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Introduction

The service delivery theme

Whether more South Africans gain access to affordable, quality services is integrally tied to the performance of the intergovernmental system. The Constitution distinctly assigns service delivery roles to the three spheres of government, and substantial spending on social, household and economic infrastructure occurs in the provincial and local government spheres. The notion of an equitable share of nationally raised revenue, allocated as entitlement to provincial and local governments, is premised on these roles.

What the Review covers

Building on the first two *Intergovernmental Fiscal Reviews,* this publication provides budget and spending information in sectors managed by provinces and municipalities:

?? While updating all the sectors covered in previous *Reviews,* the 2001 edition also deals with housing and provincial roads. Provinces' annual reports for 2000/01 were not taken into account, but final assessment of those reports should benefit from the observations and analysis here.

?? In addition to the overviews of municipal budgets, transfers to local government and capital investment trends and options in the local sphere, the *Review* also draws initial lessons from the local government transformation process. It highlights fiscal considerations relevant to this process.

?? For the first time, it presents non-financial information to facilitate the assessment of outputs and outcomes. This should support public debate, the work of parliamentary and legislature committees as well as municipal councils, and policy formulation and decision-making in national and provincial departments and municipalities.

To provide the context, this introduction outlines key features of the intergovernmental system, highlights key observations and trends from the *Review* and suggests some points for the agenda as South Africa further consolidates its intergovernmental system.

The intergovernmental system

Apartheid legacy

South Africa is a middle-income country with GDP of R896, 5 billion in 2000/01 and a population of 43,3 million. Economic and social discrimination against black South Africans under apartheid left the country with considerable income inequality along racial lines. Apartheid public budgets directed little expenditure towards education, health, housing and basic needs of black South Africans. A poverty study in 1998 found that the poorest 40 percent of the population earned only 11 percent of income, while the wealthiest 10 percent earned 40 percent.[1]

Post apartheid system

The 1994 post-apartheid system therefore aims to democratise state institutions, redress inequality and extend services to the broader population. The system comprises three "spheres" of government namely national, provincial and local. They are called spheres, rather than tiers or levels, to reflect that they are distinct governments in their own right, each accountable to its own elected legislature or council.

Components of the system

It is necessary to outline briefly the main components of the system:

- South Africa has a unitary system with three spheres, and significant decentralisation of powers, functions and budgeting.
- National Parliament comprises two houses: a national assembly, and a national council of provinces representing provincial legislatures and organised local government.
- The nine provinces each have own legislatures and executive committees, as well as administrative structures.
- There are 284 municipalities, categorised according to whether they are metropolitan, district wide or local structures, and comprised of political and administrative components.[2]
- Provinces are accountable to provincial legislatures, and local governments to councils.
- The system of election at the national and provincial level is one of proportional representation, whilst the local level is a mix of directly elected and proportional representation.
- The Constitution assigns functions to the three spheres of government[3]. National and provincial governments are concurrently responsible for functions like school education, health, welfare and housing. In practice, national government's role is primarily to determine policy, while provincial governments shape some policy and have a considerable role in implementation. Exclusive functions for provinces are not significant in budgetary terms, with the notable exception of provincial roads. Most local government functions involve user fee services like electricity, water and sanitation, but they also provide public goods such as municipal and household infrastructure, streets, streetlights, and refuse collection. Related to the redemarcation of municipal boundaries, processes are underway to decide on a final assignment of powers between district and local municipalities.

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[1] J.May (ed.), 1998, *Poverty and Inequality in South Africa*, Praxis, Durban.

[2] Local government has undergone a three-phase transformation since 1993. The pre-interim phase entailed negotiations in the Local Government Negotiating Forum; the interim phase since 1995 saw the creation of 843 *transitional* municipalities, combining adjoining white and black areas; and the post interim phase started in December 2000, with significantly changed boundaries incorporating urban and rural areas, and a reduced number of 284 municipalities. The new system consists of 6 one tiered urban metropolitan governments or metros, and 232 *primary* municipalities falling within 46 *district* municipalities.

[3] Schedules 4 and 5 of the Constitution divide functions on a concurrent and exclusive basis between the three spheres.

- The Constitution entrenches '*cooperative governance*', obliging the three spheres of government to cooperate and to negotiate political and budgeting issues between them. Numerous intergovernmental forums, including the Budget Council[4] and Budget Forum[5], facilitate cooperation 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 70 percent are in the provinces: a total of about 740 000. Municipal employees are not part of this public service, but are employed by their respective municipalities. Municipalities (and most public entities) tend to have different remuneration scales. A key feature of the public service is the high level of unionisation, and collective and centralised bargaining. This reinforces the uniform nature of the public service, not only in the national and provincial spheres, but it also drives municipalities to converge towards similar conditions of service and salary structures.

The intergovernmental fiscal system

Revenue sharing

South Africa's fiscal system is based on a *revenue-sharing* model, with provinces largely dependent on transfers from the national government, while municipalities are only partially dependent. The underlying principles of the system are grounded in the Constitution and related legislation, and its functioning has evolved since 1994.

Expenditure patterns

Expenditure patterns reflect that national government's role is foremost one of policy making, with provincial and local governments performing major roles in social and basic service sectors (table 1.1). A major fiscal challenge is to support these roles through effective revenue mechanisms.

The actual budget of the national government for 2000/02 is R84 billion, after excluding debt service, intergovernmental grants and grants-in-kind. National government's main spending is not directed at social or basic services: this funding flows through provinces and local government. National direct expenditure is mainly targeted at the criminal justice system (police, justice, prisons) and defence, which make up around 54 percent of its expenditure, after all intergovernmental grants have been excluded. Higher education transfers to universities and technikons make up a further 8,2 percent. Smaller but significant budgets include transport (national roads and rail), water affairs (excluding all grants-in-kind), foreign affairs, administrative functions, home affairs (identity documents and passports), and revenue services.

[4] The Budget Council comprises the national Minister of Finance and Members of Executives in the provinces responsible for Finance.

[5] The Budget Forum consists of the members of the Budget Council and representatives of organised local government.

Table 1.1 The division of revenue between the spheres of government[1]

R million	1999/00 Actual	2000/01 Budget[2]	2000/01 Revised estimate	2001/02 Budget	2002/03 Medium-term estimate	2003/04 Medium-term estimate
National allocation[3]	66 154	75 212	74 414	84 286	89 954	95 432
Provincial allocation	99 032	106 037	108 736	117 387	126 564	135 221
Equitable share	*86 595*	*94 408*	*96 186*	*104 136*	*112 560*	*120 215*
Conditional grants	*12 437*	*11 629*	*12 551*	*13 251*	*14 004*	*15 006*
Local government allocation	4 419	3 713	5 712	6 506	7 155	7 849
Equitable share	*2 136*	*2 330*	*2 330*	*2 618*	*3 002*	*3 551*
Conditional grants	*2 243*	*1 383*	*3 382*	*3 888*	*4 153*	*4 298*
Allocated expenditure[4]	**169 605**	**184 962**	**188 863**	**208 180**	**223 672**	**238 502**
Percentage shares						
National	*39,0%*	*40,7%*	*39,4%*	*40,5%*	*40,2%*	*40,0%*
Provinces	*58,4%*	*57,3%*	*57,6%*	*56,4%*	*56,6%*	*56,7%*
Local government	*2,6%*	*2,0%*	*3,0%*	*3,1%*	*3,2%*	*3,3%*

[1] The data set out in this table are extracted from the 2001 Budget Review to show broad trends and have not been updated. The provincial figures are not strictly comparable with those contained in other parts of the Review, as they are baseline figures published in the Budget Review in February 2001.

[2] For comparative purposes, local government transfers have been shifted from provincial share to the local government share

[3] Excludes transfer to Umsobomvu Fund of R855 million

[4] Excludes the contingency reserve for the period 2001/02 to 2003/04, which was unallocated at the stage when these figures were compiled in the 2001 Budget Review.

National government's oversight role

National education, health, social development and housing departments focus on policy-making and monitoring rather than implementation, and have small budgets, once grants to provinces and transfers to universities or technikons are excluded. National government also has oversight over public entities, including government business enterprises. Whilst national government has responsibility for few per capita type expenditures, provinces and local government are responsible largely for such population-dependent functions. The more people in a province or municipality, the more pressure on their budgets to spend in order to provide services to local or provincial populations.

Provinces implement

Provincial governments have the largest spending budgets. They are responsible for the implementation of major social services, including school education, health (including academic and regional hospitals, as well as primary health care), social grants and welfare services, housing and provincial roads. Since these functions have limited or no cost recovery potential, provinces are largely dependent on transfers from nationally raised revenue.

Provincial budgets totalled R121,4 billion in 2001/02, comprising R117,5 billion of transfers from national, and R3,9 billion own revenue. The transfers came in the form of unconditional "equitable share"[6] of R104 billion, and R13,4 billion of conditional grants. The

[6] Section 214 of the Constitution provides for revenue-sharing where provincial and local spheres of government are entitled to an unconditional equitable share to enable them to provide basic services and perform the functions assigned to them.

most significant own revenue sources are motor car license fees, casino and horseracing taxes and hospital fees.

Local government has more fiscal capacity

Local government generally has more fiscal capacity than the provinces. Although there are big variances among municipalities, they raise on aggregate about 90 percent of own revenue. Municipalities can raise property tax and turnover/payroll regional levies on businesses, as well as user charges (and a surcharge) on the provision of electricity and water. However, although budgeting on the expectation of collecting all their revenue, many municipalities do not collect a significant portion of revenue due. This results in deficits at the end of the financial year.

No additional taxes (except possibly for local betterment taxes) are planned for local government: the focus is on reforming the current design of local taxes, modernising collection and billing systems and improving the efficiency of expenditure. The budgeting system is also being modernised to provide for multi-year budgets and ensure more realistic revenue projections.

A more supportive system

The Government recognises that the local sphere should be strengthened if it is to discharge its developmental mandate. It is therefore examining refinement of the intergovernmental fiscal system to improve national and provincial support to local government. There is also a concerted attempt to enhance cross-sphere linkages in local planning and budgeting, through the Integrated Sustainable Rural Development Support Programme and the Urban Renewal Strategy.

Functional shifts have fiscal implications

The system continues to evolve:

?? In line with the Constitution, many national and provincial departments are considering which of their functions are best performed in the local sphere, and should be devolved to local government. Functions under such review include housing delivery, primary health care and the district health system, water and municipal policing.

?? Decentralisation of management is also being considered, for functions like education (to regions), health (to districts and hospitals) and justice (cost centers at local court level).

?? Within the local government sphere, legislation promulgated in 2000 lay the basis for a new division of powers and functions between district and local municipalities, and polic y processes continue to assign these powers.

These proposed developments have marked fiscal implications. Shifting of functions will not only involve shifts in funds, fiscal powers, assets and liabilities, but also of personnel. This challenge is all the greater, as the pressure to equalise remuneration and conditions of work introduces cost pressures. The fiscal challenge is to manage these pressures to avoid them squeezing out funding for service delivery and non-personnel expenditure.

Fiscal efficiency

Link to macro-economic objectives

Services delivered by the public sector (either directly or through a system of public regulation) are targeted at the delivery of public goods and quasi-monopolistic services, redressing poverty and stimulating economic development. These services and expenditures are directly linked to Government's macro-economic policy objectives. It is therefore critical that the greatest possible outputs are achieved at the lowest possible cost. Innovative alternatives, like private sector participation, make it possible to enhance productive efficiencies and release resources for investment in core priorities and areas of need. Fiscal management is expected to focus on outcomes and outputs, rather than inputs and on the allocation of resources on multi-year policy and strategic objectives. Each sphere is accountable for fiscal discipline, and although receiving fiscal transfers, sub-national governments are expected to improve their revenue-raising potential.

Lessons from the provincial experience

The new provincial governments had little or no time to prepare for their establishment in 1994. Initially, they spent a lot of time just becoming operational, having had to merge 17 different administrations into nine new ones. Since there was a centralised budget process before 1994, most provinces had to develop capacity, expertise and information. The pressures to extend service delivery, in order to correct past injustices, were also considerable.

Capacity problems

The new provincial treasuries were initially not in a position to monitor or control the expenditure of departments. They had to depend on the one-year input-driven budgeting system used at that time, and lacked proper management systems. There were long delays before financial statements were completed, weakening spending accountability. As a result, budget problems were not identified early enough.

Overspending, particularly in departments like education, health and welfare, was only identified late in 1997, during preparations for the 1998 budget. During this time, departments frequently ignored their budgets, and provincial treasuries proved unable to curb spending. All provinces experienced similar over-spending, albeit in varying degrees. This was also due in large part to implementing a nationally negotiated salary agreement and new national policies in the education, health and welfare sectors. Some provincial treasuries ran large overdrafts, and national government was forced to intervene when banks refused to extend additional overdraft facilities to two provinces.

Measures to address problems

Provinces, supported by national government, took a number of initiatives:

?? Spending controls, a freeze on employment, and cutbacks in non-social security expenditure reined in spending. A monthly reporting system was created and the National Treasury assisted provinces in drawing up more realistic budgets for the 1998 financial year.

?? Co-ordination was improved by creating joint intergovernmental forums, between the treasuries and with functional departments. For example, a joint MinMEC comprising the national Ministers of Finance and Education, together with their counterparts in provinces, met at least once a year to co-ordinate policy-making, budgeting and implementation. These structures are supported by technical forums from national and provincial treasuries and line function departments. These forums, referred to as "4x4s", comprise officials from the National Treasury and the national department, as well as officials from three provincial treasuries and three provincial departments. They ensure that budgets and national policy are aligned. Meanwhile, the Budget Council has served as an ongoing platform for policy debate and information flows between the Minister of Finance and MECs for Finance.

?? *Peer learning* played a significant role in the turn-around of provincial finances. When one provincial treasury piloted its three-year budgeting process, its officials were inundated by requests from other provincial treasuries to help implement similar reforms.

?? A further impetus for reform emerged through benchmarking. The publication of the first *Intergovernmental Fiscal Review* in 1999 marked the culmination of attempts to benchmark provincial budgets, especially for the education, health and welfare sectors. In 2000, the *Review* started to cover local government, and this 2001 issue takes the process further with analysis of service delivery.

Finances turned around

These measures helped turn around provincial finances. By 1998/99, a R0, 6 billion surplus replaced the R5, 6 billion deficit a year earlier. Provinces stabilised personnel expenditure, and began shifting funds towards non-personnel budgets and debt payments. The implementation of a multi-year budget from 1998 onwards also helped provinces prepare more realistic budgets in line with policy priorities. Provinces have shown surpluses every year since 1998. This put them in a strong position to eliminate or reduce debt, focus on the micro reforms necessary to improve the quality of spending in education and health, and on increasing their infrastructure budgets.

Some problems remain. Not all provincial governments have improved their revenue collection. Staff costs also remain high, and provinces have to contend with national-level wage negotiations and agreements that are not fully sensitive to their specific fiscal challenges. But the trends have been positive and provide a basis for further consolidation and for learning by all three spheres.

Local government experience

It is harder to assess local government finances. The line item budgeting system inherited in 1994 did not promote in-year management of budgets. Hence, budgets were often not adhered to, making the budget information base inconsistent, lacking uniformity, and of poor quality. There were also delays in preparation and submission of financial statements.

Variance in capacity

There is great variance in fiscal capacity and financial management between municipalities. The major urban municipalities have strong revenue-generating powers, and are only marginally dependent on transfers from national government. Many rural and smaller urban municipalities, however, have very weak fiscal capacity and depend considerably on transfers from national government. A major challenge is to align the elements of local government transformation: developmental management and service delivery; institutional reform and capacity building; the demarcation of boundaries; fiscal reform; and the creation of a vibrant borrowing environment.

Weak information

Local government budget information is often not reliable and is currently fragmented as the newly demarcated municipalities are amalgamating. Outdated budgeting systems and inconsistent accounting or budgeting practices and systems translate into poor recording of data and inaccurate planning. Budgeted and actual figures often differ considerably. Budget reforms, including three-year budgeting, are intended to facilitate improvements in these areas.

The 2001 Intergovernmental Fiscal Review

Eleven chapters focus on service delivery

Concerned with the fiscal foundations for provincial and municipal service delivery, the eleven chapters of this *Review* provide overviews of trends and analyses of key policy issues and fiscal challenges in the intergovernmental system:

Overviews

?? This *Introduction* covers broad trends and the main features and fiscal principles of the intergovernmental system.

?? Chapter 2 reviews provincial budgets and actual revenue and expenditure from 1997/98 through the current MTEF 2003/04. It shows stabilisation in provincial budgets since 1998/99.

Sectors

?? Chapters 3 to 5 deal with the role of provinces in the social sectors, showing a return to real expenditure growth in education, health and social development. Provinces are now positioned for improved service delivery. This follows two years of real declines in 1998/99 and 1999/2000 when they had to pay for their debt and establish sustainable expenditure levels.

?? Chapter 6 examines provincial expenditure on housing and roads. In both sectors, spending has been inadequate, but the MTEF provides for a turnaround.

Cross cutting issues

?? Chapter 7 discusses issues that cut across the sectors served by the provinces, such as personnel, infrastructure development, the conditional grants system, and the implementation of the PFMA.

Local transformation and service delivery

?? Chapter 8 reviews the strategic fiscal environment for local government service delivery and transformation. It highlights key expenditure pressures facing municipalities, such as personnel costs, the reallocation of powers and functions and the funding of basic service delivery, particularly to poor households. It also reviews the policy on free basic services, budget reform, capacity building, integrated development planning, the consolidation of grants, and restructuring of the service sectors.

Municipal budgets

- Drawing on case studies and aggregate data, chapter 9 provides an overview of municipal budgets. It shows that, charged with a significant role in basic service delivery, municipalities face various budget challenges, such as the demand for services, personnel costs, poor revenue and weak information. The challenge is to plan and budget more accurately and to bolster financial management.

Transfers

- Chapter 10 discusses transfers to local government, highlighting how national government is refining the system of intergovernmental transfers to municipalities. The chapter raises the challenges of multi-year allocations, grant consolidation, targeting and integration of transfer flows with local budgets.

Capital investment

- Chapter 11 discusses the need for municipalities to obtain external investment to support their capital programmes. Progress with partnerships is reviewed and some policy challenges identified. Municipalities themselves will make most local capital investment in infrastructure and must be able to borrow wisely in order to make these investments. Over the recent past, there has been little new lending by the private sector to municipalities, and municipalities have come to rely more on public sources of loan finance. The challenge with both borrowing and partnerships is to establish clear and predictable rules and to build the necessary capacity to attract capital.
- The annexures include the provincial fiscal framework adopted by national government and provinces in 1999. Though it is dated, it reflects the broad approach towards phasing in provincial fiscal powers and fiscal decentralisation. The current *Review* indicates progress made since adoption of the framework. Other annexures include an extract from the *2001 Budget Review* on the division of revenue between the spheres; provincial and local government tables; and demographic information.

Some key pointers

Based on the trends observed in the *Review*, a number of pointers and lessons become clear:

Intentions vs. outcomes

- Intentions and outcomes are not always in sync. Provincial and local government budgets often show clear intent to address backlogs and poverty alleviation, but poor spending capacity often results in these intentions not being realised. This is particularly true of poorer provinces and weaker municipalities.

Affordability

- Affordability is a major issue. For example, government has contributed to more than 1,1 million housing opportunities since 1994, and provided many social and basic services, but the beneficiaries can often not afford municipal service charges. The situation has been aggravated by ongoing increases in bulk prices that ultimately get passed on to consumers.

The right incentives

- Budget choices must balance effective subsidisation of the poor with creating an enabling environment for sustainable growth and development. It is important to design incentives and benefits that minimise the risk of permanent dependency. The fiscal system must reward institutions and individuals that take responsibility, while addressing real poverty-related needs.

HIV/Aids

- The impact of HIV/Aids is becoming more visible and is likely to be felt severely in the provincial and local spheres.

Personnel challenges

- The public sector must prioritise managing its personnel. High personnel spending means less is available for service delivery and capital development. Provinces are beginning to break through the constraints, but municipalities face new demands as staff from previously separate structures are amalgamated and often demand remuneration on the scale of the highest common denominator.

Dedicated capacity building

- Both local and provincial governments require dedicated capacity-building support, particularly to strengthen their financial management. The Public Finance Management Act and the Municipal Finance Management Bill introduce fundamentally new approaches, but their success depends on the ability of the respective spheres and departments to implement them.

Sequenced decentralisation

- The challenges that confront provinces and municipalities underscore the importance of a well-considered and properly sequenced approach to decentralisation. These spheres will perform their roles better if duly accountable and empowered and not stretch beyond their capacity. When changes are introduced and new requirements set, the trade-offs involved, and the fiscal implications that follow, must be carefully considered.

Non-financial indicators must improve

- While this *Review*, for the first time, focuses on non-financial information, there is a marked lack of such information and little common methodology for comparisons. Where information is available, it is not *readily* available, indicating many managers do not fully use such data. Reforms to modernise management, including the Public Finance Management Act, aim to change this. The ability to provide information, particularly on the cost-drivers underlying any departmental budgets, is a good indicator of the quality of management.

The need for clear principles

- The future development of the intergovernmental system would benefit from clarity and debate about its underlying principles. On the basis of the Constitution, various policy documents, legislation and the analysis here, the following could be a point of departure for this debate:
  - *Accountability and autonomy:* All governments in the three spheres are distinctive and accountable in their own right, with specific constitutionally defined powers and responsibilities. Each is accountable to its legislature/council only, and empowered to set own priorities. The power of national and provincial governments to intervene in other spheres is confined to where a sphere fails an executive obligation.
  - *Good governance:* At the heart of this is the accountability of political representatives to the electorate and transparent

reporting arrangements within and between spheres. This is achieved through the electoral process, due reporting to national parliament, provincial legislatures and municipal councils, and an effective flow of information. Whilst political executives are responsible for policy and outcomes, the head officials are responsible for implementation and outputs, and are thus charged with the responsibility of accounting-officer.

– *Redistribution:* All three spheres play roles in redistribution, but because inequalities spread across the national economy, the redistribution of resources is primarily a national function. The equitable share formula therefore relies heavily on poverty-related criteria and various conditional transfers to provincial and local government focus on the poor. In as far as provinces and municipalities undertake redistribution, the challenge is to do this in line with fiscal capacity and not undermine sub-national economic activity and financial viability.
– *Broadened access to services:* The Constitution and current government policy prioritise service delivery to all South Africans. The responsible spheres are expected to broaden access to services at affordable costs to consumers, designing appropriate levels of service to meet customer needs, exploring innovative and efficient modes of delivery, and leveraging public and private resources to acquire capital for investment.
– *Revenue-sharing:* The fiscal system takes into account fiscal capacity and the functions assigned to each sphere, with each empowered to determine its own budgets, collect revenue due and spend funds. Provinces and municipalities are funded through own revenue collected, equitable share allocations and conditional and unconditional grants. The grant system must be simple and comprehensive and not compensate sub-national governments who fail to collect revenue due.
– *Vertical division:* In determining allocations to each sphere, trade-offs are involved between spheres. For this reason, the budget allocation process should be comprehensive, driven by political priorities and covering governance and service delivery. Separate and ad hoc requests for funds fragment budget allocation and undermine political prioritisation.
– *Responsibility over budgets:* Each government has the right to determine its own budget and responsibility to comply with it. To reduce moral hazard and ensure fairness, national government will not bail out provinces or municipalities that mismanage, nor provide guarantees for loans.

Conclusion

Provincial and local governments are mandated to perform critical service delivery roles. The *Review* shows that both have made progress, but that many challenges remain, requiring greater fiscal efficiency across all components of the intergovernmental system. Renewed focus on core principles would add value as the system evolves to sustainably deliver services to all South Africans.

2

Trends in provincial budgets

Prudent financial management paying off

Provincial finances have seen a marked turnaround since 1998/99. Prudent financial management helped provinces turn a combined deficit of R5,6 billion in 1997/98 into a surplus of R0,6 billion in 1998/99. Provinces have since been posting surpluses, which they largely used to repay the 1997/98 deficit and other debts that they incurred in subsequent years.

A basis for expanded delivery

The newly implemented *Public Finance Management Act* (PFMA), and the expanded expenditure envelope for the 2001/02 to 2003/04 medium-term expenditure framework (MTEF), lay a base for provinces to reinforce key programmes and expand service delivery.

The effects should be visible in HIV/Aids programmes in health, the early childhood development programme in education, extended coverage of the social security safety net and infrastructure development.

This chapter provides an overview of revenue and expenditure trends in the provinces. It uses actual expenditure data for the period 1997/98 to 1999/2000, estimated expenditure for 2000/01, and budgeted spending for 2001/02 through 2003/04. Real expenditure is also used to describe trends where appropriate.

The chapter should be read with reference to chapters 2-7, where more detailed analysis covers education, health, social development, housing, roads and transport and some issues that cut across provincial functions. Certain programmes in agriculture and land affairs, the environment and nature conservation (and related tourism) are not covered in this *Review*. While relatively small in budgetary terms, it is recognised that they are critical to economic development and poverty eradication in the rural areas where many poor South Africans live. Attempts will be made to analyse them in future *Reviews.*

Institutional reform and budget performance

Intergovernmental system more streamlined

The last seven years saw significant institutional reform of South Africa's intergovernmental system. This entailed the creation and strengthening of new institutional arrangements, building management capacity and streamlining links between the different spheres of government.

More recently, the PFMA has provided a firmer legal framework for accountable and transparent governance in national and provincial government. Stable budgets and improving financial management mean that provinces can now focus more on quality of spending and value for money.

Overall fiscal position of provinces

Trends in provincial revenue

Total provincial revenue grew at about the same rate as inflation over the three years to 2000/01. National transfers, comprising the equitable share and conditional grants, grew at an average annual rate of 7,1 percent a year. Provincial own revenue grew by 9,3 percent. The growth rate in provincial revenue over this period is however exaggerated by interest revenue derived from significant bank balances held as provinces accumulated surpluses to repay debts.

Provincial expenditure down but set to grow

Because of these debt repayments, total provincial expenditure did not keep pace with inflation. Total provincial expenditure declined by an average annual rate of 1,8 percent in real terms in the three years to 2000/01, but is set to show a very strong recovery through 2003/04, and beyond. This growth will be made possible by substantially reduced provincial debt and increases in national transfers to provinces of R5,4 billion in 2001/02 and R9,4 billion in 2002/03, over baseline. It is also supported by average annual real growth of 1,8 percent in total provincial revenue over this period.

Consolidation of programmes

Focus on social services continues

Social services – health, education and welfare – are a priority. Their share of total provincial spending is expected to stabilise at around 81 percent over the MTEF.

Over the next three years, social services expenditure will grow by 3,1 percent in real terms between 2000/01 and 2001/02, and by a projected 2,6 percent per annum through 2003/04. This will correct recent sluggish growth that resulted from debt overhang, where, despite annual nominal growth of 4,9 percent since 1997/98, expenditure on social services declined in real terms by 1,6 percent.

Welfare expenditure set to rise

Social security grants are an effective mechanism against poverty. Provinces are therefore allocating more resources to welfare programmes, providing for increased take-up rates of the child support grant, while further extending coverage of all other grants. The share of welfare spending in total provincial expenditure is hence projected to rise to over 19 percent over the MTEF.

Scaling up Early Childhood Development

In education, non-personnel spending is set to increase to ensure adequate provision of learning support materials and other complementary inputs. Provincial budgets allow for the scaling up of the provision for early childhood development. Together, these changes will improve efficiency and enhance the quality of teaching and learning.

Increased spending on health and HIV/Aids

Total health spending by provinces grows by 8,8 percent between 2000/01 and 2001/02, and is budgeted to grow at an average annual rate of 7,1 percent through 2003/04. This translates to real growth rates of 2,4 and 1,6 percent, respectively, and puts the health sector in a better position to cope with cost pressures such as HIV/Aids.

Provincial revenue

National transfers

Transfers comprise 95 percent of revenue

Provinces continue to rely on national transfers for most of their revenue. Transfers from national Government comprised over 95 percent of total provincial revenue in 2000/01. These transfers are made up of two components – the equitable share, which constitutes about 84 percent of total provincial revenue, and conditional grants that are approximately 11 percent of total provincial revenue. Table 2.1 lays out trends in provincial revenue.

Table 2.1: Total provincial revenue and expenditure

	Actual			Estimated actual	Medium term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Transfers from national budget	88 874	94 266	99 576	109 220	117 548	126 784	135 452
Of which: equitable share	*83 846*	*81 542*	*86 595*	*96 186*	*104 136*	*112 560*	*120 216*
Conditional grants	*5 028*	*12 723*	*12 981*	*13 034*	*13 412*	*14 224*	*15 236*
Own revenue	3 458	3 433	4 039	4 514	3 904	4 207	4 581
Total provincial revenue	**92 332**	**97 699**	**103 614**	**113 734**	**121 452**	**130 991**	**140 032**
Education	38 492	38 723	39 828	43 255	46 947	50 164	53 335
Health	22 483	23 025	24 110	26 421	28 745	30 433	32 448
Welfare	17 554	18 441	19 373	20 929	22 840	24 620	26 530
Contingency reserve	–	–	–	–	182	632	1 070
All other expenditure	19 435	16 944	16 744	19 892	21 759	24 190	25 716
Total expenditure[1]	**97 964**	**97 133**	**100 055**	**110 498**	**120 473**	**130 039**	**139 099**
Surplus/(deficit)	**(5 632)**	**566**	**3 559**	**3 237**	**978**	**952**	**933**

[1] Total provincial expenditure includes grants earmarked for local government up to 2000/01

Strong growth in equitable share

The growth in national transfers is most marked in the equitable share component. At an average real annual growth rate of 2,2 percent over the next three years, the equitable share is projected to increase from R96,2 billion in 2000/01 to R104,1 billion in 2001/02 and R120,2 billion by 2003/04. This is significant from a fiscal management perspective, because this is the portion of national transfers over which provinces have most spending discretion.

Adjustments to provincial revenue and expenditure

Shifts in responsibilities and flow of funds

As the intergovernmental system evolves and institutional capacity of spheres improves, functions get shifted across spheres. This has had an impact on resource allocation and transfer mechanisms.

Local government equitable share

Table 2.2 shows an adjustment to provincial revenue and expenditure data to exclude grants to the local government sphere that used to flow through provincial revenue funds. These are now included under the local government equitable share allocation, while the R293 town grant has been incorporated into the provincial and local government equitable shares. The above adjustments allow comparability of the data over time, and provide an accurate picture of growth rates in spending.

Table 2.2: Adjusted provincial revenue and expenditure

	Actual			Estimated actual	Medium term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Total provincial revenue	92 332	97 699	103 614	113 734	121 452	130 991	140 032
Total provincial expenditure	97 964	97 133	100 055	110 498	120 473	130 039	139 099
Less: local govt grants[1]	1 999	1 132	463	463	–	–	–
Total adjusted revenue	**90 333**	**96 567**	**103 151**	**113 271**	**121 452**	**130 991**	**140 032**
Total adjusted expenditure	**95 965**	**96 001**	**99 592**	**110 035**	**120 473**	**130 039**	**139 099**

[1] Before 2000/01 local government grants were transferred through provinces. For comparison these are deducted from both revenue and expenditure.

Real growth in provincial share

The strong nominal growth rates contained in table 2.3 show that the provincial sphere benefits considerably from the expanded expenditure envelope contained in the 2001 budget framework. Although as a share of nationally raised revenues the provincial share remains fairly stable around 56,5 percent over the MTEF, it grows at an average annual rate of 2,2 percent, in real terms.

Table 2.3: Average annual change in adjusted provincial revenue

	1997/98-2000/01	**2000/01-2003/04**
	% change p.a.	**% change p.a**
Transfers from national budget	7,8%	7,6%
Of which: equitable share	*5,5%*	*7,7%*
conditional grants	*35,7%*	*6,6%*
Own revenue	9,3%	0,5%
Total provincial revenue	**7,8%**	**7,3%**
Consumer Price Index	6,6%	5,1%

Lower growth in conditional grants

Simultaneously, government's policy is to rationalise conditional grants into fewer and more effective transfers. Hence, after increasing through the period to 1999/2000, conditional grants are expected to stabilise over the MTEF. Reflecting the prioritisation of infrastructure development, however, the new provincial infrastructure grant will grow from R0,8 billion in 2001/02 to R2,5 billion in 2003/04.

Provincial own revenue

Four years ago, provinces were optimistic about their own revenue collections, but they now tend to be more conservative.

Some growth in own revenue

In the three years to 2000/01, provincial own revenue grew at an average annual rate of 9,3 percent a year, from R3,5 billion in 1997/98 to R4,5 billion in 2000/01. The strong growth was due, in part, to significantly high positive bank balances that provinces held during this period, as they needed surpluses to repay debts.

…but forecasts are conservative

Due mainly to lower forecasts for interest revenue and conservative estimates of revenue collections, all provinces, except Northern Cape and Northern Province, project a fall in own revenue between 2000/01 and 2001/02. The biggest drop is in KwaZulu-Natal (34,8 percent) and Eastern Cape (15,8 percent).

Varying fiscal capacity between provinces

Table 2.4 shows marked variations in the fiscal capacities of provinces, especially in actual revenue collected by each province. With shares of 25,9 percent and 17,1 percent in 2000/01, respectively, Gauteng and Western Cape account for about 43 percent of total provincial own revenue. While the variations may partly reflect differences in fiscal effort, they show close correlation with the levels of economic activity in the provinces.

Table 2.4: Total own revenues, by province

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	222	421	374	395	332	367	399
Free State	263	251	262	306	265	275	281
Gauteng	901	929	1 046	1 168	1 042	1 106	1 177
KwaZulu-Natal	641	432	613	904	589	647	712
Mpumalanga	257	194	363	155	210	225	225
Northern Cape	102	79	79	66	82	87	93
Northern Province	202	295	247	321	324	350	433
North West	304	304	321	425	368	379	398
Western Cape	565	528	733	774	691	771	863
Total	**3 458**	**3 433**	**4 039**	**4 514**	**3 904**	**4 207**	**4 581**
Percentage growth							
Eastern Cape	–	89,2%	-11,1%	5,5%	-15,8%	10,5%	8,7%
Free State	–	-4,3%	4,3%	16,7%	-13,3%	3,7%	2,0%
Gauteng	–	3,1%	12,5%	11,7%	-10,8%	6,1%	6,4%
KwaZulu-Natal	–	-32,6%	41,9%	47,3%	-34,8%	9,8%	10,0%
Mpumalanga	–	-24,7%	87,3%	-57,2%	35,1%	7,3%	0,0%
Northern Cape	–	-23,0%	0,0%	-15,7%	23,6%	6,2%	6,7%
Northern Province	–	45,7%	-16,2%	29,8%	1,0%	8,0%	23,8%
North West	–	0,2%	5,6%	32,4%	-13,4%	2,8%	5,1%
Western Cape	–	-6,6%	39,0%	5,6%	-10,8%	11,6%	11,9%
Total	**–**	**-0,7%**	**17,6%**	**11,8%**	**-13,5%**	**7,8%**	**8,9%**
Percentage of total revenue							
Eastern Cape	1,4%	2,6%	2,2%	2,1%	1,7%	1,7%	1,8%
Free State	4,2%	3,7%	3,7%	3,9%	3,2%	3,1%	3,0%
Gauteng	5,9%	5,7%	6,0%	6,2%	5,1%	5,0%	5,0%
KwaZulu-Natal	3,4%	2,2%	3,0%	4,0%	2,5%	2,5%	2,5%
Mpumalanga	4,7%	3,2%	5,4%	2,1%	2,6%	2,5%	2,3%
Northern Cape	4,6%	3,5%	3,1%	2,6%	2,9%	2,8%	2,8%
Northern Province	1,8%	2,4%	1,9%	2,2%	2,1%	2,1%	2,4%
North West	4,0%	3,8%	3,8%	4,6%	3,7%	3,6%	3,5%
Western Cape	5,6%	4,9%	6,5%	6,5%	5,5%	5,8%	6,2%
Total	**3,7%**	**3,5%**	**3,9%**	**4,0%**	**3,2%**	**3,2%**	**3,3%**

Composition of provincial own revenue

Road Traffic fees a key source of revenue

The data in table 2.5 show that Road Traffic fees are projected to make up about 45 percent of provincial own revenue in 2001/02. These include motor vehicle licences and registrations, driver's licences and learner's permits. Although projected to decline marginally by 0,3 percent this year, road traffic fees will grow faster over the MTEF. The projections are also likely to be more accurate than in previous years, as most provinces now review and revise these every year.

Collection of hospital patient fees improving

The downward trend in hospital patient fees is reversed. The decline in recent years was mainly due to the introduction of free medical care for children under six and expectant mothers and lower numbers of paying patients. However, starting from 2001/02, provinces are projecting growth in these fees. They are making concerted efforts to enhance cost recovery in the health system, including investing in new IT systems, reviewing billing systems and improving incentives by introducing measures such as revenue retention in hospitals.

"All other revenue" disproportionately large

As the figures in table 2.5 also show, at 39,8 percent in 2000/01, the category "all other revenue" is disproportionately large. This is an agglomeration of a range of once-off revenues, most of which are not identified through the financial systems of provinces. However, in future this category of provincial revenue is expected to decrease below 30 percent of total provincial revenue, as provinces improve tax administration and systems.

Table 2.5: Total own revenues, by type of revenue

	Actual			Estimated actual	Medium-term estimate		
R million	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Road Traffic Act fees	1 198	1 256	1 514	1 745	1 739	1 875	2 071
Hospital patient fees	383	346	321	352	411	427	438
Gambling[1]	290	259	170	167	169	178	187
Interest	76	142	268	454	407	479	498
All other	1 511	1 429	1 765	1 796	1 177	1 249	1 386
Total	**3 458**	**3 433**	**4 039**	**4 514**	**3 904**	**4 207**	**4 581**
Percentage growth							
Road Traffic Act fees	–	4,9%	20,5%	15,2%	-0,3%	7,8%	10,5%
Hospital patient fees	–	-9,8%	-7,1%	9,5%	16,8%	3,9%	2,5%
Gambling[1]	–	-10,4%	-34,5%	-1,6%	1,2%	5,1%	5,2%
Interest	–	86,9%	88,4%	69,4%	-10,5%	17,7%	4,0%
All other	–	-5,4%	23,5%	1,8%	-34,5%	6,1%	11,0%
Total	**–**	**-0,7%**	**17,6%**	**11,8%**	**-13,5%**	**7,8%**	**8,9%**
Percentage of total own revenue							
Road Traffic Act fees	34,6%	36,6%	37,5%	38,6%	44,6%	44,6%	45,2%
Hospital patient fees	11,1%	10,1%	8,0%	7,8%	10,5%	10,2%	9,6%
Gambling[1]	8,4%	7,6%	4,2%	3,7%	4,3%	4,2%	4,1%
Interest	2,2%	4,1%	6,6%	10,1%	10,4%	11,4%	10,9%
All other	43,7%	41,6%	43,7%	39,8%	30,2%	29,7%	30,3%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

[1]*Gambling includes horse racing/betting and casino levies*

Provincial Tax Regulation Process Bill

Expanded taxation powers for provinces

The *Provincial Tax Regulation Process Bill* is expected to improve the fiscal capacity of provinces. The Bill gives effect to section 228 of the Constitution by laying out a procedure for provinces to introduce new taxes.

The Bill is the outcome of extensive consultation within the Budget Council. While it does not prescribe which taxes provinces can impose, it sets out steps that a province proposing a new tax must follow. Once a tax has been approved, all provinces would be allowed to impose it.

There is wide recognition that laws alone do not mean more revenue, and that fiscal effort must also improve to yield returns. Provinces are therefore currently strengthening their tax administration capacity.

Provincial expenditure

Growth in expenditure

While provincial revenue generally kept pace with inflation over the three years to 2000/01, growth in adjusted provincial expenditure was somewhat slower. It grew at an average annual rate of 4,7 percent a year, from R96,0 billion to R110,1 billion. This is 1,8 percentage points below the average inflation rate.

Provincial liabilities now negligible

However, the lower growth must be viewed against the background of much faster growth in the period up to 1996/97. This culminated in huge budget overruns in provinces, and a combined deficit of R5,6 billion in 1997/98.

To enable provinces to deal with their liabilities, and to place spending on a sustainable trajectory in line with revenue, growth in spending was scaled down in the period up to 1999/2000. Provinces had to budget for surpluses, starting with R0,6 billion in 1998/99. The cumulative surpluses in subsequent years have reduced provincial liabilities to negligible levels.

Strong recovery in provincial expenditure

As a result, provinces are now beginning to allocate more resources to priority programmes. Total provincial expenditure rises from R110,1 billion in 2000/01 to R139,1 billion in 2003/04, an average real growth rate of 2,6 percent per annum.

Table 2.6: Adjusted provincial expenditure

	Actual			Estimated actual	Medium term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Education	38 492	38 723	39 828	43 255	46 947	50 164	53 335
Health	22 483	23 025	24 110	26 421	28 745	30 433	32 448
Welfare	17 554	18 441	19 373	20 929	22 840	24 620	26 530
Contingency reserves	–	–	–	–	182	632	1 070
All other expenditure	17 436	15 812	16 281	19 429	21 759	24 190	25 716
Total provincial expenditure	**95 965**	**96 001**	**99 592**	**110 035**	**120 473**	**130 039**	**139 099**

Provincial surpluses and reserves

Provinces are overcoming debt

Provinces had significant surpluses in the past three years. These surpluses are not purely unspent funds. In the cash based budgeting and accounting system, payments of debts for expenditures incurred in the past are scored in the year in which the payments are effected. The *Government Finance Statistic* system prescribes that funds set aside for debt repayment be recorded as a surplus.

The surpluses also include funds that are committed to specific projects that are underway or services that have been rendered for which payments could not be made by the end of the financial year.

Table 2.7: Provincial surpluses and finance reserves

	2001/02		2002/03		2003/04	
R million	**Surplus**	**Reserve**	**Surplus**	**Reserve**	**Surplus**	**Reserve**
Eastern Cape	340	–	389	–	363	–
Free State	93	50	59	100	26	138
Gauteng	218	–	239	300	304	500
KwaZulu-Natal	–	–	–	–	–	–
Mpumalanga	17	40	15	43	–	47
Northern Cape	–	20	–	21	–	21
Northern Province	219	–	169	–	190	168
North West	–	72	–	168	–	196
Western Cape	92	–	80	–	50	–
Total	**978**	**182**	**952**	**632**	**933**	**1 070**

More confidence in financial management

In addition to the surpluses, provinces set aside funds to cater for unforeseen contingencies and unanticipated expenditure. In the past, all provinces set aside substantial reserves. However, for 2001/02, five provinces – Eastern Cape, Gauteng, KwaZulu-Natal, Northern Province and Western Cape – have not set aside reserves. The other four provinces have only budgeted for a combined reserve amount of R182 million.

The coming into effect of the PFMA thus seems to have made provinces more confident that departments can manage their finances better. This will be bolstered by ongoing capacity building to improve budgeting and financial management.

Composition of provincial expenditure

Social services dominate provincial spending

Alongside municipal basic services, provincial delivery of the critical social services – education, health and welfare – constitute the core of government's pro-poor programmes. Together these social programmes account for over 80 percent of total provincial spending.

The other component of provincial spending goes to economic development programmes such as provincial agricultural support, roads and other economic and rural infrastructure, including parks and other tourism infrastructure.

Variations across provinces

Spending and service delivery trends in specific functional areas, as well as inter-provincial comparisons, are analysed in other chapters.

These analyses offer important nuances, as the aggregates presented here mask variances across the provinces. Table 2.8 shows variations in the share of social services across provinces, compared to the national average. This is explained by differences in demographic profiles, prioritisation and budgetary choices made by provinces, among other things.

Table 2.8: Expenditure on social services

	Actual			Estimated actual	Medium term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Social services	81,8%	83,5%	83,7%	82,3%	81,8%	80,9%	80,7%
Education	40,1%	40,3%	40,0%	39,3%	39,0%	38,6%	38,3%
Health	23,4%	24,0%	24,2%	24,0%	23,9%	23,4%	23,3%
Welfare	18,3%	19,2%	19,5%	19,0%	19,0%	18,9%	19,1%
Non-social services	18,2%	16,5%	16,3%	17,7%	18,2%	19,1%	19,3%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**
Percentage of provincial expenditure							
Eastern Cape	84,2%	85,9%	86,0%	83,1%	83,4%	81,0%	81,4%
Free State	77,7%	77,6%	83,4%	82,0%	78,7%	78,4%	78,4%
Gauteng	85,9%	85,2%	85,2%	84,9%	84,4%	83,1%	82,1%
KwaZulu-Natal	82,2%	86,5%	85,5%	84,4%	84,3%	83,8%	83,6%
Mpumalanga	75,5%	78,6%	78,4%	77,5%	76,3%	75,8%	76,7%
Northern Cape	79,0%	82,1%	81,7%	78,5%	77,3%	76,3%	76,3%
Northern Province	80,8%	82,4%	81,9%	80,3%	79,4%	78,7%	78,0%
North West	73,8%	76,1%	76,8%	76,8%	77,7%	78,6%	78,1%
Western Cape	85,4%	86,2%	85,4%	84,1%	83,1%	82,3%	82,7%
National Average	**81,8%**	**83,5%**	**83,7%**	**82,3%**	**81,8%**	**80,9%**	**80,7%**

Personnel expenditure

Personnel expenditure comprises 57,3 percent

Personnel expenditure comprises the bulk of total current expenditure in provinces – 57,3 percent in 2000/01. Table 2.9 shows that until 1999/2000 the share of personnel spending was on the increase, from 56,2 percent in 1997/98 to 58,8 percent in 1999/2000.

Although total personnel spending grew slightly slower than the inflation rate in this period, it still grew faster than the other components of expenditure. Growing at an average annual rate of 5,3 percent, it rose faster than total provincial expenditure (4,7 percent), and much faster than non-personnel expenditure (3,8 percent). This was largely due to increases in health, education and personnel numbers and the 1996 wage agreement.

…but personnel spending growth slowing

Personnel expenditure is however set to grow slower than total expenditure and other components of current expenditure. Its share is expected to decline to 53,8 percent by 2003/04. However, the need to fill critical posts and/or retain specialist personnel, for example in health, might impede some provinces' ability to reduce personnel costs this rapidly.

Table 2.9: Expenditure by economic classification

	Actual			Estimated actual	Medium term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Current expenditure	87 834	89 783	93 167	102 393	109 092	116 420	123 952
Personnel	*53 925*	*56 643*	*58 593*	*63 024*	*67 166*	*70 913*	*74 828*
Transfers	*21 683*	*21 534*	*21 614*	*23 940*	*25 223*	*27 444*	*29 517*
Other current	*12 226*	*11 607*	*12 959*	*15 429*	*16 703*	*18 063*	*19 608*
Capital expenditure	8 131	6 218	6 426	7 642	11 199	12 987	14 077
Contingency reserve	–	–	–	–	182	632	1 070
Total	**95 965**	**96 001**	**99 592**	**110 035**	**120 473**	**130 039**	**139 099**
Percentage composition:							
Current expenditure	91,5%	93,5%	93,5%	93,1%	90,6%	89,5%	89,1%
Personnel	*56,2%*	*59,0%*	*58,8%*	*57,3%*	*55,8%*	*54,5%*	*53,8%*
Transfers	*22,6%*	*22,4%*	*21,7%*	*21,8%*	*20,9%*	*21,1%*	*21,2%*
Other current	*12,7%*	*12,1%*	*13,0%*	*14,0%*	*13,9%*	*13,9%*	*14,1%*
Capital expenditure	8,5%	6,5%	6,5%	6,9%	9,3%	10,0%	10,1%
Contingency reserve	–	–	–	–	0,2%	0,5%	0,8%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

The figures in table 2.10 also reflect a marked turnaround in both social transfers and "other current" expenditure – respectively projected to grow some 3,7 and 0,7 percentage points faster than inflation.

Table 2.10: Average annual change in adjusted provincial expenditure

R million	**1997/98-2000/01**	**2000/01-2003/04**
	% change p.a.	**% change p.a**
Current expenditure	5,2%	6,6%
Of which: personnel	5,3%	5,9%
Transfers	3,4%	7,2%
other current	8,1%	8,3%
Capital expenditure	-2,0%	22,6%
Total expenditure	**4,7%**	**8,1%**
Consumer Price Index	6,6%	5,1%

The higher growth in transfers is mainly due to increases in social security grants. The strong growth in "other current" expenditure is largely due to increased allocations for quality-enhancing inputs such as learning support materials in education, medicines and other consumables in health.

Non-personnel expenditure

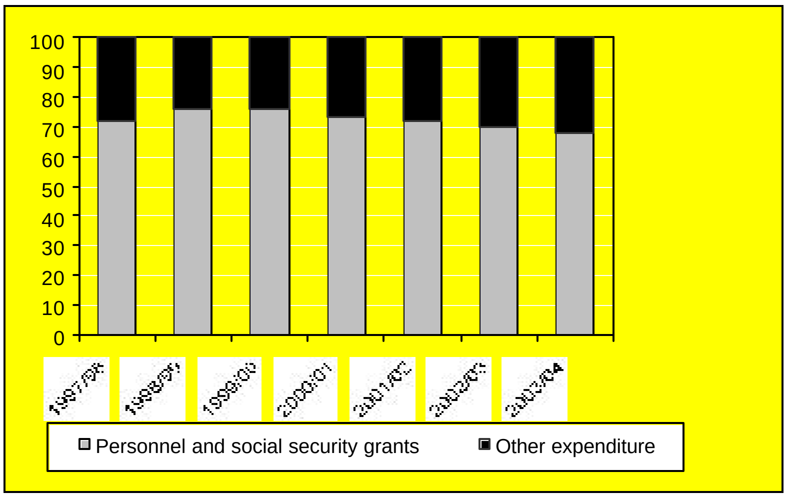
Increased allocations for non-personnel spending

The slowdown in provincial spending over the three-year period to 2000/01 was largely due to a reduction in non-personnel expenditure. The share of non-personnel expenditure dropped by about 2,8 percentage points between 1997/98 and 1998/99, from 43,8 to 41 percent. While the decline in non-personnel spending occurred in both social and non-social services, its impact is more pronounced in the latter case. Non-personnel spending in the non-social services functions dropped by over 7,7 percent between 1997/98 and 2000/01, while it increased by 0,8 percent in social services.

Capital expenditure set to increase

However, as Figure 2.1 shows, the 2000 Budget saw the beginning of a reversal in this trend. Total provincial capital expenditure grew by 18,9 percent between 1999/2000 and 2000/01, and is projected to grow at an average annual rate of 22,6 percent through 2003/04. Despite starting from a substantially lower base, growth rates of this magnitude will reduce backlogs, especially if accompanied by low debt obligations.

Figure 2.1: Fixed costs as share of adjusted expenditure



Prioritising provincial infrastructure

Falling share of capital expenditure

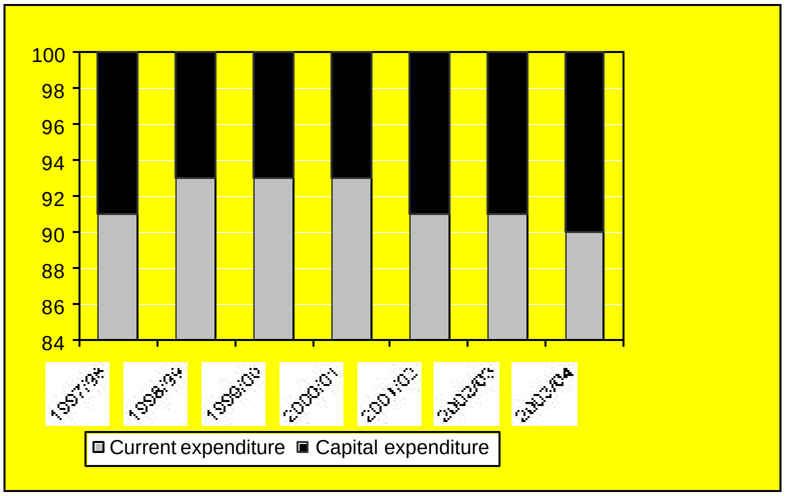
During the period up to 1999/2000, provinces sought to service their debts while simultaneously providing social services. As a result, provincial capital expenditure declined from 8,5 percent of total provincial spending to about 6,9 percent in 2000/01. Details of this are contained in chapter 7 and figure 2.2 depicts these trends.

…but marked increase over next three years

The 2001 Budget identifies infrastructure spending as one of the key priorities for the 2001-2004 MTEF. Having successfully dealt with their debts, and assisted by the expanded expenditure envelope, provinces are budgeting for substantially increased spending on infrastructure.

Budgeted capital expenditure in 2001/02 is 46,6 percent higher than the estimated outcome for 2000/01. The turnaround in provincial capital expenditure will see its share rising to about 10 percent by 2003/04, thus surpassing past levels. To achieve this requires a focused effort to enhance capacity for the planning and implementation of projects. Faced by a disappointing failure to meet budgeted expenditure projections in 2000/01, such capacity-building currently receives attention in several provinces.

Figure 2.2: Capital and current expenditure: 1997/98 to 2003/04



Budget priorities and spending pressures

Using fiscal strength to improve services

Mindful of the need to translate the benefits of a strong fiscal position into accelerated service delivery, government is consolidating delivery of social and other services.

Social security grants probably represent the most effective poverty alleviation programme of government. However, grant increases over the last three years have been below inflation, eroding their real value. Higher increases could not be effected amidst uncertainty about the full budgetary impact of the rising take-up of the child support grant.

The current budget framework makes provision for increases in social security grants that are at least equal to inflation. Nonetheless, sharp changes to beneficiary numbers, the greater dependence on grants likely to be created by HIV/Aids, and the impact of grant types not coupled with upward revisions of provincial funding, could impede these efforts.

Cost pressures arising from HIV/Aids

HIV/Aids and related diseases continue to impose pressure on provincial health budgets. Total health spending grows by 8,8 percent between 2000/01 and 2001/02, and is budgeted to grow at an average annual rate of over seven percent over the next three years. This should help put the sector on a sound footing to cope with the disease. Further upward revision may nonetheless become necessary.

Rollout of ECD programmes

Early childhood development is central to improving the efficiency and effectiveness of the education system. After running pilot programmes for a number of years, government plans to increase coverage significantly over the next ten years. In the poorer and predominantly rural provinces, this is expected to have significant budgetary implications.

More spending on infrastructure needed

Starting from 2000/01, provinces are allocating increasing amounts to infrastructure. This will reduce backlogs in maintenance of existing infrastructure and expand public capital stock to previously disadvantaged areas. Partnerships with the private sector will be necessary to leverage more investment and expertise. The Public-Private Partnership Unit in the National Treasury is playing an active role supporting the provinces in this regard.

Conclusion

Through sound financial management, provinces have placed their finances on a firm footing. The challenge now is to translate the gains of prudent fiscal management into tangible development that creates a better life for all South Africans. Current spending and budget trends suggest that provinces are consolidating social services delivery, increasing capital expenditure, and enhancing the quality of spending. Their capacity will continue to be tested by the need for social services and infrastructure.

3

Education

South Africa has made progress in turning education around. This has been an arduous task, as apartheid denied millions, especially black people, access to good education.

Transformation of education is about equity, quality and a skills base adaptable to the changing global economy. All this has to be achieved in a context of weak management experience, tight resource constraints, poorly trained teachers and a culture where learning had fallen by the wayside.

Expenditure trends

This chapter analyses expenditure trends in education, with emphasis on the forward estimates for provincial education departments. Education expenditure rose rapidly in 1996/97, partly due to the 1996 salary agreement discussed in chapter 7. This level of growth in budgets was unsustainable. In order to achieve long-term transformation of the education system, budgets had to be placed on more sustainable footing. Education expenditure has declined by about 9,5 percent in real terms since, and a concerted effort has been made to bring personnel spending under control. The 2000 Budget marked a shift towards renewed growth in provincial education spending.

Non-financial education indicators

While expenditure trends are important, measuring actual performance and outputs are more important. This requires a focus on non-financial information, like service delivery indicators. The purpose is to give the public, as well as education managers, a better sense of the quality of spending, the impact of policies and budgets and to support forward planning. The analysis of expenditure trends is followed by a brief examination of non-financial indicators in education across the provinces. This includes enrolment trends, classroom provision, water and sanitation in schools, the provision of textbooks and school-leaving exam results.

Provincial education expenditure trends

Historical trends

Aggregate education expenditure

In 1996/97, provincial education expenditure rose by 22,1 percent. Table 3.1 shows key features of this increase. This dramatic rise was due to increased salaries for teachers, new teachers appointed to ensure lower pupil-teacher ratios, the costs of amalgamating various departments, and in some cases, poor financial management systems. Education spending then stabilised in most provinces, and between 1997/98 and 2000/01 declined on aggregate by an annual average of 2,4 percent in real terms. Personnel expenditure declined by about

1,7 percent per annum, and non-personnel spending by 8,9 percent per annum in real terms.

Table 3.1: Provincial education expenditure

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Personnel	34 095	35 252	36 118	39 237	41 215	43 376	45 734
Capital	842	481	459	501	1 162	1 791	2 099
Other recurrent	3 554	2 990	3 251	3 517	4 570	4 997	5 503
Total	**38 492**	**38 723**	**39 828**	**43 255**	**46 947**	**50 164**	**53 335**
Percentage change (av. Annual)	1997/98 – 2000/01				2000/01 – 2003/04		
Personnel	4,8%				5,2%		
Capital	-15,9%				61,2%		
Other recurrent	-0,4%				16,1%		
Total	**4,0%**				**7,2%**		

Provincial growth rates

Provinces where real declines between 1996/97 and 1999/2000 were most pronounced are Western Cape (5,3 percent), Eastern Cape (4,2 percent) and KwaZulu-Natal (2,4 percent). Table 3.2 shows that education spending has on aggregate declined as a percentage of provincial expenditure since 1997/98, although some provinces (Free State, Mpumalanga, and Northern Cape) have experienced upward movements. Table 3.3 provides nominal spending figures.

