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Introduction

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As South Africa enters the Second Decade of Freedom, the country prides itself for having created a vibrant and well-functioning intergovernmental system founded on the constitutional principle of co-operative governance.

Marked improvement in the pace of service delivery

Provinces are at forefront of the delivery of services that seek to reduce vulnerability, poverty and inequality. In line with government's programme to improve access and the quality of pro-poor services, the share of non-interest spending allocated to provinces is growing quite strongly. The *Provincial Budgets and Expenditure Review: 2002/03 – 2008/09* builds on previous publications by highlighting how the growth in provincial spending has translated into tangible improvement in the quality of life of all South Africans, especially those who use public services. Trends in the sector chapters show that:

- Access to the school system has improved with gradual improvement in matric pass rates. Maths and science enrolments are increasing so is the number of children passing these subjects.
- Access to public health care services continues to rise due to increased number of health facilities and rising employment of health professionals.
- Welfare service expenditure is growing very rapidly on the back of the shift in social assistance grants to the national sphere. This will ensure that the impact of social pathologies on communities, particularly the poor, are minimised.
- Housing delivery is accelerating and there is a particular focus on creating sustainable human settlements.

- Investment in economic infrastructure continues to grow rapidly as some of the capacity constraints are being addressed through various technical support initiatives.
- Through its expanded public work programmes in roads, government has created 47 530 jobs and built the requisite skills to beneficiaries to find sustainable employment.
- 196 667 households have benefited from the land reform programme and agricultural support to emerging farmers stepped up.

There are a number of changes that impact on this year's *Review*:

The social assistance function excluded from this year's Review

- Firstly, a major change in intergovernmental relations relates to the shift in the administration of the social assistance function from provinces to a national agency. This year's *Review* does not include information on social assistance.

Review still based on old provincial boundaries

- Secondly, although provincial boundaries were revised in March this year, the data presented in this publication are broken down according to the old boundaries because until now fiscal transfers to provinces have been divided according to the old boundaries.

The *Provincial Budgets and Expenditure Review: 2002/03 – 2008/09* begins by giving an overview of the architecture of South Africa's intergovernmental system, the next part of this chapter. It then presents analyses of school education, health, social development, housing, agriculture and roads and transport. It concludes by providing a consolidated picture of revenue and expenditure trends in provinces for the period 2002/03 through 2008/09.

The South African intergovernmental system

The South African intergovernmental system is designed so that certain functions are exclusive (performed by one sphere only), while others are concurrent (shared between different spheres). The Constitution divides functions among the three spheres of government and clearly distinguishes between exclusive and concurrent responsibilities.

Provinces are key implementers of policy in school education, health, social development, housing, agriculture and roads

Concurrent functions include policy-making, legislation, implementation, monitoring and performance assessment. Functions such as school education, health services, social welfare services, housing and agriculture are shared between national and provincial governments. 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 responsible mainly for implementation in line with the nationally determined framework. Provincial departments therefore have large budgets for implementing government programmes, while the national departments have a relatively small share for their functions.

Each sphere of government has specific exclusive functions. For national government, these include national defence, the criminal justice system (safety and security, courts), higher education, water and energy (electricity) resources and administrative functions (home affairs, collection of national taxes). These absorb a large proportion of national government's budget. Exclusive functions for provinces include provincial roads, ambulance services and provincial planning.

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A major change in the current intergovernmental arrangements is the overall administration of the social assistance grants function. The function has shifted from being a concurrent function to an exclusive national government function. This is discussed in detail in Chapter 4, which covers social development.

National government is now exclusively responsible for social assistance grants

The intergovernmental system depends largely on well co-ordinated policy, planning, budgeting, implementation and reporting. This is necessary both within spheres and between spheres and is effected at the technical, executive and legislative levels. The following intergovernmental forums play an important role in co-operative governance and in shaping national and provincial policy and resource allocation decisions:

A number of intergovernmental forums play an important role in co-operative governance

