realised growth in expenditure between 2000/01 and 2002/03, to decline in the outer years of the MTEF in 2005/06. It should be noted that although the allocations shows some decline in percentage terms, in nominal terms, the allocations are increasing, to reach R198 billion in 2005/06.

2.9. AUDITOR-GENERAL'S (AG) REPORTS

Table 3 shows a summary of national and provincial reports on expenditure outcomes by the Auditor General (AG). Some reports are Unqualified[1]; others received qualified[2] opinions by the Auditor General.

Table 3: Summary of national and provincial annual reports

Province	No of Departments with Unqualified Audit Reports	No of Departments with Qualified Audit Reports	No of Departments with Qualified Audit Reports
Eastern Cape	0	13	(6)
Free State	10	2	(2)
Gauteng	7	6	(6)
KwaZulu-Natal	11	5	(3)
Limpopo	0	12	(12)
Mpumalanga	10	2	(2)
Northern Cape	0	13	(11)
North West	7	6	(4)
Western Cape	8	3	(2)
Sub Total (Provinces)	**53**	**62**	**(48)**
National Departments	**25**	**8**	**(8)**
Total	**78**	**70**	**(56)**

Source, 2003 IGFR, National Treasury (the number in brackets indicate the number of votes with adverse qualified opinions)

2.10. CONCLUSION

Provinces and national departments still have more work to do in so far as qualified AG audit reports. This shows that not only should government put more attention on budgeting, but also on spending and the outcomes that emanate from the spending.

[1] Unqualified opinion means audit findings do not justify any further audit disclosure

[2] Qualified opinion means that except for matters highlighted under the qualification, the financial statements present a fair view.

2.11. TRANSFERS TO PROVINCES

As table 4 shows, national allocations make up over 96% of total provincial revenue.

Table 4: National allocations to provinces

	1999/00 Actual	2000/01 Actual	2001/02 Actual	2002/03 Estimated Actual	2003/04	2004/05	2005/06
					Meduim Term estimates		
Transfers from national budget	99,576	109,223	121,398	136,936	158,995	175,468	191,590
Of which:							
equitable share	89,095	98,398	107,460	123,457	142,386	155,313	167,556
conditional grants	10,482	10,825	13,938	13,479	16,609	20,155	24,033
Own revenue	4,039	4,531	4,942	5,624	5,087	5,402	5,707
Total revenue	**103,615**	**113,754**	**126,340**	**142,560**	**164,082**	**180,870**	**197,297**
Share of total provincial revenue							
Of which:							
equitable share	96.1%	96.0%	96.1%	96.1%	96.9%	97.0%	97.1%
conditional grants	10.1%	9.5%	11.0%	9.5%	10.1%	11.1%	12.2%
Own revenue	3.9%	4.0%	3.9%	3.9%	3.1%	3.0%	2.9%

Source: National Treasury, 2003 IGFR

2.12. CONCLUSION

Provincial own revenue shows a declining trend, compared to the equitable share and conditional grants allocations, which are showing increasing trends. The declining trends in own revenue collection in provinces is an area of concern. This raises question over the operational efficiency of the own revenue collection system in provinces. This also shows that the more allocations the national sphere transfers to provinces in the form of equitable share and conditional grants, the more provinces seem disincentified to revamp their strategies to collect more revenue.

2.13. PROVINCIAL OWN REVENUE

Unlike five years ago wherein provinces were optimistic about their own revenue collections, trends are indicating that they are beginning to by deliberately. Table 5 shows provincial own revenue collections by type, from 1998/99 financial year to 2001/02 outcomes as well as 2003/04 moving forward to 2005/06 projections (National Treasury 2002:3).

Table 5 provincial own revenues by type

R million	Actual 1998/99	1999/00	2000/01	2001/02	Medium-term estimate 2002/03	2003/04	2004/05
Road Traffic Revenue	1,256	1,514	1,745	1,968	1,874	2,137	2,242
Health Patient Fees	346	321	352	455	428	451	478
Horse Racing and Betting	259	170	167	152	179	191	203
Gambling	142	268	454	382	449	470	549
Other	1,429	1,765	1,796	2,011	1,152	1,176	1,308
Total	**3,433**	**4,039**	**4,514**	**4,968**	**4,083**	**4,425**	**4,779**
Percentage growth							
Road Traffic Revenue		20.5%	15.2%	12.8%	-4.7%	14.0%	4.9%
Health Patient Fees		-7.1%	9.5%	29.3%	-6.0%	5.5%	5.9%
Horse Racing and Betting		-34.5%	-1.6%	-9.3%	17.6%	7.0%	6.1%
Gambling		88.4%	69.4%	-15.8%	17.5%	4.6%	16.7%
Other		23.5%	1.8%	12.0%	-42.7%	2.0%	11.2%
Total		**17.6%**	**11.8%**	**10.1%**	**-17.8%**	**8.4%**	**8.0%**
Percentage of total own revenue							
Road Traffic Revenue	36.6%	37.5%	38.6%	39.6%	45.9%	48.3%	46.9%
Health Patient Fees	10.1%	8.0%	7.8%	9.2%	10.5%	10.2%	10.0%
Horse Racing and Betting	7.6%	4.2%	3.7%	3.1%	4.4%	4.3%	4.2%
Gambling	4.1%	6.6%	10.1%	7.7%	11.0%	10.6%	11.5%
Other	41.6%	43.7%	39.8%	40.5%	28.2%	26.6%	27.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source National Treasury, 2002 IGFR: 32

2.14. CONCLUSION

Generally, all revenue sources show some declining trends. The most cases that warrant some closer investigation are the health patient fees, horse racing and betting. At an aggregate level, own revenue shows a decline from 17,6 percent between 1998/99 and 1999/00 to reach a projected low level of 8 percent in 2005/06.

2.15. CLASSFIFICATION OF PROVINCIAL EXPENDITURE

Table 6 shows provincial expenditure by economic classification, from 1999/00 fiscal year to 2005/06 fiscal year's projections. Viewed from economic classification (i.e. personnel, transfers, non personnel and capital expenditure), provincial trends shows that a share of personnel drops to 46, 4 percent, while non-personnel expenditure shows some strong recovery.

Table 6: total provincial spending per economic classification

	1999/00 Actual	2000/01 Actual	2001/02 Actual	2002/03 Estimated Actual	2003/04	2004/05 Meduim Term estimates	2005/06
Current expenditure	93,662	102,153	111,236	131,122	146,426	161,095	175,983
Personnel	59,140	63,805	67,645	74,829	81,143	86,800	92,077
Transfers	21,624	23,712	26,589	34,647	40,921	46,999	53,751
Other current	12,898	14,636	17,002	21,646	24,362	27,296	30,154
Capital expenditure	6,426	8,254	11,327	13,765	18,606	19,649	22,121
Contingency reserve					178	225	273
Total	**100,088**	**110,407**	**122,563**	**144,887**	**165,210**	**180,969**	**198,377**
Non-personnel expenditure	40,948	46,602	54,919	70,057	84,066	94,169	106,299
Non-personnel non-capital	34,522	34,522	43,591	56,292	65,283	74,296	83,905
Percentage share in spending							
Personnel	59.1%	57.8%	55.2%	51.6%	49.1%	48.0%	46.4%
Transfers	21.6%	21.5%	21.7%	23.9%	24.8%	26.0%	27.1%
Other current	12.9%	13.3%	13.9%	14.9%	14.7%	15.1%	15.2%
Capital expenditure	6.4%	7.5%	9.2%	9.5%	11.3%	10.9%	11.2%
Contingency reserve	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%
Non-personnel expenditure	40.9%	42.2%	44.8%	48.4%	50.9%	52.0%	53.6%
Non-personnel non-capital	34.5%	31.3%	35.6%	38.9%	39.5%	41.1%	42.3%

Source: National Treasury, 2003 IGFR

2.16. CONCLUSION

It is encouraging to note that personnel expenditure as a percentage of total provincial spending is declining over time. This shows that provinces are beginning to realise the importance of allocating more resources to non-personnel items such as learner support material in education, drugs and medicine in health and other infrastructure projects that enhance service delivery, such as roads, clinics, schools etc. A healthy growth in non-personnel non-capital is also an encouraging factor in the sense that more investment in capital projects is foreseen in the near future.

