1

Introduction

Introduction

This *Provincial Budgets and Expenditure Review* covers a period of exceptional turbulence in the world economy. The global financial crisis that began during 2008 has had far-reaching consequences for South Africa, most notably a sharp fall in employment from which the economy has yet to fully recover. However, sound management of public finances has enabled South Africa to avoid the most severe effects of the global crisis.

Sound fiscal management enabled South Africa to avoid the worst effects of the global crisis

Government continues to explore ways to grow the economy; ensure sustainable livelihoods; improve access to services; provide comprehensive social security; invest in human resource development and in community services; eradicate corruption; and entrench constitutional rights and good governance.

Provincial expenditure is closely aligned with the priorities expressed in government's 14 Outcomes. National transfers to provinces have grown rapidly in line with these priorities, from R205 billion in 2007/08 to R325.5 billion in 2010/11. In 2013/14, transfers amounted to R416.1 billion, and this is projected to rise to R508.3 billion in 2016/17. In practical terms, this has enabled provinces to expand access to social services, education and health in particular.

National transfers to provinces have supported expanded access to education and health

However, as this report highlights, expanded access has not always seen a commensurate rise in the quality of services provided, as evidenced by poor performance on a broad range of indicators. Improving the quality of public services, and achieving government's outcomes, are primary objectives over the medium term.

About the *Review*

This *Review*, the 13th report on provincial budget and expenditure trends, contains consolidated information on provincial government performance and projections for the period 2010/11 to 2016/17. Thus it is both a review of the recent past and a forward-looking document that forms part of National Treasury's commitment to budget transparency.

The Review provides the public and Parliament with a comprehensive perspective on the use of public funds

The *Review* provides the public, elected officials, policy analysts and public servants with information on the use of public resources. It gives Parliament and provincial legislatures a comprehensive perspective on what government is spending on provincial functions such as education, health, social development, human settlements, roads and agriculture. It also enables them to compare and benchmark provinces against one another in assessing the extent to which their budgets give effect to national priorities.

The *Review* has four broad objectives:

- To provide a consolidated picture of the financial performance and plans of provinces
- To assess the performance of provincial governments in providing critical social services and supporting economic growth through increased investment in strategic and economic infrastructure
- To assess the financial management capacity of provinces
- To highlight challenges, and the recommendations, possible solutions and policy initiatives designed to address them.

Sustainable communities, infrastructure delivery, compensation trends and financial management are key focus areas

Based on the reported trends, several observations can be made:

- Building sustainable communities remains a major issue. Since 1994, access to social and basic services has grown rapidly. The Department of Human Settlements reports that government has contributed to more than 3.7 million "housing opportunities" (a departmental measure that includes houses built or under construction, and subsidies approved). However, the sustainability of some of these communities is debatable.
- There is a continuing need to improve infrastructure delivery. Sharp increases in provincial capital budgets have not been matched by the quality of delivery mechanisms. Provinces need to absorb and entrench good practice in infrastructure planning, budgeting and implementation.
- Personnel expenditure trends should be examined. In 2013, approximately 1.96 million people were employed by the broader public service, accounting for 10.6 per cent of the labour force and 14.3 per cent of the employed population. The public sector wage bill has increased by more than 5 per cent above inflation every year since 2007/08, putting enormous pressure on the provincial fiscus.
- A comprehensive, coordinated initiative is required to bring about sound financial management across the public sector.

Provinces and national policy

The National Development Plan

Government's outcomes approach is designed to ensure that the public sector focuses on achieving real improvements in the lives of all South Africans. Provinces make important contributions to achieving the aims of the NDP, which are summarised in Table 1.1.

Table 1.1 The National Development Plan (NDP) in brief

By 2030

- Eliminate income poverty – Reduce the proportion of households with a monthly income below R419 per person (in 2009 prices) from 39 percent to zero.
- Reduce inequality – The Gini coefficient should fall from 0.69 to 0.6.