Table 3.2: Education as percentage of provincial expenditure

Percentage of total expenditure	**Actual**			**Estimated actual**	**Medium-term estimate**		
	1997/98	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	42,0%	42,6%	40,7%	39,7%	40,1%	40,1%	39,8%
Free State	37,0%	37,1%	42,0%	40,7%	39,3%	39,0%	39,0%
Gauteng	37,7%	37,3%	37,5%	37,6%	36,8%	36,4%	35,9%
KwaZulu-Natal	37,8%	38,5%	37,9%	37,8%	38,4%	37,8%	38,2%
Mpumalanga	41,8%	43,3%	43,1%	42,8%	39,5%	38,5%	39,3%
Northern Cape	35,6%	37,7%	36,4%	36,7%	36,4%	36,1%	36,4%
Northern Province	48,2%	48,2%	46,1%	44,2%	44,5%	43,8%	42,4%
North West	42,0%	41,2%	41,7%	40,3%	39,4%	39,2%	38,6%
Western Cape	36,9%	36,3%	35,7%	34,9%	34,7%	34,5%	34,3%
Total	**40,1%**	**40,3%**	**40,0%**	**39,3%**	**39,0%**	**38,6%**	**38,3%**

Improved education management

Lower spending did not necessarily mean lower quality. Financial management improved, greater equity was achieved in the deployment of teachers, and personnel costs were brought down. Budgets are now more sustainable, with more balanced ratios of personnel, capital and other recurrent spending. The introduction of the Tirisano Campaign in 1999 extended these improvements into the schoolground. Focusing on school performance, this campaign played an important role in creating stability in schools, involving parents in school management and improving the culture of learning.

Table 3.3: Provincial education expenditure

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	6 765	6 585	6 616	7 191	7 825	8 364	8 828
Free State	2 539	2 613	2 785	2 990	3 239	3 427	3 628
Gauteng	5 865	6 055	6 310	6 834	7 418	7 964	8 423
KwaZulu-Natal	7 280	7 130	7 299	8 185	9 177	9 820	10 708
Mpumalanga	2 506	2 624	2 809	2 997	3 204	3 424	3 784
Northern Cape	839	900	906	965	1 041	1 117	1 201
Northern Province	5 546	5 795	5 854	6 370	6 860	7 384	7 707
North West	3 240	3 196	3 408	3 699	3 888	4 133	4 325
Western Cape	3 912	3 823	3 840	4 023	4 296	4 531	4 732
Total	**38 492**	**38 723**	**39 828**	**43 255**	**46 947**	**50 164**	**53 335**
Percentage change (Average Annual)	**1997/98 – 2000/01**				**2000/01 – 2003/04**		
Eastern Cape	2,1%				7,1%		
Free State	5,6%				6,7%		
Gauteng	5,2%				7,2%		
KwaZulu-Natal	4,0%				9,4%		
Mpumalanga	6,1%				8,1%		
Northern Cape	4,8%				7,6%		
Northern Province	4,7%				6,6%		
North West	4,5%				5,4%		
Western Cape	0,9%				5,6%		
Total	**4,0%**				**7,2%**		

Real increases from 2000/01

After three years of decline, education spending began rising in real terms in 2000/01. Aggregate education expenditure grew by 1,4 percent in 2000/01, due to larger transfers to provinces, healthier provincial budget balances and reduced provincial debt. In KwaZulu-Natal, education spending grew 4,7 percent in real terms in 2000/01, with strong growth also achieved in Eastern Cape (1,5 percent) and Northern Province (1,6 percent). Significantly, in an important shift, both capital and non-personnel expenditure grow in real terms. Compared to a 1,1 percent real growth in capital and non-personnel expenditure, personnel expenditure grows by 1,5 percent in 2000/01. This contrast is even more significant, as personnel spending faced upward pressures due to an extraordinary payment of severance packages. These packages are discussed in the section on personnel trends elsewhere in this chapter.

Actual expenditure was R43,255 billion

Table 3.4 shows actual provincial outcome across provinces. Total provincial education budgets for 2000/01 were R43,255 billion. The original budget was adjusted by R2,557 billion to R44,7 billion, mainly because of higher than expected salary increases, and bringing forward annual bonuses normally paid in April of the next financial year to January, February and March of the 2000/01 financial year.

Total actual education spending for 2000/01 amounted to R43,255 billion. This reflects an increase of R3,4 billion or 8,6 percent compared to 1999/2000 actual expenditure, and is over

R1 billion or 2 percent lower than the adjusted budget. Actual expenditure in Gauteng and Eastern Cape is substantially lower than their adjusted budgets and closer to their voted budgets. Actual expenditure in KwaZulu-Natal is moderately lower than its adjusted budget.

Table 3.4: Actual outcome for 2000/01 in education

	2000/01 Budget	2000/01 Adjustments Estimate	2000/01 Actual Outcome	Actual Outcome as % of Adjusted Budget
Eastern Cape	7 187	7 440	7 191	96,7
Free State	2 951	3 153	2 990	94,8
Gauteng	6 835	7 418	6 834	92 1
KwaZulu-Natal	7 840	8 367	8 185	97,8
Mpumalanga	2 818	3 038	2 997	98,7
Northern Cape	914	965	965	100,0
Northern Province	5 992	6 379	6 370	99,9
North West	3 517	3 733	3 699	99,1
Western Cape	4 090	4 208	4 023	99,8
Total	**42 144**	**44 701**	**43 255**	96,7

Teacher-training colleges

Teacher-training colleges are being transferred from provincial education departments to the national education department. This is part of a strategy to create a more coherent higher education system incorporating all aspects of tertiary education. In the main, teacher-training colleges are being incorporated into existing universities. However, where this has not been possible, teacher-training colleges have been amalgamated to ensure that they are viable in the long-term.

More trained teachers required

While there has been a reduction in the number of teachers since 1997, Government is likely to maintain a teaching core of about 350 000. The present number of teachers is 346 000. Approximately 12 000 to 15 000 teachers a year leave the system due to natural attrition. This rate of about 4 percent is standard, if not low, by international standards. However, South Africa would have to increase the number of teachers that it trains to meet these requirements and replace departing teachers.

Medium-term projections

Education spending set for real rise

The boost in provincial spending in 2001/02 is reflected in education budgets too, with budgeted real growth of 2,2 percent. Over the MTEF period, 2000/01 to 2003/04, when total provincial spending is projected to grow in real terms by 2,3 percent a year, education spending will rise by an average 1,7 percent a year.

This real growth will occur especially in KwaZulu-Natal, Mpumalanga, Eastern Cape and Gauteng. In North West and Northern Cape, spending grows slightly slower than inflation. After adjusting for once-off items of expenditure – such as severance packages – all provinces project real growth higher than 2,5 percent, with KwaZulu-Natal's expenditure growing at over 6 percent a year.

Capital spending rises rapidly

Table 3.5 shows that personnel spending increases over the MTEF, while table 3.1 showed simultaneous growth in capital spending. In real terms, personnel spending stays relatively constant. Even though it may be difficult to achieve such rapid growth in capital spending, it does reflect a commitment by provincial governments to tackle classroom backlogs, the lack of water, sanitation and electricity, and the shortage of furniture in schools. Other non-personnel spending rises by 10,1 percent a year in real terms over the period. This should allow for greater provision of textbooks, equipment and teacher support programmes than during the past four years.

Table 3.5: Personnel expenditure for education by province

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	5 850	6 031	6 371	6 771	6 956	6 988	7 352
Free State	2 265	2 388	2 472	2 674	2 812	2 970	3 137
Gauteng	5 153	5 289	5 345	5 841	6 268	6 765	7 171
KwaZulu-Natal	6 531	6 503	6 721	7 535	8 273	8 753	9 338
Mpumalanga	2 289	2 434	2 587	2 788	2 853	3 015	3 220
Northern Cape	732	746	773	814	872	928	978
Northern Province	4 988	5 469	5 401	5 871	6 025	6 468	6 727
North West	2 875	3 018	3 129	3 403	3 393	3 555	3 728
Western Cape	3 412	3 374	3 318	3 542	3 764	3 932	4 082
Total	**34 095**	**35 252**	**36 118**	**39 237**	**41 215**	**43 376**	**45 734**

Provinces spend average of R3 658 per learner

The gap in spending per learner across provinces has narrowed since 1996. Nevertheless, there are still significant disparities. In 2000/01, provinces spent an average of R3 658 per learner. The provinces that spent the most per learner are Northern Cape (R4 801), Gauteng (R4 396) and Western Cape (R4 392). The Northern Cape spends 23,8 percent above the national average while Gauteng spends 16,8 percent more. Provinces that spent the least per learner are KwaZulu-Natal (R3 067), Eastern Cape (R3 436) and Northern Province (R3 453).

The reason for these disparities mainly lie in variations in the number of learners enrolled in the province as a percentage of population. Poorer provinces have a higher number of children and a legacy of high failure rates. Class sizes are larger and there are fewer qualified teachers.

14,6 percent to non-personnel spending

In 1998, provincial education departments and provincial treasuries agreed to move non-personnel budgets up to at least 15 percent of total education expenditure. The MTEF projections for 2003/04 show that all provinces with the exception of Northern Province, Free State and KwaZulu-Natal are expected to meet this target.

On average, non-personnel budgets will rise to about 14,6 percent of total expenditure by 2003/04. While provincial budgets grew relatively slowly between 1997/98 and 2000/01, healthy growth is forecast for the MTEF period. This growth, especially in capital and non-personnel expenditure, combined with developments in improved school and district management, bodes well for turning school education around.

Conditional grants in the education sector

In contrast to the health sector, conditional grant funding has not played an important role in the education sector. Amounts are relatively small and focused on specific initiatives to transform the education system. This is evident in table 3.6.

Table 3.6: Transfers and spending of education grants

	Actual	Actual Transfers and Expenditure		Estimated Actual		Medium-term estimate		
		1999/00		2000/01				
Grants	**1998/99**	**Transfers**	**Spending**	**Transfers**	**Spending**	**2001/02**	**2002/03**	**2003/04**
Classroom backlogs	39	–	–	13	–	–	–	–
ECD	–	–	–	–	–	21	52	88
Financial management	26	192	99	202	150	213	224	234
HIV/AIDs	–	–	–	26	6	64	–	–
Total	65	192	99	241	156	298	276	322
Under-spending	–	–	93	–	100[1]	–	–	–
Provincial roll overs	–	–	–	48	–	–	–	–

[1] Under-spending includes R48 million provided for roll overs at provincial level

Quality improvement and financial management

The largest conditional grant was introduced in 1998/99 with an allocation of R100 million to support quality enhancement and improvement of financial management in education departments. As with several other grants, expenditure was slow to start but has improved in recent years. While transfers of money to provinces are now flowing smoothly, some delays have taken place in spending. The grant is set to increase to R234 million in 2003/04. It supports, among other things, strengthening of district management in education, financial management in departments, and projects aimed at restoring the culture of learning and teaching in schools (COLTS).

Three other conditional grants flow to provincial education departments:

HIV/Aids

- A portion of the special allocation for an integrated strategy to confront HIV/Aids funds lifeskills training in schools, aimed at prevention through inducing behavioural change. In 2000/01, R26 million was allocated for this purpose, and R64 million in 2001/02. Amounts are set to grow over the MTEF.

Early Childhood Development

- A new grant introduced in 2001 enables piloting of models of early childhood development (ECD). Building on earlier donor-funded projects, amounts allocated are R21 million in 2001/02, R52 million in 2002/03 and R88 million in 2003/04.

Infrastructure

- The education sector is also set to benefit substantially from the conditional grant for infrastructure to provinces, initiated in 2001.

?? A small amount from the central poverty relief allocation supports innovation in school-building.

Personnel trends

Staff categories

As table 3.5 showed, personnel spending grew at an annual average rate of 4,8 percent from R34,1 billion in 1997/98 to R39,2 billion in 2000/01. This was below the inflation rate. Table 3.7 analyses the actual numbers of educational personnel in the provinces. Of the personnel listed below, about 346 000 are educators. The remaining 63 000 fall into two categories – those who staff the administrative sections of education departments, including provincial head offices and district offices; and staff based at schools performing a clerical, cleaning or security function.

Table 3.7: Provincial education departments personnel numbers

	2000/01	2001/02	Civil servants per 1000 people
Eastern Cape	76 754	75 339	11,2
Free State	29 841	29 338	10,5
Gauteng	60 027	57 272	7,4
KwaZulu-Natal	79 593	78 511	8,7
Mpumalanga	29 559	28 376	9,5
Northern Cape	9 389	8 888	10,0
Northern Province	61 570	60 730	11,4
North West	37 676	36 436	10,1
Western Cape	34 489	34 440	8,3
Total	**418 898**	**409 330**	**9,7**

Rationalisation and redeployment process

In early 1999, Government and teacher unions signed an agreement dealing with rationalisation and redeployment. This agreement used provincial education budgets as a basis for determining the number of educator posts available. Schools were then allocated a number of posts, based on a formula that took into account the subject mix of the school and the number of learners. Educators within schools were then absorbed into this post allocation. Temporary teachers, or teachers who could not be accommodated were asked to apply for vacant posts in schools that advertised vacancies. The contracts of temporary teachers who could not be absorbed into the system were not renewed, while permanent teachers still remain within school establishments, sometimes surplus to the school.

This process of rationalisation and redeployment has contributed towards more equal learner:educator ratios and resulted in a decrease of over 24 000 teachers. This process is drawing to an end in most provinces.

During 2000/01, personnel expenditure growth is R3 billion, or 8,6 percent higher than 1999/2000. This is slightly above inflation and mainly due to the payment of severance packages and annual service bonuses in the first three months of calendar year 2001. As the process of rationalising and right-sizing education departments draws to an end, a larger than normal total amount of severance payments were made during 2000/01. Adjusting for these anomalies, personnel spending continued to decline by about 1 percent in real terms in 2000/01.

Non-financial indicators in education

Progress with service delivery indicators

Non-financial indicators give the public additional information to judge provincial education departments' performance. Recent years have seen improvements in the data available on a range of issues such as basic components of the system (enrolment), inputs (personnel, classrooms and other infrastructural services) and outputs (matric results). Nonetheless, important gaps remain, particularly with regard to outputs and impact before the final school year and in providing indicators of effectiveness and quality.

Enrolment rates, learner:educator ratios and classrooms

Impressive school enrolment ratios

School enrolment in South Africa increased steadily throughout the late 1980s and accelerated rapidly after 1994. Enrolment went up by almost 2 million during this period. In 1996, school enrolment as a percentage of the age cohort that ought to be in school reached 101 percent. This enrolment rate signalled that Government has successfully tackled the question of access to basic education. Other indicators can assist to assess equity and quality.

Table 3.8 indicates that there has been a 4 percent decline in enrolment between 1996 and 2000. Eastern Cape, Western Cape and KwaZulu-Natal have had the largest percentage reduction in learners. Educators numbers declined too, but by less than learner enrolment rates. This has resulted in a lower learner:educator ratio in 2000 of 32,7. Provinces that have made significant reductions in learner:educator ratios are the Eastern Cape, KwaZulu-Natal and Mpumalanga.

As pass rates improve and enrolment patterns revert to normal demographic patterns, enrolment rates are likely to slow down. Preliminary estimates from 2000 Department of Education data signal that this slowdown has already begun. The policy of increasing the minimum school-going age to 7 has also helped reduce net enrolment rates. Table 3.8 shows how enrolment has decreased from 1996 levels. South Africa should experience a decline in school enrolment over the next ten years as pass rates improve and population growth slows.

Independent schools

There are 243 732 pupils (2,1 percent of all learners) in 963 independent schools. The highest number of pupils in independent schools is in Gauteng 117 531 (7,6 percent of learners in the province), followed by KwaZulu-Natal with 43 749 learners (1,6 percent). Independent schools consume 0,63 percent of total provincial education budgets. Gauteng spends 2,14 percent of its budget on independent schools. Independent schools have an average learner:educator ratio just above 16.

Table 3.8: Enrolments rates and related data 1996 and 2000

	School enrolment[1]		Learner:educator ratio		Learner:classroom	
Thousands	**1996**	**2000**	**1996**	**2000**	**1996**	**2000**
Eastern Cape	2 325	2 106	36,3	31,5	55	43
Free State	780	743	30,1	31,9	38	33
Gauteng	1 569	1 554	29,2	30,9	34	32
KwaZulu-Natal	2 772	2 669	37,1	35,7	45	40
Mpumalanga	931	894	36,0	34,8	45	48
Northern Cape	204	201	30,2	30,6	32	27
Northern Province	1 823	1 845	33,9	33,5	50	40
North West	946	909	30,2	30,3	40	34
Western Cape	963	916	32,9	30,7	33	31
Total	12 314	11 836	33,7	32,7	43	38

[1] *Includes both public and independent schools*

Increase in learner numbers in 1996

In 1996, provincial education departments acted to address teacher shortages. As enrolment increased and norms and standards on average learner:educator ratios were published by the Department of Education, provinces employed between 40 000 and 60 000 new educators. This employment and a higher entry age for grade 1 resulted in a decrease in average learner:educator ratios from about 40 to about 35. This mostly meant smaller class sizes.

However, in many cases, schools increased the numbers of educators and learners without having the classrooms to accommodate them. Lower learner:educator ratios did not necessarily translate into smaller class sizes, and many teachers were left without classrooms. This leads either to teaching outside buildings or some educators not teaching at full capacity, because there are not enough classrooms.

Learner:classroom ratios

The learner:classroom ratio is an indicator of the state of overcrowding. Table 3.9 shows that, in general, this ratio has declined from 43 to 38, reflecting both declining enrolment and an increase in the number of classes. The Northern Province, for example, has a learner:educator ratio of 33,5 which is low by international standards, but has a learner:classroom ratio of 40, which means that overcrowding is still a major problem.

Substantial numbers of teachers do not have classrooms, and are therefore not employed as productively as possible. The number of classrooms in South Africa increased by 25 102 over the period. South Africa still has a shortage of about 50 000 classrooms. The bulk of these shortages are in the Eastern Cape, Northern Province and KwaZulu-Natal.

Classroom shortages

As table 3.9 indicates, the number of schools indicating they have a shortage of classrooms has dropped from 49 percent to 41 percent between 1996 and 2000. The largest drop occurred in North West, where overcrowded schools dropped from 42 percent to 28 percent. More schools in Gauteng and Western Cape have complained about a shortage of classrooms in 2000 compared to 1996.

Table 3.9: Schools complaining of classroom shortages

Percentage	1996	2000
Eastern Cape	65	52
Free State	25	16
Gauteng	24	26
KwaZulu-Natal	61	48
Mpumalanga	49	56
Northern Cape	16	10
Northern Province	66	50
North West	42	28
Western Cape	16	17
Total percent	49	41

Source: 1996 and 2000 Schools Register of Needs

Teacher shortages

Significant teacher shortages remain in some rural provinces. However, Government's stance is generally that provinces should first build the required infrastructure and support systems before additional teachers are hired. In this way, new classrooms and schools can be adequately staffed and resourced and provincial education departments will have the capacity to support the school in its developmental phase. Hiring teachers when there are no classrooms will not result in improved quality in education.

Physical infrastructure in schools

More buildings in need of repair

While Government has made good progress in building classrooms, more work still needs to be done. The new provincial infrastructure grant, of which about 40 percent should go to education, should allow provinces to meet classroom backlogs over the next five to seven years. Success in the provision of other physical infrastructure has been more sporadic. Most improvements entailed increasing the number of schools with adequate telecommunication and sanitation and smaller improvements in the provision of water and electricity. In general, the number of buildings needing renovation has increased since 1996.

Telephones, water, sanitation and electricity

In 1996, 59 percent of schools had no telephones. With the advent of cellphones, this dropped to 34 percent in 2000. The number of children in schools without sanitation dropped from 55 percent to 17 percent. While this improvement is significant, schools reported that 15 percent of their toilets did not work, due to a lack of routine maintenance. In 1996, 40 percent of all schools had no access to running water. This number declined to 34 percent. The largest reduction in schools without water occurred in the Northern Province where there was a 12 percentage point decline. A total of 2 400 schools were electrified during this period, increasing schools that have power from 40 percent to 53 percent. Some 6,7 percent of schools use solar power, and this figure is as high as 25 percent in the Eastern Cape.

Building maintenance

Provinces have generally performed poorly in the maintenance of school buildings. It is estimated that the number of schools that are in excellent or good conditions has declined from about 11 000 to about

5 000 between 1996 and 2000. The number of schools in need of repair has increased from about 10 500 to 12 100 and those in weak condition increased from about 3 000 to 7 000. The reason for the decline in the state of buildings is that expenditure on routine maintenance generally declined during the period 1996 to 2000. In 2000, only 1 percent of all buildings were being renovated.

Spending on fixed assets

In 1996/97, provinces spent R1,4 billion on new buildings and other land improvements. By 1998/99, this figure had dropped to R432 million. Similarly, in 1996/97, provinces spent R232 million on maintenance, and by 1998/99, only R104 million. As a percentage of budget, total expenditure on fixed assets dropped from 4,5 percent in 1996/97 to 1,6 percent in 1998/99. The Eastern Cape experienced the largest drop, from 4,6 percent to 0,25 percent. Expenditure on fixed assets in KwaZulu-Natal declined from 6,8 percent in 1996/97 to 1,0 percent in 1998/99. Gauteng experienced the smallest decline in its spending on fixed assets during this period: from 3,0 percent to 2,8 percent.

Computers in schools

The number of schools with computers has increased off a low base. In 1996, 2 241 schools (8,3 percent) had 34 483 computers. This figure has increased to 6 581 schools (24 percent) with 59 333 computers. The number of schools without computers in the Northern Cape, Western Cape and Gauteng number 41 percent, 20 percent and 16 percent respectively. The remaining six provinces reported that over 70 percent of their schools had no computers for administrative or educational purposes. The province that fared the worst is the Eastern Cape with over 84 percent reported as having no computers.

Crime in schools

Criminal activity in schools is a key factor in reducing resources to schools or at least lowering standards. In 2000, there were 24 540 burglaries at schools, resulting in losses of over R155 million. Almost 5 000 assault cases were reported, with 1 860 serious crimes (such as murder and rape) occurring. KwaZulu-Natal experienced the highest levels of crime in schools followed by the Eastern Cape, Gauteng and the Western Cape.

Matric results

Improved matric results

Matric results in 2000 improved substantially over the previous three years. As table 3.10 shows, the overall matric pass rate went up from 47 percent in 1997 to 58 percent in 2000. Provinces with the best matric pass rates are Western Cape (80,6 percent), Northern Cape (71,2 percent) and Gauteng (67,5 percent). The lowest matric pass rates were recorded in Eastern Cape (49,8 percent), Northern Province (51,4 percent) and Free State (52,7 percent). All provinces saw an increase in their pass rates from 1997 to 2000 with Northern Province achieving the biggest gain from 31,9 to 51,4 percent. Overall, 61 percent of male candidates and 55 percent of female students passed.

Lower number of candidates

The improved matric results confirm continuous improvement in the standard of education across all provinces but is also due to the lower than normal number of repeaters allowed to rewrite their exams. The total number of people who wrote the exams dropped from 559 233 in 1997 to 489 941 in 2000. This is a 14 percent decline, but there are marked variances. Northern Province, for example, registered a 35 percent decline in the number of people who wrote matric.

Fewer schools have pass rates under 20 percent. Western Cape, North West and Mpumalanga showed most progress. Similarly, the number of schools producing pass rates of over 80 percent went up from 20 percent to 22 percent. Provinces that performed best in this regard were Eastern Cape and Free State.

Table 3.10: Matric pass rate by province, 1997 to 2000

Percentage	1997	1998	1999	2000
Eastern Cape	46,2	45,1	40,2	49,8
Free State	42,5	43,4	42,1	52,7
Gauteng	51,7	55,6	57,0	67,5
KwaZulu-Natal	53,7	50,3	50,7	57,2
Mpumalanga	46,0	52,7	48,3	53,2
Northern Cape	63,8	65,4	64,3	71,2
Northern Province	31,9	35,2	37,5	51,4
North West	50,0	54,6	52,1	58,3
Western Cape	76,2	79,0	78,8	80,6
Total	**47,4**	**49,3**	**48,9**	**57,9**

Mathematics and science results

Enrolments and passes in mathematics and physical science show a disconcerting decline. The number of students who wrote mathematics on the higher grade declined from 50 105 in 1999 to 38 520 in 2000 and those that passed dropped from 27 187 to 24 877. However, the number of people passing mathematics on the standard grade increased from 95 038 to 103 265.

Similarly, the number of students writing physical science on the higher grade dropped from 66 486 to 55 699, while those who passed on the higher grade dropped from 40 528 to 36 283. The low number of female students doing mathematics and physical science is a concern.

Systemic evaluation

A wider range of indicators

The national Department of Education is determined to use a broader range of education indicators for planning and is acutely aware that matric pass rates provide an imperfect measure of success.

To add to matric results as indicators for the education system as a whole, the new Systemic Evaluation programme focuses on educational outcomes and contextual factors. This programme has been tested in a random sample of some 1 400 primary schools – 5 percent of all primary schools. Currently, the focus is on educational outcomes in Grade 3, but this will soon be expanded to other levels, starting with Grades 6 and 9.

Progress with implementation of the PFMA

Provincial education departments have made substantial progress in implementing the Public Finance Management Act (PFMA), and are expected to start reaping the benefits during 2001/02.

Appointment of CFOs

All departments were to appoint a Chief Financial Officer (CFO) by 1 April 2001 as part of their top management team. Table 3.11 shows that two provinces appointed CFOs at Deputy Director-General (DDG) level, six at Chief Director (CD) level, and one in a Director position. Four provincial education departments have appointed permanent CFOs while Eastern Cape, Mpumalanga, Northern Cape and North West have acting CFOs. Northern Province made a contract appointment.

CFO forum

In order to build the capacity of provincial departments to implement the PFMA, an Education CFO forum was established in 2001/02. This forum utilises a peer-learning approach, comparing the different provincial approaches to determine (and follow) best practice. A focus area is the preparation and use of monthly management reports assessing budget performance.

Status of Internal audit and audit committees

More modern systems of internal control, and audit committees, will enable government departments to become more pro-active in identifying and resolving problems. Further, the CFO forum is expected to develop critical documents around risk management strategy, fraud prevention, and audit charters. Almost all provinces instituted a shared service arrangement or centralised audit committee. Seven education departments established internal audit units.

Table 3.11: *CFOs* appointed in education departments

Province	Full Appointment	Nature of appointment	Level of appointment
Eastern Cape	No	A	CD
Free State	Yes	P	CD
Gauteng	Yes	P	DDG
KwaZulu-Natal	Yes	C	CD
Mpumalanga	No	A	CD
Northern Cape	No	A	CD
Northern Province	Yes	C	DDG
North West	No	A	D
Western Cape	Yes	P	CD
Total	**5/9**	**3 P + 2 C + 4 A**	
		Permanent Appointment = P *Contract Appointment = C* *Acting CFO = A*	*Director = D* *Chief Director = CD* *Deputy Director-General = DDG*

Submission of financial statements

A further indication of improvement in financial management is the submission of financial statements to the Auditor-General within two months after the end of the financial year. This is in line with Section 40(1)(c) of the PFMA. In previous years, the financial statements were submitted between 6 and 18 months after the end of the financial year, adversely undermining financial accountability. Table 3.12 provides a status report on the submission of financial statements.

With the exception of Mpumalanga and Northern Cape, provincial education departments have met the deadlines.

Table 3.12: Submission of financial statements by 31 May 2001

Provinces	Vote number	Submitted Yes / No	Submitted after deadline but before 14 June 2001
Eastern Cape	6	Yes	N/A
Free State	6	Yes	N/A
Gauteng	5	Yes	N/A
KwaZulu-Natal	5	Yes	N/A
Mpumalanga	7	No	Yes
Northern Cape	4	No	Yes
Northern Province	3	Yes	N/A
North West	8	Yes	N/A
Western Cape	5	Yes	N/A

Challenges

Given the large number of personnel in education, general management, especially personnel management, is critical to the financial management strategy in education. On many issues, management responsibility is decentralised to the school level. The recent Auditor-General's report on performance of provincial education departments highlighted the need for proper management of leave and absentee registers, alignment of actual personnel expenditure with acceptable norms set for school funding, and for associated targets to be met. Other specific financial management issues relate to the management and reporting arrangements around school fees and other revenue collected by schools. School fees are exempt from depositing into provincial revenue funds in terms of section 22(1) of PFMA (Schedule 4). New budget formats would make education budgets easier to examine, with clear categories for text books, transfers to schools and maintenance.

Conclusion

Emerging from transition

Following difficult transition, there has been good progress in education in provinces since 1996. Financial management has improved budgets and their cost drivers are sustainable, and MTEF projections indicate strong real growth. Adjustments to improve the sustainability of budgets have been well managed and budgets reflect a better balance between personnel, capital and non-personnel items.

Infrastructure and quality as priorities

Strong projected growth in capital spending should help reduce backlogs and improve maintenance of existing infrastructure. Slight real growth in spending should allow for a small increase in the number of educators. Increased allocations for textbooks and other non-personnel expenditure provide resources for equipment, maintenance and media resources.

In general, the prospects of real growth in education spending, successes achieved in stabilising the system, and improved management should allow for accelerated enhancement in the quality of schooling.

4

Health

A significant private sector role

The private and public health sector comprises about 8 percent of South Africa's GDP, and the public health sector just more than 13 percent of total government expenditure. Unlike the other social sectors, the private sector plays a significant role in health, mainly through hospitals, doctors and medical aid coverage. However, only a minority of the population can rely on private health care.

The challenge to the public health sector in 1994 was to restructure service provision, providing access to appropriate services at the right locations. This necessitated a shift towards primary health care with a large clinic building program, the introduction of free primary health care services and the establishment of a district-based health system. Priority health programs such as for maternal and child health, tuberculosis, sexually transmitted infections, HIV/Aids and mental health have been reinforced.

This chapter contextualises the public sector's role in health, and more specifically that of the provinces, before analysing expenditure trends, conditional grants, personnel related issues and service delivery progress.

Public health in context

Public spending less than private

Private sector health care is provided by individual general practitioners, specialists, private clinics and hospitals. They generally provide health care for people with medical aid coverage, or who can afford direct payment.

The National Health Accounts Project reports that in 1999 less than 20 percent of the population was covered by private "institutional" financing intermediaries. These include medical schemes, covering 16 percent of the population, health insurance products, and workplace health services provided by private firms. However, as many as 30 percent of non-scheme members may use private services on a direct payment basis.

Public sector role

The fact that 84 percent of the population is not covered by medical aid or health insurance, indicates the importance of the public sector. To broaden access to appropriate services remains a major challenge where a substantial part of the population cannot afford private health care. Table 4.1 shows that with less funding the public sector has to care for a much larger number of people than the private sector.

Only 16 percent on medical aid

Another indicator of private sector size is the number of private sector hospital beds compared to the public sector. Private hospital beds increased from 16 415 in 1994 to 24 537 in 2000. In contrast, public sector hospitals have over 110 000 beds. Private health care expenditure increased at a rate double that of inflation between 1996 and 1998, from R24,7 billion to R33,3 billion. There have also been steep rises in medical aid rates, as gross contributions per member increased by 20,1 percent in 1997 and 12,9 percent in 1998. By 1999, only 16,4 percent of the population belonged to medical aids, leaving a bigger proportion of the population to rely on the public sector.

Table 4.1: South African health sector expenditure, 1998/99

	Public sector	Private sector	Total
Expenditure	R28,7 bn*	R33,3 bn (1998)	R62bn
Hospital beds (2000)	110 143	24 537	134 680
Hospital beds per 1000 population	3,08	2,94	3,06
Coverage	80%	20%	100%
Population covered (2000)	35,6m	8,4m	44m
Doctors	11 448	16 697	28 145
Doctors per 10 000 population	3,2	20	5,1
Medical schemes (1998)	–	194	194

** Full public health expenditure 1998/99 in 1999 prices, National Health Accounts project*

The limited access to private health care is illustrated by the analysis of medical aid coverage per province as shown in table 4.2. There is uncertainty as to whether the sharp declines in medical scheme coverage recorded in the October Household Survey are accurate or reflect sample errors. This matter is important to clarify, given its potentially large influence on the equitable share formula and evaluation of equity issues.

Table 4.2: Medical aid coverage by province

Province	Coverage of population by medical schemes	
	1995	1999
Eastern Cape	8,1%	10,2%
Free State	17,7%	14,8%
Gauteng	40,3%	26,9%
KwaZulu-Natal	13,1%	12,7%
Mpumalanga	14,0%	14,2%
Northern Cape	20,9%	19,1%
Northern Province	7,6%	8,7%
North West	13,6%	13,0%
Western Cape	28,5%	29,4%
Total	**18,1%**	**16,4%**

Source: October Household Survey 1995 and 1999

Pressures

Pressures on public health provision include perceptions of deteriorating quality in hospital services, escalation of HIV/Aids, squeezing out of non-personnel expenditure such as medicines and maintenance, and inadequate management decentralisation. Indicators show few signs of efficiency gains in hospitals. In response, a number of initiatives to reform the hospital sector are in place, including a programme to improve hospital management.

Is there a financing problem?

While these problems are often attributed to the stringent fiscal environment in the period after 1996, financing is not necessarily the dominant factor. Pressures in the system were compounded by remuneration increases, such as rank and leg promotions that escalated personnel costs, management and institutional transformation and increased demand as a result of HIV/Aids.

Provincial health expenditure trends

Over 2 percent real spending growth in 2000/01

In 2000/01, provincial health expenditure grew by more than 2 percent in real terms, from R24,1 billion in the previous year to R26,4 billion (see table 4.3). This points to an upturn, after real declines in the two previous years.

Adjustments in 1998/99 and 1999/2000

The downward real adjustment in health expenditure in 1998/99 and 1999/2000 resulted partially from unsustainable growth, particularly following large personnel related cost increases in 1996/97 and 1997/98. It is however not a trend, but resulted rather from a once-off correction, before real increases in expenditure resumed.

… a strong upward trend over longer term

As pointed out in the *South African Health Review 2001*, "total public health sector financial resources grew substantially between 1992/93 and 1998/99 by approximately 9 percent (in real terms) per annum, reflecting similar growth in general taxation financing of the public health sector. The drop in 1998/99 is, therefore, not part of a previous trend." Expenditure figures for 2000/01 and MTEF projections confirm that the upward trend in real health expenditure has resumed. Per capita spending, however, remains under pressure.

Table 4.3: Personnel vs other health expenditure

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Personnel	13 772	14 826	15 489	16 385	17 458	18 435	19 411
Other	8 711	8 198	8 621	10 036	11 287	11 998	13 037
Total	**22 483**	**23 025**	**24 110**	**26 421**	**28 745**	**30 433**	**32 448**
Percentage change (average annual)	**1997/98 – 2000/01**				**2000/01 – 2003/04**		
Personnel	6,0%				5,8%		
Other	4,8%				9,1%		
Total	**5,5%**				**7,1%**		

Table 4.4 portrays expenditure by province. While the decline in health expenditure cut across all provinces in 1998/99, subsequent trends have varied.

Sharp upward adjustments in the subsequent two years in Eastern Cape and Northern Province led to average annual real growth over the period 1997/98 to 2000/01 of 1 percent and 3 percent respectively. Over the three-year period, KwaZulu-Natal saw health expenditure remain almost constant in real terms.

Real declines in Gauteng, Northern Cape and Western Cape could have been expected, given the required adjustments in health spending towards inter-provincial equity and appropriate service delivery. There were real annual declines in expenditure in Free State (4 percent), Mpumalanga (4,1 percent) and North West (2,1 percent). This suggests that further effort is required to enhance equity across the provinces. The financial dimension of such effort must be complemented by appropriate institutional support and capacity building.

Table 4.4: Provincial health expenditure

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	3 031	3 048	3 496	3 790	3 835	3 967	4 307
Free State	1 659	1 692	1 589	1 777	1 880	1 985	2 099
Gauteng	5 299	5 478	5 605	5 942	6 716	7 167	7 597
KwaZulu-Natal	4 806	4 900	5 110	5 776	6 381	6 738	7 007
Mpumalanga	1 047	1 058	1 147	1 117	1 410	1 517	1 729
Northern Cape	376	392	433	438	497	531	577
Northern Province	1 954	2 081	2 221	2 566	2 635	2 885	3 115
North West	1 375	1 342	1 384	1 561	1 732	1 871	2 024
Western Cape	2 937	3 032	3 125	3 453	3 659	3 772	3 995
Total	**22 483**	**23 025**	**24 110**	**26 421**	**28 745**	**30 433**	**32 448**
Percentage change (average annual)	*1997/98 – 2000/01*				*2000/01 – 2003/04*		
Eastern Cape	7,7%				4,4%		
Free State	2,3%				5,7%		
Gauteng	3,9%				8,5%		
KwaZulu-Natal	6,3%				6,7%		
Mpumalanga	2,2%				15,7%		
Northern Cape	5,3%				9,6%		
Northern Province	9,5%				6,7%		
North West	4,3%				9,0%		
Western Cape	5,5%				5,0%		
Total	**5,5%**				**7,1%**		

Table 4.5 shows actual provincial outcomes for 2000/01. The total budget was adjusted by R1,8 billion to R26,8 billion, mainly because of higher than expected salary increases. Another factor was that annual bonuses that would normally have been paid in the next financial year were brought forward.

Total actual provincial health spending for 2000/01 amounted to R26,4 billion. This reflects an increase of R2,3 billion or 10,1 percent compared to 1999/2000 actual expenditure, and is over R0,8 billion or 3 percent lower than the adjusted budget. Actual expenditure in Mpumalanga, Gauteng and Northern Cape was lower than their adjusted budgets and closer to their voted budgets.

Table 4.5: Actual financial outcome for 2000/01 in health

R million	2000/01 Budget	2000/01 Adjustments estimate	2000/01 Estimated actual outcome	Actual outcome as % of adjusted budget
Eastern Cape	3 318	3 702	3 790	102,4
Free State	1 801	1 854	1 777	96,9
Gauteng	6 129	5 956	5 942	88,5
KwaZulu-Natal	5 556	5 832	5 776	99,0
Mpumalanga	1 162	1 302	1 117	85,9
Northern Cape	412	458	438	95,7
Northern Province	2 395	2 550	2 566	100,6
North West	1 565	1 576	1 561	99,1
Western Cape	3 447	3 524	3 453	101,8
Total	**25 785**	**26 754**	**26 421**	**96,6**

Medium term projections

Real growth continues over MTEF

Real growth in provincial health expenditure is projected to continue over the MTEF at an average of 1,7 percent per year. There are a number of interesting trends however between provinces with different profiles and health facilities:

- Total health expenditure is projected to rise from R26,4 billion in 2000/01 to R32,4 billion in 2003/04 (tables 4.3 and 4.4). Growth is strong in 2001/02, with provincial health expenditure set to rise by nearly 3 percent in real terms:

Provincial figures

- All provinces, except Western Cape and Eastern Cape, will see real growth in health spending over the MTEF. Eastern Cape's downward trend follows on real growth over the previous three years and some once-off payments in 2000/01, related particularly to backlog rank and leg promotion payments. Very high average annual growth is projected for Mpumalanga.

Non-personnel expenditure recovers

- Between 2000/01 and 2003/04, personnel expenditure is projected to grow fractionally faster than inflation. This leaves the bulk of real growth in non-personnel expenditure, which is set to grow in real terms by about 3,5 percent per year over the period.
- Personnel expenditure again declines to less than 60 percent of provincial health expenditure in 2003/04.
- The provinces without central hospitals/academic complexes all project personnel expenditure to decline in real terms. In contrast, the provinces with academic complexes project personnel expenditure rising faster than inflation.

Capital expenditure growth

- Between 2000/01 and 2003/04, health capital expenditure is projected to increase from 4,1 percent of expenditure to 8,9 percent. Capital expenditure grows strongly by more than 20 percent per year in all provinces except Western Cape and Free State.

Table 4.6: Health as percentage of total provincial expenditure

Percentage of total expenditure	Actual			Estimated actual	Medium term estimate		
	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Eastern Cape	18,8%	19,7%	21,5%	20,9%	19,6%	19,0%	19,4%
Free State	24,2%	24,0%	23,9%	24,2%	22,8%	22,6%	22,5%
Gauteng	34,0%	33,8%	33,3%	32,7%	33,3%	32,8%	32,4%
KwaZulu-Natal	25,0%	26,5%	26,6%	26,7%	26,7%	26,0%	25,0%
Mpumalanga	17,4%	17,4%	17,6%	15,9%	17,4%	17,1%	18,0%
Northern Cape	15,9%	16,4%	17,4%	16,7%	17,4%	17,2%	17,5%
Northern Province	17,0%	17,3%	17,5%	17,8%	17,1%	17,1%	17,1%
North West	17,8%	17,3%	16,9%	17,0%	17,6%	17,7%	18,0%
Western Cape	27,7%	28,8%	29,1%	30,0%	29,5%	28,7%	28,9%
Total	**23,4%**	**24,0%**	**24,2%**	**24,0%**	**23,9%**	**23,4%**	**23,3%**

Variances

As shown in table 4.6, the share of health expenditure compared to total expenditure for 2000/01 varies from a high of 32,7 percent in Gauteng, to a low of 15,9 percent in Mpumalanga. The provinces with central hospitals have a higher share. Over the MTEF, Mpumalanga, Northern Cape and North West will allocate relatively more to health, while this sector receives relatively less in Eastern Cape, Western Cape and Northern Province. The data in table 4.7, which excludes conditional grants, suggests that health service expenditure is below average in Mpumalanga, Northern Province and North West.

Table 4.7: Expenditure per person without private medical cover, 2000/01

Province	Total health expenditure	Expenditure excluding central hospital and training grants	Population without medical cover[1]	Health expenditure per person without medical coverage	
				Total health expenditure	Excluding grants
	R million	R million	R millions	Rand	Rand
Eastern Cape	3 790	3 766	5 657	670	666
Free State	1 777	1 475	2 243	792	658
Gauteng	5 942	3 946	5 369	1107	735
KwaZulu-Natal	5 776	5 223	7 346	786	711
Mpumalanga	1 117	1 094	2 403	465	455
Northern Cape	438	415	680	644	610
Northern Province	2 566	2 542	4 503	570	565
North West	1 561	1 538	2 920	535	527
Western Cape	3 453	2 199	2 796	1235	786
Total	**26 420**	**22 198**	**33 917**	**779**	**654**

[1] Source: OHS 1999

Equity in health spending

Initial narrowing of expenditure gap

Up to 1998/99, differences in per capita spending between provinces seem to have declined, partly as a result of reallocations between provinces through centralised health allocations. The slowdown in budget growth around 1998/99, as well as more decentralised (provincial) allocations, seem to have constrained narrowing the gap.

Large spending differentials

As indicated in table 4.7, large per capita spending differentials remain, even if central funding for tertiary services (central hospital and training grant) is excluded. The central funding of specialised services is premised on the fact that the four provinces with central hospitals provide these services to the country as a whole. Excluding this central funding, per capita expenditure on health services in Gauteng is still nearly twice that of Mpumalanga and 1,6 times that of Northern Province.

These inequalities suggest large differentials in access and point to possible variations in quality of services for inhabitants of the different provinces, as shown in table 4.8. For example:

?? Hospital beds range from 3,49 to 1,82 per thousand of population.

?? Hospital admissions range from 155 to 85 per thousand of population.

?? Inequities in expenditure are reflected in service delivery at all levels: for example, Mpumalanga, with 0,9 specialists per 100 000 population, was significantly lower than Gauteng with 30,9. Other examples of inequities are shown in table 4.8.

Table 4.8: Interprovincial inequities

	Specialists per 100 000 (public sector)	Hospital beds per 1 000 (public sector)	Hospital admissions per 1 000 (public sector)	Private hospital beds	Private doctors
Eastern Cape	2,8	3,09	76	1 224	883
Free State	10,3	2,56	94	937	730
Gauteng	30,9	3,49	155	10 605	4 915
KwaZulu-Natal	6,6	3,44	101	4 974	2 061
Mpumalanga	0,9	1,82	85	804	499
Northern Cape	0,9	2,27	133	297	207
Northern Province	2,3	2.00	81	273	363
North West	1,5	2,08	–	795	499
Western Cape	38,5	3,54	134	3 797	2 818
Total	**10,4**	**2,79**	**102**	**105 441**	**12 975**

Spending by programme

Table 4.9 demonstrates that the three years from 1997/98 saw a strong relative increase in spending on district health services. This includes primary care expenditure. In contrast to strong real annual spending growth of about 5 percent on these programmes, provincial health services and academic health services declined in real terms.

Increased spending on facilities

Over the MTEF, expenditure on district health services falls back in relative terms and declines somewhat in real terms. "Other expenditure" grows strongly, chiefly as a result of spending on new facilities, which is mirrored in rapid growth in capital expenditure.

Table 4.9: Composition of expenditure by programme and growth

Programme	1997/98	2000/01	2003/04
% of total expenditure			
Administration	3,9%	3,6%	4,2%
District health services	37,9%	44,4%	41,8%
Provincial hospital services	28,9%	25,6%	24,7%
Academic health services	23,0%	20,1%	19,1%
Other	6,4%	6,2%	10,3%
Total	**100,0%**	**100,0%**	**100,0%**
Average annual change in expenditure	*1997/98 to 2000/01*		*2000/01 to 2003/04*
Administration	3,1%		11,9%
District health services	11,3%		4,6%
Provincial hospital services	1,4%		5,5%
Academic health services	0,9%		4,9%
Other	4,6%		26,3%
Total	**5,5%**		**6,8%**

Conditional grants in the health sector

The provincial health sector has the largest share of conditional grants, with transfers totalling more than R6,0 billion in 2000/01 and making up 47,1 percent of the value of all conditional grants. Six of the nine health grants are hospital grants. Table 4.10 shows transfers and spending of health grants between 1998/99 and 2000/01, and budgeted allocations for the 2001 MTEF.

Table 4.10: Transfers and expenditure on health grants

R million	Actual	Actual transfers and expenditure 1999/00		Estimated actual 2000/01		Medium-term estimate		
Grant	**1998/99**	**Transfers**	**Spending**	**Transfers**	**Spending**	**2001/02**	**2002/03**	**2003/04**
Central hospital	3 021	3 075	3 075	3 112	3 112	3 271	3 419	3 579
HIV/Aids	–	–	–	15	10	34	–	–
Hospital Rehabilitation	87	153	140	400	323	500	520	543
Integrated Nutrition	283	713	460	582	534	582	582	582
Nkosi Luthuli	200	189	189	331	74	104	–	–
N Mandela Academic	11	41	41	112	95	–	–	–
Pretoria Academic	–	–	–	–	–	50	70	90
Redistribution	–	57	52	276	207	182	189	198
Professional training	1 060	1 118	1 118	1 174	1 174	1 234	1 291	1 351
Total	4 662	5 346	5 075	6 002	5 530	5 957	6 071	6 343
Under-spending	–	–	271	–	472	–	–	–
Provincial roll-overs	–	9	–	6	–	–	–	–

Spending trends in health grants

Estimated under-spending amounted to R271 million and R473 million in 1999/2000 and 2000/01. Underspending on the Integrated Nutrition Programme (INP) amounted to R252 million in 1999/2000 and R48 million in 2000/01. Under-spending in 2000/01 on the Nkosi Albert Luthuli hospital amounted to R257 million. More effective utilisation of grants is therefore a priority as the public sector gears up for its role in health.

The health sector has undertaken a review of its conditional grants, and it shows interesting variations between provinces. Detailed cost analysis was done in 531 tertiary units located in 62 hospitals.

Tertiary expenditure

The result shows that the proportion of tertiary expenditure funded by the central hospitals grant varies considerably between provinces. For example, 96 percent of tertiary costs in Gauteng (in central or other hospitals) are effectively funded by the central hospitals grant, as opposed to only 3 percent in the Eastern Cape. Almost a third of tertiary care expenditure in KwaZulu-Natal takes place outside the central hospitals and hence receives no conditional funding. Mpumalanga, North West and Northern Province receive no funding through the grant.

Table 4.11: Expenditure on Tertiary Services

R'000	Modelling estimate of expenditure in Central Hospitals	Actual level of Funding for Central Hospitals Grant	Difference	Modelling estimate of expenditure in Non-Central Hospitals
Eastern Cape	9 579	13 201	3 621	481 769
Free State	305 351	249 813	-55 538	156 491
Gauteng	1 432 896	1 568 945	136 048	194 376
KwaZulu Natal	461 777	427 525	-34 252	497 725
Mpumalanga	–	–	–	53 946
North West	–	–	–	53 548
Northern Cape	–	–	–	74 335
Northern Province	–	–	–	58 632
Western Cape	939 052	1 011 436	72 383	214 877
National	**3 148 657**	**3 270 920**	**122 262**	**1 785 703**

Source: Department of Health

Redistribution of specialised-services

Spending on the Redistribution of Specialised Services Grant has been slow. In 1998/99 and 1999/2000, a total of R150 million was allocated but only R52 million was spent. Under-spending in both years was reflected by non-transfer of budgeted funds.

Transfers of this grant improved significantly in 2000/01, with the total allocation (including roll-overs) amounting to R276 million. Spending also increased from R52 million in 1999/2000 to R207 million in 2000/01. The significant improvement in spending resulted from an agreement within the health sector that allowed provinces to use part of the grant to fund the operational costs of newly developed tertiary services.

Health outcomes

Poor health status and inequalities

Two generalisations about the health status of South Africans have long been accepted, namely that:

?? Health outcomes are poor relative to other middle and even some lower income countries

?? There are extensive inequalities in health status by population group, urban/rural area and province.

These two observations are connected. In spite of relatively high levels of public sector health expenditure, unequal access to services and health outcome disparities remain concerns.

Worsening health outcomes

Information on life expectancy and infant and child mortality is presented in Table 4.12. The Demographic and Health Survey estimates life expectancy at 63 in 1999. There is growing evidence that health indicators are under pressure due to HIV/AIDS.

Table 4.12: Indicators of health status of the population

	1999
Life expectancy at birth (years)	63,0
Infant mortality rate (per 1 000 life births)	45,0
Under 5-mortality rate (per 1 000 live births)	59,0
Malnutrition prevalence (% of children under 5)	–

Source: Demographic and Health Survey, Department of Health

Primary health care (PHC)

PHC dimensions

Primary health care is the most significant component of the district hospital program. The *National Primary Health Care Facilities Survey 2000* focused on a number of PHC dimensions such as services (availability), human resources, equipment, infrastructure, drugs and supplies, supervision, record keeping and support.

Facilities

Table 4.13 identifies a total of 4 428 facilities of which the bulk are "fixed facilities" (own buildings, staff and equipment and services provided on site most workdays). These main facilities are supported by 439 satellites (drawing resources from the main clinics and services and normally not provided on a continuous basis) and 899 mobile clinics. Just over 50 percent of fixed clinics serve rural areas, supported by 46 percent of satellites and 69 percent of mobile clinics.

Table 4.13: Primary health care facilities, 2000

Province	Clinics/CHCs	Satellites	Mobiles	Total
Eastern Cape	676	29	120	825
Free State	247	–	99	346
Gauteng	207	129	37	373
KwaZulu-Natal	493	78	144	715
Mpumalanga	267	13	88	368
Northern Cape	100	42	71	213
Northern Province	463	91	117	671
North West	330	1	93	424
Western Cape	307	56	130	493
Total	**3 090**	**439**	**899**	**4 428**

Source: Health Systems Trust, National Primary Health Care Facilities Survey 2000

Progress towards equity

The survey concludes that while there has been notable progress towards equity in service provision, significant inequity remains. Key points of progress noted are:

?? substantial increase in availability of antenatal care

?? improvement in turn-around times for various tests: the average turnaround time for HIV testing has decreased from 8 to 6 days

?? wide implementation (80 percent of fixed clinics) of the directly observed treatment system for tuberculosis (DOTS)

?? reduced patient loads at fixed clinics from 553 per nurse per month in 1997 to 474 (20 per day) in 2000

?? doctor availability at clinics improved between 1997 and 2000, but is still low in Eastern Cape and Northern Province and has regressed substantially in KwaZulu-Natal

?? a marked increase in availability of electricity at clinics

?? a moderate increase in availability of condoms, oxygen, penicillin and oral contraceptives.

Remaining inequities

Against this progress, problems with access to services and related to infrastructure remain. These translate into significant remaining inequities:

?? a number of important tests are often not available

?? unavailability of emergency transport

?? absence of essential, basic equipment in some cases

?? regular interruptions of telephone services and electricity and absence of piped water at many clinics

?? some key drugs are poorly stocked and certain protocols not well implemented

?? TB record-keeping is generally poor and nurse supervisor visits have declined since 1997

?? little progress has been made in facilitating community participation since 1998.

Local Government

The health sector has started an initiative to decentralise primary health care to district councils. Although this will be an appropriate approach in the long term, it is important not to underestimate the complexity of the process, which requires adequate planning. Some of the complexities involve personnel that would have to be transferred following the devolution of the functions, and the capacity of the local government to undertake increased functions given the current problems faced by municipalities associated with their transformation and pressure to effectively deliver their core functions/services (see Chapter 8). In considering the transfer of functions and personnel to municipalities, it will be important to take into consideration the experiences with the transfer of R293 personnel, which was complicated by different remuneration packages in municipalities.

Municipalities are already providing some of the primary health care services on an agency basis for the provincial government, to a varying degree. According to the gazette published by provinces on transfers to municipalities from the provincial revenue funds for 2001, with the exception of Northern Province which has not reported any transfers to municipalities, total transfers for primary health care amount to R617,9 million (discussed in Chapter 10). Part of the planning process for the transfer of functions should involve getting an accurate picture on the current level on primary health care provided by municipalities through both transfers from provinces and their budgets. Due to complexity of the process, the Division of Revenue Act requires that, prior to transfer of functions, the Ministers of Finance and Provincial and Local Government must be consulted.

HIV/Aids

Five channels of funding

Government funds the fight against HIV/Aids through at least five channels:

- *Provincial health budgets:* A recent estimate puts provincial spending on Aids-related illnesses at nearly R4 billion, including spending on essential drugs for opportunistic infections.
- *The Government Aids Action Plan:* On the vote of the national Department of Health, this is estimated at about R190 million in 2001/02. The aim is mostly prevention, through activities like distribution of condoms (expected to reach 310 million in 2001), piloting female condoms, support to NGOs, information, piloting of prevention of mother-to-child transmission projects in the provinces. Special allocation for integrated plan
- *A special allocation for an integrated strategy aimed primarily at children and youth:* Funding increased from R75 million in 1999/2000 to R125 million in 2000/01 and rises further to R300 million in 2001/02. The funding is divided between the education, health and welfare departments and flows mostly as conditional grants to provinces for implementation. Three main activities are funded from this source: rollout of life-skills training to primary and secondary schools; expansion of capacity to provide voluntary counselling and testing at health clinics; and piloting of home-based care.
- *Allocations from the provincial equitable share to deal with prevention and information:* Little detailed information is available about provincial allocations earmarked for HIV/Aids.
- *Spending by individual government departments:* This aims mostly to provide information to employees and to support them. In this regard the Department of Public Service and Administration is coordinating a Public Service HIV/Aids Project and a Public Service HIV/Aids Indaba is planned for October 2001.

Social grants and HIV/Aids

In addition to the above, social grants, such as the foster care grant and the child support grant, deal with some of the impact of the disease through providing income support to, among others, orphaned children. It is, however, clear that the current social safety net is not adequately designed for dealing specifically with the impact of HIV/Aids on households and to confront the complex interaction between HIV/Aids and poverty.

Enhanced response

There has been close interaction between the Department of Health and National Treasury recently to ensure that programmes to confront the disease are expanded to the required scale in coming years. In a number of important areas, such as condom provision, life-skills provision and voluntary counselling and testing, substantial capacity has been put in place over the last couple of years.

The challenge now is to build on these initial successes in the areas of prevention, treatment, care and support. Given the close and complex relationships between HIV/Aids and other diseases, such as tuberculosis, and the links between HIV/Aids and poverty, an enhanced response cannot be implemented in isolation from these factors and concerns.

Hospitals

Hospitals still significant

Though the emphasis of the health sector has shifted towards primary health care, expenditure on hospitals still comprises at least 46 percent of total provincial health expenditure. In provinces like Gauteng, this share is even higher, set at 73,6 percent because of the number of central hospitals in that province. Significant spending is also directed at regional and district hospitals.

Information is not reliable, as hospitals are not seen as separate cost centres. Hospital decentralisation, one of the key reforms adopted in the 10 point plan in the *Health Sector Strategic Framework 1999-2004,* should help improve information.

Output trends

Hospital output trends since 1994 were documented in a recent *Annual Health Review*.

Quantitatively, in line with the rightsizing programme for hospitals, there is a clear trend towards the reduction of hospital beds. But there is marked variation in numbers of beds per 1000 of the population between provinces, from 3,54 beds per 1000 in Western Cape to 1,82 in Mpumalanga (see table 4.8).

Key measures like in-patient days, admissions and out-patient headcounts show downward trends. There is also evidence of inefficiencies with low bed occupancy, longer than desirable stay, and outputs per staff member not showing evidence of increasing efficiency. However, encouraging increases and improvements were documented in Mpumalanga, North West and Northern Province, a positive sign of equity redress.

HIV/Aids

While hospital outputs have not increased significantly, the proportion of patients admitted for HIV/Aids related problems has grown substantially. This suggests that patients with AIDS are progressively displacing or crowding out other patients.

Problems such as inefficient bed utilisation, the AIDS epidemic, and inability to address existing capital upgrading and maintenance backlogs make hospital planning complex. For this reason an Integrated National Planning Framework is being developed for the sector to guide, amongst others, decisions on affordable bed numbers.

Existing facilities

Of the 375 public sector hospitals, 247 are district hospitals, 60 regional hospitals, 10 central hospitals, 6 tertiary hospitals and 52 specialised hospitals. The latter include psychiatric, TB and various chronic illnesses hospitals. Table 4.14 provides details per province.

