Financial and Fiscal Commission

Submission for the Division of Revenue

2008/09

Recommendations

FFC Review: Equitable Sharing Mechanisms

May 2007

FINANCIAL
AND FISCAL
COMMISSION

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For an Equitable Sharing of National Revenue

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Annexures

Abbreviations

ASGISA	Accelerated and Shared Growth Initiative for South Africa
BAS	Basic Accounting System
CGE	Computable General Equilibrium
CMBS	Constitutionally Mandated Basic Services
DoR	Division of Revenue
DORA	Division of Revenue Act
DPLG	Department of Provincial and Local Government
EMS	Emergency Medical Service
FAO	Food and Agricultural Organisation
FFC	Financial and Fiscal Commission
GEPF	Government Employees Pension Fund
GDP	Gross Domestic Product
ICT	Information and Communication Technology
IDP	Integrated Development Plan
IGFR	Intergovernmental Fiscal Relations
IO	Input Output
LEA	Local Equitable Allocation
LSM	Learner Support Materials
LOC	Local Organising Committee
MEC	Member of the Executive Council
MFMA	Municipal Finance Management Act
MinComBud	Ministerial Committee on the Budget
MPL	Member of Provincial Legislature
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
MPSA	Minister of Public Service and Administration
NCOP	National Council of Provinces
NHLS	National Health Laboratory Service
NSNP	National Schools Nutrition Program
PEA	Provincial Equitable Allocation
PES	Provincial Equitable Share
PFMA	Public Finance Management Act
PIM	Perpetual Inventory Methodology
PHC	Primary Health Care
PSA	Public Service Act
SA	South Africa
SACMEQ	South African Consortium of Monitoring Education Quality
SAM	Social Accounting Matrix
SAPS	South African Police Service
SASSA	South African Social Security Agency
TCF	Technical Committee on Finance
UNESCO	United Nations Education and Scientific and Cultural Organisation
WHO	World Health Organisation

Foreword

Review of the equitable sharing mechanisms and policy instruments is the underlying theme of the Commission's 2007 recommendations. Public finance policy discussion in Parliament and the Budget Council in the 2006/07 fiscal year was dominated by questions of equitable sharing of nationally collected revenue to meet the twin challenges of providing public services while at the same time financing infrastructure investment to stimulate economic growth and development. Prominent in this discussion was how to accommodate the hosting and financing of the 2010 Fifa World Cup. For the Budget Council discussion in early 2006 the important issue was whether financing the 2010 Fifa World Cup event and its associated infrastructure projects would compromise the ability and capacity of government to provide on-going public services. The debates also highlighted the dilemma of targeting the eradication of economic disparities and poverty while simultaneously promoting growth, development and the efficient delivery of services.

Chapter 13, Section 214 of the Constitution is explicit in its prescription that nationally collected revenue should be equitably shared such that the spheres of government are able to provide basic services and perform their functions. For the Financial and Fiscal Commission (FFC) the key task in equitable sharing is balancing the imperatives of providing constitutionally mandated basic services (as required in the Bill of Rights) against the conditions specified in Section 214 (2) of the Constitution.

Over the 2005/06 period Parliament Finance Committees and the Budget Council requested that the Commission pay particular attention to such matters in its future recommendations. Following from these requests this 2007 Submission makes recommendations and observations from the FFC review of key policy decisions likely to impact on the equitable sharing of national revenue amongst the three spheres of government. Part A of this Submission covers recommendations for the 2008/09 Division of Revenue. From a macroeconomic and public finance perspective the 2007 submission makes several observations and recommendations on the impact of the 2010 Soccer World Cup.

An issue consistently raised by the Parliamentary Select Committee on Finance was the inequitable allocations of funds for the National School Nutrition Programme. Currently the programme covers children in primary schools. There is a growing recognition that the exclusion of deserving children from secondary schools compromises the principle of equity - especially if these children are from the same household or community as beneficiaries from primary schools. Based on its own empirical research the Commission makes several recommendations for the extension of the Programme to cover secondary schools.

The principle of equity is also the subject of the Commission's review of the financing of school infrastructure; learner support material and schools exempt from collecting school fees. The Commission makes several observations and recommendations for the equitable financing of these programmes to achieve optimal education outcomes.

Roads, transport infrastructure and housing delivery are functions that are concurrently provided by all three levels of government. Apart from the operational and management shortcomings all levels of government are faced with the challenges of equity in financing infrastructure given the competing claims for promoting economic development and eradicating economic disparities. The Commission has undertaken research in these areas and presents some recommendations for consideration.

During the course of the 2006/07 fiscal year the Commission submitted four supplementary sets of recommendations to Government and Parliament. These are presented in Part B. The supplementary submissions covered the Commission's comments on the fiscal requirements applicable to windfall profits; National Treasury's draft framework for assessing market based instruments to support environmental fiscal reform; the Municipal Fiscal Powers and Functions Bill and, the fiscal implications of the re-demarcation of provincial boundaries. The submissions in this section also have implications for equity and the equitable sharing of national revenue.

As intergovernmental fiscal relations in South Africa continue to evolve the Commission recognises the need to equip itself for providing deeper analyses and more informed recommendations on mechanisms and policy instruments for the equitable sharing of national revenue. In Part C the Commission presents some initial results from its analysis of spending performance by provinces. The intention in this regard is to suggest some way for improving spending performance and capacity of provincial departments charged with delivering constitutionally mandated basic services. Secondly, Part C discusses two analytical methods that the FFC will use to inform its recommendations research in the future. The first analytical tool is an economic model for reviewing the vertical and horizontal equitable sharing of national revenue. The second, is a framework for assessing function shifts in South Africa's intergovernmental fiscal relations system. The annexure section of the submission documents the detailed technical aspects of the submission.

The Commission's research and reviews drew on the knowledge and insights of many government and parliamentary stakeholders and independent technical advisors. The Commission is grateful to all Ministries, government departments, members of intergovernmental fora and parliamentary committees for their valuable comments. The Commission also acknowledges the significant contributions of technical advisors Prof Jeff Petchy, Prof Garry MacDonald, Mr. Benoit Verhaegher, Prof. Jackie Walter and Dr. Moster Vaughan, Prof. Servaas van der Berg, Prof. Andrew Reschovsky, Prof. Oludele Akinboade and Dr. Nicholas Crisp.

Part-time and full time commissioners play a vital role in providing supervision, direction and peer review as members of research project task teams and participants at research seminars. This 2007 submission reflects only the summarised background, findings and recommendations for the 2008/09 Division of Revenue. At the request of many government and parliamentary stakeholders, and in the interests of stimulating debate, the Commission will publish in separate volumes the technical research reports on which these recommendations are based.

In conclusion, the Commission would like to express its gratitude to the Programme Managers and Researchers of the Recommendations Research Programme (RRP) and the Executive and administrative staff of the Secretariat for their commitment, dedication and efficiency in producing this submission. The Commission would also like to thank the Australian Development Agency

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(AUSAID) for its co-sponsorship of the research into the development of the economic CMBS model. This model will be published as a separate volume.

As Commissioners and the Executive of the Financial and Fiscal Commission we, the undersigned, having considered the proposals at a meeting of the Commission held on 28 March 2007, hereby submit these Annual recommendations to Parliament in accordance with the obligations placed upon us by the Intergovernmental Fiscal Relations Act (1997) and the Constitution of the Republic of South Africa.

Commissioner	Dr. Bethuel Setai
Commissioner	Jaya Josie
Commissioner	Antony Melck
Commissioner	Kamalasen Chetty
Commissioner	Tania Ajam
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Commissioner	Martin Kuscus
Commissioner	Risenga B. Maluleke

For and on behalf of the Commission

Chairperson	Dr. Bethuel Setai
Deputy Chairperson	Jaya Josie

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Executive Summary

Section 220 of the Constitution establishes the Financial and Fiscal Commission (FFC) as an independent and impartial statutory body. The Constitution mandates the Commission to make recommendations on the vertical division of nationally raised revenue among the three spheres of government, the horizontal division of revenue among provinces and among municipalities. Furthermore, the Commission is required to make recommendations under legislation pertaining to the issuing of loan guarantees by the three spheres of government, provincial tax legislation, municipal fiscal powers and functions; and provincial and municipal borrowing powers (Sections 214, 218, 228-230).

Following Sections 214 and 222 of the Constitution, Section 9 of the Intergovernmental Fiscal Relations Act (1997) provides for the Commission to make annual recommendations to Parliament and the Provincial Legislatures on the vertical and horizontal division of revenue; Section 10 requires that Government considers the Commission's recommendations. In performing its functions, the Commission takes into account the factors listed in Section 214(2) [a-j] of the Constitution and the provisions in the Bill of Rights in Chapter 2 of the Constitution. This executive summary presents the main recommendations, observations and comments of the Commission. Part A presents recommendations and advisories for the 2008 Division of Revenue. Part B is a summary of the Commission's supplementary Submissions made in the cause of the 2006/07 period. Part C presents analyses of provincial spending and two analytical methods developed by the FFC. The methods will be used for future recommendations research.

Part A: Recommendations and Advisories for the 2008 Division of Revenue

1. *Observations and advisories on the economic impacts of the 2010 Fifa World Cup*

   From a general public funding perspective, the financing of 2010 Fifa World Cup by the South African government does not negatively impact on considerations in section 214 (a-j) of the Constitution. More specifically, however, the Commission would like to submit the following observations and advisories given the likelihood of negative effects on some macroeconomic balances:

   - Government's fiscal policy stance should continue to be focused on meeting the long-term objectives by ensuring that the overall budget deficit does not exceed 3% of GDP. However, in the event of major unforeseen shocks that may lead to overheating Government has the stabilizing option of fiscal policy intervention to support monetory policy.
   - Government could also maintain the budget deficit at the required level by stimulating household savings.
   - Government financing of 2010 Fifa World Cup will have a negative impact on the current account trade balance. However, the current account imbalance implied by the envisaged 2010 Fifa World Cup expenditure should not be viewed as a threat since a large portion of this trade deficit is a result of infrastructure investment.
   - Rising inflation is likely to present a real threat. Essentially monetary concerns arise from impacts on balance of payments and nominal exchange rate movements as a result of the

2010 expenditure. The Commission believes, however, that increases in inflation driven by such causes do not justify an increase in interest rates.

- With respect to project management the Commission would like to highlight the possible public finance risks of cost overruns and project delays. The impacts of these risks have the potential to cause uncertainty and affect investment confidence in the country and the region. The increase in costs of materials during the construction phase might increase the magnitudes of the projects themselves. Project delays can in turn, increase interest rate risks.
- The Commission believes that the legacy effects of hosting the World Cup should be properly addressed, costed and financed. In its research the FFC identified specific legacy effects, namely: increased economic investments, football and sport development, human capital development, social and political development, infrastructure and technology development. These can be location specific or countrywide. However, there is not as yet an explicit commitment of resources by the government spheres to facilitate the sustainable realisation of these effects.

  The Commission proposes two approaches for sustaining the positive legacy effects of the 2010 World Cup:

  - The first is to appoint a national agency to oversee the legacy effects of a national character. In keeping with prudent macroeconomic behaviour that has characterised government policy thus far, it is recommended that household saving be stimulated and be seen as the main source of funds to finance such projects.
  - The Commission recommends, secondly, that the location specific legacy effects be left in the hands of hosting cities. As legacy benefits accrue to the City it is recommended that the City fund these from their own revenue sources.

2. *Extending the National School Nutrition Programme (NSNP) from Primary to Secondary Schools*

- All Provincial Education Departments (PEDs) should adopt and entrench the NSNP as their full responsibility.
- PEDs must engage the necessary personnel with appropriate skills levels for the implementation of the programme. PEDs should address the following as a step towards extending the programme from primary schools to secondary schools:
  - Budget allocations for the NSNP in primary schools should be increased in order to cover learners that are presently not covered. The present situation is such that a number of learners in primary schools are not covered by the programme.
  - It is necessary to boost both personnel numbers and skills levels in order to improve the implementation of the programme.
  - PEDs should begin implementing the NSNP in schools that have been declared "no-fee-schools" by the Minister of Education. Presently, the "no-fee-schools" policy deals with learners attending school in quintiles 1 and 2. Typically, these are schools serving poorer communities with greater numbers of deserving learners.
  - The National Department of Education should develop national norms and standards to guide the implementation of the NSNP in the country. Presently, there are no uniform

national minimum norms and standards for the NSNP. The lack of such norms could encourage inequity in the implementation of the programme.

- The National Department of Education should ensure that the quality of information is improved. The information obtained would be useful in the planning and budget processes of the NSNP.
- Where necessary, PEDs should supplement the NSNP conditional grant with funds from their respective budgets. Presently, this is the case in the Northern Cape.
- Where necessary, improvements in procurement procedures should be undertaken.
- Improvements in kitchen equipment and infrastructure in all provinces require particular attention.
- Improvements in the monitoring and evaluation capacity of the NSNP are vital in order to address difficulties that arise in the course of implementation.
- Increase the number of feeding days beyond the prescribed minimum.
- In certain provinces, increase the per learner per day feeding amount.

3. *A Review of the Financing of School Infrastructure and Education Outcomes*

The Provincial Infrastructure Grant (PIG) has indicative proportions for backlogs in education, health, roads and agriculture. However, in practice, actual allocations are not directed to these functions. In one province 100% of the fund in one year was allocated to only one sector. A new and improved Register of School Needs would enhance the targeting of the education component of the grant.

There are still schools with no sanitation and electricity. Coordination of planning between the Municipal Infrastructure Grant (MIG) funded infrastructure outside the school and in the school premises is critical to deal with sanitation and electrification challenges. The absence of coordination of plans undermines the functioning of school infrastructure. The existence of a school library with no books also does not serve any useful purpose.

Based on the above observations the Commission recommends:

- That the conditions of the PIG targeting educational infrastructure specify the requirement for provinces to use such funds to support development of infrastructure in areas with need and where it is most likely to improve school outcomes.
- That effective coordination of planning for the various provincial and municipal infrastructure grants be instituted as a matter of urgency to ensure optimal outcomes from school infrastructure investment.

4. *The Financing of Learner Support Materials (LSM) and the No-Fee school Policy*

Non-personnal-non-capital (NPNC) classification for LSM is unclear and inconsistent across provinces contributing to low levels of budget allocations for some provinces. Although the situation has improved in recent years the FFC research indicates serious shortages of textbooks and stationary as a result of low prioritization and inadequate funding. As LSM contributes to education outcomes the Commision proposes:

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- that LSM should be defined clearly and should mean stationery, textbooks, learner and teacher aids. Curriculum 2005 demands a well resourced classroom that should ideally include LSM such as textbooks for each learning area and other print based materials like atlases, dictionaries, stationery, and teaching equipment such as maps, charts and globes. International literature defines LSM as textbooks, stationery and reference books.
- a separate budget for textbooks, stationery, learner and teacher aids. This would help in monitoring and identifying how much was budgeted and spent in each area and help identify problems.
- a separate budget for maintenance, repairs and equipment.

In supporting the financing of the "No-Fee" school policy the Commission proposes that funding should be equitable and adequate to cover all the operations of the schools. The startng point to realize the goals of basic education for all is to provide primary education that is free and compulsary and, school fee exemptions only for deserving secondary learners. Taking this into account the Commission makes the following comments:

- Currently the FFC is reviewing the PES, hence it would consider the education component so that it reflects the socio economic profiles of learners with particular reference to the impact of income inequality and poverty.
- In addition the FFC proposes the setting of norms and standards that indicate the level of knowledge and skills that learners are expected to have acquired at various ages and stages within the schooling system.

5. *The Financing of Roads and Transport Infrastructure*

Currently not all provinces have good road management systems that are necessary in ensuring the accurate capturing of data on road conditions. In the absence of good data on the conditions of roads, funding will not go where it is most required. The Commission therefore proposes that:

- All provinces should put in place more effective road management systems that will ensure that they are able to gather accurate data on road conditions and use this information in their road spending priorities.

Unless the ongoing needs of provinces towards road maintenance are explicitly considered in the comprehensive review of the PES, the condition of provincial roads will continue to worsen and the cost thereof rise exponentially. The Commission therefore recommends that:

- The impending review of the PES formula should consider provincial road expenditure needs and should be reconfigured in a manner that enables provinces to fund their maintenance needs.

6. *A Review of the Financing of Housing Delivery*

Housing backlogs continue not only due to the legacy of the past but also because of high levels of unemployment, a growing population size and the HIV/AIDS pandemic. Other factors that compound the state of housing backlogs include the selling of subsidized houses by some beneficiaries. Housing need indicators are collected through housing surveys in other countries and homelessness is included as a variable in these surveys. This is more so because housing supply shortage is counted as one of the causes of homelessness.

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In view of the analysis presented in this submission the Commission recommends that:

- A process for the collection of data on homelessness should be initiated. Such data should, in future, be included in the housing formula as part of the indicators of housing need.

Part B: Advisories and Recommendations from Supplementry Submissions made during the 2006/07 period

7. *Assessment of the Fiscal Regime Applicable To Windfall Profits in the Liquid Fuel Sector.*

This submission reports the Commission's response to a proposal to reform the fiscal regime applicable to oil windfall profits in general and to the liquid fuel energy sector in particular. Based on its research the Commission:

- welcomes the proposals to tax abnormal profits generated in the oil industry consequent on the higher than expected world oil prices,
- recognizes that taxing oil windfalls profits could generate substantial revenue without in any way significantly threatening fuel supply,
- believes that at least in the short-term a windfall profits tax will have very little impact on prices as it does not directly affect the conditions of supply and demand,
- believes that the macroeconomic repercussions of a windfall tax for the oil sector are also likely to be minimal,
- notes that a windfall profit tax could have negative incentive effects that would lead to economic distortions over time,
- supports an energy policy that clearly diverts the economy away from fossil fuels, as oil consumption is itself a major world environmental problem,
- supports all strategies to counter industry avoidance of paying windfall taxes,
- encourages the introduction of strategies that counter exposure to external price shocks on natural resource production, especially if these shocks have negative implications on projections and predictability of nationally collected revenues,
- urges careful consideration of the extent to which provinces and municipalities could lay claim to taxes derived from the exploitation of resources located in their jurisdiction,
- discourages the use of a revised subsidy regime,
- finds some merit in the cost-based administered price regime because of its flexibility,
- prefers the progressive formula tax as there is precedence for its use and because it is equitable and flexible,
- finds the investment-linked tax and subsidy option attractive if coupled with an environmental policy objective,
- is generally unfavourable to the idea of a proposed 1% reduction in royalties for low grade coal as it is unlikely to induce any behavioural change in producers.

8. *National Tressury's Draft Framework for Considering Market Based Instruments to Support Environmetal Fiscal Reform in South Africa*

For convenience, summarised below are the preliminary comments of the Commission based on detailed arguments presented in the FFC submission to National Treasury.

