

Introduction

The publication of the *2003 Intergovernmental Fiscal Review* has been brought forward to provide Parliament and provincial legislatures with comprehensive budget information on all three spheres of Government before they conclude their 2003 Budget hearings¹.

This Review contains the latest provincial and local government budgets

The 2003 Budget allocates transfers amounting to R171,0 billion or 61,1 per cent of total non-interest expenditure to provincial and local governments. Because the national Budget is presented ahead of the tabling of provincial budgets, it does not provide details on spending plans of provinces.

Now that all nine provinces have tabled their 2003 budgets, this *Review* contains information and spending plans of provinces as set out in their 2003 budgets. Municipalities will only table their 2003 budgets during April and May, as their financial year starts three months later, on 1 July 2003. The *Review* therefore contains information on the 2002-03 municipal budgets.

Consolidated budget and expenditure information as set out in this *Review* provides the public, elected officials, policy analysts and public servants with comprehensive information on the use of public resources, including the funding of basic services. It presents portfolio committees in Parliament and provincial legislatures with a unique opportunity to get a total perspective on what Government is spending on provincial functions such as school education, health, social development, housing, roads and agriculture. The *Review* also enables them to compare and benchmark provinces against one another in assessing the extent to which their budgets are aligned with and give effect to national priorities.

Timing of the Review gives Parliament and provincial legislatures a total perspective on government spending

This *Review* does not focus on the national budget, as the 2003 *Estimates of National Expenditure* tabled with the 2003 Budget provides an in-depth analysis of national department budgets.

¹ The *Intergovernmental Fiscal Review* was not published in 2002 in order to accommodate the change of date to coincide with budget debates in Parliament and provincial legislatures. Instead, a smaller document *Provincial Budgets: 2001 Outcome and 2002 MTEF Budgets* was published.

National Government's main spending is not directed at social or basic services: this funding flows through provincial and local Government. National Government's budget of R109,0 billion is mainly targeted at the criminal justice system (police, justice, prisons) and defence, which make up over half of its expenditure, after all intergovernmental grants have been excluded. Other significant allocations are for higher education, transport (national roads and rail), water affairs, foreign affairs and administrative functions such as home affairs (identity documents and passports), and revenue services.

However, some national functions are shared with the provincial or local sphere and include education, health, water, electricity, agriculture, roads and traffic management, and personnel. In discussing these functions the *Review* highlights some of the unique challenges arising from the concurrent nature of these functions.

Budget-related publications can make oversight role of Parliament and provincial legislatures more effective

Together with other key 2003 Budget documents like the *2003 Budget Review*, the *2003 Estimates of National Expenditure*, the 2003 Division of Revenue Bill and the 2003 Appropriation Bill, the *2003 Intergovernmental Fiscal Review* intends to provide greater depth to the role of Parliament in approving the Budget, and in influencing future budgets. The challenge facing Parliament and provincial legislatures is to use these documents effectively in exercising their oversight role over government departments responsible for these functions.

The quality of information for municipalities is still poor, particularly as most municipalities are still consolidating after their establishment in December 2000. This is the only reason why the *Review* contains less detail on municipal budgets. The imminent enactment of the Municipal Finance Management Bill and supporting capacity-building programmes are expected to improve the quality of information from municipalities in the next few years. Municipalities have yet to implement many of the reforms undertaken by provinces and progress in this area is expected over the next few years.

South Africa in context

Skewed distribution of resources and income has racial and regional dimensions

With a GDP per capita of approximately R24 186, South Africa is rated as a middle-income country, with GDP of R1 099² billion in 2002 and a population estimated to be over 43,3 million. South Africa's long history of racial segregation and apartheid, combined with the uneven spread of resource endowment, created wide disparities in levels of economic activity and development, resulting in a skewed distribution of income. A poverty study in 1998 found that the poorest 40 per cent of the population earned only 11 per cent of income, while the wealthiest 10 per cent earned 40 per cent³ of income. There is a racial dimension to this skewed distribution of

² At R8 to an American dollar, this translates to GDP of \$137,4 billion, or per capita of \$3023

³ J.May (ed.), 1998, *Poverty and Inequality in South Africa*, Praxis, Durban.

income, with the majority of the poorest being black, and the wealthiest, largely white South Africans.

Regional distribution of income is also highly inequitable, with one of the nine provinces (Gauteng) accounting for approximately 41,6 per cent of the country's gross domestic product, even though its population share is approximately 18 per cent. The province contributes a proportionately large share of government revenue.

Apartheid public budgets directed little expenditure towards education, health, housing and basic needs of black South Africans.