Table 4.14: Number of Hospitals per province, 2001/02

	National Central Hospitals	Provincial Tertiary Hospitals	Regional Hospitals	District Hospitals	Specialised Hospitals	Total
Eastern Cape	–	1	8	63	11	83
Free State	1	1	6	24	1	33
Gauteng	4	–	12	7	5	28
KwaZulu-Natal	2	1	9	40	8	60
Mpumalanga	–	1	5	18	1	25
Northern Cape	–	–	1	21	3	25
Northern Province	–	2	5	32	3	42
North West	–	–	4	15	2	21
Western Cape	3	–	10	27	18	58
Total	**10**	**6**	**60**	**247**	**52**	**375**

Source: National Department of Health

Central hospitals

Central hospitals budgets total well over R4,4 billion in 2000/01, funded by the Central Hospitals (R3,1 billion) and Health Professionals Training and Research (R1,1 billion) grants. Central hospitals cater for training of doctors and nurses. Selected data are shown in table 4.15.

Table 4.15: Expenditure on central hospitals

Provinces	Number of Beds	Total Expenditure	Personnel Costs	Medium-term estimate		
		2000/01	2000/01	2001/02	2002/03	2003/04
		R'000	R'000	R'000	R'000	R'000
Free State						
Universitas	630	335 540	230 750	383 079	401 838	404 304
Gauteng	**6 532**	**2 296 075**	**1 432 637**	**2 483 775**	**2 632 801**	**2 625 194**
Chris Hani	2 888	678 552	445 050	775 106	821 612	822 548
Baragwanath						
Ga Rankuwa	1 753	450 086	330 150	474 520	502 991	500 619
Johannesburg	967	653 749	329 600	692 963	734 541	731 076
Pretoria Academic	924	513 688	327 837	541 186	573 657	570 951
KwaZulu-Natal	**1 952**	**526 827**	**362 176**	**531 566**	**538 623**	**586 819**
King Edward VIII	1 616	402 900	289 311	403 626	408 412	441 885
Wentworth	336	123 927	72 865	127 940	130 211	144 934
Albert Luthuli	–	–	–	–	–	–
Western Cape	**2 662**	**1 275 642**	**933 775**	**1 258 374**	**1 321 292**	**1 387 356**
Groote Schuur	945	575 718	428 513	567 723	596 109	625 914
Red Cross	287	140 025	98 126	135 875	142 669	149 802
Tygerberg	1 430	559 899	407 136	554 776	582 514	611 640
Total	**11 776**	**4 434 084**	**2 959 338**	**4 656 794**	**4 492 716**	**5 003 673**

Regional and tertiary hospitals

Provinces budget significant funds for tertiary and regional hospitals (table 4.16), many with budgets over R200 million.They are in KwaZulu-Natal with Free State, Gauteng, and Northern Province.

Table 4.16: Expenditure on selected regional hospitals

Provinces	Number of Beds	Total Expenditure	Personnel Costs	Medium-term estimate		
		2000/01	2000/01	2001/02	2002/03	2003/04
		R'000	R'000	R'000	R'000	R'000
Eastern Cape	**2 378**	**379 529**	**339 032**	**–**	**–**	**–**
Umtata	637	134 318	117 741	–	–	–
Livingstone	946	119 333	109 603	–	–	–
Frere Hospital	795	125 878	111 688	–	–	–
Mpumalanga	**316**	**72 785**	**39 766**	**86 663**	**91 864**	**97 376**
Witbank						
Free State	**2 374**	**441 209**	**329 648**	**434 333**	**459 611**	**514 000**
Pelonomi	720	211 049	161 592	195 791	205 001	238 000
Psychiatric	877	83 337	67 211	88 509	93 652	97 000
Gold Fields	420	85 580	56 904	85 298	89 820	101 000
Boitumelo	357	61 243	43 941	64 735	71 138	78 000
Gauteng	**2 573**	**255 612**	**189 945**	**261 112**	**276 779**	**275 473**
Kalafong	1 022	255 612	189 945	261 112	276 779	275 473
Helen Joseph	485	–	–	–	–	–
Coronation	282	–	–	–	–	–
Natalspruit	784	–	–	–	–	–
KwaZulu-Natal	**4 163**	**892 579**	**665 237**	**853 893**	**794 870**	**789 448**
Edendale	1 645	258 285	198 136	241 412	216 348	214 444
Madadeni	608	151 588	126 235	157 962	146 083	149 403
Prince Mshiyeni	1 200	245 664	189 869	196 989	179 506	173 761
Addington	710	237 042	150 997	257 530	252 933	251 840
Northern Cape	**492**	**162 166**	**110 646**	**–**	**–**	**–**
Kimberley	492	162 166	110 646	–	–	–
Northern Province	**1 491**	**228 498**	**169 611**	**209 211**	**243 501**	**260 233**
Letaba	351	43 153	36 315	44 170	47 062	49 237
Tshilidzini	543	97 807	69 083	82 075	85 615	103 873
Mapulaneng	463	62 484	45 604	63 141	88 537	83 832
Warmbaths	134	25 054	18 609	19 825	22 287	23 291
North West	**2 274**	**299 937**	**212 480**	**291 020**	**365 720**	**387 663**
Klerksdorp/Tshepong	1045	132 453	94 834	151 071	160 135	169 743
Mafikeng	544	62 965	50 733	17 050	75 313	79 831
Rustenburg	350	58 429	39 536	69 838	74 028	78 470
Potchefstroom	335	46 090	27 377	53 061	56 244	59 619
Western Cape	**733**	**142 717**	**110 584**	**153 789**	**161 477**	**169 549**
Conradie	439	71 296	58 097	84 037	88 238	92 649
Somerset	294	71 421	52 487	69 752	73 239	76 900
Total	**16 594**	**2 875 032**	**2 166 949**	**2 290 021**	**2 393 822**	**2 493 742**

Infrastructure

The 1996 national health facilities audit found a third of hospital facilities to require replacement or major repair. This is estimated to have reached about 40 percent by 2000. The cost of backlog elimination and transformation of facilities was estimated at R12 billion over eight to ten years.

Current estimates of backlogs and transformation costs are higher, hence the current grant allocation is unlikely to meet required objectives. Adequate levels of expenditure need to complement this grant. However, maintenance expenditure is currently between 1 and 0.5 percent of asset value: well below the required 3 percent or more.

Hospital rehabilitation grant

Hospital rehabilitation grant allocations increased from R100 million in 1998/99 to R400 million in 2000/01. It is budgeted to increase from R500 million in 2001/02 to R543 million in 2003/04. Under-spending in 1998/99 and 1999/2000 showed in non-transfers to provinces, but in 2000/01, all budgeted funds were transferred to provinces.

Despite such slow expenditure over the past three years, spending on the hospital rehabilitation grant has increased from R87 million in 1998/99 to R323 million in 2000/01. Several provinces encountered difficulties that delayed expenditure. Improved spending of this grant and additional funding from the provincial infrastructure grant are anticipated to make an impact on the backlogs over time.

Personnel trends

Personnel expenditure growth

Provincial health departments faced increased salary costs as a result of broad-banding and rank and leg promotions after the 1996 wage agreements. Personnel expenditure rose to as high as 64,6 percent of health expenditure in 1998/99. Rising salary costs necessitated reductions in staff numbers as well as real declines, especially in 1998/99, in non-personnel expenditure. Table 4.17 shows a decline of 15 126 health workers in the public sector since 1997/98 (6,4 percent).

Table 4.17: Number of personnel in provincial health departments

	1997/98	1998/99	2000/01	2001/02	Change 1997/98 to 2001/02	% change 1997/98 to 2001/023	Civil servants per 1000 people
Eastern Cape	34 197	36 744	31 951	31 050	-3 147	-9,2%	4,6
Free State	–	14 483	15 246	14 899			5,3
Gauteng	46 604	45 005	43 097	42 328	-4 276	-9,2%	5,5
KwaZulu-Natal	48 885	50 039	48 191	47 361	-1 524	-3,1%	5,3
Mpumalanga	11 497	11 367	11 188	11 286	-211	-1,8%	3,8
Northern Cape	3 161	3 356	3 952	3 942	781	24,7%	4,4
Northern Province	23 345	23 993	23 607	23 433	88	0,4%	4,4
North West	17 713	16 881	16 068	15 025	-2 688	-15,2%	4,2
Western Cape	28 363	26 576	23 658	24 214	-4 149	-14,6%	5,8
Total	**213 765**	**228 444**	**216 958**	**213 538**	**-15 126**	**-6,4%**	**4,9**

Table 4.18 shows bigger declines since 1995/96 because of cost increases in 1996/97. Western Cape reduced by over 8000 employees

(25 percent) from 1995 to 2000, at a 38 percent real increase in average cost per employee. Gauteng has reduced by 6278 employees (12,1 percent). Over the three-year period non-personnel expenditure declined by approximately 1,5 percent per year in real terms.

Table 4.18: Personnel expenditure: health departments

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	1 842	1 992	2 391	2 385	2 391	2 512	2 648
Free State	995	1 126	1 096	1 176	1 262	1 289	1 368
Gauteng	3 145	3 276	3 233	3 412	3 813	4 069	4 313
KwaZulu-Natal	3 023	3 191	3 332	3 577	3 825	4 053	4 222
Mpumalanga	570	644	721	775	799	835	872
Northern Cape	196	219	269	287	326	345	365
Northern Province	1 137	1 403	1 505	1 626	1 655	1 742	1 834
North West	889	972	988	1 063	1 135	1 234	1 300
Western Cape	1 976	2 003	1 954	2 083	2 252	2 355	2 488
Total	**13 772**	**14 826**	**15 489**	**16 385**	**17 458**	**18 435**	**19 411**

Advanced skills unevenly distributed

Health personnel, especially nurses, are distributed fairly equitably, but advanced skills vary across provinces (table 4.19). Medical specialists range from 0,9 per 100 000 in Mpumalanga and Northern Cape to 38,5 in the Western Cape and pharmacy staff from 2 per 100 000 in Northern Province to 8 per 100 000 in Western Cape.

Table 4.19: Estimated professional personnel in public sector as at 31 March 2001

Personnel	**Doctors**	**Doctors per 100 000**	**Specialists**	**Specialists per 100 000**	**Dentists**	**Dentists per 100 000**	**Nurses**	**Nurses per 100 000**
Eastern Cape	792	13,0	172	2,8	47	0,8	14 051	229,9
Free State	559	24,6	235	10,3	27	1,2	5 789	254,9
Gauteng	1 750	36,6	1 480	30,9	252	5,3	15 204	317,6
KwaZulu-Natal	1 837	23,2	523	6,6	68	0,9	21 316	268,8
Mpumalanga	429	16,2	24	0,9	50	1,9	4 856	183,4
Northern Cape	658	13,0	47	0,9	37	0,7	10 801	213,8
Northern Prov	199	28,4	16	2,3	11	1,6	1 721	245,5
North West	395	12,6	47	1,5	42	1,3	6 614	211,3
Western Cape	1 123	37,2	1 162	38,5	120	4,0	9 783	324,2
Total	**7 742**	**21,7**	**3 706**	**10,4**	**654**	**1,8**	**90 135**	**252,8**

Training

Some training costs hidden

Training of health personnel is funded by the national Health and Education departments, mainly through the Health Professional Training conditional grant and transfers to medical faculties of universities. Numbers of health trainees are shown in table 4.20. Just over 1200 doctors qualify every year. Information is more accurate for doctors than for nurses and training costs. Such costs are "hidden" in hospital and nursing college budgets, bursary schemes and salaries of nurses remunerated whilst studying. Integrated human resource planning in the health sector is an urgent requirement to address staff mix, numbers of existing and required personnel by type, affordability, appropriate salary differentials and training.

Table 4.20: Number of health professionals in training

Province	Medical graduates (2000)	Registrars (Posts filled 2000)	Nursing (all students 2001)
Eastern Cape	44	–	1 577
Free State	124	184	1 000
Gauteng	677	888	4 901
Wits	*200*	*487*	–
Pretoria	*213*	*241*	–
Medunsa	*264*	*160*	–
KwaZulu-Natal	124	287	4 062
Mpumalanga	–	–	781
Northern Cape	–	–	96
Northern Province	–	–	1 489
North West	–	–	740
Western Cape	302	601	1 149
UCT	*164*	*359*	–
Stellenbosch	*138*	*242*	–
Total	**1 271**	**1 960**	**15 795**

Source: Department of Health 2001

Implementation of the PFMA

Appointment of suitable CFOs

In 2000/01, the first year of PFMA implementation, many departments focused on establishing the structures necessary for implementation, like chief financial officers, internal audit units, audit committees. Provincial health departments have made good progress in this respect, and are expected to start reaping the benefits from 2001/02.

Appointment of CFOs

All departments were to appoint a CFO by 1 April 2001 as part of their top management team. Table 4.21 shows the CFOs appointed and the levels at which appointments were made in provincial health departments. Two provinces appointed CFOs at Deputy Director-General (DDG) level, six at the Chief Director (CD) level, and one at Director level. Six provincial health departments have appointed permanent CFOs while Mpumalanga, Northern Cape and North West have acting CFOs and Northern Province made a contract appointment.

To build capacity to implement the PFMA, a Health CFO forum was established in 2001/02. This forum utilises peer-learning and comparative methods to establish and promote best-practice. It also focuses on the preparation and use of monthly management reports assessing budget performance.

Table 4.21: CFOs appointed in provincial health departments

Province	Number of *CFOs* appointed	Nature of appointment	Level of appointment
Eastern Cape	Yes	P	CD
Free State	Yes	P	CD
Gauteng	Yes	P	DDG
KwaZulu-Natal	Yes	P	CD
Mpumalanga	No	A	CD
Northern Cape	No	A	CD
Northern Province	Yes	C	DDG
North West	No	A	D
Western Cape	Yes	P	CD
Total	**6/9**	**5 P + 1 C + 3 A**	
		Permanent Appointment = P	***Director = D***
		Contract Appointment = C	***Chief Director = CD***
		Acting CFO = A	***Deputy Director-General = DDG***

Appointing CEOs

The most urgent financial management reforms are in the hospital sector. Although provinces have begun to employ CEOs to run major hospitals, very little progress was made in devolving managerial powers and budgets to CEOs. Current CEOs are unable to hire, retrench or discipline hospital staff. Although the PFMA allows CEOs to be delegated accounting officers for hospitals, no province has done so. Once such powers are delegated, the CEOs of hospitals will need to employ more managerial staff to run hospitals more effectively.

The national government has made available a health management grant of R243 million over three years, primarily to assist CEOs to improve hospital management. However, the take-up of this grant has been slow, given the lack of progress in delegating accounting officer responsibilities to CEOs. The next phase of improving financial management will involve the district health system. This system is decentralised, and will need different management systems to make its operation more effective.

Status of internal audit and audit committees

Modern systems

Government has recognised the need to implement more modern systems of internal control and audit committees. This will enable government departments to move pro actively in identifying and resolving problems, rather than after the end of a financial year.

Further, the CFO forum is expected to develop critical documents around risk management strategy, fraud prevention and audit charters. Almost all provinces adopted shared service arrangements or centralised audit committees. Seven health departments established internal audit units.

Submission of financial statements

Submission of financial statements to the Auditor General within two months after the end of the financial year, would signal improved management. Table 4.22 provides a status report on the submission of financial statements. With the exception of Free State and Northern Cape, all provincial health departments met the deadline.

Table 4.22: Submission of financial statements by 31 May 2001

Provinces	Vote number	Submitted Yes / No	Department submitted after deadline but before 14 June 2001
Eastern Cape	3	Yes	N/A
Free State	5	No	Yes
Gauteng	4	Yes	N/A
KwaZulu-Natal	7	Yes	N/A
Mpumalanga	11	Yes	N/A
Northern Cape	10	No	Yes
Northern Province	7	Yes	N/A
North West	3	Yes	N/A
Western Cape	6	Yes	N/A

Challenges

Large personnel numbers and decentralised delivery in hospitals and clinics require sound personnel and general management. From a financial perspective, priorities are to effectively manage leave and absentee records, improve billing systems to enhance revenue collection, and strengthen stock control of medicine and pharmaceutical products in hospitals.

Conclusion

Public health funding has increased since 1994 and is projected to grow in real terms over the MTEF. However, the fiscal correction in 1998/99 and high wage costs necessitated rapid restructuring in the hospital sector. The result was a reduction of health workers and hospital beds since 1997/98.

Despite evidence of improved quality of primary health care services, many problems and inequities remain. Early budget estimates show the overall allocation to primary care (district hospital services) is set to decline in real terms over the next three years. Further investigation and monitoring is needed to ensure funds are aligned to policy priorities. HIV/Aids means that even real growth in health budgets will not be adequate to deal with the increase in demand for services and the impact of the disease on resources in the health sector.

Armed with the results of a Department of Health's review of large sectoral conditional grants, grant reconfiguration is currently under consideration. To enhance hospital efficiency and quality, issues in the sector include finalising an Integrated National Planning Framework; revenue retention, governance reform and management decentralisation in hospitals, and an appropriate staff mix, human resource and training strategies.

5

Social development

The social development or welfare departments in provinces are responsible for social security programmes and welfare services. Social grants have been the most important and direct instrument for Government's poverty alleviation efforts since 1994 and are considerably larger than those for welfare. The social grant programme in South Africa is exceptional compared to other middle-income or poor countries.

This chapter reviews trends in the financing of social grants and welfare services, compares expenditure between provinces and reviews the current access to grants. Issues related to the grant system and welfare services are highlighted.

Provincial social development expenditure trends

Real growth in 2000/01

As shown in Table 5.1, 2000/01 provincial social development expenditure grew in real terms by just over one percent to R20,9 billion from R19,4 billion the previous year. There were real expenditure declines in 1998/99 and 1999/2000 of 2,2 and 0,9 percent respectively. Over the three-year period to 2000/01 real expenditure declined by an average annual rate of 0,5 percent.

Table 5.1: Provincial social development expenditure

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Personnel	556	719	832	921	1 010	1 070	1 127
Transfer payments	16 383	17 015	17 700	18 948	20 498	22 084	23 856
Other	615	707	842	1 060	1 332	1 465	1 548
Total	**17 554**	**18 441**	**19 373**	**20 929**	**22 840**	**24 620**	**26 530**
% change (average annual)		**1997/98 – 2000/01**				**2000/01 – 2003/04**	
Personnel		18,3%				7,0%	
Transfer payments		5,0%				8,0%	
Other		19,9%				13,4%	
Total		**6,0%**				**8,2%**	

Source: Provincial budgets

Growth in personnel and other expenditure

Transfer payments expenditure declined in real terms over the last three years while personnel and other expenditure grew rapidly. Actual expenditure on grant transfers (excluding transfers to welfare organisations) declined by nearly 1,5 percent per annum in real terms. Personnel expenditure grew by an average annual 11,0 percent in real terms, and "other" expenditure by 12,5 percent. Given the nature of welfare services, capital expenditure has been limited.

Grants comprise 90,5 percent of spending

Transfer payments shown in Table 5.2 consist mainly of social security grants to individuals, supplementing the income of poor households. These comprise 90,5 percent of total departmental expenditure in 2000/01. Other transfers include subsidies and other payments to NGOs for services like probation and adoption, family counselling and homes for children and aged people.

Table 5.2: Social development expenditure by economic classification

	Actual			Estimated actual	Medium term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Current expenditure	17 519	18 388	19 319	20 886	22 674	24 440	26 353
Transfer payments	16 383	17 015	17 700	18 948	20 498	22 084	23 856
Of which social security	*15 521*	*16 167*	*16 772*	*18 143*	*19 613*	*21 212*	*22 900*
Other current	1 136	1 373	1 619	1 938	2 176	2 355	2 497
Capital	35	52	54	43	166	180	177
Total	**17 554**	**18 441**	**19 373**	**20 929**	**22 840**	**24 620**	**26 530**
Percentage share							
Current expenditure							
Transfer payments	93,3%	92,3%	91,4%	90,5%	89,7%	89,7%	89,9%
Of which social security	*88,4%*	*87,7%*	*86,6%*	*86,7%*	*85,9%*	*86,2%*	*86,3%*
Other current	6,5%	7,4%	8,4%	9,3%	9,5%	9,6%	9,4%
Capital	0,2%	0,3%	0,3%	0,2%	0,7%	0,7%	0,7%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

Trends by province

Tables 5.3 and 5.4 show that social development expenditure grew by 0,7 percent over the three years up to 2000/01. Adjusted for inflation, expenditure declined marginally by 0,5 percent. Government is committed to protect the real value of grants – hence increases in line with inflation provided for in baselines.

Table 5.3: Social development expenditure by province

	Actual			Estimated actual	Medium -term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	3 759	3 634	3 856	4 070	4 627	4 574	4 919
Free State	1 125	1 158	1 162	1 261	1 364	1 472	1 575
Gauteng	2 214	2 295	2 425	2 656	2 880	3 055	3 238
KwaZulu-Natal	3 739	3 984	4 051	4 335	4 584	5 198	5 744
Mpumalanga	981	1 087	1 156	1 321	1 571	1 803	1 861
Northern Cape	650	669	696	659	674	708	740
Northern Province	1 803	2 031	2 329	2 642	2 754	3 004	3 347
North West	1 071	1 371	1 491	1 779	2 039	2 292	2 416
Western Cape	2 212	2 211	2 208	2 208	2 348	2 513	2 691
Total	**17 554**	**18 441**	**19 373**	**20 929**	**22 840**	**24 620**	**26 530**

Source: Provincial budgets

Increase in inter-provincial equity

Welfare expenditure shows greater inter-provincial equity. In poor provinces, where access to the former state maintenance and other grants was low, social development spending has grown. In the three years to 2000/01, real average annual growth reached 11,1 percent in North West, 6,6 percent in Northern Province and 3,6 percent in Mpumalanga. All other provinces saw real expenditure declines. Social development constituted 19 percent of the total budgets in 2000/01, but varied from 25,1 percent in Northern Cape to 14,6 percent in Gauteng.

Table 5.4: Social development as percentage of total provincial expenditure

Percentage of total expenditure	Actual			Estimated actual	Medium term estimate		
	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Eastern Cape	23,3%	23,5%	23,7%	22,5%	23,7%	21,9%	22,2%
Free State	16,4%	16,5%	17,5%	17,1%	16,6%	16,8%	16,9%
Gauteng	14,2%	14,1%	14,4%	14,6%	14,3%	14,0%	13,8%
KwaZulu-Natal	19,4%	21,5%	21,1%	20,0%	19,2%	20,0%	20,5%
Mpumalanga	16,3%	17,9%	17,7%	18,8%	19,4%	20,3%	19,4%
Northern Cape	27,5%	28,0%	27,9%	25,1%	23,5%	22,9%	22,4%
Northern Province	15,7%	16,9%	18,3%	18,3%	17,9%	17,8%	18,4%
North West	13,9%	17,7%	18,2%	19,4%	20,7%	21,7%	21,5%
Western Cape	20,9%	21,0%	20,5%	19,2%	18,9%	19,1%	19,5%
Average	**18,3%**	**19,2%**	**19,5%**	**19,0%**	**19,0%**	**18,9%**	**19,1%**

Preliminary actual outcome for 2000/01

Table 5.5 shows 2000/01 provincial social development budgets amounting to R20 billion, adjusted to R21,2 billion late in the financial year. Estimated actual social development spending for 2000/01 is R21 billion – an increase of R1,6 billion over 1999/2000. Eastern Cape and KwaZulu-Natal's adjusted estimates are over R4 billion each, while that of Northern Cape, with its relatively low population density, is R642 million.

Table 5.5: Actual outcome for 2000/01 in social development

R million	2000/01 Budget	2000/01 Adjustments Estimate	2000/01 Estimated actual outcome	Estimate actual outcome as % of adjusted budget
Eastern Cape	3 951	4 033	4 070	100,9%
Free State	1 260	1 287	1 261	98,0%
Gauteng	2 630	2 880	2 656	92,2%
KwaZulu-Natal	4 060	4 358	4 335	99,5%
Mpumalanga	1 213	1 338	1 321	98,7%
Northern Cape	634	642	659	102,6%
Northern Province	2 548	2 571	2 642	102,8%
North West	1 521	1 793	1 779	99,2%
Western Cape	2 266	2 285	2 208	96,6%
Total	**20 083**	**21 187**	**20 929**	**98,8%**

Medium term projections

Growth over the MTEF

Social development expenditure is set to grow over the MTEF by an average annual 2,6 percent in real terms. This growth is driven largely by higher transfer payments and personnel expenditure, and increased take up of the child support grant. In fact, most growth will occur where grant access has been restricted and where there is a high proportion of poor children, namely KwaZulu-Natal, Mpumalanga, Northern Province and North West.

Doubling of grant beneficiaries between 1998 and 2003 will put pressure on social development budgets, especially in poorer provinces. Only in Northern Cape is there real decline, due to stricter controls over access to disability grants and phasing out of state maintenance grants.

Gaps in per poor person welfare expenditure

While there has been a narrowing in the social development expenditure gap between provinces, the gaps remain large. As table 5.6 shows, in 2000/01 Western Cape spent R2 790 per poor person on social development compared to R855 in Free State. This does not necessarily indicate that grants are not accurately targeted. It may be because many of the poor do not qualify for grants within the safety net, which caters mainly for specific categories of the poor such as older and disabled people. These gaps are even larger in the case of other social development services, excluding social grant transfers and administration. Western Cape spends nearly twelve times more per poor person than Northern Province and Free State. Given current trends, progress towards greater inter-provincial equity will be slow, but phasing in the child support grant will support greater equity.

Table 5.6: Social development expenditure per poor person[1]

Province	Total social development expenditure	Grant Programme	Other welfare services
Rand per poor person			
Eastern Cape	1 094	1 036	58
Free State	855	740	115
Gauteng	2 409	1 972	437
KwaZulu-Natal	1 610	1 513	97
Mpumalanga	1 210	1 137	73
Northern Cape	1 668	1 492	176
Northern Province	1 094	1 053	41
North West	1 082	1 030	52
Western Cape	2 790	2 287	503
National Average	**1 365**	**1 244**	**121**

[1] A poor person is defined in terms of the poorest 40 percent of the population

Social security grants

Since 1994, beneficiaries increased as government prioritised equity, ended racial discrimination in grant distribution and introduced new programmes. Table 5.7 shows high proportions of welfare budgets spent on social security: 82 percent in Western Cape and Gauteng and over 90 percent in Eastern Cape, KwaZulu-Natal and Northern Province. The informally agreed benchmark is 80 percent.

Table 5.7: Social grants as percentage of total social development expenditure

	Actual			Estimated actual	Medium term estimate		
	1997/98	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	94,0%	93,8%	94,2%	94,0%	93,4%	92,8%	93,3%
Free State	89,4%	88,2%	87,0%	86,6%	88,2%	88,9%	89,3%
Gauteng	83,8%	82,0%	81,5%	81,9%	80,1%	80,1%	80,1%
KwaZulu-Natal	93,6%	93,8%	94,1%	94,0%	92,7%	93,1%	93,4%
Mpumalanga	92,6%	94,0%	93,4%	94,2%	92,2%	92,8%	93,2%
Northern Cape	89,1%	89,5%	90,2%	89,4%	86,5%	86,2%	85,8%
Northern Province	97,3%	96,8%	95,8%	96,3%	94,6%	94,8%	95,0%
North West	93,0%	90,1%	88,6%	95,2%	88,2%	89,2%	89,3%
Western Cape	85,8%	80,8%	79,2%	82,0%	81,8%	82,6%	83,1%
Total	**91,3%**	**90,3%**	**90,0%**	**91,0%**	**89,5%**	**89,7%**	**90,1%**

Rapid growth in number of beneficiaries

Table 5.8 indicates grant beneficiaries increasing to 3,9 million in July 2001. The child support grant is a major factor, with beneficiaries increasing from nearly 28 000 about two years ago to over 1,1 million in July 2001. Approximately 65 000 children gain new access to the child support grant every month.

Table 5.8: Trends in beneficiary numbers

Grant Type	April 1997	March 1998	March 1999	March 2000	July 2001	Average annual growth rate over period
Old Age	1 737 682	1 702 647	1 806 493	1 859 197	1 893 077	2,2%
War Veterans	12 047	10 441	9 292	7 676	5 957	-16,1%
Disability	732 322	660 198	631 372	611 325	633 777	-3,5%
Grant in Aid	10 082	9 113	8 574	8 687	9 830	-0,6%
Parent Allowance	152 973	173 662	161 204	142 720	285	-79,2%
Child Allowance	209 658	230 633	214 463	191 613	150 263	-8,0%
Foster Care	41 865	43 906	70 650	79 437	93 357	22,2%
Care Dependency	2 895	10 126	15 234	24 073	30 628	80,4%
Child Support Grant	–	–	27 577	321 906	1 125 277	–
Total	**2 899 524**	**2 840 726**	**2 944 859**	**3 246 634**	**3 942 451**	**8,0%**
Province						
Eastern Cape	630 514	583 705	589 010	661 432	791 211	5,8%
Free State	174 727	181 994	174 562	176 879	228 644	7,0%
Gauteng	335 721	323 947	324 758	374 785	455 090	7,9%
KwaZulu-Natal	594 916	617 568	633 627	677 898	875 021	10,1%
Mpumalanga	157 091	164 656	158 780	199 342	272 096	14,7%
Northern Cape	110 301	113 592	124 080	121 186	110 443	0,0%
Northern Province	339 555	276 465	343 875	406 858	525 306	11,5%
North West	189 980	194 579	207 211	243 931	318 432	13,8%
Western Cape	366 719	384 220	388 956	384 324	366 208	0,0%
Total	**2 899 524**	**2 840 726**	**2 944 859**	**3 246 634**	**3 942 451**	**8,0%**

Source: Socpen system

The foster care, old age and special care dependency grants also show growth in beneficiaries (see tables 5.8 to 5.10). Growth rates for the foster care and special care grants have been rapid. Although the disability grant shows a decline over the period as a whole, it is now increasing after declines in 1998 and 1999, which were related to re-registration and the clean up of welfare rolls.

Table 5.9: Number of child support grant beneficiaries

	March 1999	March 2000	July 2001
Eastern Cape	5 670	55 717	167 627
Free State	1 675	13 753	64 328
Gauteng	1 872	47 910	137 326
KwaZulu-Natal	7 853	66 836	296 317
Mpumalanga	630	28 327	95 486
Northern Cape	2 255	12 805	21 732
Northern Province	2 384	53 815	166 640
North West	1 662	31 792	106 984
Western Cape	3 576	10 951	68 837
Total	**27 577**	**321 906**	**1 125 277**

Source: Socpen system

Allocations to old age grants – reflected in table 5.10 – grow more moderately, given already high coverage. Disability grants still constitutes a big proportion, but declined from R732 322 in April 1997 to R611 325 in March 2000. Significantly, the largest number of beneficiaries -20 635- was in the Western Cape, which has the most developed system and social workers.

Table 5.10: Number of old age beneficiaries

	April 1997	March 1998	March 1999	March 2000	July 2001	Average annual growth rate
Eastern Cape	370 123	348 923	361 760	383 172	393 185	1,0%
Free State	110 153	109 264	109 152	110 706	113 832	0,0%
Gauteng	218 118	220 298	226 016	227 799	225 603	1,0%
KwaZulu-Natal	361 981	362 706	390 002	389 171	389 079	2,0%
Mpumalanga	116 878	121 448	120 282	128 656	132 354	2,0%
Northern Cape	35 447	36 594	40 392	41 370	42 049	4,0%
Northern Province	265 957	231 333	272 704	278 954	285 222	1,0%
North West	130 835	135 063	143 611	154 149	153 942	4,0%
Western Cape	128 190	132 096	142 574	145 220	146 922	3,0%
Total	**1 737 682**	**1 697 725**	**1 806 493**	**1 859 197**	**1 893 077**	**2,2%**

Source: Socpen system

Grant increases now equal inflation

Given the financial problems previously experienced in provinces, the real value of grants declined over the last five years. This trend is now being reversed, and the R30 increase (for large grants) implemented on 1 July 2001 is equal to the CPI inflation anticipated for 2001/02.

The value of the child support grant was also increased by R10 from R100 to R110, the first adjustment since its inception in 1999. As a result, there is substantial pressure to ensure real increases or at least stable real values of grants in the future.

Table 5.11: Value of social grants, by grant type

	Rand value of grants, per month, with effect from …											
Type of Grant	**01/91**	**04/92**	**07/93**	**10/94**	**07/95**	**07/96**	**07/97**	**07/98**	**10/98**	**07/99**	**07/00**	**07/01**
Old age grant	314	345	370	390	410	420	470	490	500	520	540	570
War Veterans grant	330	363	388	408	428	448	488	508	518	538	558	588
Disability grant	314	345	370	390	410	430	470	490	500	520	540	570
Maintenance:												
Parent	*314*	*345*	*370*	*390*	*410*	*430*	*430*	*323*	*323*	*225*	*107,5*	–
Child	*97*	*107*	*115*	*121*	*127*	*135*	*135*	*101*	*101*	*67*	*33,5*	–
Care Dependency	314	345	370	390	410	430	470	490	500	520	540	570
Foster Care	222	244	260	274	288	305	340	350	360	374	390	410
Grant-in-aid	50	55	60	63	66	70	80	90	90	94	100	110
Child Support Grant	–	–	–	–	–	–	–	100	100	100	100	110

1991 and 1992 are grants to white pensioners. Parity in social grants was implemented from 1 September 1993

The current system of grants does not reach all categories of the poor. The Minister of Social Development has therefore appointed a Committee to investigate a Comprehensive Social Security System. A key issue for the committee is to define options for extending the social safety net amid affordability constraints. Alternatives are a basic income grant or extension of the child support grant to older children. Both alternatives require substantial financial resources.

Welfare services are the second major programme of social development departments in provinces. Given the dominance of budgets by social grants (refer to table 5.7 above) at around 91 percent, the objective is to increase the welfare share of social development budgets to 20 percent. Only Gauteng and Western Cape – at 18 percent – appear to have made significant progress.

Progress has been slow in introducing a new funding approach for welfare services. The intention is to move to a more developmental and community based approach, and some welfare services are also expected to receive contributions form the national lottery fund. Provincial information on current services is not readily available or comparable, but table 5.12 below indicates the uneven spread of facilities between provinces.

Table 5.12: Social development facilities in provinces – 2000/01[1]

	Treatment Centres	**Children's Homes**	**Creches (Not sub-sidised)**	**Places of Safety**	**Homes for Disabled**	**Protective Workshops**	**Homes for the Aged**	**Service Centres**
Eastern Cape	–	–	–	–	–	–	–	–
Free State	1	5	691	–	4	9	43	12
Gauteng	9	52	152	7	34	56	102	88
KwaZulu-Natal	2	1	–	9	2	–	1	0
Mpumalanga	–	–	–	–	–	–	–	–
Northern Cape	6	23	2	3	5	32	12	12
Northern Province	–	6	172	1	1	10	9	8
North West	1	3	120	1	1	2	27	10
Western Cape	4	43	–	–	35	41	139	169

[1] *No data were received from Eastern Cape and Mpumalanga*

HIV/Aids and social security

HIV/Aids and orphans

HIV/Aids will impact dramatically on poverty and household vulnerability in South Africa, especially the need to care for orphans below 15 who lost mothers due to Aids. Current estimates are that the number of Aids orphans will increase from about 150 000 in 2000 to more than 2 million in 2010.

Institutional care and income support

Institutional care for these children will be expensive and alternative care mechanisms will have to be established. While home- and community-based care are being piloted, significant state support will be required to ensure the burden does not fall disproportionately on the poor. The current child support grant provides a means for the state to support certain poor children, including those affected by HIV/Aids. However, the current age limits as well as the grant amounts limit its role in supporting orphans and other means of support would have to be developed.

Foster care grant

The number of beneficiaries from the foster care grant grew from R48 865 in April 1997 to R79 437 in March 2000 due to increasing numbers of Aids orphans and phasing out of the state maintenance grant. The amount is substantially higher than the child support grant (R410 against R110). Administrative processes required for such grants may however limit rapid expansion of this grant. Significantly, spending – at R20 635 in 2000 – is highest in Western Cape, which has the most developed system and most social workers.

Conditional grants in social development

Grants focused on improved management

As Table 5.13 shows, conditional grants have limited importance in the social development sector. These grants initially focused on improving financial management and administration.

Table 5.13: Transfers and spending of conditional grants

R million	Actual	Actual Transfers and Expenditure		Estimated Actual		Medium-term estimate		
	1998/99	1999/00		2000/01		2001/02	2002/03	2003/04
Grants		Transfers	Spending	Transfers	Spending			
Child Support	4	17	11	17	13	–	–	–
Criminal Justice System	–	13	6	–	1	–	–	–
Financial management	6	37	31	28	14	10	11	–
HIV/Aids	–	–	–	5	2	13	–	–
Victim empowerment	–	4	2	–	–	–	–	–
Women flagship	2	1	1	2	2	–	–	–
Total	12	72	50	52	32	23	11	–
Under-spending	–	–	21	–	42[1]	–	–	–
Roll overs	–	4	–	22	–	–	–	–

[1]Underspending includes R22 million provided for roll overs at provincial level

Slow progress in utilising these funds saw a reduction in the allocation in the years shortly after 1994. Funds assisted in procurement of additional financial management capacity for provinces, the re-registration of grant beneficiaries and purchasing equipment.

HIV/Aids and poverty relief

A small conditional grant supported the phasing in of the child support grant. The Department of Social Development channels a portion of the special allocation for the integrated HIV/Aids plan to provinces to support the development of models of home- and community-based care.

Social development departments also received allocations from the central allocation for poverty relief. This supported a range of income-generating activities to fight poverty directly and strengthen the focus on developmental social welfare. The outcome of these projects is not assessed in this *Review*.

Personnel trends

Unlike the other social sectors, personnel makes up a small component of social development budgets.

Table 5.14 shows personnel spending to have grown at an annual average rate of 18,3 percent, from R556 million in 1997/98 to R921 million in 2000/01.

Table 5.14: Personnel expenditure by province

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	88	107	124	140	147	157	164
Free State	68	83	94	102	101	105	109
Gauteng	107	125	134	152	162	172	182
KwaZulu-Natal	122	138	149	166	180	192	203
Mpumalanga	21	27	36	39	40	42	45
Northern Cape	30	35	37	44	51	54	57
Northern Province	13	32	62	67	71	74	80
North West	20	74	84	95	113	120	126
Western Cape	86	99	113	115	145	154	161
Total	**556**	**719**	**832**	**921**	**1 010**	**1 070**	**1 127**

The strong upward trend in personnel expenditure applied to all provinces, and may point towards some strengthening of capacity to deliver. Growth in "other" expenditure may be related to the costs of outsourced payment systems. Tellingly, "other" social development expenditure did not increase dramatically in the Eastern Cape where the payment system has not been outsourced to date, although this is in progress. However, it is difficult to compare costs between provinces that outsourced and those that did not, as there may be other efficiency variants over and above outsourcing. Many of these costs are often non-financial.

Management and delivery issues

The management of the processing, approval, payment and reconciliation of social grants is critical to the successful delivery of social grant programmes. A number of other aspects of social development grant delivery have received attention in recent years, and some are reflected in table 5.15:

?? Most provinces have outsourced the payment of social grants to private firms. All Pay and Cash Payment Systems are responsible for three and four provinces respectively. Only Eastern Cape now pays most social grants with cheques. The costs per grant between provinces also differ between provinces.

?? Unsatisfactory conditions at many old age pension paypoints means grant beneficiaries are often exposed to the elements and to fraud and discomfort when queuing for pensions. Queues are often long and start early in the day, and the safety of pensioners is not fully guaranteed. Partly as a result of these observations, the national Department of Social Development is auditing its infrastructure to inform capital planning. While spending on social development infrastructure may prove necessary, resource constraints may make sharing of government infrastructure between different spheres and departments a feasible option for the short-term. Sharing with NGOs may also prove useful.

Table 5.15: Pay-points, cost per grant and relevant contractor

Province	Number of Pay-points	Costs to administer a grant per beneficiary (Rands)				Contractor operating in province
		Others		Bank		
		3rd party contractor	Post office	1 day service	5 day service	
Eastern Cape	2 075	0,00	11,39	0,72	1,82	Cheques
Free State	553	18,62	N/A	0,75	1,82	All Pay
Gauteng	315	23,06	N/A	1,60	1,82	All Pay
KwaZulu-Natal	2 172	18,15	N/A	0,75	1,82	CPS
Mpumalanga	301	21,50	11,39	0,72	1,82	Empilweni
Northern Cape	214	21,04	N/A	0,75	1,82	CPS
Northern Province	1 903	14,96	11,39	0,64	1,82	CPS
North West	807	22,75	11,39	0,75	1,82	CPS
Western Cape	283	13,99	N/A	1,43	1,82	All Pay
Total	**8 723**	**–**	**–**	**–**	**–**	**–**
Average	–	19,00	–	0,90	–	–

Source: National Department of Social Development.

Cost and number of court cases unclear

?? Administrative actions by provincial social development departments to suspend beneficiaries or discontinue grants have resulted in court actions. Poorer provinces seem to be affected relatively more often. This points to a need to strengthen administrative processes and to enforce means-testing, particularly with regard to disability grants, more rigorously. It has been difficult to gather reliable data on the cases and the financial implications for provinces.

No information on processing times

?? Although data is weak, evidence suggests there is unevenness between the provinces in backlogs, the number of applications lodged monthly, and the time taken to process social grant applications.

Progress with implementation of the PFMA

Improving management and reporting

Appointment of CFO's

Social development is confronted with a range of financial management and processing issues. The development of proper systems, and the need for internal control and effective fraud-prevention plans are important priorities.

Provincial departments continually assess the need to eliminate payment to illegitimate ("ghost") beneficiaries, including the need for frequent comparisons of databases to prevent unauthorised payments. They also need to develop their capacity to process grant applications speedily, and to apply the means test more uniformly. The practise of classifying unpaid monthly grants as new revenue must also be addressed. Given the importance of transfers to welfare organisations or institutions, great oversight is required over the monitoring of such transfers, and an assessment of whether such transfers achieve their objectives.

Setting up structures to implement the PFMA should help social development departments improve financial management capacity. Table 5.16 shows the CFOs appointed in provincial welfare/social development departments and the levels at which appointments were made. A Social Development CFO forum now facilitates capacity building, peer-learning, inter-provincial comparison and best practice, monthly budget reports, risk management, fraud prevention, audit charters and pro-active identification and resolution of problems. Eight social development departments now have internal audit units.

Table 5.16: CFOs in welfare/social development departments

Province	Appointment of CFO	Nature of appointment	Level of appointment
Eastern Cape	Yes	F	CD
Free State	Yes	F	CD
Gauteng	Yes	F	CD
KwaZulu-Natal	Yes	F	CD
Mpumalanga	Yes	F	CD
Northern Cape	Yes	F	D
Northern Province	Yes	C	DDG
North West	Yes	F	CD
Western Cape	Yes	P	CD
Total	**9/9**	**1 P + 1 C + 7 F**	
		Permanent Appointment = P ***Contract Appointment = C*** ***Acting CFO = A*** ***Firm of Consultants = F***	***Director = D*** ***Chief Director = CD*** ***Deputy DG = DDG*** ***Combination = C***

Financial management improving

Table 5.17 provides a status report on submission of financial statements to the Auditor General. The aim is submissions within two months in contrast to current practices of up to eighteen months.

Table 5.17: Submission of financial statements by 31 May 2001

Provinces	Vote number	Submitted Yes / No	Submitted after deadline but before 14 June 2001
Eastern Cape	4	Yes	N/A
Free State	7	Yes	N/A
Gauteng	6	Yes	N/A
KwaZulu-Natal	13	Yes	N/A
Mpumalanga	10	Yes	N/A
Northern Cape	11	No	Yes
Northern Province	12	Yes	N/A
North West	12	Yes	N/A
Western Cape	7	Yes	N/A

Conclusion

Significant real growth expected in future

Social development expenditure, particularly spending on social grants, will continue growing in real terms in the foreseeable future, especially as child support and higher grant enhancement are phased in. In addition, welfare grants and services will play an important role in countering the impact of HIV/Aids on household vulnerability.

6

Housing, roads and transport

Key post-apartheid challenges

Housing, roads and transport are key post-apartheid challenges. The challenge relates not only to backlogs, but also to the spatial environment and the quality of community life. Alongside national and local government, provinces play a role particularly in providing housing and roads.

This chapter provides overviews of budgetary and non-budgetary issues relating to housing, roads and transport. It focuses on expenditure on these two sectors, sources of revenue, service delivery indicators as well as strategies and ways to improve service delivery. It also examines departmental issues, like progress made with implementation of the PFMA in the housing arena.

In both sectors, it is difficult to fully isolate the information. Housing data are typically dispersed across provinces and municipalities and integrated with local government information. Because many of the provinces combine their transport budget with other departmental budgets like public works and economic affairs, it is difficult to isolate all the transport-related activities in a province.

Housing

Over 1,1 million houses

Since 1994, Government has contributed to over 1,1 million low-cost houses. It continues to explore innovative alternatives to speed up delivery and to contribute to the development of sustainable settlements.

The focus in this section is on the housing subsidy grant, the human settlement grant and rental housing. Housing is part of broader integrated development and must also be seen in relation to other infrastructure programmes. The sector faces notable institutional challenges of delivery and accountability. These include the Consolidated Municipal Infrastructure Programme (CMIP) and social and economic infrastructure that contribute to the development of sustainable settlements.

The housing subsidy grant

Total provincial housing expenditures difficult to track as most provinces have combined their housing function with either land administration or local government and traditional affairs. This *Review* focuses primarily on the housing subsidy grant as the primary vehicle funding provincial expenditure on housing.

Housing subsidy

Since 1994, Government has transferred over R16 billion of the housing subsidy grant through provinces; some R11 billion of which was spent since 1997/98. The 2000 Budget provided for R3 billion worth of subsidies. Table 6.1 outlines provincial spending on housing development between 1997/98 and 2003/04. Total provincial spending decreased at an annual average nominal rate of 0,3 percent between 1997/98 and 2000/01. Real spending decreased at an annual average rate of 6 percent over the same period.

Table 6.1: SA Housing Fund – expenditure and forward estimates

Province	Actual				Medium-term estimates		
(R million)	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Eastern Cape	245	378	341	470	498	531	550
Free State	123	184	88	218	241	257	266
Gauteng	737	639	737	610	682	727	752
KwaZulu-Natal	800	628	471	560	618	659	681
Mpumalanga	157	100	118	153	208	222	230
Northern Cape	71	55	56	58	65	70	72
Northern Province	173	231	228	272	335	357	369
North West	249	170	181	262	257	274	283
Western Cape	366	364	351	341	322	343	355
Total	**2 920**	**2 749**	**2 571**	**2 945**	**3 226**	**3 440**	**3 559**

Source: National Department of Housing

Recovery in spending expected

Housing expenditures are expected to show an average real recovery of 1 percent for the period 2000/01 to 2003/04. Nominal spending should increase by 9,5 percent from R2 945 million in 2000/01 to R3 226 million in 2001/02 and at an annual average rate of 6,5 percent to R3 559 million in 2003/04.

Table 6.2 shows actual provincial expenditure outcomes for 2000/01. The total budget was adjusted by R467 million to R3 465 million, mainly because of rollovers. Actual spending on housing subsidies for 2000/01 amounted to R2 945 million, increasing by R374 million or 14,5 percent compared to 1999/2000, but R519 million or 15 percent lower than the 2000 adjusted budget. Only Northern Cape, Northern Province and Western Cape spent their entire adjusted budgets.

Table 6.2: Actual expenditure outcome for 2000/01 for SA Housing Fund

R million	2000/01 Budget	2000/01 Adjustments estimate	2000/01 Estimated actual outcome	Actual outcome as % of adjusted budget
Eastern Cape	422	500	470	94.2%
Free State	218	362	218	60.3%
Gauteng	719	719	610	84.9%
KwaZulu-Natal	588	696	560	80.4%
Mpumalanga	173	251	153	60.8%
Northern Cape	58	58	58	100.0%
Northern Province	257	257	272	105.7%
North West	221	280	262	93.6%
Western Cape	341	341	341	100.0%
Total	**2 998**	**3 465**	**2 945**	**85.0%**

Table 6.3 shows rollovers decreased between 1995/96 and 2000/01, from R2 227 million or 71 percent of provinces' housing funds in 1995/96 to R519 million or 15 percent. Of the 2000/01 rollover,

R240 million relates to subsidies earmarked for the Job Summit Rental Programme in Gauteng, KwaZulu-Natal and Mpumalanga.

The continued rollovers can be attributed to a number of factors. There was little incentive for developers to complete projects on time, particularly during the last phase of construction. Also, weak capacity and poor planning within departments slowed down spending and the 2000 local government elections and restructuring towards newly demarcated municipalities slowed down housing development. Finally, unfavourable weather patterns interfered with construction.

Table 6.3: Rollovers on SA Housing Fund

Rollovers R'million	1995/96		2000/01	
	Actual Rollover	% of Allocation	Actual Rollover	% of Allocation
Eastern Cape	451	*88%*	29	*6%*
Free State	137	*73%*	144	*40%*
Gauteng	375	*52%*	109*	*15%*
KwaZulu-Natal	464	*77%*	136*	*20%*
Mpumalanga	124	*61%*	98*	*39%*
Northern Cape	32	*40%*	0	*0%*
Northern Province	330	*95%*	-15	*-6%*
North West	215	*88%*	18	*6%*
Western Cape	100	*39%*	0	*0%*
Total	**2 227**	***71%***	**519**	***15%***

**Includes R80 million for Job Summit Rental Housing Programme.*

Subsidies approved

The subsidy level is currently R16 000

Table 6.4 shows over 1,3 million housing subsidies were approved between 1994 and March 2001.

Table 6.4: Subsidies approved, by province

Province	1994–98	1998/99	1999/00	2000/01	Total
Eastern Cape	77 483	20 088	25 332	7 536	130 439
Free State	35 897	26 209	11 056	25 772	98 934
Gauteng	209 568	92 732	54 045	42 288	398 633
KwaZulu-Natal	158 927	25 371	8 083	26 186	218 567
Mpumalanga	27 648	16 664	8 787	19 366	72 465
Northern Cape	16 498	4 506	3 870	14 138	39 012
Northern Province	62 498	14 557	21 823	16 132	115 010
North West	36 825	39 206	16 823	32 700	125 554
Western Cape	67 144	35 849	28 528	22 592	154 113
Total	**692 488**	**275 182**	**178 347**	**206 710**	**1 352 727**

Source: National Department of Housing

The housing subsidy programme is used mainly to fund the acquisition and servicing of stands and to erect top structures. It facilitates access to tenure, provision of services and building of housing units. Introduced in 1994 with a maximum of R12 500, the current subsidy level is R16 000.

The box below explains the mechanisms and purpose of the Housing Subsidy Scheme.

The Housing Subsidy Scheme

The Housing Subsidy Scheme is the primary housing assistance vehicle. In 1994, it replaced all previous government subsidy programmes, other than where commitments under previous schemes were already made. Beneficiaries with a household income of not more than R3 500 per month, who have not owned fixed residential property previously, and who satisfy a range of other criteria, can apply for the subsidy. It is intended to help households access housing with secure tenure, at a cost that they can afford, and of a standard that satisfies the minimum health and safety requirements. Spending is typically on a serviced site, and to a limited extent on top structures. A beneficiary may only receive the subsidy once, except where the scheme allows for deviations from this provision.

Its subsidy mechanisms are:

- ***Project linked subsidies*** are offered on a stepped scale, linked to household income, and assist beneficiaries to acquire ownership of fixed residential properties for the first time on a project basis.
- ***Individual subsidies*** are also offered on a stepped scale, linked to household income. It assists beneficiaries to acquire ownership of fixed residential properties for the first time, and to buy existing homes or homes under construction.
- ***The consolidation subsidy*** provides a "top-up" amount to owners of serviced sites to provide or upgrade a top structure on such a site.
- ***The institutional subsidy*** provides subsidised accommodation through institutions for people who qualify for subsidies, on the basis of secure tenure such as rental, instalment sale, shareblock, or other tenure to households.
- ***Relocation assistance*** is offered to defaulting borrowers of mortgage loans, who were three months in arrears with their instalments on 31 May 1995 or 31 August 1997 (depending on the agreement entered into by government and the financial institution concerned), and whose loans cannot be rehabilitated. It helps them to rightsize to affordable housing. This forms an integral part of government's strategy to stabilise the housing environment.
- ***Rural subsidies*** enable households who have undisputed informal land rights in terms of the Interim Protection of Informal Land Rights Act, 1996 to access the housing subsidy to provide for their housing needs.
- ***The People's Housing Process*** provides support to people who want to build their homes themselves to access consolidated, project-linked, institutional and rural housing subsidies as well as other support measures.

Housing delivery

During the period 1994 to 2000, Government contributed towards providing over 1,1 million houses, benefiting approximately 4,9 million people (at an average of 4,1 people per household). Table 6.5 outlines, by province, the number of houses completed or under construction.

Pace of housing delivery slowing

Year specific figures for the initial period indicate that delivery peaked in 1997/98 with 322 638 houses. The high number of houses in 1997/98 may reflect carry through of projects from the previous two years, after the initiation of the new housing policy. Delivery thereafter appears to be correlated to the number of subsidies approved in the previous financial year. Thus the 170 883 houses built in 2000/01 is a result of the lower number (178 347) of subsidies approved in 1999/2000. This is well below the required rate of low-income household formation (estimated at 200 000 households per year). Of the total houses built over the period, 29,8 percent were in

Gauteng, 17,7 percent in KwaZulu-Natal, and 12,7 percent in the Western Cape. The other six provinces collectively built 40 percent.

Table 6.5: Houses completed or under construction, by province

Province	1994–98	1998/99	1999/00	2000/01	2001/02	Total
Eastern Cape	48 734	29 659	10 459	9 922	4 391	**103 165**
Free State	37 043	20 391	8 177	26 088	1 102	**92 801**
Gauteng	149 076	28 726	144 575	25 911	8 492	**356 780**
KwaZulu-Natal	96 021	53 105	28 997	28 547	2 674	**209 344**
Mpumalanga	30 757	16 838	4 808	16 457	1 653	**70 513**
Northern Cape	14 635	6 621	1 558	7 623	239	**30 676**
Northern Province	26 851	22 899	12 401	20 996	3 980	**87 127**
North West	42 264	18 367	12 944	17 609	0	**91 184**
Western Cape	69 155	34 575	26 916	17 730	92	**148 468**
Total	**514 536**	**231 181**	**250 835**	**170 883**	**22 623**	**1 190 058**

Source: National Department of Housing

Bureaucratic problems also impacted negatively on the pace of delivery. In particular, municipalities delayed approving new housing developments on the grounds that provinces had to pay property rates on new housing projects. Delays on the transfer of land, and the lack of effective co-ordination with the CMIP programme further slowed down delivery. Late finalisation of allocations also contributed to slow pace of delivery.

Housing backlog

Reducing the backlog

Backlogs in housing are defined in terms of the level of overcrowding, the need for additional dwellings, the number of inadequate dwellings, and population growth or household formation. Traditional dwellings are not included in this definition. The more than 1,1 million houses built since 1994 reduced the backlog to an estimated 2,2 million.

Other indicators

The 1999 October Household Survey shows certain patterns in access to housing, water and electricity. These patterns partially reflect the impact of housing delivery on overall quality of life.

Increase in formal dwellings

The proportion of households living in formal dwellings showed a gradual increase from 65,8 percent in 1995 to 69,9 percent in 1999. However, the real number of households living in informal dwellings has also increased, as the pressure for shelter is experienced across all types of housing.

Greater access to clean water

The impact of housing must however be viewed in an integrated context, with reference to other infrastructure. Significantly then, there has been a gradual increase in the proportion of households that have access to clean water (piped water inside a dwelling or on site, communal tap or public tanker). In 1995, 78,5 percent of households had access to clean water, rising by 4,9 percentage points to

83,4 percent in 1999. At the same time there was a decrease in the proportion of households using water from boreholes and rainwater tanks, from 10 percent in 1995 to 4,7 percent in 1999. The proportion of households obtaining water from rivers, streams and dams remained constant at 11,8 percent over the same period.

Increased use of electricity

For the period 1995 to 1999, electricity consumption increased by 6,3 percentage points from 63,5 percent to 69,8 percent of energy use, and the consumption of paraffin and candles showed a gradual decrease.

Other Conditional Grants

Human settlement grant

Improving the urban environment

The human settlement grant aims to build urban communities. It identifies and addresses the nature and underlying reasons for urban dysfunctionality and provides funding to correct such dysfunctionality while gearing other sources. The grant supports coordination of development funding to ensure holistic development.

Public Sector Hostels Redevelopment Programme

The Public Sector Hostels Redevelopment Programme provides grant funding for the upgrading and/or conversion of hostels owned by public sector institutions. The aim is to create humane living conditions and to provide affordable and sustainable housing opportunities on either a rental or ownership basis. The funding limits of the Programme amount to R16 000 per family or unit, or R4 000 per individual living in a hostel owned by a municipality or provincial government. Hostels for municipal employees are excluded from the Programme. The policy allows for three forms of re-development:

?? rental for single persons or families

?? ow nership in line with the Housing Subsidy Scheme policy

?? alternative use, such as a school or community centre.

Funding limits may be increased by up to 15% at the discretion of the relevant Provincial Housing Development Board, to compensate for development costs where hostels are in a particularly poor structural condition or where there are geophysical difficulties.

For 2000/01, R35 million of the appropriated R39 million for the human settlement grant was spent. Spending is expected to increase to R100 million in 2001/02 and to R109 million in 2003/04.

Rental housing

There is a considerable need for rental housing among low-income groups. The existing subsidy mechanisms have thus far not provided for this. Developers have therefore found it difficult to provide rental housing within the limits of the subsidy amount.