- The FFC welcomes the initiatives suggested by National Treasury to address environmental problems. The Report contributes significantly to the debate on environmental management in South Africa.
- While the Report provides a detailed description of generic interventions to address environmental problems, there is very little attention as to why these interventions are the right ones for South Africa. This is crucial since the most well designed environmental policy initiative will be undermined in the implementation.
- The Report also needs to be explicit on the rationale and purpose for the intervention. As it stands, the Report appears torn between revenue raising objectives and environmental objectives. If the objective is environmental, then the FFC suggests that all aspects of market failure, including those induced by government policy ought to be considered.
- The Report's discussion of the impacts of the proposals on Intergovernmental relations needs to be strengthened. The National Environment Management Air Quality Act should be used as the major point of departure in this exercise.
- More clarity is required for the envisaged roles and responsiblities of different spheres of government. We suggest that:
  - An institutional table could be published showing the sphere of government responsible for particular environmental problems and tax instruments.
  - Consideration of earmarking environmental revenues/royalties for the Local or lowest government level where environmental damage/mining takes place.

9. *FFC Comments on the Muncicipal Fiscal Powers and Functions Bill*

The Commission welcomes the Bill and noted that municipal revenue raising powers should enhance the fiscal anatomy of local governments. Most of the points raised by the Commission were addressed in the final draft of the Bill.

10. *The Fiscal Implications of the Re-demarcation of Provincial Boundaries*

- The FFC supports the view that both the Provincial Equitable Share and the Local Government Equitable share formulae should be revised to take into account changes resulting from the re-demarcated boundaries for municipalities and provinces. The changes should include the revised census data from Satistics South Africa.
- The FFC proposes that any additional costs faced by provinces and municipalities that cannot be met through the revised equitable share allocations be funded through a once off allocation from the national government. Such an allocation may be justified on the principle that funds follow needs determined by the demographic composition in provinces and municipalities. However, currently the formulae do not fund the administrative costs associated with the prioritization and the choice of norms and standards for delivery of basic services.

- The FFC proposes that changes to the boundaries of sub- national authorities be aligned with the financial year(s) system applicable for provincial/municipal authorities. This will allow for the required fiscal changes to be phased-in and reduce the financial burden related to fiscal implications arising out of the re-determination of boundaries.

Part C: Financial and Fiscal Commission Analyses and Methods

11. *Budget Analysis: Spending Performance and Capacity of Provincial Government Departments 2003-2009*

    Based on its analyses presented in this submission the Commission makes the following observations and recommendations:

    - For the desirability of stable and predictable allocations of revenue shares between different programs and categories of spending Government should aim for stable budget growth paths over a 7-year period rather than from 3-year cycles.
    - The policy prioritization of objectives and targets of a department, program or category of spending should be supported by higher than average annual budget growth rates.
    - The further institutionalization of best practice project planning and budgeting methods should be encouraged.
    - Every departmental service delivery program should be defined by and reported in the Provincial Budget and Expenditure Review according to;
        - actual and targeted beneficiaries,
        - personnel and budget by occupational skills level and
        - current items and capital assets utilized in service delivery; These delivery statistics should be reported for both the department and its service delivery contractors.
    - A methodology to measure the socio-economic impact of government capital and current spending should be standardized across government departments and programs.

12. *Comments on the vertical and horizontal Division of Revenue: A Model for Reviewing the Equitable Sharing of National Revenue*

    - Based on the analysis and methodological framework presented in this submission, the Financial and Fiscal Commission will use the CMBS model as an analytical tool to inform its recommendations research and, its contribution to the review of equitable sharing formulae in the intergovernmental fiscal relations system with reference to:
        - The balance between the provision of constitutionally mandated basic services (CMBS) and macroeconomic and fiscal constraints that limit the availability of national revenues.
        - The objective determination of the equitable sharing of available revenue among the national, provincial and local spheres of governments.
        - The equitable allocation of provincial and municipal resources to capital spending in a way that is consistent with (a) and (b) above.

13. *A Framework for Assessing Function Shifts in South Africa's Intergovernmental Fiscal Relations System*

    Having considered the FFC research into the principles and guidelines for instituting function shifts the Commission agreed to:

    - Adopt the Checklist and Manual as the tools for use by the FFC in assessing function shifts.
    - Accept that the framework will be updated from time to time as experience dictates.
    - Distribute the documents to all organs of State to use in their own preparations for addressing proposals for a function shift.

Chapter

1

Some Economic Impacts of the 2010 Fifa World Cup

1.1 Background

During the August 2006 Budget Council Meeting, the Minister of Finance requested that the Financial and Fiscal Commission comment on the financing of the 2010 Fifa World Cup. The FFC subsequently took a decision in its November 2006 meeting to make recommendations on government financing of the 2010 Fifa World Cup. Viewed from a macroeconomic perspective, embarking on such a mega-project could lead to two possible outcomes. The first is that the event may stimulate the economy and result in long-term competitiveness. The second is that there may be negative pressure on the current account and other external macroeconomic variables.

The influence of a mega-project on macroeconomic variables can be understood by its impacts on economic growth, private investment, inflation and the current account of the balance of payments. The direct effects are normally straightforward to estimate. The total capital expenditure on the part of government is estimated at R17.4 billion, based on 2006 estimates. These direct effects are only a small part of the overall impact on the national economy.

The investments in the construction and renovation of a stadium leads to higher demand for building industry materials and employment increases in the construction sector leads to additional effects on consumption. This in turn leads to a growing demand for other goods and services. A major difficulty in assessing indirect effects lies in the lack of available data which detail and analyse these effects. Nevertheless, the indirect effects can be assessed by means of economy-wide models describing the actions of investors and consumers, and the development of the production structure.

The aim of this submission is to present the likely economic impacts of the 2010 Fifa World Cup by specifically identifying Government's overall expenditure and examining the likely impacts on the economy. The specific focus is on the extent to which funds are likely to be diverted to the 2010 Fifa World Cup event from regular expenditure objectives.

1.2 Major Costs Associated with hosting the 2010 Fifa World Cup

The Minister of Finance's Budget Speech of February 2007 outlined the Government's funding package for the 2010 Fifa World Cup.

Three provincial functions will be crucial for a successful hosting of the event. These are transport, health, sport and recreation. Provincial Departments that are involved in the 2010 Fifa World Cup initiative were asked to prepare project plans and integrate them into their respective National Department plans. Host cities have signed agreements with Fifa Local Organising Committee (LOC) which stipulate their responsibilities to include the provision of LOC/Fifa Offices, stadia and training grounds, reporting and taxes, customs and entry requirements, safety and security, transportation and airports, environmental protection, commercial display and exclusion zones, Fifa Fan Park and Fifa Partner Clubs, host city advertising and Rights Protection Program, retail opening hours and regulation of entertainment, city services and city beautification.

Table 1.1 summarises the major costs of hosting the 2010 Fifa World Cup. Of interest to the FFC is analysing the amount of R17.4 billion allocated by the South African Government for capital projects associated with the World Cup. The fiscal year 2007 will carry the bulk of Government's monetary contribution towards preparations for the 2010 Fifa World Cup.

As shown in Table 1.2, there are ten stadia of which five will be newly constructed and the other five upgraded. The allocation of funds for renovation was motivated by the nature of the work to be carried out to bring the stadia up to Fifa standards. Over 74% of the allocation goes to construction of new stadia and the rest (26%) for the upgrading of the existing stadia.

Government has undertaken to manage the 2010 Fifa World Cup budget through targeted spending for 2010 projects. Clearly this has implications for the equitable sharing of national revenue. To avoid

Table 1.1: Breakdown of costs for hosting 2010 Fifa World Cup

Investment	Cost
Stadia	**R8.4 billion**
Transport	R9.0 billion
Broadcasting	R400 million
ICT	
Security	
Fifa	R3.1 billion
Organising Committee	R3.2 billion +

Source: National Treasury (2006).

Table 1.2: Stadia allocations and seating capacity

Municipality	Stadium	Seating	Total allocation (R)
Johannesburg	Ellis Park	61,006 (upgrade)	229,000,000
Johannesburg	Soccer City	95,000 (upgrade)	1, 530,000,000
Cape Town	Green Point	70,000 (New)	1,930,000,000
eThekwini	King Senzangakhona	70,000 (New)	1,800,000,000
Nelson Mandela Bay	Nelson Mandela	48,000 (New)	895,034,525
Mbombela	Mbombela	46,000 (New)	855,000,000
Polokwane	Peter Mokaba	46,000 (New)	696,776897
Mangaung	Vodacom Park	48,000 (upgrade)	219,066,285
Rustenburg	Royal Bafokeng	42,000 (upgrade)	147,431,064
Tshwane	Loftus	50,000 (upgrade)	97,691,229
TOTAL			8,400,000,000

Source: National Treasury (2006).

using the equitable shares resources are to be made available mainly in the form of conditional grants to the government sphere under whose jurisdiction the hosting city falls. The bulk of Fifa 2010 work that government will finance takes place in nine host cities, namely Cape Town, Nelson Mandela, eThekwini, Mbombela, Polokwane, Rustenburg, Tshwane, Johannesburg and Mangaung. Thus, sharing of 2010 Fifa World Cup allocations is not based on the principle of equitable shares but is driven by whether a city is the host of the event. Even within the local government sphere, expenditures are not evenly distributed but are concentrated in those nine cities hosting the event. Thus the vertical as well as horizontal division is influenced by national interest – the sphere of government that provides the service receives the funds.

A second set of issues pertinent to the FFC is whether government financing would lead to macroeconomic instability? Macroeconomic instability can arise when the financing of the 2010 Fifa World Cup leads to inflation, expansive budget deficits and a burgeoning balance of payments deficit. It appears highly unlikely that this will be the case in South Africa. The existing macroeconomic foundations underpinning the financing of 2010 Fifa World Cup are extremely sound and resources are drawn from tax surpluses.

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Escalating Costs and Budget Shortfalls

In a 2007 submission to the Portfolio Committee on Sport and Recreation, five host cities (Mpumalanga, Limpopo, Nelson Mandela Metro, Ethekweni and Cape Town) raised concerns about budget shortfalls and escalating costs. In their submission, the host cities cited the following reasons as the main causes of the budget shortfalls:

- Escalation of the cost of raw materials
- The demand in the construction industry outstrips the supply of materials.
- The shortage of raw materials will lead to increased imports and an increase in cost due to of the fluctuating exchange rates.
- Increase in the costs of skilled labour.
- Limited time to complete projects.
- Strict procurement procedures and policies in Sections 7 and 9 of the Municipal Finance Management Act.

1.3 Modelling the impacts of hosting the 2010 Fifa World Cup

According to some macroeconomic literature, 2010 Fifa World Cup expenditures by government will stimulate economic demand. The FFC assessment is based on the use of a Social Accounting Matrix (SAM) model specially dis-aggregated for the FFC to sub-regional government level. The explanations and technical description of the model is presented in Annexure A2.

1.4 Findings and Implication of the Model results when taking into account section 214 (a-j) of the Constitution

The simulation results from the FFC analysis are based on a scenario which takes into account the investments for constructing and upgrading stadium facilities and constructing transport infrastructure. The results indicate that under favourable conditions the staging of the 2010 Fifa World Cup positively influences gross domestic product (GDP) and imports. In terms of contribution to factor remuneration, owners of capital stand to benefit more from government 2010 Fifa World Cup expenditures than owners of labour. Middle income households are the single biggest winner, followed by high income households. 2010 Fifa World Cup expenditure will redistribute incremental revenue in favour of National and local government spheres. Table 1.3 summarises the macroeconomic impact on the economy.

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Table 1.3: Impact on South Africa's Macroeconomics

	Percent (%) Change
Private Investment	0.7
Economic Growth	0.1
Current Account Deficit	1.1
Inflationary pressure	0.005

Source: Authors' calculations

Part 2 of Section 214 of the Constitution lays down guidelines that the FFC must take into account when making recommendations on equitable shares. Based on its analysis the Commission notes the following with respect to Section 214 (2) (a-j):

a) *The national interest:* The state has declared that the 2010 Fifa World Cup project is in the national interest. The FFC analysis suggests that the hosting of the event will have beneficial macroeconomic impacts. Economic growth as measured by gross domestic product will most likely go up as will sectoral production. Households in general are better off, especially skilled households. With increased incomes the project has the potential to encourage saving.

b) *Any provision that must be made in respect of the national debt and other national obligations;* The FFC's assessment in this respect is that this condition has already been largely met. National government commitments to the 2010 Fifa World Cup have been financed from a budget surplus and there was no recourse to borrowing. Hence, 2010 Fifa World Cup expenditure is carried out in an environment that is consistent with macroeconomic balance (macroeconomic and price stability, a favourable investment climate and expanded economic opportunities). However, the FFC's results point to a worsening of the current account deficit due to the surge in imports of capital goods. While this is not necessarily a negative outcome, it may impact on the future debt increases if exports are allowed to stagnate.

c) *The needs and interests of the national government, determined by objective criteria;* It is the view of the FFC that this condition has so far been satisfied. In fact, financing of the 2010 Fifa World Cup has not negatively impacted on the past Medium Term Expenditure Framework (MTEF) baselines. If anything, regular equitable allocations for the provisions of constitutionally mandated services are planned to increase in the foreseeable future.

d) *The need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them;* The financing of stadia for the 2010 Fifa World Cup is being financed through a Conditional Grant, with fairly stringent conditions. Subnational governments have budgeted separately for 2010 Fifa World Cup activities.

e) *The fiscal capacity and efficiency of the provinces and municipalities:* the overall impact on GDP and sectoral production will be positive. The modeling results indicate that the project will result in increased revenue through the knock-on effects of increased consumption. Value Added Tax (VAT), and gaming and betting taxes are likely to be the main revenue sources from the event. Thus, fiscal capacity in general, is likely to be enhanced.

f) *Developmental and other needs of provinces, local government and municipalities:* Hosting the 2010 Fifa World Cup is expected to impact positively on the developmental needs of hosting

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provinces and municipalities. Sectoral output has been shown to respond positively. Employment growth, to the extent that household income increases in response to the injected demand stimuli is likely to increase. There is a danger, though, that such development may be concentrated in the hosting areas, to the detriment of non-hosting regions. To make these gains sustainable, provinces and municipalities need to establish comprehensive contingency plans to harness these gains and other legacy effects.

g) *Economic disparities within and among the provinces:* By design, hosting the 2010 Fifa World Cup will impact on the distribution of resources within South Africa. Local government will receive most of the funds earmarked for 2010 Fifa World Cup, and expenditure will be concentrated mainly in the nine host cities. It follows then that provinces, in which host-cities are located, will disproportionately benefit from the World Cup event.

h) *Obligations of provinces and municipalities, in terms of national legislation:* Such obligations and responsibilities are catered for in the current system of intergovernmental policy instruments and the hosting of the World Cup is unlikely to change power and functions that have been the operating norm thus far.

i) *The desirability of stable and predictable allocations of revenue shares:* Any change to the steady and established distribution policy is unlikely to be violated. As noted earlier the MTEF baselines have not been destabilized to accommodate the funding of the World Cup and a separate budgeting procedure for each national department has already been put in place. The remaining task is to ensure compliance with the Public Finance Management Act (PFMA), Municipal Finance Management Act (MFMA), service level agreements, and other conditions of funding.

j) *The need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria:* The 2010 Fifa World Cup will not have a major negative impact on allocations for contingency. In fact, the FFC's recommendation below argues that in cases where National Government has applied its mind and satisfied itself that an increase in World Cup financing costs is inevitable and leads to a concomitant increase in the cost of stadia construction, it should demonstrate the necessary flexibility and provide the required additional funds.

1.5 Observations and Proposals

From a general public funding perspective, the financing of 2010 Fifa World Cup by the government does not negatively impact on considerations in section 214 (a-j) of the Constitution. More specifically, however, the Commission would like to submit the following observations and advisories given the likelihood of negative effects on some macroeconomic balances:

- Government's fiscal policy stance should continue to be focused on meeting the long-term objectives by ensuring that the overall budget deficit does not exceed 3% of GDP. However, in the event of major unforeseen shocks emanating from the 2010 Fifa World cup that may lead to overheating Government has the stabilizing option of fiscal policy intervention to support monetory policy.
- Government could also maintain the budget deficit at the required level by stimulating household savings.

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- Government financing of 2010 Fifa World Cup will have a negative impact on the current account trade balance. However, the current account imbalance implied by the envisaged 2010 Fifa World Cup expenditure should not be viewed as a threat since a large portion of this trade deficit is a result of infrastructure investment. More efforts should be directed towards export promotion (including tourism) to counter the negative effects on the current account.
- Rising inflation is likely to present a real threat. Essentially monetary concerns arise from impacts on balance of payments and nominal exchange rate movements as a result of the 2010 Fifa World Cup expenditure. The Commission believes, however, that increases in inflation driven by such causes do not justify an increase in interest rates.
- With respect to project management the Commission would like to highlight the possible public finance risks of cost overruns and project delays. The impacts of these risks have the potential to cause uncertainty and affect investment confidence in the country and the region. The increase in costs of materials during the construction phase might increase the magnitudes of the projects themselves. Project delays can in turn, increase interest rate risks.
- The Commission believes that the legacy effects of hosting the World Cup should be properly addressed, costed and financed. In its research the FFC identified specific legacy effects, namely: increased economic investments, football and sport development, human capital development, social and political development, infrastructure and technology development. These can be location specific or countrywide.

  The Commission proposes two approaches for sustaining the positive legacy effects of the 2010 World Cup:

  - The first is to appoint a national agency to oversee the legacy effects of a national character. In keeping with prudent macroeconomic behaviour that has characterised government policy thus far, it is recommend that household saving be stimulated and be seen as the main source of funds to finance such projects.
  - The Commission secondly, recommends that the sustaining of location specific legacy effects be left in the hands of hosting cities. As legacy benefits accrue to the City it is recommended that the City fund these from their own revenue sources.

Chapter 2

Extending the National School Nutrition Program (NSNP) from Primary to Secondary Schools

2.1 Background

During the Parliamentary Committee Hearings on conditional grants in May 2006, Members expressed a general dissatisfaction with the fact that the National School Nutrition Program (NSNP) catered only for primary school learners. The exclusion of learners in combined schools and secondary schools in particular was judged to be inequitable. The Chairperson of the Select Committee on Finance requested the FFC to investigate the feasibility of extending the programme to cater for learners in secondary schools.

The conditional grant framework guiding the administration of the NSNP stipulates that the programme should target learners from Grade R to Grade 7 in public schools. If applied in its strictest sense:

a) qualifying learners from the same household may not participate in the NSNP because of the different grades they attend. For example, the learner in primary school that is in Grade 7 will participate in the programme while the learner in secondary school in Grade 8 will not.

b) a qualifying learner that graduates from the primary school to the secondary school will be excluded from the programme.

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c) excluding some learners in need of nutrition in the same geographical area may be perceived as being inequitable.

2.2 International experience

Studies conducted in a number of countries have shown that nutrition programmes could contribute significantly to improving punctuality and attendance in class, the nutritional well-being of learners, and to boosting concentration levels of learners inside and outside their respective classrooms. When schools have feeding schemes poor households are relieved of the burden of feeding children.