Enabling milestones

- Increase employment from 13 million in 2010 to 24 million in 2030.
- Raise per capita income from R50 000 in 2010 to R120 000 by 2030.
- Increase the share of national income of the bottom 40 percent from 6 percent to 10 percent.
- Establish a competitive base of infrastructure, human resources and regulatory frameworks.
- Ensure that skilled, technical, professional and managerial posts better reflect the country's racial, gender and disability makeup.
- Broaden ownership of assets to historically disadvantaged groups.
- Increase the quality of education so that all children have at least two years of preschool education and all children in grade 3 can read and write.
- Provide affordable access to quality health care while promoting health and wellbeing.
- Establish effective, safe and affordable public transport.
- Produce sufficient energy to support industry at competitive prices, ensuring access for poor households, while reducing carbon emissions per unit of power by about one-third.
- Ensure that all South Africans have access to clean running water in their homes.
- Make high-speed broadband internet universally available at competitive prices.
- Realise a food trade surplus, with one-third produced by small-scale farmers or households.
- Ensure household food and nutrition security.
- Entrench a social security system covering all working people, with social protection for the poor and other groups in need, such as children and people with disabilities.
- Realise a developmental, capable and ethical state that treats citizens with dignity.
- Ensure that all people live safely, with an independent and fair criminal justice system.
- Broaden social cohesion and unity while redressing the inequities of the past.
- Play a leading role in continental development, economic integration and human rights.

Critical actions

1. A social compact to reduce poverty and inequality, and raise employment and investment.
2. A strategy to address poverty and its impacts by broadening access to employment, strengthening the social wage, improving public transport and raising rural incomes.
3. Steps by the state to professionalise the public service, strengthen accountability, improve coordination and prosecute corruption.
4. Boost private investment in labour-intensive areas, competitiveness and exports, with adjustments to lower the risk of hiring younger workers.
5. An education accountability chain, with lines of responsibility from state to classroom.
6. Phase in national health insurance, with a focus on upgrading public health facilities, producing more health professionals and reducing the relative cost of private health care.
7. Public infrastructure investment at 10 percent of gross domestic product (GDP), financed through tariffs, public-private partnerships, taxes and loans and focused on transport, energy and water.
8. Interventions to ensure environmental sustainability and resilience to future shocks.
9. New spatial norms and standards – densifying cities, improving transport, locating jobs where people live, upgrading informal settlements and fixing housing market gaps.
10. Reduce crime by strengthening criminal justice and improving community environments.

Source: National Planning Commission

National and provincial functions

Provinces are primarily responsible for implementing nationally agreed policies on social services

The Constitution divides functions between national, provincial and local government. Some functions are concurrent and others are exclusive. Concurrent functions shared between national and provincial governments include school education, health services, welfare services, human settlements and agriculture. For these functions, national government is largely responsible for providing leadership, formulating policy, determining the regulatory framework and monitoring implementation. Provinces are mainly responsible for implementation in accordance with the national framework.

Similarly, each sphere of government is responsible for certain exclusive functions. In the case of provincial government, these functions include provincial roads and traffic.

Provinces play a central role in delivering services; improving the quality of services; reducing inequality; increasing investment in communities; ensuring sustainable livelihoods; developing skills needed for the economy; ensuring efficient government; combating corruption; and regional economic development.

Economic activity and employment

After the 1994 elections, South Africa began to fully reintegrate into the world economy. By the time the present fiscal system was established, various industries, particularly in the agriculture sector, had been deregulated, and state protection and support for many sectors had either ended or was in the process of being dismantled.

As democracy evolved, government faced a range of pressing needs, including establishing new institutions to address inequality and achieve redress. Despite the various economic policies and strategies that were adopted, economic transformation has lagged behind. Countries that have kept pace with the rapid evolution of technology and production are better placed to compete in the supply of materials and manufacturing of end-products.

Provinces' role in responding to global economic challenges needs to be explored

The role of provinces in this new context needs to be clarified and sharpened. The global economy rewards countries with flexible workforces and strong state institutions that respond rapidly to challenges and opportunities. Adaptable workforces are the products of strong basic education systems that produce high levels of literacy and numeracy. Provinces, which are responsible for basic education, play a central role in developing this platform.