The 1994 post-apartheid system therefore aims to democratise state institutions, redress inequality and extend services to the broader population. The 1996 Constitution of South Africa, and the 1993 Interim Constitution which preceded it, provide the legislative framework for the new system. This establishes 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.

Post-apartheid system of three spheres intended to democratise state institutions

The new system has the following features:

- A unitary system of government with three distinctive, interrelated and interdependent spheres, with 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 their own legislatures and executive committees, as well as administrative structures
- There are 284 municipalities, categorised as metropolitan, district wide or local structures, and comprised of political and administrative components⁴
- Provinces are accountable to provincial legislatures, and local governments are accountable to councils
- The system of election at the national and provincial level is proportional representation, while the local level is a mix of directly elected and proportional representation
- The Constitution entrenches 'co-operative governance', obliging the three spheres of Government to co-operate and to negotiate political and budgeting issues between them. Numerous intergovernmental forums, including the Budget Council⁵ and

Features of new system designed to deepen democracy and encourage co-operative governance

⁴ 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.

⁵ The Budget Council comprises the national Minister of Finance and Members of the Executive Council responsible for Finance in the provinces.

Budget Forum⁶, facilitate co-operation and consultation in the budget process

- Public servants employed by national and provincial governments comprise one single public service (with similar remuneration for similar rankings, irrespective of function). Some 70 per cent are in the provinces: a total of about 753 000. Municipal employees are not part of this public service, but Government is exploring the possibility of incorporating them into the public service. A key feature of the public service is the high level of unionisation, and the impact of collective and centralised bargaining on public remuneration levels.

The intergovernmental fiscal system

Revenue sharing aimed at redressing regional imbalances

Given the regional imbalances in income distribution, South Africa's fiscal system is based on a revenue-sharing model, with most of the nine provinces receiving more funds than they raise through national taxes. Similarly, except for the major urban municipalities, most municipalities are also highly dependent on national transfers, although to a lesser extent than provinces.

The 2003 fiscal framework: allocations for the three spheres

Table 1.1 provides the fiscal framework for the 2003 national Budget published in the *2003 Budget Review*. The total consolidated national government budget (including debt service costs) for 2003/04 is R334,0 billion. This comprises R304,5 billion in revenue (mainly corporate and personal income tax, VAT, fuel and excise levies), and borrowing amounting to R29,5 billion, translating to a 2,4 per cent deficit. Before allocating the funds between the three spheres, R50 billion is set aside for debt service costs, and R3,0 billion for a contingency reserve. The reserve is for unforeseeable and unavoidable expenditure, emergencies and also for expenditure items that are not yet included in departmental allocations.

Provinces receive the largest share of nationally – raised revenue

The provincial sphere receives the largest allocation of R159 billion (or 56,9 per cent), national Government receives R109 billion (38,9 per cent) and local Government R12 billion (4,3 per cent).

Division of revenue broadly reflects functional responsibilities and fiscal capacity

The division of revenue set out in Table 1.1 is an outcome of a consultative process among the spheres of Government. It is informed by policy imperatives and priorities, and takes into account the division of functions among the spheres and their capacity to raise their own revenue through provincial and municipal taxes.

⁶ The Budget Forum consists of the members of the Budget Council and representatives of organised local Government.