The conclusions above are supported by studies conducted by the Food and Agricultural Organization (FAO), the United Nations Educational Scientific and Cultural Organization (UNESCO) and the World Health Organization (WHO). The studies have shown that hunger among learners contributes to reduced school attendance, impaired cognitive capacity, high child death rates, high maternal death rates, increased migratory labour that contributes to the high incidence of other communicable diseases.

2.3 The South African NSNP

a) The FFC carried out an empirical study on various facets of NSNP in provinces in South Africa. The study established that all Provinces were concerned about the current inadequate budget allocations for the NSNP. While a few provinces supplement the NSNP conditional grant with the Provincial Equitable Share (PES), most do not. The inadequacy of allocations is exacerbated by a rise in enrolment rates of learners in some provinces.

b) All provincial education departments express a preference for an increase in the funding of the NSNP through a conditional grant mechanism.

c) The study found that in order to cover all the learners in need in primary schools, budget allocations have to be increased by between 40 and 60 percent. It should, however, be noted that need varies across provinces. The cost of daily rations per learner per feeding day in KwaZulu-Natal being the lowest at R0,95 whereas Gauteng and the Northern Cape are the highest with R2,00 per learner per feeding day.

d) In terms of human resources, directorates running the programme are generally understaffed. There is a general lack of skills, misplacement of personnel, and a lack of job security because most jobs are fixed-term contracts. There are variations in provinces in the understaffing and skills levels.

e) To extend the NSNP from primary schools to secondary schools, the study found that budgets in some provinces would require increases of 50 per cent to 70 per cent. While the Northern Cape is covering certain learners in secondary schools, this is not so for the Eastern Cape where many learners in need are presently not even covered in primary schools.

f) All the provinces expressed satisfaction with the contribution that the programme made to the lives of learners in need. Apart from feeding learners, the programme contributes to:
   - The provision of some employment and income to the "mothers" that prepare food for the learners. Generally, there is community involvement in the running of schools. This involvement creates opportunities for small businesses in Gauteng and women suppliers in the Northern Cape, North West, and Eastern Cape provinces.
   - The programme promotes food gardens in certain schools in the provinces of KwaZulu-Natal, Northern Cape, Limpopo, Mpumalanga and the North West. In such schools, learners acquire skills as they participate in gardening activities. This also contributes to sustenance and institutionalization of the programme.
   - Although no studies have been done to show causality, some provincial education departments noted that the NSNP may be positively contributing to improved health status, school attendance and punctuality.

2.4 Conclusions

Since the inception of the programme, it has contributed to the alleviation of short-term hunger for learners from poor families. Despite the challenges the programme has the potential to enhance poverty alleviation and improved educational outcomes.

It is feasible to extend the NSNP from primary schools to secondary schools. Indeed, the Northern Cape is already providing for some learners in need in secondary schools with funding from both the conditional grant and from the main departmental budget.

2.5 Recommendations

- All Provincial Education Departments (PEDs) should adopt and entrench the NSNP as their full responsibility.
- PEDs must engage the necessary personnel with appropriate skills levels for the implementation of the programme. PEDs should address the following as a step towards extending the programme from primary schools to secondary schools:
   - Budget allocations for the NSNP in primary schools should be increased in order to cover learners that are presently not covered. The present situation is such that a number of learners in primary schools are not covered by the programme.
   - It is necessary to boost both personnel numbers and skills levels in order to improve the implementation of the programme.
   - PEDs should begin implementing the NSNP in schools that have been declared "no-fee-schools" by the Minister of Education. Presently, the "no-fee-schools" policy deals with

learners attending school in quintiles 1 and 2. Typically, these are schools serving poorer communities with greater numbers of deserving learners.

- The National Department of Education should develop national norms and standards to guide the implementation of the NSNP in the country. Presently, there are no uniform national minimum norms and standards for the NSNP. The lack of such norms could encourage inequity in the implementation of the programme.
- The National Department of Education should ensure that the quality of information is improved. The information obtained would be useful in the planning and budget processes of the NSNP.
- Where necessary, PEDs should supplement the NSNP conditional grant with funds from their respective budgets. Presently, this is the case in the Northern Cape.
- Where necessary, improvements in procurement procedures should be undertaken.
- Kitchen equipment and infrastructure in all provinces require urgent improvement.
- Improvements in the monitoring and evaluation capacity of the NSNP are vital in order to address difficulties that arise in the course of implementation.
- Increase the number of feeding days beyond the prescribed minimum.
- In certain provinces, increase the per learner per day feeding amount.

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Chapter 3 A Review of the Financing of School Infrastructure and Education Outcomes

3.1 Background

A large number of South African schools do not have water, electricity, libraries or laboratories. Furthermore school structures are considered unsafe, and are made of mud or asbestos. The legacy of apartheid continues to express itself in education inequality and this is seen in school infrastructure where historically black schools have massive infrastructure deficits.

School infrastructure deficits negatively affect schooling outcomes through the following channels; inferior academic performance, lower attendance and morale of both teachers and pupils, and a reduction in teacher effectiveness. The 21st century furthermore holds specific challenges for schools through the need for the relevant infrastructure for Information and Communications Technology to accommodate new ways of learning, and taking into account environmental concerns.

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3.2 International experiences

Literature on the links between school infrastructure on education, in Francophone and Anglophone African countries, Pakistan, the Philippines, Ghana and the United States of America (USA) show that school infrastructure has an effect on academic performance, especially when infrastructure is poor or lacking. However, a literature review of this nature is likely to overestimate the effect of infrastructure, as it only reports on those studies which actually do find an impact from infrastructure on learning. In South Africa studies based on the SACMEQ[1] dataset and datasets from the SA Department of Education show a correlation between certain school infrastructure variables and academic performance. School infrastructure variables that have a significant effect on academic performance include electricity, libraries, high technology equipment, toilets for teachers and students and the condition of school buildings (with the strongest negative effect when school buildings are in a dismal condition or made of non-standard materials such as mud).

It is important to note, however, that the infrastructure variables associated with improved academic performance may be acting as proxies for wealth, i.e. richer schools, or the fact that the school is situated in an urban area rather than a rural one.

3.3 Infrastructure and school outcomes in South Africa

The empirical analysis on which this submission is based consists of a multivariate regression analysis of the effect of infrastructure in South African schools, based on TIMSS (the Third International Mathematics and Science Study) data. TIMSS was carried out in South Africa during the second semester of the 2002 school year. This data was collected for 46 countries at Grade 8 level and measured both Mathematics and Science performance. A large number of questions were also asked of pupils (to determine something about their home circumstances, including socio-economic status and parent education), of teachers (e.g. teacher experience and qualifications) and of principals (e.g. school infrastructure). The countries covered ranged across the full income spectrum, but the number of less developed countries, particularly in Africa and Asia, that took part, was relatively limited. The TIMSS study shows that South Africa, performed consistently worst in both Mathematics and Science, with average scores of 264 and 244, compared to international averages of 466 and 473 respectively.

Various resource and infrastructure indices are constructed, which show that South Africa performs poorly in terms of resources and infrastructure, at least as far as reporting by teachers themselves is concerned. However, when considering only the relationship between the infrastructure index and Maths or Science score, South African scores are far weaker than would be expected, even considering its resources/infrastructure. In contrast, when looking at provincial performance, it is clear that the Western Cape has an advantage in performance that is greater than its resource or infrastructure advantage. The latter two points both indicate that other factors (e.g. socio-economic status and school efficiency) may dominate the effect of infrastructure.

1. Southern African Consortium for Monitoring Educational Quality

In the regression analysis a simple production function approach is used. In this analysis it is assumed that the home background of pupils (socio-economic status, parent education, books at home, language), student attitudes (confidence about the subject, how much they value the subject, whether they fear for their safety at school and effort) and, resources made available in schools all contribute to academic achievement. Without considering these other factors, it is impossible to isolate the influence that infrastructure may have.

The regression analysis shows that for Maths test scores, the Index of Infrastructure Shortage variable is significant and negative. Considering that the index ranges from 0 to 9 (i.e. from no shortage to a great shortage), the coefficient of about -2.5 indicates that infrastructure improvement could have an effect of up to 22.5 marks on the Maths test score of an individual pupil. However, this should be seen in the context of the overall poor South African results for the Maths index. If the South African infrastructure shortage index improved from its mean value of 5.45 to 0, the overall impact on mean South African test scores would be less than 14 points, thus still leaving South Africa languishing at the bottom of the sample of countries, approximately equal with Ghana. If shortages of instructional material, classroom space and calculators were to be eliminated, overall marks for individual pupils could improve by almost 60 marks. Even leaving aside calculators, the maximum gain for a pupil from removing shortages of the other two forms of infrastructure could be 43 marks. However, the mean gain over the whole school population would be less, and the overall impact may not be great compared to international performance, though equity in outcomes may improve.

For Science test scores, the regression analysis shows that individual scores could be as much as 47 marks higher if pupils who earlier experienced shortages of all these things were to be in schools which have no shortages of classroom space, calculators and laboratory equipment. Leaving aside calculators, infrastructure may bring a gain to pupils of 39 marks. Again, this is a relatively small gain compared to South Africa's existing deficit in education.

The TIMSS data is further analysed separately for schools with poor infrastructure. For comparison purposes, schools are divided into three groups of approximately similar size, based on the TIMSS sample of 219 schools. Group 1 are those 67 schools with an infrastructure shortage index of only 0-2; Group 2 includes 74 schools whose score on the index is 3-6; and Group 3 constitutes the 78 schools with 7-9 points on the infrastructure shortage index. In this latter group, it is notable that historically poor provinces such as the Eastern Cape and Limpopo dominate, with 44% and 20% of schools respectively, followed by Kwazulu-Natal with 15%. This is where a large proportion of schools located in former homelands are found. These schools that often have poor infrastructure.

Predictions using the regression coefficients show that student maths outcomes even in the poorest schools would react little to an improvement of infrastructure to the optimal level. In fact, these small gains that can potentially be made, presumably at relatively large costs, cannot weigh up against the effect of differences in socio-economic status. Science outcomes would show a very similar pattern of response. Thus one must conclude that, at least based on the TIMSS data set, not much hope should be focused on large gains in student performance from providing better school infrastructure. Other arguments for school infrastructure, such as human rights and greater equality of education resources and therefore perceived equity, may be stronger.

3.4 Conclusion

The magnitudes of the effects of school infrastructure on student performance found in this South African study are relatively small: infrastructure appears to matter, but its impact may not be very large. Available data unfortunately does not allow for much testing of the impact of individual infrastructure items. To do so would require large and accurate datasets, incorporating a large number of variables, including variables relating to management and teacher and student behaviour. Such datasets are scarce internationally and completely absent in South Africa.

There is, however, a strong human rights and equity argument for improving school infrastructure, especially basic infrastructure such as providing schools with water. School infrastructure that is in poor condition or lacking basic infrastructure can be seen as human rights violations in terms of the health, psychological well-being and access to education.

School buildings that are falling apart, poorly ventilated, made of materials such as asbestos or unsafe in any way act as a violation to a child's right to attend school in a building that does not compromise his/her safety or health. Schools without water and toilets places children at risk of contracting illnesses related to poor sanitation. School buildings in extreme states of disrepair may affect the learner's sense of self-worth and psychological well-being.

School infrastructure deficits in South Africa also raise the issue of equity – a child's right to the same educational opportunities as other children in the same country. Where schools have different levels of school infrastructure, especially in terms of libraries and science laboratories, this implies a lower possibility of students learning the same things. In the interest of improving equality within education in South Africa, there is a case for closing the gaps between the infrastructure at historically disadvantaged schools and historically advantaged schools. However, other resources (e.g. good school management and teachers) may be necessary to ensure that these possibilities are translated into better outcomes for children in poor schools. Continuous lack of complementary resources can undermine the potential gains from school infrastructure investment.

From a human rights perspective, and also because infrastructure improvements may bring best benefits in such cases, it is important to start the process of infrastructure improvement in schools where the infrastructure is weakest. The provinces with the weakest infrastructure are in that position as a result of the apartheid legacy. There is thus a strong case to be made for a more pointed targeting of existing education infrastructure conditional grants to such provinces to enable them to improve infrastructure in the schools or localities where it is the weakest.

The exact volume of this school infrastructure backlog can be estimated. However such an excercise requires new and better information based on the new School Register of Needs focusing on actual inspections of infrastructure rather than questionnaires filled in by school principals.

In its presentation to the Portfolio Committee on Finance on the 15th February 2005, the National Department of Education indicated that there were still 4771 schools without access to water and 4226 schools without sanitation facilities. Although the classroom need was reduced from 57 499 in 1996 to 31 254 in 2004, in the absence of sanitation facilities and water in some schools, this may not have been sufficient to improve attendance which is necessary for effective schooling. In provinces with challenging topography like KwaZulu-Natal, access to schooling is restricted, particularly during rainy seasons, by the lack of other infrastructure such as bridges and roads. This fact underscores the challenges of inter-departmental integration and location of schools. What is the use of a sufficient school infrastructure if there are no roads or bridges to facilitate attendance upon which improvement in outcomes is dependent?

The largest number of learners walking more than five kilometres to school is to be found in KwaZulu-Natal - 5.1% (134000) - and the Eastern Cape – 6.6% (31000). Between 2001 and 2003 KwaZulu-Natal experienced an increase of 30000 in the number of affected learners and proportional increase of 0.4% while in the Eastern Cape the number decreased from 6.6% to 4%. (Monitoring and Evaluation Report, Department of Education, 2006) It becomes clear then that KwaZulu-Natal, unlike other provinces, has a special challenge that may not be solved by scholar transportation as the roads may not be suitable, and even where schools are located closer to homes bridges may be required because of the difficult terrain.

3.5 Observations and Recommendations

The provincial infrastructure grant formula has indicative proportions for backlogs in education, health, roads and agriculture. However, in practice, actual allocations are not directed to these functions. In one province 100% of the fund in one year was allocated to only one sector. A new and improved Register of School Needs would enhance the targeting of the education component of the grant.

There are still schools with no sanitation and electricity. Coordination of planning between the Municipal Infrastructure Grant (MIG) funded infrastructure outside the school and infrastructure in the school premises is critical to deal with sanitation and electrification challenges. The absence of coordination of plans undermines the functioning of effective funding of school infrastructure. The existence of a school library with no books also does not serve any useful purpose.

Based on the above analyses the Commission recommends:

- That the conditions of the PIG targeting educational infrastructure specify the requirement for provinces to use such funds to support development of infrastructure in areas with need and where it is most likely to improve school outcomes.
- That effective coordination of planning for the various provincial and municipal infrastructure grants be instituted as a matter of urgency to ensure optimal outcomes from school infrastructure investment.

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Chapter 4 The Financing of Learner Support Materials

4.1 Background and Context

Ensuring equity in the financing of social services is one of the key mandates of the Financial and Fiscal Commission (FFC). The FFC needs to take into account equity considerations before recommendations can be made on the horizontal division of nationally raised revenue. Hence, the study focuses on two key areas within the context of school funding norms, viz; the funding of learner support material (LSM), and adequate funding for the no-fee schools policy. The submission firstly, presents its findings for the provision of the minimum funding allocations for LSM. Secondly, the submission addresses the adequacy of funding for the no-fee schools policy.

4.2 Financing of LSM

The school funding norms place on Provincial Education Departments (PEDs) the responsibility of allocating funds for non-personnel-non capital expenditure (NPNC) to public schools. Part of the NPNC should fund recurrent items like LSM; books and stationery, media collections, equipment and

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maintenance. The broad items listed under the financing and funding for LSM create confusion and inconsistency for what constitutes LSM. Some PEDs report "other recurrent and small capital equipment costs" for items such as school books, stationery, equipment and media collections, while others report the LSM as "supplies, goods and services". This confusion makes it difficult for provinces to identify exactly what items need to be covered by NPNC expenditure.

For instance, how much funding should be allocated for LSM? How much funding should be allocated for maintenance and equipment? The result is wide variations of expenditures on school allocations and per learner allocations on LSM across and within provinces.

Expenditure trends data for the period show that the per learner expenditure on LSM started at a low base, with most provinces spending less than the required minimum amount stipulated in the school funding norms. This is in spite of the growth in learner numbers. There appears to be no correlation between the LSM expenditure per learner and the learner numbers. Although the expectation would be that the more the learners, the more would be the demand for LSM and vice versa. As the LSM funds are aggregated it is difficult to assess exactly how much was spent on each of the different items such as textbooks and stationery.

The budget data for the period 2003/04 indicated a total amounting to R57 billion with the expenditure on textbooks and stationery being R1 billion and R6 million respectively, translating into 2% and 1% of the total respectively. The expenditure was more on stationery than textbooks. The expected norm would be that as the learner graduates to a higher grade, the demand for textbooks, would be greater. The field survey conducted by the Commission in 2004/05 on the provision of LSM in schools, found that there was a significant shortage of stationery and textbooks, and this was more pronounced in secondary than primary schools.

Various studies have been undertaken in many countries to determine whether LSM have a direct impact on learner performance. The results of these studies show the impact of textbooks to be positive in some cases and mixed in other cases. Internationally, there is evidence to indicate that the availability of LSM is directly correlated with learner performance when some other variables are taken into account. These variables include teacher quality, family background such as the level of education of parents, income etc.[2]

4.3 Conclusions on Learner Support Materials

The NPNC classification for LSM is unclear and inconsistent across provinces. This contributes to very low budget allocation levels. In recent years, although the situation has slightly improved it is still unclear how much of the funding is spent on textbooks and how much is spent on stationery. The Commission research indicates that there are shortages of textbooks and stationery as a result of inadequate funding and low prioritization of text books and stationery in the planning cycle.

2. Challenges of implementing free primary education assessment on quality education in Kenya. UNESCO 2005

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4.4 Recommendations on LSM

LSM should be defined clearly and should mean stationery, textbooks, learner and teacher aids. Curriculum 2005 demands a well resourced classroom that should ideally include LSM such as textbooks for each learning area and other print based materials like atlases, dictionaries, stationery, and teaching equipment such as maps, charts and globes. International literature defines LSM as textbooks, stationery and reference books. There is need for a separate budget for textbooks, stationery, learner and teacher aids. This would help in monitoring and identifying how much was budgeted and spent in each area and help identify problems. There is also a need for a separate budget for maintenance, repairs and equipment.

4.5 The Financing of the no-fee school policy

The no-fee schools policy applies to quintiles 1 and 2 of the new national schools ranking system. These schools are not required to charge compulsory school fees. The funding for the no-fee schools would be determined by the amounts on the Schools Ranking Targets Table where the "no-fee threshold" is set at R554 annually. It is assumed that this amount will be adequate for funding the poorest schools and making quality education possible. The breakdown of the schools in this category in some provinces indicate that more than half of the schools will fall into quintiles 1 and 2. The international literature and experience raise several issues with respect to the principle of no-fee schools. Firstly, the argument is that the prohibition of compulsory fees in schools serving learners from the poorest families may become an obstacle in the schooling process and discourage learners from attending school. Secondly, school fees, even if set at low levels do encourage parent participation in school governance.

