

EMBARGOED: 14:00 9 OCTOBER 2001

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INTERGOVERNMENTAL FISCAL REVIEW

ADDRESS TO THE NATIONAL COUNCIL OF PROVINCES

TREVOR MANUEL, MINISTER OF FINANCE

9 OCTOBER 2001

Madam Chair,

Honourable Members,

MEC's here present,

Representatives of Provincial Legislatures

Representatives Organised Local Government

Ladies and Gentlemen

Our Constitution enjoins us to create a caring democracy built on the strong foundations articulated in our Bill of Rights. It also requires that we develop appropriate systems of government which recognise three inter-related and interdependent spheres of government by developing appropriate norms of co-operative governance.

Because decentralisation is necessary for effective delivery, the Constitution assigns to provinces the delivery of essential services like school education, clinics and hospitals, the provision of social grants and welfare services, housing and roads. Municipalities in turn, have responsibility for the delivery of essential basic services like water, electricity,

roads and streets and emergency services. Provincial and local governments determine their own priorities and budgets.

They are governments in their own right, accountable to their legislatures and councils, and tasked with real responsibilities to serve their people.

The fiscal system **cuts to the heart of co-operative governance**, which requires the close alignment of policy, budgeting and planning. Co-operative governance will succeed because we are able to co-ordinate and reconcile the priorities of the different spheres, and transfer sufficient resources to enable provincial and local governments to provide basic services. The system will work because all institutions of government collect all revenues due, make appropriate spending choices, and spend efficiently.

In preparing this Intergovernmental Fiscal Review, we repeatedly asked whether these interrelationships are working optimally, and what we can learn from our experience to improve the functioning of our intergovernmental relationships.

The IGFR

The *Review* focuses on the outcomes of the application of nationally raised revenues shared with the two other spheres of government. It does not review the spending by national government – this task is best dealt with in the Estimates of National Expenditure that we publish alongside the Budget. Provincial governments have the largest spending budgets, totaling R121,4 billion in 2001/02, and local governments about R62 billion, after taking their own revenues and transfers into account. Sixty percent of nationally-raised revenue available after servicing our debt is transferred to provinces and municipalities.

The *Review* analyses expenditures and outcomes in the key areas of social service delivery – Education, Health , Social Services and Infrastructure - since these are essentially areas of provincial competence. We will, in future also examine other expenditure areas such as land and agriculture that are essential to uprooting poverty . Similarly, we must recognise that areas of national competence, like the criminal justice system all add up to measure the quality of life of South Africans – alongside those which are covered by the *Review*.

It is in this context that the annual *Intergovernmental Fiscal Review* must be seen:

***✍* The *Review* focuses primarily on budget and financial information, but this third edition also focuses on important non-financial information.** This should enable us to assess performance on service delivery, to set benchmarks and to identify best practice. It gives us a sense of how our provincial hospitals are shaping, how our schools measure up, how our local governments do in their task to bring basic services to people.

***✍* However, the relevance of the *Review* goes far beyond these numbers or service delivery indicators or achievements.** It tells us about the difficulties and challenges facing the three spheres of government, about achievements, delivery challenges, institutional changes, fiscal choices made and to be made. Through this learning, we can help make our Constitution work better for the people of this country, and strengthen the provincial and local spheres to deliver better and more efficiently.

~~LE~~ **The IGFR enables us to learn.** Government must learn from its own experiences so that it can improve on what it does. We have to learn from what we do correctly so that we can reinforce our successes, but we must also be mindful of our shortcomings in order to eliminate these. We can not, in the short term, deliver on all the expectations of our people, but democracy demands that we be mindful of the choices we make, and that we are able to report on the implementation of those choices.

Madam Chair, it is critical that this House champions the use of the *Review* as a tool to address broader development and delivery issues.

The IGFR is an attempt to help us answer some difficult questions and it should assist Parliament, and the NCOP in particular, legislatures and municipal councils, to strengthen their oversight function. It is the story of remarkable successes attained in a relatively short period. The *Review* details some essential elements of this wonderful transformation to democracy that we are all so important a part of. It is an invitation to engage with the executive in all spheres of government on what needs to be done. More importantly, this process offers a significant opportunity to advise on future spending choices, and hence on future allocations between the three spheres. It allows us to assess the key fiscal policy challenges that we face as a country.