Job Summit Pilot Project on rental housing

The Presidential Job Summit Pilot Project on Rental Housing was identified as a National Presidential Lead Project. This is mainly to meet the considerable unmet need for rental housing for the R1 200 and R3 500 income per month groups as the existing subsidy mechanisms do not provide for this. The programme aims to provide

45 000 units by 2003/04. Phase 1 comprises three projects in Gauteng (Newtown, Johannesburg), Mpumalanga (Tasbat and Duvha Park in Witbank) and KwaZulu-Natal (Durban) consisting of 5 000 units each.

Inherited rental stock

Significant stock was developed prior to 1994 with loan funding from the previous National Housing Commission and various own affairs statutory bodies under the Apartheid tricameral system. Former Peri-Urban boards and the Houses of Delegates, Representatives and Assembly managed this. The properties include vacant serviced sites, single houses per stand, flats, and properties disposed on deed of sale where persons are required to repay outstanding balances.

After 1994, the housing stock was transferred to provinces and municipalities, and managed by provincial housing boards and municipal housing departments. The national Department of Housing is responsible for drawing up a framework to phase out these subsidies through the discount benefit scheme.

The Discount Benefit Scheme

The discount benefit scheme applies to all state financed housing units already constructed or contracted for before 30 June 1993 and allocated to individuals prior to 15 March 1994. Under this scheme, tenants received a discount on the price of the property to enable them to buy it.Beneficiaries received a maximum discount of up to R7 500 on the price of the property. This discount could cover the full purchase price of the property and where there is an outstanding balance on the purchase price, the tenant will need to finance this with either savings or a mortgage loan. The scheme does not cover the service charge arrears, which are paid by the Provincial Housing Development Funds (in the case of stock held by provincial governments) to local authorities and are recovered from the tenants or debtors through the billing systems.

In terms of the "discount benefit scheme' from 1994 to January 2001, 377 720 residential properties, mainly in townships, were disposed of. As table 6.6 shows, 384 894 properties are owned by provinces, mostly in the Eastern Cape, Gauteng and Western Cape. Some housing was also transferred to municipalities. In terms of section 14(4)(b) of the Housing Act (No. 107 of 1997) the loans were phased out by 31 March 1998 while debts owed remained recoverable by the municipalities.

Rentals and loan repayments from the remainder of these debtors are still paid to provinces. Given inadequate record-keeping and administration, such rental payments on these properties have been weak over the last ten years, and large arrears exist.

Many tenants and owners have also not paid municipal rates and services. These arrears are major impediments preventing the transfer and possible disposal of the properties. The national Department of Housing is currently looking at appropriate policy interventions that would ensure the transfer and possible disposal of this stock.

Table 6.6: Inherited stock, 2001

Province	To be transferred
Eastern Cape	40 064
Free State	7 470
Gauteng	175 069
KwaZulu-Natal	24 264
Mpumalanga	22 000
Northern Cape	15 820
Northern Province	3 383
North West	19 000
Western Cape	77 824
Total	**384 894**

Local government and housing

When houses were transferred to provinces from the previous Own Affairs departments in 1994, some were also transferred to local government. Johannesburg, Cape Town and Durban have a sizeable number of houses in addition to these transfers. The extent of the stock transferred to these municipalities was not available at the time of print of this *Review*.

It is estimated however, that Johannesburg received over 130 000 houses, old age homes accommodating over 20 000 beds, public hostels accommodating 35 000 beds, staff hostels accommodating 10 000 beds and other accommodation (caretaker cottages, mayor's house, etc.) Cape Town received an estimated 15 000 houses, approximately 23 649 flats, 464 old age homes, hostels accommodation of over 15 000 beds and over 23 000 units that must still be transferred to beneficiaries. Currently rentals are collected on these properties. Johannesburg's rental collection is not as efficient as in Durban and Cape Town. The National Treasury is currently reviewing the governance arrangements for municipal housing development funds.

Normalising the housing environment

Rigidities in the housing sector

The low-income housing sector continues to be hamstrung by factors that include poor capacity, lack of finance (private and public) and inadequate planning and implementation. A more focused strategy is needed to address the challenges facing the housing sector especially to ensure access for private funding, emergency housing and rapid land release.

Access to private sector funding

Sustainable low-cost housing delivery requires a joint effort between government and the private sector. Government has initiated a number of strategies to encourage private sector participation in low-cost housing finance.

Normalising the lending environment

Through the establishment of Servcon Housing Solutions (Pty) Ltd in 1998, government aimed to normalise the lending environment by managing non-performing loans and properties repossessed by banks in areas where the normal legal process has broken down. In addition, the *Masakhane Campaign* was launched to change the perceptions and attitude of individuals, communities and local governments towards their responsibilities. It encourages the payment of rates, services and bonds and thus seeks to inculcate an overall culture of payment in affected communities.

Thubelisa Homes

Thubelisa Homes (a Section 21 company) was established in 1998 as a finance vehicle to create rightsizing stock and is linked to the

Servcon programme. Rightsizing is a process whereby occupants of bank-owned properties, who have defaulted on their mortgage loans, are assisted in relocating to more affordable houses.

Bridging finance to developers

The National Urban Reconstruction and Housing Agency *(Nurcha)*, aims to expedite housing delivery for low-income households over the short to medium-term. It provides guarantees to banks to encourage them to make bridging finance loans available to emerging developers and contractors, when banks are not prepared to approve such loans without additional security. The demand for bridging finance is also reduced with the speeding up of payments once projects have been completed.

Better ways of mobilising finance

Through the National Housing Finance Corporation, government aims to find better ways of mobilising finance for housing from sources outside government. The Corporation aims to create housing opportunities for low- and medium-income families by funding intermediaries to promote broader access to finance, building adequate and sustainable capacity within the organisations it funds and partnering with organisations to pioneer new finance and housing delivery options.

Private sector participation still limited

Despite government attempts to normalise the housing environment, poverty, unemployment and low payment rates deter the private sector from getting involved in low-cost housing. Mortgage lending in this sector is non-existent. To attract the private sector, Government acknowledges the need for a partnership to improve the housing environment in townships. It is particularly important to create a conducive environment for the housing market to operate in an orderly manner, to align subsidies and private finance and mitigate investment risk.

An integrated approach

The role of municipalities

Municipalities play a limited direct role in housing development, generally as developers and in the provision of internal bulk and connector infrastructure. Co-ordination of initiatives at the local level is often weak, and grant spending not optimised. Transferring funds directly to municipalities should help overcome existing resistance to being involved in housing delivery. It should improve local programme co-ordination, and speed up delivery.

Integrated development needed

Housing delivery requires not only bulk infrastructure (water, electricity and roads) and housing units, but also properly integrated communities and built environment. Many current housing projects do not take the total basic needs of communities into account. In many cases, housing projects are not complemented with social and economic infrastructure such as schools, roads, clinics and retail facilities. Businesses remain reluctant to invest in townships and new housing developments, mainly as a result of negative perceptions about crime and repayment rates.

The provision of emergency housing

The Grootboom case

Following the Constitutional Court judgement in the Grootboom case, Government is obliged to develop and implement, within available resources, a comprehensive and coordinated programme that progressively realises the right of access to adequate housing. This programme should include reasonable measures to provide access to people without land or housing, or who live in intolerable conditions or crisis situations.

Policy guidelines for the provision of emergency housing are being developed and provincial housing departments are reserving between 0,5 and 0,75 percent of their allocations to provide for a contingency fund.

Speeding up land release

Rapid land release

Government recognises the need to augment its housing delivery programme with a rapid land release programme, providing serviced sites where the need is becoming urgent. This process needs to be orderly and should create an environment in which future upgrading and self-improvement is possible.

Measuring service delivery in housing development

Measurement difficulty

One difficulty in measuring housing development is that not every subsidy translates into a completed house. Depending on the cost of land and infrastructure funded through the housing subsidy, the end product may be a serviced or unserviced site, with or without a top structure. Given the policy of incremental housing and other delays, a completed house may take a few years.

Housing department responsibilities

National and provincial government roles revolve around policy and implementation, respectively. The national Department of Housing is responsible for the development and co-ordination of a housing policy and strategy. The department also monitors implementation of national housing programmes in provinces. Provincial housing departments are the actual implementers of housing provision, mainly through the housing subsidy and human settlement programmes.

Given these different roles, the measures used to assess performance will be different for the different spheres of government:

?? Provincial output measures will include the number of subsidies approved, number of serviced sites provided, number of houses built and the impact on housing backlog.

?? National output measures focus more on policy development and monitoring, housing programme management, housing performance measurement and housing development funding.

Both financial and non-financial information, quantitative and qualitative, is important for understanding delivery. The box below offers some ideas in this regard.

Service Delivery Measures

The next phase of budget reforms emphasises the need for measurable outputs to assess performance.

For 2002/03, measurable objectives, service delivery measures and targets for each programme must be included in budget submissions (including strategic plans) and be reflected over the MTEF. It is expected that by 2004/05 this information will more accurately describe how public funds are used.

For now, it is expected that output measures in housing will be mainly quantitative. Possible service delivery indicators would include, but is not limited to, the number of:

- projects approved and started
- subsidies approved
- housing units built
- service sites allocated
- unserviced sites allocated
- households benefiting
- houses where full rental is paid
- number of rental houses transferred.

It is expected that information would be expanded towards reporting on more qualitative aspects, including the types of houses built, safety aspects of houses built, impact of housing delivery on the number of informal settlements and housing backlogs and the level of access to external finance to supplement housing subsidy.

Financial management and Implementation of the PFMA

Of all major provincial departments, housing departments face the greatest challenges in improving their system of classification and financial management. Though this *Review* is not able to analyse the audit opinions of the 2000/01 financial statements for the nine provincial departments (and their housing funds), preliminary indications are that the Auditor-General disclaims most of these. Addressing the audit queries raised by the Auditor-General, as well as modernising budgeting and financial management systems, remains an urgent priority.

Reforming the South African Housing Fund

No financial statements for SA Housing Fund

On 1 April 1994, all the rights, liabilities and the Own Affairs Housing Boards were transferred to the South African Housing Fund (SAHF) in terms of the Housing Arrangements Act of 1993.

The SAHF's purpose is to fund national and provincial housing programmes that are consistent with national housing policy and national housing delivery goals. It also aims to ensure that funds appropriated for housing are used solely for this purpose. Prior to the 2000 Division of Revenue Act, the funds flowed directly from the SAHF to the Provincial Housing Development Funds (PHDFs).

The Auditor-General reported in 1999 that apart from the 1993/94 financial statements of the former housing institutions, no further financial statements for the SAHF have been compiled, and that this jeopardises the accountability process.

Housing Fund problems

From an accountability point of view, there are a number of problems associated with the existing system of transfer of funds between the SAHF and the PHDFs. These include:

?? Performance reporting is distorted. Reporting is not done on the actual amount utilised on actual housing programmes but on transfers to the SAHF and PHDF's. The impression is created that the funds allocated for capital housing projects each year is the amount that is in fact utilised.

?? Meaningful monitoring is impossible as transfers are being monitored and being equated with expenditure.

?? A significant amount of under spending is taking place, which results in rollovers taking place, which are not subject to provincial or national treasury oversight.

?? There are significant assets in the various PHDFs that represent unsold housing stock, rental-housing stock, suspensive sale debtors and rental debtors.

Steps are being taken to address these concerns:

?? The housing subsidy grant was converted into a conditional grant for the 2000/01 financial year.

?? All funds received by provincial housing departments will now be deposited into the appropriate provincial revenue fund, improving accountability over such funds. This includes funds received for rental.

?? All expenditure incurred with respect to housing will be on budget. This includes expenditure incurred by the respective provincial housing funds.

?? Together with the Department of Housing, the National Treasury is working to implement an internationally accepted classification to measure progress in housing programmes.

Implementation of the PFMA

Whilst reforms to the SAHF and PHDFs contribute to improved financial management, broader public sector reforms set a context for sustainable change. In particular, the Public Finance Management Act (PFMA) provides a framework for such reform in government departments, provinces and public entities. Provincial housing departments have made some progress in implementing the PFMA and are expected to reap the benefits in 2001/02.

Appointment of CFO's

Table 6.7 shows progress with appointing permanent Chief Financial Officers (CFOs). There have been five full appointments, four of which are permanent. Appointments have all been either at Chief Director or Director level.

A Housing CFO forum was established recently to build financial management capacity. It provides a vehicle for peer-learning, shaping best practice, improving monthly budget reporting and facilitating pro-active problem-solving. Further, the CFO forum is expected to develop critical documents around risk management strategy, fraud prevention and audit charters.

Almost all provinces adopted a shared service arrangement or centralised audit committee, and seven of nine provincial housing departments have also established internal audit units. This puts these housing departments in a position to apply more effective auditing and financial controls, and represents another step towards improving accountable and transparent governance.

Table 6.7: Summary of CFOs appointed in provincial housing departments

Province	Full appointment	Nature of appointment	Level of appointment
Eastern Cape	No	A	D
Free State	No	A	D
Gauteng	Yes	P	CD
KwaZulu-Natal	No	A	CD
Mpumalanga	Yes	P	D
Northern Cape	No	A	D
Northern Province	Yes	C	CD
North West	Yes	P	CD
Western Cape	Yes	P	D
Total	**5/9**	**4 P + 1 C + 4 A**	
		Permanent Appointment = P	*Director = D*
		Contract Appointment = C	*Chief Director = CD*
		Acting CFO = A	

Early submission of financial statements

Table 6.8 shows that seven provincial housing departments have adhered to the deadlines of submitting financial statements to the Auditor-General within two months after the end of the financial year. The exceptions, Free State and Northern Cape, submitted theirs before 14 June 2001.

Table 6.8: Submission of financial statements by 31 May 2001

Provinces	Vote number	Submitted Yes / No	Department submitted after deadline but before 14 June 2001
Eastern Cape	7	Yes	N/A
Free State	8	No	Yes
Gauteng	7	Yes	N/A
KwaZulu-Natal	8	Yes	N/A
Mpumalanga	12	Yes	N/A
Northern Cape	9	No	Yes
Northern Province	19	Yes	N/A
North West	9	Yes	N/A
Western Cape	8	Yes	N/A

Roads and transport

South Africa has one of the most extensive road networks in Africa, totalling over 500 000 km. All three spheres of Government play a role in managing the maintenance, rehabilitation and development of this network. Approximately 223 128km fall under provincial authorities, and an estimated 7 200 km within the national road network under the South African National Roads Agency (NRA). Local government manages the rest.

Major portion of network falls under provinces

Table 6.9 provides a summary of the road network by national and provincial authority. All national roads, and about 25 percent of provincial roads are paved. The balance is gravel. Paved roads carry about 91 percent of daily traffic. A significant portion of gravel roads, largely in rural areas, is utilised by non-urban users on a daily basis. Larger shares of poor to very poor gravel roads are located in rural provinces.

Table 6.9: Road Network

Road Authority	Area (km^2)	Paved	Gravel	Total	Total road density	Km of paved road per population	% Total km of road per population	No. of vehicles per km of paved road
Eastern Cape	169 600	5 571	36 396	41 967	0,25	0,9	*6,7*	11
Free State	129 480	7 128	21 600	28 728	0,22	2,7	*10,9*	16
Gauteng	18 810	3 411	1 485	4 896	0,26	0,5	*0,7*	524
KwaZulu-Natal	92 180	6 730	34 530	41 260	0,45	0,8	*4,9*	23
Mpumalanga	78 370	6 627	9 258	15 885	0,20	2,4	*5,7*	26
Northern Cape	361 800	5 481	21 880	27 361	0,08	6,5	*32,6*	14
Northern Province	123 280	6 481	16 418	22 899	0,19	1,3	*4,6*	7
North West	116 190	6 869	16 303	23 172	0,20	2,0	*6,9*	12
Western Cape	129 370	6 340	10 620	16 960	0,13	1,6	*4,3*	69
National	–	7 200	–	7 200	–	–	*0,2*	–
Total	**1 219 080**	**61 838**	**168 490**	**230 328**	**0,19**	**1,5**	***5,7***	**30**
Percentage Shares								
Eastern Cape	13,9%	9,0%	21,6%	18,2%				
Free State	10,6%	11,5%	12,8%	12,5%				
Gauteng	1,5%	5,5%	0,9%	2,1%				
KwaZulu-Natal	7,6%	10,9%	20,5%	17,9%				
Mpumalanga	6,4%	10,7%	5,5%	6,9%				
Northern Cape	29,7%	8,9%	13,0%	11,9%				
Northern Province	10,1%	10,5%	9,7%	9,9%				
North West	9,5%	11,1%	9,7%	10,1%				
Western Cape	10,6%	10,3%	6,3%	7,4%				
National	–	11,6%	–	3,1%				

Source: Provincial treasuries and departments

37% of vehicles in Gauteng

On average, there are approximately 5,7 kilometres of provincial and national road per person, with the average for paved roads at 1,5 km. Levels of congestion are relatively high in Gauteng, reflected on average 524 cars for every kilometre of provincial road. National roads in Gauteng are more utilised and more congested than in other provinces. The level of congestion in the Northern Province is relatively low at an average of 7 cars per kilometre. Requirements for maintenance and rehabilitation will therefore be higher in Gauteng than in Northern Province.

Table 6.10 shows the number of vehicles in each province and the provincial distribution of vehicles and population. Vehicle numbers across provinces reflect the level of economic activity and incomes per province rather than population distribution. The wealthier and more urban provinces of Gauteng and Western Cape have relatively higher per capita vehicle ownership. For instance, Gauteng has 37,4 percent of all vehicles and only 18,1 percent of the population. By contrast, Eastern Cape has only 6,8 percent of the nation's vehicles but 15,5 percent of its population.

Table 6.10: Motor vehicle numbers, 1 April 2001

Type of vehicle ('000)	EC	FS	GP	KZN	MP	NC	NP	NW	WC	Total
Light	405	350	2 267	820	329	308	127	237	1 037	5 882
Heavy	32	34	165	85	38	36	11	30	60	491
Other	29	67	131	60	46	42	14	21	78	489
Total	**467**	**451**	**2 564**	**966**	**412**	**386**	**152**	**288**	**1 175**	**6 861**
Percentage of prov total										
Light	86,8%	77,5%	88,4%	84,9%	79,7%	79,9%	83,6%	82,4%	88,3%	85,7%
Heavy	6,9%	7,5%	6,4%	8,8%	9,2%	9,3%	7,3%	10,3%	5,1%	7,2%
Other	6,2%	14,9%	5,1%	6,3%	11,1%	10,9%	9,1%	7,3%	6,6%	7,1%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**
Percentage of vehicle total										
Light	5,9%	5,1%	33,0%	12,0%	4,8%	4,5%	1,9%	3,5%	15,1%	85,7%
Heavy	0,5%	0,5%	2,4%	1,2%	0,6%	0,5%	0,2%	0,4%	0,9%	7,2%
Other	0,4%	1,0%	1,9%	0,9%	0,7%	0,6%	0,2%	0,3%	1,1%	7,1%
Total	**6,8%**	**6,6%**	**37,4%**	**14,1%**	**6,0%**	**5,6%**	**2,2%**	**4,2%**	**17,1%**	**100,0%**
Percentage of Population	15,5%	6,5%	18,1%	20,7%	6,9%	2,1%	12,1%	8,3%	9,7%	100,0%

Source: National Traffic Information System

Expenditure on road infrastructure

Expenditure on road infrastructure in the provinces up to 2000/01 was funded primarily through the provincial equitable share and to a limited extent through provincial own revenue. From 2001/02, the supplementary infrastructure conditional grant complements provincial funds as part of it is earmarked for provincial roads. Expenditure on national roads is funded by national government transfers and user charges.

Greater shift towards infrastructure spending

Table 6.11 shows that, for the period 1997/98 to 2000/01, over R12 billion was spent on national and provincial roads. Total spending on provincial roads increased at an annual average nominal rate of 5,4 percent from R2,7 billion in 1997/98 to R3,1 billion in 2000/01. Although showing fairly strong growth on a year on year basis, road expenditure accounted for only 2,9 percent of total provincial expenditure in 2000/01. Total national spending on non-toll national roads increased by an annual average rate of 4,3 percent from R532 million in 1997/98 to R701 million in 2000/01.

Nominal increases, but low real spending

Total provincial expenditure grew significantly between 1997/98 and 2000/01. KwaZulu-Natal, Eastern Cape and Northern Province project to spend an increased share of their total budget for road development over the MTEF, while spending shares in other provinces remain relatively constant. The sharp increase in 2000/01 may be attributed to the increased allocation for the rehabilitation of road infrastructure damaged during the 1999/2000 floods. Mpumalanga, Northern Province and KwaZulu-Natal received additional allocations to address flood damages. Provincial spending on roads has been sluggish in the three years to 2000/01, only growing at a real average annual rate of 1,1 percent. This may be attributed to the reprioritisation of budgets towards social services.

Table 6.11: Spending on national and provincial roads

Provincial R'million	Actual			Estimated Actual	Medium-term Estimates		
	1997/98	1998/99	1999/00	2000/01	2001/02	2002/01	2003/04
Eastern Cape	404	238	154	288	560	1 148	1 131
Free State	241	289	186	165	224	261	290
Gauteng	252	374	405	363	425	483	495
KwaZulu-Natal	565	371	505	655	810	854	1 010
Mpumalanga	164	203	182	216	152	182	277
Northern Cape	127	102	96	104	121	134	142
Northern Province	233	167	325	586	439	577	658
North West	292	267	227	258	184	193	203
Western Cape	417	334	347	525	493	610	623
Provincial spending	**2 695**	**2 346**	**2 427**	**3 160**	**3 407**	**4 442**	**4 828**
National spending	532	698	923	715	1 055	1 192	1 295
TOTAL	**3 227**	**3 043**	**3 350**	**3 875**	**4 462**	**5 634**	**6 123**
Percentage of total provincial expenditure							
Eastern Cape	2,5%	1,5%	0,9%	1,6%	2,9%	5,5%	5,1%
Free State	3,5%	4,1%	2,8%	2,2%	2,7%	3,0%	3,2%
Gauteng	1,6%	2,3%	2,4%	2,0%	2,1%	2,2%	2,2%
KwaZulu-Natal	2,9%	2,0%	2,6%	3,0%	3,4%	3,3%	3,6%
Mpumalanga	2,7%	3,3%	2,8%	3,1%	1,9%	2,1%	2,9%
Northern Cape	5,4%	4,3%	3,9%	4,0%	4,3%	4,4%	4,3%
Northern Province	2,0%	1,4%	2,6%	4,1%	2,8%	3,4%	3,7%
North West	3,8%	3,4%	2,8%	2,8%	1,9%	1,9%	1,8%
Western Cape	3,9%	3,2%	3,2%	4,6%	4,0%	4,6%	4,5%
Average	**2,6%**	**2,4%**	**2,2%**	**2,9%**	**2,8%**	**3,4%**	**3,5%**

Source: Budget statements

Spending on new roads and major rehabilitation

On average, 33 percent of total spending on roads between 1997/98 and 2000/01 was on new roads and major rehabilitation. For 2000/01, spending in this category was relatively high in Gauteng, KwaZulu-Natal, Northern Province, North West and Western Cape. Disproportionately higher spending in Northern Province might be attributed to the 1999/2000 floods. National government spending on non-toll national roads was R263 million in 2000/01.

Spending on routine maintenance

Between 1997/98 and 2000/01, 26 percent of provincial spending on roads was on routine maintenance. Of the more rural provinces, KwaZulu-Natal showed consistent growth in spending between 1997/98 and 2000/01 with Eastern Cape showing substantial growth in 2000/01. National government spending on routine and periodic maintenance on non-toll national roads was R417 million.

Medium-term estimates

Recovery in real spending

The 2001 Budget marks a turnaround in provincial infrastructure spending in general and is expected to have a positive impact on budgets for roads over the MTEF. Provincial spending is projected to grow at an annual average rate of 15,2 percent to R4,8 billion in 2003/04. For 2001/02, it is projected that total provincial spending would be R3,4 billion which is 7,8 percent higher than in 2000/01. The major increase of 30 percent is to occur between 2001/02 and 2002/03. Spending in real terms is expected to recover and grow at an annual average rate of 9 percent between 2001/02 and 2003/04.

New projects

Spending on provincial roads in Eastern Cape, Free State, KwaZulu-Natal, Northern Cape and Western Cape is anticipated to grow strongly while Gauteng, Mpumalanga and North West show moderate growth. For 2001/02, provinces project to finance the maintenance and rehabilitation of over 2 868 km of roads of which 1 398 km is paved and 1 470 km is gravel. Table 6.12 gives a breakdown of projects for 2001/ 2002.

Table 6.12: Proposed projects for 2001/02

	Kilometers *of road*		
	Paved roads	**Gravel roads**	**Total**
Eastern Cape	31	49	80
Free State	75	90	165
Gauteng	235	65	300
KwaZulu-Natal	55	650	705
Mpumalanga	29	110	139
Northern Cape	150	300	450
Northern Province	216	123	339
North West	130	83	213
Western Cape	–	–	–
National	477	–	477
Total	**1 398**	**1 470**	**2 868**

Better access roads for rural population

There is an almost even total expenditure between paved and gravel roads, whilst traffic distribution is substantially lower on gravel roads. Given low levels of usage of gravel roads, it is anticipated that the large proportion of spending on gravel roads is targeted at providing better road access to the rural population.

Impact of spending on road infrastructure development

The slow budget growth contributed to the overall deterioration of roads and the increase in maintenance, rehabilitation and new construction backlo gs.

Road backlogs

The estimated cost, according to provinces, to meet backlogs in road infrastructure development is R23 billion. Approximately 53 percent of the backlog is identified as maintenance and rehabilitation spending; 28 percent is associated with upgrading, and 19 percent is for new roads. The backlog is high across provinces.

Over R10 billion per annum is required to address the backlog over 5 years. Of this, over R4 billion and R5,8 billion per annum is needed respectively to eradicate maintenance and rehabilitation backlogs and annual needs over 5 years. The backlog estimate is high at R6 billion in Eastern Cape, and is on average R3 billion in each of Free State, KwaZulu-Natal, Mpumalanga and Northern Province. Allocations for 2001/02 will not meet the backlog. Provinces where backlogs are higher seem to allocate relatively less funds to road development than provinces where backlogs are lower.

Bus and Rail subsidies

Implementation of policy and strategy

In addition to road infrastructure development, Government also oversees the payment of bus and rail subsidies; provides support information and research services; promotes planning for intermodal land transport infrastructure and operations; and also manages the Urban Transport Fund. While bus and rail subsidies are currently a national function, the beneficiaries of each service are at provincial or local level. National transport policy is to devolve these funds to local government or transport authorities in future. Table 6.13 shows national expenditure trends on policy, strategy and implementation between 1997/98 and 2003/04.

Table 6.13: Expenditure on policy, strategy and implementation

Policy, Strategy and implementation	Actual			Estimated Actual	Medium-term Estimates		
(R'million)	1997/98	1998/99	1999/00	2000/01	2001/02	2002/01	2003/04
Bus Subsidies	1 088	1 154	1 323	1 449	1 542	1 657	1 734
Rail Subsidies	1 212	1 405	1 595	1 727	1 716	1 791	1 912
Urban Transport Fund	202	37	30	22	38	40	42
Other	301	71	30	54	81	100	82
Total	**2 804**	**2 667**	**2 978**	**3 252**	**3 378**	**3 587**	**3 770**
Percentage growth	5%	-5%	12%	9%	4%	6%	5%
As % of total national transport budget							
Bus Subsidies	30,2%	32,5%	32,6%	34,9%	33,2%	33,2%	32,8%
Rail Subsidies	33,6%	39,5%	39,3%	41,6%	36,9%	35,9%	36,1%
Urban Transport Fund	5,6%	1,0%	0,7%	0,5%	0,8%	0,8%	0,8%
Other	8,4%	2,1%	0,7%	1,3%	1,7%	2%	1,5%
Total	**77,8%**	**75,1%**	**73,3%**	**78,3%**	**72,7%**	**71,8%**	**71,3%**

Bus subsidies

Bus subsidies support low-income households displaced from major metropolitan areas by historical apartheid laws and thus using major bus routes in provinces. These subsidies constitute on average 33 percent of total expenditure of the national Department of Transport's budget. They increased at an annual average rate of 10 percent from R1,1 billion in 1997/98 to R1,4 billion in 2000/01. Spending is projected to grow 6,4 percent between 2000/01 and 2001/02 and at an annual average rate of 6,2 percent to R1,7 billion in 2003/04. Table 6.13 shows the bus subsidies allocated to provinces between 1997/98 and 2003/04, and that the major allocations go to Gauteng, KwaZulu-Natal, Western Cape and Mpumalanga. National government retains part of the allocation as a monitoring fee, hence the figures in table 6.14 reflects the net allocation to provinces, as opposed to the total figures in table 6.13.

Table 6.14: Bus subsidies between 1997/98 and 2003/04

Provincial R'million	Actual		Estimated Actual	Medium-term Estimates		
	1998/99	1999/00	2000/01	2001/02	2002/01	2003/04
Eastern Cape	38	41	46	50	54	56
Free State	65	72	81	87	93	98
Gauteng	471	488	551	595	637	665
KwaZulu-Natal	225	289	326	352	377	394
Mpumalanga	103	121	137	148	158	165
Northern Cape	4	4	5	5	5	6
Northern Province	64	44	50	54	58	60
North West	27	18	21	22	24	25
Western Cape	157	171	193	209	233	233
TOTAL	**1 154**	**1 248**	**1 409**	**1 522**	**1 639**	**1 702**

Rail subsidies

Rail subsidies constitute on average 37 percent of total expenditure on the national Department of Transport's budget. These subsidies increased at an annual average rate of 12 percent from R1,2 billion in 1997/98 to R1,7 billion in 2000/01. Spending is projected to decline by 1 percent between 2000/01 and 2001/02 and to grow at an annual average of 4 percent to R1,9 billion in 2003/04. The Rail Commuter Corporation projects spending R450 million on capital over the MTEF. Of this, R275 million is for routine capital expenditure and R175 million is to fund rolling stock refurbishment. It is anticipated that 176 coaches will be renewed during the first two years at a cost of R360 million. A new long-term recapitalisation programme is in the making, to improve rail safety and enhance rail transport as a viable public transport alternative.

Urban Transport Fund

The Urban Transport Fund mainly finances the implementation of transport infrastructure in metropolitan transport areas. Spending on the fund amounted to R22 million in 2000/01 and is anticipated to grow to R42 million in 2003/04.

Sources of revenue for roads

Roads revenue key for provinces 'own income'

Provincial road infrastructure is funded through national transfers and provinces' own revenue. The transfers include the equitable share and the supplementary infrastructure allocation, while provinces derive own revenue from fees as prescribed by the Roads Traffic Act and associated regulations. National road infrastructure is funded by national government through transfers from the national Department of Transport. Concessions and toll fees levied complement national government funding. Table 6.15 provides perspective on the revenue collected in terms of the Act.

Table 6.15: Revenue collected in terms of the Road Traffic Act

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	62	53	59	62	42	44	48
Free State	79	87	103	137	110	114	116
Gauteng	388	413	528	572	516	549	580
KwaZulu-Natal	247	275	305	352	329	344	378
Mpumalanga	74	55	65	79	74	79	85
Northern Cape	28	26	37	44	50	54	57
Northern Province	35	40	43	60	50	54	82
North West	59	55	76	93	141	146	161
Western Cape	226	251	299	344	428	492	565
Total	**1 198**	**1 256**	**1 514**	**1 745**	**1 739**	**1 875**	**2 071**
Percentage growth							
Eastern Cape		-14,5%	12,0%	4,6%	-32,5%	7,0%	7,0%
Free State		11,1%	18,1%	32,9%	-19,9%	3,6%	2,0%
Gauteng		6,4%	27,7%	8,5%	-9,8%	6,2%	5,7%
KwaZulu-Natal		11,3%	10,9%	15,7%	-6,6%	4,6%	9,9%
Mpumalanga		-24,7%	16,6%	22,6%	-6,5%	6,0%	8,0%
Northern Cape		-7,7%	42,2%	20,3%	12,3%	7,8%	7,1%
Northern Province		14,4%	7,6%	40,8%	-17,2%	8,0%	51,1%
North West		-6,7%	37,2%	21,9%	51,5%	3,6%	10,3%
Western Cape		11,0%	18,9%	15,1%	24,3%	14,9%	14,9%
Average		**4,9%**	**20,5%**	**15,2%**	**-0,3%**	**7,8%**	**10,5%**
Percentage of total own revenue							
Eastern Cape	*27,6%*	*12,5%*	*15,8%*	*15,6%*	*12,5%*	*12,1%*	*11,9%*
Free State	*30,0%*	*34,8%*	*39,4%*	*44,9%*	*41,5%*	*41,5%*	*41,5%*
Gauteng	*43,1%*	*44,5%*	*50,5%*	*49,0%*	*49,6%*	*49,6%*	*49,3%*
KwaZulu-Natal	*38,5%*	*63,5%*	*49,7%*	*39,0%*	*55,9%*	*53,2%*	*53,1%*
Mpumalanga	*28,6%*	*28,6%*	*17,8%*	*51,1%*	*35,3%*	*34,9%*	*37,7%*
Northern Cape	*27,4%*	*32,9%*	*46,8%*	*66,8%*	*60,6%*	*61,6%*	*61,8%*
Northern Province	*17,2%*	*13,5%*	*17,3%*	*18,8%*	*15,4%*	*15,4%*	*18,8%*
North West	*19,6%*	*18,2%*	*23,7%*	*21,8%*	*38,2%*	*38,5%*	*40,4%*
Western Cape	*40,1%*	*47,7%*	*40,8%*	*44,5%*	*61,9%*	*63,7%*	*65,5%*
Average	***34,6%***	***36,6%***	***37,5%***	***38,6%***	***44,6%***	***44,6%***	***45,2%***

Source: FMS and Budget Statements

Categories of Road Traffic Act fees

The volatility of growth rates in road traffic revenues can be partly explained by a revision of fee schedules and the inconsistency in payments by a collecting agent.

Western Cape projects a relatively higher share of road traffic revenues as a percentage of total own revenue, from about 44,5 percent in 2000/01 to 65,5 percent in 2003/04. In contrast, Eastern Cape averages about 12 percent per year over the MTEF.

Table 6.16 details road traffic revenues collected between 1 April 2000 and 31 March 2001. In general, fees can be divided into four categories. Motor vehicle licences include both vehicles and trailers while operator licences include both driver's licences and learner permits. Other fees are for roadworthy testing and motor vehicle registration. Motor vehicle licensing fees generate at least 80 percent of total road traffic revenues, except in Northern Province where it is about 70 percent. Operator licences generate another 11 percent of revenue, with an exceptionally large proportion of about 24,4 percent in Northern Province.

Table 6.16: Road Traffic Act Fees collected, 2000/01

R million	EC	FS	GP	KZN	MP	NC	NP	NW	WC	Total
Motor vehicle licences	94,2	112,6	564,8	306,5	105,7	41,2	52,7	88,9	326,0	1 692,7
Operator licences	16,3	13,7	69,2	40,9	15,3	4,9	18,4	15,0	34,1	227,8
Roadworthy	1,4	2,5	6,1	0,5	3,1	1,5	1,0	1,8	4,9	22,6
Vehicle registration	3,9	5,6	58,9	11,6	5,8	2,1	1,5	5,9	17,8	113,0
Other	2,6	1,7	3,1	12,2	2,0	0,7	1,8	2,9	7,9	34,9
Total	**118,3**	**136,1**	**702,1**	**371,7**	**131,9**	**50,4**	**75,4**	**114,4**	**390,7**	**2 091,1**
Percentage shares										
Motor vehicle licences	79,6%	82,8%	80,4%	82,5%	80,2%	81,7%	69,8%	77,7%	83,4%	80,9%
Operator licences	13,%8	10,1%	9,9%	11,0%	11,6%	9,8%	24,4%	13,1%	8,7%	10,9%
Roadworthy	1,2%	1,8%	0,9%	0,1%	2,3%	2,9%	1,3%	1,6%	1,3%	1,1%
Vehicle registration	3,3%	4,1%	8,4%	3,1%	4,4%	4,2%	2,0%	5,1%	4,6%	5,4%
Other	2,2%	1,3%	0,4%	3,3%	1,5%	1,3%	2,4%	2,5%	2,0%	1,7%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

Source: National Traffic Information System

Note: The totals in tables 6.15 and 6.16 for 1999/2000 differ as they are based on different sources. Generally, FMS amounts are lower than NaTIS amounts and the differences are due to timing and deduction of commissions.

Motor vehicle licence fees

Higher fees for bigger vehicles

Motorists are required to pay vehicles licence fees on an annual basis, based on the weight of their vehicle. Table 6.17 outlines the fee structure of the different provinces. The principle behind setting higher rates for bigger vehicle weights is that road damage and, therefore, maintenance costs are directly related to vehicle size. Fees rise in line with vehicle weight, but increase exponentially by more than 50 percent at the 5000kg mark. There is a large number of motor vehicle fee categories, differing across provinces, and varying from over R26 829 for a double-decker bus in Free State to R40 for a small trailer in Northern Province. Sedan car licenses could cost anything between R79 for a Citi Golf in the Northern Province to R393 for a

BMW 735 in Western Cape. Generally, Northern Province charges less than other provinces.

Monitoring

Considerable effort has gone into improving the monitoring of licensing fees. The National Traffic Information System (NaTIS) can list the vehicle licences that are coming up for renewal. Using this information, most provinces send out renewal notices to motorists. The system can also identify non-complying motorists and calculate the outstanding revenues, including penalties. On average about 8 percent of road traffic revenue is made up of penalties and arrear payments.

Table 6.17: Comparison of motor vehicle licence fees, 1 September 2001

Rand	Tare (kg)	EC	FS	GP	KZN	MP	NC	NP	NW	WC
Cars										
Citi Golf	844	96	122	114	114	135	135	79	114	189
Mercedes-Benz C230	1 410	153	168	180	210	171	213	119	180	309
BMW 735/A	1 860	204	207	252	297	243	285	172	252	393
Trucks										
Nissan (1 tonne)	1 239	123	140	126	162	129	168	92	126	228
Toyota Dyna (5 tonne)	2 260	318	309	372	426	360	438	251	372	621
Toyota Dyna (10 tonne)	4 460	795	768	948	1 065	906	1 101	634	948	1 512
Peterbuilt (cab only)	8 340	3 516	4 005	4 194	4 692	4 044	4 869	2 805	4 194	6 003
Trailers										
Venter	200	45	59	60	75	72	63	40	60	165
Afrit (10 tonne)	3 300	882	1 287	1 032	1 182	603	1 221	704	1 032	972
Afrit (20 tonne)	6 610	2 400	2 730	2 838	3 210	2 691	3 321	1 916	2 838	4 080
Multi-passenger										
Toyota Hiace (combi)	1 560	183	189	216	252	216	252	145	216	348
Passenger bus	10 252	5 208	5 970	6 198	6 951	5 988	7 209	4 158	6 198	8 769
Double-decker bus	16 960	12 760	26 829	15 108	17 052	14 421	17 295	10 672	15 108	23 205

Source: National Traffic Information System

Agents

Local governments as agents

All provinces, except Free State, appointed agents to administer licensing and related activities covered by the Road Traffic Act. Provinces generally use their respective local authorities for these tasks, but some also employ magistrates' offices, Home Affairs offices, post offices and private agents. KwaZulu-Natal, in particular, uses post offices in addition to its local authorities, thereby creating competition in the appointment of agents. Free State is the only province to have developed its own internal infrastructure. In total, there are over 400 registering authorities across the country.

Toll roads

Tolls help fund national roads

Toll roads and concessions are complementary sources of revenue that contribute to the maintenance of the national road infrastructure and reduce the pressure on the fiscus. Just over 29 percent of national roads are under toll or concession and the funds generated are used to repay loans and maintain the roads covered by the toll. The remaining national network is maintained by the fiscus.

Negative externality

Tolling may have negative externalities with financial implications for the maintenance and rehabilitation of roads under provincial or local government authority. Toll roads sometimes change the behaviour of road users in that they use alternative routes. Often these alternative routes fall under provincial and local government authority and may lead to additional maintenance costs.

Service Delivery Measures

For 2002/03, measurable objectives, service delivery measures and targets for each programme must be included in budget submissions (including Strategic Plans) and be reflected over the MTEF. It is expected that by 2004/05 this information will more accurately describe how public funds are being used. For now, it is expected that output measures in roads development would concentrate on quantity. Possible service delivery indicators would include information on:

- the time it takes to evaluate and approve projects
- projects approved and started
- kilometers of roads maintained or rehabilitated
- kilometers of new roads built
- number of bridges maintained, rehabilitated or constructed.

Conclusion

Both housing and transport pose considerable challenges to provinces. Spending in both sectors has recently been sluggish, but institutional reform and new allocations should facilitate upward trends. The needs are considerable, and provinces face the challenge to position themselves to meet this need more assertively. They also have to develop measures of their performance that would ensure effective application of resources to an improved built environment. Both sectors have to work closely with the national and local spheres to achieve this.

7

Cross-sectoral issues in the provinces

The previous five chapters focused on the biggest sectors of provincial service delivery. This chapter deals with more general issues that transcend sectors and departments, personnel, institutional issues impacting on infrastructure development, conditional grants and financial management, including the implementation of the Public Finance Management Act.

Personnel issues

Provincial services highly labour intensive

Many of the key services delivered by provincial governments are labour intensive. Of the 1 million civil servants employed by national and provincial government, provinces employ over 70 percent. Personnel spending consumes almost 60 percent of total provincial budgets, and over 64 percent of health and 89 percent of education expenditure.

Stabilising personnel expenditure

Public policy over the past four years has sought to maintain a balance between stabilising personnel expenditure at the provincial level while increasing resources for recurrent non-personnel and capital spending. This objective was key in stabilising provincial finances and improving the quality of services delivered.

Increased employment and skills retention

As provincial budgets grow in real terms over the MTEF, the challenge is to increase personnel expenditure moderately. This increase in spending would make it possible to recruit and retain employees with essential skills especially in health.

Trends in provincial personnel management

1996 Salary agreement

Provinces, in general, have been successful in reducing the personnel component of their expenditure. Table 7.1 shows that this has moved from a high of 59 percent of total provincial spending in 1998/99 to about 57,3 percent in 2000/01. The effect of this success is that provincial budgets are more balanced, releasing resources for complementary inputs such as textbooks, medicine and maintenance. Further evidence of these successes can be measured in the growth of capital spending in 2000/01.

This has been a significant achievement, as the 1996/97 salary agreement in the public sector – while giving effect to the constitutional stipulation of one unified public service – created upward cost pressures.

Following the agreement, personnel spending in 1996/97 rose by 11,3 percent above the inflation rate. This was negotiated in the same fiscal year that Government announced its macroeconomic framework, which saw an emphasis on a lower deficit. The net result was a decrease in other categories of spending. This negatively affected service delivery.

Table 7.1: Provincial expenditure by economic classification

	Actual			Estimated actual	Medium -term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Personnel	53 925	56 643	58 593	63 024	67 166	70 913	74 828
Capital	8 131	6 218	6 426	7 642	11 199	12 987	14 077
Transfers	21 683	21 534	21 614	23 940	25 223	27 444	29 517
Other recurrent	12 226	11 607	12 959	15 429	16 885	18 695	20 677
Total	**95 965**	**96 001**	**99 592**	**110 035**	**120 473**	**130 039**	**139 099**

Decrease in personnel numbers

Between 1997/98 and 2001/02, personnel spending declined by approximately 0,9 percent a year in real terms. The number of people employed by provinces declined by 8,5 percent, or about 3 percent a year. This implies that provinces managed to contain personnel expenditure, mainly through voluntary severance and natural attrition.

During this period, unit labour costs continued to increase in real terms by 1,2 percent a year. The main contributor to this increase was rank and leg promotions in health departments and once-off severance packages in education departments. Rank and leg promotions are automatic promotions from one rank to another without a department necessarily needing anyone at a higher rank or having a vacancy at that rank or even having the resources to effect the promotion. This system of automatic promotions has been terminated, but promotion backlogs still exist.

Spending cuts largest in Gauteng and W. Cape

Table 7.2. shows that from 1997/98 to 2000/01, Western Cape and Gauteng made the biggest strides in reducing personnel spending with real annual average reductions of 4,7 percent and 2,2 percent respectively. Mpumalanga increased personnel expenditure in real terms by about 1,1 percent a year, while the remaining six provinces experienced real declines under 1 percent a year.

Employee numbers decreased by 8,5 percent

Provinces were able to reduce personnel spending principally through a decrease in the number of people employed. These numbers declined by 69 166 or 8,5 percent from 1997/98 to 2001/02. Of the reduced employment level, about 30 000 were educators, 14 000 health workers and 25 000 non-social service employees. Some of the non-social service employees were transferred to local governments, particularly in former R293 towns, along with grants from provinces to local authorities to cover salaries.

Largest decrease in numbers in KZN

KwaZulu-Natal managed to reduce their personnel numbers by 11,4 percent between 1997/98 and 2000/01. Gauteng, Western Cape, Eastern Cape and Free State all reduced their numbers by more than 8 percent. Western Cape, Northern Cape and Gauteng managed to reduce unit labour costs, while the other six provinces saw increases in their average cost of labour. A negative consequence of this reduction may be that these provinces replaced experienced educators with less qualified and less experienced educators, thereby reducing the average cost, but possibly compromising quality.

Table 7.2: Provincial personnel expenditure 1997/98 to 2003/04

	Actual			Estimated actual	Medium-term estimate		
R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Eastern Cape	8 837	9 305	10 238	10 661	10 938	11 159	11 746
Free State	3 875	4 186	4 290	4 629	4 855	5 078	5 367
Gauteng	8 815	9 151	9 185	9 930	10 872	11 698	12 401
KwaZulu-Natal	10 586	10 778	11 190	12 300	13 370	14 177	15 038
Mpumalanga	3 336	3 619	3 882	4 168	4 291	4 552	4 836
Northern Cape	1 087	1 142	1 236	1 307	1 441	1 531	1 617
Northern Province	7 559	8 302	8 370	9 065	9 302	9 982	10 483
North West	4 432	4 748	4 899	5 305	5 428	5 752	6 040
Western Cape	5 798	5 817	5 767	6 122	6 669	6 984	7 300
Total [1]	**54 325**	**57 049**	**59 056**	**63 487**	**67 166**	**70 913**	**74 828**

[1] Includes personnel grants earmarked for local government up to 2000/01

The number of people employed in each province per one thousand citizens raises some contradictions. For example, Gauteng employs just 13,9 people per 1 000 residents as opposed to the Northern Province's 21,1. However, Gauteng has 5,5 health workers per 1 000 people whereas the Northern Province has just 4,4. Gauteng has an average learner:educator ratio of 30,9 and the Northern Province 33,5. While the Northern Province is overstaffed relative to Gauteng, they have fewer health workers and educators. The bulk of this overstaffing is in departments such as agriculture, public works and roads.

Impacts on capital budgets

The real effect of these distortions is that while Gauteng can afford to have a capital budget of almost R2 billion, the Northern Province has a capital budget of just one quarter of that. Unless Northern Province is able to reduce staff numbers in non-social sectors, it will not be able to employ more educators, health workers or allocate more to capital expenditure. Provinces that display a similar distorted pattern of employment to Northern Province are Free State, Eastern Cape, North West and KwaZulu-Natal. Table 7.3 provides a sectoral analysis of provincial staff.

The composition of staff in a province provides some insight into personnel issues. Whilst the average proportion of staff in the three non-social sectors is about 14,6 percent, and totals 106 341, the poor provinces that include a former homeland have significantly higher shares of their personnel in the non-social sectors. Relatively poor provinces have higher shares: Northern Province at 23,9 percent (or 26 752), Free State 19,9, North West 18, Mpumalanga 18,4, Eastern Cape 15,1 and KwaZulu-Natal 10,8 percent. This totals to 93 502 staff, out of 106 341. Provinces without former homelands like Gauteng only have 5,9 percent of their staff in non-social services, and Western Cape 7,3 percent. Northern Cape is above average at 11,2 percent, but lowest in actual numbers at 1703.

Table 7.3: Sectoral analysis of provincial staffing levels 2001

Number of civil servants	Education	Health	Welfare	Other	Total
Eastern Cape	75 339	31 050	1 695	19 178	127 262
Free State	29 338	14 889	1 454	11 361	57 042
Gauteng	57 272	42 328	2 053	6 387	108 040
KwaZulu-Natal	78 511	47 361	2 210	15 498	143 580
Mpumalanga	28 376	11 286	486	9 049	49 197
Northern Cape	8 888	3 942	629	1 703	15 162
Northern Province	60 730	23 433	846	26 752	111 761
North West	36 436	15 025	78	11 664	63 203
Western Cape	34 440	24 214	1 308	4 749	64 711
Total	**409 330**	**213 538**	**10 759**	**106 341**	**739 958**
% of total provincial staff in sector					
Eastern Cape	59,2	24,4	1,3	15,1	100,0
Free State	51,4	26,1	2,5	19,9	100,0
Gauteng	53,0	39,2	1,9	5,9	100,0
KwaZulu-Natal	54,7	33,0	1,5	10,8	100,0
Mpumalanga	57,7	22,9	1,0	18,4	100,0
Northern Cape	58,6	26,0	4,1	11,2	100,0
Northern Province	54,3	21,0	0,8	23,9	100,0
North West	57,6	23,8	0,1	18,5	100,0
Western Cape	53,2	37,4	2,0	7,3	100,0
Average	**55,5**	**28,2**	**1,7**	**14,6**	**100,0**
Civil servants per 1000 people					
Eastern Cape	11,2	4,6	0,3	2,8	18,9
Free State	10,5	5,3	0,5	4,0	20,3
Gauteng	7,4	5,4	0,3	0,8	13,9
KwaZulu-Natal	8,7	5,3	0,2	1,7	16,0
Mpumalanga	9,5	3,8	0,2	3,0	16,4
Northern Cape	10,0	4,4	0,7	1,9	17,0
Northern Province	11,4	4,4	0,2	5,0	21,0
North West	10,1	4,2	0,0	3,2	17,6
Western Cape	8,3	5,8	0,3	1,1	15,6
Average	**9,7**	**4,8**	**0,3**	**2,6**	**17,4**

The reasons for these distortions in the balance between social and non-social sectors can be traced to the manner in which provinces came about. Provinces like Eastern Cape, KwaZulu-Natal, Northern Province and Mpumalanga that incorporated homeland administrations are overstaffed relative to those that did not have to integrate with former homeland administrations, like Gauteng amd Western Cape.

The absence of a retrenchment tool made it difficult to adequately align employment trends with policy and budget priorities. While natural attrition and voluntary severance are useful tools in rightsizing provincial structures, they do not allow for more targeted interventions in personnel management. The amalgamation of former provinces and homelands required such targeted intervention to manage staff numbers and deployment.

Table 7.4: Provincial personnel numbers 1997/98 to 2003/04

	1997/98	1999/00	2000/01	2001/02	1997/98 to 2001/02	Civil servants per 1000 people
Eastern Cape	139 497	136 935	131 857	127 262	*-8,8%*	18,9
Free State	62 627	61 054	58 509	57 042	*-8,9%*	20,3
Gauteng	120 056	112 851	111 495	108 040	*-10,0%*	13,9
KwaZulu-Natal	162 092	153 687	148 716	143 580	*-11,4%*	16,0
Mpumalanga	52 043	51 355	50 492	49 197	*-5,5%*	16,4
Northern Cape	15 077	14 821	15 241	15 162	*0,6%*	17,0
Northern Province	118 182	119 465	113 902	111 761	*-5,4%*	21,0
North West	67 688	67 169	64 922	63 203	*-6,6%*	17,6
Western Cape	71 862	67 940	64 261	64 711	*-10,0%*	15,6
Total	**809 124**	**785 277**	**759 395**	**739 958**	***-8,5%***	**17,4**

Medium term projections

Personnel spending to grow over MTEF period

As with other elements of provincial spending, the 2000/01 fiscal year saw personnel expenditure increase by 0,3 percent in real terms over the 1999/2000 level. Six of the nine provinces experienced real growth in personnel spending, while Eastern Cape, Northern Cape and Western Cape continued to reduce personnel spending in real terms. This shift reflects a healthier budget position in most provinces.

During the MTEF, from 2000/01 to 2003/04, total provincial spending is projected to grow in real terms by 2,3 percent a year. Personnel spending is projected to rise by 0,2 percent a year over the same period.

Prioritisation of social services

Over the MTEF, health personnel budgets should grow faster than other departments' budgets. This should accommodate the payment of rank and leg promotions backlogs, an expansion of health services, community based care and the response to HIV/Aids. Education budgets are also set to grow in real terms as provinces complete deploying appropriately qualified teachers in formerly disadvantaged areas.

Personnel budgets in non-social service departments are set to decline in real terms due to natural attrition. If an agreement on a retrenchment tool is reached with unions, non-social service personnel budgets could decline even faster, releasing more resources for maintenance and new capital projects, thus paving the way for improved service delivery.

Attracting Managers and Professionals

The skills mix of staff in each provincial sector must also be reviewed. For example, provinces have 40 percent of senior managers while employing 70 percent of all civil servants. National departments have 60 percent of senior managers while they employ just 30 percent of staff. Table 7.5 provides insight into these trends.

Table 7.5 Senior Management Services (SMS) in provinces

Province	Head count			Cost		
	SMS	Total	Percentage	SMS (million)	Total (million)	Percentage
Eastern Cape	213	127 262	0,17%	183	13 498	1,36%
Free State	156	57 042	0,27%	90	4 168	2,16%
Gauteng	411	108 040	0,38%	246	8 799	2,80%
KwaZulu-Natal	302	143 580	0,21%	181	10 312	1,76%
Mpumalanga	148	49 197	0,30%	69	3 672	1,88%
Northern Cape	131	15 162	0,86%	67	4 753	1,41%
Northern Province	80	111 761	0,07%	34	1 183	2,87%
North West	200	63 203	0,32%	94	7 828	1,20%
Western Cape	375	64 711	0,58%	161	5 220	3,08%
Total	**2 016**	**739 958**	**0,27%**	**1 125**	**59 433**	**1,89%**

For more effective delivery, administrative structures in education, health and social development services are normally decentralised into smaller districts and cost centers. For example, the health sector provides primary health care on a district health basis, requiring managers for such districts. The appointment of CEOs for hospitals to decentralise hospital management will also require the employment of more managers.

A second area to address is that of critical professional staff (specialists and other doctors, professional nurses, mathematics and science teachers, engineers). Effective and expanded service delivery in health, education, housing and roads is dependent on the employment of skilled personnel. To attract and retain such professionals, remuneration packages, work conditions and non-remunerative benefits (such as research linkages to universities) will need to improve.

The problem is even more serious in poorer provinces, where even the private sector fails to attract sufficient professionals. In order to recruit and retain skilled professionals, particularly in areas such as management, finance, IT, health and project management, poorer provinces may need to pay a premium.

Policy to effect a better distribution between the private and public sectors, and between provinces, must take account of the emigration of professionals from South Africa to richer countries like the USA, UK, Australia, Saudi Arabia and the Emirates. The Department of Public Service and Administration is developing policy to attract and retain staff with scarce skills throughout the public sector, but focusing on geographic disparities as well.

Policy challenges

Training in the public sector

Government has prioritised training. The imposition of a skills levy, and the creation of the various Sector Education and Training Authorities (SETAs), demonstrates this commitment. Government also funds universities and technikons to educate and train students.

This *Review* will not deal with these areas of national competence, except to comment on the implications for the provincial sphere.

The national Department of Education is shifting teaching colleges into the university arena. This involves a shift from provincial education departments to the national sphere. In most instances, teacher-training colleges are incorporated into higher education institutions, such as the incorporation of the Johannesburg College of Education into the University of Witwatersrand. In other cases, teacher-training colleges have been merged with smaller colleges and strengthened as free standing training institutions.

Transfer of teaching colleges

The national departments of education and health are discussing shifting nurse training from a provincial health competence to higher education institutions. A further issue relates to the training of doctors, and the further training of specialists. The training of health personnel requires effective co-ordination between the higher education sector and the hospital sector, both of which receive funding for this purpose. Given the exodus of doctors and nurses from the public sector, and from the country, South Africa has to train or recruit professionals to sustain an effective supply for both the public and private sectors. Similar issues relate to training other professionals, like engineers, IT professionals, and finance.

There is also a need for the public sector to convey its future needs to higher education institutions, and to school learners. Given the reduction in public service employees after 1997, there is a widespread perception that jobs for teaching, nursing, medical personnel, engineers are not available. This perception is not correct, as education institutions are no longer training sufficient personnel for future needs. Even where learners are prepared to register for such courses, the schooling system may not be producing a sufficient number of students with appropriate learning (e.g. with higher grade maths and science). Whilst bridging programmes at universities can address some of this gap, a more sustainable solution is to ensure schools guide learners in their choice of subjects. The conditional grants for such training are under review (e.g. Hospital Training Grant).

Personnel spending should grow moderately

As provincial budgets have stabilised, real growth in spending is projected. However, if provinces want to continue increasing maintenance and capital programmes and social welfare grants beneficiaries, they need to control personnel expenditure.

It is nonetheless not realistic to expect the same rate of decline in personnel expenditure as seen over the past four years. Further, service delivery will only improve if more management positions are created in provinces, and renewed efforts are made to attract and retain key professionals. Similarly, as the health system expands to cope with the effects of HIV/Aids, hiring more people may become a necessity. To achieve this, personnel spending should grow by between 1,0 and 1,5 percent in real terms over the MTEF period. Presently, provincial budgets do not cater for real increases of this magnitude.

Rank and leg promotions

Provincial governments also face the costs of backlogs in rank and leg promotions. In terms of an agreement with public service unions, Government will pay these backlogs over the next three years. The estimated cost of promotion backlogs in provincial health departments is estimated to be about R300 million, and in welfare departments about R200 million. From a human resource management and financial point of view, it is advisable for provinces to make these outstanding promotions sooner rather that later, since the cost will increase as time goes on. The payment of these obligations will add further pressure to provincial personnel budgets, limiting the prospect of increasing employment in critical areas such as health.