In a field study in 2004/05 conducted by the FFC on the provision of LSM, the schools that were interviewed mentioned that parents hardly pay, especially in communities serving the poor. However, South Africa, has signed the Dakar Framework of Action in 2000, where countries are required to provide basic education that is compulsory for all school going age children. The education provided should be of quality and in which financial capacity should not be a barrier to access for any child. It has also been observed by the Centre for Applied Legal Studies that South Africa is required to abide by the international agreements that it has signed.[3] The international literature for adequate funding is linked to performance standards that learners need to have acquired in the schooling process. Essential resources are considered necessary for learners to achieve some minimum education standards. Before determining adequate funding levels certain steps need to be followed. Academic goals with an emphasis on academic standards must be set. If the required level of spending is too high to meet goals, then consideration should be given to either lower the original standards or create a long term plan to gradually obtain the necessary funds for progressively meeting and achieving the goals.

3. The Constitution and the international instruments to which South Africa is signatory, place a duty on the state to provide adequate resources to all public schools, so that compulsory charging of school fees would be unnecessary, that education at least at primary level should be free and compulsory and that measures such as exemption provision be allowed only in respect of secondary education.

4.6 Conclusions on No-Fee School Policy

The Commission believes that the application of the no-fee schools is sound. However, challenges that hinder the implementation process need to be addressed. Firstly, the amount to fund the no-fee schools should be adequate given that it would be the only source of funding for those schools to run their day to day functions. Secondly, with provinces where more than half of the schools are in the no-fee school category the equitable share funding should be able to cover the functioning of those schools. The annual review of the no-fee schools policy needs to be treated with caution so that it does not result in perverse incentives.

The starting point to realise the goals of basic education for all is to provide primary education that is free and compulsory and, for any measures of exemption only to be applicable at secondary schools in schools serving learners from the poorest families. While the international literature in defining and determining adequate funding levels for school financing, involves processes and stages in order to progressively realise the goals and it calls for national outcomes to be set. The FFC in its comments to the Department on the school funding norms highlighted that government should set norms and standards that should indicate what level of knowledge and skills (in different learning areas) learners are expected to have acquired at various ages and stages within the schooling system.

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Chapter 5 The Financing of Roads and Transport Infrastructure

5.1 Background

The Financial and Fiscal Commission (FFC) noted in its 2006/07 Submission for the Division of Revenue that the delivery and funding of road and transport infrastructure occurred in a fragmented manner. This fragmentation expressed itself through lack of clarity among the spheres of government responsible for roads and transport infrastructure. Among its recommendations, the FFC called for all roads to be classified and assessed. The Commission also recommended the development of a funding framework that takes into account the provincial equitable share and the relevant infrastructure grants.

5.2 Purpose and Objectives

This submission of the Commission follows from its observation made in past submissions that certain roads were being taken over from certain provinces by the South African National Roads Agency (SANRAL) without due consideration for the implications that some roads remained a provincial responsibility. This submission carries forward the work that the Commission presented in its submission for the Division of Revenue 2005/06 and places particular emphasis on equitably financing road infrastructure in the provinces given that the responsiblity for roads will be shared between provinces and the SANRAL.

5.3 Key Findings

The FFC research found that South Africa's national road network system is among the best in the world and provides connectivity between major economic centers. However, significant parts of the provincial road network system are under heavy strain and, accelerated deterioration is threatening logistics and safety. Furthermore parts of the municipal access road system, including un-proclaimed roads, are among the poorest in the world, often denying communities access to opportunities.

5.4 The Policy Environment

The 1996 White Paper on National Transport Policy called for the establishment of a professionally managed Roads Agency for maintaining and operating a primary economic road infrastructure network.

In support of the White Paper the Department of Transport released its Road Infrastructure Strategic Framework for South Africa (RISFSA) in October 2006. The Framework calls for the formation of a Roads Co-ordinating Body for streamlining and co-ordinating service delivery planning and implementation and ensuring integrated delivery across spheres of government.

The Framework also proposes a new road classification system. However, the Framework is not intended to suggest how priorities and funding allocations should be made. These are to be the functions of roads authorities themselves as per their legal mandate. The new classification system divides roads in six ways: the primary, regional and district distributors, district collectors, access roads and non-motorized access ways. The decision criteria for which roads would serve as national roads was developed after a study on the Strategic Road Network was undertaken.

5.5 Funding Framework

a) General Principle for Road Delivery and Financing

The rate of deterioration is a function of the ability of the pavement structure to resist damage. Early interventions (i.e. before there is a significant drop in pavement quality) by means of routine or periodic maintenance are more cost-effective than deferred treatments, which will require some form of rehabilitation or reconstruction. If road maintenance is delayed, the cost of repairs and rehabilitation increases exponentially.

According to a SANRAL study in 2002, a delay in road maintenance by 3 to 5 years increases the required repair costs by between 6 and 18 times (SANRAL 2002). Also, because of the subsequent decrease in riding quality, the vehicle operating costs (i.e. road user costs) could easily double, with an associated ripple effect on the economy.

The assessment above has several implications for the management of road networks. Firstly, it calls for road authorities to capture the condition of the road networks under their control, to record the condition data and to assess deterioration trends over time. Secondly, the road condition data thus captured should be used as an input into the budgeting processes and to prioritise and optimise the maintenance/rehabilitation needs in line with available funding. Thirdly, road condition data enable road authorities to set key performance indicators and assess the performance of the road network against such indicators. This will assist road authorities in quantifying the size of the backlogs and formulating strategies to address these backlogs. One example of a possible key performance indicator is a recommendation by the World Bank that a well-managed road network should have no more than 10 percent of roads in a poor to very poor condition.

b) An Assessment of the Road Network Condition, Management and Service Delivery

The State of National Infrastructure report card released by the South African Institution of Civil Engineers awarded the following grades to roads. (A: very good; B: good; C: fair; D: poor; E: very poor):

- National roads: Grade C – Most in fair to very good condition, with recent strategic acquisitions in poorer shape. Increasing use of user-pays (tolling), but funding remains a challenge, especially given that key roads will soon require extensive refurbishing;
- All other roads: Grade D – Generally inadequate funding and management systems leading to neglect of maintenance, combined with overloading, means that maintenance backlogs are growing. Less condition monitoring than in the past. Shortages of skilled personnel. Decisions have been taken to stop maintaining some roads (SAICE 2006)

While it is accepted that transport is crucial to the well-being of any nation. The condition of transport infrastructure in South Africa has on the whole been allowed to deteriorate. Concern was noted in the report card that 72 percent of the national road network, with an asset value of approximately R50 billion and carrying over 70 percent of the national road freight, is nearing the end of its design life, placing additional pressure on the maintenance and rehabilitation backlogs. However, of greater concern is that the condition of the provincial and municipal road networks, with an estimated combined asset value of approximately R260 billion, generally continues to deteriorate. The reasons stated for the deterioration are, (a) insufficient funding in the past resulting in significant backlogs, (b) increased traffic volumes and heavy vehicle usage, (c) ageing network conditions, (d) unreliable road network condition data (i.e. a large number of road authorities capture road condition data haphazardly) and (e) the short supply of engineering skills.

On a more positive note, budgets for new capital works and for infrastructure rehabilitation have increased in the last few years. However, these budget increases have to a large extent been offset by a significant escalation in contract prices. In the Western Cape, for instance, contract prices towards the end of 2006 came in between 20 and 70% higher (30% higher on average) than what was estimated conservatively prior to going on tender. The higher contract prices were attributed to escalations in the costs of fuel, construction materials (e.g. bitumen) and skilled labour, amongst others.

A study undertaken in 2000 for the Department of Transport at provincial level indicated that 23% of all surfaced provincial roads were in 'poor' condition and 12% in 'very poor' condition and that, apart from the Province of the Western Cape, all other provinces reported more than 10% of the surfaced road network being in 'poor' to 'very poor' condition.

According to the Development Bank of Southern Africa 2006 report, the road network of the Gauteng Province appears to be in a fairly good condition, whereas the condition of the remainder of the provincial road network continues to decline. Assuming that the statement is correct, the Gauteng provincial road network thus presents a "best-case scenario" for protecting the network against further deterioration, relative to the situation in other provinces. However, 2005 data from the inventory of the Pavement Management System of the Gauteng Province show that 3 100 km or 80% of the total road network in Gauteng has a pavement structure older than 20 years, which is normally considered the design life of a road. In the 20 years since 1985, the proportion of roads in 'poor' and 'very poor' condition has increased from 4 to 24%, and the proportion of those in acceptable or better condition has reduced from 96 to 76%.

The overall decline in the condition of road infrastructure is partly the result of severe funding constraints experienced by provinces, but is also characteristic of the age of the network and implies the need for greater levels of maintenance and rehabilitation. The national government and provinces have acknowledged that over time road quality declines, and levels of funding have increased for almost all provinces. However, this increased level of funding has been insufficient to reverse the decline in road quality.

Provinces need to implement more effective road management systems to enable them to prioritise spending more effectively. Whereas some provinces have well-established road management systems in place, others have weak management systems; with some provinces allocating funds for maintenance and rehabilitation without any systems guiding their decisions. As was noted earlier, management systems serve no purpose if the information is inadequate, outdated or unreliable, which is currently the norm in a number of provinces. A comprehensive study should be undertaken to assess the overall condition of roads within the country and quantify the backlogs so as to provide a mechanism to assist in better prioritising funding.

c) Funding Flows for Provincial Roads

Over 96% of provincial expenditure is financed from transfers. Provincial allocations are split into the various provincial functions based on the provinces' own budgeting processes. The implication of this is that the provincial allocation to road infrastructure has to compete with other provincial needs such as housing, health and education for a share of the cake. In most provinces, the expenditure requirements to address social needs are such that the roads departments are left with inadequate financial resources to meet their basic road maintenance needs.

From a revenue generation perspective, less than half of the revenue collected in the form of fuel levies and other road traffic ordinance fees finds its way back to the road authorities and less than one-quarter was used as direct road expenditure. The larger amount is appropriated as part of general taxation allocated to meet the many competing needs of government. In 2000/01, it was estimated that backlogs for the rehabilitation of national and provincial roads were between R25 and R35 billion, and annual backlogs for road maintenance in the order of R4.6 billion for surfaced roads and R6.4 billion for gravel and access roads. These are, at best, approximations and a road needs study should be undertaken to obtain more reliable data.

The Department of Transport's Road Infrastructure Strategic Framework for South Africa does not offer clear solutions for addressing the annual maintenance shortfalls (reportedly R6 billion per annum in 2001) and rehabilitation backlogs for national and provincial roads. The Framework, however, does argue that the outcomes of road needs studies and improved information and management systems will provide support for a motivation to National Treasury for increased levels of funding allocations for road infrastructure delivery. It also suggests other funding streams to augment current funding such as fuel tax increases and surcharges on licence fees as short-term measures, and congestion pricing and weight-distance charging as longer-term measures.

d) Accounting for roads infrastructure spending in the PES formula

The design and implementation of an appropriate provincial equitable share formula is of critical importance for ensuring efficient and equitable public sector service delivery in South Africa. Following the review of the PES formula in 2004, the weight of the economic activity component of the formula was reduced to 1% and the backlog component was removed. The latter has to a large extent been absorbed in the Provincial Infrastructure Grant. There is obvious concern that the reduction in the weight of the economic activity component, following the 2004 revision of the PES formula, may have adversely affected the availability of funding for the maintenance of provincial roads, particularly since the revenue raising powers of provinces have not changed meaningfully notwithstanding the Provincial Tax Regulation Process Act of 2001. Conditional grants, such as the Provincial Infrastructure Grants are not designed to cater for routine and periodic maintenance of infrastructure, as they have to be spent on capital projects within defined parameters. As was noted earlier, neglecting maintenance could increase the repair costs by between 6 and 18 times.

Unless the provinces are able to raise their own revenue through borrowing or provincial taxation to cover their infrastructure maintenance needs, it is recommended that the impending PES formula review take into account road funding needs in order to enable the transfer of more funding to provinces for them to address their basic road maintenance needs. Failure to do so will result in an overall neglect of road maintenance in the provinces, and the provinces would have to rely on the Provincial Infrastructure Grant to reconstruct their assets at an exorbitant cost to the economy.

Sufficient levels of funding should thus be provided not only for the maintenance and replacement of infrastructure, but also for the upgrading of road space. In terms of road space management, road authorities have to deal with two types of backlogs which both impact on road user costs, namely:

road pavement condition and congestion. Congestion relates to traffic density, which is a function of the number of vehicles employing a road space at any point in time. Congestion goes hand-in-hand with a lack of road space to satisfy a demand. Whereas the existing road space, and the associated maintenance and replacement needs, can fairly easily be determined, it is more difficult to translate the lack of road space into a parameter that can be used in a formula. Hence, the infrastructure backlogs associated with congestion are probably best addressed by means of conditional grants.

5.6 Observations and Recommendations

Currently not all provinces have good road management systems that are necessary in ensuring the accurate capturing of data on road conditions. In the absence of good data on the conditions of roads, funding will not go where it is most required. The Commission therefore proposes that:

- All provinces should put in place more effective road management systems that will ensure that they are able to gather accurate data on road conditions and use this information in their road spending priorities.

Unless the ongoing needs of provinces towards road maintenance are explicitly considered in the comprehensive review of the PES, the condition of provincial roads will continue to worsen and the cost thereof rise exponentially. The Commission therefore recommends that:

- The impending review of the PES formula should consider provincial road expenditure needs and should be reconfigured in a manner that enables provinces to fund their maintenance needs.

Chapter 6 A Review of Financing of Housing Delivery

6.1 Background

The Financial and Fiscal Commission Submission for the 2006/07 Division of Revenue focused on the institutional factors hindering the speedy delivery of housing in South Africa. It gave attention to processes that negatively affected housing delivery such as the purchasing of land, environmental impact assessment and the proclamation of residential areas. The role of the different spheres of government in the housing delivery process was also discussed. The Submission further noted the delays and added costs attending the administration of applications for housing. The FFC recommended the acceleration of housing delivery through the realignment of its processes. It further recommended that municipalities with the capacity to deliver housing be accredited for this purpose. Moreover, it called for the linking of the Municipal Infrastructure Grant (MIG) and the local government equitable share with the housing conditional grant for coordinated and effective delivery. Government was receptive of these recommendations but noted that increases in the MIG accured in conjunction with increases in the equitable share.

In the 2007/08 Submission for the Division of Revenue the FFC gave attention to the housing conditional grant formula and its components. It noted that the grant was biased towards rapidly urbanizing provinces since it did not take account of traditional housing among its components. It also brought to the fore the differential costs in the delivery of housing in provinces.

The Submission also highlighted problems associated with the use of unofficial statistics to estimate the number of homeless people. Among its recommendations, the FFC called for the elimination of housing backlogs through the use of provincial cost different factors in the housing formula. Lastly, it recommended that monitoring of compliance with minimum standards be enhanced in order to ensure that quality is not compromised.

In its response to the FFC recommendations, the National Department of Housing indicated that some of the concerns raised by its research into the formula have since been addressed. The formula has been reviewed and traditional dwellings together with the development potential of rural areas are now included in the revised housing formula. The formula now uses the latest available and official statistics such as mid-year estimates published by StatSA to capture the need for housing. However, the National Department of Housing indicated that the projection of homelessness is difficult to estimate and has been excluded in the revised formula. The Department also indicated that, consistent and readily available data of housing need has to be investigated.

The purpose of this submission is to contribute to the development of a well and properly designed formula for the allocation of funding toward the rapid delivery of housing. Emphasis is placed on understanding the extent to which homelessness can be used as an indicator of housing need and if its exclusion in the revised formula has any impact on access to housing.

6.2 Key Findings

Housing plays a number of very important functions within society. At its most fundamental, it is necessary for shelter and protection against the elements. Through the provision of housing, exposure to the vagaries of whether such as searing heat, heavy rainfalls and colds can be avoided. More importantly, in South Africa, where the majority of citizens never had houses of their own but occupied government houses on a 99-year lease, the provision of housing is a critical basic right. Housing backlogs in South Africa remain a problem even against the good track record of housing delivery performance since 1994. Among others, high levels of unemployment, a growing population size and the scourge of HIV/Aids are some of the factors that render many households unable to own a house of their own. Some of the critical factors inhibiting the rapid and successful delivery of housing are discussed below.

a) Problems with the Design of the Subsidy

Among its attempts at addressing housing backlogs, government opted for a once-off capital subsidy. The design and operation of the housing subsidy scheme has had far reaching and undesirable effects on the delivery of housing in South Africa. The housing subsidy scheme has resulted in the poor location of housing units, the absence of integration, poor quality, and inadequate involvement of beneficiaries in the delivery of housing units led to the perception that the housing subsidy scheme was a government hand-out.

In terms of its design only a limited portion of the subsidy can be spent on purchasing land for housing. In the recent past a booming housing market has resulted in well-located land becoming unaffordable. The consequence was the building of subsidized houses on poorly-located land. Subsidized housing is therefore located in areas characterized by minimized income-generating opportunities away from the centers of economic activity. This state of affairs is contrary to the policy intention of creating sustainable communities that offer individuals access to economic opportunity as captured in the White Paper on Housing of 1994.

The poor location of subsidized housing is also attributed to the profit-making motives of private construction companies that initially dominated the provision of subsidized housing in South Africa [4](Mitlin undated). The capping of a specific portion of the subsidy amount for the purchasing of land ended up working against the profit maximization interests of private construction companies. The increase in land prices on the back of booming property market led to a situation where private construction companies could no longer recoup costs and their profit margins declined. As a result many private construction companies exited the subsidized housing sector in order to take advantage of growing profit margins in the high end of the housing market. One of the challenges currently affecting the rapid delivery of housing is the absence of large well-resourced construction companies. Under such circumstance, trying to halt housing backlogs becomes even more difficult.

Government believes that by providing those who cannot afford to purchase a house of their own with subsidized housing it is investing in their asset-building process for the future. However, evidence indicates that some of the beneficiaries of government-subsidized housing do not regard these houses as assets. The resale of subsidized housing is known to occur [5](Baumann in Gardner 2003: 12). The provision of a complete house through the subsidy scheme only, without the element of individual contribution, is among the factors leading to their re-sale. This state of affairs has fueled a perception that these houses are government handouts.

In the context of unemployment, people sell subsidized houses as a means of survival. A study by the Human Sciences Research Council found that, housing is unaffordable for the poor. The study concludes that the provision of serviced housing amid high levels of unemployment alone is not adequate. Jobs are also necessary in order to lift households out of poverty [6](Cross et al 2005). This however, is beyond the mandate of the housing department.

An observer of housing issues considers the amount of the subsidy in South Africa to be low in comparison to housing subsidies in other countries, especially Latin America [7](Gilbert in Rust 2003). Although the subsidy amount provides for the cost of connecting services such as electricity, water and sanitation, recurrent costs arising from the utilization of these services takes its toll on poor households and some sell their houses in order to eke out a living. The fact that this happens despite a law against such practices indicates the level of desperation.

Experience in Latin America, especially in Chile, shows that housing subsidies succeed when they are demand-driven rather than supply-driven [8](Katsura and Romanik 2002). Demand-side subsidies offer households the chance to choose houses that meet their housing needs. Such subsidies recognize the fact that the housing needs of households differ from one another.