- *Extended Cabinet:* This is made up of the national cabinet, premiers of provinces and the chairperson of the South African Local Government Association (SALGA). It is the highest co-operative governance mechanism, advising the national cabinet when it finalises the fiscal framework and the division of revenue, on which MTEF budgets are based.
- *The President's Co-ordinating Council:* This is chaired by the President and comprises the nine provincial premiers, the chairperson of SALGA, and the national ministers responsible for cross-cutting functions such as provincial and local government affairs, public service and administration and finance. Other national ministers may be invited to participate.
- *The Budget Council:* This is established under the Intergovernmental Fiscal Relations Act (1997). The Minister of Finance and the members of the executive councils (MECs) responsible for finance in each of the provinces make up this body. The national and provincial spheres consult on any fiscal, budgetary or financial matter affecting provinces as well as any legislation that has financial implications for provinces.
- *MinMECs:* These are sectoral policy forums made up of the national ministers responsible for concurrent functions and their provincial counterparts.
- *Joint MinMECs:* These are sectoral meetings between selected sector MinMECs and the Budget Council.

- *Several intergovernmental forums:* These consist of senior officials which provide technical support to the political forums.

Key principles underpin the intergovernmental system

The following key principles underpin the intergovernmental system:

- *Accountability and autonomy:* Each sphere has specific constitutionally defined powers and responsibilities, is accountable to its legislature or council, and is empowered to set its own priorities. The power of national government to intervene in provincial and local government matters, and provincial governments to intervene in local government matters, depends on whether the relevant sphere fails to carry out an executive obligation.
- *Good governance:* Accountability of political representatives to the electorate and transparent reporting arrangements within and between spheres is at the heart of the intergovernmental system. While political executives are responsible for policy and outcomes, the head officials, functioning as accounting officers, are responsible for implementation and outputs.
- *Redistribution:* The three spheres all have important roles to play in redistribution, but because inequalities exist across the country, the redistribution of resources is primarily a national function. Where provinces and municipalities undertake redistribution, the challenge is to do this in line with their fiscal capacity and not to undermine economic activity and their financial viability. Redistribution among the three spheres is achieved through the process of the vertical division of revenue. Redistribution among provinces and municipalities is effected through their respective equitable share formulae.
- *Vertical division:* Determining allocations to each sphere inevitably involves trade-offs through a comprehensive budget allocation process, driven by political priorities, and which covers all aspects of governance and service delivery. Separate and *ad hoc* requests for funds fragment budget allocation and undermine the political process of prioritisation.
- *Revenue-sharing:* The fiscal system takes into account the fiscal capacity and functions assigned to each sphere. 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 which fail to collect revenue due.
- *Broadened access to services:* The Constitution and current government policy prioritises service delivery to all South Africans. The responsible spheres are expected to broaden access to services at affordable costs to consumers, design appropriate levels of service to meet customer needs, explore innovative and

efficient modes of delivery, and leverage public and private resources to acquire capital for investment.

- *Responsibility over budgets:* Each sphere of government has the right to determine its own budget, and the responsibility to comply with it. To reduce moral hazard and ensure fairness, national government will not bail out provinces or municipalities that mismanage their funds, nor provide guarantees for loans.

Intergovernmental fiscal relations

The design of South Africa's intergovernmental system is informed by the Constitution, which, among other things:

- establishes the three spheres of government as distinct, autonomous and interdependent.
- assigns powers and functions to the three spheres.
- prescribes revenue-sharing arrangements that are supposed to be equitable and transparent.

National transfers are used to address fiscal imbalances that exists between the three spheres of government

The current fiscal imbalances among the different spheres of government result in varying revenue-raising capacities. Intergovernmental transfers from nationally raised revenue are used to address these fiscal imbalances. To meet their expenditure responsibilities, provinces rely largely on national transfers which make up 96,4 per cent of total provincial revenue. At the same time, income and resource distribution imbalances that exist between provinces are addressed through a revenue-sharing model.

Instruments for sustainable intergovernmental fiscal relations

The following are key instruments in place to ensure transparent and sustainable intergovernmental fiscal relations:

Consultation on fiscal and financial matters, and legislation that impact on provinces

- *The Intergovernmental Fiscal Relations Act (1997)* provides the framework in which revenue is shared between the three spheres of government. It establishes the Budget Council which allows national and provincial spheres to consult on any fiscal, budgetary or financial matter affecting provinces as well as any legislation that has financial implications for provinces.