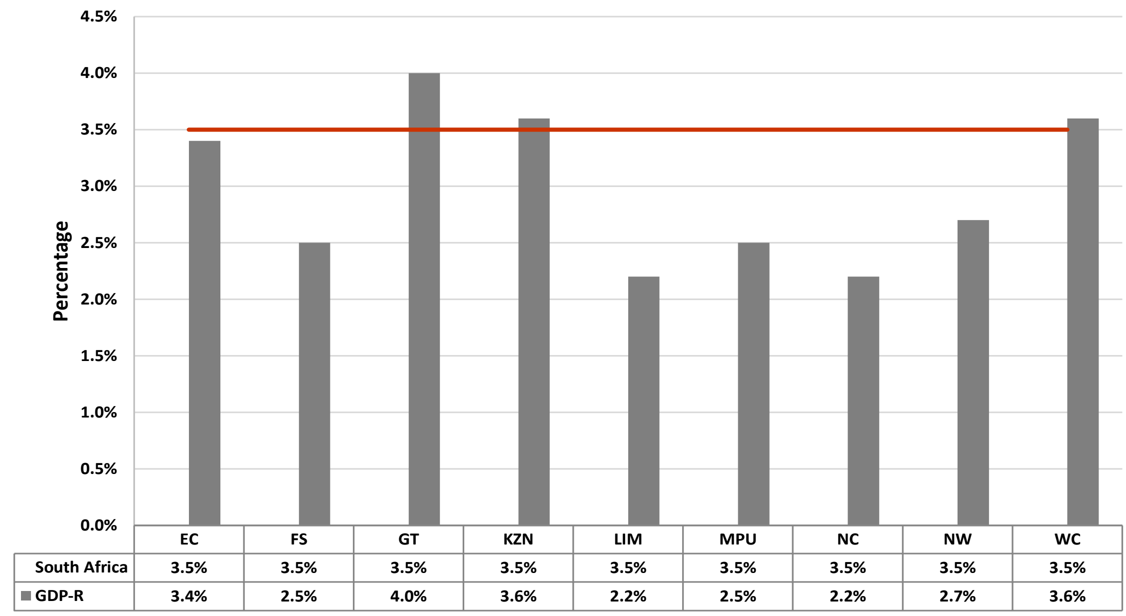
The level of competitiveness demanded by the global economy, however, requires both specialisation and concentration of economic activity that builds on regional strengths. The role of provinces in facilitating specialisation, and in providing the public goods and infrastructure that support economic concentration, needs to be clearly defined.

Economic activity

Economic activity in South Africa remains highly concentrated in a few regions. Figure 1.1 below shows real economic growth per province (with a comparison to national government) while figure 1.2 shows the contribution of each province to national gross domestic product (GDP).

Gauteng, KwaZulu-Natal and Western Cape account for more than 64 per cent of national GDP. The largest sectors are finance; manufacturing; government services; wholesale and retail; motor trade; accommodation; transport and related; and mining and quarrying. Together, these amount to 83 per cent of South Africa's GDP. Over 75 per cent of each of them (excluding government services) is concentrated in only three or four provinces.

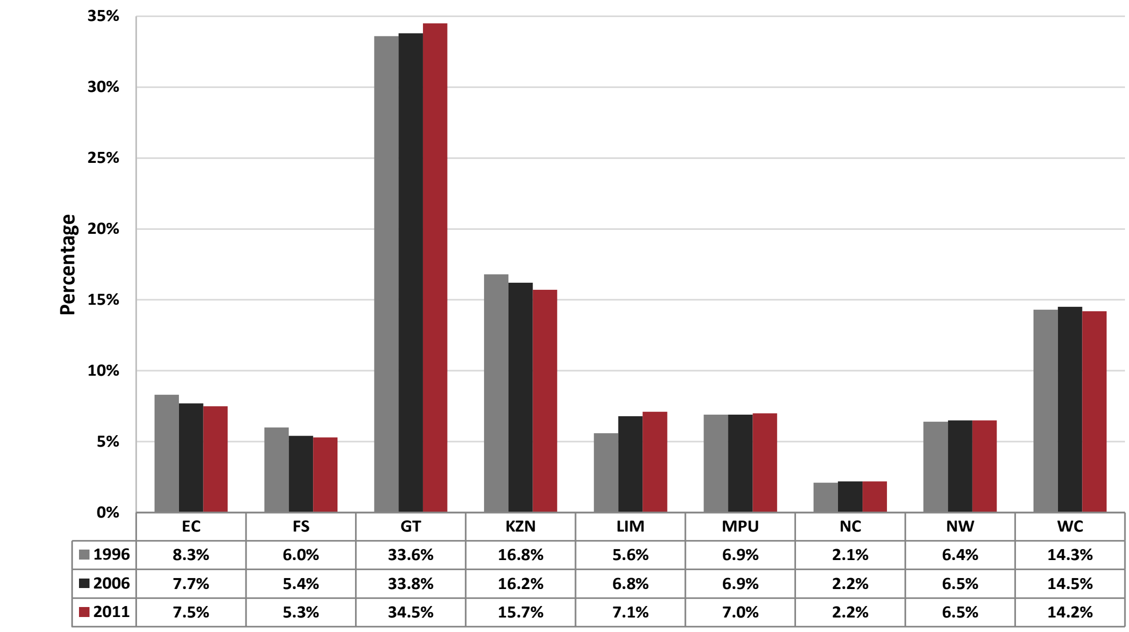
Figure 1.1 Real annual economic growth rate per region (GDP-R), 2011