HIV/Aids

One of the most serious challenges facing the public sector is the impact of HIV/Aids on its workforce, its productivity and its skills base. Presently, South Africa is not training enough nurses and teachers to cope with demand, given relatively high rates of natural attrition and a projected increase in Aids-related deaths. The Department of Public Service and Administration has conducted extensive research into the possible effects of the disease on the public sector and ways of managing it. A series of education and awareness programmes are planned in all sectors of the civil service. In addition, a more concerted plan is required to increase training in critical areas such as education, health, policing and justice.

Infrastructure development

The apartheid legacy

South Africa's post-apartheid government inherited considerable infrastructure backlogs in previously neglected areas. This has been especially prevalent in education, health, housing, clean water, roads and electricity, where provincial and local governments have major responsibilities. This section will only deal with provincial trends, as local government infrastructure is dealt with later. Since provincial systems do not accurately differentiate between maintenance and capital, this chapter largely refers to both when it refers to infrastructure spending.

Provincial capital expenditure is organised into four functional categories:

- *Housing* – national housing grants to provinces, including national grants to households from 1997/98 to 1999/2000, when the programme was not operated by provinces
- *Roads* – construction and rehabilitation of roads for which provinces are responsible
- *Social* – mainly schools, clinics and hospitals, as welfare has negligible capital spending
- *Other* – parks, tourism infrastructure, dams, and capital projects not classified in other categories.

Increased spending on infrastructure

Faced with many financial pressures, provinces reduced spending on infrastructure maintenance, rehabilitation, and construction over the three financial years ending in 2000/01. In recognition of this trend, the 2001 Budget identified accelerated infrastructure service delivery as one of its main priorities. A targeted infrastructure initiative, including a new conditional grant, was facilitated by positive economic and financial trends and a significantly expanded expenditure envelope.

Progress in addressing infrastructure backlogs is set to continue over the next three years, but significant challenges remain. Core among these is the need to improve the institutional arrangements, particularly those related to planning and implementation in order to ensure sound provincial capital investment.

Historical expenditure trends

Construction and rehabilitation

Table 7.6 presents a summary of provincial capital expenditure and sources of funding from 1997/98 to 2003/04. It identifies national funding through grants in housing, health, flood reconstruction, and the new provincial infrastructure conditional grant. It also identifies provincial funding for capital expenditure, mainly from their equitable share allocations. This review of expenditure trends is limited to expenditure for construction and rehabilitation. Information about maintenance spending is dispersed, as it is funded from operating funds and generally classified as current/recurrent expenditure. The table shows that in 1997/98 provincial funding for capital expenditure represented 64 percent (R5,2 billion) of total provincial capital expenditure of R8,1 billion. The remaining 36 percent came from the national housing grant.

Table 7.6: Provincial capital expenditures

	Actual			Estimated Actual	Medium-term Estimates		
R'million	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/01**	**2003/04**
Housing Subsidy	2 920	2 749	2 571	2 945	3 226	3 440	3 559
Health	–	298	370	492	654	590	633
Hospital Rehabilitation	–	*87*	*140*	*323*	*500*	*520*	*543*
Nkosi Luthuli Hospital	–	*200*	*189*	*74*	*104*	–	–
Nelson Mandela Hospital	–	*11*	*41*	*95*	–	–	–
Pretoria Academic	–	–	–	–	*50*	*70*	*90*
National Treasury	–	–	–	681	1 400	1 950	2 514
Flood reconstruction	–	–	–	*681*	*600*	*400*	*200*
Provincial Infrastructure	–	–	–	–	*800*	*1 550*	*2 314*
National funding	2 920	3 047	2 941	4 118	5 280	5 980	6 706
As % of total capital expenditure	*35,9%*	*49,0%*	*45,8%*	*53,9%*	*47,1%*	*46,0%*	*47,6%*
Provincial funding	5 211	3 171	3 485	3 524	5 919	7 007	7 371
As % of total capital expenditure	*64,1%*	*51,0%*	*54,2*	*46,1%*	*52,9%*	*54,0%*	*52,4%*
Total Capital expenditure	**8 131**	**6 218**	**6 426**	**7 642**	**11 199**	**12 987**	**14 077**

National capital spending grew

In 1997/98, capital expenditure for housing was the only major national program for capital expenditure in the provincial sphere. Over the three years through 2000/01, national funding for provincial capital projects rose from R2,9 billion to R4,1 billion, or from 36 to 54 percent of total provincial capital expenditure.

Critical needs

In 1998/99, government responded to a critical need for hospital capacity with new conditional grants for academic hospitals and hospital rehabilitation. In 2000/01, major flood damage necessitated a conditional grant for flood reconstruction as shown in table 7.7.

Declining infrastructure expenditure …

During this three-year period, when national infrastructure funding was expanding, provincial infrastructure allocations from own sources were contracting. Provinces had to deal with substantial debt, increased personnel costs resulting from policy initiatives of the mid-1990s, and slower than expected revenue growth. Over the three years to 2000/01, total provincial funding for capital expenditure declined from R5,2 billion to R3,5 billion.

New infrastructure grant

Given substantial concerns about the overall downward trend, government responded with a new infrastructure conditional grant to provinces. The grant was funded in the 2001/02 MTEF with R4,7 billion, of which R800 million was appropriated for the 2001/02 financial year.

Table 7.7: Flood reconstruction grant

	Budget	Estimated Actual	Medium-term Estimates		
R million	**2000/01**		**2001/02**	**2002/01**	**2003/04**
Eastern Cape	90	51	130	70	23
Free State	38	38	128	58	21
Gauteng	10	10	–	–	–
KwaZulu-Natal	142	97	12	–	–
Mpumalanga	241	124	98	90	36
Northern Cape	6	6	7	–	–
Northern Province	343	335	196	182	120
North West	25	20	11	–	–
Western Cape	–	–	18	–	–
Total	**895**	**681**	**600**	**400**	**200**

Trends by province

From decline to growth

Reductions in expenditure for infrastructure construction and maintenance to deal with budget shortfalls are common in public sector budgeting. South Africa's provinces were no exception to this. They cut their capital spending to deal with short-term financial pressures created by debt, rising personnel costs, and slow revenue growth. The decline of provincial capital expenditure and the reversal of that trend are shown in table 7.8.

Downward trend reversed

Following total provincial capital spending of R8,1 billion in 1997/98, capital expenditure dropped 24 percent to R6,2 billion the following year. Eight provinces reduced spending, with Gauteng the only exception. The next year, 1999/2000, was also lean, with capital expenditure remaining below 1997/98 levels in seven provinces. Only Gauteng and Northern Province managed to have small increases. For 2000/01, the downward trend was clearly reversed. Capital spending rebounded with a 19 percent increase to R7,6 billion, and all provinces spent more than the previous year.

Table 7.8: Total Provincial Capital Spending

R million	Actual 1997/98	1998/99	1999/00	Estimated Actual 2000/01	Medium-term Estimates 2001/02	2002/03	2003/04
Eastern Cape	745	529	583	732	1 304	1 919	2 112
Free State	627	421	210	313	677	685	709
Gauteng	1 424	1 542	1 780	1 832	2 580	2 909	3 064
KwaZulu-Natal	2 183	1 472	1 351	1 692	2 394	2 616	2 944
Mpumalanga	729	481	509	605	753	897	920
Northern Cape	207	170	144	170	214	227	258
Northern Province	479	435	626	719	1 304	1 525	1 697
North West	890	431	497	629	963	1 131	1 278
Western Cape	846	737	725	951	1 009	1 078	1 095
Total	**8 131**	**6 218**	**6 426**	**7 642**	**11 199**	**12 987**	**14 077**

Functional trends

Table 7.9 shows capital expenditure by function across all provinces combined. Only roads and health spent more in 1999/2000 than in 1997/98. While positive accomplishments can be cited, most infrastructure backlogs increased above levels previously measured. Expenditure has, however, increased in 2000/01 and is set to increase substantially in the medium-term.

Table 7.9: Provincial capital expenditure by function

R'million	Actual 1997/98	Actual 1998/99	Actual 1999/00	Est. Actual 2000/01	Medium-term estimates 2001/02	2002/03	2003/04
Housing	2 920	2 749	2 571	2 945	3 226	3 440	3 559
Roads	810	868	918	1 675	1 772	2 310	2 704
Social infrastructure	1 748	1 256	1 442	1 596	3 444	4 302	4 996
Education	*842*	*481*	*459*	*501*	*1 162*	*1 791*	*2 099*
Health	*906*	*775*	*983*	*1 095*	*2 282*	*2 511*	*2 897*
Other	2 653	1 345	1 495	1 426	2 757	2 935	2 818
Total expenditure	**8 131**	**6 218**	**6 426**	**7 642**	**11 199**	**12 987**	**14 077**

Health

?? The growth in Health's 2000/01expenditure level was higher than in 1997/98, because it was largely funded from ring-fenced conditional grants for hospital construction and rehabilitation. In spite of this, over a third of public hospitals still require replacement or major rehabilitation. While there has been a marked increase in the availability of electricity at South Africa's over 4 000 primary health care facilities, service interruptions in electricity, phones and piped water remain a problem at many. Statistics South Africa surveys show a gradual increase over time in the use of public hospitals and clinics.

Housing

?? 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. Although surveys conducted by Statistics

South Africa show a steady increase in the proportion of households living in formal housing, backlogs are still estimated at 2,2 million units.

Roads

?? About 223 000 of South Africa's 500 000 kilometres of roads are under the responsibility of provinces. Only limited amounts were spent on new roads and rehabilitation, with most spending for roads devoted to maintenance. Overall, there was deterioration in roads and increases in maintenance and rehabilitation backlogs.

Education

?? Capital expenditure in education between 1997/98 and 1999/2000 saw an average annual reduction of 26 percent. Education capital expenditure decreased from R842 million in 1997/98 to R459 million in 1999/2000. In spite of these cuts, the number of school classrooms increased by over 25 000 between 1996 and 2000. Significant progress was also made in reducing the percent of schools without sanitation to 17 percent, those with no access to running water to 34 percent, and those without power to less than 50 percent. But based on the *Schools Register of Needs*, 40 percent of South Africa's schools still have classroom shortages that total 50 000.

Capital expenditure set to surpass R14 billion

Over the medium-term, provincial capital expenditure is set to grow strongly at an average annual rate of 23 percent and is 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.

Strengthening institutional capacity

Management capacity a key challenge

Success in ramping up expenditure depends on reforming the institutional and funding mechanisms to improve and accelerate infrastructure planning and management. Capital projects involve long term efforts to plan, design and develop project specifications. They generally require extensive consultation, their financing tends to be complicated, and design, engineering, procurement, tendering, and other technical issues are often complex. All these factors can delay project planning, financing, management, and implementation.

South Africa's provincial governments are relatively new spheres of government. Their political and administration staff do not always have extensive experience with capital project planning and management. Shortfalls in financial and personnel resources have also eroded provincial capacity in key areas, including infrastructure.

New approaches considered

Provincial capital investment capacity is often fragmented among provincial departments. The delivery model followed by most provinces involves public works departments as planners, implementing agents, technical advisors or managers of contracts on behalf of line function departments. Typically, this arrangement involves unclear purchaser-provider relationships and insufficient performance incentives to ensure that providers deliver upon agreed results. There are also concerns that some provincial treasuries are not appropriately involved in capital project oversight. Possible changes are discussed in the text below.

Changing institutional arrangements for infrastructure

All provinces are dependent (or have been dependent) on a department of public works which is responsible for all infrastructure in the province. In most instances, the infrastructure budget of a functional department resides within the Public Works budget. Whilst the budgets for infrastructure are now being shifted to line function departments themselves, most provinces have not shifted implementation responsibility to the line function departments. Given that many public works departments have excess personnel, and in the absence of a retrenchment tool, much of its budget is committed on personnel rather than spending on infrastructure. This approach has tended to confuse accountability mechanisms over the spending on infrastructure, and resulted in significant underspending.

Provinces are in the process of reviewing their current approach, with Gauteng and Northern Province setting up specific institutions for major infrastructure. Two provinces have arrangements with the National Roads Agency for their roads construction and maintenance, and all provinces are also exploring the use of public-private partnerships. Provincial departments of education and health are also exploring taking full responsibility for school, hospital and clinic infrastructure. These reforms to modernise infrastructure delivery are expected to reap real benefits in the effectiveness and efficiency of infrastructure spending. Procurement reforms are also expected to help, particularly with capital expenditure.

Provinces tend to begin planning only after their allocations are finalised. This delays planning and construction and gives rise to rollovers and inefficient resource utilisation.

In some areas, provincial and national planning processes are not well linked, with the result that provincial actions do not take full account of national priorities, norms, and standards. Similarly, provinces use little of the available demographic and socio-economic information to inform the capital planning process.

Both national and provincial treasuries have learned valuable lessons from the flood reconstruction projects, and are developing refinements to improve the efficiency and effectiveness of capital planning and management in the future.

Clear reporting on projects

In May 2001, the Budget Council's Technical Committee on Finance (TCF) agreed that provinces would revise plans to meet basic requirements of the Division of Revenue Act 2001. The provinces will provide a summary of medium/long term infrastructure investment plans, as well as a consolidated summary of three-year allocations. This will cover education, health, public works and roads, and rural development. Projects in each sector will be listed, indicating start and completion dates and anticipated costs each year over the project life.

Reviewing the public works model

To support effective planning and management, several new practices are being considered or already applied:

- Provinces are actively exploring alternatives to the current public works model. Modifications include introducing more clearly defined purchaser-provider contracts, and redesigning the incentive system such that excessive costs due to factors within the control of the provider have consequences for the provider. Clear provisions are also necessary to deal with provider default.

Dedicated capacities

- An option being explored in some provinces involves creating capital planning and management capacities separate from public works departments. Some, like the Northern Province, have also outsourced aspects of their capital investment programmes that lend themselves to public-private partnerships and other arrangements with the private sector.

Reporting

- There is also merit in standardised and more regular reporting so that information can be aggregated across provinces. For example, allocation and expenditure information should distinguish between new capital projects, rehabilitation, and current expenditure maintenance.

Using data in planning

- Planning in each sector should be guided and informed by the latest data available. Provinces should increasingly make use of relevant data from government publications such as the Schools Register of Needs, Census 1996, Household Surveys, Measuring Poverty in SA, 2000 and other publications.

Cost benefit analysis

- All capital projects should be subjected to cost-benefit analysis, with a thorough assessment of their budgetary implications. This should include operational costs throughout the life of the project, revenue streams expected and attendant risks.

Intergovernmental orientation

- In the case of concurrent functions, national departments should assume a role in defining and/or developing norms and standards for the sector. Stronger and more focused intergovernmental forums – so-called '4x4s' and MinMECs – can guide this process.

Borrowing

- Finally, there could be merit in linking borrowing to capital budgeting. Linking the two could facilitate the protection of capital allocations, while at the same time ensuring that all borrowed funds are used to expand public capital stock.

Benefits

- There are valuable lessons to be learned from the step-by-step process followed by Public Private Partnership projects (PPPs). Of particular relevance are issues of affordability, value for money and assessment of the socio-economic and environmental impact of projects.

Public Private Partnerships

Public-Private Partnerships (PPPs) are taking root as national and provincial departments seek assistance to enhance their own capacity, and private investors explore new opportunities. These partnerships enable private financing, efficiencies and skills to be harnessed to improve and propel public infrastructure and service delivery.

Different stakeholders benefit from such projects and facilities. Departments and provinces achieve savings and greater efficiency; the users of a service should gain easier access to quality services; private parties find business opportunities; and broader society may benefit from specific project objectives included in the contract.

These benefits are achieved through deals that shift technical, operational and financial project risk to the private party in exchange for a fee and/or other benefit. In a PPP, government is not procuring an asset, rather it is procuring a specific level of service.

Treasury Regulations require that a PPP:

?? is affordable to the department over the life of the contract

?? is good value-for-money to the public

?? transfers risk appropriately to the private party.

Affordability is key

Affordability is a cornerstone of fiscal management, and no less so in PPPs. While a PPP may shift the capital financing requirement to the private party and thus defer budgetary impact over time, this still requires that a department's budget is able to honour the cost of the service. PPPs force the public sector to calculate real costs. Such rigorous appraisal is required of all potential PPP projects during a feasibility study stage, prior to seeking private interest. This study must demonstrate affordability and show how value-for-money can be achieved through risk transfer.

A number of provinces are embarking on PPP initiatives, as indicated in table 7.10. Most are in the early phases of planning and feasibility studies. Project values cannot be issued for all listed projects, either because these have not yet been determined, or because it would be prejudicial to reveal them at this stage in the procurement process. None of the provincial PPPs have to date reached financial closure (the programme is just over a year old), although five significant projects are close to finalisation.

Since the promulgation in 2000 of the Treasury Regulations governing PPPs, provinces are identifying a wide range of service sectors and infrastructure initiatives that lend themselves to PPP delivery. This first phase of entering the PPP project cycle is spurred by increasing pressures on provincial resources that limit opportunities for direct capital spending from voted budgets, and multiple efficiency problems in service delivery.

Of critical importance in the years ahead is the development of provincial treasury capacity to oversee the unfolding of the PPP agenda across provincial departments. The National PPP Unit, located in National Treasury, presently has the regulatory responsibility for all national and provincial PPPs. Its technical support and guidelines add impetus to this role. Since 1999 it has published a strategic framework and several guidelines, worked with provinces and national departments, and undertook training ventures.

However, as the standards become set, experience grows, market confidence increases, and project volumes escalate in the forthcoming years, this regulatory role will need to decentralise. Provincial treasuries will have a pivotal role to play in ensuring that affordability, value-for-money and risk transfer are properly regulated. For now, the National PPP Unit is working closely with all provincial treasuries on the pioneering phase of their PPPs.

Capacity building is a priority. The skills required for long–duration that entail significant risk are still in short supply in provinces. Dealing with this requires at least a two-fold approach: first to build required capacity, and second, to reduce the demand on capacity through measures that mitigate the complexity of PPP arrangements.

Table 7.10: Provincial PPPs

Provincial Dept	PPP project	Project status	Approx project value
Eastern Cape Dept Arts & Culture	Bayworld – PE museum, snake park, oceanarium	Transaction Advisors to be appointed November 2001	not yet determined
Eastern Cape Dept Health	Hospital co-location projects	Feasibility Studies underway	build value R20 million
Eastern Cape Dept Transport	Fleet Management	Transaction Advisor being appointed	not yet determined
Free State Dept Education	Schools construction and maintenance	Transaction Advisors to be appointed September 2001	not yet determined
Free State Dept Health	Universitas and Pelonomi Hospitals – co-location	Preferred bidder announced, financial closure expected October 2001	build value R80 million
Gauteng Blue IQ	Hi-speed train	Feasibility Study under review by National Treasury.	not yet determined
KwaZulu-Natal Dept Health	Inkosi Albert Luthuli Hospital equipment and maintenance	Negotiations in final stages with preferred bidder. Financial closure due September 2001	R0,5 billion equipment and facilities capital worth
KwaZulu-Natal Ezemvelo KZN Wildlf.	Eco-tourism – Vivane resort/ Pongolapoortdam	Bidders' proposals due for Vivane; RFP issued for Pongolapoort	not yet determined
Mpumalanga Dept Finance/Econ	Eco-tourism – Zithabiseni Resort	Bids from investors due September 2001	not yet determined
Northern Cape Dept Transport	Fleet Management	Negotiations underway with preferred bidder. Financial closure due September 2001	R150 million
Northern Province Dept Public Works	GIS web-linked management info system for the Province	Transaction Advisors to be appointed September 2001	not yet determined
Northern Province Dept Finance/Econ	Eco-tourism – Manyelethi Reserve and Letaba Ranch	Preferred bidders selected. Financial closure due Sept 2001 for Pungwe, Khoko Moya, Honey Badger, North Letaba.	not final
Northern Province Dept of Health	Emergency vehicles Fleet management	Transaction Advisors being appointed	not yet determined
NorthWest Parks&Tourism Board	Eco-tourism – Boskop Dam, Rustenburg, Oog Malemani, Borakalalo	Bids received for Rustenburg; RFPs issued for others	not yet determined
North West Dept Transport	Bus Transport-NTI	Transaction Advisor being appointed.	not yet determined
Western Cape Dept Transport	Chapman's Peak Toll Road Concession	Four bidders pre-qualified. Tender documents issued end-July 2001	build value R160 million
Western Cape Dept Health	Hospital co-location projects	Feasibility Studies underway	not yet determined
Western Cape Nature Cons. Board	Eco-tourism – 13 sites	Terms of Reference being drafted for Transaction Advisors	not yet determined

Conditional grants

Conditional grants were introduced in 1998/99 as part of the intergovernmental transfer system, and constitute about 12 percent of transfers to the provinces. The health sector administers 7 conditional grants, amounting to more than 40 percent of total conditional grants. Allocations for conditional grants are set out in the Division of Revenue Act, which is enacted annually with the national budget. The

Division of Revenue Act also sets out equitable share allocations for each sphere and includes provisions for the management and administration of transfers to provinces and municipalities.

The equitable share is an unconditional transfer to provincial and municipal governments to fund provision of basic services and other functions assigned to them by the Constitution. The formula used to allocate equitable shares is redistributive, allocating more funds to poorer provinces and municipalities.

Conditional grants have been used to:

- ensure fulfilment of national policy priorities regarding the provision of standard levels of service
- compensate for inter-jurisdictional spill-overs resulting from services provided by sub-national governments
- support capacity building and structural adjustment within the recipient administrations
- address backlogs and regional disparities in economic and social infrastructure.

Administration of conditional grants

The administration of conditional grants involves both transferring (national) and receiving spheres (provincial or local government). The receiving governments are responsible for expenditure and financial accountability. The national departments are responsible for monitoring compliance with the conditions of the grants, and to assess whether they are achieving the desired outputs and outcomes. Conditional grants are voted as transfers in the national budget and recorded as revenue in the budget of the receiving sphere. They are also voted in the departmental budgets of the receiving sphere.

Experience with conditional grants

The introduction of conditional grants has experienced some initial problems, resulting in non-transfers and under-spending and non-transfer. These problems were a result of, among other things, confusion over accountability, poor design and planning, inadequate transparency in allocations, too many conditional grants and poor monitoring. Since 1999/2000, successive Division of Revenue Acts have introduced reforms to address these problems, allowing for a smoother flow of grants. The result has been a significant reduction of roll-overs at the national level.

Types of Provincial Conditional Grants

Conditional grants can be classified into two broad categories – block grants and specific purpose grants. These are listed in table 7.11.

Block grants compensate for spill-over costs

Block grants involve large allocations to complement the equitable share allocations to provinces. These grants are not necessarily earmarked for particular projects or spending programmes; they fund functions assigned to provinces or that benefit more than one province or provide for general budget support to provinces. The provinces that provide assigned functions cannot be compensated adequately for these spill-over benefits and resulting costs through the equitable share. Because block grants provide for general budget support, in-year monitoring of expenditure on the grant is not required. The three block grants in the system amount to about R6,5 billion in 2000/01 – approximately 50 percent of conditional grants to provinces.

Block grants in Health sector

?? The health sector administers two: the central hospital and health professional training grants, amounting to about R4 billion per year. These grants form part of general funding for hospitals in provinces in which central and academic hospitals are located. They are conditional upon non-discriminatory access to services and tariffs for residents and non-residents. The health sector has completed a review of their conditional grants, and a more consolidated approach will be phased in from 2002/03.

Supplementary allocation grant

?? The supplementary allocation, administered by the National Treasury, amounts to almost R2,2 billion. It provides general budgetary support to encourage good budgeting and financial management practices. In the 2001/02 budget, this grant is also used as a mechanism to consolidate various small grants, covering housing, transport and financial management, to the amount of R248 million. This has streamlined grant administration and facilitated a focus on outputs rather than spending.

Specific purpose grants

Specific purpose grants support specific priorities and interventions by the national government. These are more discretionary, set more stringent conditions, and require monitoring of spending. They can be withheld on failure to comply with the conditions.

Table 7.11: Conditional Grants to Provinces

Grants	Actual Transfers	Medium-term estimate		
R'000	2000/01	2001/02	2002/03	2003/04
Block Grants	**6 498**	**6 753**	**6 861**	**7 088**
Central hospital grant	3 112	3 271	3 419	3 579
Health Professional training	1 174	1 234	1 291	1 351
Supplementary Allocation	2 212	2 248	2 152	2 158
Specific Purpose Grants	**6 538**	**6 659**	**7 362**	**8 148**
Infrastructure Grants:	**5 129**	**5 562**	**6 273**	**7 013**
Hospital Rehabilitation	400	500	520	543
Redistribution specialised services	276	182	189	198
Hospital Construction	443	154	70	90
Housing Fund	3 064	3 226	3 440	3 559
Human Settlement	38	100	104	109
Provincial Infrastructure*	895	1 400	1 950	2 514
Classroom backlog	13	–	–	–
Recurrent Grants:	**1 409**	**1 097**	**1 090**	**1 135**
Integrated Nutrition Programme	582	582	582	582
HIV/AIDS	46	110	–	–
Financial Management	309	223	235	234
ECD	–	21	52	88
Local Government Support	78	160	220	230
R293 Personnel	375	–	–	–
Social Development	19	–	–	–
Total	**13 036**	**13 412**	**14 224**	**15 236**

** Includes flood reconstruction grant*

Infrastructure and recurrent grants

There are two categories of specific purpose grants: infrastructure and recurrent. The infrastructure grant transfers amount to R5,1 billion in 2000/01, and increase to R5,6 billion in 2001/02 (10,3 percent) to R7 billion by 2003/04. They are administered by the Departments of Health and Housing with the National Treasury.

Infrastructure grants in Health

- Health Infrastructure grants – The main grant under health has been the hospital rehabilitation grant, to assist provinces to rehabilitate and upgrade hospital facilities. The redistribution grant also has a significant capital component. It was introduced to support provinces without central hospitals to build some capacity to provide tertiary care services. The hospital construction grant has since 1998/99 also provided funds for the construction of academic hospitals in Eastern Cape (R164 million), KwaZulu-Natal (R824 million) and Gauteng (R210 million).

Housing Fund

- Housing grants – The Housing Fund was initiated prior to 1998/99 as part of the RDP programme, to provide subsidies for housing development to poor households. With the change in the intergovernmental grant system in 1998/99, the grant was administered as an agency payment, and was converted into a conditional grant in 2000/01. It constitutes about R3 billion in 2000/01, or 61 percent of infrastructure grants, and is budgeted to increase to more than R3,6 billion in 2003/04.

Infrastructure grant used to fund rehabilitation

- Provincial infrastructure grant – The provincial infrastructure grant is a general infrastructure grant to assist provinces address infrastructure backlogs in education, health, roads and rural infrastructure. First introduced in 2000/01, the initial allocation of R300 million went mostly to provinces affected by the flood disasters of 1999/2000 (Northern Province, KwaZulu-Natal, Mpumalanga and Eastern Cape). An additional allocation of R595 million was made in the 2000/01 Adjustments Estimates for rehabilitation of infrastructure damaged by floods, and the 2001/02 MTEF also includes R1,2 billion for flood reconstruction. The provincial infrastructure grant was given a major boost with an allocation of R800 million in 2001/02, and a total of R3,9 billion over the rest of the MTEF.

Specific purpose grants for recurrent expenditure

Other specific purpose grants fund recurrent spending. The total allocation amount to R1,4 billion in 2000/01, and decreases to R1,1 billion in 2003/04 due to phasing out of the R293 staff grant. The major grants in this category target:

- Capacity building – Most transitional grants have been used to support capacity building, focusing on improving financial management. The Department of Education administers the largest of these grants (R202 million), aimed at addressing the general lack of effective management systems at provincial, district and school level. The National Treasury has administered a grant to support overall improvement in financial management (R100 million). This grant has been subsumed into the supplementary grant in 2001 MTEF. Provision has been made within the supplementary grant for R243 million for the 2001/04 MTEF years to pilot a programme for improvement in hospital management. Social Development grants have focused on improving capacity and systems for administering social security grants. The Social Development conditional grants include an allocation for enabling provinces to streamline systems for increased uptake of the child support grant. All welfare grants phase out in 2002/03.

Support to provinces and local government

?? Provincial and local government support – The Department of Provincial and Local Government (DPLG) has been allocated R630 million over the 2001 MTEF to enable provinces to support municipalities in financial difficulties. There have also been allocations to support provinces, which carried R293 Towns staff between 1994 and 2000. This grant has been now been phased into the local government equitable share with the transfer of staff and operational budgets to municipalities.

Other recurrent grants

?? Other recurrent grants provide direct support for service delivery. These include the Integrated Nutrition Programme (INP) in Health, Early Childhood Development (ECD) administered by the Department of Education, and a grant for implementation of an integrated strategy for the prevention of HIV/AIDs.

Trends in Transfers and Spending of Conditional Grants

The grant system continues to evolve. Hence, the 1998/99 figures on conditional grants to provinces by department, reported in table 7.12, differ from the *2000 Intergovernmental Fiscal Review* because they have been adjusted for the agency grants that were converted to conditional grants. Examples are the Housing Fund and Education grant.

Non transfer of grants

As the conditional grant system evolved, most conditional grants began to flow on the basis of a payment schedule. This has reduced the difference between actual transfers and budgets for conditional grants. However, there is divergence between transfers and spending, indicating under-spending of transferred amounts by provinces. Neither national nor provincial departments monitored actual spending and were unable to report accurately in this respect.

Spending of conditional grants

For the first time in this review an attempt is made to review spending of conditional grants by provinces since 1998/99. Whereas reported transfers are considered accurate, they are only indicative at this stage. Most provinces were not able to report accurately on individual grants as their information systems were not set up to provide such information.

Review necessary

For a better understanding of the achievements of each grant, it is necessary for the respective national departments to undertake a review of each grant over the period starting from 1998/99. Further, provinces have now set up their systems so that they can report more accurately on grant spending. It is therefore expected that trends will be more accurately tracked in the future.

Conditional grants amounted to R12,5 billion in 1998/99, but actual spending was R547 million below budgeted amounts. Most of the non-transfer was in health infrastructure grants and the Integrated Nutrition Programme (INP). Transfers of grants increased to R13 billion in 2000/01, mainly due to improvements in the transfer system, rather than increases in grant allocations. The flows of grants up to 2000/01 included amounts not transferred in preceding years. Compared to transfers in 1999/2000 and 2000/01 (about R13 billion per year), estimated spending at provincial level amounted to R12,3 billion in 1999/2000 and R12,1 billion in 2000/01. The estimated spending indicates that grants have in aggregate been under-spent by R635 million (or 5 percent) in 1999/2000 and R957 million (or 7,3 percent) in 2000/01. Most under-spending was with infrastructure grants, INP and the financial management grant in education.

Table 7.12: Conditional grants, transfers and expenditure

	Actual	Actual Transfers and Expenditure		Estimated Actual		Medium-term estimate		
		1999/00		2000/01				
Department	**1998/99**	**Transfers**	**Spending**	**Transfers**	**Spending**	**2001/02**	**2002/03**	**2003/04**
DPLG	939	693	579	452	458	160	220	230
Education	65	192	99	241	156	298	276	322
Health	4 662	5 346	5 075	6 003	5 530	5 957	6 071	6 343
Housing	2 752	2 596	2 578	3 112	2 975	3 326	3 544	3 668
National Treasury	4 000	4 020	3 908	3 176	2 928	3 648	4 102	4 672
Social Development	12	72	50	52	32	23	11	–
Other	72	62	57	–	–	–	–	–
Total	**12 502**	**12 981**	**12 346**	**13 036**	**12 079**	**13 412**	**14 224**	**15 236**
Percentage of transfers and spending								
DPLG	7,5%	5,3%	4,7%	3,5%	3,8%	1,2%	1,5%	1,5%
Education	0,5%	1,5%	0,8%	1,8%	1,3%	2,2%	1,9%	2,1%
Health	37,3%	41,2%	41,1%	46,0%	45,8%	44,4%	42,7%	41,6%
Housing	22,0%	20,0%	20,9%	23,9%	24,6%	24,8%	24,9%	24,1%
National Treasury	32,0%	31,0%	31,7%	24,4%	24,2%	27,2%	28,8%	30,7%
Social Development	0,1%	0,6%	0,4%	0,4%	0,3%	0,2%	0,1%	0,0%
Other	0,6%	0,5%	0,5%	0,0%	0,0%	0,0%	0,0%	0,0%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

Transfers are budgeted to increase to R13,4 billion (or by 2,9 percent) in 2001/02, rising again by 13,6 percent to R15,2 billion in 2003/04. The small increases in the allocations in 2001/02 reflect the phasing out of transitional grants, and of the hospital construction grants for Eastern Cape and KwaZulu-Natal. Increases in the two outer years of the 2001 MTEF are mainly due to significant growth in the allocation for provincial infrastructure. Smaller grants are to fund Early Childhood Development (R161 million) and the Pretoria Academic hospital (R210 million).

Under-spending of transferred funds

Reforms introduced in 1999/2000 and 2000/01 improved the flow of funds to provinces, but problems remain with actual spending. Monitoring by national departments tended to be on the transfer schedule, instead of spending. The design and planning for some grants have not always been adequate, delaying finalisation of allocation decisions. Slow tendering processes have also been a constraint.

Further refinement of the conditional grants system

Division of Revenue Act Reform

The provisions included in the *Division of Revenue Act 2001* builds on previous legislation, and introduces measures aimed at strengthening the conditional grants system. The Act consolidates the previous reforms and is better aligned with the PFMA than its predecessors. This will enhance certainty and predictability, and promote advance planning. New amendments to the PFMA will set reporting requirements for conditional grants, improving planning and management.

There are also legislative reforms that have been instituted, are aimed at clearer grant policy frameworks, including statements of purpose and objectives, as well as conditions and criteria for allocations between provinces. Provinces, in turn, have to prepare implementation plans based on the policy framework. It is envisaged that, for the 2002 MTEF, the grant frameworks will be finalised by October, and the allocations published before national Budget Day. Although the Act legislates one year allocations, it has included indicative allocations for the subsequent two years of the 2001 MTEF period. This should facilitate better planning and enhance transparency.

Other reforms needed

In addition to the reforms introduced in 2001/02, further initiatives are still necessary. This includes reducing the number of grants, thus lowering the administrative burden, while streamlining decision-making and consultation.

Implementing the Public Finance Management Act

Government is committed to improve financial management in the public sector. To achieve this objective, the Public Finance Management Act aims to modernise the management of public finances. First implemented in 2000/01, the Act is aimed at facilitating more effective and efficient delivery, better value for money and improved public services. Other complementary reforms to modernise financial management include procurement reforms, and the phasing out of various tender boards.

The main emphasis in the first year of implementation was to develop the capacity of government departments to implement the Act. To facilitate this, the National Treasury issued a *PFMA Implementation Guide*, new *Treasury Regulations* and a *Guide for Accounting Officers*.

Priorities

Seven priorities have been identified for the first year of implementation, and should guide Ministers/MECs when considering the performance of heads of departments. Three priorities not discussed here are the need to clear up outstanding audit queries, the control of banking and suspense accounts, and improved management of transfers. The chapters on education, health, social development and housing contain more specific information on each sector's progress in implementing the PFMA. For the purposes of this discussion, a few overall observations on progress are appropriate.

In-year management, monitoring and reporting

Monthly reporting

The Early Warning Reporting System (EWS) was introduced amidst of the provincial financial crisis in 1997/98. This system of monthly management forms the core of the most important reporting requirement of the PFMA. If accounting officers are to effectively manage the budgetary resources available to them, they require accurate monthly information. The monthly reports form the basis for the monthly and quarterly information gazetted by the Treasury.

Non-financial indicators

While the PFMA focuses on financial data, accounting officers are expected to also develop monthly non-financial information to improve performance.

Effective internal controls

Audit units and committees

Another important element of the PFMA is the need to establish internal controls and audit units. A department head is expected to ensure that the department's revenue, expenditure, assets and liabilities are efficiently and effectively managed.

Two of the principal tools available to assist the head of a department to discharge this responsibility are the Internal Audit Unit and the Audit Committee. Both report to the accounting officer. They are critical mechanisms to enable the head of a department to be more pro-active in identifying financial problems during the financial year. One of the key instruments is the preparation of risk management and fraud prevention plans.

Audit Charter

Many provinces have opted to share internal audit units and audit committees. The success or feasibility of this approach cannot be assessed at this stage, but table 7.13 provides some perspective on progress.

Table 7.13: Internal audit and audit committees

Provinces	Institutional Arrangements / Management Approach	Audit committee functioning	Audit committee per PFMA established in 2001	Reliance on internal audit	Internal audit function established in 2001
Eastern Cape	Centralised	Yes	Yes	Limited	Yes
Free State	Centralised	No	No	No	No
Gauteng	Shared service	Yes	Yes	Limited	Yes
KwaZulu-Natal	Shared service	Yes	Yes	Yes	Yes
Mpumalanga	Combination	No	No	No	Yes
Northern Cape	Shared service	No	No	No	No
Northern Province	Shared service	No	Yes	No	Yes
North West	Centralised	Yes	Yes	No	Yes
Western Cape	Shared service	Yes	Yes	Limited	Yes

Appointment of Chief Financial Officers (CFOs)

All departments were to appoint a CFO as part of top management by 1 April 2001. Though financial management is the responsibility of every line manager, the CFO is responsible for the overall co-ordination and leadership in financial management.

Table 7.14 shows the extent of compliance by provincial departments with the appointment of CFOs in Education, Health, Social Development (Welfare) and other departments. It highlights the number of appointments, the nature of appointments and the level at which appointments were made across provinces.

Most provinces have made progress with the appointment of CFOs, with the exception of Northern Cape. While a number of provincial departments have appointed a CFO, there is a concern that some lack the requisite experience. To assist provincial treasuries with the implementation of the PFMA, the National Treasury has arranged a programme of assistance. This includes the setting up of sectoral forums for CFOs in Education, Health, Social Development (Welfare) and Housing.

Although the aggregate amount of funds in suspense accounts is relatively small, they could impact on the quality of information published as part of quarterly Section 32 publications. Therefore monthly movements in suspense accounts have been included in the modified formats for provincial in-year management and reporting.

7.14: Appointments of CFOs

Province	Number of Votes	Number of CFOs appointed per provincial department				Nature of appointment				Level of appointment			
		Education	Health	Welfare	Others	Education	Health	Welfare	Others	Education	Health	Welfare	Others
Eastern Cape	3/13	–	1	1	1	A	P	F	1 P	CD	CD	CD	CD
Free State	8/12	1	1	1	5	P	P	F	4 P + 1 F	CD	CD	CD	CD
Gauteng	12/12	1	1	1	8	P	P	F	5 P + 4 F	DDG	DDG	CD	CD
KwaZulu-Natal	11/13	1	1	1	8	C	P	F	7 P + 1 C	CD	CD	CD	C
Mpumalanga	9/12	–	–	1	8	A	A	A	9 P	CD	CD	CD	C
Northern Cape	1/12	–	–	1	0	A	A	F	–	CD	CD	D	D
Northern Province #	10/12	1	1	#	8	C	C	#	8 C	DDG	DDG	#	CD
North West	8/12	–	–	1	7	A	A	A	8 P	D	D	D	D
Western Cape	9/10	1	1	1	6	P	P	P	6 P	CD	CD	CD	D
Total	**71/108**	**5**	**6**	**8**	**53**	–	–	–	–	–	–	–	–

 # Shared arrangement

Permanent Appointment = P
Contract Appointment = C
Acting CFO = A
Firm of Consultants = F

Director = D
Chief Director = CD
Deputy Director-General= DDG
Combination = C

Completion of financial statements on time

Status reports

The PFMA requires annual financial statements be submitted to the Auditor-General within two months of the year-end. According to the 2000/01 Audit Report, Free State, Mpumalanga and Northern Cape failed to meet the deadline of 31 May 2001. The quality of these reports will be known once the Auditor-General submits an audit opinion as part of the provincial departments' annual reports, to be tabled in legislatures during September 2001 (see table 7.15).

Table 7.15: Submission of Financial Statements by 31 May 2001

Provinces	Total number of budget votes	Number of departments submitted on time	Number of departments not submitted on time	Number of departments submitted after deadline but before 14 June 2001
Eastern Cape	15	15	–	–
Free State	13	5	8	–
Gauteng	12	12	–	–
KwaZulu-Natal	16	16	–	–
Mpumalanga	13	7	6	5
Northern Cape	14	1	13	6
Northern Province	12	11	1	1
North West	14	14	–	–
Western Cape	10	10	–	–
Total	119	91	28	12

Source: Auditor-General's report – 31 March 2000

Conclusion

This chapter highlighted issues that cut across the sectors served by the provinces. The PFMA provides an important anchor for improved governance, and will have an effect not only on general management practice, but also on the administration of conditional grants. Together with tighter control over personnel expenditure, this will support improved service delivery and increased infrastructure investment. Armed with the legal and fiscal framework for better governance, and additional funding, provinces are positioned to step up service delivery.

8

Municipal transformation challenges

Transformation since 1994 has aimed to make municipalities more accountable, financially sustainable and able to deliver critical services to all residents. This is in line with the constitutional vision of the role of local government and the policies outlined in the 1998 White Paper on Local Government.

Pressures to manage

Changes have included rationalisation from 843 to 284 municipalities, new legislation on operational and financial management, and re-assignment of powers and functions between municipalities outside the metropolitan areas. Municipalities also have to adapt to national initiatives such as the restructuring of the electricity distribution industry.

While the changes create many opportunities, municipalities also face pressures, such as new demands to increase personnel expenditure. The challenge is to effectively manage these pressures. From a fiscal point of view, it is important that transformation recognises constraints and introduces innovative ways to deal with revenue shortfalls and emerging expenditure requirements.

This chapter reflects on these challenges, especially expenditure pressures facing municipalities, and reviews government initiatives to support municipalities in addressing them.

The transformation agenda

Transformation stages

Since 1994, local governments have gone through three stages of transformation, starting with the pre-interim phase in 1994 and 1995, the transitional phase from November 1995 elections to December 2000, and now the final phase starting with the newly demarcated municipalities after the December 2000 elections. Most municipalities have experienced multiple changes in their boundaries during this process. The change in boundaries is also accompanied by further changes to the powers and functions of various categories of municipalities.

White Paper and other policies

The Department of Provincial and Local Government (DPLG) has steered a variety of initiatives to effect this wide-ranging transformation programme. After transitional legislation to kick-start the deracialisation and democratisation of municipalities, the 1998 White Paper provided a comprehensive vision and plan of action. Its purpose was to democratise local government, bolster its service delivery capacity, enhance integrated development planning and management, direct organisational transformation towards these ends, and write the script for a fiscally sustainable approach. Subsequent legislation like the Municipal Structures Act and the Municipal Systems Act took these policies further. The Municipal Finance

Management Bill and related budget reforms, driven by the National Treasury, as well as DPLG's Property Rates Bill, are intended to add to this process. The DPLG, National Treasury and other departments also manage various transfers targeted at municipal infrastructure programmes and capacity building, and co-operation with provinces is being extended to ensure more effective and coherent support to local government.

The outcome should be well-managed municipalities, able to represent their residents, developmental in their approach, and effective at sustaining and extending service delivery. To achieve this requires that municipalities and other spheres of government are alert to the pressures of transformation, and the delicate trade-offs and choices these pressures require.

Key challenges in restructuring service delivery

Competing pressures

Municipalities face a range of competing pressures on resources available for service delivery. Reforms to municipal planning and budgeting processes are being introduced to assist municipalities to make these trade-offs on the basis of clear policy priorities and local contexts. These are discussed later in this chapter.

The key trade-off required is the relative importance attached to service quality and equity objectives:

On the one hand, municipalities must maximise resources available to expand and sustain access for poor households that cannot afford basic levels of service. However, non-poor consumers (such as commercial users and wealthier households) also demand improvements in the quality of services to which they already have access. These consumers provide the economic base of a municipality, and thus contribute significantly to its revenue. Declining service quality is likely to undermine both local economic performance and payment morality, thus jeopardising the effective tax base of a municipality and its ability to pursue equity objectives.

Limited resources

As with other spheres of government, resources available to meet these pressures are limited in the short-term. This highlights the importance of efforts to effect medium to long term adjustments to expenditure pressures facing municipalities. Municipal restructuring is necessary for municipalities to modernise their systems of service delivery, as Johannesburg is doing through its Igoli restructuring. Similar processes are likely in other larger municipalities.

The rural challenge

The challenge of establishing effective local government in rural areas cannot be overstated. In these areas, the absence of formally planned settlements means that revenue generation potential is low, institutions weak, and service provision differently structured and priced. The local revenue sources are limited and do not adequately cover basic administrative requirements. During the current year, these municipalities have also been affected by uncertainties associated with the transition and funding of free basic services. This situation is under review at ministerial level.

Expenditure pressures

Five major pressures

Collectively, five major pressures affect municipal budgets and the ability to extend or enhance service delivery: personnel; shifts in municipal powers and functions; the free basic service policy; rising bulk supply costs; and transitional costs associated with amalgamation. They all have marked fiscal implications.

Personnel challenges

Municipalities employ in total over 200 000 people: about 109 000 in metros, 90 000 in category B municipalities and 8 000 in district councils. Despite concerns that the large share of personnel expenditure threaten to squeeze out service delivery, salaries continue to make up the largest share of municipal expenditure and continue to rise faster than inflation.

Salaries as a portion of expenditure

Municipal staff salaries have risen considerably over the last ten years. Table 8.1 shows the average cost per employee has increased in three metros since 1999: by 15,54 percent in Tshwane, 8,18 percent in Nelson Mandela and 4,54 percent in Johannesburg. While the total number of employees declined in Johannesburg and Nelson Mandela, they rose by almost 5percent in Tshwane. In Johannesburg, numbers declined in part because staff were moved to utility companies.

Table 8.1: Personnel Statistics in three metros [1]

	City of Johannesburg			Tshwane Metro			Nelson Mandela Metro		
	1999-00	2000-01	*% Change*	1999-00	2000-01	*% Change*	1999-00	2000-01	*% Change*
Total number of employees	27 000	26 437	*-2,09*	13 379	14 000	*4,64*	7 255	7 234	*-0,29*
Total cost of employees	2,009bn	2,056bn	*2,36*	1,248bn	1,509bn	*20,90*	0,556bn	0,600bn	*7,86*
Ave cost per employee (rands)	74 411	77 790	*4,54*	93 295	107 792	*15,54*	76 704	82 975	*8,18*
Total cost of package for highest ranked employee (rands)	614 500	671 500	*9,28*	543 613	720 000	*32,45*	475 500	494 468	*3,99*
Total cost of package for lowest ranked employee (rands)	30 160	35 815	*18,75*	47 949	52 150	*8,76*	35 040	42 460	*21,18*

[1] Figures were submitted by the municipalities and due to the amalgamation these might show a level of inaccuracy

Both Johannesburg and Nelson Mandela Metro show a narrowing gap between the highest ranked and lowest ranked employees. The case study in table 8.2 illustrates this trend in Nelson Mandela Municipality in Port Elizabeth. Percentage increases for the lowest paid employees have been consistently greater than for the highest paid ones. One of the mechanisms used to achieve this has been the implementation of absolute monetary increases in wages as opposed to relying on percentage increases. A negative effect of this approach could be that the total percentage wage increases for smaller municipalities are greater than for larger municipalities. This limits the ability of smaller municipalities to deliver services.

Table 8.2: Minimum wage vs. maximum salary – Port Elizabeth[1]

	90-91	91-92	92-93	93-94	94-95	95-96	96-97	97-98	98-99	99-00	00-01
Minimum	550	720	850	1 055	1 214	1 401	1 561	1 781	2 011	2 241	2 471
Maximum	10 975	12 420	14 055	14 758	15 890	17 082	18 363	19 648	20 827	21 973	23 291
Ratio (Max / Min)	19,9	17,2	16,5	13,9	13,0	12,1	11,7	11,0	10,3	9,8	9,4
% Min Increase	–	*30,9%*	*18,0%*	*24,1%*	*15,0%*	*15,4%*	*11,4%*	*14,0%*	*12,9%*	*11,4%*	*10,2%*
% Max Increase	–	*13,1%*	*13,1%*	*5,0%*	*7,6%*	*7,5%*	*7,5%*	*7,0%*	*6,0%*	*5,5%*	*6,0%*

[1] Although the costs used for the above table represent only the basic salary for the lowest and highest paid employees, the same trend would apply to the total package.

Conditions of service

Municipal employees have conditions of service and salary bands quite distinct from national and provincial governments. Within these other spheres, there is one public service, where all employees have the same system of pensions, benefits and salary bands.

Apart from differences in the basic salary, non-remunerative benefits also vary. This is relevant to transformation because conditions of service are inevitably at stake when major change occurs. There have in fact been calls for the integration of municipal employees into one public service with national and provincial government officials.

Pensions

Pension funds are one factor that has to be considered for such a merger into a single public service. The issue here is not only the differences in pension schemes and contributions, but that the employer contributions in municipalities are generally well above the norm in other sectors. Table 8.3 provides details of a sample of municipal pension funds.

Table 8.3: Key indicators in a sample of municipal pension funds

Fund	A	B	C	D	E	F	G	H
Cape Joint Pension Fund	6 627	7 306	65	9,0%	18%	27%	16,0%	11,0%
Cape Joint Retirement Fund	18 777	226	60	9,0%	18%	27%	16,0%	11,0%
Cape Municipal Pension Fund	15 572	–	60	8,5%	18%	27%	16,0%	10,5%
Joint Municipal Pension Fund	3 204	4 136	65	9,0%	22%	31%	16,0%	15,0%
Municipal Employees Pension Fund	17 572	3 238	65	7,5%	22%	30%	16,0%	13,5%
Municipal Employees Gratuity Fund	29 572	–	65	7,5%	22%	30%	16,0%	13,5%
SALA	22 173	4 310	60	8,6%	17,9%	27%	16,0%	10,5%
Germiston Retirement Fund	1 560	498	65	8,3%	26,8%	35%	16,0%	19,1%
Potchefstroom	513	83	65	8,5%	22%	31%	16,0%	14,5%
Natal JMPF Superannuation	5 966	2 146	65	9,25%	18%	27%	16,0%	11,3%
Natal JMPF Retirement	9 912	2 413	65	5,0%	9,75%	15%	16,0%	-1,3%
KZN Joint Municipal Provident Fund	1 728	–	65	5,0%	9,75%	15%	16,0%	-1,3%
Durban Pension Fund	13 466	9 673	63	8,2%	18,86%	27%	16,0%	11,1%
Soweto City Council Pension Fund	3 478	348	60	8,0%	16%	24%	16,0%	8,0%
Johannesburg Municipal Pension Fund	4 387	5 044	63	9,5%	20%	30%	16,0%	13,5%
City of Johannesburg Pension Fund	8 426	2 692	63	9,5%	16%	26%	16,0%	9,5%

A. Membership	E. Employer contribution
B. Pensioners	F. Total contribution
C. Retirement age	G. National and Industry average
D. Employee contribution	H. Excess municipal burden

Variances

Based on information from 16 of the 21 municipal pension funds, the variances between different funds, and between them and the current national and provincial pension funds, are evident. For example, national and provincial government employees (the current public service) receive an employer contribution of 15 percent for pensions. Average municipal pension contributions are much higher, with the employer contribution at 26,8 percent for a total of 35 percent.

The need to equalise

Consolidating the public service to include municipalities would require service benefits equalisation. This could mean a compromise of benefits by either the current public service or municipal employees. Although the Pension Funds Act provides for the amalgamation of pension funds, the equalisation of salaries for municipal employees will require significant funding.

Moreover, initiatives to form an integrated public service would have to take cognisance of the number of employees in the sphere as a whole, the different pay scales, and other challenges of amalgamation. Further work is also required to assess the financial impacts of other benefits, such as medical aid, on municipalities.

Other initiatives and salary parity

Other transformation initiatives raised further parity issues. Demarcation and the shifting of functions between local and district municipalities, or between municipalities and Regional Electricity Distributors (REDs), will all require staff transfers.

Moving staff will involve equalising salaries for similar work in the new structures, and municipalities will be under pressure to equalise salaries to the highest level. It is not possible to quantify the effects of these salary parity issues at this stage. A proper analysis cannot be completed until new organisational structures are approved and job evaluations have been completed for all positions.

Information collected from selected category B municipalities indicates the challenges that are likely to be faced in attempting to achieve salary parity. The minimum total salary package of Mangaung, Louis Trichardt and Albert Lutheli municipalities for 2001-01 was R32 305, R24 768 and R37 331 respectively.

Questions to consider

While it may not be possible to make broad predictions of the impact of demarcation on salary levels, it is clear that municipalities should direct attention towards this issue. The following questions require interrogation:

- If the new municipalities all increase salaries to the highest level, what would be the maximum cost increases?
- How would this increase affect the expansion of services and delivery of free basic services?
- What would be the effect on local and national economic growth?
- How would municipalities fund increases, given that national government does not prioritise such consumption spending?
- How does the central bargaining system take account of differences between conditions of work and the differing capacities of municipalities?

?? How can employer contributions be brought in line with more generally accepted ratios?

?? How could moving to one public service avoid raising costs due to demands to move to the highest common denominator?

?? How do new REDs ensure that they avoid raising personnel costs by moving to the highest common denominator?

Salary parity between municipalities

Salary parity between municipalities is also an important issue, with a major project in this area currently underway. Undertaken by SALGA and unions representing municipal employees, it entails developing frameworks to assist streamlining structures, job evaluation methodologies and conditions of service across local government.

The objective of these frameworks is to encourage the use of consistent methodologies and principles whilst recognising that different circumstances across the spectrum of municipalities will require different solutions. A key parameter for this initiative is the affordability of changes for different types of municipalities. The framework will also need to account for variations in the costs of living between jurisdictions.

Councillor remuneration

A new dimension of personnel expenditure is the pressure for increases in councillor remuneration. Prior to December 2000, the remuneration of councillors cost approximately R418 million per annum. Demarcation reduced the number of councillors by some 30 percent, from 11 368 to 8 939. However, the introduction of full-time councillors and the expanded role of executive committees, has led to the need to revise remuneration scales. It has been estimated that the new councillors will collectively earn approximately R756 million. The overall increase is 55 percent.

Shifts in municipal powers and functions

Powers and functions of non-metropolitan municipalities

The shifting of powers and functions between categories of non-metropolitan municipalities, either through demarcation or sectoral policy reforms, is a significant challenge for local government.

Legislative aspects

Recent amendments to sections 84 and 85 of the Municipal Structures Act have re-allocated the bulk of municipal functions to district municipalities. The Minister of Provincial and Local Government has, however, authorised municipalities to continue performing functions in accordance with the position before re-demarcation of municipal boundaries. Work is currently underway to determine an appropriate allocation of functions in each municipal area.

Fiscal implications

The shifting of powers and functions between Category C (district) and Category B (local) municipalities could have wide-ranging fiscal, service delivery and personnel implications. From a fiscal point of view, the recommendations of the Financial and Fiscal Commission (FFC) are particularly relevant. These are summarised in the box below.

Summary of the FFC's submission on municipal powers and functions

In August 2001, the Financial and Fiscal Commission (FFC) released a prognosis on the division of powers and functions between district and local municipalities. The FFC sets out a number of principles that should inform the division:

- The default position should be that local municipalities are responsible for the delivery of municipal services, as this is consistent with government policy. Many local municipalities lack the capacity to deliver these services, and in such cases the district municipality should provide the services until local capacity is developed.
- Issues of redistribution should not influence the division of powers and functions between local and district municipalities, given the primary role that national government should play in funding redistribution.
- A number of factors should influence the division, such as the need for equitable, efficient, and affordable municipal services, and the need to achieve economies of scale. Each service should be evaluated separately against these factors, which could well result in one service being optimally provided by districts and another by local municipalities.

These principles were applied to four services, namely municipal health, water, sanitation, and electricity.

The function of ***electricity distribution*** should remain with local municipalities. The electricity supply industry will be re-organised into regional electricity distributors, and the transfer of this function from local to district municipalities and then to regional distributors will result in substantial and unnecessary costs. In addition, the loss of income from electricity surpluses (or municipal levy income in future) will significantly weaken the service delivery capability of local municipalities.

In the case of ***municipal health***, the function should be assigned to district municipalities. This is consistent with the policy of the national Department of Health, which seeks to establish an integrated district health system. Health service delivery is complex, and health provision by districts minimises spillovers and captures economies of scale.

Responsibility for ***water supply and sanitation services*** should rest with local municipalities, except where they lack the necessary capacity. There are not compelling economic reasons to assign these functions on a district-wide basis, except in the case of regional schemes, which usually transcend district boundaries. Furthermore, assigning one aspect of retail service delivery to districts will compromise the development of integrated revenue collection and credit control systems at local level.

Uncertainty to be avoided

Municipal stakeholders and potential investors agree that the key danger in the current debate on the powers and functions is the paralysis that may be induced by uncertainty on future functional allocations. For instance, a local municipality that anticipates losing the function of water services will be unable to plan for future service delivery, and may be unwilling to maintain optimal levels of investment in the service.

The Department of Provincial and Local Government is undertaking a detailed study on the optimal division of powers and functions, in conjunction with key stakeholders. Rapid resolution of this issue should have an important impact on municipalities' budgeting and creditworthiness.

Decentralisation or devolution of functions to municipalities

Changing how services are provided

Restructuring of service delivery is also under consideration in various sectors, with likely implications for municipalities. Proposed initiatives to transfer water services, devolve health functions, decentralise certain public transport functions, and regionalise electricity distribution could fundamentally alter the role of municipalities, with associated implications for staffing and expenditure needs.

Electricity

The impacts on municipal finance of the establishment of Regional Electricity Distributors (REDs) are complex, and the subject of a detailed investigation by national government together with SALGA. These complexities are outlined in the box below.

Some municipal fiscal issues around electricity restructuring

Electricity distribution functions involve operation, maintenance and replacement of major infrastructure assets. The skill set required to manage these functions is similar to that required to manage infrastructure assets in other functional areas such as roads and water distribution. Therefore, synergies and economies of scale can be achieved when staff from the various functions can interact and plan together. Also, development of new areas requires the coordination of all services and synergies can be achieved when there is an integrated approach.