2.17. PROVINCIAL CAPITAL EXPENDITURE

Table 7 shows provincial capital expenditure by province. The upturn in capital expenditure, which started in 1999/00, is contributing to the strong recovery in non-social services expenditure. Provincial capital expenditure grew from R6, 4 billion in 1999/00 or 6, 4 percent of total percent of total provincial expenditure, to a projected R13, 8 billion, or 9, 5 per cent of total provincial expenditure in 2002/03.

Table 7: Provincial capital expenditure

	1999/00 Actual	2000/01 Actual	2001/02 Actual	2002/03 Estimated Actual	2003/04	2004/05	2005/06
					Meduim Term estimates		
Eastern Cape	576	943	1,162	2,248	3,132	2,665	2,862
Free State	235	422	702	873	871	1,089	1,154
Gauteng	1,781	1,558	2,266	2,770	5,022	5,549	6,803
KwaZulu-Natal	1,351	1,869	2,947	2,951	3,935	4,306	4,634
Limpopo	604	1,096	1,279	1,463	1,773	1,796	2,021
Mpumalanga	510	567	865	843	1,050	1,150	1,318
Northern Cape	176	191	271	298	373	399	426
North West	482	672	690	921	1,022	1,194	1,294
Western Cape	710	938	1,146	1,397	1,427	1,500	1,609
Total	**6,425**	**8,256**	**11,328**	**13,764**	**18,605**	**19,648**	**22,121**
Percentage of total spending							
Eastern Cape	3.5%	5.2%	5.9%	9.4%	11.2%	8.9%	8.7%
Free State	3.5%	5.7%	8.5%	8.7%	7.9%	8.9%	8.6%
Gauteng	10.6%	8.6%	11.2%	11.5%	18.6%	18.7%	20.6%
KwaZulu-Natal	7.0%	8.6%	11.8%	10.2%	12.0%	11.8%	11.6%
Limpopo	4.7%	7.6%	8.2%	7.9%	8.3%	7.7%	7.9%
Mpumalanga	7.8%	8.1%	10.2%	8.6%	9.2%	9.2%	9.6%
Northern Cape	7.0%	7.2%	9.2%	8.7%	9.5%	9.2%	9.1%
North West	5.8%	7.3%	7.0%	8.1%	7.7%	8.1%	8.1%
Western Cape	6.6%	8.1%	9.2%	9.6%	8.7%	8.5%	8.5%
Total	**6.4%**	**7.5%**	**9.2%**	**9.5%**	**11.3%**	**10.9%**	**11.2%**

Source: National Treasury, 2003 IGFR

In 2003 budgets, capital expenditure grows by 27, 4 per cent in real terms to reach R18, 6 billion in 2003/04. Spending on capital allocations is set to grow at an average annual rate of 11, 1 per cent over the Medium Term Expenditure Framework to R22 billion by 2005/06, exceeding 10 per cent of total provincial expenditure (National Treasury 2002:24).

2.18. SUMMARY

Although the intergovernmental grant transfer system is moving towards maturity in South Africa, especially since the introduction of the PFMA and other pieces of legislation, there are still some grey areas that need to be adressed in the system. Notwithstanding, provincial spending has been growing remarkably, varying across provinces. Provinces and national departments still have more work to do in so far as qualified audit reports. It is encouraging to note that personnel expenditure as a percentage of total provincial spending is declining over time.

CHAPTER THREE

3. LITERATURE REVIEW

3.1. PURPOSE

The aim of this chapter is to provide an overview of literature on the trends in intergovernmental fiscal relations in South Africa. The chapter also highlights some of the trends internationally, but mainly focuses on the South African case study.

3.2. INTRODUCTION AND BACKGROUND

South Africa's fiscal policy is expansionary, within the framework provided by sound management of state finances, and stewardship of the economy. Significant allocations are made to infrastructure development and to social transfers targeted at most risk and vulnerable. While the South African economy is open to the benefits of global integration, the measures of the South African government are aimed at addressing poverty an inequality.

3.3. FISCAL POLICY

Fiscal policy is defined as government's expenditure and taxation policies, as well as the regulatory functions, which have a bearing on fiscal matters such as subsidies and transfer payments (Abedian, Ajam & Walker, 1997:144).

South Africa's fiscal policy stance aims to reinforce growth and development. Social spending and infrastructure investment is targeted to increase strongly, while tax relief benefits lower income and encourages targeted industrial development a budget deficit of between 2 and 2.5 percent of Gross Domestic Product (GDP) over the next three years is accommodated within a fiscal framework and a declining debt-GDP ratio (National Treasury, 2002: 6).

Basic to the modern fiscal policy is the philosophy that the government cannot be subjected to the same rules as individuals with respect to spending. For example, while individuals must reduce spending, and are encouraged to do so by governments, when their income fall, national governments not only do not have to do so, but should not do so, because such action will aggravate the general decline in economic activity (Due, 1966:508).

3.4. THE GOAL OF FISCAL POLICY

As with all goals, the appropriate goals of fiscal policy cannot, of course, be ascertained by economic analysis, but reflect value judgments. The generally accepted goal of fiscal policy is that of the attainment of greater economic stability (Due, 1966:513).

3.5. PROBLEMS WITH THE INTERGOVERNMENTAL SYSTEMS.

The following are generic problems that tend to be found in intergovernmental fiscal relations systems:

3.5.1. Expenditure-revenue mismatch

The absence of correlation between the amounts of expenditure which particular spheres of government wish to make and the potential yield of taxes/resources stifle spheres to deliver on their functions. As a consequence, some spheres have inadequate revenues, compared to their functions and expenditure needs. The criteria for allocating functions of government to different spheres should, among others, be informed by the revenue raising capacity of the sphere concerned. Thus, a need to align the expenditure functions and allocation of taxing powers between different spheres of government (Due, 1966:435).

3.5.2. Unequal revenue sources

The uneven distribution of tax capacity relative to functions of governments at the same sphere remains one of the fundamental challenges of intergovernmental fiscal relations. The most serious problems arise with local governments. Poorer districts either operate with poorer standards or levy higher taxes than affluent areas. Effectively, this may result in discriminatory double taxation (Due, 1966:442).

3.5.3. Perverse fiscal policy

In years of depression, either due to less funding from national spheres, or under collection on revenue, sub-national spheres tend to cut expenditures, while increasing their construction programs in years of prosperity (Due, 1966:442).

3.5.4. Fiscal Illusion or "Santa Claus" Doctrine

A troublesome factor in the field of intergovernmental problems is one called fiscal illusion – the belief on the part of many people that higher expenditure from higher levels of government does not cost them anything. People tend to turn to higher spheres of government when their immediate spheres do not meet their demands, motivated, in large measure, by the illusion that aid by the larger sphere is costless. For instance, if a new school is built with local funds, a direct and immediate increase in local taxes may be seen, while the case would be different if funds from the national sphere are used. Partly, this result from complexities of budget making (Due, 1966:442).

3.5.5. Intergovernmental Transfers/Grants

A critical component of fiscal decentralisation in many countries is a system of intergovernmental transfers. Intergovernmental transfers have been employed to fulfil a variety of objectives, and the design of the transfer scheme depends on the purpose for which it is given. Clarifying the purpose of intergovernmental transfers is critical (Mundle, 1997: 241).

3.6. RATIONALE FOR USING INTERGOVERNMENTAL GRANTS

The following are some of the crude rationale behind the introduction of intergovernmental grants:

3.6.1. Closing the fiscal gab

An important reason for giving transfers is to enable the sub central governments to satisfactorily undertake their functions as the revenue assigned to them is found inadequate. Even when the assignments are made solely on economic considerations, the comparative advantage of the central government in undertaking redistributivee and stabilisation functions and the state's comparative advantage in the allocative function do create vertical fiscal imbalances, and this would have to be resolved by a system of central transfers to states (Mundle, 1997: 241).