	EC	FS	GT	KZN	LIM	MPU	NC	NW	WC
South Africa	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
GDP-R	3.4%	2.5%	4.0%	3.6%	2.2%	2.5%	2.2%	2.7%	3.6%

Source: Statistics South Africa

Figure 1.2 Contribution of each province to GDP, 1996, 2006 and 2011



	EC	FS	GT	KZN	LIM	MPU	NC	NW	WC
1996	8.3%	6.0%	33.6%	16.8%	5.6%	6.9%	2.1%	6.4%	14.3%
2006	7.7%	5.4%	33.8%	16.2%	6.8%	6.9%	2.2%	6.5%	14.5%
2011	7.5%	5.3%	34.5%	15.7%	7.1%	7.0%	2.2%	6.5%	14.2%

Source: Statistics South Africa

Since provinces receive more than 96 per cent of their income from national government (this is set to rise to over 97 per cent in 2016/17), their own revenues are not greatly affected by the size or growth of their economies. However, provinces with large economies are likely to have large populations, and this influences the amount of funding apportioned through the equitable share.

There is compensation for provinces whose roads are affected by coal haulage

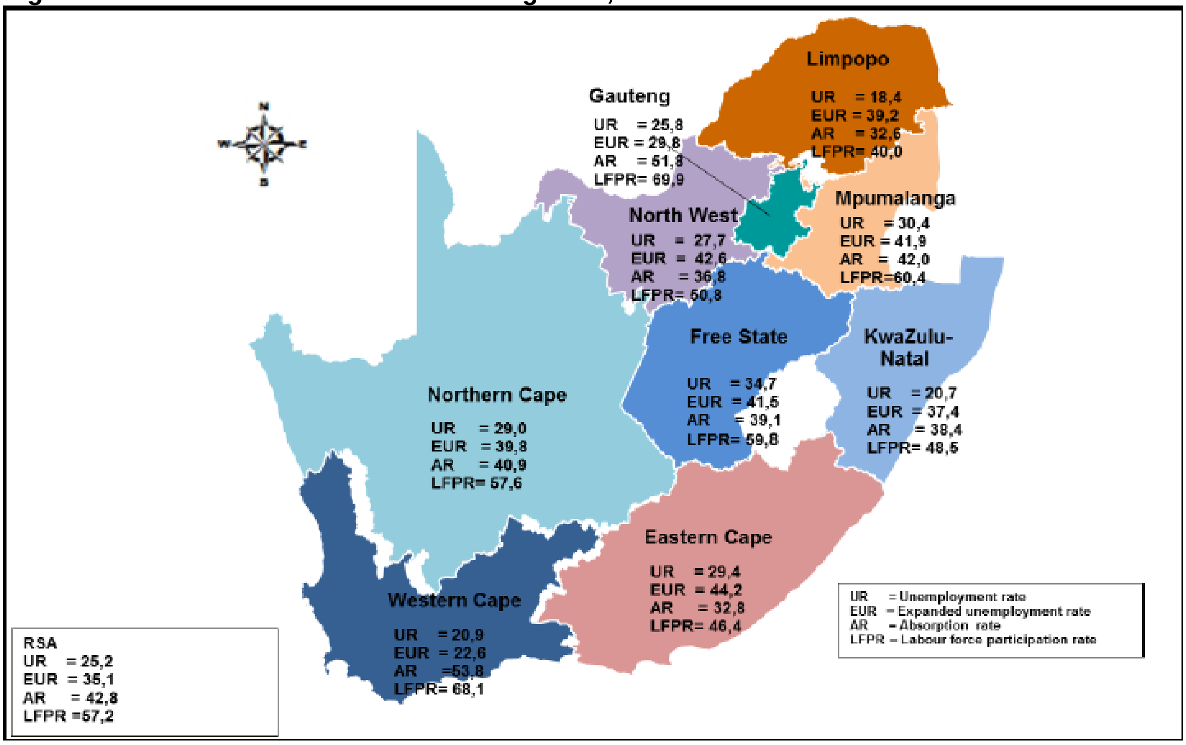
In some provinces, the structure of the economy has significant consequences for provincial expenditure. For example, the transport demands of mining and quarrying put a strain on roads. If these are provincial roads, there will be greater demand on a province's roads budget, but it will only receive a small share of the contribution to national GDP from mining through the provincial equitable share. In this instance, from 2011/12, provisions have been made to compensate provinces affected by coal haulage. Similar budget pressures arise in provinces with large agricultural sectors, which require support services.