Furthermore, given its size relative to the total operations of the municipality, the electricity function most likely consumes a large portion of administrative costs such as the provision of human resources services and information technology services. Some of these administrative support costs may be avoidable in the long term, but in the short term the planned REDs require that other functions of the municipality will have to absorb much higher support costs.

The challenge of putting staff under one regional entity is illustrated by the variety of wage levels between municipalities. For example, the category B municipalities in the Northern Free State district (Moqhaka, Ngwathe, Metsimaholo and Mafube) have reported minimum wages of R34 680, R25 808 and R25 968 respectively.

It is therefore necessary to ask rigorous questions, such as:

- What will be the impact on municipal staffing structures and salaries?
- What will be the impact on economies of scale and synergies associated with providing an electricity function?
- What will be the financial implications of this?
- What will be the tariff and funding implications of merging diverse tariffs, for example between Pretoria and Louis Trichardt, into a new level?
- How will redistribution affect different jurisdictions?
- What will the impact be on local, urban and rural economies?
- What will be the service delivery implications?

Water

Water service provision will be substantially decentralised over the next few years with notable institutional and financial implications for local government. The Department of Water Affairs and Forestry plans to devolve responsibility to municipalities for the operation of schemes that serve some six million predominantly rural people. DWAF and several provinces are also considering options such as multi-jurisdictional municipal service providers.

Complexities to be considered

Electricity and water distribution reforms highlight the complexities of service delivery restructuring, and the potential implications for staff movements and municipal finances. Additional financial pressures can emerge from the need to apportion assets and liabilities in the restructuring process.

Each reform requires careful assessment of these impacts to ensure that the costs of restructuring are not solely borne by municipalities. The experience of R293 personnel transfers from provincial to local government is relevant in this regard, and is discussed in the box below. The transfer of approximately 6 000 staff from DWAF to local government will encounter similar challenges.

The transfer of R293 town staff to municipalities

Some former homeland governments did not have municipalities, and performed municipal functions themselves. These areas are referred to as R293 towns. The Transfer of Staff to Municipalities Act, 1998 provided for the transfer of these employees from the province to municipalities concerned. Municipalities were required to accept staff as may be necessary for the effective administration of the municipality in question and to render efficient municipal services.

Difficulties in the personnel transfer process were due to staff being transferred from a uniform set of service conditions and salaries to a variety of differing ones in individual municipalities. This was a complex process. When the transfer resulted in salary increases it was easy to move staff, although this resulted in an increase in the unit cost of delivering the same service. However, staff transfers were very difficult to effect when salaries were likely to be reduced.

Very little progress was made with the transfer of R293 staff to municipalities for four years up to the end of 2000. National government undertook various further actions to promote the transfer of R293 towns to municipalities, including:

- an audit of R293 town personnel records during the last quarter of 1999 up to the end of March 2000;
- technical assistance to provinces to speed up the transfer of staff from 1999 to 2000; and
- a workshop with all provinces at the beginning of July 2000 to assist them in resolving issues hampering the transfer of R293 staff to municipalities.

The above-mentioned actions, as well as concerted efforts by provinces and municipalities, led to substantial transfers during the second quarter of 2000 up to the stipulated deadline for transfers of the end of September 2000. 8 572 staff (65 percent) were transferred by the stipulated deadline for transfer.

Staff not transferred by the stipulated deadline is deemed to be provincial employees and need to be completely withdrawn from municipalities and from providing any municipal services. Conversely, as R293 town staff transferred to municipalities are fully-fledged municipal employees, provinces will have no future role in respect of these staff. Any further transfers after the stipulated deadline are deemed normal municipal appointments and must accordingly be funded from own municipal revenues.

After transfers have been effected, the municipality concerned is responsible for determining appropriate salary packages for these staff. The municipality will be responsible for any additional costs resulting from increased municipal benefits, parity in salaries, promotions, and similar considerations.

From the 2001/02 financial year, the R293 town personnel allocation was divided between provinces and municipalities, based on staff transferred to municipalities and those retained by provinces. The allocation to local government was based on 100 percent of the salaries payable by provinces as at transfer. The remainder was allocated to provinces based on the projected annual expenditure for retained staff.

Free basic services

Commitment to service delivery

Government has made service delivery to all South Africans a priority. Constitutionally, all spheres of government carry some responsibility to ensure that this occurs, and local government is particularly charged with delivering basic household services. Changes in the local sphere must therefore contribute to broadening service delivery that is affordable, to both municipalities and consumers.

The challenges of municipal service delivery are broader than the commitment to free basic services alone. These services are critical inputs to local economic activity, and thus national economic growth and development. Apart from the poor who cannot afford services, those who can afford to pay must also be assured continued supply.

Policy matters

The pillars of policy therefore must enable local governments to:

- make basic municipal services accessible to all citizens
- provide free basic services for poor citizens who cannot pay

?? enforce strong credit control with regard to those who can pay improve the quality of services in response to consumer demands.

What services?

While there is currently some debate as to whether the policy should apply to all citizens, fiscal constraints make it a priority to target, people who cannot afford to pay for the basic level of essential services first. On this basis, some national funding to assist local governments has already been provided 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 pay. While the policy commitment has sometimes been understood as "free basic services to all", the policy target is those poor households that are currently unable to obtain access to basic services on an ongoing basis. Additionally, resource constraints at a municipal level may mean that municipalities will be unable to immediately provide the full basic service level at no cost, but will rather have to rollout such a programme over a period of time.

Given local variations, it will be important for municipalities to be flexible in defining the quantum of basic services they will provide for free. Meanwhile, deliberations between the responsible government departments and key stakeholders provide some pointers towards such a package of services:

?? 6 kilolitres of drinking water per month, delivered to a point within 200 meters of the household

?? ventilated improved pit latrine or better, at the household

?? 50 kilowatt hours of electricity per month, or equivalent, delivered to the household

?? household refuse disposal from a street container within 200 meters of the household.

In general, these levels of basic services have been accepted, though in the case of water, it has been urged that households who are connected to water-borne sanitation cannot get by on only 6 kiloliters of water. As a practical matter, those municipalities who are already providing free basic water vary in the quantity that they provide for free.

Subsidy mechanism

There are a number of mechanisms that can be utilised to provide sustainable services access to poor consumers. The choice of mechanism will be informed by the importance attached to the related principles of efficiency and local discretion, as well as the appropriateness of each mechanism in a particular area. For instance, an increasing (or rising) block tariff is known to allow significant leakage of subsidies to low consumption, wealthier households. This mechanism may encourage inefficiency by service providers who manage the subsidy on the supply-side, as the real cost of service delivery is difficult to determine. More importantly, it may distort the demand for a service if its price diverges significantly from the actual cost of delivery. Finally, it is not a suitable mechanism for poor rural areas where an insufficient number of wealthy, high consumption households exist to cross-subsidise poorer ones. However, the administrative costs of other mechanisms, such as account credits that require the identification of each poor household, may outweigh the benefits of the subsidy that is being provided.

Responsibilities

Fiscal and financial arrangements exist to ensure that these national policy objectives are met. All spheres of government have a role to play:

National government

- The provision of a basic level of essential services is a national issue, implying that the costs of assisting poor households to obtain this basic level of essential services must be borne primarily out of the national budget. National government is therefore primarily responsible for fiscal equalisation to ensure the availability of resources to poorer jurisdictions. It also has to create an appropriate regulatory framework and enabling environment for municipal service standards and prices.

Provinces

- Provincial governments have a critical support role to play in assisting municipalities develop appropriate subsidy mechanisms, and monitoring the implementation of these mechanisms to ensure that both equity and efficiency objectives are met.

Local government

- Local government has a service delivery and subsidy implementation role. Municipalities need to expand access to infrastructure, reorient their budgets to ensure adequate resources are available for free basic services for those who cannot pay, and promote effective and efficient service delivery. Those with significant fiscal capacity should direct their own resources to basic service delivery in a co-operative relationship with national and provincial government. All municipalities must reprioritise expenditure to meet the basic needs of all South Africans. Notwithstanding this requirement, the scope for redistribution is limited in the local sphere.

Allocating subsidies efficiently

Leakage must be avoided

The efficiency with which services and subsidy resources are allocated among households has a significant impact on the total cost of service delivery. For instance, efficient targeting of subsidies to households in need will ensure that subsidies do not benefit wealthy households unnecessarily.

Additionally, ensuring that non-subsidised services are priced correctly will assure that services are allocated in an economically efficient manner.

The poor should benefit

The challenge is foremost to ensure that poor households are the primary beneficiaries of the free services policy, and associated public resources. It is also important to mitigate fiscal risks implicit in subsidy schemes of this nature. Two related interventions are necessary:

Subsidies targeted

- Measures must be taken to control untargeted subsidies from the national fiscus, such as those delivered through the water services trading account and various transfers to water boards.

Credit control

?? Cost recovery is central to any sustainable subsidy system, and includes clear policy and support to municipalities regarding cut-offs, metering, billing and collection systems, and associated capital investments. Tighter credit control is necessary with regard to consumers that are able to pay. This not only improves cash flows, but also releases additional funds to subsidise consumers who cannot pay and ensures that available resources are utilised in accordance with an agreed subsidy framework, rather than providing an ad-hoc subsidy to payment defaulters.

Bulk supply costs

Price increases for bulk service purchases by municipalities have placed pressure on municipalities, as they cannot always pass higher bulk costs on to consumers without experiencing a rise in non-payment levels, political resistance or lower demand for services.

Water Board Tariffs

The main function of water boards is to provide bulk potable water to municipalities while a number of boards have also been involved in water reticulation to low income communities. The combined water sales revenue of the two largest boards (Rand Water and Umgeni) is in excess of R2,5 billion which gives an indication of the potential significance of water board activities for the economy.

Rapid increases

In recent years water board tariffs have increased at a rate faster than inflation and consumers have at times been confronted with dramatic price hikes. For example, Umgeni Water recently proposed a 22 percent tariff increase for the 2001/2002 financial year. This was due in part to a drop in the water demand of its largest consumer (Durban). The city invested heavily in a water recycling plant which reduced use of Umgeni's system and brought onto the balance sheet the capital costs and finance charges of rural schemes financed by Umgeni Water. This was compounded by low operational cost recovery from those schemes. Similar tariff hikes were experienced by Bloem Water in the 1996/97 financial year and by Rand Water in 1997/98. In the Rand Water case the driver was the need to absorb the cost impact of incorporating the Lesotho Highlands Scheme in the raw water price.

Water prices must reflect costs

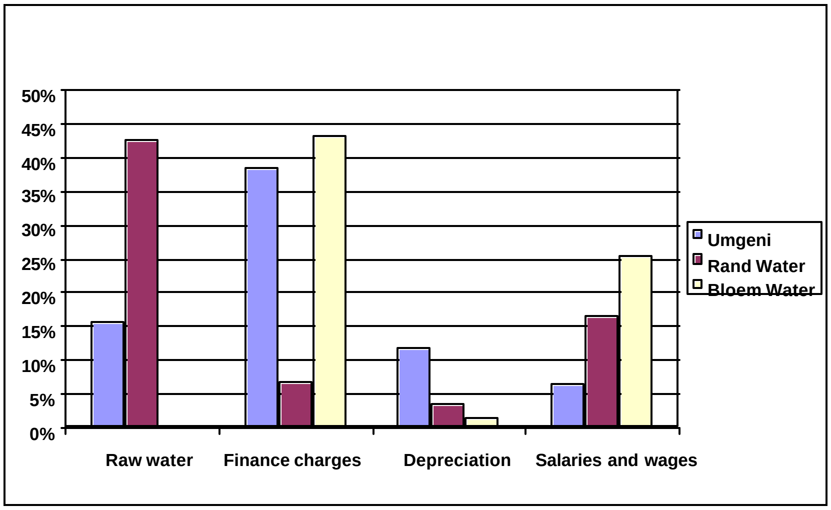
In a water scarce country, raw water prices will tend to rise by substantially more than inflation, as they adjust to levels that reflect the value of the resource. This reflects the requirement for capital schemes to bring additional water from more costly sources, and encourages efficient water use. The challenge is to balance this with affordable provision of water as a social good, to poor consumers, such as through the Free Basic Water programme.

Making bulk scheme affordable

Bulk water distribution is a capital-intensive business marked by high finance charges. Large capital expansion projects must eventually be recovered from the end user. It is also important to phase such large projects into affordable elements, to minimise the carrying costs associated with unused capacity.

Other important cost drivers in the water board industry are raw water charges and labour costs as shown in Figure 8.1.

Figure 8.1 Main cost drivers as % of revenue



Electricity generation tariffs

Electricity costs low in South Africa

Electricity is primarily distributed by ESKOM and municipalities. ESKOM sells 58,6 percent of the 171TWh electricity that is available for end-use. Municipalities, many of whom buy in bulk from Eskom, and the private sector distributes the remaining 41,4 percent. At an average cost of 8c/kWh, South Africa's electricity generation costs are very low by international standards. Domestic electricity users pay the highest price for electricity, at 24,6 c/kWh, and the mining sector the lowest at 12,3 c/kWh. Distribution costs account for approximately 62 percent of the total cost of electricity supply, but total costs of distribution declined by 23,8 percent from 1998 to 1999.

While service charges should in principle reflect the cost of delivery, and be calculated on a defensible accounting basis, municipalities often use tariffs or taxes to over- or undercharge for various services. This shifts the incidence of taxation onto those who may not use a service, often with no explicit policy objective in mind. Moreover, service charges have tended to rise at levels well above the rate of inflation in recent years.

Transitional costs associated with amalgamation

Amalgamating former municipalities involves some complex issues, such as consolidating assets and liabilities on a single balance sheet and balancing extended service provision with levying of taxes, fees and charges across diverse communities. Vastly increased property rates and service charges could affect the affordability of services, particularly for poor households. Some of these issues are explored briefly in the case study of challenges facing the new Tshwane metropolitan municipality.

Facing the challenges in a new metro: Tshwane

The City of Tshwane offers some insight into the fiscal and institutional challenges municipalities face against the backdrop of demarcation and institutional transformation.

Firstly, it will be a challenge to address infrastructure and service delivery requirements given that the tax base has remained relatively stable while areas requiring services have significantly increased. Secondly, the new municipal area, with about 2,2 million people and measuring at its furthest points about 68 km north/south and 52 km east/west, is extremely diverse, and straddles the boundaries of the North West and Gauteng provinces. It includes areas as diverse as the former city councils of Pretoria, Centurion and Northern Pretoria MLC, and former rural councils in Mabopane, Temba and Winterveld. It also inherited diverse service provision arrangements: the municipality serves some areas, while others receive their services through the North West province or other providers, like the Magaliesburg Water Board.

Backlogs are vast, especially in outlying areas:

- **Water and Sanitation** - Approximately 40 000 households are without basic services. It will cost approximately R97 million to provide the most basic services and projections indicate up to five years to be on RDP standards in the North West areas. The water supply to Hammanskraal and Temba is insufficient due to water boards not being able to meet demand. Sewer treatment is also lacking. Tshwane aims to concentrate on water supply in the 2001/02 financial year, while sewerage will be addressed in future years.
- **Roads** - Tshwane consists of 6 500 kilometres roads of which 60 percent is tarred and 40 percent gravelled. Many of the gravel roads are severely potholed and become impassable in the rainy season. The service levels provided and general quality of the tarred roads are also questionable.
- **Housing** –The housing programme backlog for the Pretoria MLC shortly before amalgamation, was 25 000 dwellings and with the amalgamation this figure has grown to almost 113 000.

During its first budget process, the new metro has been grappling with these challenges. Budget control and reform is a priority. A hands-on approach is used to determine expenditure trends compared to budget. A Budget Advisory Committee was established to assist councillors. Regular budget review reports are provided to this Budget Advisory Committee and any deviations must be explained and remedial action taken if necessary. Tshwane is participating in the National Treasury pilot programme for financial management and budget reform and has begun to implement measures to comply with uniform norms and standards. Key aspects to note from this process are:

- **The operating budget** represents 86,8 percent of a total budget of R5,3 billion. Approximately 30 percent relates to remuneration of staff. Provision of electricity accounts for roughly 30 percent of the budget and water and sanitation for 19 percent.
- **The capital budget** of R736 million represents 13,2 percent of the total budget. This is markedly lower than the national average of 22 percent as shown in chapter 9, which reinforces infrastructure backlog issues. Previous surveys have indicated that the previous Pretoria MLC had significant infrastructure backlog issues with capital backlogs and deferred maintenance for roads, electricity and water infrastructure in the region of R280 million for 1999-00 (5,3 percent of the 2001-02 budget).
- **Budgeted operating revenue** for 2001-02 is R4,6 billion. Electricity charges account for 37 percent, property rates 24 percent, water charges 14 percent, sewerage 5 percent and refuse removal 3 percent.
- **Property rates and tariffs** for services have been standardised across the whole area and free basic services are made available to almost all of the community. 6kl of free water and 30kwh of free electricity is provided to most households. Some areas of Temba, Mabopane, Ga-Rankuwa and Winterveldt are currently excluded from receiving free electricity because Eskom rather than Tshwane is the provider.
- **Debtor management** has received special attention with a special initiative for debtor management set up, consisting of volunteers from the old debtor administration. In just two weeks R4,8 million of outstanding accounts was collected in Pretoria and R1 million in Centurion. A problem is still being experienced in Akasia. If and when services are taken over in the North West areas, a credit control system will have to be put in place. In some of the new included areas, no pay points have previously existed and it will take R300 000 to upgrade Winterveld.
- **The first Integrated Development Plan (IDP)** will be finalised in August 2001 and a long term IDP will be developed. At the same time, the municipality will begin work on a medium-term budget that links to its strategic priorities. The planning process is particularly complex as, in accordance with legislation, it must be coordinated with plans of two provinces for functions such as health and education services and provincial roads.

Source: Tshwane 2001/02 Budget

The local government transformation plan

In order to assist municipalities in addressing the challenges outlined above, national government has placed increased emphasis on its tangible and relevant support to municipalities.

Fiscal support to municipalities

Chapter 10 identifies the main forms of fiscal support from national government to assist municipalities in meeting the service delivery challenge.

The local government equitable share provides general budgetary support to municipalities while conditional grants support capital programmes and institutional needs. Other fiscal measures to assist municipalities meeting their service delivery commitments are evolving at national level. The current work programme includes assessments of:

?? the adequacy of funding provided to municipalities in relation to their fiscal capacity

?? the efficacy and consolidation of the current system of infrastructure transfers in coherently supporting the policy commitment to service delivery, especially to the poor

?? the accuracy of current targeting systems in distributing resources to areas of greatest need and incoprorating operating subsidies into the equitable share.

Progress in extending service delivery

Considerable progress has been made in developing programmes to support municipalities in implementing policy on developmental service delivery. Additionally, many municipalities have taken the initiative to determine their own approaches.

Free basic water

Other than the national reform strategies outlined above, additional national support to municipalities has focused on strategies for free basic water and electricity. Sanitation and solid waste services have, to date, taken a back seat. The Department of Water Affairs and Forestry has developed a phased implementation programme for larger municipalities to implement the commitment from 1 July 2001. Others are supported to do so over the next 2 years.

Lifeline electricity strategy

The Department of Minerals and Energy has initiated a pilot programme to identify appropriate policy parameters for a lifeline electricity strategy. The key concern here is the role of Eskom's distribution entities, and how a subsidy might be transmitted to them. This is particularly important as Eskom supplies households in the lower-income end of the electricity market (see textbox below). The findings of the pilot programme will have resonance beyond the electricity distribution industry, as private sector or community suppliers provide services in other industries as well.

Electrification Programme

The RDP White Paper in 1994 made a commitment to an accelerated electrification programme to provide access for an additional 2,5 million households by 2000. It was estimated that this would increase access to about 72 percent. With funds channeled by Eskom mainly through municipalities, this target was exceeded as some 2, 7 million households benefited by 2000. Because of rapid housing development, the percentage households electrified have however not met the original target and stood at 62,96 percent at the end of 2000.

On an annual basis, the actual households electrified by Eskom and Local Government were:

1994	1995	1996	1997	1998	1999	2000
435756	478767	453995	499311	427426	443290	397019

Improvements in rural and semi-urban areas were particularly significant in 1999 and 2000 as the table shows.

Year	Rural	Semi-urban	Combined
1997	3%	11%	14%
1998	3%	14%	17%
1999	15%	10%	25%
2000	23%	16%	39%

Because of a slowdown in housing delivery, and some inertia in the light of municipal demarcation and transformation, the rate of electrification was also impeded in 2000. However, there were some highlights, such as the allocation of R31 million for 10 300 new connections in the development of neglected areas in the Eastern Cape. Unspent money on the original R347m was transferred to the 2001 programme allocation for non-grid systems and for special projects including special ministerial requests.

Budget reform

A number of factors have necessitated reform of municipal budget approaches, processes and formats, as a key input into the effective transformation of service delivery. In many municipalities, the budgeting systems are inadequate primarily due to a lack of financial management capacity. Budgets are presented line item by line item, one year at a time. They are prepared in different formats and provide widely divergent information. It is even difficult to compare similar size municipalities. Few budgets, if any, are linked to the local government's strategic priorities. Many Integrated Development Plans (IDPs) are not yet of an appropriate standard to make such linkages. This makes it difficult for citizens and elected office bearers to understand how scarce resources are allocated and to depict financial trends in the municipality. This lack of strategic budgeting, and the unreliable information, create uncertainty about the financial status of municipalities, impeding the long-term municipal lending market.

In most cases, municipalities overestimate revenues. Failure to account for under collection of rates and tariffs has led to year-end deficits. Municipal budgets often do not include accurate information on grants and transfers from national and provincial government.

Therefore, they neither project total revenue for the fiscal year nor accurately show all revenues and expenditures on budget.

Many municipalities do not have proper processes for adjusting their budgets throughout the year. Some do so frequently, suggesting that they have not planned properly. Government's new legislative framework attempts to balance flexibility with a system that induces proper planning and due process.

The lack of accurate reporting by cost centre prevents municipalities from determining fair pricing structures, accurate surpluses or deficits. For example, few municipalities know the total cost of providing water or electricity services. They report bulk purchasing costs, but often exclude the costs of reticulation, such as staffing, maintenance, information technology and billing.

In the light of these problems, Government is leading a process of budget and financial management reform in the local government sphere. Implementation of the Municipal Financial Management Bill, when adopted, is a cornerstone of these reforms, as is the move towards three-year municipal operating and capital budgets, as in the national and provincial spheres. While municipalities will be expected to ensure that all revenues and expenditures are accurately shown on budget, they are supported by Government simplifying and increasing certainty in grants flows, and the introduction of Generally Accepted Municipal Accounting Practices (GAMAP). The implementing of a borrowing policy framework to develop a municipal bond market will bring the efficiencies of such a market to bear on municipalities

The National Treasury has developed a range of reforms to modernise local government systems and ultimately improve service delivery. Key among these reforms is multi-year budgeting, now being piloted in eight municipalities. Other reforms include Generally Accepted Municipal Accounting Practice (GAMAP), budget and reporting formats, in-year financial reporting, a municipal investment framework, activity-based costing and procurement modernisation.

Revenue reforms

The long-term sustainability of municipalities is closely linked to their access to own revenue. This requires reform of the revenue sources themselves, better credit control and improved collection of those revenues. Reform of property tax, an important source of local government revenue, is one such initiative.

The Property Rates Bill, published in August 2000, creates a nation-wide legal and regulatory framework for valuing property and levying rates. The provisions of the Bill would require that all municipalities, by 1 July 2006, use the total improved value of property, i.e. the combined land and improvement value, as the tax base. The Bill would also leave decisions about differential rating of different categories of property, as well as exemptions and rebates to municipal councils. It would require each council to adopt a property rates policy governing these matters, and to reflect the implicit cost of all exemptions and rebates as budget expenditures.

One important impact of the Bill and of the December 2000 demarcations will be that a great deal of previously unrated rural, agricultural, and government property may be brought into the tax net. If municipal rates revenue is held constant, the rates paid by owners of property within former municipal boundaries should go down, as previously unrated properties take on a share of the burden. The Bill's requirement for comprehensive re-valuations will mean that properties which have appreciated or depreciated significantly in recent years will be taxed at a value closer to their market value.

Institutional Support

Four aspects

Four aspects of institutional support to local government warrant mention here:

- Steps have been taken to provide an effective intergovernmental voice on fiscal matters for local government. The Constitution requires consultation with organised local government and the FFC when budgetary allocations to local government are determined. While vertical allocations to local government are ultimately determined by Cabinet, subject to parliamentary approval of the Division of Revenue Bill, the Budget Forum has been set up to facilitate such consultations. Organised local government is able to use the Budget Forum to acquire information, raise questions and put forward its position on priorities and the size of allocations.
- Capacity building grants support institutional and management development and reform. In the short-term, a special grant supports municipalities in managing post-demarcation transition. Elements of the reform programme assist municipalities to increase participation by community members in service delivery, improve the accuracy of information on service delivery, enhance political oversight over decision-making, and improve accountability for service delivery outcomes. They are also supported to apply more robust financial management and credit control. These reforms have been developed into increasingly coherent programmes to provide nationally driven technical support to local decision-making.
- The Municipal Finance Management Bill requires that managers be allowed to manage. This means delegation of powers, effective cooperation between councillors and officials, and appropriate capacity. In the short term, it is necessary to build on existing capacity. For the longer term, there is a positive relationship between capacity and powers and functions; hence, decentralisation that makes local governments accountable is likely to support capacity building in its own right.

Integrated development plans and performance indicators

- The Department of Provincial and Local Government is implementing a number of reforms to assist municipalities to direct their resources towards key policy priorities, such as free basic services. For example, work is being done to investigate the costs of a package of services to households. Considerable attention is also focused on integrated development plans (IDPs) and performance management through key performance indicators

(KPIs). Improvements in municipal budgets and financial management systems are critical to successful implementation of these reforms. In particular, if IDPs are to provide meaningful direction to municipalities, they must be linked to their capital and operating budgets, and be measurable through accurate and timely financial information and measurable KPIs.

Conclusion

The extent and variety of pressures facing municipalities will require ongoing attention over the next three to five years. While the problems are not insurmountable, they have a significant impact on municipalities' ability to re-engineer their service delivery systems.

Municipalities are emerging from a prolonged period of uncertainty resulting from the boundary demarcation and institutional transformation processes. Intergovernmental support to local government, and initiatives within municipalities themselves, must therefore be well sequenced. Failure to achieve this, could overload the municipal system, with negative impact on its core service delivery functions. Government has taken steps to facilitate greater stability and sustainable capacity, but it needs to stay rigorous in monitoring progress and impacts, and targeted in interventions.

9

Overview of municipal budgets

Budgets show priorities

The budgets of municipalities provide important insight into their progress with service delivery, and also serve as management tools for planning. They should clarify what municipalities spend on, and how they raise funds for those purposes.

The analysis of budgets in this chapter (and Annexure D) therefore provides perspective not only on the recent state of municipal budgets and on progress with budget reform, but also on service delivery. Apart from aggregate information, some specific pre-demarcation municipal budgets are analysed. The sample of municipalities used is based on the availability of data. It attempts to build continuity with last year's edition, and draws on the budget reform pilot projects undertaken under guidance of the National Treasury. The budgets of the largest ten pre-demarcation municipalities are specifically analysed.

Mostly looking back, before demarcation

Because this chapter looks back at the previous year, its information is not structured around new municipalities. Next year's *Review* will be able, for the first time, to reflect budget trends in the newly demarcated municipalities.

Data issues

Building on last year's Review

Last year's *Intergovernmental Fiscal Review* was a first attempt to review municipal financial information, and this year's edition builds on that analysis. However, there are still significant gaps. The structure and content of this information is currently being developed and it will take a few years before reliable trend information for the new municipal structures is available.

843 councils combined into 284

It is difficult to compare the financial information of the 843 pre-demarcation municipalities with that of the 284 new ones. Chapter 8 considers a self reported sample of municipalities to provide understanding of service-related trends and a basis for future analysis.

Gap between budgeted and actual figures

Reliable financial data remain difficult to come by, amid outdated budgeting systems, inconsistent municipal accounting and budgeting practices, and weak financial management capacity. Data in this chapter is based primarily on self-reported financial information on "expected" revenues, expenditures, and on budgets. However, budgeted and actual figures differ considerably. This is aggravated by the absence of a uniform budgeting standard, chart of accounts and reporting classification system. Furthermore, audited accounts are often heavily qualified (or disclaimed) and therefore do not provide reliable information for comparison and analysis.

A multi-year data project

Given this background, developing good financial data for the local government sphere will be a multi-year project. The project to implement reforms to budgeting and financial statements has begun and a small number of pilot municipalities have initiated measures to formulate multi-year budgets according to a new nationally developed format. Standard classifications for revenue and expenditure line items, and for broad functional classifications, will enable more reliable analysis and comparison, as well as benchmarking between municipalities, within South Africa and internationally.

Municipal revenue and expenditure data

Chapters 9 and 10 of this *Review* are based on the transfers from the 2001 MTEF budgets of the national and provincial governments, as tabled in February 2001 and the 2000-01 local government budgets. The 2000/01 local government budget data used in this chapter come from the municipal budget database maintained by the National Treasury to monitor municipal finances. Each fiscal year, municipalities report to the national Treasury their estimated actual revenues and expenditures for the previous year and their budget for the new financial year. Actual revenues and expenditures for all municipalities are currently not available. In this chapter, all summary information for fiscal years 1996-97, 1997-98, 1998-99 and 1999-00 represents municipalities' self reported projected actuals and the 2000-01 data represent budgeted figures (see Annexure D).

Information on all transfers from provinces to municipalities (e.g. transfers for the provision of primary health care services) is currently not available. Therefore, actual data on intergovernmental transfers to municipalities are doubtful. The information on municipal revenue and expenditure is different from that reported by the South African Reserve Bank (SARB). The SARB reports on data received from surveys of municipalities collected quarterly by Statistics South Africa. In contrast, the summary data in this report are based on budget information consisting of over 600 municipalities.

General budget trends

Use all data cautiously!

Data weaknesses and inconsistent formats make it difficult to compare budgets and financial statements. It is also difficult to generalise since municipalities differ considerably in size and scope. For example, the largest ten pre-demarcation municipalities accounted for 66 percent of all municipal expenditure. A number of notable trends are nonetheless evident from tables 9.1 and 9.2.

Municipal budgets totalled R61,8 billion

In 2000-01, municipal budgets totalled R61,8 billion. Of this, approximately 78 percent supported the operating budget – that is, the delivery of services and overheads. The remainder of approximately 22 percent was allocated to capital projects, primarily the extension of water and electricity infrastructure. In the four years of projected actual expenditures for the ten biggest demarcation municipalities, the average annual increase in overall budgets was 6,4 percent.

Table 9.1: Total municipal expenditures

	Estimated Actual				Budget
R billion	**1996-97**	**1997-98**	**1998-99**	**1999-00**	**2000-01**
Operating	34,0	38,2	41,9	43,1	48,1
Capital	10,4	9,4	8,6	10,3	13,7
Total	**44,4**	**47,6**	**50,5**	**53,4**	**61,8**

Increases may be overstated

The 2000-01 figures show an increase of 15,7 percent from the previous year actual but it is likely that this is an over estimation. Municipalities often spend less than the budgeted amounts due to, among others, problems securing funding for capital projects and problems with revenue collection. The local government annexure shows that the budget to budget growth is not as dramatic. That is, total budgeted expenditure in 1999-2000 was R58,8 billion (compared to an estimated actual of R53,4 billion) and the budgeted figure for 2000-01 was R61,8 billion.

The gap between actual results and budgeted figures is mainly due to:

- capital projects being included in the budget without first securing funding
- uncertainty about transfers due from national and provincial governments
- inability to spend the allocated capital budget due to lack of capacity
- forced reduction of expenditure due to problems collecting monies due.

Table 9.2: Expenditure in large pre-demarcation municipalities

	Projected actual				Budget
R million	**96-97**	**97-98**	**98-99**	**99-00**	**00-01**
Johannesburg Metro	8 299,7	6 910,0	7 144,1	7 297,0	8 138,0
Cape Metro	6 481,5	7 226,3	7 488,1	8 443,2	9 025,0
Durban Metro	5 320,1	5 703,1	6 159,4	6 685,9	7 438,0
Pretoria Metro	4 130,8	5 005,4	5 902,9	5 711,4	6 363,0
Kyalami Metro	1 378,0	1 670,2	1 863,6	1 965,8	2 055,8
Port Elizabeth	1 206,8	1 346,1	1 531,5	1 561,2	1 566,1
Pietermaritzburg	712,5	867,7	858,9	941,2	1 045,1
Lekoa-Vaal Metro	798,0	859,7	899,3	947,1	1 060,8
East London	466,9	629,5	732,2	743,6	928,7
Bloemfontein	575,5	662,5	738,1	766,0	839,4
Total	**29 369,8**	**30 880,6**	**33 318,1**	**35 062,4**	**38 459,9**

The new municipalities were established in the middle of the financial year. To avoid disruption in service delivery, guidelines were issued that municipalities should continue with their 2000-01 budgets. In many cases only minor adjustments were made to accommodate changes for the remainder of the financial year.

Operating expenditure still too high

The overall budget figures for 2000-01 suggest that operating expenditures still represent an unduly high proportion of municipal expenditure. The policy emphasis on extending service delivery means that more new capital expenditure could be expected, both in absolute terms and as a proportion of total expenditure. Also, more emphasis needs to be placed on maintenance of infrastructure assets in order to ensure that capital expenditure is optimised. There is some confusion about the distinction between maintenance and capital expenditure although this should become clearer with the introduction of Generally Accepted Municipal Accounting Practices (GAMAP).

Fiscal flows becoming more predictable

National government has addressed the problem of uncertainty surrounding intergovernmental transfers, such as the equitable share and conditional grants, by moving to a system of three-year allocations. This will allow municipalities to plan their finances and service provision more accurately.

… and transparent

Many grants are not shown on municipal budgets. National and provincial departments also provide in-kind services that are not included in municipal budgets. Budget and financial reforms will require that all revenue is accurately shown on budget and grants in–kind are adequately tracked.

Financial and budget reforms are targeting improved revenue collection and more accurate revenue forecasting. Some aspects of these reforms are discussed in the section below on municipal revenue.

… with uniform reporting standards

It is difficult to make comparisons between municipalities or even between years in the same municipality in the absence of a standard accounting or reporting format. This will be remedied with the introduction of GAMAP and uniform standards and formats for budgeting and reporting.

Municipal revenue

Municipalities, overall, generate 92 percent of revenue

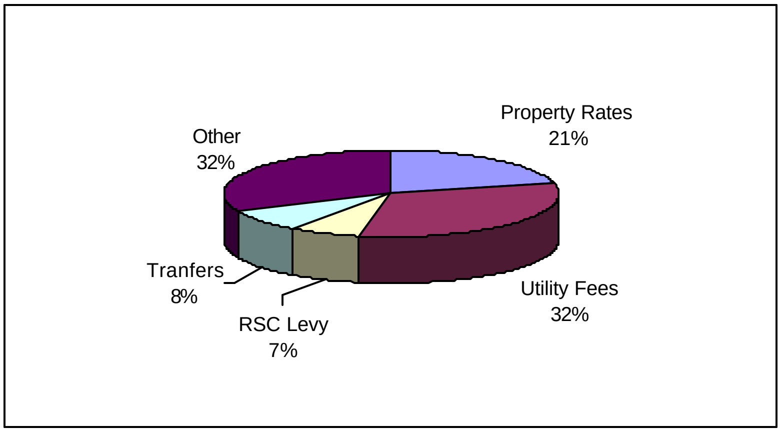
Municipalities generate, in aggregate, approximately 92 percent of their own revenue. The remaining comes from transfers from the national and provincial spheres.

On average, metros mobilise 97 percent of revenue themselves and own revenue constitutes 92 percent of the income of non-metros with budgets larger than R300 million. In contrast, those with budgets smaller than R300 million raise 65 percent of revenue themselves. However, these are aggregate figures, and the revenue mix for individual municipalities varies depending on local circumstances. Furthermore, in many municipalities the poor quality of collection policies and systems undermines actual revenue received.

Sources of revenue

Data provided to National Treasury inflates total utility fees received by municipalities, by including bulk charges for utility services in the calculation, essentially double counting revenue. The data has therefore been adjusted to remove these bulk charges from gross revenues. These adjusted figures still do not reflect all costs associated with the provision of utility services. This problem will be addressed by reforms to the costing methodology. Figure 9.1 gives the most accurate available representation of net revenues. After adjustments, the property rates component comprises 21 percent of the revenue base of municipalities, utility fees total 32 percent, intergovernmental transfers 8 percent, RSC levies 7 percent, and other revenues 32 percent.

Figure 9. 1: Sources of local government revenues, 1999-00



Utility fees

Utilities provide almost one-third of revenue

Gross utility fees from trading services, at 32 percent in aggregate, are the main sources of municipal revenues, with electricity making up the largest share.

Many municipalities use surplus fees generated by trading services to subsidise general government services. However, in many cases, municipalities do not attribute full costs to their trading service accounts. Hence any "surplus" for that sector may be overstated. Work on developing activity-based costing methodologies is currently underway. This should assist municipalities to measure actual costs and determine true surpluses or deficits relating to individual utilities.

Major implications flow from electricity changes

Changes in the electricity distribution industry will have a major impact on municipal revenues and cost structures since electricity fees represent such a large portion of municipal revenue. In many instances, revenue from utilities is not classified by function. They are not comparable between municipalities or even between fiscal years in a specific municipality. They therefore offer limited scope for analysis, making it difficult, for example, to determine the impact of the reorganisation of the electricity distribution industry on overall municipal revenues. However, it appears that the loss of cash inflow from electricity distribution will have significant implications for municipal finances. This issue is discussed in chapter 8.

Property rates

After utility fees, property rates are the next major source of revenue. Property rates are critical for funding governance, recreation, street lighting, libraries and other public goods and services that are not fully supported by fees.

Property rates systems vary significantly

Property rates are regulated by various provincial ordinances that existed before the democratisation of local government. There is a great deal of variation, with some municipalities taxing only site values, others taxing land and improvements at different rates, and still others taxing the total improved value at a single rate. In addition, there have been flat rate systems in some places. The systems are poorly administered in many municipalities. In many cases, comprehensive re-valuations have not been done in a decade or more. The Property Rates Bill published in August 2000 addresses these issues and others. Chapter 8 further explores issues surrounding the Property Rates Bill.

Intergovernmental transfers

Intergovernmental transfers comprise, in aggregate, approximately 8 percent of local government revenue. These transfers flow to municipalities through the equitable share and conditional grants. A detailed discussion of transfers is provided in chapter 10, but a few brief observations are pertinent here.

Equitable share favours poorer municipalities

The equitable share is an unconditional transfer from the national government to municipalities, based on a formula that attempts to measure the number of households in poverty. The formula favours poor rural households, and has resulted in reduced allocations to the larger metropolitan areas.

This is demonstrated in table 9.3. Johannesburg, coming from a base of just under R300 million in 1993-94, received only R24,6 million in 1999-00. From 1996-97 to 1999-00, Bloemfontein and Port Elizabeth experienced reductions of nearly 50 percent in their equitable share allocations. Even with the recent increase in the overall amount of the equitable share, the allocations to larger municipalities are substantially less than before. This loss of equitable share revenue has introduced a significant fiscal pressure on larger municipalities.

Table 9.3: Equitable share allocation in selected municipalities

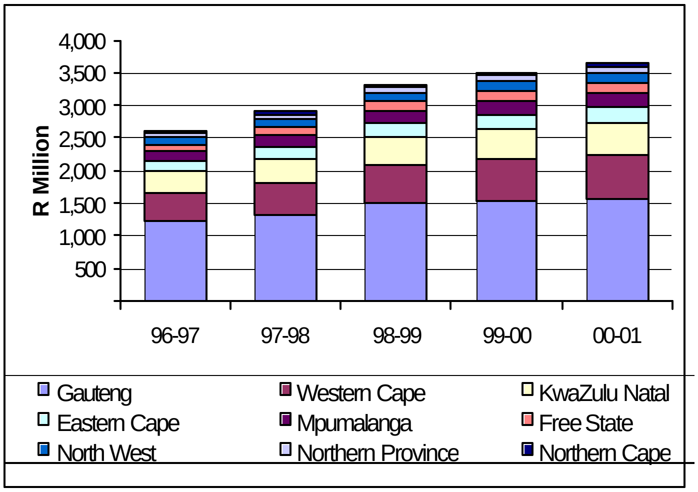
	1996-97	**1997-98**	**1998-99**	**1999-00**	**2000-01**
R 000	**Actual**	**Actual**	**Actual**	**Actual**	**Budget**
Bloemfontein	16 394,4	7 992,8	10 314,8	8 993,2	9 151,6
Johannesburg	49 763,8	48 409,1	42 487,9	24 670,8	35 712,2
Port Elizabeth	30 785,2	40 823,8	21 942,5	20 661,8	32 090,9
Total	96 943,4	97 225,7	74 745,2	54 325,8	76 954,7
R increase/(decrease)		282,3	(22 480,5)	(25 996,6)	22 628,9
% increase/(decrease)		*0*	*(23)*	*(35)*	*42*

Regional Service Council levies

RSC levies collected from business

Regional service levies represent 7 percent of local government revenue, 10 percent of the revenue of metropolitan municipalities, and are the primary source of revenue for district municipalities. Collected from businesses, these levies comprise two components. The first, based on turnover, makes up two-thirds of the total levy. The second component, a third of the total, is a regional establishment levy on the annual value of payroll. Current government policy states that the levies should be used to fund capital infrastructure. The budgeted revenue from these levies, by province, is shown in figure 9.2.

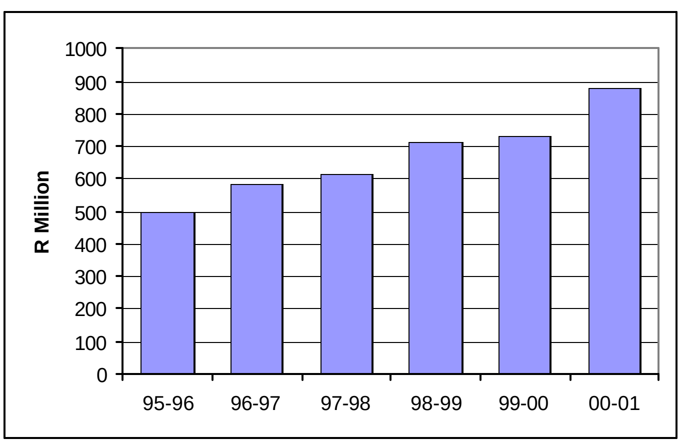
Figure 9.2: RSC levy by province (budgeted)



RSC levy system under review

Based on self-assessment by businesses, the levy is assessed and paid monthly to district municipalities and metros. The system is administratively cumbersome, difficult to audit, and marked by problems in levy collection. Government is therefore exploring ways to improve it. A case study in Johannesburg demonstrates nonetheless that improvements in collection techniques and systems can increase this revenue stream. Figure 9.3 shows the total actual RSC levy received by the City of Johannesburg over the past 6 years. The 75 percent increase over five years in RSC levy revenue collected by Johannesburg Metro has occurred largely because of better administrative procedures, including electronic payment direct to the municipality's bank account and improved methods of recording and tracing potential levy payers.

Figure 9.3: Actual RSC levy for Johannesburg Metro



Other revenues

Other revenues include interest on investments, non-trading services, fees and charges (such as recreation or burial fees), and fines. Although this category makes up a large slice of total municipal revenue, it is not possible or practical to separate it into further sub-categories. This is mainly due to the wide range of other revenue sources across various municipalities and the lack of a uniform classification methodology.

The fact that some municipalities record total vehicle licence fees, collected on behalf of provincial government, as revenue, may distort the true picture. The appropriate treatment would be for the municipality to record as revenue only the commission earned as a result of performing the agency task. Reforms currently underway will introduce standard and uniform classifications to enable better analysis and facilitate comparison across municipalities.

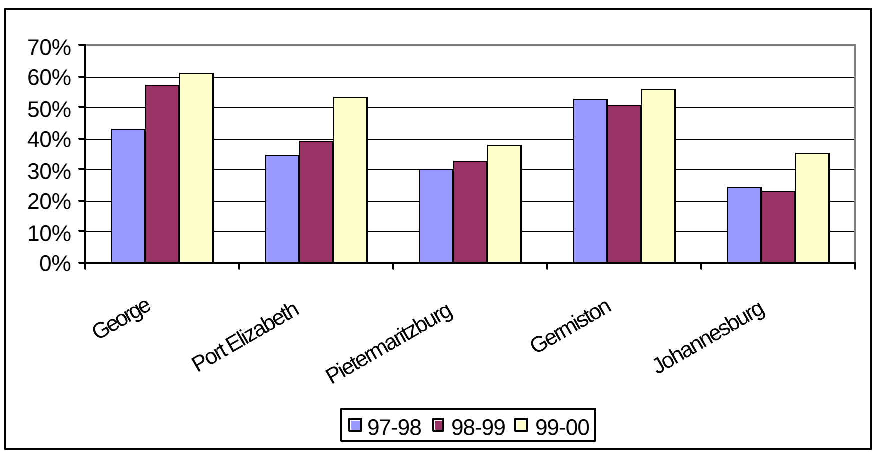
Revenue Collection

Revenue collection needs urgent attention

A major financial problem in the local government sphere is inadequate collection of revenue due. This is rooted in outdated billing and accounting systems and in the increasing level of outstanding debtors.

The result is year-end deficits, a reduction in services to balance the budget, and higher fees and taxes for those who do pay. Figure 9.4 shows that the level of outstanding debtors as a percentage of annual billing in selected municipalities has steadily increased. Revenue collection problems continue and old debt is not being recovered or written off.

Figure 9.4: Outstanding debtors as a percentage of annual billing

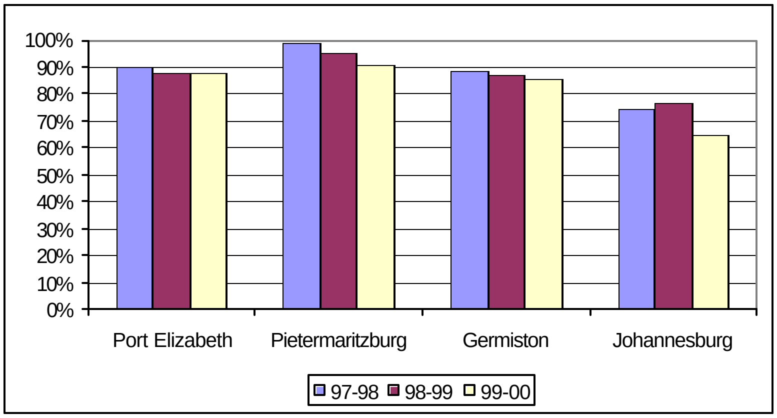


In response, Government attempted over the past four years through “Project Viability” to obtain quarterly reports on the state of municipal liquidity. However, not all municipalities have supplied this information timeously, formats have been inconsistent, and data inadequate. The current line item budgets also make it difficult to link in-year financial reporting to budgets. The reduction in the number of municipalities, current budget reforms, and new in-year reporting requirements in terms of the Municipal Finance Management Bill suggest that this programme must be reviewed.

More steps to improve debt collection

Figure 9.5 shows that, for the selected municipalities, revenue collection levels (the amount collected as a percentage of the amount billed) have worsened over the last three years. With the implementation of financial and budget reforms and GAMAP, and continued monitoring, it is expected that this problem will be brought under control. Such monitoring would strengthen councils that are committed to effective revenue collection, and help to identify those that lack such commitment.

Figure 9.5: Revenue collection levels



Average monthly household accounts

Municipalities receive revenue primarily from households, businesses and industries that pay fees for services and property rates based on land or property values. To determine the financial impact of these fees and rates on households, the National Treasury has been requesting municipalities to report the monthly charges on the following:

?? Property rates on 1 000 m^2 erven and 150 m^2 improvements

?? Electricity base charges and consumption charges on 1000 units

?? Water base charges and consumption charges on 30 kilolitres

?? Sewer sanitation charges

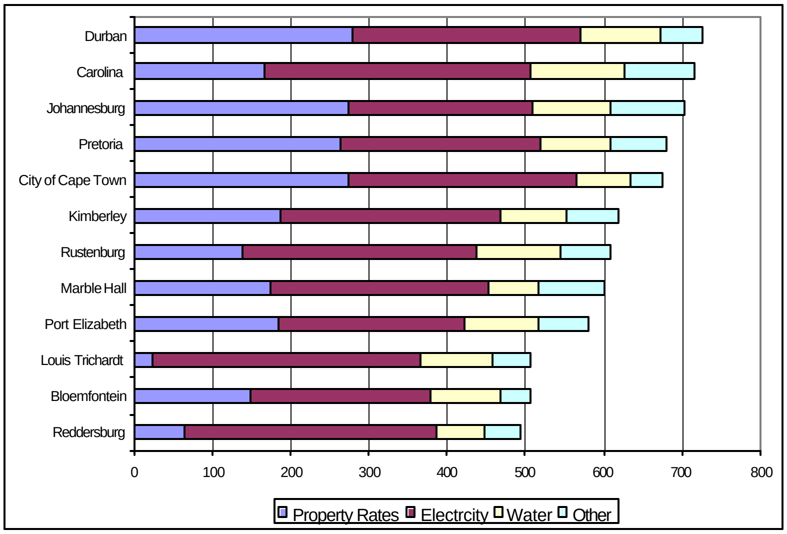
?? Refuse collection charges.

The above reflects an average middle income dwelling. An example of the types of charges likely to be incurred in poor 'townships' – with lower levels of service - is included at the end of this section.

Middle-class household accounts averaged R618

The monthly household cost for these services for 12 sample municipalities is provided in figure 9.6 and table 9.4. For these municipalities, the average monthly household accounts in July 2000 range from a high of R727 in Durban (KwaZulu-Natal) to a low of R494 in Reddersburg (Free State).

Figure 9.6: Average monthly household account (rands) July '00



Electricity is the largest portion

The data show that electricity (the main trading activity for municipalities) is the largest portion of monthly charges for the average household at 47 percent in July 2000. Property rates is the next highest at 29 percent, while water accounts for 14 percent of the average monthly account in the selected municipalities. The differences in the spread of revenue for these sample municipalities shows that each municipality has a different funding mix for the services it provides.

Table 9.4: Average monthly household account (rands), July '00

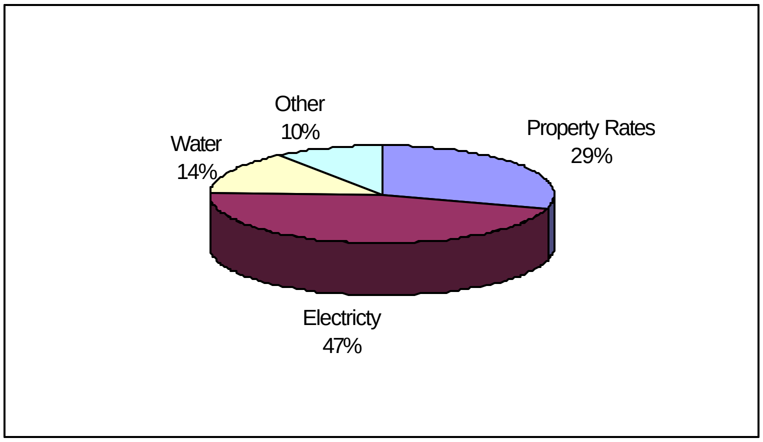
Municipality	Property	Electricity	Water	Other	Total
Durban	280	290	102	55	727
Carolina	166	340	121	90	717
Johannesburg	273	237	99	94	703
Pretoria	263	257	90	70	680
City of Cape Town	273	291	70	40	674
Kimberley	188	282	82	68	620
Rustenburg	138	299	107	64	608
Marble Hall	174	278	64	84	600
Port Elizabeth	184	237	95	64	580
Louis Trichardt	25	342	90	51	508
Bloemfontein	149	230	90	38	507
Reddersburg	65	322	60	47	494
Average	**181**	**284**	**89**	**64**	**618**

A complex reality to consider

This mix would have to be considered in the pending restructuring of service sectors, such as the electricity and water industries, and in the division of powers and functions between category B and C municipalities. The municipal sector is too diverse to allow for a general approach, and it is necessary to consider carefully – for each municipality – the impacts on property rates of removing user charges.

There are implications for the overall fiscal viability of municipalities, and for the cost of living in their jurisdictions. For example, Louis Trichardt and Reddersburg both have a low average household account for property rates and very high charges for electricity. Therefore, it is likely that charges for electricity are subsidising services that would normally be funded by property rates.

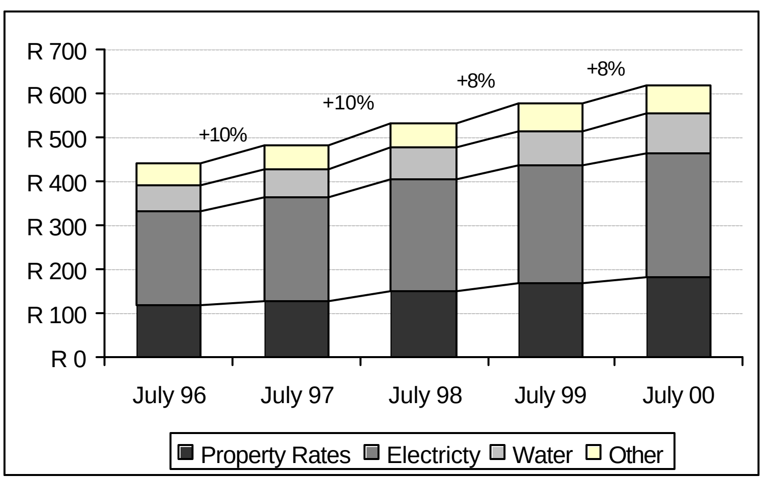
Figure 9.7: Breakdown of aggregate household account, July '00



The trend shows declining increases

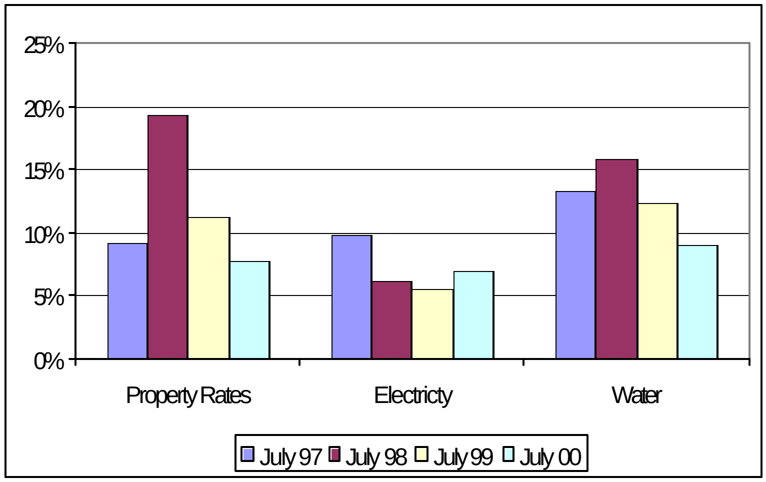
The average trend regarding increases in household accounts, for these 12 municipalities, is shown in figure 9.8. The average monthly accounts increased by 10 percent per annum from 1996 to 1998, and slowed to 8 percent per annum in the following two years. However, of concern is that these increases have been above the rate of inflation and negatively affect government inflation targets.

Figure 9.8: Average monthly household account



In similar vein, figure 9.9 shows a recent decline in the annual percentage increase applied to major components of the average monthly household account. This can be attributed mainly to capping of expenditure and revenue limits by Government.

Figure 9.9: Increases in major components of household accounts

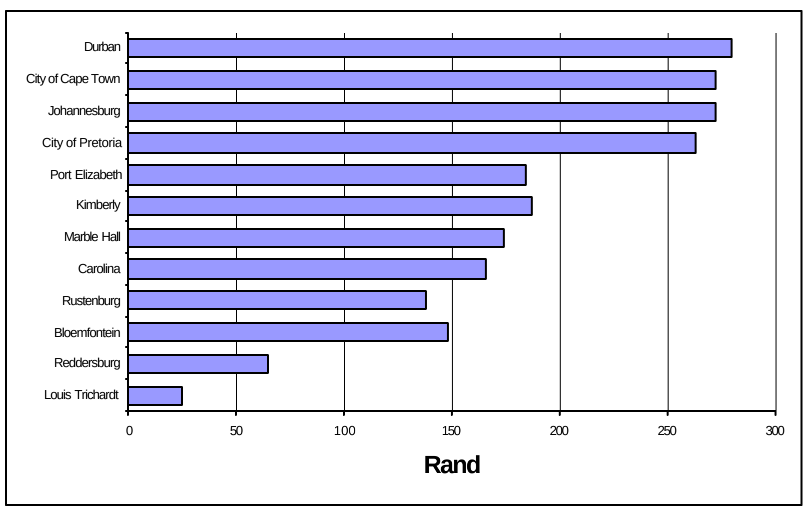


Property Rates

Property rates vary widely

Monthly property rates in 2000 in the surveyed municipalities (for a 1 000 m^2 erf with 150 m^2 of improvements) ranged from a high of R280 in Durban to a low of R25 in Louis Trichardt. This is illustrated in figure 9.10. The major metropolitan areas reported property rates of about R270 per month. Actual property rates are determined by valuations and by the level of the rate. Some valuations consider land value only while others are assessed at land value plus improvements.