3.6.2. Equalisation

The imbalance between revenue capacity and expenditure need varies across different states, depending on the size of their tax base, the size and the composition of population and other factors affecting the cost of providing public services. The richer states, in view of their higher revenue capacity, can provide better standards of public services than poorer counterparts. To offset this fiscal disadvantage, equalisation transfers are necessary (Mundle, 1997: 243).

Even in cases where there exist no fiscal imbalances in aggregate, some authorities may be unable to finance programmes that other authorities find easy to handle. In this category, the objective is to close the gab between revenue sources and expenditure responsibilities between different authorities (Cullis and Jones, 1992:312).

3.6.3. Correction of spillovers

When there is no perfect 'mapping', the provision of public services by central services by sub central governments may spill over the jurisdiction and such externalities result in the non-optimal provision of public services. To be cost effective, specific purpose transfers made to sub central units to ensure the optimal provision of public services require matching contributions from the states. The design of the transfer system, should, thus, be specific purpose, open-ended with matching requirements and the matching ratios should vary with the size of the spill over (Mundle, 1997: 245).

3.6.4. Inter-jurisdictional spillovers

There may be external benefits for neighbouring localities as a result of any one jurisdiction's expenditure. The fact that the spillovers are external benefits implies that the local authority responsible for such activity takes no account of it in decision making (Cullis and Jones, 1992:312).

3.6.5. Promoting merit

Central government may, on merit good grounds, think it appropriate that a local authority provide more of a particular service. The use of open matching specific grants for each individual service would appear reasonable to assist central government to achieve the goal of spending money where it has been envisaged to be spent on. Closed lump-sum grants might be preferable if there is simply some relatively high level of consumption, which appears 'desirable and adequate'. Grants would be appropriate if the grantor feels that all local services were merit goods (Cullis and Jones, 1992:312).

3.6.6. Revenue Sharing

Since they are unable to finance all those expenditure programmes that are considered desirable, local authorities, in aggregate, may suffer fiscal imbalances. Thus, central government may encourage local governments to raise more tax revenue by introducing new taxes, levying charges or borrowing. However, one alternative is for national government to collect tax revenue on behalf of local governments and then simply to turn the revenue over to them. If the central government plays a role purely in terms if revenue raising, then an unconditional grant would seem the most appropriate instrument from the point of view of benefiting the recipient local authority (Cullis and Jones, 1992:312).

3.7. CRITICISMS WITH CONDITIONAL GRANTS

Corry (1997: 276) summarises the criticisms of using conditional grants: firstly, that they enable the national sphere to interfere with provincial planning of expenditure. Secondly, he argues that federal priorities in expenditure may not coincide with provincial expenditure priorities. Thirdly, the termination of programs might not be easy, or the provinces might not find it easy to terminate them. Fourthly, the conditional grants can distort provincial expenditure trends.

In response to the challenges inherent in the use of conditional grants, Corry (1997: 126) proposes a set of alternatives: firstly the replacement with unconditional grants. This alternative may not be acceptable to national sphere as the sphere sees this as its direct responsibility. Secondly, those provinces are allowed to "opt out" of shared-cost programs in return for the "fiscal equivalence", which is a sum equivalent to the central government's share of the program in the province and which the province could use in any way it desired. Finally, he discourages the use of shared-cost programs, unless in cases where there is unanimous agreement among the provinces, or agreement by the majority of the provinces representing a large percentage of the population.

Some commentators argue that unconditional grants have some economic effects. Unconditional grants require that the recipient government spent the money without the requirement been placed on the programmes. When the sub national sphere receives an unconditional grant, its budget constraint shifts outward to a new budget constraint. In general, unconditional grants exert influences similar to those seen when local governments receiving lump sum grants that do not stipulate that all grants be spent on public sector goods (Marlow, 1995:597).

3.8. TYPES OF GRANTS

3.8.1. Matching and Non-matching grants

Conditional grants specify, in some detail, which public programs the grants are to be spent on. Non-matching conditional grants transfer fixed (lump) sums of revenue to recipient governments. For matching grants, the grantor government specifies some rate, usually from 5 to 50 percent, at which they match the funding by the recipient governments. A match rate of 35 percent, for example, means that, for every rand of spending, the grantor government provides 35 cents to recipient government. The additional 65 cents is the responsibility of the recipient government (Marlow, 1995:598).

3.8.2. Block Grants

In contrast to the conditional grant, the block grant is given in a lump sum, without specifications of the purpose and without specifications. The recipient government is free to use the money as it wishes. The block grant seems to be one of the most satisfactory methods of meeting the problem of the unequal distribution of tax resources (relative to expenditure needs). Also, the inequalities and adverse economic effects produced by unequal tax resources will be avoided (Due, 1966:452).

Block grants interfere less with the autonomy of recipient governments than does conditional grants since the latter is free to use the funds as it deems fit. On the other hand, the unconditional grant provides no stimulus to particular activities of the smaller units and no insurance of raising standard of performance. Finally, it is difficult to find an allocation formula, or method, which meets general approval. There is a tendency for various recipients to argue constantly for revised formulas that will increase their share (Due, 1966:452).

3.9. CONDITIONAL GRANTS: A SOUTH AFRICAN CASE STUDY

Conditional grants were introduced in South Africa in 1998/99 to enable provinces to meet nationally determined priorities or to provide for services that spill over to other provinces. A conditional grant is voted in the national budget as a transfer, and it is recorded as revenue in the provincial accounts. Provinces report on receipts and expenditure to National Treasury on a monthly basis (National Treasury, 2000:56).

The Intergovernmental Fiscal Relations Act was introduced in 1998 and implemented in 1999. This Act gives effect to the tabling of the annual Division of Revenue Act with the budget. The Act sets out the equitable division of revenue for the three spheres of government and between the nine provinces. These transfers are done by allocating and transferring funds to provinces in the form of equitable share and conditional grants (Gauteng Provincial Treasury, 2002:23).

Although conditional grants were introduced in 1998/99, the actual spending and transfers were not closely monitored until 2000/01 financial years, the reporting mechanism was also not in place. Some of the grants were transferred to the province on a claim basis. Claims were submitted towards the end of the financial year leading to overspending and funds being transferred in the following financial year (Gauteng Provincial Treasury, 2002:25).

These problems were increased because there were no clear guidelines or framework from national departments to assist provincial departments. The under spending in 1999/00 (for financial management and quality enhancement grants in particular) occurred as a result of late approval of business plan by National department, late transfer of funds and the delay in the procurement process by the department. The late transfer of funds by the department is another reason for under spending. This in turn led to funds being rolled over to the next financial year. The late approval hindered/slowed down the implementation process and exacerbated by the inadequate understanding of the procurement process, the lack of skills in drafting tender documents (Gauteng Provincial Treasury, 2002:27).

The reforms introduced through the Division of revenue Act since 2001/02 assisted the departments to monitor and report on actual expenditure incurred against the projections made and submitted at the beginning of the financial year. This enabled the department to take remedial action at an earliest opportunity (Gauteng Provincial Treasury, 2002:28).

The Gauteng province's view regarding the introduction of conditional grants remain the prerogative of the national departments since grants were introduced to provide for national priorities, promote national norms and standards, address backlogs and regional disparities in social infrastructure. Provinces must be informed in time to ensure buy - in, avoid overspending due to insufficient funding and conduct research, as they will be playing a pivotal role of implementing the grants (Gauteng Provincial Treasury, 2002:30).

Another problem with the conditional grants relates to the flow of funds to provinces. There are instances where funds to provinces do not flow according to payment schedules and this further cause confusion. In some cases Provincial treasuries are not informed in time of the additional requirements and the non-transfer of funds (Gauteng Provincial Treasury, 2002:40).

Fiscal transfers should not discourage sub-national governments to improve their revenue raising potential. Currently, provinces are largely dependent on national transfers. Local governments already have clear and substantial taxation powers and enjoy access to several user-charge revenue sources. Effective use of these powers should be encouraged, including accurate pricing, affordable delivery standards, and strict credit control. Monitoring across spheres is also important in this respect. Systematic oversight would ensure that problem cases are duly identified and dealt with (National Treasury, 2002:10).