The Financial and Fiscal Commission oversees the vertical and horizontal division of revenue process

- *The Financial and Fiscal Commission (FFC),* an independent constitutional body, oversees the division of revenue process. It also makes recommendations to government for the vertical division of revenue among the three spheres of government and the horizontal division of revenue between provinces and municipalities. When tabling the national budget, government must show how the division of revenue for that year takes the FFC's recommendations into account.

The MTBPS allow for early engagement on the division of revenue before the tabling of the annual budget

- *The Medium Term Budget Policy Statement (MTBPS)*, now a permanent feature in the system, is a pre-budget policy statement, which gets released about four months before the budgets are tabled. Through the MTBPS, which is a culmination of interaction of the respective intergovernmental fora on financial and fiscal matters, government signals how it intends using public resources to give expression to its policies over the next three years. The MTBPS is the first signal of the division of revenue and the transfers from nationally-raised revenue to provinces over the next three years and the policy priorities that underpin them. Its early publication allow for early engagement on the budget before it is formally passed by Parliament.

Division of Revenue Act outline all national transfers to provinces and municipalities

- *The Division of Revenue Act* is required in terms of section 214 of the Constitution and must be accompanied by a memorandum, which explained how government had taken into account each of the factors set out in section 214(2)(a to j) for determining the division of revenue between the three spheres. The Act outlines all national transfers (conditional and unconditional) to provinces and municipalities and the rules that underpin them.

A thorough explanation of the division of revenue

- *Explanatory memorandum to the division of revenue* give effect to section 10 of the Intergovernmental Fiscal Relations Act which requires that the Division of Revenue Bill be accompanied by a memorandum that details how the annual division of revenue takes into account each of the factors set out in section 214(2)(a to j) of the Constitution, government's response to the annual recommendations of the FFC, and any assumptions and formulae used in arriving at the respective divisions among provinces.

Better planning framework

- *The Medium Term Expenditure Framework (MTEF)* details government spending plans over the next three years. It aims to ensure efficient financial and fiscal planning and management; provides a framework within which policy proposals can be assessed; more transparency in government; and a clear demonstration of how fiscal targets will be met.

Autonomy and accountability in public sector management

- *The Public Financial Management Act (1999)* seeks to promote good financial management through a modernised system of financial management; autonomy and accountability in public sector management; monitoring and reporting; and the elimination of waste and corruption.

Provinces have scope to expand their revenue base

- *The Provincial Tax Regulation Process Act (2001)* sets out a framework for provinces to introduce new taxes. A province contemplating a new tax submits a detailed tax proposal developed according to the guidelines that have been agreed to with the Minister of Finance. After examining the proposal and taking account of the recommendations of the Financial and Fiscal Commission, the Minister approves or disapproves the requested tax. So far, the Western Cape has been granted approval to introduce a fuel levy.

- *The Borrowing Powers of Provincial Governments Act (1996)* allows for borrowing by provinces. The Budget Council agreed that provincial borrowing would have to be linked to specific infrastructure programmes or projects; would not encumber any specific revenue stream for any funds borrowed, and the total amount of funds each province is allowed to borrow would be determined by its capacity to raise its own revenue, as well as the amount of funding it receives in the form of national infrastructure grants to provinces. To date, no province has borrowed under the recently agreed framework.

Provincial borrowing for capital projects

Provincial government finances

Table 1.1 provides the fiscal framework for the 2006 National Budget published in the *2006 Budget Review*. The vertical division of revenue reflects national government's policy role, and provincial and local governments' implementation role in service delivery. It is determined by the functions of each sphere, target population, inputs required for policy implementation and the fiscal capacities of each sphere.

Over 42 per cent of total government non-interest spending is through provinces

Provincial governments' budget makes up 42,3 per cent of total government expenditure and reflects this sphere's key role in the delivery of social services, including school education, health (academic and regional hospitals, as well as primary health care), social welfare services, housing and roads.

National transfers finance 96,4 per cent of provincial expenditure

Provincial budgets totalled R183 billion in 2006/07, comprising national transfers of R176,7 billion (96,4 per cent of total provincial revenue) and own revenue of R6,6 billion. Provinces also budgeted for a surplus of R211 million in 2006/07. The equitable share transfer, which is unconditional, with provinces having discretion on how it is allocated, is R150,8 billion or 85,3 per cent of national transfers. Conditional transfers are R25,9 billion or 14,7 per cent of national transfers.