Table 1.1 Main budget expenditure: 1999/00–2005/06

| R million | 1999/00 | 2000/01 | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 |
|-----------------------------------|----------------|----------------|----------------|----------------|-----------------------|----------------|----------------|
| | Outcome | Outcome | Outcome | Revised | Medium-term estimates | | |
| National departments ¹ | 66 385 | 73 178 | 87 709 | 98 853 | 108 983 | 117 549 | 126 323 |
| Provinces | 99 465 | 108 899 | 121 099 | 136 919 | 158 995 | 175 468 | 191 590 |
| <i>Equitable share</i> | <i>89 094</i> | <i>98 398</i> | <i>107 460</i> | <i>123 457</i> | <i>142 386</i> | <i>155 313</i> | <i>167 556</i> |
| <i>Conditional grants</i> | <i>10 370</i> | <i>10 501</i> | <i>13 638</i> | <i>13 462</i> | <i>16 609</i> | <i>20 155</i> | <i>24 033</i> |
| Local government | 4 610 | 5 536 | 6 516 | 8 801 | 12 001 | 13 249 | 14 624 |
| <i>Equitable share</i> | <i>2 163</i> | <i>2 315</i> | <i>2 607</i> | <i>3 964</i> | <i>6 343</i> | <i>7 078</i> | <i>7 698</i> |
| <i>Conditional grants</i> | <i>2 447</i> | <i>3 221</i> | <i>3 909</i> | <i>4 837</i> | <i>5 658</i> | <i>6 171</i> | <i>6 926</i> |
| Non-interest allocations | 170 460 | 187 613 | 215 324 | 244 573 | 279 979 | 306 266 | 332 536 |
| <i>Percentage increase</i> | <i>7,4%</i> | <i>10,1%</i> | <i>14,8%</i> | <i>13,6%</i> | <i>14,5%</i> | <i>9,4%</i> | <i>8,6%</i> |
| State debt cost | 44 290 | 46 321 | 47 581 | 47 250 | 50 986 | 53 079 | 55 070 |
| Contingency reserve | – | – | – | – | 3 000 | 4 000 | 8 000 |
| Main budget expenditure | 214 750 | 233 934 | 262 905 | 291 823 | 333 965 | 363 345 | 395 606 |
| <i>Percentage increase</i> | <i>6,6%</i> | <i>8,9%</i> | <i>12,4%</i> | <i>11,0%</i> | <i>14,4%</i> | <i>8,8%</i> | <i>8,9%</i> |
| Percentage shares | | | | | | | |
| <i>National departments</i> | <i>38,9%</i> | <i>39,0%</i> | <i>40,7%</i> | <i>40,4%</i> | <i>38,9%</i> | <i>38,4%</i> | <i>38,0%</i> |
| <i>Provinces</i> | <i>58,4%</i> | <i>58,0%</i> | <i>56,2%</i> | <i>56,0%</i> | <i>56,8%</i> | <i>57,3%</i> | <i>57,6%</i> |
| <i>Local government</i> | <i>2,7%</i> | <i>3,0%</i> | <i>3,0%</i> | <i>3,6%</i> | <i>4,3%</i> | <i>4,3%</i> | <i>4,4%</i> |

1. Includes a transfer of R855 million to the Umsobomvu Fund in 1999/00.

Concurrent and exclusive functions

The South African Constitution divides functions between the three spheres of Government. Some functions are shared (concurrent) and others are exclusive. The provincial sphere performs functions like school education, health and social grants, which do not lend themselves to substantial cost recovery, but account for a substantial proportion of public spending. Provinces only raise about 4 per cent of their own revenue. Municipalities, by contrast, have significant revenue-raising powers and collect between 60 to 95 per cent of their own revenue, as two-thirds of their activities such as water, electricity and refuse-removal, are self-funded.

The big concurrent functions shared between national and provincial governments include school education, health services, social security and welfare services, housing and agriculture. For these functions, national Government is largely responsible for providing leadership, formulating policy, determining the regulatory framework including setting minimum norms and standards, and monitoring overall implementation by provincial governments. Provinces are mainly responsible for implementation in accordance with the nationally-determined framework. Given these different responsibilities, it is provincial departments that have large budgets for implementing services, while the national department has a relatively small share for its functions.

Concurrent functions shared between national Government and provinces

On the other hand, the exclusive functions are the sole responsibility of the relevant government only. In the case of national Government, large exclusive functions include national defence, the criminal-justice system (safety and security, courts), higher education, water and energy (electricity) resources and administrative functions such as

Exclusive functions for national Government and provinces

home affairs and collection of national taxes. These exclusive functions absorb a substantial proportion of national Government's budget. For provinces, exclusive functions include provincial roads, ambulance services, and provincial planning.

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

Co-operative governance

Co-operation among spheres important for shared functions

The South African Constitution enjoins the three spheres of Government to co-operate in policy-making and implementation. All spheres of Government have to face the challenge of aligning their policy and implementation processes. In the context of a young democracy, such co-operation is critical, particularly for shared functions.

The following intergovernmental forums all play an important role in shaping policy and resource-allocation decisions:

- Extended Cabinet and President's Co-ordination Council, which comprises of the national executive, nine premiers and the chairperson of the South African Local Government Association (Salga) for Extended Cabinet. The Extended Cabinet is the highest co-operative mechanism advising the national Cabinet when finalising the fiscal framework and division of revenue on which MTEF budgets are based.
- Budget Council, which is constituted by the Minister of Finance and the nine Members of the Executive Council responsible for finance in the provinces.
- The Budget Forum, which is made up of the Budget Council and local government representatives.
- MinMECs, which are sectoral policy forums of the Ministers and their provincial counterparts.
- Joint MinMECs between selected sectors and the Budget Council.

There are also several intergovernmental forums comprising of senior officials which provide technical support to the political forums.