3.10. FISCAL FEDERALISM

In all federations, governmental units have an inherently competitive relationship. The competition can be both intergovernmental (i.e. between different spheres of government) on inter-jurisdictional (among different units within a level). An efficient competitive federalism, however, requires (i) a clear demarcation of functions and resources to carry them out (ii) adherence to the set rules by the governmental units and interaction between them to foster mutual trust and understanding, and (iii) an independent and just mechanism to conduct and monitor the interaction between different governments units (Mundle, 1997: 225).

Analysis of the actual fiscal assignments in different federations, however, underlines three important features. First, the existence of vertical fiscal imbalance is a feature of all federations. This is so because the actual the assignment of tax and expenditure powers is broadly according to the principle of comparative advantage. Secondly, the assignments of powers minimising concurrence or overlap can only be in a *de jure sense*. *De facto*, overlapping of tax and expenditure powers between different jurisdictions is unavoidable. Thirdly, the concurrency in tax and expenditure powers is not necessarily undesirable if there is a mechanism to coordinate the policy actions of different governmental units, and the benefit of coordination exceeds its costs (Mundle, 1997: 227).

3.11. PUBLIC EXPENDITURE

The subject matter of public finance is (i) public expenditure on the provision of goods, services and state benefits, (ii) government revenue, the chief source of which is taxation, (iii) public borrowing and the national debt. Fiscal policy embodies government's decisions on the size, composition and timing of public expenditure and revenue to achieve economic social and political aims (Trotman-Dickenson, 1996:71).

3.11.1. Theories of Public Expenditure

3.11.1.1. The Doctrine of laissez-faire

Adam Smith is the father of laissez-faire. The doctrine argues for minimum state intervention in the workings of the economy. Adam Smith argued that: "governments are always and without exception the greatest spindrifts of society because they spend other people's funds. The supporters of the theory maintain that people should be left unhindered to pursue their best interest and in the process they would benefit the society. The implication of this is low expenditure and taxation (Trotman-Dickenson, 1996:71).

3.11.2. The optimum level of expenditure theory

Having accepted the need for some public expenditure, economists turned their attention to the question of what was its desirable level. Economists believe that the application of the marginal utility theory to public finance could be used to answer the question. The theory postulates that as a person's consumption increases, each additional (marginal) unit of good consumed gives lower satisfaction (utility) than the one before. Thus the consumer experiences diminishing marginal utility. The implication is that the more additional money becomes available for expenditure, the less importance the spender attaches to each individual rand (Trotman-Dickenson, 1996:71).

3.11.3. Displacement theory

An analysis of the time pattern of public expenditure by Professor A.T. Peacock and J. Wiseman has established the displacement effect. Expenditure tends to increase during periods of social/economic displacements or crisis, e.g. wars and stabilises when the war end or the crisis resolved (Trotman-Dickenson, 1996:78).

3.11.4. Keynesian theory

In his book, *The General Theory of Employment, Interest and Money* (1936), John Maynard (later Lord) Keynes argued that the government should use public expenditure as a tool of economic policy, to manage a national economy so as to counteract unemployment. The Keynesian prescription was to inject more money in the economic system. This required an expansive fiscal policy, in which government would deliberately aim at a budget deficit by spending more money than it raised in taxation (Trotman-Dickenson, 1996:82).

3.12. CONSEQUENCES OF GROWTH IN PUBLIC EXPENDITURE

National debt increase as a result of borrowing and this affect interests rates. A political consequence is the increased size of the public sector and hence the power of the state. The social consequence of the extension of welfare system is to ally the fear of deprivation that is consequent to unemployment, sickness and old age. The need for people to provide for themselves is reduced. The development of a 'welfare mentality' is likely to increase people's dependence on government support (Trotman-Dickenson, 1996:87).

3.13. TIEBOUT HYPOTHESIS

Tiebout (1956) argued that individuals select the local community whose provision of goods best satisfies their preferences. Tiebout's analysis was framed as a direct response to a conclusion that individuals would not reveal their preferences for public goods and services. Tiebout argued that individual "vote with their feet". The model has a number of critics. Firstly, Tiebout assumed that individuals have full knowledge of commodity characteristics (Cullis and Jones, 1992:300).

Secondly, the model assumes that costless mobility impels that there are no work problems, i.e. that households can move without having to obtain alternative jobs or without having to worry about the transport costs. Also, the model does not take into account issues of externalities: that the movement of household from one locality may cause externalities in the form of added congestion. As individuals migrate, externalities are experienced by those already resident in the community (Cullis and Jones, 1992:300).

Fourthly, the model does not cater for issues of economies of scale. When there are diverse preferences for public goods, the number of local communities required to produce equilibrium would be extremely large. Fifthly, the benefits provided by one locality may spill over to residents in another jurisdiction. The two localities may 'internalise' this spillover by a process of direct bargaining. Sixthly, the model assumes that preferences for public services do not change over the life cycle. In reality, at certain ages, individuals have a priority for educational facilities for children, later they will be more concerned with facilities for old-age pensioners. (Cullis and Jones, 1992:300).

3.14. DIVISION OF REVENUE IN SOUTH AFRICAN SYSTEM

3.14.1. Revenue sharing

The division of revenue in South Africa is based on the revenue sharing model. After the top slicing, the vertical division of total revenue pool and the contingency reserve, the provincial revenue is then divided equitably among the nine provinces, using the equitable share formula.

3.14.2. Equitable Share

Section 214 and 227 of the Constitution obligate the national government to share its revenue and provide an equitable share to provinces to enable them to provide basic services and perform their functions of service delivery. The Equitable share follows a redistributive approach, allocating more funds to poorer (e.g. Limpopo, Eastern Cape) and provinces than affluent ones (e.g. Western Cape and Gauteng) (National Treasury: 2002, 10).

The equitable share is the biggest grant. It allocates nationally collected revenue across the different spheres in line with their Constitutional responsibilities (the provision of basic services and assigned functions) and to support their effective functioning. It complements the own revenue of each sub-national government. It should be noted that this vertical division therefore takes account of the fiscal capacity and expenditure functions of sub-national governments (National Treasury 2002:11).

The equitable share is divided among provinces by means of a redistributive formula, comprising of seven components:

- An Education share (41 per cent) based on the size of the school age population (ages 6-17) and the average for three year's enrolment.
- A Health share (19 per cent) based on the proportion of the population without medical aid or health insurance.
- A Social security component share (18 per cent) based on the estimated number of people entitled to social security grants - elderly, disabled and children - weighted using the poverty index derived from the Income Expenditure Survey.
- A basic share (7 per cent) derived from each province's share of total population of the country.

- A backlog component (3 per cent) based on the distribution of capital needs as captured in the schools register of needs, the audit of hospital facilities and the share of rural population.
- An economic output component (7 per cent) based on the distribution of total remuneration in the country.
- An institutional component (5 per cent) divided equally among the provinces (National Treasury, 2003: 160).

The equitable division of revenue between national, provincial and local government is required by section 214 of the Constitution (National Treasury, 2003: 138).

3.15. PROVINCIAL BORROWING

Given the absence of substantial own revenue stream for provinces, and the sectoral focus of provincial expenditure, there a need for provincial borrowing. The most important point to remember is that provinces are, in terms of the constitution, autonomous legal entities that have powers to borrow, subject to national legislation (Gauteng Provincial Treasury, 2002:50).

In the same token, South Africa is also characterized by provinces with very different problems. Not all provinces have the same resources, be it natural or technological advancements. For instance Gauteng, Western Cape and KwaZulu Natal would perhaps find it a little less difficult to raise finance due to the developments in those provinces as opposed to provinces such as Free State and Limpopo. Proper and clear framework would need to be put in place before rushing into provincial borrowing as this could lead to unsustainable debt by the province and the country as a whole (Gauteng Provincial Treasury, 2002:53).

3.16. ADVANTAGES OF BORROWING

In terms of funding capital projects, borrowing by provinces can help them to leverage their revenues and also to improve their infrastructure on a pay as you go basis. This can be a very efficient way of financing capital projects without using their annual budgets. Managing cash from a multi-year loan is usually more efficient than managing proceeds from an annual appropriation, and it avoids problems in the management of annual operating budgets (Gauteng Provincial Treasury, 2002:53).