This year's *Review* covers both provincial and local government issues across provincial functions like education, health, welfare or social development, housing and provincial roads and looks at critical issues such as infrastructure and personnel. It looks at the challenges facing the new municipalities:

~~LE~~ To consolidate the new structures, their staff and budgets

- ✍ To coordinate grants that will ensure effective capacity-building, infrastructure development and service delivery
- ✍ To finalise the powers and functions of different categories of municipalities to bring greater certainty to this sphere
- ✍ To improve budgeting, financial planning and data management
- ✍ To address the policy and implementation issues around the commitment to free basic services

Lessons from the Provinces

Previous *Reviews* have covered the remarkable turnaround in provincial finances since 1998/99. The *Review* indicates that this trend continues. Personnel spending moved from a high of 59 percent of total provincial spending in 1998/99 to 57,3 percent in 2000/01. Provinces are no longer running deficits, and are in fact running bigger surpluses than projected.

There are a number of successes that government can be proud of. I want to outline some of these briefly.

✍ **The spending and provision of social services are the key priority for Provincial governments.** The three social sectors (education, health and social development) cover about 83% of provincial budgets. This share varies by province, depending on their demographics and history. For example, poor provinces like Eastern Cape spend about 22% of their total budget on social development, whilst Gauteng spends only about 14%. However, given that Gauteng has more academic hospital complexes, it spends over 30% of its budget on health compared to the

average of around 24%. Nonetheless, the trends show progress, more access and greater equity. The measurable inequalities present the greatest ongoing challenge to all of us as decision-makers.

~~2/2~~ **We have made good progress in turning the education system around.** Given the legacy of apartheid, the transition over the past five years has been tough. Despite the many problems, the transition in education has been well managed, mainly due to the cooperative relationship between national and provincial governments and between the education and finance arms of Government.

Enrolment rates increased in South Africa to about 12,3 million in 1997, mainly due to a concerted effort to increase school enrolment after 1994. Learner-educator ratios have declined from about 33,7 in 1996 to 32,7 in 2000. More importantly, average class size has declined from 43 to 38 over the same period. Over 25 000 classrooms have been built since 1996. Most provinces report a reduction in the number of schools that are overcrowded, with the exception of Gauteng and Western Cape.

✍ There have also been great leaps in coverage of the social grants system to the aged, children under six, foster care and the disabled. This success is probably Government's most effective tool in alleviating poverty. There are now 3.9 million beneficiaries of social grants. The number of beneficiaries in 2003 are expected to double from 1998. This rate of change is unsurpassed anywhere, but we must recognise that this remarkable take-up of grants places enormous stress on provincial social welfare budgets. Welfare grants and services will play an important role in countering the impact of HIV/Aids on household vulnerability, especially the need to care for orphans below 15 who lost parents due to Aids. The beneficiaries of the foster care grant grew from around 40 000 in April 1997 to 79 437 in March 2000, due in part to increasing numbers of Aids orphans.

✍ **The extension of primary health care has made basic health care more accessible to all South Africans.** Provincial health expenditure grows by more than 2percent in real terms in 2001/02, from R24,1 billion in the previous year to R26,4 billion. Indeed, the private health care system only allows access to less than a fifth of all South Africans, mainly those covered by medical aid schemes. We must not allow this gap to widen. The *Review* points out that 84 percent of the population is not covered by medical aid or health insurance. With less funding the public sector has to care for a much larger number of people than the private sector.

One of our key areas of achievement was primary health care, and the IGFR cites surveys that show much progress, such as:

✍ substantial increases in ante-natal care

✍ improvement in turn-around times for various tests, such as for HIV/Aids

✍ wider treatment of tuberculosis (DOTS)

~~///~~ reduced patient loads at clinics

~~///~~ doctor availability at clinics

~~///~~ a marked increase in availability of electricity at clinics

~~///~~ increases in availability of condoms, oxygen, penicillin and oral contraceptives.

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~~///~~ Honourable Members will learn from the *Review*, the distribution of all health professionals – doctors, specialists, dentists and nurses is unbelievably uneven across the Provinces. This set of statistics, and the fact that we are aware of it, presents us with enormous policy challenges.

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~~///~~ **Government spent over R16 billion on provincial housing** development between 1994/95 and 2000/01, R11,2 billion of which was spent since 1997/98. This contributed towards the building of more than 1,1 million housing units accommodating about 4,9 million people. Apart from providing shelter, this also means job creation. The challenge remains vast, and one person without shelter, one household without water, are one too many. But a dent has been made in the backlogs.