4. Mitlin, D. Undated. Behind 'Win-Win' – The Politics, Interests and Ideologies within Subsidised Housing Development, School of Architecture and Planning. University of the Witwatersrand. Johannesburg, South Africa.
5. Gardner, D. 2003. Getting South Africans Under Shelter: An overview of the South African Housing Sector. Housing Finance Resource Programme. Johannesburg, South Africa.
6. Cross et al. 2005. Poverty pockets in Gauteng: How Migration Impacts Poverty, Urban, Rural and Economic Development. Human Sciences Research Council, Pretoria.
7. Rust, K. 2003. No shortcuts: South Africa's Progress in Implementing its Housing Policy, 1994-2002. Institute for housing of South Africa. Auckland Park. South Africa.
8. Katsura, H.M. and Romanik, C.T. 2002. Ensuring Access to Essential Services: Demand-Side Housing Subsidies. Social Protection Discussion Paper Series. World Bank Institute, Washington, D.C.

b) **Homelessness is an Important Housing Need Indicator**

Allocating housing subsidies requires good data and good analysis. This calls for regular collection and analysis of data containing crucial housing indicators such as housing interview surveys, housing supply studies, land market analysis and a housing finance review [9](Mayo 1999). Specifically designed housing needs surveys are used in many countries including America, Australia and the United Kingdom. Many countries also mix their population census with a census on housing [10](Senn and Yentis 1971). Such a census assists in measuring housing stock shortages, the number of households living in inadequate housing, overcrowding and houses without connector services.

In Australia for example, factors that are included in determining housing need include homelessness, overcrowding and affordability [11](Neutze et al 2002). Homelessness is measured by looking at people living in places for the homeless and shelters. In the United States, some local jurisdictions carry out surveys at night to count those regarded as 'rough sleepers' among the homeless. These include people found sleeping under bridges and other inconvenient places as result of being homeless. However, some observers raised concern over the non-inclusion of homelessness in the general American housing survey (Koebel et al 2003). While acknowledging the risk of double-counting that homelessness may engender, these authors advocate the inclusion of homelessness in housing surveys through use of a single point-in-time measure that best estimates homeless households. It is important therefore that the variable of homelessness is properly defined. The need to include homelessness as a variable for measuring housing need also emerges because housing supply shortages and high costs are an important cause of homelessness. In fact the United Nations research into homelessness that was published in 2000 mentions the provision of permanent housing and its subsidization as among interventions required to address homelessness. Homelessness is therefore a variable with enough explanatory power for inclusion in the housing formula.

6.3. Conclusion

Housing backlogs continue not only due to the legacy of the past but also because of high levels of unemployment, a growing population size and the HIV/AIDS pandemic. Other factors that compound the state of housing backlogs include the selling of subsidized houses by some beneficiaries. Housing need indicators are collected through housing surveys in other countries and homelessness is included as a variable in these surveys. This is more so because housing supply shortage is counted as one of the causes of homelessness.

In view of the analysis presented in this submission the Commission recommends that:

- A process for the collection of data on homelessness should be initiated. Such data should, in future, be included in the housing formula as part of the indicators of housing need.

9. Mayo, S.K. 1999. Subsidies in Housing. Sustainable Development Technical Papers Series. Inter-American Development Bank, Washington. D.C.
10. Senn, C.I. and Yentis, D. 1971. Defining and Measuring the National Housing Needs. American Journal of Planning and Housing. Volume 61 (12). Pp. 2341-7.
11. Neutze, M., Sanders, W. and Jones, R., 2000. Estimating Indigenous Housing Need for Public Funding Allocation: A Multi-Measure Approach. Center for Aboriginal Economic Policy Research. The Australlian National University.

Chapter 7 Assessment of the Fiscal Regime Applicable to Windfall Profits in the Liquid Fuel Sector

7.1 Introduction

The prices of petroleum products in South Africa are subject to substantial government intervention. The price makes adjustments for world oil price fluctuations, markups or 'margins' of the refineries and wholesale and retail costs. There are a number of taxes levied without discrimination on fuel derived from imported crude oil and synthetic sources. The synthetic oil industry in South Africa uses this administered pricing framework without reference to its production costs. With phenomenal increases in world oil prices driven by events completely outside the control of the synthetic industry, it is clear that synthetic oil companies are making substantial super normal profits. This issue has recently captured the attention of government and it set up a Task Team to advise the Minister of Finance on possible reforms to the fiscal regime applicable to windfall profits in the synthetic fuel industry.

In response to a request for comment on the discussion paper as well as other issues pertaining to windfall profit taxation, the Financial and Fiscal Commission (FFC) submitted the comments set out below. From the perspective of the FFC reforms to the fiscal regime applicable to windfall profits in general and to the liquid fuel energy sector in particular are likely to have significant implications for intergovernmental fiscal relations (IGFR).

7.2 General Comments on Proposals to Impose a New Windfall Tax On Oil Companies

The basic logic behind a windfall profit tax is quite simple. The (synthetic) oil industry made its investment and production plans under the assumption that oil would be selling for less than today's prices. Recall that even as recently as 1998, oil was selling for less than USD$15 a barrel, and it was averaging less than USD$25 prior to the recent surge in prices. This low oil price regime changed as soon as the United States began preparing to invade Iraq in 2002. This bred uncertainty and supply disruptions when the war commenced, leading to a dramatic but more importantly unexpected increase in world prices. The unexpected increase in demand from China and India further fuelled the energy price spiral. Since the industry was looking at much lower prices when it made most of its investment and production decisions, it can cover its costs and make a normal profit at prices that are less than a quarter the USD$70-USD$80 a barrel price seen at present in world markets. The synthetic oil industry has benefited in the sense that it sells into a captive domestic market at administered prices without reference to its production costs. This surge in prices has led to an unexpected glut of profits for the (synthetic) oil industry. The FFC's first impression is that taxing these unexpected windfalls could easily generate substantial revenue without in any way significantly threatening fuel supply in South Africa precisely because these profits were unexpected at the time of investment. It is this aspect of "unexpected" oil price increases that the FFC would wish to add to the definition of windfall profit. The FFC argues that a tax directed at windfall profits should also have very little impact on prices to consumers, since it does not directly affect the conditions of supply and demand in the market, at least in the short-term.

However, as is well known from the tax literature, a windfall profit tax could have negative incentive effects and could lead to economic distortions over time. The FFC's view is that these might prove acceptable under current circumstances. This is due to the high coal intensity of domestic oil production. In terms of incentive, any reduction in oil industry profits will reduce the oil industry's incentive to open new coalfields, which will be in line with the country's proposed environmental strategy towards reduction of greenhouse gases (see National Treasury's discussion document on environmental management posted on the National Treasury website in April 2006).

Since oil consumption and coal utilization in oil production is itself a major world environmental problem due to global warming, the major thrust of energy policy clearly must be to divert the economy away from fossil fuels, not to increase their production. For this reason, the modest long-term disincentives for opening up new coalfields that could result from a windfall profit tax should be viewed positively.

It is likely that oil firms will find ways to manipulate a tax based on their profits over time. In the international experience, oil firms have been known to merge with other companies, sell off parts of their operations or engage in other maneuvers that would make it difficult to construct a useful baseline against which to assess a windfall profits tax. To counter such manipulation, the FFC proposes that one option could be a temporary profit tax. As explained further on, the uncertainty

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around a temporary tax, that could in principle be renewed when necessary, presents a significant deterrent against manipulation. A company will be much less likely to incur the costs associated with manipulating the system, if it is uncertain that the tax will be in place after three years.

It is not impossible that world oil prices may revert to their pre-Iraq war levels. This will effectively erase the windfall profits currently being enjoyed by the oil industry and the resulting tax revenue. If such a price decline were to occur, then the near-term boost to the economy would almost certainly lead to an increase in other tax revenues that would offset the loss of the windfall profit tax revenue. Thus, the windfall profit tax effectively provides a limited hedge – if oil prices rise a great deal and slows down the economy, government has a new source of revenue into which it can tap. However, if oil prices drop back to their pre-war levels, then the economy will be growing fast enough such that the windfall profit tax revenue will not be needed.

7.3 Reforms to fiscal regimes and the equitable division of nationally raised revenue among national, provincial and local spheres of government

All taxes received by government are paid into the National Revenue Fund (Constitution, S213) from whence it is allocated equitably to National, Provincial and Local spheres of government (Constitution, S214 (1) (a, b, c)). In making the allocations, Government and the FFC are required to take into account several factors listed in S214 (2) a-j of the Constitution. From the above it is clear that reforms to fiscal regimes applicable to windfall profits in general will have a direct bearing on contributions to nationally collected revenue and the National Revenue Fund.

Significant changes to the volumes of the National Revenue Fund are likely to have positive or negative impacts on the factors listed in S214 (2) a-j. An important consideration in this respect is the factor "(i) the desirability of stable and predictable allocations of revenue". If windfall profits on natural resources are a function of external price shocks outside the control of government then any fiscal regime reform must examine these implications. These implications may relate to projections of expected annual national revenue collection. Such projections go into the determination of medium term expenditure plans and corresponding future obligations related to procurement and human resource engagement of all three spheres of government. The medium term planning process was introduced specifically to take into account the need for stable and predictable allocations. Clearly, an estimation of the impact of windfall taxes on this factor needs to be considered with respect to IGFR. Volatile changes in the national revenue collection may also impact negatively on predicting national debt service ratios and deficit financing requirements. In turn this may widen the country's exposure to negative interest rate, exchange rate, balance of payments and inflationary pressures. The extent to which these pressures impact on long term development and growth requires careful examination. As argued above, one way to address this would be to make the tax explicitly a temporary one. The FFC will continue to research this issue and will make its recommendations through the National Treasury at a later date.

7.4 Fiscal Regime Reforms and the Rights of Provinces and Local Governments to Raise their Own Revenues

In addition, the nature of the reforms themselves, especially those applicable to inputs into the liquid and synthetic fuel energy sector, will impact directly on the provincial and municipal sources of those inputs. This is particularly relevant for provinces and communities (e.g., Mpumalanga, Gauteng, Free State, Limpopo, North West, Northern Cape, KwaZulu Natal) where coal, gold, platinum, iron ore and other minerals are mined. Implied in the list of factors in the Constitution outlined above are developmental, environmental and fiscal capacity considerations. The extent to which provinces and municipalities use their legislative policy instruments and powers and functions [See sections 226, 227, 228, 229, the Provincial Tax Regulation Process Act (2001) and related legislation] to lay claim to taxes derived from the exploitation of resources located in their jurisdiction is an important point to consider. These spheres of government have constitutional and legislative powers to levy taxes and royalties to achieve the goals implied in the list of factors. Some communities such as the Bafokeng have already levied royalties on the mining of platinum on their land. These royalties revert directly to the community. Any fiscal regime reforms project needs to take account of these issues when assessing fiscal policies applicable to windfall profits in South Africa.

7.5 Specific Comments On Fiscal Measures

Below are the FFC's comments on the other specific measures outlined in the Task Team Discussion document.

- Revised subsidy regime:

  In a case where companies involved are of strategic importance and the measure does appear to make sense a subsidy may be the best option. However, the FFC argues that the floor price should be as close as possible to a price at which the industry makes a normal return and not excessive profit. Any price above the floor price should be recouped by the State.

- Cost-based administered price regime:

  This proposal is also sensible. It has flexibility and ensures that only the windfall portion of the profit is taxed. The tax will disappear once oil prices return to normality. The approach, however, is problematic in the sense that it inadvertently introduces distortions by treating differently perfectly substitutable goods (synthetic industry output and other oil industry output) as well as introducing rigidities in the budget system. Because the tax will disappear with the windfall, the latter may introduce uncertainty into the revenue sharing formulae. If government spheres were to make arrangements for future expenditure based on this revenue, this may cause problems should windfall revenue disappear during the course of a project cycle.

- Progressive formula tax:

  This regime is preferred by the FFC because there is precedence for such taxes and also because

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it has an equitable element in that the tax is progressive and directly linked to profit. The tax also displays flexibility and is easy to administer.

- Investment-linked tax and subsidy options:

  The view of the FFC is that subsidies should be used very selectively and only in cases where a case of genuine need is made. Environmental considerations may warrant such a need.

- Other alternative fiscal measures that may be appropriate

  The FFC is generally unfavourable to the idea of a proposed 1 percent reduction in royalties for low grade coal that is used to manufacture synthetic fuels and/or electricity. The costs of the synthetic fuel industry are "sunk-costs" so that costs of acquiring feedstock do not influence operations. Also, there is no merit in giving incentives to activities that damage the environment. If the alternative was towards providing an incentive for cleaner coal technology, then the proposal may have merit. Our contention, however, is that royalties may in the future be considered as provincial own revenue sources.

7.6 Conclusion and Recommendations

This submission documents the initial response to a recent proposal to reform the fiscal regime applicable to oil windfall profits in general and to the liquid fuel energy sector in particular in South Africa. Based on discussions above, the Financial and Fiscal Commission:

1. welcomes the proposals to tax abnormal profits generated in the oil industry consequent on the higher than expected world oil prices
2. recognizes that taxing oil windfalls profits could generate substantial revenue without in any way significantly threatening fuel supply
3. believes that at least in the short-term a windfall profits tax will have very little impact on prices as it does not directly affect the conditions of supply and demand
4. analysis indicates that the macroeconomic repercussions of a windfall tax for the oil sector are also likely to be minimal
5. notes that a windfall profit tax could have negative incentive effects that would lead to economic distortions over time
6. supports an energy policy that clearly diverts the economy away from fossil fuels, as oil consumption is itself a major world environmental problem
7. supports all strategies to counter industry avoidance of paying windfall taxes
8. encourages the introduction of strategies that counter exposure to external price shocks on natural resource production, especially if these shocks have negative implications on projections and predictability of nationally collected revenues
9. urges careful consideration of the extent to which provinces and municipalities could lay claim to taxes derived from the exploitation of resources located in their jurisdiction
10. discourages the use of a revised subsidy regime
11. finds some merit in the cost-based administered price regime because of its flexibility

12. prefers the progressive formula tax as there is precedence for its use and because it is equitable and flexible
13. finds the investment-linked tax and subsidy option attractive if coupled with an environmental policy objective
14. is generally unfavourable to the idea of a proposed 1 percent reduction in royalties for low grade coal as it is unlikely to induce any behavioural change in producers
15. will undertake further detailed research on the sustainable responses to high oil prices and will communicate its findings through National Treasury.

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Chapter 8

A framework for considering market based instruments to support environmental fiscal reform in South Africa: Initial Comments On National Treasury's Draft Policy Paper

8.1 Introduction

This submission makes comments on a recently released draft environmental policy paper by the National Treasury (the document is available at http://www.treasury.gov.za). The draft policy paper has two major parts: The first provides the analytical machinery necessary to demonstrate instances when market based instruments such as environmentally related taxes and charges could be important in supporting sustainable development in South Africa. The second defines the many actual tax and incentive proposals to support sustainable development. From the perspective of the Financial and Fiscal Commission (FFC), the proposed reforms are likely to have significant revenue consequences, impacting on fiscal capacity of government levels as well as on intergovernmental fiscal relations (IGFR).

8.2 Summary and Recommendations

This submission gives an initial response to a recently released draft environmental policy paper by the National Treasury. It presents some detailed chapter by chapter comments pertaining to the

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possible economic impacts and IGFR implications that may be associated with reforms to environmental management.

For convenience summarised below are the preliminary comments of the Commission based on detailed arguments presented in the FFC submission to National Treasury.

- The FFC welcomes the initiatives suggested by National Treasury to address environmental problems. The Report contributes significantly to the debate on environmental management in South Africa.
- While the Report provides a detailed description of generic interventions to address environmental problems, there is very little attention to why these interventions are the right ones for South Africa. To be useful for actual policy discussion, there is need to deepen the discussion, moving from generic discussion towards a South African tailored discussion. The FFC finds details of implementation lacking (as opposed to broad policy intent). This is crucial since the most well designed environmental policy initiative will be undermined in the implementation.
- The Report also needs to be explicit on the rationale and purpose for the intervention. As it stands, the Report appears torn between revenue raising objectives and environmental objectives. If the objective is environmental, then the FFC suggests that all aspects of market failure, including those induced by government policy ought to be considered.
- The Report's discussion of the impacts of the proposals on IGFR needs to be strengthened. The National Environment Management Air Quality Act which clearly lays out national, provincial and local roles, norms and standards and monitoring and evaluation frameworks which are conducive to market based instruments should be used as the major point of departure in this exercise.
- There is a need for more clarity of roles and responsibility envisaged. We suggest that:
  - An institutional table could be published showing the sphere of government responsible for which environmental problem and which tax instrument
  - Is there not a case for earmarking environmental revenues/royalties at the local or lowest government level where environmental damage/mining takes place?
- There is also a comment on the issue of Sustainability raised in the submission. The issue is that environmental revenues are fully reflected in the budget but sustainability issues are not explicitly addressed in the budget. This raises the problem that
  - They are fully fungible[12] with the other resources in the Consolidated Fund and spent through the standard appropriation process
  - There are no policies discussed to set aside part of the environmental revenues for the benefit of future generations.
- Earmarking taxes is usually a contentious issue and is often subject to criticisms that it violates the constitution. In the particular case of addressing environmental problems, the FFC finds the reasons advanced to be sound because:

  a) The issue is NOT revenue raising but addressing an environmental problem

12. **Fully Fungible** means substitutable, capable of being interchanged. This applies to revenue that, regardless of its original source, can be spent on any activity or programme.

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b) Earmarking is reasonable because there is a clear and strong link between taxes and benefits/costs of damage

c) Examples of such earmarking are widespread in South Africa and abroad.

However, the FFC would want to raise the following concerns:

a) Excessive use of earmarking can reduce transparency as well as fiscal policy control and flexibility

b) Thus, arrangements should be subjected to the same discipline as other budget appropriations. Activities undertaken through earmarked funds should be not overly influenced by short term considerations that affect the budget

- The FFC finds the idea of formalizing and standardizing the environmental policy development process appealing. However, the Report needs to present more detail or processes to be followed.
- Policies on waste should be expanded to include those covering both transboundary movement of waste and waste minimization within national and subnational boundaries. There should be a discussion of the informal participation in e-waste disposal that can have important implications for poverty reduction.
- Proposals put forward on agriculture should cover a discussion on poverty as well as the importance of multi-functionality of agriculture.
- Policies to promote renewable energy and technology transfer should be prioritized.
- The FFC is favourably disposed to the idea of revenue recycling. However, the FFC would like to point out that environmental taxes of the magnitude required to substitute for income taxes could constitute a significant shock to the economy. We suggest that after careful evaluation, they be phased in gradually if studies do indeed confirm potential existence of the said dividends. As well, the exact details of revenue recycling on intergovernmental relations needs to be carefully spelt out, specifying whether it applies across provinces and lower level jurisdictions.
- The Report notes that the proposed changes impact on efficiency, welfare, equity, poverty, fiscal capacity and the macroeconomy. Increases in environmental taxes are basically a contractionary fiscal policy that would tend to reduce aggregate output and employment and produce a temporary increase in the rate of inflation above the baseline. This would further impact on revenue raising capacity of government, hence impacting on service delivery. Without a clearer understanding of the economic effects in this way and the magnitude of the impacts, it is hard to judge the appropriateness of the Report's enthusiasm for market based instruments to address environmental problems. The FFC suggests that further research addresses these issues.
- One of the major concerns that the FFC has is the apparent lack of coordination between the proposals by National Treasury and those by other government units such as the Department of Trade and Industry's spatial development plan and the Accelerated and Shared Growth Initiative in South Africa. Thus for instance, the latter are targeting certain industries for

public support based on their high economic multipliers without taking into account the environmental degradation such industries may cause. A case in point is aluminium smeltering. The FFC would like to encourage higher coordination between the environment and economic plans.