Employment

Increases in unemployment place indirect pressures on provincial budgets

Figure 1.3 gives a snapshot of the labour market in each province. Due to the structure of transfers to provincial government, the direct effect of employment levels on provincial income is limited. But increases in unemployment do create budget pressures. For example, increased unemployment is likely to put greater demand on all social services.

Figure 1.3 Labour market measures at a glance, 2014



Source: Statistics South Africa: Quarterly Labour Force Survey (First Quarter 2014)

There is no direct correlation between the size of the labour force and the size of the poor population

As expected, the share of GDP closely follows the share of the national labour force. However, there is no direct correlation between the size of the labour force and the size of the poor population in each province. Gauteng and Western Cape have the largest labour force participation rate (LFPR), while the LFPR is lowest in Limpopo and Eastern Cape. In addition, the population in the Western Cape is about half the population of KwaZulu-Natal, yet their shares of GDP and the labour force are similar. Gauteng has the largest population, yet its poor population is smaller than the poor population of KwaZulu-Natal and is similar in size to the poor population of Free State.

Long-term data from Statistics South Africa's Labour Force Survey show that patterns of labour concentration largely mirror patterns of economic concentration. The Labour Force Survey from March 2012 and the first Quarterly Labour Force Survey for 2012 suggest that total national employment grew at an average annual rate of 2 per cent. Individual sectors, however, varied widely and changes were significant:

- Agriculture and related activities contracted at an annual average rate of 8.7 per cent
- Mining and quarrying shrank at an annual average 3.4 per cent
- Wholesale and retail grew at an annual average 2 per cent
- Transport and related activities grew at an annual average 4 per cent
- Construction expanded at an annual average 2.9 per cent
- Finance grew at an annual average 6.2 per cent.
- Community, social and personal services grew at an annual average 3.7 per cent.

Table 1.2 Relative size of provincial economies by industry, 2011

	Eastern Cape	Free State	Gauteng	KwaZulu-Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape
Agriculture, forestry and fishing	1.5%	4.3%	0.4%	3.8%	2.5%	2.8%	6.0%	2.1%	3.5%
Mining and quarrying	0.2%	13.3%	3.3%	1.9%	29.4%	24.9%	26.7%	33.6%	0.3%
Manufacturing	12.2%	8.5%	13.5%	15.8%	2.5%	11.5%	2.1%	4.4%	11.8%
Electricity, gas and water	1.4%	3.1%	2.4%	2.5%	2.8%	5.4%	3.0%	1.4%	2.0%
Construction	2.1%	2.0%	4.3%	3.0%	2.5%	3.3%	1.6%	2.6%	4.3%
Wholesale, retail and motor trading catering and accomodation	14.7%	12.3%	14.2%	15.5%	10.8%	10.3%	9.9%	9.3%	17.0%
Transport, storage and communication	7.9%	7.1%	8.3%	11.9%	5.4%	5.8%	7.8%	6.1%	9.1%
Finance, real estate and business services	18.6%	14.2%	22.8%	16.5%	14.0%	10.9%	11.6%	11.1%	26.6%
Personal services	9.1%	10.2%	3.6%	5.8%	3.8%	4.3%	8.1%	7.0%	5.1%
General government services	22.0%	14.7%	17.0%	13.3%	16.0%	10.5%	12.8%	12.1%	10.2%
All industries at basic prices	**89.7%**	**89.7%**	**89.8%**	**90.0%**	**89.7%**	**89.7%**	**89.6%**	**89.7%**	**89.9%**
Taxes less subsidies on products	10.2%	10.3%	10.1%	10.0%	10.3%	10.3%	10.2%	10.3%	10.0%
GDP at market prices	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: Statistics South Africa, GDP estimates 2011

Table 1.2 illustrates the relative size of each industry in each province at the time of Census 2011.

Fiscal context

Provinces receive three forms of revenue, including own revenue

Provinces receive three forms of revenue: the provincial equitable share, provincial conditional grants and own revenue. During the national budget process, Cabinet approves a division of revenue that determines the share of nationally raised revenue that each sphere of government will receive. In broad terms, the relative financial value of the transfer expresses the relative political priority attached to the functions performed by that sphere of government.