~~///~~ **Infrastructure spending is now growing strongly.** Capital spending in provinces rebounded with a 19 percent increase to R7,6 billion, and all provinces spent more than the previous year. This should continue, bolstered by the additional funding announced in the Budget this year. Over the medium-term, provincial capital expenditure is set to grow strongly at an average annual rate of 23 percent and is set to surpass R14 billion by 2003/04. It will thus more than double its 1999/2000 level. During this period, the provincial share of funding for capital expenditure is expected to rise from R3,5 billion in 2000/01 to R7,4 billion

in 2003/04, at which time the provincial share will be 52 percent of total capital expenditures.

Lessons from Local Government

Enormous changes have been effected in respect of local government since the period under review. Honourable Members would observe that the section on Local Government has been expanded to four discrete chapters in the *Review*. The changes were the result of the process of demarcation and the establishment of 284 new municipalities created by the elections last year.

In many respects the lessons of the earlier period will prove extremely important to deliver the quality of democracy which local government must provide, the kind which touches the lives of all of us on a daily basis.

***✍* We have advanced substantially with local government transformation, and the fiscal conditions to support developmental municipalities are taking shape.**

Transfers are being consolidated to ensure that they effectively support a municipal sphere that serves communities best, and that addresses the needs of the poor. The report shows however that many transformation issues require very careful consideration to ensure that the new structures are fiscally sustainable:

✍ Powers and functions of district and local municipalities must be clarified soon, to assist planning and budgeting, and to create certainty for investors. Shifting of functions not only entails shifting of funds, but also of personnel. Similar pressures apply when restructuring in sectors such as electricity and water.

~~///~~ Grants need to be coordinated and better targeted

~~///~~ The need is to accelerate budget reforms, introduce 3-year budgets and develop more management orientated budget formats. Municipalities must develop credible IDPs that link to their budgets and that take available resources into account.

~~///~~ **Public resources for the expansion and improvement of municipal services will always be limited.** A key tool to expand service delivery is the development of partnerships with the private sector, either in the form of equity partnerships, where private sector skills are used to improve service delivery, or through responsible municipal borrowing. National government has developed robust regulatory frameworks for both forms of partnerships. The Review notes the successes in equity partnerships that have been achieved, particularly through the work of the Municipal Infrastructure Investment Unit. Municipal borrowing, however, has remained stagnant despite enormous infrastructure backlogs. Apart from INA and the DBSA most institutions are not lending to municipalities. This highlights the importance of providing a stable and predictable environment for both lenders and municipalities themselves.

~~///~~ **The commitment to free basic services fits our developmental agenda and policy work is moving ahead to ensure that we get this right.** To be successful, municipalities must carefully target those this policy must benefit and focus time and energy managing the implementation. Fiscal constraints require that we first target people who cannot afford to pay for the basic level of essential services. National funding assists local governments through the equitable share and municipal

infrastructure grants. Priority must be given to extending essential services to those who have no service, and to providing basic services to those who cannot afford to pay.

Cost recovery is central to any sustainable subsidy system. Municipalities must apply tighter credit control to consumers that are able to pay. This not only improves cash flows, but also releases additional funds to subsidise consumers who cannot pay.

Future Challenges

Madam Chair, I want to now focus on key lessons from the *Review*, and what they suggest for the future.

✍ Firstly, there are considerable institutional and management challenges. There is much to be learnt from the provincial experience, both for the provinces themselves and in our approach to the local sphere as it goes through its final stage of transformation.

Provinces are now enjoying the benefits arising from better management and policy maneuverability, though there is still a deficit of skilled and experienced managers, especially in the middle to lower ranks of management. As we decentralise delivery to districts, hospitals, and so on, we have to increase the number of managers, both higher and middle-level, to effect these changes. A staggering fact that emerges is the imbalance in the distribution of skilled personnel. For example, we find that the per capita number of doctors in poorer provinces is shockingly low compared to Gauteng and the Western Cape.

The same personnel problems affect provinces as they seek to improve their financial management and establish proper internal controls, and implement the PFMA. The challenge is to enhance the culture of service delivery, and to live the principles of Batho Pele. Governments in all spheres must make every effort to attract and retain professional staff and they must look into ways to make all staff more service orientated.

~~SES~~ **We must continue to align policy choices with spending:** In recognising the formidable changes that have taken place, we must sharpen the focus on the outcomes of resource allocation. The Public Finance Management Act is a powerful tool to measure the changes taking place. We have a responsibility to trumpet the successes in financial management by provincial governments because this creates the policy space to drive transformation. At the same time, we must commit to developing new instruments to measure the impact on the lives of intended beneficiaries.