- The FFC will undertake further detailed research on the sustainable responses to high oil prices and will communicate its findings through National Treasury.

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Chapter 9 Financial and Fiscal Commission Submission on the Municipal Fiscal Powers and Functions Bill

9.1 Introduction

This submission is made in terms of Section 229 of the Constitution of the Republic of South Africa, which requires the Commission to make recommendations to the Minister of Finance before any legislation enabling the implementation of local government fiscal powers.

9.2 General comments

1. The Financial and Fiscal Commission (FFC) welcomes the Bill tabled by the National Treasury enabling legislation supporting section 229 of the Constitution. The legislation outlines processes which municipalities (and The Minister of Finance) have to follow in exercising fiscal powers and functions as stipulated in the Constitution. It must however be noted that revenue raising powers assigned to the municipalities, although subject to national legislation, should be based on the principle of enhancing the fiscal autonomy of the local government sphere. The Bill therefore should not go beyond creating the enabling environment for municipalities to

exercise their fiscal powers as assigned by the Constitution. While it is appropriate that the Minister prescribes national norms and standards for municipal surcharges, there is no requirement for the Minister to pronounce on how the revenue derived should be spent. The manner in which revenue is spent is the primary responsibility of the municipality as it is accountable to its electorate and taxpayers.

2. The FFC notes that in the section dealing with the general objects of the Bill, reference is made to the Constitution, however throughout the Bill there is no reference to the role of the FFC. Section 3 of the Amended Financial and Fiscal Commission Act of 1997, requires any organ of state in one sphere of government seeking to assign a power or function in another sphere of government in terms of a law to first, before assigning the power or function, notify the Commission of the fiscal and financial implications of such assignment and also request the recommendation or advice of the Commission regarding such assignment.
3. As is the case with the Provincial Tax Regulation Process Act (2001), the Bill should include a clause outlining the constitutional role of the FFC and specify a time frame between receipt of tax proposal and submission of comments/recommendations to the Minister by the Commission.
4. The Bill is a fiscal Bill, and should thus deal with taxes first, and surcharges thereafter. Taxes are a primary tool, and surcharges are secondary tools, imposed on taxes. This implies that the structure should be revised so that the section dealing with taxes precedes the one dealing with surcharges.

9.3 Specific Comments

1. Objects of Act
   a) In section 1, "municipal tax" is already defined to include, "tax, levy or duty", so there is no need to repeat this latter terminology. These two points have obvious implications for sections 2 and 3, which logically (and more simply) should read as follows:
2. The objects of this Act are to -
   a) to (d) - no changes by –
      i) authorising the municipal taxes and municipal surcharges that municipalities may impose under section 229(1) (b) of the Constitution; and
      ii) regulating the exercise by municipalities of their power to impose municipal taxes and municipal surcharges, if authorised.
   b) Section 2 (a) should also include the promotion of "transparency".
   c) Section 2(b) should also include differentiation between different capacities of municipalities responsible for the imposition, administration and collection of the surcharges. It should also identify different tax bases and revenue potential.
2. Application of Act
   a) S4(2)(b) envisages that the imposition of surcharges and the levying of new taxes will be widely differentiated. Specific taxes may only apply to particular kinds of municipalities,

outside the constitutional categories A,B,C. Surcharges may differ between categories and classifications of taxpayers or service users. This allows a level of price discrimination that may be used effectively, and will enable local governments to develop their own revenue mix appropriate to their revenue bases. Regulation of prices under these circumstances is, however extremely difficult.

b) S5 should include a clause requiring the municipality to include a surcharge in the adoption of a tariff policy as in Section 74 of the Municipal System Act and the relevant amendment in the Section 10 of the Municipal Systems Amendment Act (2003).

c) S6: The Bill needs to link the imposition of surcharges to Section 41-43 of the Municipal Finance Management Act? This link should be cross-referenced to this Act.

d) S6: It is unclear why "organized local government" should make an application for a tax given that organized local government is usually consulted on a proposed local government tax. While it is an organ of state it is not an executive or government authority for implementing taxes– provinces and local government are executive authorities.

e) S13(1) should read:

(1) A municipality must within six months of the date on which this Act commences, apply to the Minister in accordance with the provision of this Act for the authorization of any tax or surcharge, other than a regional establishment levy or regional services levy imposed under the Regional Services Council Act, 1985 (Act No. 109 of 1985) and the KwaZulu and Natal Joint Services Act, 1990 (Act No. 84 of 1990), imposed by that municipality and in force immediately prior to the commencement of this Act.

The reason for this is that the current wording implies that it only applies to tax (and not surcharges), and also implies that the paragraph does not apply to tax imposed before the commencement of the new Act.

3. Memorandum on the Objects of the Bill

a) Regional Services Councils (RSC) and Joint Services Board (JSB) levies: Paragraph 1.2

The Bill finally repeals s 93 (c) of the Municipal Structures Act under which RSC levies were collected. The onus of finding a replacement now seems to rest upon local governments themselves, jointly with SALGA or independently. This will be a heavy burden for local government in the absence of significant resources and appropriate administrative capacity. Furthermore, there is no indication of the status of the National Treasury's own initiatives in this regard. With the repeal of the RSC/JSB levies National Treasury seemed to be playing a significant role in the process of local government tax reform.

The Bill shifts the initiative for initiating a new tax onto the local government community, but as the Constitution provides, the right of approval is in the hands of the Minister of Finance. The burden of finding a replacement for the RSC levies thus is placed on the shoulders of local governments themselves. This allows local communities greater say, but places heavy reliance on their capacity to undertake a complex process of tax modeling and seeking approval. Currently, it seems that only metropolitan and some larger district municipalities have the capacity to undertake such complex processes. It is also hard to see how a coherent set of fiscal reforms can result, without national government, through its authorization powers, assisting local government in exercising this function. The Act requires that all existing taxes and surcharges be subjected to this process within a very short period, or be automatically revoked. The only exemption from this provision is property rates. Such a limited timeframe requirement could be onerous, imposing a heavy "burden of proof "on municipalities. An extension of the timeframe should be considered.

b) Financial implications to the state: Paragraph 5

It is possible that there may be financial implications for municipalities, especially those distributing electricity, where surcharges are already high and used for cross-subsidisation of a range of other basic services. Any lowering/changes to surcharges could negatively impact on the revenues of such municipalities.

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Chapter 10 The Fiscal Implications of the Re-demarcation of Provincial Boundaries - Financial and Fiscal Commission Supplementary Submission for the Division of Revenue 2007-08

10.1 Introduction

This submission was made in terms of section 214 of the Constitution and section 3 of the Financial and Fiscal Commission (FFC) Amended Act (2004). In its Submission on the Division of Revenue for 2007/08, the Commission's recommendations did not take into account the recent re-demarcation of provincial boundaries and the fiscal implications arising from the re-determination of boundaries. While the Commission's submission on the Division of Revenue for 2007 was made to Parliament before the legislation enabling the newly re-demarcated provincial boundaries was tabled and approved, the FFC was never directly consulted on the matter. However, the FFC Amendment Act (2004) requires that the Commission should be consulted and its recommendations submitted to the Minister of Finance in cases where the decision of any organ of state has fiscal implications on another sphere of government. In addition to complying with the provisions of section 214 of the Constitution, this submission complies with the relevant provision of the FFC Amendment Act.

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In South Africa, provincial governments have responsibility for a wide range of functions. Most important among these are education, health care, social welfare, and public transportation. The 1996 Constitution allows provincial governments to impose taxes on any base except personal and corporate income, general sales, value added, customs and property. However, the narrow nature of available tax bases means that for most provinces, income raised within their jurisdictions as "own revenue" (mainly from motor vehicle licenses and hospital fees) amount to less than 5 percent of provincial budgets.

To ensure that provincial governments have sufficient resources to deliver on their expenditure responsibilities and functions, the Constitution entitles provincial governments to an equitable share of fiscal resources collected at the national level. While the total pool of funds dedicated to the provincial sphere (the vertical allocation) is determined through a political process, each province's share of the pool (the horizontal division) is determined using the provincial equitable share (PES) formula. The PES formula has six components – education, health, basic share, poverty, economic activity and institutional component, and is mainly driven by the demographic characteristics (number of people, number of poor households, number of learners etc) underlying a particular province.

In March 2006, national government announced a number of changes to municipal boundaries. These included:[13]

- The elimination of nine cross border municipalities
- The movement of three whole municipalities to new provinces, and
- The incorporation of six district municipal areas into existing municipalities.

While the changes occurred at the local government sphere, there have also been significant implications, in terms of population sizes, for the provincial areas of the Eastern Cape, Gauteng, Kwazulu-Natal, Limpopo, Mpumalanga, Northern Cape and North-West. Updated statistics indicate that:

- The population of the Eastern Cape province reduced by 158, 111 persons
- The population of Gauteng province increased by 341,696
- Kwazulu-Natal's population increased by 158, 114
- 278, 106 persons are no longer within the jurisdiction of the Limpopo province
- The population size of Mpumalanga increased by 242, 895
- Northern Cape province gained 169,192 persons, and
- The population in the North-West province decreased by 475,674.

10.2 Assessing Fiscal Implications of Re-demarcation

a) General Issues

From the Financial and Fiscal Commission's (FFC) perspective, changes in provincial demographics following the amendments to municipal boundaries will have significant implication for South Africa's intergovernmental fiscal relations. The fiscal implications can be divided into two broad areas:

13. Information derived from Statistics South Africa.

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- Direct implications related to changes in the PES allocations as a result of changes in provincial demographics, and
- The indirect implications which result from the application of different norms and standards in provinces.

As mentioned earlier, the PES formula is mainly driven by the underlying demographic characteristics of provinces. The equitable share formula is reviewed and updated every year for new data, taking into account the recommendations of the FFC. At present, the formula consists of four main components and two smaller elements, all of which capture the relative demand for services between provinces and take into account particular provincial circumstances. The components relate to education, health, population per province (or basic share), institutional capacity, poverty and economic output.[14] With the movement of municipalities leading to a re-determination of provincial boundaries, provinces are bound to experience significant changes in the composition of the population in terms of the number of poor people, poor households, school learners, health care facilities, access to medical aid etc, which are all essential for attaching weights to the components of the PES formula and deriving equitable share allocations to provinces. These changes are outlined in the discussion that follows.

Available data include historical releases (2002 and 2003) of the General Household Survey (GHS) which have been brought in line with Statistics South Africa's recent update of its mortality assumptions for the 2004 and 2005 GHS. This new data necessitates a revision of the PES formula to align it with previous benchmarks to include the 2005 GHS, 2006 enrollment numbers and the 2004 regional GDP figures. The effect of the re-alignment of data on components of the PES formula can be summarised as follows:

- The major population shifts occur in the provinces of Gauteng, Kwazulu-Natal (KZN) and Northern Cape. These provinces experience an increase in their respective population sizes (by 4.6, 2.1 and 21.9 percent respectively) while the population in the Eastern Cape, Limpopo and North West decline by 2.5, 4.5 and 15 percent respectively. The most significant effect of the change in population sizes is on the basic component share of the PES. The changes in each province's basic component share (based on per provinces share of total population) as a result of the demarcation indicate that the relatively significant changes are to the increased shares of Gauteng, Mpumalanga and Northern Cape, as well as the decreased shares of the North West province.
- With respect to the education component, the shifts in re-aligned Census 2001 school age-cohort data appear to be in line with new provincial boundaries with 2006 enrollment numbers closely correlated to available school age-cohort data. Based on post demarcation figures, the weighted shares for Eastern Cape, Free State, Limpopo, North West and Western Cape decline, while the weighted shares for the other provinces increase.
- The health component is affected in the same manner as changes in the basic component with the notable change been the decrease in the weighted shares of Eastern Cape, KZN, Limpopo, North-West and Western Cape
- Owing to the difficulty in re-aligning the 2000 Income and Expenditure Survey [IES] to new provincial boundaries, the poverty component is simply updated to reflect the number of poor

14. For a detailed presentation on the design of the PES formula and structure & distribution per component, see Annexure E of National Treasury's 2006 Intergovernmental Fiscal Review, and Rao & Khumalo (2004).

households as well as the number of poor people. With these updates, the significant change occurs in the decline of the poverty shares for Limpopo, North-West and Western Cape

- With the data on regional GDP (GDP-R) falling outside the sampling areas of Statistics South Africa, the economic activity component is not re-aligned to the new provincial boundaries. Instead the component is updated using the 2004 GDP-R data. It is however important to note two key issues
  - i) Stats SA's indication that it does not foresee the re-determination of provincial boundaries having an impact on its GDP-R figures
  - ii) The late release (in November 2006) could make it difficult to factor in 2005 GDP-R figures into the formula as the PES shares are already known to provinces, and provinces are also at an advanced stage in their budgetary process. According to National Treasury, the decision to update the formula with latest GDP-R figures will be informed by the magnitude of post-medium term budget policy statement revisions to the formula.
- The institutional component remains unchanged

In addition to the changes outlined above, there are two crucial policy decisions that must be taken into account. The first relates to discontinuing the use of 'moving averages' in calculating PES allocations. The FFC has in the past noted that the use of moving averages tends to (i) distort demographic shifts in provinces as historical information tends to significantly mute migration patterns, especially towards provinces that have greater inward migration, and (ii) introduce lags in the formula given the important role historic information plays in determining formula allocations.

The second decision is whether or not to phase-in the changes in allocations resulting from the revisions to the PES formula.

b) Preliminary Comments from the FFC

From the perspective of the FFC, the following comments are pertinent:

1. The discontinued use of moving averages is welcomed. As previously noted by the FFC, the weights for the seven components in the PES formula are determined historically. Although this might have depended on expenditures when it was initially introduced, the weights are not sensitive to the changing composition of expenditures. To take this process forward the following important policy issues need to be considered:
   - i) The use of alternative factors instead of the current weighted averages (in case of the education component, the FFC has in the past recommended the use of actual enrollment figures as opposed to moving averages of school-age population and enrollment).
   - ii) Further discussion and research on the technical revisions to the components of the PES formula for the horizontal division. In this regard particular attention is required for revisions to the data used. In addition further research is required on the impact of the changes in population statistics and the implications of phasing-in these changes over a ten year census cycle for different provinces..
   - iii) The proposed research above will require a quantitative assessment of the data and projected allocations under different scenarios i.e. sensitivity analyses needs to be done on the relevant variables from the PES formula to quantify the changes.

2. Demarcation of boundaries raises a number of concerns relating to expenditure commitments that are outside the bounds of the PES (and indeed LES). These include for example, the transaction costs associated with the transition phase of the demarcation process. For such issues to be properly addressed will require an assessment of the extent of the costs differences associated with the application of different norms and standards across provinces and, other the relevant issues that are beyond the control of the provinces. To highlight these, we note some examples:
   i) The quality of health care facilities: Anecdotal evidence suggests that richer provinces such as Gauteng and KZN may be able to provide health care facilities in line with or above nationally agreed norms and standards. Health care facilities inherited from North-West or Eastern Cape may not be equivalent to what obtains in Gauteng or KZN. For equity purposes, Gauteng and KZN might wish to spend resources to ensure such facilities meet provincial standards.
   ii) The argument above also applies to the quality of education facilities and infrastructure. In addition, provinces fund different learners in different quintiles differently. Beyond the budgets for education, how do provinces fund different learners in similar quintiles? Also, there are programs such as the school nutrition program that are funded in differing ways across provinces. What are the implications of harmonizing the funding programs for provinces receiving new education centers?
   iii) The movement of persons and the drawing up of municipal boundaries have implications for revenue bases of provinces. For instance, re-demarcation has meant that the North-West Province experienced the loss of two casinos. These casinos where located in an area where the North-West province was receiving a significant amount of own revenue. The loss of these casinos and associated economic activity implies that the North-West own revenue has declined. It is thus a matter of technical analysis to show whether or not the trade-off between the economic activity and poverty components of the PES formula fully compensate the North-West province.
   iv) Crucially, there will be a movement of administrative personnel across provinces. Although in many instances, the public service structures across provinces are relatively similar, some provinces, in order to promote skills retention may have incentive packages for certain groups of employees. For instance, North-West offers its social workers car allowances. If these social workers move to Gauteng, will they lose these benefits? There would also be implications for the receiving province as they would need to maintain parity in remuneration scales.
3. It is difficult to determine with certainty, a priori, whether GDP-R is totally unaffected by the demarcation process. In order to ascertain the full impact, a careful assessment needs to be conducted of per capita or average income levels and the amount of taxes generated by persons located in municipalities transferred to other provinces. In addition, it would be pertinent to determine the level of "net fiscal benefit" arising from the re-demarcation process, and its potential effects in creating fiscally induced migration.[15]

15. 'Net fiscal benefit' in this case can be measured as the difference between the value of publicly provided services and /municipal/provincial taxes. In cases where individuals are moved to new provinces, it might well result in positive net fiscal benefits, and cause greater fiscally induced migration. In such a scenario, it may be important for the PES to be able to compensate provinces for the provision of services in line with their Constitutional mandate.

4. It is well known that local governments that were affected were not compensated. Based on sound principles of intergovernmental relations, the re-allocation of functions will require that when national government changes boundaries, compensation is provided for any resulting vertical fiscal externalities. As provinces do not apply uniform norms in the delivery of basic services, there are bound to be certain expenditures that are not directly addressed through the PES. In that case, there are inadequate mechanisms and processes in place to enable provinces to adjust standards downwards or apply them differently. Under these circumstances, there may be genuine reasons to compensate negatively affected provinces.
5. Given the absence of policy guidelines, it is important that a set of principles be established as a guide for future changes to provincial and municipal boundaries. This will ensure that the intergovernmental fiscal system is not destabilized.

10.3 Recommendations

i) The FFC supports the view that both the Provincial Equitable Share and the Local Government Equitable share formulae should be revised to take into account changes, including the revised census data from Statistics South Africa, resulting from the re-demarcated boundaries for municipalities and provinces.

ii) The FFC proposes that any additional costs faced by provinces and municipalities that cannot be met through the revised equitable share allocations be funded through a once off allocation from the national government. Such an allocation may be justified on basis that in principle the formulae are designed such that funds follow need determined by the demographic composition in provinces and municipalities. However, currently the formulae do not fund the administrative costs associated with the prioritization and the choice of norms and standards for delivery of basic services.

iii) The FFC proposes that changes to the boundaries of sub- national authorities be aligned with the financial year(s) system applicable for provincial/municipal authorities. This will allow for the required fiscal changes to be phased in and reduce the financial burden related to dealing with fiscal implications that might arise out of the re-determination of boundaries.