If provinces were to borrow from the private sector, this would instil some discipline and professionalism in the way provinces operate. For instance it would be imperative upon the provinces to get clean audit reports in their annual financial statements hence a provincial government must maintain certain financial discipline while it owes the debt and surrender financial control in the event of default (Gauteng Provincial Treasury, 2002:55).

3.17. SUMMARY

In this chapter we learnt that fiscal policy cannot totally separated from the objectives of government. The generally accepted goal of fiscal policy is that of the attainment of greater economic stability. Intergovernmental grants are mainly used to bridge the gab between revenue and expenditure responsibilities. Other goals of intergovernmental grants include equalization, correction of spillovers, revenue sharing, etc.

CHAPTER FOUR

4. BUDGET REFORMS IN SOUTH AFRICA

4.1. PURPOSE

The aim of this chapter is to provide a broad overview of the budget reforms that took place in South Africa within the intergovernmental fiscal relations system from the period 1994 to date (2003). In particular, the main budget reforms that came about with the introduction of the Medium Term Expenditure Framework, as well as the introduction of the Public Finance Management Act will be considered.

4.2. BACKGROUND

To understand some of the reforms, some crude definition of the term budget is necessary. The Gauteng Department of Finance defines a budget as "a plan that identifies how the money available is going to be spent, to achieve the goals set". (Gauteng Provincial Government, Department of Finance and Economic Affairs: Budget Special, 2003:1).

Laura Walker and Berhanu Mengistu (1999: 27), provide three objectives of the public budget system. First, that public funds must be spent on the delivery of services, with spending aimed at achieving governments' objectives at least costs. Secondly, while resources must be allocated to meet the nation's priorities, not all needs can be met simultaneously. Thirdly, spending must be sustainable and affordable – to enforce fiscal discipline to avoid inflicting unnecessary burdens on the population.

4.3. BUDGETING APPROACHES

Today, public budgets are presented in one or a hybrid of the following formats:

4.3.1. Line budgeting

Line item budget system presents budgets by object classification or expenditure, without reference to the programme or the departments that the expenditure intends to serve. The main advantage of a line-item budget is that it is easy to prepare and simple to understand. This system of budgeting, however, does not provide alternative methods of providing the same level of services that any reasonable choices require and does not tell much about the activities or functions of the organisation (Walker & Mengistu, 1999: 10).

4.3.2. Programme budgeting

The programme budgets allocate money to the functions or activities of an organisation rather than to specific items of cost. The main advantage of this system is that it shows the activities for which money will be spent and the emphasis that the budgeting authority places on the same activities. The key disadvantage, however, is that it does not show the level of services that would be produced by the activities for which money has been allocated (Walker & Mengistu, 1999: 10).

4.3.3. Performance budgeting

Performance budgeting allots money to various activities or programmes of an organisation, and at the same time describes the workload or work output that would be produced with the expenditure. The control thrust of a performance budget is to arrive at a performance target and efficiency norm from which the cost responsibility centre or individual responsibility centre can be established. Sometimes rated the most useful method, this method provides the advantage that funding agencies are able to regulate/evaluate in a positive way both the quality and quantity of services (Walker & Mengistu, 1999: 10).

Performance budgeting system, however, is not easy method to prepare the budget: it is difficult to define the unit by which the work of a department or activity can be measured, even if the units can be measured, it may not be easy to establish a system that will supply reliable measures of the work outputs (Walker & Mengistu, 1999: 10).

4.3.4. The Planning-Programming-Budgeting System (PPBS)

The Planning-Programming-Budgeting System (PPBS) attempts to identify goals established through planning, and relates them to activities required for goal achievement (programming) and shows the mix of resources required (budgeting). In brief, the PPBS attempt to answer the question why, i.e. to provide the rationale for a given expenditure (Laura Walker and Berhanu Mengistu, 1999: 15).

4.3.5. Zero-based budgeting

The Zero-based budgeting is a budget system in which departments or agencies develop a series of requests for different levels of services assuming a zero base. The merit of this system is that programmes that are no longer needed are discontinued, while those that are necessary are continued with the same, reduced or increased funding, depending on the priorities. The process may, however, not be compatible with policy areas such as Defence and Security and core governmental programmes that have societal mandates, for instance (Laura Walker and Berhanu Mengistu, 1999: 17).

4.3.6. Target-based budgeting

The target-based budgeting is a top-down rationing processes concerned with establishing priorities and limits at the top of the organisation and is a means to force choice between alternatives at the bottom. This process involves allowing additional funding for new proposals through a limited "policy reserve" or "discretionary reserve". The process stresses political feasibility and political expediency rather than economic efficiency, defined as the maximum output for the least input (Laura Walker and Berhanu Mengistu, 1999: 19).

4.3.7. Multi-Year Budgeting

Some commentators argue that most budget ills are not due to the length of the budget cycle, but due to other procedural and structural issues. Advocates of an annual budget cycle argue that multi-year budgeting is the lack of flexibility relative to the annual cycle. Furthermore, they argue that Multi-year budgets are less friendly towards contingencies that arise, with fewer opportunities to make adjustments. Situations can change rapidly (market crash, war break out, natural disasters) and multi-year budgets are less responsive than annual budgets (Laura Walker and Berhanu Mengistu, 1999: 24-25).

Another downside of multi-year budgeting is that there is also a higher degree of institutional permanence with multi-year budgeting. The longer any programmes continues, the greater its chance of survival. There are also political issues associated with work on multi-year budget. When executive power shifts to another political party, a new chief executive may not support the programme and may place budgetary priorities elsewhere (Laura Walker and Berhanu Mengistu, 1999: 24-25).

Multi-year budgeting involves appropriations that cover expenditure requirements for specified fiscal years. For example, in many states of the United States, budgeting is a biennial process while the appropriation becomes an annual process. Although two-year budgets are appropriated in full at the time of submission, adjustments to these appropriations can be made annually to respond to political and environmental changes. Hence, the term multi-year budgeting refers to the budget cycle and the process of making and approving a legally binding budget for a fiscal year, plus a number of outer years (Laura Walker and Berhanu Mengistu, 1999: 24).

Advocates of multi-year budgeting cycles claim that one-year-at-a-time budgeting leads to short sightedness, overspending, conservatism and parochialism. They also claim that a multi-year presentation allows for better presentation of programmes (Laura Walker and Berhanu Mengistu, 1999: 24).

Another advantage of multi-year budgeting is the saving of time and effort for budget preparation and passage. From the administration perspective, alternate years could be devoted to analysing what occurred in the previous budget year. Outcomes could be measured against expenditures, and trends could be measured and analysed, resulting in higher quality budget recommendations during the following budget cycle (Laura Walker and Berhanu Mengistu, 1999: 25).

4.3.8. Medium Term Budgeting

A medium term expenditure framework appears to be the intermediary alternative to these two extremes.

The process of budgeting cannot be divorced from the planning process. In fact, the performance based programme budget must be the basis for planning. If done independently from planning, budgeting is reduced merely to paper exercise (Iraj Abedian, Brigid Strachan and Tania Ajam, 1998:128)

South Africa uses the MTEF budgeting system. The underlying objective of the medium term expenditure framework is growth and development and progressive realisation of social and economic rights of citizens (National Treasury, 2003: 14).

The medium term expenditure framework is more than a technical tool or technique for achieving the target, it represents a way of doing business in government. It is about effectiveness, rather than merely accounting. The Medium-term approach makes policy and funding choices in tandem, so that expenditure is driven by priorities while choices are made from affordable set of alternatives (Laura Walker and Berhanu Mengistu, 1999: 27).

Not only does it provide an analytic framework for evaluating the trade-offs inherent in policy choices, but it also creates a mechanism for resolving the conflict between affordable and delivery needs. For the medium term expenditure framework to be successful, there must be supporting institutional arrangements that provide the correct incentives and assist in balancing priorities with affordability (Walker & Mengistu, 1999: 27).