The provincial equitable share is transferred directly from the National Revenue Fund to provinces. Conditional grants are transferred by the national department responsible for that particular grant. For example, the Department of Health transfers the comprehensive HIV and AIDS grant directly to provinces.

Provincial equitable share

Provincial equitable share accounts for 81.2 per cent of transfers to provinces

The provincial equitable share is allocated among the nine provinces through an objective formula. In 2013/14, the provincial equitable share accounted for 81.6 per cent of national transfers to provinces. The formula consists of six components, each weighted differently. Unlike conditional grants, no conditions are attached to the equitable share transfers.

The provincial equitable share formula is based on a set of objective criteria

The structure of components in the formula recognises the expenditure assignments of provinces. For example, provinces are assigned the education function, and the education component uses enrolment in schools, because each province's share of learners should be a reliable indicator of their share of national expenditure on basic education. The education component is shared according to each province's share of enrolled learners and of the school-going age cohort of the population (5- to 17-year-olds). A new health component was introduced in the 2011 Budget that weights a health-risk-adjusted profile of a province's population against the patient load in provincial hospitals. The weights of the health and education components are not indicative of what provinces should spend in these sectors and cannot be used to influence provincial budgets, regardless of whether the value of the component grows or shrinks.

The basic component is the next largest share of the formula, at 16 per cent. Provinces receive their share based on their portion of the national population. The institutional component is 5 per cent of the equitable share and is shared equally across provinces. The institutional component recognises that predominantly rural provinces have to cover the larger unit costs of service delivery associated with dispersed populations.

The poverty component is 3 per cent of the equitable share and is apportioned according to each province's share of the two poorest national quintiles (in other words, the poorest 40 per cent of the population) according to the 2005 income and expenditure survey. Finally, 1 per cent is shared out based on each province's contribution to GDP. While the formula recognises that demographic profiles and the size of the regional economy create certain budget pressures on provinces, the individual components of the formula do not fund any specific provincial activities.

Provinces have discretion to prioritise programmes, making the most of opportunities to maximise interdependencies

Provinces have discretion to prioritise programmes, making the most of the opportunities provided by the simplicity of the formula, the interdependencies that exist between services and the reduced pressure on budgets that will be created by effective service delivery. A province that prioritises preventative health care, strengthens primary health care and promotes health education at schools, for example, is likely to reduce the burden placed on its health system. Patient visits will decline, but the financial value of the health component of the provincial equitable share will not decline as much, freeing resources for other purposes.

Most components of the provincial equitable share formula are updated annually. The components are driven by demographics. So the formula responds to population migration, one of the most significant cost components in provincial services, albeit with a time lag.

Conditional grants

Conditional grants account for 18.8 per cent of transfers to provinces

In 2013/14, conditional grants accounted for 18.4 per cent of national transfers to provinces. Conditional grants are introduced for specific purposes. Grants currently in the system:

- Fund the transfer of functions from or to provinces
- Provide incentives for job creation
- Protect funding for national priorities and new services
- Compensate for cross-boundary flows
- Protect funds for disasters.

Preferably, conditional grants should be associated with defined time periods during which they are phased into the provincial equitable share or terminated. Only grants that compensate for cross-boundary flows, or which protect funds for disasters, should exist indefinitely. After the grants are phased into the provincial equitable share, national departments should use norms and standards or policy frameworks to ensure that provinces achieve the objectives of the grant.

Fiscal outlook

Sound management of the fiscus helped government stabilise the economy in the face of the global downturn

Sound management of the national finances enabled South Africa to respond with strong measures to stabilise the economy in the face of the global economic storm that struck in 2008. In 2007/08 the national budget surplus was 1.7 per cent of GDP. As a result of this surplus, government could respond with measures to help stimulate the economy and sustain expenditure on key social programmes, bringing the national budget to a deficit of 6.6 per cent of GDP in 2009/10. The increased deficit was funded through borrowing. While the economic recovery has been uneven, government needs to ensure that growing debt-service costs do not crowd out core economic and social expenditure.