~~SES~~ **Our new municipalities face considerable challenges in expanding service delivery to all South Africans:**

~~SES~~ These include, amongst others, the establishment of new institutional structures. Re-demarcation of boundaries created some municipalities that must be built from the ground up, and the need to absorb personnel into new organisations, both as a result of the municipal amalgamations and the re-organisation of the powers and functions of municipalities. As highlighted in the *Review*, the cost of personnel and benefits has in recent years been the highest cost driver for

municipalities with salaries continuing to consume the largest portion of operating expenditures at 31%, closely followed by costs to provide bulk services.

The transfer, movement and placement of staff in newly amalgamated municipalities have added upward pressure to equalise on salary and other employer benefits. This issue is possibly the most critical area for consideration and sober discussion. The outcomes of this process will determine whether adequate resources are available for us to expand service deliver to all citizens. Similar pressures apply to the restructuring of the electricity industry.

✍ A further challenge for municipalities is to increase the aggregate level of capital spending by municipalities. This area continues to present major financial challenges for municipalities and must be addressed through a systematic and comprehensive approach to financial management. Budgets often show clear intent to address backlogs and poverty alleviation, but poor spending capacity often results in these intentions not being realised.

✍ **Each government must take full responsibility for exercising its powers – we should not create perverse incentives which reward poor conduct.** The fiscal system must have the appropriate incentives to ensure all governments improve their management. We recognise the decision-making power of provincial and local governments, we give them discretion, and thus we make them duly accountable for the services they need to deliver. In fact, the turn-around in provincial finances show the potential for policy maneuverability, which is the outcome of better management. Government did not throw money at provinces that were in trouble, but allowed them

to manage their way out of trouble and take ownership for sound financial management.

 **Affordability is a major issue.** The report shows for example that while government has contributed to more than 1,1 million houses built since 1994, and provided many social and basic services, beneficiaries cannot always afford municipal service charges. So, how do we work smarter to reduce the costs and offer people real choices? How do we ensure that rapid and sustainable improvements in the quality of life of people, where all the basic needs are met? How do we make it affordable for them, and support it in ways that are fiscally sustainable for the sphere of government concerned?

 **Any decentralisation must be well-considered and properly sequenced.** Provinces and municipalities will perform better if duly accountable and empowered and not stretched beyond their capacity. We have made many major changes over the past seven years, to enhance democratic accountability, fiscal sustainability and service delivery. We are no doubt about the need for major change, but the trade-offs and fiscal implications must be carefully considered. The IGFR gives us a lot of stimulating data and thought to think through these issues, and manage the choices.

Conclusion

Madam chair, the *Review* is borne of the desire to empower provinces and local governments, and those who deal with them. And it will assist parliament, and the NCOP in particular, in their oversight function.

A government, alive to its responsibilities to build a deep democracy must continually appraise its own performance. It must ask itself the questions that this *Review* attempts.

Questions such as:

- ~~✍~~ Are we giving effect to the requirements of the Constitution? Not in a legal-technical sense, but in respect of empowering the various spheres of government to fulfill their respective mandates?
- ~~✍~~ Are our policies adequate to provide democracy, in the form of essential and shared services to our people?
- ~~✍~~ Is governance co-operative? Does each sphere of government make the appropriate spending choices? Is spending efficient? Does it collect revenue optimally? Are there unfunded mandates?
- ~~✍~~ What has been the progress towards improving financial management? Has an effort been made to equip departments with the appropriate skills to manage financial resources?
- ~~✍~~ Are there measurable improvements in the delivery of goods and services?
- ~~✍~~ What does the comparative analysis of similar spheres – be they provinces or local authorities teach us? Are we making sufficient progress in eliminating backlogs?

These are tough questions with no easy solutions. This is what we offer the National Council of Provinces as a subject for detailed examination. As I have already stated, we invite distinguished members to analyse the report in the finest detail. We wait to be advised on in this House on 23 October in the report to be tabled. This, Honourable Chairperson, is an enormous undertaking in the building of accountable government. Every aspect of the report will be considered by us – the observations of members from their constituencies matters immensely because it is the litmus test of what we observe

from the perspective of the Treasury; similarly, the suggestions which this House will make in respect of realigning spending priorities in the future will be closely studied.

Let us build the caring democracy that the Constitution entreats us to. Let us undertake this together!

Madam Chair, I submit now to this House the IGFR 2001.