4.3.8.1. Rationale for MTEF

After the 1994 elections, South Africa had compelling reasons to transform its budget system; the Constitution entrenched basic human rights- thereby guaranteeing access to market services and introducing a new intergovernmental framework (Laura Walker and Berhanu Mengistu, 1999: 50).

4.3.8.2. Benefits of the medium term expenditure framework

Abedian et al, (1997) summarised the benefits on the medium term expenditure as follows:

Table 8: benefits of medium term expenditure framework budgeting

Advantages for legislatures	Advantages for civil society and citizens	Advantages for government
▪ Provides a broader platform for political participation in the budget process ▪ Politicians can judge whether output targets have been met than if an amount of money has been spent ▪ Provides greater transparency and accountability ▪ Provides stronger political role in deciding priorities and negotiating budget trade-offs ▪ There is better quality information for legislatures to us in exercising their supervisory role	▪ Creates an enabling environment for government to do its job better ▪ Greater transparency and accountability gives citizens a better idea where and how their tax money is being spent ▪ Encourages greater public participation by creating forums for consultation and debate ▪ Emphasis on operational efficiency should improve service delivery ▪ Holding managers accountable encourages innovation in delivery	▪ medium term expenditure framework enhances government to be able to set up its strategic plans ▪ Emphasis on affordability leads to fewer policy choices that are unlikely to be implemented, thus enhancing the credibility of the government ▪ Identifying actual costs of providing services moves departments from an incremental approach to budgeting ▪ It accommodates capital projects that cannot be completed within a single budget framework

Source: Abedian et al, 1997: 23

4.3.9. Medium Term Expenditure Framework role players

A budget is the outcome of extensive planning and consultation. It involves, in the main, the work by National Treasury, provincial Treasuries and other departments in developing strategic plans, evaluating options and assessing spending priorities. It takes into account Parliamentary resolutions, representations by business, labour and community stakeholders, expert analysis and public opinion (National Treasury, 2003: 129).

4.3.9.1. The Budget Council

The Budget Council is a forum established to coordinate the financial relations between national and provincial government, comprising the Minister and Deputy Minister of Finance and the nine provincial Member of Executive Council (MEC's) for finance. It determines the planned vertical and division of revenue. In considering the allocations, the Budget Council first takes out the top slice from the total revenue pool and thereafter provides for a policy fund (also known as the contingency reserve) which would be available for later allocation by Cabinet. This, thus allows Cabinet some flexibility in altering the vertical split (Iraj Abedian, Brigid Strachan and Tania Ajam, 1998:44).

4.3.9.2. The Financial and Fiscal Commission (FFC)

The FFC is an independent and impartial advisory body established under the Constitution. Its main function is to make recommendations in three main areas:

a) The division of nationally collected revenue between national, provincial and local government,
b) Determination of an equitable formula for the horizontal division of revenue between the nine provinces and between local authorities, and

c) Any other budgetary allocations to sub national governments and any conditions to be applied to these amounts.

Although the recommendations by the Financial and Fiscal Commission must be taken into account by the Minister of Finance in making final proposals on the vertical and horizontal split, the final decision on the allocations in the division of revenue still lies with Parliament (Laura Walker and Berhanu Mengistu, 1999: 67).

4.3.9.3. The Minister of Finance

After considering the recommendations of the Financial and Fiscal Commission and the Budget council, the Minister of Finance decides on the proportions in which nationally colleted revenue is to be shared for the next and the subsequent two fiscal years. First, the top slice is taken from the total revenue pool (Iraj Abedian, Brigid Strachan and Tania Ajam, 1998:43).

4.3.9.4. The Auditor-General (AG)

The AG is responsible for auditing expenditure at all levels of government. The Auditor-General provides reports on budgets and expenditure in any given year. The Auditor-General reports to the Public Accounts Committee on the reports. The chain is, however, weakened by two factors. Firstly, the reports are only available two years after expenditure has taken place and secondly, inadequate mechanisms exist to take decisive action for the recovery of fraudulent or "fruitless" and unauthorised expenditure (Laura Walker and Berhanu Mengistu, 1999: 68).

4.3.9.5. Minister's Committee on Budget (MINCOMBUD)

This Committee plays an instrumental role in generating political support in the budget process. It examines the budget proposals before submission to the Cabinet for evaluation. The committee was chosen firstly because it provides the Cabinet with the assurance that policy imperatives have been fully captured in the budget proposals. Secondly, it cuts down the detailed interrogation of the numbers that Cabinet has to do since the Committee has already done this, so that Cabinet can restrict itself to debating policy choices to be made (Laura Walker and Berhanu Mengistu, 1999: 68).

By early September, the MinComBud (a special Minister's Committee on the budget) signals priorities, which are approved by Cabinet in mid-September. In October, the medium term expenditure framework Committee presents its recommendations to the Minister of Finance, MinComBud and the Budget Council. The MinComBud reviews the allocations for national and provincial spheres and Cabinet approves the national medium term expenditure framework subsequently (Iraj Abedian, Brigid Strachan and Tania Ajam, 1998:45).

4.3.9.6. The Extended Cabinet

The extended cabinet meeting include premiers, and a menu of options are discussed in determining the trade-offs required to close the gab in balancing the budget within available resources (Iraj Abedian, Brigid Strachan and Tania Ajam, 1998:45).

4.4. BUDGET REFORMS

The reformation of the budget system is key to service delivery. According to Iraj Abedian et al, budget reforms attempts to ensure that value for money is achieved in South Africa (Iraj Abedian, Brigid Strachan and Tania Ajam, 1998:47).

4.5. PROGRESS WITH BUDGET REFORMS

The following is a summary of the key elements of the budget reforms:

- Measurable objectives must be submitted to Parliament for each main division within a department's vote. Measurable objectives are defined as quantifiable results that can be achieved within a foreseeable time period.
- Departments are required to report on outputs measures and targets established in the previous year.
- Financial reporting includes public entities.
- Adoption of the standardised Government Financial Statistics (GFS) classification as the basis for budgetary reporting.
- In terms of Infrastructure reporting requirements, departments are now required to breakdown their infrastructure estimates into standardised categories including 'large infrastructure projects' (costing over R20 million) and 'small projects', 'infrastructure transfers' and others.

Other significant progress to date includes:

- The consolidation of the intergovernmental fiscal system following its establishment in 1997, gave effect to the three spheres.
- Medium term expenditure framework budgeting introduced in 1998 has tightened the links between Government's policy choices, its budgets and delivery of services.
- The promulgation of the Public Finance Management Act provides public sector managers more autonomy and flexibility for delivering

services effectively, within a regulatory framework that strengthens accountability and oversight.

- The increasing focus on output targets alongside spending plans provides a basis for assessing the value for money. (National Treasury, 2003 Budget Review).

4.6. SUMMARY

In this chapter we learnt that there are various budgeting approaches, each with own advantages and demerits. South Africa uses the Medium Term Expenditure Framework for budgeting and dividing revenue amongst spheres of governments and state agencies. Like any other approach, the Medium term expenditure framework has its own strengths and weak points. Despite this, its introduction remains one of the milestone reforms in the public sector budgeting cycles. The introduction of the Public Finance Management Act attempts to modernize budgeting and financial management in the public sector.

CHAPTER FIVE

5. ANALYSIS AND INTERPRETATION OF DATA

5.1. Purpose

The purpose of this chapter is to analyse the data and interpret the findings of the study. The reporting of findings will follow the sequence of the questionnaire administered (see annexure A). The relevance of these findings will also be discussed in this chapter, and consolidated into final recommendations in chapter 6. Table 9 below shows a summary of key results from data collection for the study.