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Chapter 11

Budget Analysis: Spending Performance and Capacity of Provincial Government Departments

11.1 Objectives and methodology

The primary objective of this component of the Financial and Fiscal Commission's submission for the 2008 Division of Revenue is to measure and analyze the fiscal and financial performance of provincial government departments and to make observations and advisories on how capacity to improve performance can be further developed. This analysis will inform the Commission's future recommendations.

The Commission is developing a methodology, in consultation with Parliament and the Provincial Legislatures and stakeholders in national and provincial government departments to measure fiscal performance and capacity on the basis of the evaluative criteria listed in Section 214 (2) a-j of Chapter 13 of the Constitution. This methodology builds on a base of analytical research criteria developed by the Commission in its earlier submissions.

The quantitative aspects of the methodology involve comparing budgeting and spending trends over the previous 3 years (i.e. FY 2003 to FY 2005) with projected budgets for the forthcoming Medium-Term Expenditure Framework (i.e. FY 2007 to FY 2009). The source material used is the Annual

Financial Statements and Budget Statements of provincial government departments as collated by the National Treasury.

On the basis of (a) national policy directives and (b) the stability of past budget and spending growth paths and the degree of equivalence between budgets and spending, observations and advisories are proposed in respect of budgetary allocations for the outer years of the 2007 and 2008 MTEF periods (i.e. FY 2008 to FY 2010).

Ideally these financial indicators are supplemented with non-financial indicators such that measures of progressive realisation (or backlog eradication), cost-efficiency of service delivery outputs and cost-effectiveness of socio-economic developmental impact can be measured and used to inform recommendations on the outer-year budgetary allocations.

Currently, the most comprehensive source of data on provincial government delivery performance is the Provincial Budget and Expenditure Review (PBER). However to date, this contains limited time series data making trend analysis patchy.

Coverage of provincial government departments, programs and categories is, as yet, incomplete. However, analyses of all departments listed in or implied by the Bill of Rights are in a separate report presented in Annexure A3.

11.2 Policy Performance

Policy performance is analyzed by comparing relative (real, annual) growth rates of budgets against the prescripts of national policy objectives and priorities. Where departments, programs or categories grow at a faster rate than the provincial government average, that department, program or category is assumed to have been, de facto, prioritized. Lower than average budget growth (or perhaps decline) implies the opposite and is the necessary trade-off against scarce resources.

Where national policy emphasis and relatively high budget growth rates coincide, this is noted in the analysis. Where there are clear disjunctures between the prescripts of national policy and budgetary allocations, observations will be made about allocations for the outer years of the 2007 medium-term budget.

National policy prescripts are derived from several sources. In the first instance, the over-arching, macro-scale socio-economic development strategies of ASGISA (Accelerated and Shared Growth Initiative of South Africa) and JIPSA (Joint Initiative on Priority Skills Acquisition) are taken to imply a budgetary growth emphasis on infrastructure capital provision and professional and other scarce skills generation. By implication, the trade-offs will be felt in personnel and other components of the operating budget.

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Table 7.1: Policy and Spending Performance Indicators of Provincial Governments – FY 2003 to FY 2009

Item	Policy Performance			Spending Performance
Department / Category	Real Growth of Budgets between FY 2003 and FY 2005	Real Growth of Budgets between FY 2007 and FY 2009	% of Total Government Spend - FY 2006	Under- or (Over-) Spending FY 2003 to FY 2005
All Provincial Departments	5.02%	4.13%	100.00%	2.25%
Personnel	3.20%	2.29%	56.00%	0.54%
Training*	Not known	7.35%	0.77%	Not known
Capital	8.82%	5.46%	8.51%	10.59%

Source: Annual Financial Statements (2004, 2005) and Budget Statements (2007) of Provinces

Note: Training data is incomplete in terms of time series and cross-provincial coverage

As indicated in Table 7.1 above, provincial government capital and training budgets have been or are projected to continue growing at above average rates, whilst the majority category of spending, namely personnel, is growing at below average rates of provincial government budget growth. Training constituted 1.38 percent of personnel budgets in 2006 and this is appropriately higher than the 1 percent stipulated by the Department of Labour for funding the Sectoral Education and Training Authorities (SETA). To date, personnel budgets have not been dis-aggregated into skills categories. Disaggregation would enable closer analysis of how professional and other skills shortages are being tackled through budgetary measures designed to develop, attract and retain skills.

Other compatible national policy prescripts can be derived from the Extended Public Works Program (EPWP). This programme which favours infrastructure development that adopts labour- and small contractor- intensive construction and maintenance methodologies, coupled with access to skills training initiatives. Apart from prioritizing capital and training budgets; departmental or programmatic emphases might be placed on road infrastructure (Transport), housing, on-and off-farm infrastructure (Agriculture), schools (Education) and possibly clinics and hospitals.

National policy emphases for the forthcoming medium-term cycle of strategic, operational and budgetary planning can be identified from the State of the Nation and Budget speeches presented to Parliament in February 2007 by the President and the Minister of Finance respectively. These speeches translate the long-term and over-arching policy priorities indicated above, as well as other considerations (such as preparations for the 2010 World Cup) into both general and department-specific emphases for the medium-term. The more department- or sector-specific priorities are analysed further in Annexure three.

These national policy objectives and priorities are taken to represent the following evaluative criteria as listed in Section 214 (2) a-j in the Constitution:

a) the national interest;

b) the needs and interests of the national government, determined by objective criteria; and

c) the obligations of the provinces in terms of national legislation such as the Division of Revenue Bill.

11.3 Spending and Budgeting Performance

Spending performance is measured by the proportion of the budget that is under-or over-spent.

Over-spending is considered unauthorized expenditure by the Auditor-General and may be considered indicative of the moral hazards of inter-governmental fiscal relations that can threaten macro-economic stability. Criteria (b) of Section 214 (2) a-j notes that Commission recommendations should take into account "any provision made in respect of the national debt and other national obligations". Current fiscal policy stance involves reducing the government deficit and sustaining the current budgetary surplus.

Under-spending often implies institutional capacity constraints in delivery and is viewed negatively by the Auditor General if higher than 5% of budget. It is possible that challenges of institutional co-ordination and systems development (especially in respect of capital spending) and skills or experience gaps (in respect of newer programs) may explain persistent under-spending over the medium-term.

However, under- or over-spending could simply be re-interpreted as over- or under-budgeting. For example, particularly with respect to smaller categories of departmental spending (such as capital and training) and with minority or newly established programs, there appears to be a common pattern of policy prioritization, over-budgeting, under-spending and budget cut-backs. Sometimes the pattern is in the opposite direction. The result is a medium-term cycle of erratic accelerations, decelerations and even declines in budgets and spending. Unpredictable funding flows disable and delay effective planning and implementation.

With the exception of new start-ups, real budgetary growth in excess of 10% p.a. is unlikely to induce a rapid enough supply-side response to avoid under-spending. Alternatively, unless a program is being deliberately wound down, declining budgets may induce over-spending or, if previously under-spent, a reduction in the rate of under-spending. The latter option is often a short-term response by the financial authorities to ensure a closer match between budgets and spending but it also counters criteria (i) of Section 214 (2), namely the "desirability of stable and predictable allocations of revenue shares". Furthermore, these erratic budgeting practices can interfere with appropriate policy prioritization in determining budgets.

Criteria (j) of Section 214 (2) establishes "the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria". In general, provincial personnel budgets follow stable growth paths and exhibit low rates of under- or over-spending. It is likely that departmental staff will be vigilant in this respect. Furthermore and in general, the larger, more dominant or well established the program, the fewer the mismatches between spending and budgets and the more stable the growth path.

Temporary needs (and sometimes emergencies) in these more inviolate and fixed core programs are however often accommodated at the expense of smaller programs and infrastructure capital and personnel training budgets.

11.4 Inter-Sphere and Inter-Departmental Co-ordination

There are several instances where under- or over-spending and/or budgeting can be rectified with improvements in co-ordination between spheres of government and between departments or departmental programs.

Amongst the more common systemic reasons for under-spending include excessive adjustments following the second quarter of the financial year; late disbursements of approved funds and, final quarter "fiscal dumping" of unspent funds on lower spheres of government or service delivery contractors without due consideration for their capacity to spend. Most of these may be avoided with due attention paid to project planning allowing for at least a year for programme preparation and procurement (or two years for bigger infrastructure projects); and, with due attention paid to aligning the operational planning, procurement and implementation phases with the financial year. These project planning techniques are applicable to construction and renovation projects; the start-up and operationalization of new programs; the implementation of new legislation and, the expansion of existing activities.

The separation of preparation from implementation and alignment of these phases to the budgeting year will enable easier co-ordination between separate budgeting and operational agents without recourse to late adjustments, virements and disbursements. This applies, in particular, to the relationship between Public Works and client departments and between departments and their service contractors.

11.5 Delivery Performance and Impact

These are several indicators that may be used to assess delivery performance and impacts of programmes. For example, a comparison of the growth of actual and targeted beneficiaries can yield measures of coverage (one form of progressive realization as called for in the Bill of Rights). Numbers of beneficiaries per staff member or per infrastructure asset are examples of service level norms that can be valued, costed and budgeted.

Comparisons across provinces (and districts) can enable the calculation of minimum, average and maximum per capita service levels and cost-efficiency. Efforts to reduce "economic disparities within and among the provinces" (criteria g of Section 214 (2)) will need to take these cross-sectional differences into account.

Once time series data is collected and collated, per capita spending trends can be measured and analyzed. This enables more realistic measures of fiscal and institutional capacity to be generated. Growth in capacity is a useful basis with which to inform targeting.

In order to measure the effectiveness of government spending, indicators of socio-developmental outcomes such as poverty, inequality, deprevation, literacy, mortality, accessibility and, economic impact indicators such as contributions to employment, small enterprise promotion and geographic product are being developed in an ad hod fashion. In many instances, academics and specialists have reached little consensus on the appropriate methodology. An important conceptual issue is the ability to distinguish the relative influences or impact of different spheres of government, departments and programs on the outcome or the indicators.

11.6 General Observations and Advisories on Spending Performance

Based on the analyses presented in this submission the Commission makes the following observations and advisories related to policy, spending and delivery:

- For the desirability of stable and predictable allocations of revenue shares between different programs and categories of spending; Government should aim for stable budget growth paths over a 7-year period from past 3 years cycle throuhg the forthcoming MTEF.
- The spending prioritization of policy objectives and targets of a department, program or category should be given effect through higher than average, real, annual budget growth rates. Current budgetary contraints imply that half the budget must grow at lower than average rates.
- The further institutionalization of best practice programme planning and budgeting methods should be encouraged.
- Every departmental service delivery program should be defined by and reported in the Provincial Budget and Expenditure Review with respect to;
  - actual and targeted beneficiaries,
  - personnel numbers and budgets by occupational skills level and
  - current items and capital assets utilized in service delivery
- Delivery target data should be reported for both the department and its service delivery contractors.
- A standardised methodology to measure the socio-economic impact of government capital and current spending should be encouraged across government departments and programs.

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In Annexure three the Commission presents a more detailed analysis of the policy, spending, and budgeting performance of the Provincial government departments providing basic service.

Based on the analyses presented in this submission the Commission makes the following observations and recommendations:

- For the desirability of stable and predictable allocations of revenue shares between different programs and categories of spending; Government should aim for stable budget growth paths over a 7-year period rather than from past 3 years cycles.
- The policy prioritization of policy objectives and targets of a department, program or category of spending should be given effect through higher than average, real, annual growth rates of budgets.
- The further institutionalization of best practice project planning and budgeting methods which separate preparation from implementation phases and align them to the financial year should be encouraged.
- Every departmental service delivery program should be defined by and report in the Provincial Budget and Expenditure Review on;
    - actual and targeted beneficiaries,
    - personnel and budget by occupational skills level and
    - current items and capital assets utilized in service delivery; These delivery statistics should be reported for both the department and its service delivery contractors.

    Where sub-programs can be defined by the above measures, they should be elevated to the status of programs.

Chapter 12 The Vertical and Horizontal Division of Revenue – A Model For Reviewing the Equitable Sharing of National Revenue

12.1 Background and rationale

Through the Bill of Rights, the Constitution of South Africa explicitly recognizes citizens' rights to have access to basic public services and, that it may be necessary to progressively provide these services over time taking into account the availability of resources. In other words, the principle of 'progressive realisation' of access to services is embodied in the Constitution.

Thus, the Constitution puts the onus clearly on the state to provide all citizens with access to basic public services. However, the Constitution does not provide any details on what the standard of basic service should be but it does define basic services to include education (basic and further), health, welfare (social security), food and water.

Given the high degree of vertical fiscal imbalance (VFI) in South Africa, together with the fact that provinces and municipalities have been assigned responsibility for providing basic services, if the national government is to achieve the universal access to services called for in the Bill of Rights, then it will have to do so through the inter-governmental grant system. While local governments raise much of their own revenues, provinces do not have the taxation or borrowing resources to do so themselves. Moreover, given the potential resources required to achieve access for all citizens to basic services such rights will have to be addressed over time (progressive realization - as allowed for in the Constitution). For the national government to ensure the provision of constitutionally mandated basic services (CMBS) any norms and standards that it sets will have to be uniform and equally accessible for all citizens. Uniform norms and standards and equality of access to basic services will have implications for the way in which the provincial and local equitable allocations are estimated.

While Section 214, Part (1) of the Constitution stipulates that an Act of Parliament must provide for the Division of Revenue (DoR) raised nationally among the national, provincial and local spheres of government, the methodology to be used in determining the equitable shares is not mentioned in the Constitution.

As a consequence, there has been much debate over what the equitable share of each sphere of government should be, and a formulaic approach to split available revenue has subsequently been adopted. There are three policy issues that the present formulaic approach is unable to cater for adequately, namely:

a) How to balance the need to provide constitutionally mandated basic services (CMBS) within macroeconomic constraints that limit the available resources?
b) How to objectively determine the equitable sharing of available revenue among the national, provincial and local spheres of government?
c) What provincial resources to allocate to capital spending in a way that is consistent with the answers to the first two questions?

In its 2002 submission, the Financial and Fiscal Commission (FFC) recommended that Government consider the possible incorporation of elements and parameters in the intergovernmental transfer formulae, which would balance the need to provide constitutionally mandated obligations, taking into account considerations listed in Section 214 (2) (a–j) of the Constitution. In November 2002 the Commission embarked on a research project to construct such an economic model, so that it may be better equipped to fulfil its obligations under Section 220 of the Constitution. This model is referred to as the CMBS model as it takes account of financing constitutionally mandated basic services (CMBS) within the limits stipulated in Section 214 (2) (a-j) of the Constitution.

There are at least two conceptual approaches to deriving the cost of providing public services. The first approach is the costed norms method proposed by the FFC in its 2000 Submission. This method estimates the average cost (AC) of providing a particular service. This estimate is usually based on historical estimates of capital, labour and variable input costs, per unit of service provided. The next step is to devise output standards that are to be achieved for each service. Using the estimates of average cost it is then possible to deduce the total cost of providing a service at some specified standard.

If one then sums across all services, it is possible to obtain an estimate of the total costs to be met by each sphere of government based on the derived average costs and chosen output standards. This FFC proposal was not accepted by Government because of serious data constraints and the absence of established policy norms and standards.

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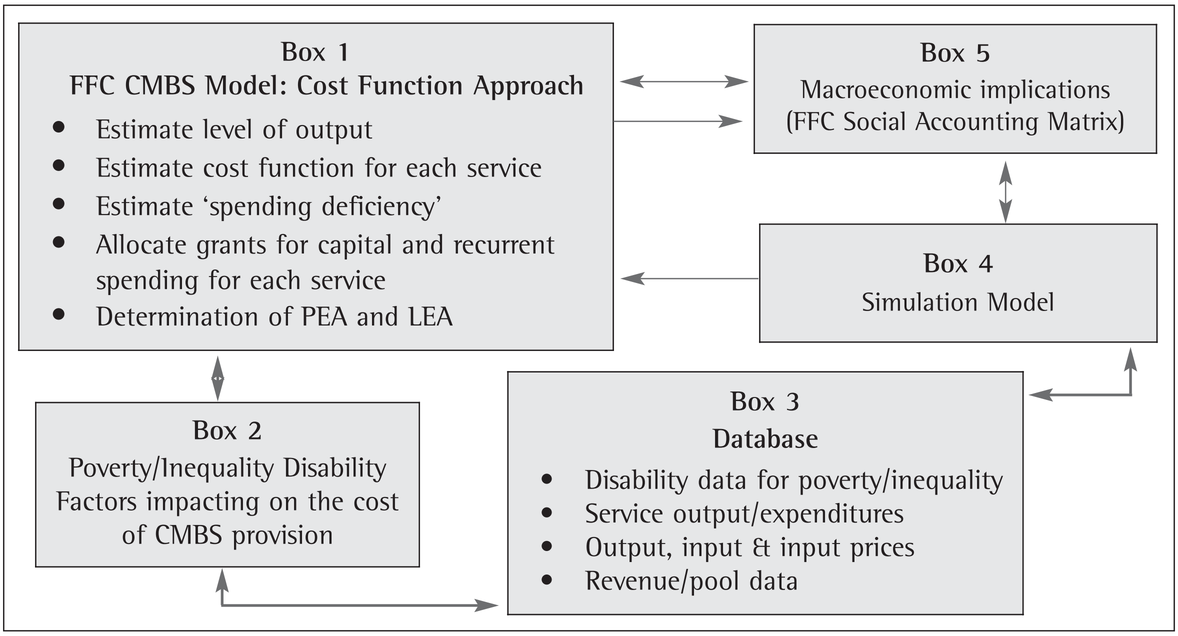
A second approach to deriving the cost of public services is to estimate a 'cost function' for each provided service. Cost functions are widely used in economic analysis and, for given costs of inputs, define the minimum cost of producing various levels of output. The advantage of the cost function approach is that once the cost function for a service is estimated for any time period, it is simple to find the minimum cost of providing any level of service and hence any point on the average and marginal cost curves. This is more difficult with the costed norms approach. Through a tedious process the costed norms approach identifies a single point on the total cost curve, and from this provides an estimate of the total cost of providing a given standard. To estimate the average and total costs associated with some other norm, or output level, one has to go through a laborious re-estimation process. Another problem with costed norms is that the total cost associated with whatever norm has been chosen usually exceeds the resources available.

The advantage of the cost function approach is that the whole curve is estimated at the outset. This facilitates quick and frequent re-estimation of outputs and costs to meet the macroeconomic budget constraint and other limitations in each period.

12.2 How the CMBS model works

The structure of the model is illustrated in Figure 12.1. As can be discerned from the Figure, the CMBS model is essentially an over-arching simulation model that addresses all of the issues discussed above in a coherent fashion and brings together much of the past research efforts of the FFC into one logical structure.