Figure 9.10: Monthly prope rty rate charges, 2000

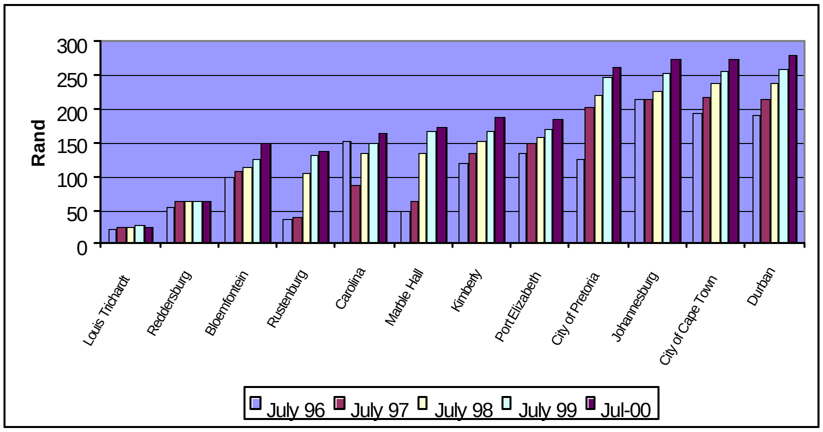


Costs and benefits of system change

There is currently no generally accepted benchmark for property rates. The fiscal effort required to implement a comprehensive rating system is often greater than the fiscal capacity to do so. That is, it may be easier for a municipality to rely on established systems for collecting electricity fees than to develop and maintain a complex property rating system. This is true not only of decisions around property rates, but also applies to a number of service delivery areas. The result is a wide range of property rates and service charges.

Figure 9.11 shows most of the sample municipalities have had steady upward trends in property rate charges.

Figure 9.11: Trends in monthly property rate charges, 1996-2000

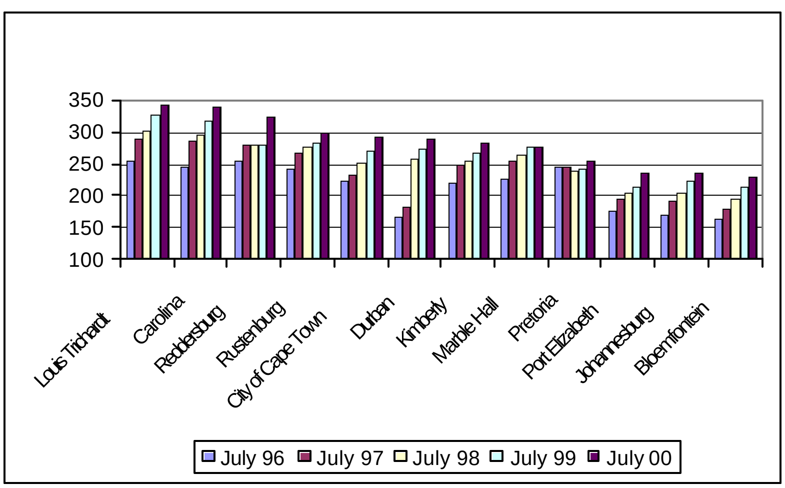


Domestic Electricity

Electricity needs careful assessment

Figure 9.12 presents trends in the monthly domestic charges for 1 000 units of electricity. Louis Trichardt, which has the lowest property rates among the selected municipalities, has the highest electricity charges. These higher charges may be due to higher costs to provide electricity, inefficiencies in service delivery or because electricity may be used to generate a surplus to keep property rates low, effectively taxing consumption of services rather than property.

Figure 9.12: Trends in monthly electricity charges, 1996-2000



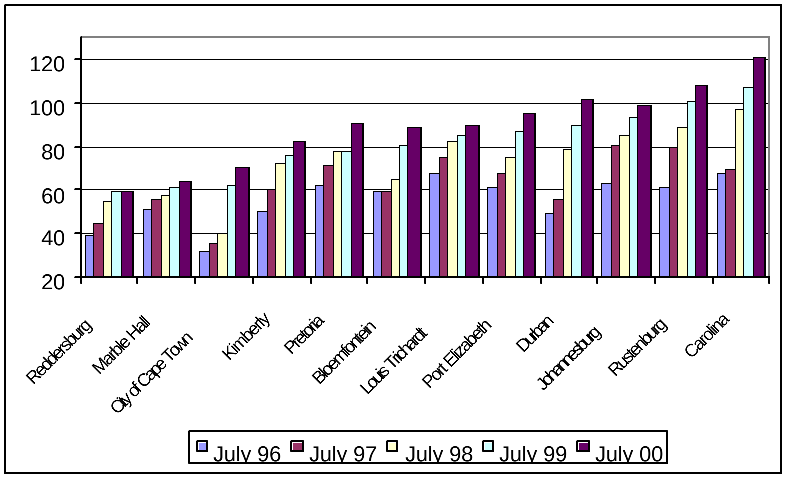
This type of complexity must be considered when the restructuring of the electricity industry is planned. Different municipalities will be affected differently, and the fiscal implications for each as well as for the broader service delivery system, must be carefully assessed.

Domestic water

Upward trends in water tariffs

Monthly charges by municipalities for 30 kilolitres of water in the selected municipalities range from a high of R121 in Carolina to a low of R60 in Reddersburg. But figure 9.13 also shows an upward trend in these charges, across the range of sample municipalities. As discussed in chapter 8, this is probably mainly due to high input costs for bulk water, and the impact of the integration of black and white residential areas as well as the introduction of subsidies to poor households.

Figure 9.13: Trends in monthly water charges (30 kl), 1996-2000



Household accounts in 'townships'

'Township' accounts generally different

Historically, data has been gathered that reflects typical middle class residential settlements. The comparisons and analysis above is based on this type of dwellings due to the availability of data. However, below is a tentative analysis of a typical 'township' dwelling.

The sample, reflected in table 9.5, provides an example of monthly charges in an average domestic stand in selected townships in Johannesburg for 2001-02. The figures are generally not substantially lower than those in typical 'middle class' areas.

The previous and new value for land is shown as well as rates charged under the old system and in terms of the new system for the 2001-02 budget year. While the assessed value has increased substantially in most cases, the municipality has made all stands less than R20 000 exempt from property rates. Hence, no rates are payable in any of the townships in the selected sample.

Historically, with regard to electricity, Eskom supplied certain suburbs whilst others were serviced by the municipality. This anomaly still continues and therefore some figures in table 9.5 are blank. While average costs have been difficult to ascertain, it is estimated that Eskom charges are slightly higher than electricity charges by the city. This lack of certainty with the data is an area that will be followed up for the next *Review*.

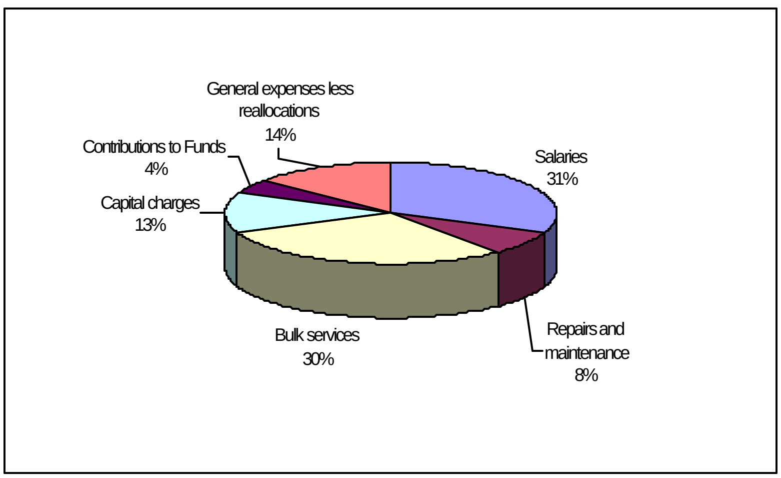
Table 9.5: Some Johannesburg 'township' charges (R's), '01-02

Township	Land Value Previous	Land Value New	Rates Old	Rates New	Elec.	Water	Refuse	Sewer
Alexandra East Bank	30,000	11,000	82,32	0,00	225,81	52,90	32,50	67,00
Chiawelo	7,500	11,920	20,58	0,00	–	52,90	18,40	34,00
Dobsonville	12,000	19,816	32,93	0,00	–	52,90	18,40	34,00
Doornkop	10,000	16,570	27,44	0,00	–	52,90	32,50	67,00
Drieziek	7,000	15,312	19,21	0,00	–	52,90	18,40	34,00
Dube	7,000	12,362	19,21	0,00	–	52,90	18,40	34,00
Jabavu	5,500	5,575	15,09	0,00	–	52,90	18,40	34,00
Jabulani	7,000	17,112	19,21	0,00	–	52,90	18,40	34,00

Municipal expenditure

Municipalities projected R43,1 billion in operating expenditures in 1999-00. Figure 9.14 shows the breakdown of these expenditures.

Figure 9.14: Operating expenditure, 1999-00



Salary and Wage Issues

Salary increases outpaced inflation

Salaries continue to take up a large portion of municipal expenditure. Increases in salaries are due in part to central bargaining agreements with municipal employee unions at national level, and have continued to outstrip inflation over the past four years.

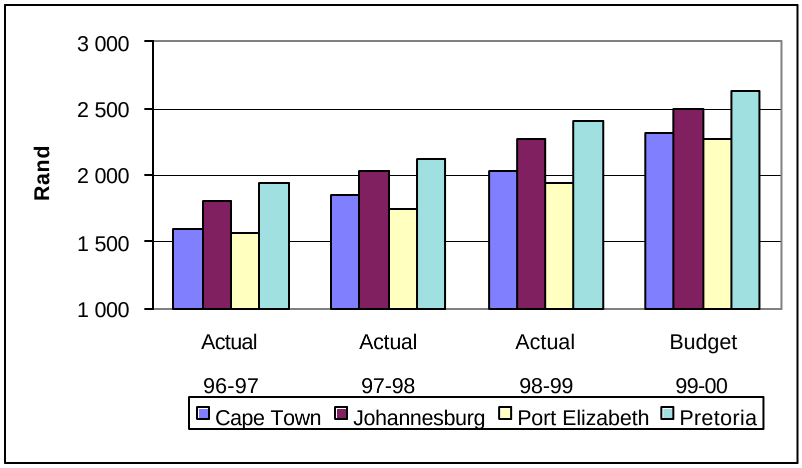
Other topical issues in relation to municipal salaries and wages include total salaries and wages costs as a percentage of total expenditure; the gap between the highest and lowest paid employees;

and the impacts of attempting to achieve salary parity in newly demarcated municipalities. These issues are considered in chapter 8.

Salary growth exceeded budget growth

The average monthly minimum wage for four municipalities is shown in figure 9.15. In the four cities, the average monthly minimum wage increased by 12 percent per annum from 1996-97 to 1998-99, and 13 percent in 1999-00. This is a cumulative increase over the four years of 41 percent. Over the same period, the increase in the total budgets for these municipalities amounted to 29 percent.

Figure 9.15: Average monthly minimum wage, 1996-2000

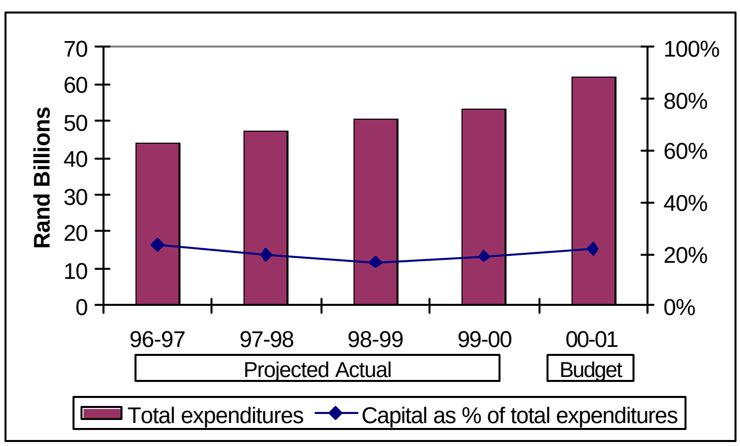


Capital Expenditure

Capital Spending has declined

After expenses incurred in purchasing bulk electricity and water, the next major expenditure item is capital projects. Figure 9.16 and table 9.6 show that capital expenditure as a percentage of total expenditure declined from 1996/97 to 1998/99, with a slight increase in 2000/01.

Figure 9.16: Capital as percentage of total expenditure



However, as discussed under table 9.1, the actual amount spent will probably be lower. This decline in spending on capital infrastructure is a result of financial problems at the municipal level, as increasing operating expenditure and rising non-payment of rates and charges crowd out capital expenditure. Moreover, long-term lending to municipalities by the private sector, an important source of funds for capital projects, has stagnated. As Chapter 11 shows, this has further reduced municipalities' ability to finance capital infrastructure.

Table 9.6: Capital backlogs and deferred maintenance, 1997-2000

	Pretoria			Port Elizabeth		
Roads	**1997-98**	**1998-99**	**1999-00**	**1997-98**	**1998-99**	**1999-00**
	R'000	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**
Actual Operating Expenditure	92 187	132 254	171 534	54 767	55 945	59 708
Actual Operating Income	2 801	2 194	5 677	4 624	7 285	3 628
Actual Annual Maintenance	66 769	67 307	64 769	25 961	28 686	31 359
Estimated Deferred Annual Maintenance	19 500	22 400	25 800	1 054	3 073	3 496
Actual Capital Expenditure	153 100	110 900	49 600	12 202	25 202	29 174
Estimated Backlog of Capital Expenditure	61 000	15 300	12 400	12 208	8 448	12 000
	Km	**Km**	**Km**	**Km**	**Km**	**Km**
No. of new KMs of Tarred Road this Year	13	254	22	13	15	23
Total KMs of Tarred Road at Year End	3 054	3 308	3 330	2 052	2 067	2 090
No. of new KMs of Gravel Road this year	2	21	24	21	25	77
Total KMs of Gravel Road at Year End	191	212	235	470	495	572
Electricity	**1997-98**	**1998-99**	**1999-00**	**1997-98**	**1998-99**	**1999-00**
	R'000	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**
Actual Operating Expenditure	846 914	976 679	984 695	528 617	534 686	579 319
Actual Operating Income	1 095 574	1 219 311	1 269 963	554 496	561 742	584 282
Actual Annual Maintenance	135 059	146 806	126 827	8 844	12 256	11 929
Estimated Deferred Annual Maintenance	145 278	150 623	144 319	–	–	–
Actual Capital Expenditure	53 300	49 800	48 300	49 636	51 350	45 385
Estimated Backlog of Capital Expenditure	75 200	62 600	47 100	–	–	–
	No.	**No.**	**No.**	**No.**	**No.**	**No.**
New Household Connections this Year	5 765	1 860	1 332	5 047	4 779	5 701
Total Households Connected at Year End	188 392	186 532	185 200	145 470	150 249	155 950
Total Households with No Connection at Year End	na	na	na	2 948	2 359	2 549
Water	**1997-98**	**1998-99**	**1999-00**	**1997-98**	**1998-99**	**1999-00**
	R'000	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**
Actual Operating Expenditure	256 104	286 455	328 300	104 457	118 650	130 551
Actual Operating Income	273 515	327 329	386 035	103 606	115 443	141 542
Actual Annual Maintenance	28 289	29 267	35 715	22 998	27 215	29 713
Estimated Deferred Annual Maintenance	37 918	32 024	34 028	21 495	23 883	25 960
Actual Capital Expenditure	31 400	19 400	17 400	12 562	19 326	14 034
Estimated Backlog of Capital Expenditure	26 600	15 300	15 200	1 770	19 950	2 013
	No.	**No.**	**No.**	**No.**	**No.**	**No.**
New Household Connections this Year	15 812	1 949	407	4 087	11 089	12 884
Total Households Connected at Year End	127 982	129 931	129 524	77 000	88 089	100 973
Total Households with No Connection at Year End	na	na	Na	40 000	35 000	32 000

The trends in table 9.6 show actual capital expenditure and annual maintenance to be either declining or relatively stable. While estimated backlogs and deferred maintenance seemed stable or falling, they still indicate a substantial need for expanding service delivery.

Furthermore, these figures may change when asset registers are completed and all assets are valued according to generally accepted municipal accounting practices.

Operating expenditure by functional classification

Historically, information collected for municipal areas of expenditure (at a national level) has not been aggregated with any degree of certainty. This is because the 843 municipalities had many varied classification systems.

Reforms are addressing the information gap

The new financial and budget reforms are addressing this information gap. It is expected that trend data will be built up over time. Coupled with output performance measures for service delivery levels, this will assist policy decisions in all spheres of government.

Case study on expenditure by functional classification

Three metros analysed

Table 9.7 shows the 2001-02 operating expenditure budgets of three metropolitan municipalities split into the major functional classifications required under the new budget reforms. As the reforms are still in early stages, some adjustments had to be made to the submitted figures in order to facilitate more accurate classification. This is because business units and functional areas of municipalities are still adapting to the new reporting requirements.

Table 9.7: Operating expenditure functional classification's, '01-02

Functional Operating Exp	Johannesburg		Cape Town		Tshwane		Total	
	Rm	%	Rm	%	Rm	%	Rm	%
Electricity	2 814	*30,2*	2 024	*29,6*	1 447	*31,4*	6 285	*30,3*
Water & Sanitation	2 064	*22,1*	1 054	*15,4*	854	*18,5*	3 972	*19,1*
Finance & Admin	924	*9,9*	507	*7,4*	397	*8,6*	1 828	*8,8*
Public Safety	639	*6,9*	540	*7,9*	386	*8,4*	1 565	*7,5*
Roads Stormwater & drainage	552	*5,9*	473	*6,9*	292	*6,3*	1 317	*6,3*
Refuse	480	*5,2*	344	*5,0*	232	*5,0*	1 056	*5,1*
Exec & Council	360	*3,9*	172	*2,5*	337	*7,3*	869	*4,2*
Parks & Recreation	300	*3,2*	371	*5,4*	131	*2,8*	802	*3,9*
Community Services	283	*3,0*	342	*5,0*	120	*2,6*	745	*3,6*
Housing	189	*2,0*	216	*3,2*	46	*1,0*	451	*2,2*
Transport	206	*2,2*	286	*4,2*	85	*1,8*	577	*2,8*
Planning & Development	139	*1,5*	208	*3,0*	129	*2,8*	476	*2,3*
Health	196	*2,1*	252	*3,7*	90	*2,0*	538	*2,6*
Other	173	*1,9*	52	*0,8*	64	*1,4*	289	*1,4*
Total	9 319	*100,0*	6 841	*100,0*	4 610	*100,0*	20 770	*100,00*

The average percentage of expenditure for each functional area for the three sample municipalities – illustrated in figure 9.17 – gives an indication of where a large metropolitan municipality spends its operating budget in 2001-02.

In brief the following points should be noted:

?? Electricity distribution is the largest area of expenditure and accounts for almost a third of total operating expenditure. This is why restructuring of the electricity industry would have a marked impact on municipal finances.

?? Water and sanitation is the next largest function comprising 19,12 percent of operating expenditure. This is especially significant considering that one of the major pricing pressures on local government is above inflation increases in bulk prices for water.

?? The rest of expenditure categories fall below 10 percent each. Finance and administration represents organisational support costs including financial services, information technology, human resources and administration, and collection of rates and other revenues. A review of activity based costing methodologies would most likely lead to more costs being allocated to the functions receiving the services. The Executive Committee and Council (4,18 percent) essentially represents governance costs for the municipality.

?? Public safety (7,53 percent) relates mainly to local policing and ambulance services. Roads, storm water and drainage (6,34 percent) relates to maintenance and operation of the major infrastructure assets and this function would normally also account for a significant proportion of the capital budget. Refuse collection and disposal accounts for 5,08 percent of operating expenditure while maintenance and operation of parks and recreational facilities make up 3,86 percent.

?? While the remaining functional areas each account for around 3 percent of the budget or less, this does not diminish their importance. Functions like Community Services, Housing, Public Transport and Health are crucial to redistribution and providing basic services.

Comparisons are difficult

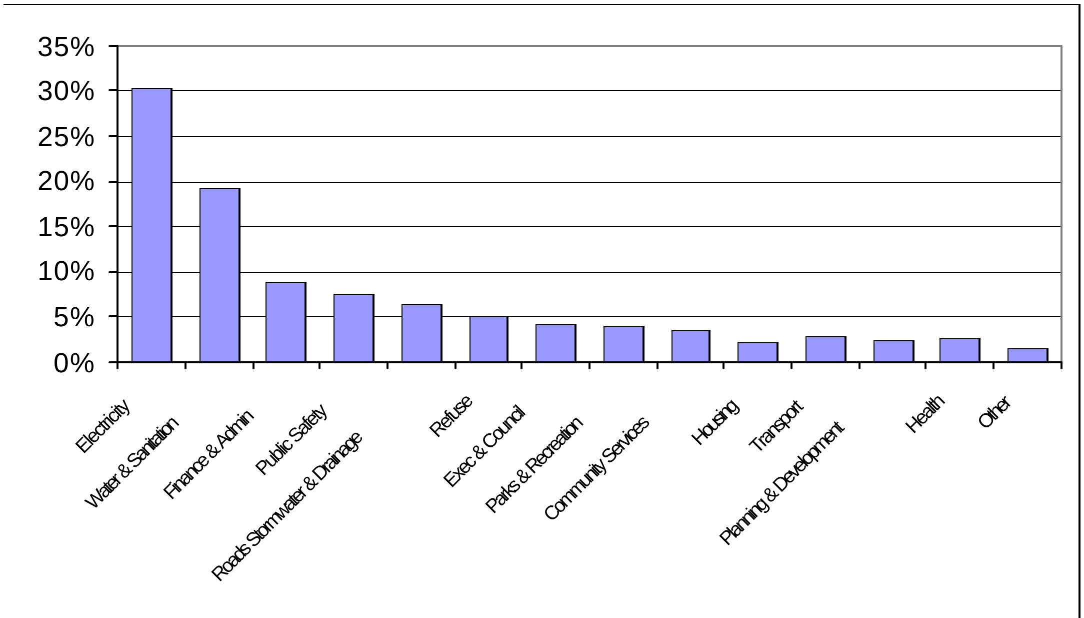
On the whole, however, it is still difficult to compare the functional expenditures of municipalities for a number of reasons:

?? Different municipalities use different costing methods. That is, indirect costs are allocated to functions in different ways, and not always equally clearly reflected. Standardised activity based costing methods, as proposed under the reforms, would enhance comparability.

?? Different municipalities may each place a different emphasis on service delivery levels in various functions due to unique local circumstances. These circumstances could include variations in demographics, geography, economic development and local politics.

?? Municipalities are at different levels of reform. Their systems may not have been completely adapted to provide information on the standardised functional areas in a uniform manner as required by the reforms.

Figure 9.17: Average percentage split by functional classification (Jhb, C. Town, Tshwane)



Conclusion

As mentioned earlier, it is too early to capture sound budget data for the newly demarcated municipalities. The next *Review* will provide such information and analysis. This overview nonetheless highlights trends with relevance to budget management during transformation.

Basic service delivery suffers as municipalities face various budget challenges. Operating expenditures, and especially the share of salaries in the expenditure figures, continue to be high. Capital expenditure declined as a percentage of total spending. Revenue from property rates, electricity, water and other significant sources steadily increased, as did outstanding debtors. But many municipalities find it difficult to collect revenue effectively, and the pricing, planning for, and management of revenue must be priorities. Inadequate information undermines budgeting, and makes benchmarking, comparisons, and tracking of funding flows, difficult.

Reforms are necessary in both the contents and formats of budgets. This should increase the availability and accuracy of information on municipal finances. Trend analysis will also improve over the next few years. These reforms will increase transparency at the local level and provide elected office bearers, citizens and financial institutions with a better understanding of the financial position of municipalities. Improved financial management, in turn, will facilitate more effective allocations to the service needs of communities.

10

Transfers to local government

Intergovernmental transfers to local government make up a small yet important component of total municipal revenue. They help municipalities meet the challenge of ensuring that all South Africans have access to basic services, such as water and sanitation, a reliable energy source, and refuse removal.

Subsidising services to poor households has recently been accorded increased attention in government policy. While municipalities themselves perform the central role in implementing the free basic services commitment, transfers from national government provide a significant portion of the financial resources necessary to do so. The 2001/02 year also saw the introduction of the Local Government Transition Grant to assist municipalities with the costs associated with amalgamation following the redrawing of municipal boundaries [1].

This chapter outlines how the transfer system works. It presents basic data and examines the effectiveness of expenditure. It should be noted that the assessment is constrained by data limitations. In particular, historical data at a municipal level for both actual allocations to municipalities and the quantum of actual municipal expenditure is often unavailable, inaccurate, or outdated due to recent changes to municipal boundaries.

The context of allocations to local government

On average, municipalities have sufficient revenue raising powers to fund the bulk of their expenditure, and finance over 90 percent of their recurrent expenditure out of own revenues. Two key points should be stressed here.

Functions of local government

First, this situation is a function of the specific role and powers of municipalities in South Africa. Unlike many other countries, where transfers typically contribute between 30 and 50 percent of municipal revenue, South African local government is not responsible for large tax-funded social services. Here, for example, health and education are provincial responsibilities. Over 60 percent of local government

[1] The 2000 *Intergovernmental Fiscal Review* contained detailed information on the role and design of individual grant programmes. This assessment does not repeat that detail. Up to date information on the design of each municipal transfer programme is available in Government Gazette No's. 22304 of 15 May 2001 and 22350 of 31 May. 2001 respectively, and are also available on the National Treasury's website (www.treasury.gov.za).

revenue is derived from utility services (water, sanitation, power), that generate their own revenues and are self-funding.

Differences between municipalities

Second, the aggregate situation disguises many differences between municipalities. In general, rural municipalities are more reliant on intergovernmental transfers than are urban ones. This is examined later in this chapter. The equitable share formula – based on the number of households in poverty – has been designed specifically to take these differences into account. However, national government expects all municipalities to improve the collection of their own revenue. Municipalities failing to collect their own revenue will not be bailed out by national government.

The role of national transfers to municipalities

Conditional and unconditional transfers

Revenue is shared through a system of intergovernmental national transfers, consisting of both unconditional transfers (primarily the equitable share) and conditional grants. These transfers, together with own revenue, make up the resources available to each sphere. Revenue-sharing is an integral element of cooperative governance, and requires the systematic involvement of all three spheres.

National government allocated over R6,5 billion to municipalities in the 2001/02 financial year. These allocations are made annually in the national budget, with allocations to individual municipalities regulated by the annual Division of Revenue Act. Transfers from provincial governments supplement those from national government to municipalities. The Division of Revenue Act also regulates these provincial transfers, with obligations and allocations to individual municipalities to be gazetted by the province.

Three categories of transfers

National transfers to local government, as shown in figure 10.1, can be analysed in three broad categories, namely:

- The equitable share and related transfers constitute 57 percent of the total allocation to the local sphere and are made up of three grants. The "core", formula-driven equitable share allocation is the most significant. The other programmes are the Local Government Transition Fund and the Water Services Operating Grant.

… infrastructure

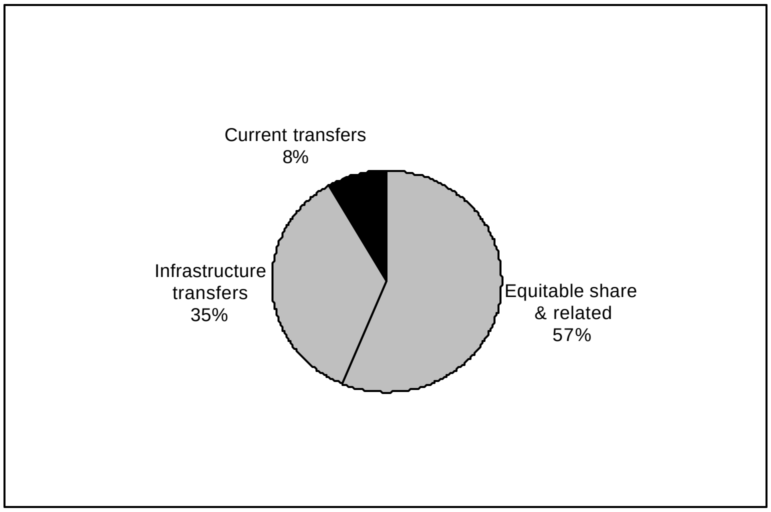
- Municipal infrastructure transfers constitute 35 percent of the total allocation and are delivered through eight different programmes. Of these, the Consolidated Municipal Infrastructure Programme (CMIP) and the Implementation of Rural Water Services Projects make up the largest proportion.

… capacity development

- Recurrent transfers to support municipal capacity development and restructuring constitute 8 percent of the total allocation. This includes two grants that support municipal restructuring and two grants supporting the enhancement of municipal capacity.

In keeping with government's service delivery and poverty alleviation objectives, the bulk of these transfers are targeted towards areas with large numbers of poor or under-serviced households.

Figure 10.1: Composition of allocations (projected 2000/01)



The division of revenue

The vertical division

Growth in local government share

Local government is set to receive an increasing percentage of national revenue. The growing share results from the increasing priority given to basic service delivery by local government. Table 10.1 presents the basic data. Minor discrepancies may continue to exist between these figures and those provided elsewhere in the *Review*. This is due to the finalisation of provincial accounts and the recording of the Local Government Support Grant in both the provincial and local shares. This grant is transferred through the provinces.

Table 10.1: Vertical division of revenue

R millions	Actual 1995/96	Actual 1996/97	Actual 1997/98	Actual 1998/99	Actual 1999/00	Projected 2000/01	Budget 2001/02	Budget 2002/03	Budget 2003/04
National government	47 124	53 967	58 204	60 926	65 974	74 459	84 245	89 862	95 302
Provincial government	71 465	83 213	86 875	93 134	98 962	108 767	117 388	126 564	135 222
Local	3 905	5 150	6 049	4 687	4 669	5 637	6 547	7 246	7 978
Total	**122 494**	**142 330**	**151 128**	**158 747**	**169 605**	**188 863**	**208 180**	**223 672**	**238 502**
Percentage shares									
National share (%)	*38,5*	*37,9*	*38,5*	*38,4*	*38,9*	*39,4*	*40,5*	*40,2*	*40,0*
Provincial (%)	*58,3*	*58,5*	*57,5*	*58,7*	*58,3*	*57,6*	*56,4*	*56,6*	*56,7*
Local (%)	*3,2*	*3,6*	*4,0*	*3,0*	*2,8*	*3,0*	*3,1*	*3,2*	*3,3*
Total	***100,0***	***100,0***	***100,0***	***100,0***	***100,0***	***100,0***	***100,0***	***100,0***	***100,0***

Total allocations to local government have been fairly volatile, and peaked at R6 billion in 1997/98 before falling to R4,7 billion in the subsequent year. This volatility was due to the introduction and subsequent dissolution of the RDP fund. There is, however, some doubt as to whether all these funds actually accrued to municipalities, as the transfers were seldom reflected on municipal budgets and may have been used to build assets not fully reflected in local government asset registers. These transfers may also have continued after 1997 in the form of grants-in-kind or transfers from provincial own revenue.

Transfers set to increase 11% per annum

The period from 1998/99 has seen a recurrence of the strong growth in transfers to the municipal sphere. From 1995/96 to 1997/98 transfers grew by over 30 percent per annum, on average, and from 1998/99 to 2001/02, by an average, of R784 million, or 17 percent a year.

The local government share of nationally raised revenue increased from 2,8 to 3,1 percent. This trend is projected to continue into the medium-term. Local government's share will be rising by 11 percent a year in real terms, a faster increase than the allocations to other spheres of government, albeit off a low base.

Provincial transfers to local government

Provincial transfer information improving

Transfers to municipalities from provincial own revenue are made at the discretion of the province concerned. They reflect service delivery arrangements for provincial functions such as primary health care, road maintenance and library services.

Little information is available on the extent or focus of transfers to municipalities from provincial own revenue. The Division of Revenue Act, 2001, requires provinces to publish detailed information on these transfers for the current financial year. Preliminary estimates of provincial transfers are shown in the table below.

Provincial transfers fund agency functions

Table 10.2 indicates that R1,2 billion is scheduled to be transferred in the current financial year. Transfers for community health and emergency services functions account for 75 percent of these transfers.

Table 10.2: Provincial transfers to municipalities in 2001/02

R'000	Community health	Roads	Rental Housing	Sports devt	Disaster & Emergency Services	Municipal Basic Services	Admin. Assistance & planning	Libraries	LED	Enviro. Conserv	Total 2001/02
Eastern Cape	123,885	–	–	–	81,008	–	–	–	–	11,911	–
Free State	64,978	–	–	–	–	–	–	–	–	–	64,978
Gauteng	178,135	–	1,623	326,708	128,200	–	–	–	–	250	634,916
Kwazulu Natal	41,715	1,399	–	–	–	–	–	12,700	1,000	1,803	58,617
Mpumalanga	33,429	–	–	–	1,887	–	4,755	–	1,696	–	41,767
North West	31,023	–	–	–	6,000	78,280	10,000	–	–	–	125,303
Northern Cape	3,222	34,830	–	–	–	–	–	–	–	889	38,941
Northern Province	–	–	–	–	–	–	–	–	–		–
Western Cape	141,576	15,200	–	2,600	71,760	1,500	4407	5932	–	3,000	245,975
Total	**617,963**	**51,429**	**1,623**	**329,308**	**288,855**	**79,780**	**19,162**	**18,632**	**2,696**	**17,853**	**1,210,497**
% total	**51%**	**4%**	**0%**	**27%**	**24%**	**7%**	**2%**	**2%**	**0%**	**1%**	**100%**

The horizontal division of allocations to local government

The horizontal division of allocations between programmes has also shifted considerably since 1995/96, due to the consolidation of transfer programmes and phasing out of others. This reflects the priority placed on basic municipal service delivery and is shown in table 10.3.

The programmes listed in the table have been classified into three broad categories that reflect the intention to restructure the system of transfers to municipalities. These categories are the local government equitable share and related transfers, transfers for municipal infrastructure and transfers to support recurrent municipal expenditure. They exclude transfers made from a provincial government's own revenue.

Changes in composition of allocations

The composition of these categories has also changed significantly:

?? The equitable share rose from 38 percent of the total allocation in 1995/96 to 62 percent in 1999/2000, and thereafter declined to 56 percent. It is projected to stabilise over the medium-term. Infrastructure transfers grew to 41 percent of the total in 1997/98, before declining to 35 percent by 1999/2000. Again, this category is projected to stabilise at this level over the medium-term.

?? Recurrent transfers declined dramatically from 42 percent of the total allocation in 1995/96 to 3percent in 1999/2000, before rising to 8 percent in 2000/01, likely to stabilise over the medium-term.

Transfers occurred primarily through provinces until 1998/99, when the equitable share was introduced. However, provincial transfers continue to exist, as shown in table 10.2.

Trends in categories of allocations

Allocations remain volatile

Figure 10.2 shows volatility in all categories of transfers, although the equitable share has always registered positive annual growth in the period under review, at an average of 10 percent annually. Nominal allocations for this category have grown by over R2 billion from 1995/96 to R3,5 billion in the current financial year.

The bulk of this growth has occurred within the "core" constitutionally guaranteed equitable share transfer to local government, introduced in 1998/99. This trend reflects the significance attached to equitable share transfers in South Africa's emerging intergovernmental fiscal system.

Consolidation of programmes

The ongoing effort to consolidate a large number of small transfer programmes into a smaller number of large programmes is evident in table 10.3. This is necessary to ensure equity and transparency and to align grant programmes to Government's policy priorities. Streamlined transfers also limit the risk of undue intrusions into local resource allocation processes, and erosion of the democratic accountability of a municipality to its residents. There are also functional benefits, such as linking funding for different types of infrastructure into an integrated package that serves a range of community needs.

Table 10.3: Allocations to local government by programme

R'm	Actual 1995/96	Actual 1996/97	Actual 1997/98	Actual 1998/99	Actual 1999/00	Projected 2000/01	Budget 2001/02	Budget 2002/03	Budget 2003/04
Equitable share (incl IGGs)	830	806	903	1 024	1 673	1 867	2 618	3 002	3 551
R293 personnel	560	864	883	951	463	463	–	–	–
R293 transfer	86	80	68	–	40	–	–	–	–
Transition grant	–	–	–	–	–	100	250	200	–
CWSS (Operating)	0	497	493	599	710	746	692	644	662
Equitable share & related	1 476	2 247	2 347	2 574	2 886	3 176	3 560	3 846	4 213
% increase	–	*52%*	*4%*	*10%*	*12%*	*10%*	*12%*	*8%*	*10%*
% of total allocation	*38%*	*44%*	*39%*	*55%*	*62%*	*56%*	*54%*	*53%*	*53%*
Agency transfers	78	82	78	–	–	–	–	–	–
Traditional subsidies	23	26	48	–	–	–	–	–	–
Other	48	162	45	–	–	–	–	–	–
CMIP (incl MIP, EMIP, BCIG)	126	540	846	702	696	883	994	1 159	1 407
Implement Water Services Projects	496	321	919	1 016	626	609	822	818	835
Community based public works	–	–	–	152	274	374	374	374	374
Building for Sports & Rec. prog.	–	–	–	–	–	–	40	90	130
LED Fund	–	–	–	–	5	104	76	99	127
Urban Transport Fund	–	–	202	37	30	22	81	40	42
Infrastructure transfers	771	1 131	2 138	1 908	1 632	1 992	2 387	2 580	2 915
% increase	–	*47%*	*89%*	*-11%*	*-14%*	*22%*	*20%*	*8%*	*13%*
% of total allocation	*20%*	*22%*	*35%*	*41%*	*35%*	*35%*	*36%*	*36%*	*37%*
Agency transfers	956	1 074	1 073	–	–	–	–	–	–
Traditional subsidies	59	98	85	–	–	–	–	–	–
Other	643	600	258	–	–	–	–	–	–
Land development objectives	–	–	3	24	14	44	–	–	–
Municipal systems improve prog.	–	–	–	–	–	–	30	30	30
Financial management	–	–	–	–	–	50	60	120	125
LG support grant	–	–	145	181	137	150	160	220	230
Restructuring grant	–	–	–	–	–	225	350	450	465
Current transfers	1 658	1 772	1 564	205	151	469	600	820	850
% increase	–	*7%*	*-12%*	*-87%*	*-26%*	*211%*	*28%*	*37%*	*4%*
% of total allocation	*42%*	*34%*	*26%*	*4%*	*3%*	*8%*	*9%*	*11%*	*11%*
Total	**3 905**	**5 150**	**6 049**	**4 687**	**4 669**	**5 637**	**6 547**	**7 246**	**7 978**
% increase	–	*32%*	*17%*	*-23%*	*0%*	*21%*	*16%*	*11%*	*10%*

Notes: Figures exclude some agency payments for health and public works functions, transfers from provincial own revenue after 1997/98, as well as non-cash support to municipalities. Figures differ from those in the 2001 Budget review due to the inclusion of the Building or Sports and Recreation Programme and revised projections for 2000/01 expenditure.

Sustainable local control

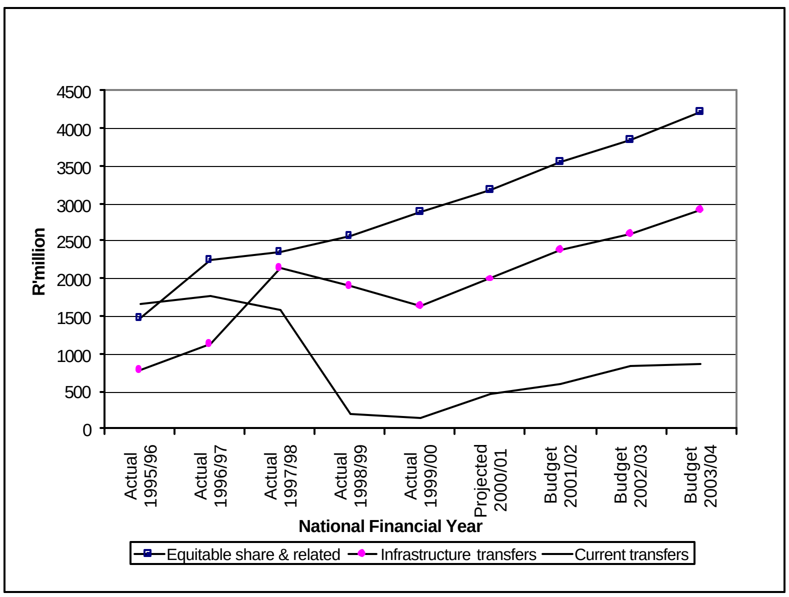
The consolidation programme has a number of dimensions. With regard to the equitable share, ad hoc transfers to support municipal service delivery are phased into the equitable share. This will enhance the significance of the "core" equitable share over the medium-term. In particular this will be achieved through phasing out the water services operating subsidy, currently funded via an augmentation to the Water Services Trading Account on the vote of the Department of Water Affairs and Forestry. Infrastructure programmes are also being merged into a single municipal infrastructure grant. The aim is to improve the predictability of these transfers and ensure that investment decisions are sustainable over the life-cycle of assets created. Municipalities will increasingly decide on the type of infrastructure developed and the level of service provided, in line with their ability to operate and maintain assets.

Growth in infrastructure transfers

Municipal infrastructure transfers have grown by R1,6 billion in nominal terms from 1995/96 to R2,4 billion in the current financial year, representing an average annual growth of 35 percent. There has been much restructuring of agency transfers and traditional subsidies, which were biased towards formerly white municipalities.

Phasing out of the RDP fund left an impact in the water services capital programme, which experienced a 39 percent decline between 1998/99 and 1999/2000. More recently, infrastructure transfers have experienced renewed growth at an annual average of 31 percent between 1999/2000 and 2001/02. This is projected to slow over the medium-term, at which point infrastructure transfers will have recovered to near levels last seen in 1997/98. A programme of consolidating infrastructure transfer programmes is being implemented over the medium-term.

Figure 10.2: Local Government transfers (1995/96 to 2003/04)



Capacity building support

Transfers to support municipal capacity building and restructuring programmes, classified here as recurrent grants, are the smallest and most volatile component of local government transfers. The local government support and restructuring grants encourage municipalities to proactively address the causes of fiscal distress. The Municipal Systems Improvement Programme and Financial Management Grant assist them to build strategic, developmentally oriented management systems.

These transfers have historically been disbursed on an ad-hoc and relatively opaque basis to municipalities, mostly through provinces.

They have tended to overlap with the objectives of other categories of transfers, particularly the equitable share. The redefinition of the role of national and provincial government in local government matters led to a sustained decline of over R1,5 billion in these allocations between 1995/96 and 1999/2000. This was an average annual decline of 31 percent, and transfers dropped to a mere R151 million. However, this category of allocations grew by 20 percent in 2000/01 with the introduction of targeted new grant programmes to support transition. Average annual growth of 17 percent is projected in this category over the medium-term, as the full range of initiatives to support local government transformation is unveiled.

The distribution of transfers among categories of municipalities

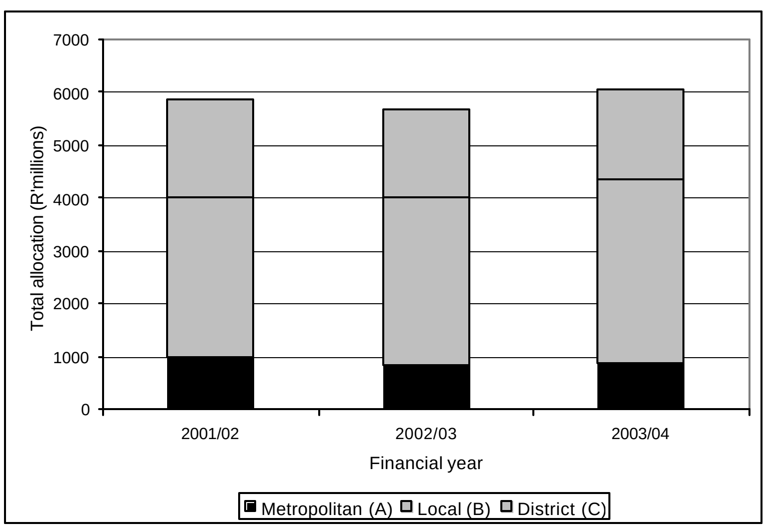
Funds follow function

Funds are allocated to municipalities based on the functions they perform and the extent of service delivery challenges they face. In most instances municipalities are allocated funds on the basis of a formula, although they may be required to submit business plans.

Transfers benefit non-metropolitan areas

Figure 10.3 indicates that non-metropolitan municipalities receive 83 percent of all transfers. This is projected to grow to 86 percent over the medium-term. In non-metropolitan areas the bulk of allocations are directed to Category B (local) municipalities, which receive 52 percent of all allocations. This is projected to grow to 58 percent by 2003/04 and is mirrored by a decline in the proportion received by both Category A (metropolitan) and Category C (district) municipalities. The allocations to Category B municipalities are dominated by the equitable share, which is not allocated directly to district municipalities. Allocations to district municipalities are dominated by infrastructure transfers, as the bulk of such programmes target these municipalities only.

Figure 10.3: Allocation by category of municipality



Transfers may differ from allocations

The actual outcome of these transfers may differ significantly from allocations made if a transfer of funds occurs between Category B and

C municipalities. Some Category B municipalities lack the financial management and service delivery capacity to use transfers for their intended purposes. In these instances funds will be directed to the district municipality to use to the benefit of that local jurisdiction. Infrastructure transfers to district municipalities will, often be transferred on to the local municipalities for infrastructure investment.

Fiscal capacity important

The allocation of the bulk of funds to non-metropolitan areas reflects the greater fiscal capacity of metropolitan municipalities. Fiscal capacity can be defined as the ability of a municipality to raise revenue commensurate with its' expenditure needs. It should not be confused with fiscal effort, which is the extent to which a municipality exploits its available revenue sources (or actual revenue less potential revenue). The level of fiscal effort is typically a more accurate indicator of the financial health of a municipality.

Detailed and disaggregated information on the fiscal capacity of individual municipalities is currently not available. It is thus necessary to use proxy indicators of the ability of a municipality to raise its own revenue as a proxy. The indicator most commonly employed in this regard is that of poverty level, measured by the number or proportion of households spending under R1 100 per month. A further indicator used is the annual budgeted expenditure of a municipality per household.

Both these indicators are weak substitutes for more detailed data on fiscal capacity, which is most commonly measured by the total value of all properties in a jurisdiction. For example, municipal expenditure per household, which is a function of the size of a municipal budget, does not account for the scope or scale of services that a municipality provides. The number of households in poverty does not indicate the ability of a municipality to shift the burden of taxation to other components of its tax base.

The equitable share formula contains a component intended to measure fiscal capacity. However, data constraints have prevented this component from being fully utilised to date. Work is underway to develop more detailed and accurate data on the fiscal capacity of individual municipalities.

Table 10.4 indicates that municipalities with an annual budgeted expenditure of under R300 million in the 1999-2000 municipal financial year will receive 74 percent of the total allocated transfers in the 2001/02. Municipalities with annual budgeted expenditure below R300 million rely on transfers to finance 35 percent of their income in the current financial year.

In contrast, those with expenditures over R300 million and metropolitan municipalities have dependency levels of 8 percent and 3 percent respectively. The level of grant dependence is influenced by the relatively high levels of total municipal expenditure in large urban areas. This reflects the greater number of services provided by these municipalities, but may be influenced by under-reporting or the absence of data from smaller and rural municipalities.

Table 10.4: Allocated transfers* and municipal expenditure

	2001/02			2002/03			2003/04		
	Allocated Transfers (R'000)	% of total allocation	% of aggregate expenditure (**)	Allocated Transfers (R'000)	% of total allocation	% of aggregate expenditure (**)	Allocated Transfers (R'000)	% of total allocation	% of aggregate expenditure (**)
Metro	994 280	17%	3%	850 416	15%	3%	873 408	15%	3%
Non-metro (>R300m)	500 555	9%	8%	525 725	9%	8%	580 124	10%	9%
Non-metro (<R300m)	4 349 087	74%	35%	4 271 875	76%	35%	4 557 336	76%	37%
Total	**5 843 922**	**100%**		**5 648 016**	**100%**		**6 010 868**	**100%**	

Notes:

* *Allocated transfer figures exclude funds not currently allocated to municipalities*

** *Budgeted municipal expenditure based on submissions by municipalities to National Treasury for 1999/2000.*

Integrated Sustainable Rural Development Programme(ISRDS)

Thirteen identified rural nodes

The 13 rural district municipalities identified by the President for support through the ISRDS receive a considerable proportion of all allocations to local government. This is due to the nodes being selected on poverty-weighted criteria, similar to many existing grant programmes. For this reason, the ISRDS has not been conceived as a separate funding programme, but rather as one in support of existing funding which focuses on improving service delivery.

Table 10.5: Allocations to ISRDS nodal municipalities

	Equitable Share			Recurrent			Infrastructure			Total (all transfers)		
(R'000)	**2001 /02**	**2002 /03**	**2003 /04**	**2001/02**	**2002/03**	**2003/04**	**2001/02**	**2002/03**	**2003/04**	**2001/02**	**2002/03**	**2003/04**
ISRDS Nodes	869 550	1 006 941	1 153 007	4 610	16 100	24 100	701 953	626 853	636 473	1 576,1	1 649,9	1 813,6
Total allocation	**3 559 974**	**3 846 125**	**4 213 125**	**600 471**	**820 290**	**850 418**	**2 685 494**	**2 580509**	**2 915 473**	**6 845,9**	**7 246,9**	**7 979,0**
% of total	24%	26%	27%	1%	2%	3%	26%	24%	22%	23%	22,8%	22,7%

Transfers to poorest councils

Table 10.5 indicates that the nodal municipalities will receive 23 percent of all transfers to municipalities in the current financial year. The slight decline in nodal allocations is currently being addressed through the reprioritisation of spending programmes.

The efficacy of infrastructure transfers

Benefits of infrastructure investment

The main objective of allocations for municipal infrastructure is to expand delivery of basic infrastructure services to poor households. This is associated with several benefits. Extending and rehabilitating social infrastructure and extending municipal services, results in greater equity, social access and development. In addition decent municipal infrastructure has positive spin-offs for economic activity. And equally, there are negative impacts that a decline in the technical integrity and coverage of infrastructure services can have on economic growth and development. A further benefit flows from the job creation and skills training that accompanies both the construction of infrastructure and the longer term expansion of municipal services. Both have a tendency to be labour-intensive.

A total of R2,3 billion has been budgeted for municipal infrastructure programmes in the current financial year, with three-year allocations made to individual municipalities in the Division of Revenue gazettes. The total allocation is projected to rise to R2,7 billion in 2003/04. Allocations are made through a number of separate infrastructure programmes that are listed in table 10.3, above. These are:

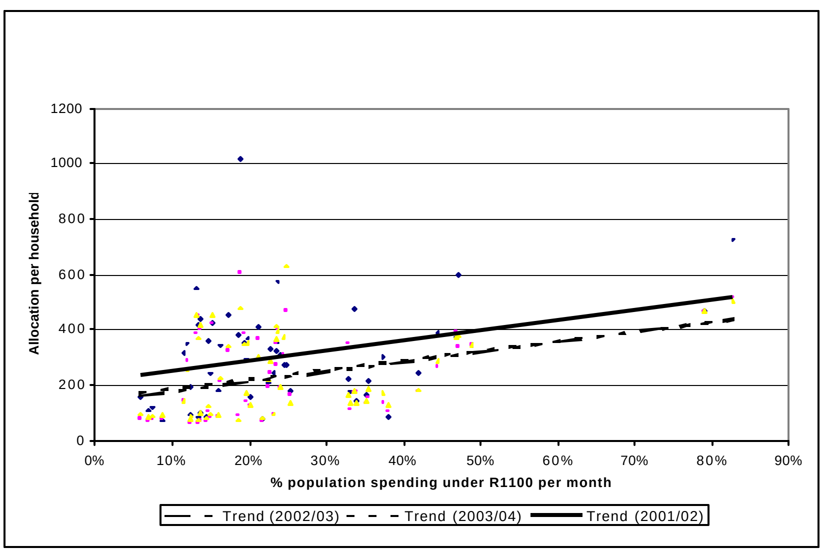
- the Consolidated Municipal Infrastructure Programme (CMIP) and the Local Economic Development (LED) Fund that are operated by the Department of Provincial and Local Government
- the Implementation of Water Services Projects and Historical Water Services Subsidies operated by the Department of Water Affairs and Forestry
- the Urban Transport Fund of the Department of Transport and the Community Based Public Works Programme (CBPWP) operated by the Department of Public Works.

The CBPWP and the LED Fund originate from poverty relief allocations. However, these programmes generally mostly make transfers directly, to metropolitan and district municipalities. This enables them to direct resources to areas of greatest need, mix grant funding with income derived from regional services levies and ensure adequate funding of regional infrastructure that might otherwise be under-funded by local municipalities.

Transfers are poverty focussed

Municipal infrastructure transfers are, in broad terms, allocated to areas of greatest need. When allocations are compared to levels of poverty, it is evident that infrastructure transfers are heavily equalising in nature. They benefit municipalities with high levels of poverty. Figure 10.4 demonstrates the progressive nature of allocations in this respect. Infrastructure allocations per household rise sharply from R200 in low poverty areas to above R500 where poverty is high. This trend is projected to continue over the medium-term.

Figure 10.4: District and metro pro-poor infrastructure allocations



Not all transfers are adequately targeted

However, when allocations are measured against household access to services, a more complex picture emerges. For example, figure 10.5 indicates that infrastructure allocations are inversely related to levels of access to sanitation in a municipal area. This may indicate the relative lack of priority that is attached to sanitation services in the current allocation formula. Municipalities with high levels of access to adequate sanitation will receive over R2000 per household in the current financial year, while those with the lowest levels of access will receive considerably less per household. Explanatory factors for this include:

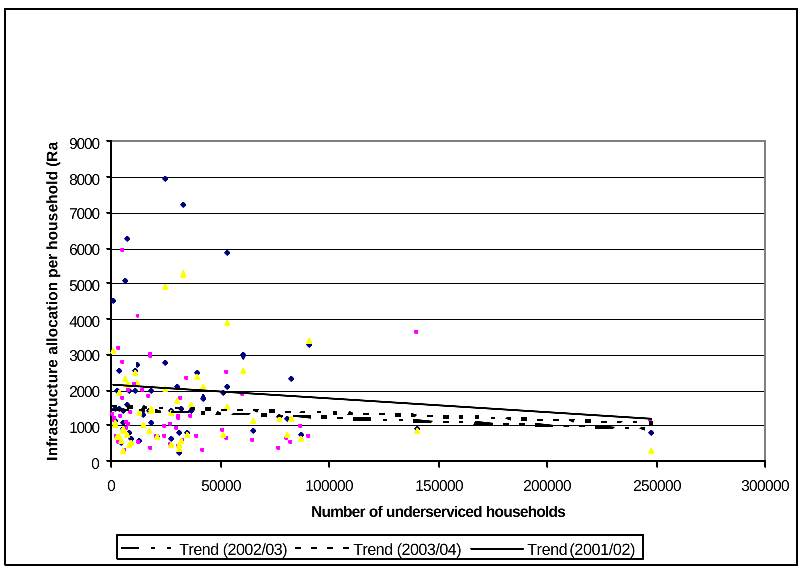
?? municipalities with high levels of under-servicing also lack capacity to address their infrastructure challenges rapidly, and thus grant take-up is low

?? the diversity of formulae and underlying data deployed in allocating funds in different programmes do not adequately account for levels of access to sanitation

?? there is an incentive to municipalities to increase levels of servicing within their jurisdictions without losing access to funding

Projected allocations for 2002/03 and 2003/04 address these problems.

Figure 10.5: District and metro allocations for sanitation



Large backlogs remain

Demand for the expansion of municipal infrastructure continues to outstrip supply, leading to rising backlogs in some services such as sanitation. Municipal spending on infrastructure extension and rehabilitation remains sub-optimal due to fiscal constraints. This has led to erosion of the technical integrity of infrastructure networks, delays in expansion of service delivery, and under-funding of certain services in poorer areas, particularly internal road networks.

Private sector participation is critical

The public sector alone does not have the resources to meet the infrastructure requirements of communities. Government policy has thus repeatedly emphasised the importance of leveraging private sector capital in support of municipal infrastructure investment. If correctly conceptualised, national government spending on municipal infrastructure can complement private sector investments by focusing on those municipalities unable to access private capital. However, public spending may also "crowd-out" the role of private markets in infrastructure investment if allocated in direct competition to private sector agencies.

Current allocation mechanisms are fragmented and disbursement mechanisms invariably project-based and centralised. This undermines integrated development and prevents effective planning at a municipal level. The recent introduction of three-year allocations by each infrastructure programme to individual municipalities aims to enhance integrated development. Ongoing progress with the consolidation of infrastructure transfers should to have a similar effect.

Division of Revenue Act regulates transfers

The Division of Revenue Act, 2001, has two provisions that specifically regulate these transfers. Section 12 prescribes a framework for all infrastructure transfers intended to promote coordination and rationalisation of funding streams. This should improve the ability of municipalities to budget for both capital spending and associated operations and maintenance costs. Section 13 regulates infrastructure programmes that provide grants-in-kind to municipalities, through building infrastructure for eventual transfer to a municipality for operating purposes. The Act clearly indicates that a municipality must provide evidence of its willingness to assume ownership of such assets before projects can be initiated. These programmes will be converted into cash transfers in future years.

The efficacy of equitable share allocations

Equitable share is guaranteed

The equitable share is a constitutionally guaranteed transfer to assist municipalities to perform their basic functions, and is the cornerstone of national fiscal policy towards local government. The final equitable shares for national, provincial and local government are determined annually by government, based on strategic priorities

Personnel grant phased into equitable share

From this financial year the R293 town personnel allocations have been incorporated into the equitable share, although the agreement governing funding for these staff will continue to be honoured for three years. Two other transfer programmes other than the R293 transfers are scheduled to be incorporated within the equitable share:

?? The Water Service Operating Grant, which is an in-kind resource transfer from the Department of Water Affairs and Forestry, and is provided to municipalities on a historical basis where the department operated water services schemes on behalf of a municipality.

?? The Local Government Transition Grant, which is operated by DPLG, and provides short-term funding to municipalities to assist amalgamation following the re-drawing of municipal boundaries.

The local government equitable share formula has been designed to facilitate an equitable distribution of resources among municipalities[2]. This formula has two components. The I-grant component is meant to ensure that every eligible municipality has sufficient funds to maintain a functioning administration. The S-grant is the largest part of the equitable share and its purpose is to ensure that low-income households in all municipalities receive access to basic municipal services. It is thus based on the number of households with an imputed income of below R1100 a month.