Over the 2014 medium-term expenditure framework (MTEF) period, transfers to provinces are projected to continue to grow in nominal terms, at an average annual rate of 6.9 per cent, from R416.1 billion in 2013/14 to R508.3 billion in 2016/17. Most additions to the budget baseline are focused on dealing with wage agreements, as well as priorities in education and health. Over the 2011 MTEF, the emphasis in education was on eradicating backlogs in school infrastructure and ensuring that provinces can cover the cost of wage agreements. Over the 2012 MTEF, the emphasis was on Grade-R and no-fee schools. In health, the emphasis is on stabilising the sector for the implementation of national health insurance. These additions are aligned with the role of provinces in achieving government's priority outcomes.

Social trends

Migration is generally towards provinces with large economies

Over the past 40 years, the world has seen a sharp increase in urbanisation. South Africa is no exception to this trend and its consequences, which have become more pronounced over the past decade. There has been significant migration into Gauteng and Western Cape – and to a lesser degree into KwaZulu-Natal – and significant migration out of all other provinces.

In the short term, the impact of urbanisation on provincial government is not as pronounced as it is for local government. Municipalities have to expand basic services such as water and sanitation to meet the needs of growing populations, but because most migrants are job seekers and generally out of school, this trend affects fewer provincial services. In the longer term, as new communities are established and children are born, the impact of migration on provincial education and health expenditure will become more noticeable.

HIV and AIDS continue to have a major impact on provincial expenditure

Data from Human Sciences Research Council surveys in 2002, 2005 and 2008 point to a declining trend in new HIV and AIDS infections. Government has also made significant gains in the provision and effectiveness of treatment and prevention programmes. Yet given the scope of infection, HIV and AIDS continues to exert a large influence on provincial expenditure and planning. The pandemic creates direct pressures on health budgets for prevention and treatment, increases the workload for social welfare services and affects the well-being of provincial workforces. Accordingly, the comprehensive HIV and AIDS conditional grant grows from R10.5 billion in 2013/14 to R15.7 billion in 2016/17. This does not include an additional R1 billion that was included in the provincial equitable share in 2013/14 for this priority.

Evolving fiscal system

The provincial equitable share formula and conditional grants are part of an evolving fiscal system. Each year, the formula and the grants are reviewed and adapted to align them with provincial fiscal reforms. For example, incentive grants that reward provinces for creating jobs through labour-intensive projects were introduced in 2009/10. The management of infrastructure conditional grants was changed in the 2011 Budget. Provinces are now required to publish three-year infrastructure project lists and must follow standards identified by the Construction Industry Development Board. These changes seek to improve oversight and encourage provinces to follow best practices in infrastructure planning. In addition, beginning in the 2013 MTEF, provincial allocations for infrastructure are no longer made upfront or on the basis of increments to previous allocations. The quality of plans, the readiness of departments in respect of their capacity and compliance with project management requirements will play a key part in determining which provinces receive an allocation for infrastructure. This will address the long-running challenge of poor spending and poor performance, as well as the moral hazard inherent in a guaranteed allocation.

The main sources of provincial own revenues are car licences, gambling taxes, hospital fees and liquor licences. Revenue assignments such as these to provinces allow them to raise additional funds for discretionary purposes.

Given the need to expand health services, improve and expand infrastructure in education, and eliminate large backlogs in road maintenance, there is a need for additional revenue in provincial budgets. Provinces can only make use of additional taxes and fees by displacing existing revenue sources elsewhere in the intergovernmental system. While the distribution of economic activity, and therefore of the potential to raise revenues, is uneven, the need for social services is widespread. This creates a need for redistributive mechanisms and limits the scope to devolve additional revenue-raising powers to provinces.

There is little scope to devolve additional revenue-raising powers to provinces

Interdependence

While the functions of provinces are assigned in the Constitution, their effectiveness depends on a wide range of factors over which they have varying degrees of control.

Provinces' effectiveness depends on a wide range of factors over which they have varying degrees of control

The successful implementation of any one provincial function is influenced by the others. The impact of a health awareness campaign, for example, will be influenced by literacy rates and the quality of houses that people live in. The ease with which sick people access hospitals is affected by the extent to which a province has provided and maintained roads, particularly in rural areas.

The links between provincial and municipal functions also have a material impact, and provinces have a strong interest in supporting and monitoring the performance of their municipalities. Local governments are responsible for providing basic services such as electricity, water and sanitation, and many municipalities also implement housing projects on behalf of provinces. Provincial policies are implemented at local level: schools and clinics are built within municipal boundaries, and municipalities provide them with water, electricity and sanitation.

The effectiveness of local government makes the provision of provincial services possible. Teaching at schools, treatment at hospitals and support to farmers all require clean water and a reliable electricity supply from municipalities. The cleanliness of cities and towns influences the rate at which diseases are prevented or spread, with consequences for provincial health care.