Peer learning initiatives bear fruit, but need to address non-financial aspects

One measure bearing fruit is the peer learning forums established for financial officials in key sectors like education, health, social development, agriculture, housing, local government and transport, roads and public works. These forums have contributed to developing uniform approaches to common challenges, providing a forum for promoting best practices, and at the same time allowing for comparisons of similar activities between different governments. The forums need to be expanded, to cover non-financial aspects for non-financial staff, in areas like planning, personnel management, procurement and infrastructure.

Past reforms

In the last seven years a series of carefully sequenced budget reforms were introduced, with the view to improving planning, enhancing transparency, strengthening accountability, and improving public service delivery. These include:

Reforms are improving financial management in the public sector

- The introduction of three-year budgets which are now being extended fully to local Government, including the three-year allocations per municipality published with the 2003 Division of Revenue Bill.
- The promulgation of the Public Finance Management Act (1 of 1999) (PFMA), which together with other public services reforms, establishes institutional mechanisms for strengthening financial management and fostering accountability for results and outputs. Publication of reports keep Cabinet, Parliament, legislatures and the public informed of the state of public finances on a quarterly basis. Departments also submit annual financial statements for auditing within two months after the end of the financial year.

Current and future reforms

While the reforms set out above have resulted in remarkable improvement in budgeting and financial management in Government, further qualitative improvements are essential. One of the key intergovernmental reforms implemented in the 2003 Budget was the publication of all local government allocations per municipality for the next three years. Provinces have done the same in their budgets. The certainty and transparency of the budget allocation process will make it easier for provinces and municipalities to budget for all grants received, and to plan their spending for the next three years. This *Review* does not provide information on these allocations or reforms, as these are all published in the 2003 Division of Revenue Bill.⁷

Future reforms seek to strengthen alignment between strategic plans, budgets and annual reports

A range of reforms currently under way is being considered to accomplish this. Central to the current and future reforms is further strengthening of alignment between departmental strategic plans, budgets, financial statements and annual reports. The reforms will also seek to give effect to the provisions of the Public Service Act and Regulations. Other reforms to be effected include:

- Developing and publishing service delivery measures and indicators to complement financial information, together with strategic plans, revised budget formats and annual reports. Given the importance of these reforms, the section below provides further details.
- Extending financial management and budget reforms currently implemented by national and provincial departments to the local government sphere under the auspices of the soon-to-be

⁷ The *2003 Division of Revenue Bill*, as well as the gazette to be published when the Bill is enacted in Parliament on 9 April 2003, will be available on the National Treasury website: www.treasury.gov.za.

promulgated Municipal Finance Management Act. Supply chain reforms to modernise procurement practices in Government. Some provinces, like Gauteng with its shared services concept, are leading innovations in this area.

Departmental strategic plans

Strategic plans are key to evaluating performance and benchmarking departments

One of the most exciting reforms implemented in provincial budgets in 2003/04 are the strategic plans to be tabled by provincial departments during March and April 2003, and on which the 2004 Budget will be built. These strategic and performance plans are based on uniform budget formats for each of the social services sectors. They will attempt to set uniform measurable objectives and performance targets and indicators for each budget programme and subprogramme. Key to this reform is ensuring that there is a close relationship between the strategic plans and budget allocations so that, in reporting, departments can reflect what they delivered with the resources allocated to them.

Common programme structures and indicators for concurrent functions

For provincial functions, it is also vitally important that the strategic plans enable the national department to assess progress with implementation of its policies at sub-national level, and benchmark provinces against one another so that good practices can be shared across provinces. This year's strategic plans for education, health and social development, which have been developed following an extensive and intensive consultative process, represent the first step towards accomplishing this goal.

The strategic plans for these sectors are based on an agreed uniform programme and subprogramme structure for each sector. In some cases sectors have taken a step further to agree common sets of indicators for their programmes and subprogrammes. In addition to allowing aggregation across provinces, this also permits inter-provincial comparisons.

Annual reports

Annual reports should be statements of fact

In the last two financial years, departments have prepared and published annual reports, as they are now legally required to do so. Annual reports provide financial statements and account for the activities of a department for a particular financial year. The end of the year reports should demonstrate strong links with the strategic plans and budgets adopted before the start of that financial year.

Reporting on non-financial information needs to be strengthened

The quality of annual reports published in the last two years varies greatly. A number of areas have been identified as requiring improvement with the view to enhancing their usefulness as a way of accounting to Parliament and legislatures for the use of public funds. These include:

- Ensuring that there is a clear link between strategic plans and annual reports: the first is a statement of intent with deadlines and targets, while the second is a *post facto* statement of progress or achievements

- Giving a detailed account of transfers of conditional grants to provinces and local government; noting the extent to which the recipient sphere has complied with the conditions relating to the grant; and a consolidated report on the performance of the conditional grant funded programmes
- Providing verifiable quantitative non-financial information on service delivery by programme or subprogramme.