5.2. Summary of key results from data collection

Table 9: summary of key results from data collection

Questions	Total Number of respondents	Percentage of respondents who agree	Percentage of respondents who disagree
MTEF is suitable for the government sector	18	90 %	10 %
There is some need to further advance the advantages of MTEF budgeting.	18	7 %	93 %
Politicians should leave budgeting entirely in the hands of officials.	18	71 %	29 %
There should not be some shared/equal powers between the Office of Premier and Provincial Treasury in the budgeting process.	18	95 %	5 %
The equitable share formula allocation of revenue to provinces is not a fair reflection of the equitable distribution of resources.	18	57 %	43 %
The Equitable Share formula does not take into account the diversity of the provinces in terms of their economic profiles, poverty and other socio-economic factors.	18	20 %	80 %
The provinces should develop some capacity and be responsible in managing the funds that flow to them.	18	50 %	50 %
The level of spending on conditional grants has been very low in the past years. Respondents' rating was as follows:			
• Poor/inadequate planning	18	52 %	48 %
• Too much allocation	18	24 %	76 %
• Political interference), lack of political guidance	18	7 %	93 %
• Problems with implementation of projects	18	6 %	94 %
The conditions of grants are overly strict and that this inhibits proper functioning of the conditional grants system.	18	59 %	41 %
The efficacy of the IGFR institutional structures as fair, implying that more can still be done by these structures.	18	52 %	48%
The are some teething problems with own revenue management in the provinces. Respondents views were as follows:			
• The respondents indicated that the provinces do not have the capacity to collect their own revenue efficiently,	18	79 %	21 %
• The respondents indicated that the problems are compounded by the fact that provincial own revenue sources are not predictable.	18	21 %	79 %
The powers of provinces to borrow should be extended.	18	70 %	30 %
The pace of budget reforms in South Africa is supported	18	80 %	20 %
More reforms should not be introduced further until the current reforms have been satisfactorily implemented.	18	8 %	92 %
The respondents indicated that requires further attention.	18	68 %	32 %

A total number of 18 questionnaires were sent to provinces. Of the 18 questionnaires sent, 11 questionnaires were filled and returned. The unreturned questionnaires (7) were followed up through structured telephonic interviews.

5.3. Sampling

"Sampling is a technical accounting device to rationalise the collection of information, to choose in an appropriate way the restricted set of objects, persons and events from which the actual information will be drawn. A sample is a subset of the whole population which is investigated by a researcher and whose characteristics will be generated to the entire population" (Bless & Higson-Smith, 1995: 85-86).

5.4. Type of Research

It is important to remember that the type of the research used in this study is qualitative in nature, attempting to interpret the perceptions of budget managers in provinces on the current transfer and budgeting system in South African.

5.5. Unit of analysis

Bless and Higson-Smith (1995:66) defines a unit of analysis as the person or object from which the social researcher collects data.

In this study two (2) questionnaires were sent to each of the nine provincial departments of finance/treasury. In other words, a total of 18 questionnaires were sent to provinces. Of the 18 questionnaires sent, 11 questionnaires were filled and returned. This represents a response rate of 61 percent on the questionnaires. The remainder of the 7 (seven) unreturned questionnaires (39 percent) were followed up by structured telephonic interviews with the respondents, following the drafted questionnaire step by step. Thus, a representative sample was drawn for this study.

5.6. Data analysis and Interpretation

The study attempted to interpret the perceptions of budget managers in South Africa's nine provinces and the extent to which they felt that the government is using the "correct" system of budgeting. According to the results of the questionnaire, 90 percent of the respondents agreed that the Medium Term Expenditure Framework (MTEF) is suitable for the government sector.

Although respondents were generally satisfied with the Medium Term Expenditure Framework, a relatively small portion of the respondents (7 percent) felt that there is some need to further advance the advantages of MTEF budgeting.

Some respondents felt that public sector budgeting is defeated by political goals, rather than rationality and objectivity. A larger proportion of the respondents (71 percent) felt that politicians should leave budgeting entirely in the hands of officials.

80 percent of the respondents argued that the role of the Office of the Premier as far as public finance management and budgeting is concerned should not be enhanced, but rather that the Provincial Treasuries should continue to coordinate the budgeting process, without interference by the Premier's Office.

The majority of respondents (95 percent) argued that there should not be some shared/equal powers between the Office of the Premier and that of the Provincial Treasury in the budgeting process.

57 percent of the respondents felt that the equitable share formula allocation of revenue to provinces is not a fair reflection of the equitable distribution of

resources. Some respondents (20 percent) indicated that the formula does not take into account the diversity of the provinces in terms of their economic profiles, poverty and other socio-economic factors.

Half of the respondents (50 percent) indicated that the problem is not whether the equitable share formula for allocating funds is equitable or not, but that the provinces should develop some capacity and be responsible in managing the funds that flow to them.

International experience shows that the use of conditional grants could assist in averting, or at least reduce vertical fiscal imbalances among sub national spheres. In terms of the argument of the respondents, 57 percent indicated that the use of conditional grants is only but one tool among measures/means to deal with vertical fiscal imbalances. These respondents indicated that there is room for improvement in terms of the extent to which conditional grants have been successfully used to address problems.

The level of spending on conditional grants has been very low in the past years, although some level of improvements has been noted. Some respondents (52 percent) indicated poor/inadequate planning as a factor that mostly contributed to low spending. Other factors included too much allocation (24 percent), political interference (7 percent), lack of political guidance (6 percent) and others referred to problems with implementation of projects (10 percent).

A large number of respondents (59 percent) indicated that the conditions of grants are overly strict and that this inhibits proper functioning of the conditional grants system.

52 percent rated the efficacy of the IGFR institutional structures as fair, implying that more can still be done by these structures. These structures include the 4x4's Budget Council Technical Committee of Finance (TCF) Budget Lekotlas and Others.

The study also showed that there are some teething problems with own revenue management in the provinces. Most respondents (79 percent) indicated that the provinces do not have the capacity to collect their own revenue efficiently, while others (21 percent) indicated that the problems are compounded by the fact that provincial own revenue sources are not predictable.

A majority of respondents (70 percent) felt that the powers of provinces to borrow should be extended. They argue that because the system in South Africa is such that provinces do not raise adequate revenue, coupled with operative inefficiencies on conditional grants, provinces should be given the latitude to borrow, although within the legal parameters set by the national government.

The low spending on capital allocations is a major issue in provincial budgets. The majority of respondents (63 percent) indicated that this low spending could be attributed to problems of capacity to spend the allocated funding by provinces, while others (24 percent) related this to poor planning, and 13 percent to political interference.

80 percent felt that the pace of budget reforms in South Africa is supported. Some respondents (8 percent) suggested that more reforms should not be introduced further until the current reforms have been satisfactorily implemented.

Lastly, the majority of respondents (68 percent) indicated that the area that needed further attention in terms of improvement/implementation is the reporting mechanism regarding non-financial outcomes.

5.7 Conclusion

In this chapter the writer reported on the data received from the nine provinces, administered through a questionnaire and telephonic interviews.

Areas of concern were noted and discussed and will be brought in the next chapter as part of the recommendations.

Amongst other issues, it is important to note the following key findings that emanated from the questionnaire, namely:

- The poor coordination of planning contributed to the low spending patterns in terms of conditional grants and capital allocations.
- The provinces should advance their capacities to collect more revenue in order to reduce their over reliance on national transfers.
- The provinces should be allowed to borrow from the private sector to compliment their own revenue streams.
- The provinces should manage their resources more efficiently and effectively, irrespective of the size of the resources envelope.

CHAPTER SIX

6. CONCLUSIONS AND RECOMMENDATIONS

6.1. Purpose

The purpose of this chapter is twofold, first, to present a summary of the conclusions that were drawn during the course of this study and secondly to make some recommendations. The conclusions and recommendations cover the following areas: the system of intergovernmental and fiscal relations in South Africa, provincial own revenue, conditional grants, provincial borrowing, and budget reforms in South Africa.

6.2. Conclusions

The study shows that the system of South African intergovernmental fiscal relations has been subjected to a continuous process of change since 1994. The main driver of this change has been the new constitutional dispensation.

One of the effects of this change is that provinces are no longer merely spending agencies for central government. Instead, they have been empowered by the Constitution to fashion their own policy priorities in certain areas and to translate these into resource allocations that will support policy objectives.

The study also showed that provinces have different demographic and socio economic profiles. These diverse profiles make the task of efficiently disbursing funds and grants to sub national spheres difficult.