The success of rural development initiatives hinges on the strength of rural institutions. Farmers supported by provincial agricultural programmes are likely to use provincial roads to transport their produce to markets, which in turn are reliant on municipal services. If links to markets are not functional, development initiatives will fail.

Success of rural development hinges on the strength of provincial and municipal institutions

Interprovincial linkages affect services and planning. Many people travel long distances to access tertiary health services (specialised consultative services and facilities) in other provinces, especially when the quality of tertiary care in their province of residence is poor. Provinces should use referral systems so that clinics are the first point of access to the health system. Patients needing further treatment will be referred to a tertiary or district hospital. A proper referral system is needed for an efficient public health system, because it is much more expensive to see a patient at a tertiary or district hospital than a clinic. A province that implements a referral system, when a neighbouring province does not, will bear additional costs.

There are significant policy and service interdependencies between provinces and national government. Well-maintained roads are used, and badly maintained roads are avoided, without regard to whether they are a national or provincial responsibility. The avoidance of poorly maintained roads increases maintenance costs on alternative routes and takes business away from the original routes.

Provinces' social development services are affected by national competencies

Social development services provided by provinces rely to a large extent on the quality of policing and efficient judicial services, which are national competencies. Social workers spend a great deal of time dealing with the consequences of domestic violence. Their work depends on sensitive and responsive policing, which in the past was provided through specialised policing units.

The ability of tertiary institutions to produce graduates capable of entering an increasingly competitive job market depends on the quality of teaching provided by provincial schools, all the way back to early childhood development.

Aligning provincial programmes with national priorities

The Constitution enables national government to ensure that provinces implement national policies in line with defined norms and standards. This feature of the intergovernmental system, along with the funding of social services through an unconditional transfer to provinces, is in line with international best practice.

An effective intergovernmental system requires institutional capacity at various levels, most critically in national departments and provincial treasuries.

National departments need to be able to interact with the provinces, set policy norms and standards, and provide support. In addition, national departments must have the capacity to monitor how provinces are complying with policy norms and achieving required standards of performance. This requires sufficiently skilled staff to visit provinces to observe and ensure compliance.

Adequate capacity in provincial treasuries can help ensure that budgets achieve desired outcomes

Provincial treasuries provide financial management support to provincial departments, and ensure that resources added to the provincial equitable share and conditional grants are allocated in budgets as intended by national government. This requires treasuries to have an understanding of the context in which policies are implemented, and the processes that must be planned for and followed to achieve policy objectives. There are competing demands for provincial resources, and the treasuries need both hard and soft skills to ensure that funds are allocated in ways that best serve the policy interests of the country as a whole.

These factors underline the need to strengthen public financial management capacity in provincial departments.

Expanding and institutionalising financial management capacity and the necessary systems in treasuries and line departments should lead to improved service delivery and value for money. Managers and decision makers in line departments need to grasp a wide range of financial management factors when planning and implementing programmes – from supply chain management to contract management, cost and cash management.

Chapter overview

This *Review* has 11 chapters:

- Chapter 2 discusses trends in provincial revenues and expenditure for the seven-year period covered in the *Review*. The trends show that despite the less favourable fiscal outlook, there is still growth in national transfers to provinces, laying a solid foundation for real growth in provincial spending.
- Chapters 3, 4 and 5 analyse trends in expenditure in the social sectors of education, health and social development. Government policy and spending initiatives have successfully ensured greater access to these services. Equity and equalisation of spending is improving, but outcomes are not improving at a commensurate rate.
- Chapter 6 examines human settlements funding and delivery. It shows that over the life of the housing programme, 3.7 million "housing opportunities" have been delivered.
- Chapter 7 covers roads and transport. Increased investment in roads infrastructure will contribute to the faster movement of goods, people and services, reducing the cost of doing business.
- Chapter 8 reviews the role of public works as it relates to engineering and construction of infrastructure, and the management of government's fixed assets.
- Chapter 9 discusses agriculture and land issues. Some 5.4 million hectares have been redistributed under the auspices of the restitution and redistribution programmes, benefiting 1.73 million households. Support for emerging farmers is also expanding.
- Chapter 10 looks at environmental affairs and biodiversity management.
- Chapter 11 provides an overview of provincial employment statistics, and highlights leadership and management challenges.
- Chapter 12 looks at capacity building to support improvement in the planning, procurement and management of infrastructure delivery at the provincial level.