Community Water Services and Free Basic Water

Government's decision to adopt a Free Basic Water and Electricity policy has forced service providers to reconsider the efficacy of their practices. The Department of Water Affairs and Forestry (DWAF) has turned to its implementing agents to look at best management practices for community water supply, and have provided encouraging results upon which to build a new strategy.

This has led to an approach that does not rely on capital-intensive, high-tech investment. Past over-designed projects escalated capital costs and consumed time, imposing extra costs on authorities and communities. The findings of a comparison between the community water supply approaches of Durban Metro and those of the Department's work through Umgeni Water are illuminating. Umgeni's project at Umbumbulu, which provided yard taps in 980 houses, cost R26,3 million (or R26 818 per household served). In contrast, Durban Metro provided water in yard tanks to 1 000 households at R2 000 per household, or R2 milllion in total.

The arguments put forward by Durban Metro led DWAF to revisit the approach to supplying water in the Mzinyathi area. The original plan was to supply water to this community of approximately 5100 households using unrestricted yard taps. The original cost estimate, for the water component only, was R70 million (or R13 725 per household). There are also the health and financial sustainability factors to take into account.

- Water carried from a yard tap into a house deteriorates in quality, to the point that it is unfit for human consumption within a few hours, in an informal house.
- The capital repayment cost of this scale of investment, assuming a monthly consumption of 6kl, is over R30 per kl. To this must be added the bulk water charge and the operations and maintenance charges.

The Durban Metro alternative was to use ground tanks and also provide double pit latrines, at an estimated cost of R20,5 million, based on the actual costs of completed projects. The average cost per house served with water in urban poor communities using the Durban alternative is less than R4 000 per house.

The Durban Metro approach is designed to fill up a tank of water once a day. The tank is placed inside the house, thereby having the greatest health benefits. Residents get clean, purified water at the Free Basic Water level on a daily basis. Leaks and unaccounted-for water are minimized, as the water is turned off after the tanks are filled. There are also massive savings in the low-technology approaches, which avoid high-pressure connections as far as is practicable. The municipality favours the double pit sanitation option because it is cheaper from a lifecycle costing point of view. To empty a 'wet' single pit costs in excess of R400. The price premium for a second pit is about R600. Moreover, when the sludge in the full pit dries out, it can be emptied easily, using a shovel.

The long-term operational costs of the Durban Metro approach will thus be at a small percentage of the original approach, meaning that the Free Basic Water initiative will have a far greater chance of sustainability. Moreover, there will be significant benefits for water conservation (delaying building expensive dams prematurely), health (especially given the problems of cholera), sanitation, speed of service provision, payment for services above the free basic water level, and the security of supply.

Durban Metro has had eight years of experience using this approach, and has had excellent results. By exploring this approach, DWAF and its partners are hoping to cut the capital, operating and maintenance costs of their community water supply projects, and to speed up their delivery of water and sanitation. The extent to which the Durban Metro model can be replicated in different situations, still needs to be determined. However, it is likely to be extensively used. This initiative shows that there is a real willingness to learn, in honouring the Government's commitment to community water supply and to Free Basic Water tariffs.

[2] See "*The Introduction of an Equitable Share of Nationally Raised Revenue for Local Government*" by the Department of Finance (now the National Treasury) in 1998 (available on www.treasury.gov.za).

Equitable share protects municipalities

The equitable share provides an ideal mechanism for the delivery of bulk national transfers to municipalities as it is formula-driven and does not impede the budgeting discretion of municipalities. Category B municipalities are the primary beneficiaries of these transfers, receiving an average of R510 per household in the current financial year. As indicated in table 10.6, this rises to R611 per household over the medium-term. In contrast, allocations per household in metropolitan areas average R151 in this financial year, rising to R194 by 2003/04.

Table 10.6: Average equitable share per household

	2001/02	2002/03	2003/04
Category B (local)	R510,47	R574,34	R611,30
Category A (metropolitan)	R150,99	R170,75	R193,80

An equalising transfer

Equitable share allocations are equalising in nature, in that they target municipalities with high levels of poverty and low levels of municipal expenditure per household. Figure 10.6 demonstrates this trend. Municipalities with low levels of poverty receive approximately 25 percent of the allocation of those municipalities with a high proportion of poor households. This trend is anticipated to intensify over the medium-term due to the significant increases in the funds available and the equalising nature of the formula.

Figure 10.6: Equitable share allocations per poor household

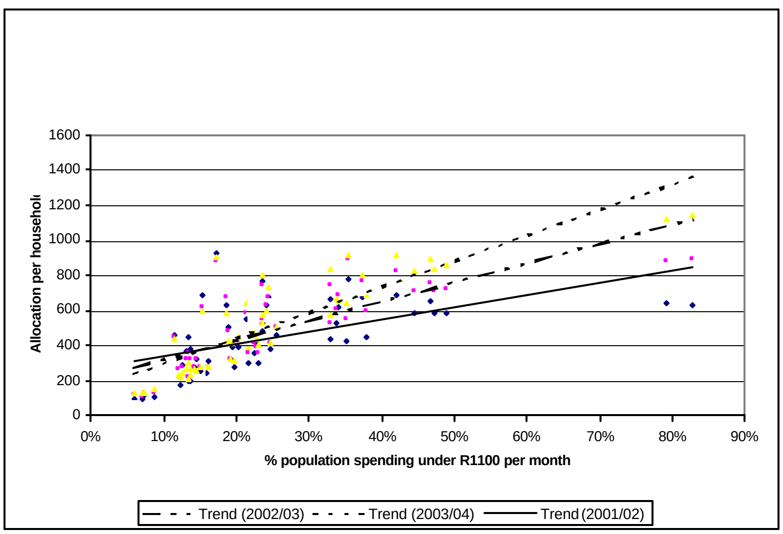
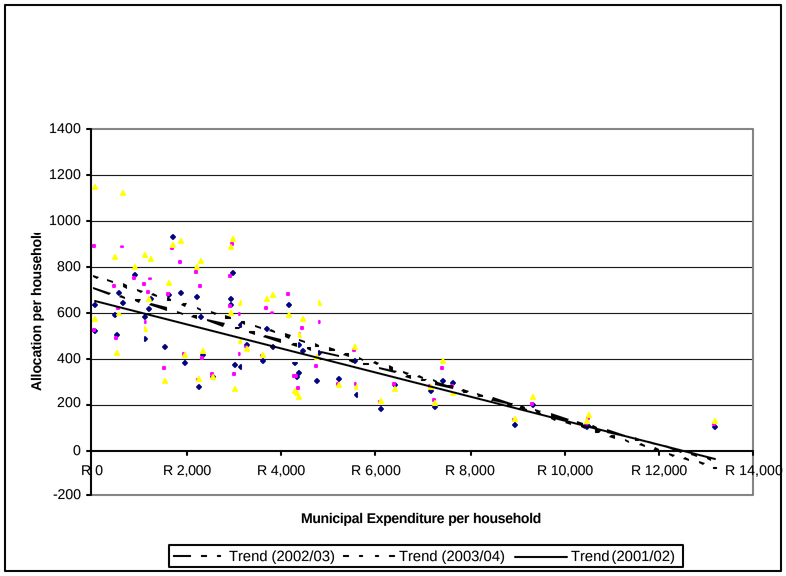


Figure 10.7 reinforces this observation, demonstrating that as budgeted municipal expenditure per household rises, the equitable share allocation falls. This trend mimics that shown in fgure 10.6, indicating that the use of a poverty indicator as a proxy for fiscal capacity is strikingly accurate in the current formula.

Figure 10.7: Municipal expenditure of equitable share



Targeting errors and free basic municipal services

Minimising subsidy leakage

No formula-driven grant programme is immune to targeting errors. Perhaps the most serious are errors of exclusion, when members of the target group are not captured by the eligibility criteria and hence fail to receive benefits. Errors of inclusion occur when those outside the target group fortuitously comply with the eligibility criteria and consequently receive benefits. Such leakage to unintended beneficiaries reduces the efficiency of a programme and inflates the cost to taxpayers.

Water services operating grant

The Water Services Operating Grant, which is not formula-driven, demonstrates errors of inclusion. Allocations per household decline as levels of poverty in a municipal jurisdiction increase. Municipalities receive this grant as assistance in-kind. The Department of Water Affairs and Forestry operates water services schemes on their behalf, primarily for historical reasons. The distribution of these transfers has not, therefore, been as equitable or reflective of policy priorities as government would desire. A phased programme to incorporate these funds into the formula-driven equitable share has thus been pursued.

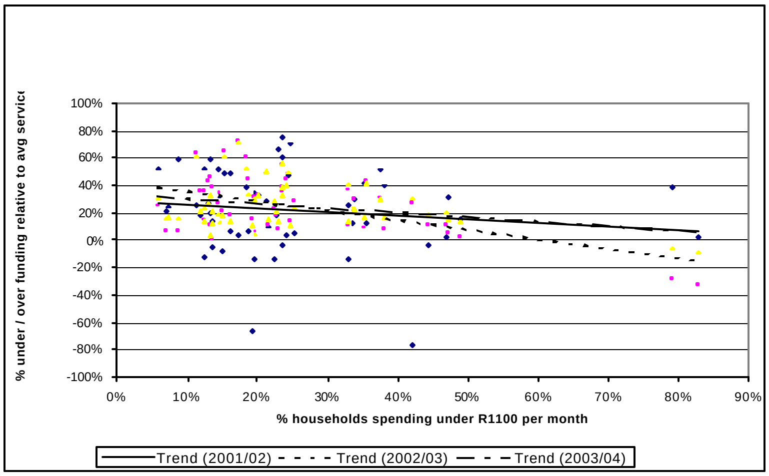
Errors of exclusion

Errors of exclusion are more difficult to determine, due to data constraints. The cost of delivering a package of basic municipal services is a key assumption necessary to assess the efficacy of targeting the equitable share. Data on these costs is difficult to generate, with most policy analysis relying on modifications to modelling done by the Development Bank of South Africa (DBSA) in 1995. This analysis estimated average service costs per household at R87 per month, or R113 per month in 2000 prices. However, costs of service vary significantly between municipalities, the cost of bulk supply and the capital costs of infrastructure. For example, water-borne sanitation systems are significantly more expensive to operate and maintain than lower technology solutions, such as pit latrines.

Figure 10.8 demonstrates that wealthier municipalities are better able to meet the free basic services challenge from their equitable share allocations than those in poorer jurisdictions. Of equal concern is the range of allocations, as evident in the points on the figure. The vertical axis in this case is the percentage excess or shortfall in equitable share funding per household relative to the cost of delivering a basic package of services (currently estimated at R113 per household per month). The cost of service is likely to be higher in urban areas, which will counteract the regressive trend evident in the figure.

Wealthier municipalities better equipped

Figure 10.8: Adequacy of the equitable share



The formula for the horizontal distribution of the equitable share was introduced in 1998, in the context of former municipal boundaries. A review is currently underway to determine the efficacy of the equitable share formula in distributing resources to municipalities within new boundary demarcations. It is anticipated that this review will address concerns in the horizontal distribution of the equitable share.

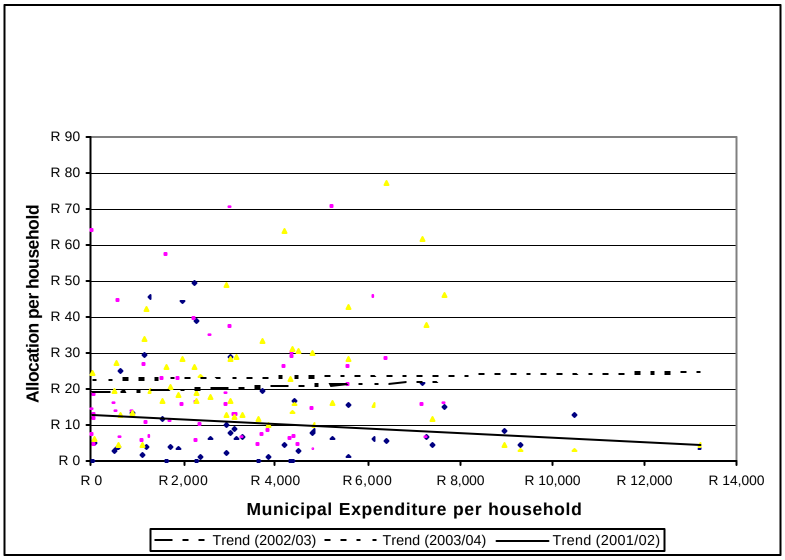
Formula retained for stability

The efficacy of capacity building and restructuring grants

This category of grants assists municipalities to enhance their capacity to perform their functions in an effective and efficient manner. The Financial Management Grant assists municipalities to develop and implement three-year budgeting systems. The Local Government Support Grant and the Restructuring Grant assist smaller and larger municipalities respectively to implement medium-term restructuring exercises that enhance service delivery and promote financial sustainability. The Restructuring Grant is targeted at municipalities with annual budgets over R300 million, and currently constitutes only 5 percent of the total allocation to municipalities.

Figure 10.9 shows the allocation of the Municipal Systems Improvement Programme and the Financial Management Grant by level of municipal expenditure per household (excluding the Restructuring Grant and the Local Government Support Grant). This demonstrates that while allocations in the current financial year favour poorer municipalities, this trend changes over the medium-term and is anticipated to become largely neutral. It should be noted that allocations under review amount to only 4 percent of the total allocation to municipalities in the current financial year.

Figure 10.9: Recurrent conditional grant allocations



Efficiency of grant management

The size of administrative overheads and extent of unallocated funds reflect some of the efficiency problems experienced in conditional grant programmes. These indicators are shown in table 10.7

Table 10.7: Administrative overheads and unallocated funds (2001-02 to 2003-04)

	2001/02		2002/03		2003/04	
	(R'000)	% of total	(R'000)	% of total	(R'000)	% of total
Unallocated funds	582 257	*9%*	1 250 847	*17%*	1 594 584	*20%*
Administrative overheads	272 595	*4%*	182 580	*3%*	197 029	*2%*
Allocated to municipalities	5 991 087	*88%*	5 813 497	*80%*	6 187 402	*78%*
Total	**6 845 939**	***100%***	**7 246 924**	***100%***	**7 979 016**	***100%***

Unallocated funds a cause for concern

Although the proportion of funds unallocated to municipalities grows over the medium-term, the primary cause for concern is funds unallocated to municipalities in the current financial year. This amounts to 9 percent of the total allocation to local government. Administrative overheads remain within acceptable boundaries averaged across all programmes. However, this can be ascribed to the low administrative costs of large, formula-driven grant programmes rather than the efficiency of individual programmes.

Conclusion

Transfer system continually refined

National government is continuously refining the system of intergovernmental transfers to municipalities in order to improve their efficiency, equity, transparency and predictability. In support of these objectives, three-year allocations to individual municipalities have been introduced from the 2001/02 financial year for programmes where this is possible and appropriate. This initiative is intended to assist municipalities with their planning and budgeting, specifically the introduction of three-year budgets and the drafting of meaningful integrated development plans. In addition, the Division of Revenue Act, 2001, has introduced various other measures to improve the functioning of the system of fiscal transfers to municipalities.

Additional funds under consideration

Additional allocations to local government, particularly for infrastructure and the equitable share, may increase as grants are consolidated and streamlined.

Local government, like national government, is held accountable for the resources it manages and for the mix and quality of basic services provided. It remains the responsibility of each municipal council to determine its priorities and pro-actively manage its funds throughout the fiscal year in keeping with these priorities. Funds provided from national government are not intended to replace revenue municipalities generate from the taxes and user charges they are empowered to levy and collect.

11

Capital investment in local government

In terms of the Constitution, municipalities are charged with providing services, promoting social and economic development, and promoting a safe and healthy environment. Municipal capital investments include items such as water and wastewater treatment plants and reticulation networks, solid waste disposal facilities, streets and sidewalks, clinics, parks, sports fields and other municipal facilities. Capital investments in municipal infrastructure are essential if municipalities are to meet their constitutional obligations.

Four main reasons for investing

There are four main reasons why municipalities must have capital to invest. These are:

- to extend services to all citizens, so that South Africans everywhere have access to basic services
- to provide services above the basic level, at users' cost, to those who want and can afford more than basic services
- to provide strategic infrastructure that will attract direct investment, as part of economic development efforts
- to upgrade and update infrastructure that has reached the end of its useful life.

This chapter discusses the options for obtaining capital investment in support of municipal infrastructure, and reflects on progress with municipal public-private partnerships as well as borrowing. It also offers suggestions as to how both private sector participation and municipal borrowing could be enhanced.

Who will build municipal infrastructure?

To build local infrastructure, municipalities must either obtain the capital themselves, or they must attract private partners who will provide the necessary capital.

Private provision of local infrastructure

Indirect access to capital

Public-Private partnerships (PPPs) involve indirect access to capital. Municipalities enter into agreements with private partners who agree to finance improvements, in the expectation of a reasonable return on their investments. The credit strength of the private partner can sometimes make financing cheaper than it would be for the municipality. Operational efficiencies can also be realised in partnerships, and these can lower financing costs.

The World Bank's Public-Private Initiative (PPI) Data Base indicates that during the 1990s over 1900 partnerships for infrastructure were concluded in the developing world alone, representing over US$ 580 billion in investment. The fastest growing variety of partnership world-wide involves municipal water and wastewater.

First PPPs involved waste and water

In South Africa, the first long-term municipal public-private partnerships, concluded mostly in the late 1980s and early 1990s, reflected apartheid-era divisions. Towns like Stutterheim, Fort Beaufort, and Queenstown entered into contracts for water and sanitation, which were primarily management contracts involving little investment. At that time, most disadvantaged areas were not included in municipal boundaries, and received little attention in these arrangements. However, there have been several more progressive public-private partnerships completed in South Africa since 1994.

Local government provision of infrastructure

Municipalities will build most local infrastructure

Practitioners agree that PPPs will build only a portion of local infrastructure. Municipalities will build the majority. The capital they will use must come from one of the following sources:

?? national government, in the form of intergovernmental transfers

?? municipal taxes, such as property rates or RSC levies

?? user charges, such as tariffs and connection fees

?? borrowing through loans or bond issues.

How will poor municipalities build infrastructure?

All municipalities must bring operating expenditures into line with revenues. For some, these balanced budgets may be relatively small. National Government provides intergovernmental transfers that form part of municipal revenues. For some poor and rural municipalities, these transfers are their main source of revenue: they have neither the property values (in the case of local municipalities) nor the business activity (in the case of district municipalities) to generate much of their own revenue. These municipalities may have little potential to attract responsible public private partnership investment.

?? In the short term, poor municipalities are likely to continue to rely on grant funding from national government for their investment capital. As private sector funding is geared towards larger and financially stronger municipalities, more national funding will become available for these municipalities.

?? In the longer term, if formula-based transfers are made stable and predictable, they can be used to repay debt as with any other municipal revenue source.

National government provides some investment capital for local infrastructure through programs such as CMIP and DWAF capital grants. Plans for the consolidation and rationalisation of these programs are described in other chapters. However, even with the real increases anticipated in these programs, there are no conceivable scenarios under which national government can finance all local capital needs. Current capital transfers from national to local government amount to some R2 685 million in the 2001/02 financial year, rising to R2 915 million over the current MTEF. At this rate, if municipalities were to finance the extension of basic services with intergovernmental capital transfers only, it would take some 10-15 years simply to extend basic service access to all citizens.[1] Significantly, this projection excludes any investment beyond that needed for basic services, such as investment for strategic economic development or investment to replace existing facilities that reach the end of their useful life.

Municipalities need to leverage funds

To extend access to basic and other services more quickly, and to replace ageing physical plant, municipalities will need to use local revenue sources, such as taxes and user charges, as well as intergovernmental grants. However, more infrastructure can be built more quickly if municipalities leverage their revenues through borrowing for capital investment.

Borrowing distorted under apartheid

Municipal borrowing was distorted in the past, both by apartheid and by centralised government. Historically, white municipalities could borrow, though many relied on internal cash flows, to finance capital investments. Consumers in these municipalities were generally able to pay for services, enabling them to pay their debts reliably. It was widely believed that provincial and/or national government would intervene to support any municipality that ran into financial trouble. By contrast, municipal structures in black areas had little or no access to credit or capital grants, built far less infrastructure, and provided far fewer services to their communities.

No net new private lending

Today, the fundamental rules have changed. Amalgamated municipalities have been created that include well-served areas, areas with no services, and everything in between. These new, decentralised municipalities must extend infrastructure and services to all citizens. Although private lending has continued throughout the transitional phase from 1994 to 2000, there has been no net new private lending to local government. New debt extended has been balanced by old debt retired. This stagnation can be attributed, in part, to the absence of reliable financial information. However, investors have also had doubts about the financial viability of municipalities in transition, especially after demarcation, and they have been uncertain about the legal and regulatory regime related to municipal debt. The fact that some municipal debt has experienced default has also impeded investor interest.

Public private partnerships

Nelspruit led the way with PPPs

The town of Nelspruit led the way with post-apartheid long-term PPPs. The 1994 shifts in municipal boundaries dramatically impacted on the town's ability to provide its residents with essential services. Virtually overnight, Nelspruit's official population increased from 24 000 to 240 000 and the land area under its jurisdiction increased eightfold as black and white areas were integrated under one jurisdiction. Because many of the new areas had never received water and sanitation services, the town's official system of infrastructure service provision was suddenly, and dramatically, inadequate.

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[1] This calculation assumes a total cost for such basic local infrastructure of some R40bn, no expansion of the basic services mandate, no population growth, and efficient spending of capital transfer funds by municipalities.

Service delivery challenges

The Town Council's initial investigation into the extent of the inadequacy, produced alarming results. The 1994 amalgamation increased the number of residents per length of water pipe from 110 to 601, and the number of residents per length of sewer pipe from 96 to 830.

The difficulties faced in overcoming this shortfall were exacerbated by the obvious inability of many new residents to help cover the costs of required investment. Although the population had grown by ten times, the total income of the municipal area grew by only 38 percent. Nelspruit needed a radical, innovative solution if it was going to fulfil its obligation to make universal service coverage a reality.

The Nelspruit water and sanitation concession, concluded in April 1999, is still the largest long-term municipal PPP signed in South Africa. Making use of cross subsidisation and massive private investment, the contract calls for every citizen in Nelspruit to receive a basic level of service within five years.

Recently completed projects

Table 11.1 summarises information on several PPPs completed in South Africa since 1998. This group includes long-term concessions, like those signed in Nelspruit and Dolphin Coast, which started development in late 1996. It also includes a variety of later partnerships, including one notable public-public partnership (in Harrismith) and several divestiture projects, involving the sale of non-core municipal businesses and related assets.

The table classifies projects according to what the partnership is designed to accomplish (operations and maintenance, operations and maintenance plus capital investment, or divestiture), as well as the direction in which contract-related payments and investments flow.

Most short-term partnerships that do not require capital investment or assumption of commercial risk by a contractor involve payments to the contractor by the municipality for services rendered. Many long-term partnerships, involving investment and/or commercial risk responsibilities by the contractor, involve payments back to the municipality in the form of fees or investment in municipal infrastructure.

Includes cases where contractors are paid

Cases where a council is providing payments to a contractor are included. In some cases, they are a step toward acquiring private sector capital by achieving management efficiencies, ring-fencing activities, and generating information that would be necessary to a private investor. In other cases they are intended to make capital expenditure more efficient – the public money is better targeted because of private contractor expertise.

Partnerships worth R5,6 bn concluded

The total contract value of the 18 major partnerships concluded since 1998 amounts to over R5,6 billion. This value includes all payments to and from municipal partners, and all capital investment, over the lifetime of these contracts.

Table 11.1: Examples of PPPs – revenue and expenditure

Local Government	Sector	Length of contract (years)	Contractor Payments to Council (Millions of Rand)				Council Payments to Contractor	Contract for investment in Non-Council Infrastructure
			Fees	Lease Payments	Sale Proceeds	Related Capex	For services, Equip, Capex	
Operate & Maintain (O&M)								
Harrismith	Water	3	6	–	–	–	–	–
Johannesburg	Parking	5	10	–	–	2	–	–
Thabazimbi	Waste	5	–	–	–	–	7	3
Robertson	Waste	1	–	–	–	–	0.5	–
Jhb. West. MLC	Waste	5	–	–	–	–	0.6	–
Johannesburg	IT	5	–	–	–	–	590	–
O&M plus Capex								
Dolphin Coast	Water	30	19	42	–	325	–	–
Nelspruit	Water	30	40	106	–	1 300	–	–
Pretoria	Airport	20	243	3	–	60	–	–
Johannesburg	Fleet Mgmt	10	–	–	–	–	2 400	–
Richards Bay	Airport	20	1	13	–	3	–	–
Tzaneen	Waste	5	–	–	–	–	12	8
Divestiture								
Johannesburg	Airport	–	–	–	18	–	–	10
Johannesburg	Gas	–	–	–	110	–	–	276
Totals			**319**	**164**	**128**	**1 690**	**3 010**	**297**

Some of the noteworthy projects on this list include:

Nelspruit water and sanitation

?? *Nelspruit Water and Sanitation Concession:* Signed in 1999, Nelspruit's PPP design calls for a private concessionaire to take over, manage, maintain, build, rehabilitate, and transfer back to the city after 30 years, all the infrastructure assets related to the city's provision of water and sanitation services. The company will be responsible for metering, billing, revenue collection, as well as capital investments to progressively extend water and sanitation services to under-served areas. Existing assets will not be sold to the company, but existing municipal staff working in the Council's water and sanitation sectors will be taken over by the company on equal or better conditions of service. Local consultants and contractors must be used, as part of a local employment-generation strategy approved by the Council. The Council will regulate the contractor's activities, including tariff setting, asset maintenance, and new asset construction and/or acquisition. The company must provide the Council with regular financial reports; and penalties will be imposed for failure to adhere to pre-determined service performance criteria.

Johannesburg Metro Gas

?? *Johannesburg Metro Gas Sale:* On 18 August 2000, Johannesburg announced the sale of Metro Gas, the municipal gas distribution business that serves approximately 15 000 business and residential customers in the metropolitan area. The price for Metro Gas was R110 million. The new owners are expected to invest another R276 million in the facility over ten years. The total size of the deal, including sale price and future capital investment, makes it arguably the biggest municipal privatisation sale in the country's history. One key condition of the sale was the environmental clean up of this site, expected to cost over R12 million.

Harrismith's public-public partnership

?? *Harrismith Water and Sanitation Management Contract:* On 19 October 2000, Harrismith and Rand Water signed a three-year management contract, concluding what has become the first public-public water and sanitation contract negotiated on commercial terms. This contract is the first step in a two-part process. The municipality is able to delay major capital expenditure for the three years, and during that period with Rand Water's help it will ring-fence the water system, resolve management and personnel problems, generate data on the system itself, and become comfortable working with a service delivery partner. At the end of three years, the town will have a stand-alone water utility. It can then use the accumulated fees and information to prepare a longer-term solution to its service delivery needs.

Richards Bay airport

?? *Richards Bay Airport Concession:* On 16 November 2000, Richards Bay and a private contractor signed a 20-year concession contract for the operation, maintenance, and development of the Richards Bay airport. This contract involves R13 million in payments to the municipality. This will be used to repay the debts associated with the facility, plus a probable investment of another R7 million in runway upgrading (depending on the results of an independent assessment later in the contract period). In addition, 20 percent of the concession company, and 20 percent of its dividends, will go to a "community trust" dedicated to the development and support of the local community, particularly the traditional communities near the airport.

Various solid waste contracts

?? *Solid Waste Management Contracts:* These projects, including contracts recently concluded in Robertson, Tzaneen, and Thabazimbi, represent what is probably the most rapidly expanding single sector of PPP activity in South Africa. Although individual solid waste management projects do not typically involve large amounts of capital investment, they address a notable need in many communities.

The future of PPPs

Municipal interest in public-private partnerships continues to grow, particularly with the post-demarcation expansion in responsibilities. The Municipal Infrastructure Investment Unit (MIIU) estimates that over one-third of South Africa's new local municipalities are capable of developing and benefiting from some form of PPP for municipal services.

Lessons

If these projects are to be successful in the future, they must incorporate lessons from the past:

?? The private sector must not be seen as a panacea for all problems. Service delivery systems without real prospects for cost recovery are not good candidates for such partnerships.

- ?? Most municipalities will need funding and technical assistance to conclude partnerships that achieve optimal levels of benefits for residents. In large part, such funding is necessary to generate the large amounts of information needed about the current and proposed service delivery systems, which are critical for the design and contracting out of partnerships.
- ?? Consultation with stakeholders, including community groups and organised labour, is essential in the preparation of any kind of partnership.
- ?? A careful review is needed of municipal responsibilities in the development of such arrangements, as detailed in new legislation, such as the Municipal Systems Act.
- ?? Ongoing assessment and adjustments are essential to the legal and regulatory framework within which public-private deals are developed. For this reason, Government continues to monitor progress with partnerships and the impact of its regulatory mechanisms. Policy dialogue continues with municipalities, private investors, community groups and trade unions on the Municipal Systems Act and other regulatory issues.

Municipal borrowing

Some municipal infrastructure cannot attract private equity investment through PPPs. In other cases, municipalities prefer not to enter into public-private partnerships for policy reasons. In the absence of immediate grant funding, such municipalities must finance infrastructure from their own revenues. To answer the challenge of creating local infrastructure quickly, well-run municipalities can borrow funds from capital markets. The funds borrowed can be used to build infrastructure, and then be repaid either from existing revenue streams (such as intergovernmental transfers or municipal taxes and tariffs) or from charges to new users.

Borrowing at market rates

The 1998 *White Paper on Local Government* and the *2000 Policy Framework for Municipal Borrowing and Financial Emergencies* make it clear that government policy, regarding municipal borrowing, must be based on a market system, and on lenders pricing credit to reflect the risks they perceive.

Legal and regulatory environment

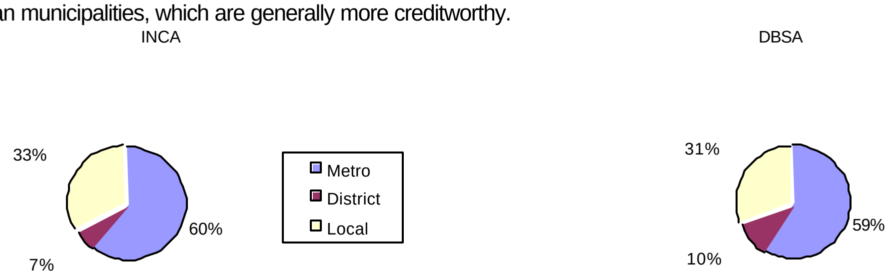
To assure that municipal borrowing from capital markets is effective and efficient, the legal and regulatory environment must be clear and predictable. Both borrowers and lenders must have good information, and the risks from poor decisions must be appropriately assigned. With these objectives in mind, the national Government last year adopted the *Policy Framework for Municipal Borrowing and Financial Emergencies*. This was published together with the Municipal Finance and Management Bill which contains the legislative provisions to give effect to the policy framework.

Debt to public sector up, debt to private sector flat

Despite the need for capital markets to finance infrastructure, long-term private lending to municipalities has been essentially flat for at least four years. National Treasury figures since 1997 show that municipal debt owed to the private sector has not changed greatly, generally remaining between R11 billion and R12 billion. At the same time, debt owed to public sector institutions, including the Development Bank of Southern Africa (DBSA), has grown significantly, from R5,6 billion to R8,1 billion. (see figure 11.1 and the textbox below).

A tale of two lenders

The Development Bank of Southern Africa (DBSA) is a public sector lender. The Infrastructure Finance Corporation Limited (INCA) is a private sector lender. Both lend to municipalities and other infrastructure providers. The DBSA's share of outstanding municipal debt has doubled over the four years that National Treasury has been tracking municipal debt, while INCA's market share has increased more than ten-fold in the same period. The loan portfolios of the two institutions appear similar, in that both lend mostly to large metropolitan municipalities, which are generally more creditworthy.

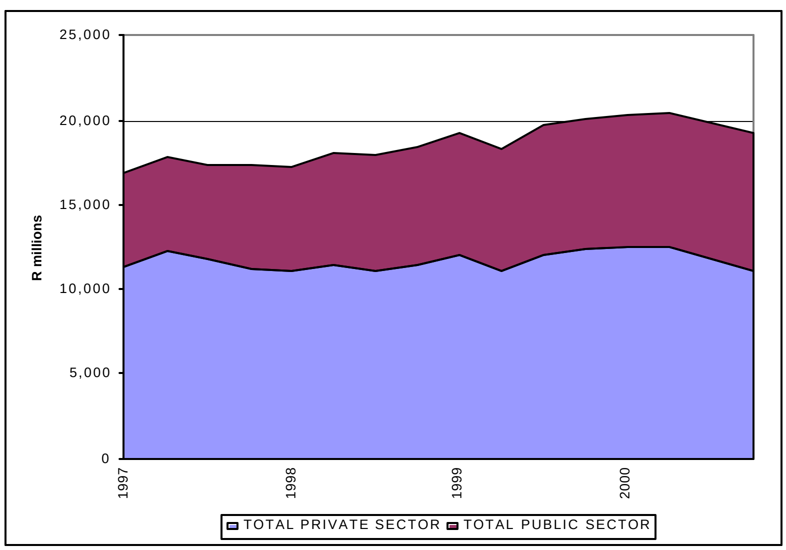


Source: DBSA and INCA

More private investment needed

This increasing reliance on public sector debt is inconsistent with government's policy goal of increasing private sector investment. While new policies and legislation will not, by themselves, guarantee that private sector lending increases, there is no chance of an increase without clear policies and legislation.

Figure 11.1: Total municipal debt outstanding



The legislative reforms envisioned by the Municipal Finance Management Bill, including increased powers to commit a municipality to long term projects, will help attract both lenders and equity investors to municipal infrastructure investments. In addition to these reforms, key factors necessary to assure the growth of private sector investment relate to municipal skills and experience in areas such as:

?? project management

?? capital planning (project identification, prioritisation, and analysis)

?? facility operation and management

?? budgeting (capital and operating implications to borrowing)

?? accounting and financial reporting

?? collection and disbursement operations

?? procurement of goods and services; and

?? legal and negotiating skills.

Using future revenues

Four sources of revenue

The financial resources available to municipalities for building infrastructure can come from four sources:

?? revenues from trading services, such as water, sewer, and solid waste removal

?? surcharges on fees for services

?? general taxes, such as property rates and the RSC levy

?? transfers from other spheres of government.

Most of these resources are typically used for a municipality's operating expenses. However, a portion of these resources is usually set aside for capital investments, and in the case of some intergovernmental transfers, resources must be used for capital investments. Total projected actual municipal expenditures for 1999/2000 were R53,4 billion, with approximately 19 percent (or R10,3 billion) being for capital expenditure.

Loans not an additional source of revenue

Borrowing capital to finance infrastructure does not represent an additional source of revenue. Borrowing, instead, makes future revenues, some of which can come from consumers not yet connected to a service network, available for current use. With any given level of available revenue, a municipality can build more infrastructure, more quickly, through the wise use of credit than it can on a pay-as-you go basis.

The speed with which a municipality can build infrastructure depends critically on three factors:

?? the degree to which revenue streams can be effectively leveraged by borrowing

?? the amount of revenue available for investment after considering operating needs

?? the municipality's capacity, skills and experience to plan and manage projects.

Borrowing is a two-edged sword

The commitment of future revenues to current use through borrowing is a two-edged sword: used wisely, borrowing accelerates service provision and local economic development. Used unwisely, it can saddle future generations with debt without providing corresponding benefits. For this reason, the Constitution prohibits borrowing for consumption expenditure.

Private capital and market capital

Government stresses private investment

Government's 1998 *White Paper on Local Government* stressed the importance of gearing in private investment, and of using capital markets to do so. It notes:

"Ultimately, a vibrant and innovative primary and secondary market for short and long term municipal debt should emerge. To achieve this, national government must clearly define the basic 'rules of the game'. Local government will need to establish its creditworthiness through proper budgeting and sound financial management, including establishing firm credit control measures and affordable infrastructure investment programmes. Finally, a growth in the quantum, scope and activities of underwriters and market facilitators (such as credit-rating agencies and bond insurers) will be required.

"The rules governing intervention in the event that municipalities experience financial difficulties need to be clearly defined and transparently and consistently applied. It is critical that municipalities, investors, as well as national and provincial government, have a clear understanding of the character of their respective risks. Risks should not be unduly transferred to national or provincial government."

The *White Paper* stresses the importance of both private sector investors and capital markets:

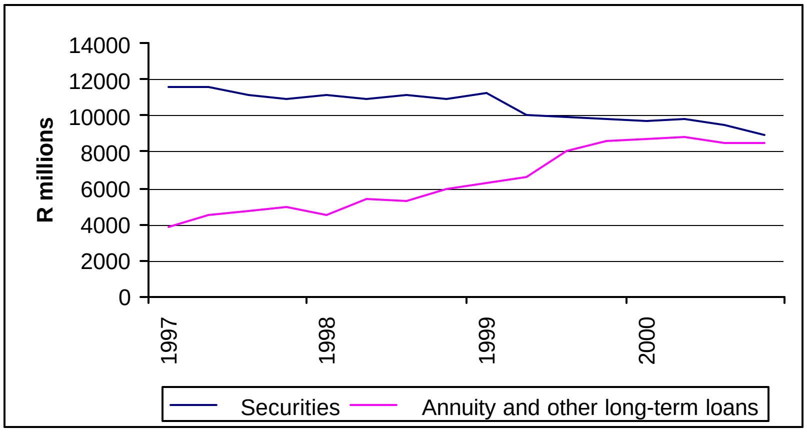
?? Private sector lenders and investors are important not only because they bring additional funding to the national table. Also, they tend to have better expertise for evaluating projects and credit risk, and of managing outstanding loans, than public sector lenders.

?? Active capital markets, with a variety of buyers and sellers, and a variety of financial products, can offer more efficiency than direct lending. First, competition for municipal debt instruments tends to keep borrowing costs down, and create structural options for every need. Second, an active market implies liquidity for an investor who may wish to sell. Liquidity reduces risk, increases the pool of potential investors, and thus improves efficiency.

DBSA's debt stock has grown

However, National Treasury's municipal debt monitoring project suggests that things are not yet as envisioned in the *White Paper*. The expansion in municipal debt over the last four years has been due to a growth in public sector lending to municipalities, and especially lending by the DBSA. The DBSA's municipal debt stock has grown both because of acquisitions (primarily the Local Authorities Loan Fund, which was acquired from national government) and because of new loan origination. It increased from under R2 billion in March of 1997 to nearly R6 billion at the end of 2000. Although the private sector has been the major supplier of credit to municipalities, the net amount of private sector lending is essentially unchanged over the period that National Treasury has been monitoring the data.

Figure 11.2: Form of municipal debt



Composition of debt changing

Not only is private sector lending relatively stagnant, as shown in figure 11.1, but the outstanding debt stock is becoming less suitable for capital markets, as shown in figure 11.2. There has been a marked change in the form of debt over the period that National Treasury has been monitoring outstanding municipal debt. The earliest figures in the study show municipal securities at R11,6 billion, and long-term loans at R3,8 billion. By December of 2000, the pool of outstanding (and theoretically tradable) securities had fallen to just under R9 billion, while long-term loans had more than doubled to R8,5 billion.

The ongoing substitution of loan debt for securities debt represents a challenge for the development of a municipal capital market. It reflects poor municipal financial information and unclear rules. Improved accounting and financial statements, and clarity about the rights and remedies of lenders, could reverse this trend.

Municipal bonds and capital markets

A municipality can borrow by taking a loan from a financial institution, or by issuing bonds.

A **municipal bond** is a debt instrument that can be traded. An underwriter may purchase an entire bond issue, and then sell it at retail to institutions and individuals. Each bondholder buys only a small piece of the total debt, so smaller investors can participate.

With functional **capital markets**, bonds and other debt instruments can be readily traded. This means that a bond-holder need not keep the bond to maturity. The risk is lessened by the existence of a market, where the investor can sell the bond if need be. This liquidity also brings more potential investors into the picture.

South Africa has efficient capital markets for government, parastatal, and corporate bonds. Municipal bonds can easily play a role in this market, once there is a sufficient stock of bonds.

Tax structured loans increased

Municipal loans with tax-structured aspects have also become more important over the last four years, growing from some R187 million in March 1997 to R332 million in December 2000. However, as a percentage of total municipal debt, these loans account for only about 1,7 percent of total outstanding municipal debt. One reason for their small market share is that these structures require a match between the tax needs of particular financial institutions and the assets of a particular municipality. Tax structured loans will seldom be traded, and thus are of little relevance to the development of capital markets.

Elements of an active capital market exist

An active capital market requires several elements. Naturally, a market requires a supply of tradable debt stock. It also requires investors who are interested in holding municipal debt instruments (either to maturity or for some shorter period). Finally, it requires mechanisms for easily identifying trading opportunities and efficiently settling trades.

South Africa is fortunate, compared to many emerging economies, in that it has the key elements in place. Both potential investors and institutional structures now exist, and participate actively in capital markets for other kinds of debt instruments, namely national government and corporate debt.

Among investors that could invest in municipal bonds in an active capital market are those that are active investors in municipal debt, such as the DBSA, INCA, and banks. Others, such as mutual funds and individuals, have not yet been major purchasers of municipal debt. Finally, some investors such as pension funds and insurance companies have been active in the past, but have stopped acquiring municipal debt or sold their debt holdings.

A need for municipal debt securities

South Africa's challenge is to develop a genuine municipal capital market, and for that market to effectively channel funds to the municipalities that need them. The missing element to achieve this is a supply of debt securities from municipalities which have publicly available, high-quality financial information.

New favourable conditions for borrowing

Many important changes have occurred over the last year that suggest that increased municipal borrowing from the private sector, ideally via the capital markets, is likely.

Demarcation process completed

Boundaries clear, some powers and functions not

With demarcations in 2000, long-pending amalgamation and boundary questions have been resolved. There has been a view among South African investors that earlier municipal amalgamations diluted the value of formerly sound investments. Concern about the potential for further dilution has often been cited by investors as a reason for their reluctance to lend more to municipalities.

With the December 2000 elections and the establishment of firm boundaries, that concern has been addressed. However, the division of functions between C and B municipalities will need clarification if those municipalities are to access capital markets autonomously. Similarly, regional electricity distribution issues could delay lending to the energy sector. But for metropolitan municipalities (and for B and C municipalities that are willing to co-operate on debt issues), the chronic uncertainty is over.

Falling inflation and interest rates

Lower rates make borrowing cheaper

Inflation has been declining over the long term, from an annual rate over 16 percent in the early 1990s, to well under half that rate over the past 24 months. This trend and other positive economic factors have resulted in lower interest rates. At the start of August, and again at the end of September, yield on the widely traded R150 government bond (due 2005) fell below 10 percent for the first time since the bond began trading in 1989. Only last year, in May 2000, the R150 yield was at an average of 14,14 percent. Lower interest rates obviously mean that borrowing is cheaper. A given level of debt service will buy more infrastructure, and revenue-generating projects that were not viable at higher interest rates become attractive to municipalities and investors alike.

General debt and revenue debt

When a municipality borrows, it may either agree to repay the debt from any and all revenues or it may pledge particular cash-flows, e.g. revenues from a water treatment plant or toll-road. The latter approach is known as revenue or project debt.

- Revenue debt can leave a municipality with more financial flexibility, though it can cost more in interest.
- Not all projects generate sufficiently reliable revenue to be acceptable to investors.
- Municipal loans and municipal bonds alike can be structured either as general obligations or as revenue obligations.
- Some investors may require both a specific revenue pledge and a general obligation.

Falling national government borrowing

Capital released for other investments

Spending restraint and better tax collection at the national level have reduced budget deficits, and thus the national government's need to borrow. In 2000/01 the public sector borrowing requirement amounted to only 1,7 percent of GDP, down from a high of 5,3 percent in 1996/1997. This decline in national government debt is expected to continue, and has already freed up significant amounts of investor capital for other quality investments. From both a municipal infrastructure perspective and a capital markets/liquidity perspective, national Government is interested in seeing high quality, tradable, municipal securities on the capital markets.

Local political stability

A five year mandate

With last December's municipal elections, local councils are in place for at least the coming five years. This puts councils in an excellent strategic position to assess their infrastructure needs and debt capacity, and make plans for the responsible use of debt as part of their service delivery and economic development strategies.

Predictability of intergovernmental transfers

MTEF makes planning commitments easier

Without stable, predictable, and adequate revenues, municipal borrowing may well be unwise. For municipalities that cannot rely on own-source revenues from taxes and tariffs, predictability in intergovernmental transfers is a key to leveraging in private investment. With three-year indicative allocations in both the equitable share and capital programs, national Government is committed to giving local government the information they need to make informed decisions about borrowing. Leveraging in private capital on the strength of committed future transfers can be a responsible local choice. By providing clear commitments (and limitations) as to future transfers, national government can empower rural municipalities without significant own-source revenues to access private capital markets, and realise well-targeted capital investment.

What needs to be done to make capital markets work for municipalities?

The legal reforms anticipated in the Municipal Finance Management Bill will not by themselves make credit available. Other ingredients in the recipe for effective capital markets include:

- Financial viability – municipalities must be sure that expenditures are in line with revenues.
- Financial information – municipalities must have clear budgets and capital plans, along with timely and accurate financial reporting. This allows investors, analysts, and credit rating agencies to make informed judgements about municipal financial health.
- Disclosure – the potential buyer of municipal bonds must have ready access to reliable information about a municipality's debts, any defaults, and other information material to an investment decision.
- Experience – as municipalities begin to enter the capital markets, they will become more familiar with its demands, and as investors have positive experience with municipal debt, they will become more comfortable with it as part of an investment portfolio.

Legal reforms

Councils must be able to commit

If a lender is to invest a significant amount of capital, it must have confidence that the borrower will repay the debt. This means that the Council must have the legal right to bind the municipality over the long term, and the right to make commitments in connection with future budgets and revenues that will secure the debt.

The weight of legal opinion is that a municipal council probably cannot make such a binding commitment as things stand today. This limits investors' willingness to invest their capital. Once a municipality makes a binding promise to pay, investors will want clear remedies if the municipality should fail in its obligations.

Because municipalities seldom, if ever, defaulted on their debts under the apartheid regime, South Africa's law on remedies in the context of municipal debt is underdeveloped. This has led to prolonged uncertainty and ineffective remedies in some recent municipal defaults. Creditors and borrowers alike will benefit from clarity about the consequences of non-payment. Knowing what happens if things go wrong reduces uncertainty, and thus reduces the cost of credit to a municipal borrower.

New legislation on municipal borrowing and financial emergencies has now been developed. This will provide clarity about municipalities' ability to secure their debt through collateral promises and about what happens in the event of a municipal financial emergency. These legislative provisions are included in the Municipal Finance Management Bill.

Can municipalities go bankrupt?

Unlike private corporate assets, municipal assets cannot readily be liquidated for the benefit of unpaid creditors. Water treatment plants and pipes in the ground, for example, have little or no value in liquidation. In any event, they are needed to provide essential services to citizens. Bankruptcy models drawn from the corporate context are therefore of little help in structuring remedies for municipal insolvency.

The draft Municipal Finance Management Bill takes a more modern approach, focusing on rehabilitating the municipality and restoring its financial health. If a municipality becomes completely unable to meet its obligations, a state of financial emergency can be declared by the High Court. A financial administrator will consult with all creditors, the municipality, and other stakeholders to develop a recovery plan. The plan can include such measures as expenditure controls, the liquidation of unnecessary assets, and raising taxes and tariffs.

In the extraordinary event that a municipality will never be able to meet its obligations under any possible recovery plan, the High Court can order obligations discharged, so that the municipality and its citizens can have a fresh start.

Which municipalities should borrow?

All municipalities can be sustainable

National government's view of the local government sphere is that there should be no such thing as an unsustainable municipality. To the extent that municipalities do not have access to adequate own source revenues, they will have access to predictable streams of equitable share revenue. Regardless of the sources of revenue, sustainable municipalities will limit the services they deliver to what they can afford.

Need skills to analyse options and impacts

Municipalities must have the ability to prepare and use multi-year budgets. When considering new capital investments, they must understand how both debt service and increased operation and maintenance expenses impact on these budgets. They must be able to project accurately any increased revenue they expect from new investments. To plan strategically for capital investment, they must be able to analyse options and scenarios. Where these skills are lacking, municipalities are ill equipped to make the best decisions for their community and to engage the investor community. All of this implies that technical assistance and training for elected representatives and appointed officials alike may be a wise investment.

Wise use of credit accelerates delivery

Once the basics are in place, the capital component of any municipal budget, of any rural or urban municipality, is generally susceptible to leverage. If a municipality has the capacity to borrow wisely and to manage multiple construction projects, more infrastructure can be put in place more quickly if the municipality borrows, and uses a portion of its capital budget for debt service. More people can get a service sooner, and a sound base for economic development can be built more quickly.

A new legal environment

In July 2000, the Cabinet adopted and published a *Policy Framework on Municipal Borrowing and Financial Emergencies.* The policies detailed in that document include proposed legislation to deal with financial emergencies in municipalities. The framework document was published at the same time as the draft Municipal Finance

Management Bill, which includes draft legislation regarding municipal borrowing.

New Municipal Finance Management bill

Following extensive public input, Cabinet approved a revised version of the Municipal Finance Management Bill during August 2001. Draft legislation on borrowing is included as Chapter 5 of the Bill. These provisions clarify how municipalities can borrow, for what purposes, and describe the undertakings they can give to bondholders, lenders, and investors in order to attract investment. Draft legislation on municipal financial emergencies is included in the Bill. These provisions provide an option for municipalities in extreme financial distress to deal with problems they cannot solve themselves.

Once this draft legislation has become law, the legal framework will be in place to make it possible for municipalities to borrow responsibly from private lenders, including capital markets. Borrowers and lenders will both be able to understand exactly what happens in the event that debt is not paid as, and when due. This clarity will reduce the risk premium for all municipalities, and can make the debt of a well-managed municipality attractive to investors. The virtual elimination of legal risks helps municipalities that borrow wisely to access the markets at the lowest possible cost.

Building municipal capacity to access and use debt

The first challenge for municipalities is to develop the information and planning necessary to determine if borrowing is a wise choice. Second, they need the analytical and presentation skills to market municipal debt.

Reliable information essential

Before it can responsibly consider borrowing, and before it can hope to interest an investor, a municipality must have current, audited financial statements. This is the starting point to make an informed judgement about a municipality's ability to take on debt. Both the municipality and its potential investors have to make such a judgement. The recent municipal amalgamations will present a challenge in this regard, as it may be a year or more before most municipalities have the financial information they need. High quality financial information is the key to borrowing at reasonable rates, and to having a choice of lenders and investors.

A clear capital improvement plan

A municipality must also have a credible and comprehensive capital improvement plan. This implies that the newly elected Councils and their officials must identify all the community's needs, prioritise them, and consider the financing options available. Again, the amalgamations present a challenge. Most municipalities include newly incorporated areas whose infrastructure needs must be considered systematically. The Municipal Systems Act requires municipalities to develop an integrated development plan (IDP) which includes much of what is needed. But not all IDPs have been completed, and not all of those that have been developed represent a genuine community consensus on needs and priorities, nor on local economic development strategy. The challenge is to link IDPs to budgets.

Borrowing can stimulate growth

Borrowing may be the most powerful tool in a municipality's financial toolbox. It can lay the foundation for economic development and a virtuous cycle of growth, or if used unwisely it can leave crippling debt for the next generation. Currently, private sector credit is available for good municipal projects - using debt wisely is the challenge of the moment. To assist local governments, national government and organised local government (SALGA) must co-operate on a meaningful program of technical assistance and training to help municipalities to:

?? identify and analyse community needs and establish priorities

?? plan for meeting these needs through an appropriate mix of projects, funding options, and sequencing through capital improvement planning and integrated development planning

?? study project feasibility and analyse the impact on municipal budgets of both debt service costs, and the increased (or sometimes decreased) operational and maintenance cost resulting from new projects

?? develop designs and specifications suitable for competitive procurement

?? manage the tender process and other procurement issues

?? manage construction projects

?? market the municipality, its projects, and its debt instruments to investors.

Options for raising capital

There have been concerns about the pace at which a municipal capital market will develop, and about such a market's preference for large and financially secure municipalities. This has led to the consideration of various forms of stimulus for markets, or direct assistance to municipalities that cannot access capital through the market. In particular, small but creditworthy borrowers may need assistance, since their projects may be too small to attract the markets' attention. Municipalities with insufficient capacity need assistance both accessing capital and spending it well.

Borrowing-related assistance options can be grouped in various ways. The list that follows begins with the most direct mechanisms and ends with the least direct.

Government grants

Advantages

One of the most direct forms of assistance is to simply provide investment capital directly to a municipality. There are existing grant programs, such as CMIP, that do this. These will continue to play a role for the foreseeable future. The main advantages are simplicity and that national government can control the flow of funds and influence or direct what is built.

National grants are simple but …

One disadvantage is that this spending costs real money, and that money is not leveraged. Limited resources constrain the pace at which infrastructure is built. Local communities may not share national government's view of their needs or of what projects are appropriate to address those needs. Projects mandated by national governments in many countries, including South Africa, have been criticised as inappropriate for local conditions and as expensive or impossible to maintain. Some of these effects can be limited with adequate community involvement, provided that due account is taken of financial realities.

Government lending

Neither a borrower nor a lender be?

Another option is for the National Treasury, or another government agency, to lend directly to sub-national governments. The first advantage is the low cost at which national government can borrow funds for use by provinces and municipalities. Secondly, it gives national government the ability to direct lending to priority programs. The main disadvantages usually associated with such programs are the moral hazard implicit in government-to-government business transactions and the potential crowding out of the private sector.

Including the Local Authorities Loan Fund, the DBSA now accounts for over 30 percent of all outstanding municipal debt, a percentage that has nearly doubled over the last four years. The challenge is to find a balance between public and private lending.

Government guarantees and insurance

Government guarantees are less direct than outright lending to sub-national governments. The main advantage is that guarantees are less costly than direct lending, at least in the short term. Furthermore, a national government guarantee can induce private lenders to provide credit for sub-national borrowers at low rates.

There are four principal disadvantages:

?? such guarantees increase government's contingent liabilities

?? the cost of guarantees is difficult to predict and quantify

?? the investor's focus shifts from the creditworthiness of the borrower and/or the project to the creditworthiness of national government.

?? investors become willing to lend to any guaranteed borrower regardless of its independent ability to repay, or the project's financial viability.

Risks within the control or responsibility of national government may be appropriate for government guarantees or insurance. For instance, government could guarantee or insure against risks associated with changes in sub-national boundaries, or legislative changes in the powers and responsibilities of sub-national governments.

Government subsidies for local borrowing

Subsidies an option but risky

Some countries provide subsidies for local government borrowing, often in the form of tax exemptions on income generated by municipal debt. The United States is the most commonly cited example. Such tax subsidies are often criticised on the grounds that they erode the tax base. They also tend to create a preference for the public sector at the expense of the private sector, and are less transparent than budget allocations for the same purpose. Non-tax subsidies are also possible. The challenge would be to design a pure subsidy that minimises distortion of capital markets. This is an especially difficult challenge given that municipal capital markets are themselves dormant.

Special purpose intermediaries

Intermediaries can assist smaller councils

The world's capital markets convey huge flows of money every day, with great efficiency. Not every small municipality can access these capital markets directly, so there must be market intermediaries that step financial flows down to user-friendly levels. Such intermediaries can be especially useful for small and medium-sized municipalities. All bank lending to municipalities represents intermediated capital market access. A bank lends funds to a municipality that it has acquired either from another intermediary or directly from capital markets. But from the perspective of a small borrower, even a bank can be a large and impersonal entity. From the perspective of a large bank, a small municipality may not be worth the effort. To make credit more available to small municipalities, many countries around the world have developed special purpose intermediaries, such as bond banks and bond pools. South Africa's own INCA – a private sector institution – has received international attention as a positive model.

The DBSA and INCA are the two most important intermediaries now operating in the municipal market. Between them, they hold about half of the outstanding municipal debt stock.

Technical assistance and training

Training and assistance will bear fruit

The most strategic long-term investment is likely to be technical assistance and training. This should be aimed at both councillors and officials, to help them develop the skills to define needs and projects, and to interact with capital markets and market-driven intermediaries. This technical assistance and training is compatible with any other form of assistance, including grant funding. Wise and efficient use of capital resources, however obtained, is manifestly in the best interest of both national and local government.

Supportive environment

Indirect but critical elements in supporting local governments' access to credit markets include:

- assuring financial viability – municipalities must have adequate revenues, including intergovernmental transfers where necessary, to meet their constitutional service delivery and governance obligations.
- user-friendly financial information – municipalities must provide clear and accurate financial information, and national government can help sponsor systems that make such information freely

available to interested parties, including investors, analysts, and credit rating agencies to make informed judgements about municipal financial health.

?? disclosure systems – if active trading in municipal securities is to occur, potential buyers of municipal bonds must have ready access to reliable information material to an investment decision.

While efforts to artificially stimulate municipal borrowing through guarantees and subsidies are superficially tempting, helping municipalities with the basics – sufficient revenues, capital planning, effective management and reliable information – is likely to yield the most sustainable capital finance system for municipalities.

Conclusion

Capital investments in municipal infrastructure are essential if municipalities are to meet their developmental mandate. They need to work with partners that can attract such investment, or access the capital market directly through borrowing. This chapter discussed the options, and reflected on progress with municipal public-private partnerships as well as borrowing.

It is evident that private sector lending has been sluggish, but the market is ready for an upturn. This is due to the fact that municipal demarcations are now known, other public sector borrowing has declined, grant reforms, falling inflation and interest rates, legal and policy reform, and greater political stability. A stable policy environment, capacity building, and a careful selection of institutional models and approaches for borrowing, will enhance these trends. The priority is to create greater stability and certainty that would comfort potential investors.