It is envisaged that systematically implementing and consolidating these reforms over the next three to five years will assist Parliament and provincial legislatures in exercising their oversight role.

Chapter overview

The 11 chapters provide overviews of trends and analyses of key policy issues and fiscal challenges:

- This Introduction covers broad trends in the sectors covered in this *Review* and the main features of the intergovernmental system.
- Chapter 2 provides information on the 2003 provincial MTEF budgets, and also reviews provincial budgets and actual revenue, since 1999/00. It shows that the 2003 budgets reinforce the real growth in provincial budgets and expenditure which started over the three years to 2002/03. The chapter also notes that the composition of provincial expenditure is changing, with rising shares for non-personnel expenditure. This is being fuelled mainly by strong growth in capital expenditure on construction and rehabilitation of public facilities and assets such as school buildings, hospitals and roads; and rising spending on housing and on critical items like textbooks and medicines.
- Chapter 3 outlines trends in local government budgets, providing consolidated information on the 2002-03 municipal budgets. The chapter describes key pressures like rising salaries that may undermine the ability of municipalities to deliver free basic and other services. It also provides information on the 2003 national budget allocations.
- Chapters 4, 5 and 6 deal with the key social services sectors: education, health and social development. Provinces play a key role in these sectors, with the policy role residing with national Government. Overall, the chapters show that while the share of these services in total provincial spending is stable at around 81 per cent, within social services, the share of social development grows to about 25 per cent in 2005/06, reflecting the impact of the phasing in of the Child Support Extension Grant. However, each sector's spending grows in real terms.
- Chapter 7 covers agriculture and land. This is the first time that this sector is covered in the *Review*. The chapter identifies critical interventions required by provinces to reduce their share of personnel expenditure in order to provide vital services to support and develop commercial and subsistence farmers. The rapid progress made on land restitution is also impressive.

- Chapters 8 and 9 deal with infrastructure spending, for roads and housing. Although budgets for such infrastructure are increasing, they still exceed the spending capacity of those departments. Both chapters emphasise the need for more effective intergovernmental co-ordination. Approaches to housing which create sustainable communities are highlighted in the housing chapter; and the chapter on roads looks at roads, public transport and road safety.
- Chapter 10 deals with personnel issues, and reviews the challenges for the public sector to attract and retain the appropriate skills, particularly in health and education. It also raises the problem of excess personnel in roads, public works and agriculture departments in provinces. The chapter highlights issues that need to be tackled in order to incorporate municipal personnel into the public service. One of the biggest challenges facing local Government is the rapid rise in personnel expenditure as a share of total operating budgets. Overall, this share has risen to 32 per cent, and may rise further to 45 per cent if the purchase of bulk water and electricity is excluded. This is in stark contrast to provincial trends on personnel, where the share has been declining.
- Chapters 11 and 12 cover water and electricity, which are largely shared between local and national governments. These sectors were not covered in previous years. Key issues in these chapters relate to extending these services to all residents, and to provide free basic services to very poor households. They examine the price-setting processes in these sectors. The chapter on electricity assesses the impact of the restructuring of the electricity distribution sector on municipalities.

Conclusion

This *Review* underscores that South Africa's intergovernmental system has matured. With intergovernmental institutions of governance firmly in place, and building on the expansionary fiscal stance, provinces and local Government are better placed to play a central role in delivering critical pro-poor social services, thus giving expression to a better life for all.

With the pending publication of Census 2001 results this year, national Government will review all intergovernmental grants, and their formulae, for the 2004 Budget. This process will take account of the functions performed and the fiscal capacity of the three spheres of Government. The *2003 Intergovernmental Fiscal Review* provides valuable information for this. Government will also promote greater consistency in its redistribution objectives, and getting the appropriate balance between national grants and cross-subsidisation.

One of the major challenges facing Government is to improve the quality of delivery, and the production of non-financial performance information. In this respect, it is important that management of resources is appropriately decentralised to schools, hospitals, clinics and other cost centres.

This *Review* will assist the various intergovernmental forums like MinMECs to better prepare for the 2004 Budget process. It should also assist in the implementation of the 2003/04 budgets.

However, the greatest challenge is left for Parliament and provincial legislatures. There is a wealth of information that is available on budgets and spending – the critical challenge is for Parliament and provincial legislatures to make effective use of this information to oversee the quality of delivery by government departments.