Table 1.1 Division of nationally raised revenue, 2002/03 – 2008/09

R million	2002/03	2003/04 Outcome	2004/05	2005/06 Revised estimate	2006/07	2007/08 Medium-term estimates	2008/09
State debt cost	46 808	46 313	48 851	51 160	52 049	53 324	55 716
Non-interest expenditure	244 716	282 396	319 690	367 816	420 676	465 850	515 552
Percentage increase	*13,7%*	*15,4%*	*13,2%*	*15,1%*	*14,4%*	*10,7%*	*10,7%*
Total expenditure	**291 524**	**328 709**	**368 541**	**418 976**	**472 725**	**519 174**	**571 268**
Percentage increase	*10,9%*	*12,8%*	*12,1%*	*13,7%*	*12,8%*	*9,8%*	*10,0%*
Contingency reserve	–	–	–	–	2 500	5 000	8 000
Division of available funds							
National departments	**129 297**	**148 142**	**168 018**	**196 429**	**214 964**	**233 996**	**254 495**
Provinces	**107 317**	**122 673**	**137 836**	**154 528**	**176 679**	**196 351**	**217 481**
Equitable share	93 895	107 538	120 885	135 292	150 753	167 701	187 100
Conditional grants	13 422	15 135	16 951	19 237	25 926	28 649	30 382
Local government	**8 102**	**11 581**	**13 837**	**16 859**	**26 532**	**30 503**	**35 575**
Equitable share	4 187	6 350	7 678	9 643	18 058	20 076	22 775
RSC levy replacement					*7 000*	*8 000*	*9 000*
Conditional grants	3 916	5 231	6 159	7 215	8 474	10 428	12 801
Total	**244 717**	**282 396**	**319 690**	**367 816**	**418 176**	**460 850**	**507 552**
Percentage shares							
National departments	52,8%	52,5%	52,6%	53,4%	51,4%	50,8%	50,1%
Provinces	43,9%	43,4%	43,1%	42,0%	42,3%	42,6%	42,8%
Local government	3,3%	4,1%	4,3%	4,6%	6,3%	6,6%	7,0%

Source: Budget Review 2006

Chapter overview

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

- This *Introduction* covers the main features of the intergovernmental system and introduces the sectors covered in this *Review.*
- *Chapters 2, 3 and 4* deal with the key social services sectors: education, health and social development. Provinces play a key delivery role in these sectors, while national government takes responsibility for the policy function. Overall, the chapters show that while the share of these services in total provincial spending is stable at around 75 per cent, within social services the share of education grows to 58,2 per cent in 2008/09. Each sector's spending does, however, grow in real terms.
- *Chapter 5* deals with housing delivery and highlights alternative approaches to housing which seek to create sustainable communities.
- *Chapter 6* covers agriculture and land. The chapter identifies critical interventions required by provinces to ensure vital services

for supporting and developing commercial and subsistence farmers are in place. It looks at the impressive and rapid progress made in land restitution. The chapter highlights the steps taken to provide agricultural support to beneficiaries of the land reform programme.

- *Chapter 7* deals with roads and transport. Although budgets for such infrastructure are increasing, they still exceed the spending capacity of these departments. The chapter emphasises the need for more effective intergovernmental co-ordination. It also examines public transport and road safety.
- *Chapter 8* provides information on the 2006 provincial MTEF budgets, and also reviews provincial budgets and actual revenue since 2002/03. It shows that the 2006 budgets reinforce the real growth in provincial budgets and expenditure, which started in the last four years.

Annexures setting out provincial government financial and non-financial information is attached at the back of the *Review*.

Conclusion

This *Review* shows that provincial finances are stable and progress is being made in extending the outreach of pro-poor services. The *Review* also shows that despite this progress, further steps need to be taken to ensure that the quality of services improves. It further shows that, despite a well-functioning intergovernmental fiscal system, it is not sufficiently used to ensure the efficient use of resources in delivering public services, particularly to the poor.

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