Fiscal policy cannot be separated from the overall objectives/goals of government, e.g. addressing poverty, unemployment, etc. The generally accepted goal of a fiscal policy is that of the attainment of greater economic stability. The study showed that intergovernmental grants are mainly used to bridge the gab between revenue and expenditure responsibilities.

The study also showed that the spending on capital allocations remains an area of concern, especially in provinces that are poor compared to the more affluent ones. The poor spending of the conditional grants imply that those policy objectives that are supposed to be achieved by conditional grants funding are sometimes a failure, because these funds are not spent in time.

There are various budgeting approaches, each with its own advantages and disadvantages. The South Africa government uses the Medium Term Expenditure Framework for budgeting purposes.

Like any other approach, the Medium Term Expenditure Framework has its own strengths and weaknesses. Despite this, its introduction remains one of the milestone reforms in the public sector budgeting cycles. The introduction of the Public Finance Management Act attempts to modernize budgeting and financial management in the public sector.

6.3. RECOMMENDATIONS

As an area of further study, it is recommended that an overall audit of the current intergovernmental fiscal systems and mechanisms be done to address some of the weaknesses inherent in the intergovernmental system as identified in this study. This would, among others, include the need to develop a mechanism for the equitable allocation of capital grants for infrastructure development.

Further, it is recommended that more explicit budget processes and mechanisms that incorporate Government's requirement to take account of Section 214 (2) (a) to (j) of the Constitution be developed.

In order to improve on the allocation of funds to sub national spheres, it is recommended that policy objectives should be quantified in terms of indicators and be monitored. These can take the form of service delivery indicators, which measure the outputs of current and capital spending. Performance outputs and indicators must be analysed and monitored on a regular basis, and the results fed back into the design of the current system and the monitoring of governmental performance.

Targets for these policy objectives should be set, and all reasonable policy instruments should be put in place. These policy instruments may be legislative, administrative and/or institutional.

It is necessary that the government determine the budget required to finance the cost of achieving the set policy targets and objectives. The options of channelling these funds are already available in the system: the equitable share, conditional grants, other inter-governmental transfers, own revenue, and donor funding.

To augment their revenue, it is recommended that the provinces be given more autonomy to borrow. The Borrowing Powers of Provincial Governments Act sets out norms and conditions for provincial borrowing. Provincial governments often cannot borrow for long-term capital projects because they often do not generate sufficient own revenue to meet debt obligations.

By giving provinces more powers to borrow, especially for financing projects that benefit more than one generation, this would spread the debt burden across generations, making it more likely that the generation that enjoys the benefits of those capital projects pay for them. Such debts however need to be discharged within the active lifespan of the project.

Lastly, it is recommended that formula driven grants be introduced in the South African intergovernmental transfer system, in addition to the formula driven equitable share allocations. Formula grants have a number of advantages over those that are determined by a year-to-year discretionary basis by national sphere because they are more transparent, reliable and predictable, and are less subject to short-term fiscal constraints and day-to day political considerations.

6.4. CONCLUSION

It is anticipated that the recommendations of this study will stimulate further discussions and research on the efficiency and effectiveness of the intergovernmental grant system in South Africa. In short, in this chapter, the following recommendations are were made, namely, that:

- An overall audit of the current intergovernmental fiscal systems and mechanisms be done to address some of the weaknesses inherent in the intergovernmental system as identified in this study.
- Policy objectives should be quantified in terms of indicators and be monitored.
- Targets for these policy objectives should be set, and reasonable policy instruments should be put in place.
- Performance outputs and indicators must be analysed and monitored on a regular basis.
- To augment their revenue, it is recommended that the provinces be given more autonomy to borrow.
- Formula driven grants be introduced in the South African intergovernmental transfer system, in addition to the formula driven equitable share allocations

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ANNEXURE A: QUESTIONNAIRE

A. RESPONDENT DETAILS

Name and Surname of the participant:______________________________
Title (e.g. Director, Deputy Director, etc)______________________________
Organisation (e.g. Department of Finance/Provincial Treasury_______________
Province____
Other optional details (if any)_____________________________________

B. QUESTIONS

1. Is, in your opinion, the government is using the "correct" system of budgeting?

Please motivate:

____
____
____
____
____

2. What do you consider the most advantages of the MTEF budgeting?

List them:

____
____
____
____
____

3. What suggestions would you recommend to further advance the advantages of MTEF budgeting?

____
____
____
____
____

4. Politicians should leave budgeting entirely in the hands of officials. Your comments, please…

____
____
____
____
____

5. The role of the Office of the Premier as far as public finance management and budgeting should be enhanced?

Motivate for your answer.

____
____
____
____
____

6. Some people believe that there should be some shared/equal powers between the Office of the Premier and the Provincial Treasury in the budgeting process. Your comments please..

7. The equitable share allocation of revenue to provinces is fair, equitable. Your comments please?

8. Your province is getting a fair share of nationally collected revenue? What are your views on this issue?

9. Within the South African Intergovernmental fiscal system, the use of conditional grants is one of the measures/means to deal with vertical fiscal imbalances. To what extend to you think this aim is achieved?

10. How would you rate the level of the following factors on conditional grants under spending? Put 0 (none), 1 (low) 2 (high), 3 (very high)

Poor/inadequate planning	
Too much allocation	
Political interference	
Lack of political guidance	
Problems with implementation of projects	

11. What are your comments on the conditions of grants generally? Are the conditions overly strict or OK per your assessment? Please motivate.

12. How do you rate the efficacy of the following IGFR institutional structures (choose between good, fair, poor, excellent)

4x4	
Budget Council	
TCF (technical Committee of Finance)	
Budget Lekotlas	
Other (provide name)	

13. Own revenue collection in provinces is difficult to manage, due to:

____
____
____
____
____

14. What would you say are the loopholes with the equitable share formula?

____
____
____
____
____

15. Social security grants should be funded from the national government as part of the top slicing of revenue. What are views?

____
____
____
____
____

16. The powers of Provinces to borrow should be extended

Agree	
Disagree	

17. How would you rate the impact of the following factors on the low spending of capital allocations by provinces in South Africa?

Poor planning	
Too many allocations	
Problems of capacity to spend	
Political interference	
Other (specify)	

18. What is you assessment of the pace of budget reforms in South Africa?

Very slow	
Very slow	
Just right	
Fast	
Very Fast	

19. In what areas do you think government need quicker on budget reforms? Put 0 (none), 1 (low) 2 (high), 3 (very high)

Budgeting	
Reporting on non financial	
Monitoring	
Legislation to enforce reforms	
Reporting on non financials of expenditure	
Other	

20. Do you think that the Intergovernmental Relations Systems has sufficient legislation to govern it properly?

Agree	
Disagree	

21. Some argue that there is some level of duplication between the PFMA and DoRA. What are your comments

____
____
____
____
____

22. Section 40 (1) of the Constitution provides that." All spheres of government are distinctive, interdependent and interrelated." In your opinion do you think provinces are distinctive?

____
____
____
____
____

23. Provinces largely under spent their funds because of lack of credible spending planning.

Agree	
Disagree	

24. How would you rate the impact of the following factors in under spending/overspending on provincial budgets?

	None	Low	High	Very High
Poor/inadequate planning				
Poor budgeting				
Political interference				
Other (specify)				

ANNEXURE B: ABBREVIATIONS

IGFR	Intergovernmental fiscal relations
AFReC	Applied Fiscal Research Centre
SARB	South African Reserve Bank
IPFA	Institute for Public Finance and Administration
SAIPA	South African Institute for Public Administrators
PFMA	Public Finance Management Act
DoRA	Division of revenue Act
MTEC	Medium Term Expenditure Committee
MTEF	Medium Term Expenditure Framework
MINCOMBUD	Minister's Committee on Budget
MEC	Member of Executive Council
MINMEC	Minister and Member of Executive Council
GDP	Gross Domestic Product
HDI	Human Development Index
KZN	KwaZulu-Natal
FFC	Financial and Fiscal Commission
TR	Treasury Regulations
AG	Auditor General
PPBS	Planning Programming Budgeting System
ZBB	Zero Based Budgeting
GFS	Government Financial Statistics