Figure 12.1: CMBS Model Flow Chart



PEA = Provincial Equitable Allocation
LEA = Local Government Equitable Allocation

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The model commences by first demonstrating how a system of cost functions can be developed. This shows the total cost of services as functions of the level of output of those services (Box 1). Poverty and inequality cost disabilities are defined as the costs of socio-economic and geographic disparities that differentiate provinces and municipalities from each other (Box 2).

Box 1 also shows how the FFC's existing provincial capital grant model can be modified to become a sub-model of the developed over-arching simulation model.

Box 2 is the module that adjusts the cost function for poverty and inequality cost disabilities that a region may have.

In Box 3 the data requirements for running the model are specified and linked to the cost functions through a simulation model in Box 4.

Box 5 thereafter illustrates how the cost information can be linked to a macroeconomic feasibility constraint via a macroeconomic model. The cost and macroeconomic information are combined to demonstrate how the equitable shares of the three spheres of government can be determined objectively.

The following discussion presents a brief overview of the CMBS model developed in sufficient detail to give the reader a good understanding of how the model works. Readers interested in the technical details are referred to Annexure 1. The model works in five related steps as follows:

First, for each provincial and local government service included in the model, one would start by listing the estimated level of output that authorities envisage for a defined future period, for example, the year 2010.[16] This per capita national service specific standard would then be applied in each province and local government sector to derive the total level of service provision needed to meet the per capita national standard. These are referred to as the 'desired outputs' for each service. The next step would be to 'adjust' the desired aggregate output levels depending on whether a province displays 'poverty and inequality cost disabilities'. Such disabilities reflect the fact that a province with a relatively high concentration of unemployed, household income inequality, poor people, or people with special heath needs, would, given the equality of other variables, face higher per capita demands for public services than other regions. Thus, cost disabilities capture differences in poverty and inequality across regions, and the design of the grant scheme recognises these variations in poverty and inequality by region in the measure of the desired output.

The second step estimates the cost of providing each government service (in any given budgetary period) as a function of the level of service output. This yields a relationship between disability adjusted output for each of the services and the total **least cost** expenditure that must be undertaken to achieve that output. Using these cost functions enables the conversion of desired future outputs into the least cost expenditures that must be undertaken to achieve those outputs.

Third, the CMBS model then estimates **current spending** on each service by relevant government sector, and, by comparing current spending with the desired least cost spending (associated with the desired output in step 2), the model is able to estimate a 'spending deficiency'. This is just the difference between actual spending on each service in the current period, for example, 2007, and the desired least cost spending needed to achieve the future (e.g. 2010) level of output.

16. This is assumed to be exogenously derived (e.g. determined from the political and policy-making process).

With the above steps completed, in step four the model then develops a dynamic process which allocates grants to provinces and local governments, for both capital and recurrent spending, and for each service. The grants ensure that over some period of time (e.g. from 2007 to 2010) the actual levels of spending converge to the least cost level of spending needed to achieve the target outputs. Thus, the CMBS model shows how policymakers can achieve two things: increase output to achieve some nationally determined per capita standard output, and at the same time, push provincial and local spending to the minimum levels needed to achieve those targets. Both of these objectives are consistent with the Constitutional case for grants.

Finally, in step 5 the expenditures that need to be made under the CMBS model can be summed across services and regions in each time period to calculate the monetary resources required by the provinces and local governments, in aggregate, and for each period specified. For a given set of desirable outputs and cost functions, it is possible that for any given period, this sum would exceed the fund actually available from the national government. This means that the desirable outputs would have been set too high, in relation to current actual expenditures. Consequently, desired outputs would need to be reduced, to the point where the sum of the expenditures required would match the available funds. Once the provincial and local government equitable allocations have been thus determined, government will be able to establish the allocations available for the unique functions of the National government sphere.

Conceptually, this process of simultaneously arriving at both the vertical and horizontal division of revenue may be illustrated in the Table 12.1 Framework for Financing CMBS and Section 214(2) a-j of the constitution presented on the next page:

12.3 Relevance to the Financial and Fiscal Commission and Policy-Makers

The national government has a dominant role to play in making transfers to provinces. This is because South Africa's public finance system is highly centralized in the sense that tax powers reside almost solely with the national government while many expenditure powers rest with the provinces. Thus, there is a high degree of vertical fiscal imbalance (VFI) in the South African public finance system and a need for extensive transfers to the provinces to enable them to provide the basic services noted in the Bill of Rights, especially health, education, housing, transportation and welfare. Indeed, the Constitution makes special reference to these transfers. Section 214 Part (1) notes that 'An act of Parliament must provide for -

a) the equitable division of revenue raised nationally among the national, provincial and local spheres of government;

b) the determination of each province's equitable share of the provincial share of that revenue; and

c) any other allocations to provinces, local government or municipalities from the national government's share of that revenue, and any conditions on which those allocations may be made.

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Table 12.1: Framework for Financing CMBS and Section 214 a-j of the Constitution				
Allocations (taking account of Sec. 214 a-j)	National ES; CG; Other Grants	Provincial Other ES; CG; Grant	Local ES; CG; Other Grants	Total
National Interests				
National Debt (Macro-economic)				
Needs & Interests of National Government				
Provincial & Municipal Basic • Services • Housing • Health • Education • Transport • Water • Electricity				
Fiscal Capacity				
Efficiency				
Economic Disparities				
Provincial/Municipal • Obligations in terms of National legislation • Safety and security				
Contingency Reserve				
Emergencies				
Other Considerations • Fiscal capacity • Economic disparities • Stability and predictability of allocations • Need for flexibility				

Defining the Budgeted Pool of Funds from the Division of Revenue				
All Allocations:	National Sphere (current/capital)	Provincial Sphere (current/capital)	Local Sphere (current/capital)	Total Expenditures (current/capital)
Discretionary	NES+	PES+	LES=	ES
Conditional Grants	-PCG – LCG	+PCG	_LCG	CG=PCG+LCG
Total	(NES-PCG-LCG)+	(PES+PCG)+	(LES+LCG)=	TNR

Annual Revenue				
	National Sphere	Provincial Sphere	Local Sphere	Total Revenu
Taxes				
User Charges				
Borrowing				

TNR = (NES–PCG–LCG)+(PES+PCG)+LES+LCG)

Where:

TNR = Total national revenue available for equitable division
NES = National government equitable share
PES = Provincial government equitable share
LES = Local government equitable share
PCG = Provincial government conditional grants
LCG = Local government conditional grants

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While the Constitution does not say how the equitable allocations should be determined, Part 2 of Section 214 does lay down guidelines which set the framework within which the [17](PEA) and (LEA) are determined. Specifically, Part 2 notes that the equitable sharing of revenue can only be enacted after the FFC, provinces and local governments have been consulted and the following factors taken into account:

a) the national interest;

b) any provision that must be made in respect of the national debt and other national obligations;

c) the needs and interests of the national government, determined by objective criteria;

d) the need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them;

e) the fiscal capacity and efficiency of the provinces and municipalities;

f) developmental and other needs of provinces, local government and municipalities;

g) economic disparities within and among the provinces.

h) obligations of the provinces and municipalities in terms of national legislation;

i) the desirability of stable and predictable allocations of revenue shares; and

j) the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria.

Not only does the Constitution stipulate that decisions over the equitable shares must take account of the matters listed in (a) to (j) above, it also says that the FFC must take these issues into account when making its recommendations to the national government on the equitable sharing of revenue among and within the spheres of government (Section 220, Part 3).

An advantage of the CMBS model is that it can be used to inform policy-makers in advance of the potential provincial and local government allocations, in order for authorities to achieve the goal of the progressive realisation of national standards in the provision of basic service outputs. The model's main value, however, is its ability to deliver to policy analysts two key pieces of information, dependant on how the model is used:

i) The model could provide estimates about the level of service provision that could be achieved under differing assumptions, and estimates of the size of the allocations available. The estimates are calculated taking into account all macro and micro economic constraints and limits.

ii) The model could provide estimates of the size of the allocations required to achieve particular target levels of service provision, specified by the policy-maker, over a particular period. In this way basic service outputs may be provided as a function of minimum costs over a planned cycle of medium term expenditure periods.

12.4 Implications for FFC Recommendations Research

Given the analysis and methodological framework presented in this submission, the Financial and Fiscal Commission will use the CMBS model as an analytical tool to inform its recommendations

17. provincial equitable allocations (PEA)
Local government equitable allocations (LEA)

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research and its contribution to the review of equitable sharing formulae in the intergovernmental fiscal relations system with reference to:

a) The balance between the provision of constitutionally mandated basic services CMBS and macroeconomic and fiscal constraints that limit the availability of national revenues.

b) The objective determination of the equitable sharing of available revenue among the national, provincial and local spheres of governments.

c) The equitable allocation of provincial and municipal resources to capital spending in a way that is consistent with (a) and (b) above.

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Chapter 13

Framework for assessing function shifts in South Africa' Intergovernmental Fiscal Relations Systems

13.1 Background

The Constitution of the Republic of South Africa, 1996 (Act No.108 of 1996) defines three spheres of government, national, provincial and local and it broadly assigns functions to each sphere. The Act also provides for three types of local governments.

Since the promulgation of the Constitution functions have been shifted between government departments and between spheres of government. The motivation for the shifts is usually a belief that they will lead to greater efficiency and effectiveness of government in delivering services to the population. The shifting of any function has far-reaching consequences, not the least of which is the implication for the allocation of funds through the budget.

Legislation has been enacted requiring the FFC to assess and comment on functions shifts. To respond efficiently and timeously to this task a framework was developed to guide the work of the FFC.

The framework provides an outline of criteria and issues that would have to be taken into account when assessing function shifts.

The framework will also be used to make an assessment of the location of current functions and the suitability of such arrangements. A key factor would be the manner in which services are provided in a co-ordinated and integrated manner.

13.2 Concepts, Principles and Guidelines for Assessing Function Shifts in South Africa

Government has been re-assigning functions since 1994 and the lessons that can be learnt from this experience have proved extremely useful for creating the framework. Existing policy research and documents that may be useful for informing an approach for assessing the implications of a shift are sparse. However, the Department of Provincial and Local Government (DPLG) has published Draft Guidelines on the Assignment and Delegation of Functions.[18] This work, together with the experiences from a handful of different shifts has proved very useful in drafting the framework.

On the understanding that the South Africa Constitution intends governance to be as close as possible to the people, key principles for **subsidiarity**[19] have been identified.

The research on which this submission is based is the result of consultations with government departments and members of Parliament and a review of existing policy research and documents. Existing FFC recommendations on powers and functions have been noted and incorporated into the framework.

The purpose of the submission is to suggests some guidelines from experiences of functions shifts that have already taken place in government; provide an outline of criteria and issues that would have to be taken into account when assessing function shifts and, provide a starting point for developing a framework for discussion and review.

It is necessary to understand what 'function shifts' are in order to be able to assess whether they are appropriate and viable. In this submission 'function shift' means that a function previously assigned by the Constitution or any law made by Parliament or a Provincial Legislature to any 'organ of state' is reassigned to a different organ of state.

'Organs of State' that are assigned functions are many and varied in their status and structure. They can be broadly categorised as:

a) all national departments;

b) all provincial departments;

c) all municipalities;

d) public entities established under Schedules 2; 3 and 4 of the PFMA;[20] and

e) Constitutional Institutions referred to in Schedule 1 of the PFMA.

There are three different types of municipalities defined in the Constitution (Types A, B and C) and several types of public entities (Major public Entities, Other Public Entities, National Government

18. General Notice 636 in Gazette No. 27518 dated 22nd April 2006.
19. "The principle that a central authority should have a subsidiary function, performing only those tasks which cannot be performed at a local level": South African Concise Oxford Dictionary 2002.
20. Public Finance Management Act, 1999 (Act No. 1 of 1999).

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Business Enterprises, Provincial Public Entities and Provincial Government Business Enterprises). Furthermore the Public Service Act[21] (PSA) lists the current national and provincial departments but these may change from time to time and technically such changes require 'function shifts'.

Several case studies of function shifts in South Africa have been reviewed for the purpose of this report. These are summarised below.

a) **National Health Laboratory Service (NHLS)**

   Laboratories of the provincial health services and a national public entity, the South African Institute for Medical Research (SAIMR), were amalgamated under a single new national public entity. The planning took place between 1999 and 2001.

b) **Forensic Pathology Service (FPS)**

   The SA Police Service Medico-Legal Mortuary service was transferred to the nine provincial departments of health. A new, more comprehensive service was established in each provincial department of health.

c) **South African Social Security Agency (SASSA)**

   The payment of Social Assistance Grants was a function of the nine provincial departments responsible for social services (names differ between provinces). The function was transferred to a newly established national public entity.

d) **Primary Health Care (PHC)**

   Historically clinic and health centres plus environmental health services were provided by the municipalities in urban areas and by the provincial health departments and homeland governments outside of towns and cities. Clinic and health centre services have become the statutory function of provinces.

e) **Emergency Medical Services (EMS)**

   Historically ambulance services were provided by the municipalities in urban areas and integrated with fire-fighting services into 'emergency services'. The ambulance services outside of towns and cities were rendered by the provincial health departments and homeland governments. The Constitution assigns 'ambulance services' as an exclusive provincial legislative competence (Schedule 5A) and fire-fighting services as concurrent national and provincial functions that must be assigned to local governments (Schedule 4B).

f) **Provincial and Local government borders**

   The Municipal Demarcation Board has made recommendations for changes to provincial and municipal borders. These changes will result in numerous horizontal function shifts and changes to allocations of equitable shares and conditional grants.

13.3 Principles Applying to Shifting of Functions

Subsidiarity is the point of departure when consideration is given to a function shift. Any organ of state considering a transfer of functions should consider whether:

21. Public Service Act, 1994 (Act No. 103 of 1994)

a) a shift of the function will respect, promote and fulfill the provisions of the Constitution that apply to delegation and assignment, and

b) the shift contemplated fits in with a general framework of an established government policy.

Co-operative Government

Chapter 3 of the Constitution sets down principles for cooperative government. Any organ of state considering a transfer of functions should consider whether:

- the decision to assign or delegate a function is based on what is appropriate for the Republic as a whole, rather than on what is appropriate for a particular sphere of government or organ of state
- the assigning or delegating department or organ of state accepts the funding requirements or support that is necessary to make the assignment or delegation successful
- the assigning or delegating department or organ of state accepts responsibility for constantly monitoring or reviewing the function assigned or delegated
- an agreement reached between the parties to assign or delegate a function has been reached by consensus and not forced on either party
- the benefits for government as a whole in the Republic have been thoroughly explored and understood

Enhancing subsidiarity

In accordance with section 156(4) of the Constitution, a function listed in Part A of Schedule 4 or Part A of Schedule 5 which necessarily relates to local government must be assigned by national or provincial departments to a municipality, by agreement and subject to any conditions if:

- the function would be most effectively administered locally; and
- the municipality has the capacity to administer the function.

Therefore in the event of a motivation for centralisation of any function or refusal to decentralise the delivery of any service by any more central authority the reasons for such resistance needs to be very carefully interrogated.

By the same token the Constitution is careful to require that the shift is "by agreement" and "subject to any conditions" so that the parties cooperate in the shift and management of the function.

Transfer of the Authority Role

There cannot be more than one authority for a function and accordingly the assignment of functions is subject to the following requirements:

- the authority role must be transferred in full when a function is assigned between spheres of government or other organs for state;
- a function must not be split between spheres of government;

- a function must not be spilt between a district and a local municipality, but need not be assigned uniformly to either district or local municipalities for the whole country or to all local municipalities within the area of a district municipality; and
- a function must not be spilt between a government department and a public entity, but need not be assigned uniformly to either government department and a public entity for the whole country.[22]

Efficient, Effective and Sustainable Delivery of Service

When evaluating the principle decision for the shifting of a function a number of factors from the White Paper on Local Government must be considered:[23]

a) Equitable, efficient, affordable, economical and sustainable access to basic services by all customers
b) The placement of responsibility of providing services as close as possible to the communities the services are meant to serve (subsidiarity)
c) Minimising costs of services to consumers and customers
d) Achieving economies of scale in the delivery of services
e) Minimising jurisdictional spillovers
f) Benefiting the greatest number of residents
g) Causing the least disrupting effect on the delivery of services
h) Promoting a safe and healthy environment
i) Promoting efficient, effective, accountable public administration
j) Promoting cooperative government
k) Addressing the historical inequalities in society

These factors provide a healthy tension that makes it important to carefully understand the function and its context when considering the locus for delivery. Sometimes achieving economies of scale means centralising functions. Placing services close to the people can sometimes be done by centralising administration and appointing private agents, etc.

13.4 Authority for Execution of Functions

The focus of management for the delivery of the service can be achieved by primary assignment, delegation or assignment.

a) **Primary assignment**

Primary assignment is determined by a Constitutional mandate.

b) **Delegation**

22. This occurred in the case of the NHLS where KwaZulu Natal remained outside of the NHLS for a period of 5 years owing to the unique structure of the laboratory services in KwaZulu Natal compared with the other provinces.
23. General Notice 2592, 12 July 2000, Government Gazette 21370.

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Delegation involves either:

- the temporary transfer of the service provision component of a power or function in provincial or national legislation to a another executive organ of state by agreement as envisaged in section 238(a) of the Constitution; or
- the temporary transfer of the service provision component of any power or function in the provincial or national sphere as envisaged in section 238(b) of the Constitution.

The **provider role** in respect of a function should only be delegated to another organ of state if a general or specific assignment is not appropriate, such as if permanent transfer of the authority role in relation to a function is not appropriate or the transfer of the entire authority role is not appropriate.

Responsibility for the service provision component of a function should only be delegated to another organ of state if agreement is reached with that other organ of state which is expressed in a service level agreement and which specifies:

- the term of the delegation;
- that the delegation is in terms of section 238(a) or 238(b) of the Constitution, whichever is applicable;
- a precise description of the provider role to be performed by the recipient authority specifying-
  - a) service levels;
  - b) performance indicators;
  - c) risks transferred to the recipient authority; and
  - d) whether the recipient authority functions as an agent of the assigning organ of state; the remuneration to which the recipient authority is entitled for performing the provider role, whether from subsidies, direct transfers from the primary authority or through authority to levy fees for service, or a combination of these mechanisms.

c) Assignment

Assignment of a function may be general, asymmetrical or specific

General Assignment

A general assignment is the transfer by legislation of a function in the national sphere of government to all provinces or in the provincial sphere of government to all municipalities that fall within a designated category. General assignment is the favoured mechanism for transferring functions.

A function should not be transferred by general assignment unless:

- the function has been comprehensively and unambiguously defined;
- agreement has been reached between the parties;
- compliance with financial conditions has been ensured;
- compliance with labour requirements has been ensured: and
- compliance with legislative requirements has been ensured.

For instance in the case of a general assignment of a function by National Government, section 9(1) of the Local Government: Municipal Systems Act, 2000 (Act 32 of 2000) requires that the cabinet member or Deputy Minister responsible for the function, must within a reasonable time before the draft Act providing for the assignment is introduced in Parliament.

- request the Financial and Fiscal Commission to assess the financial and fiscal implications of the legislation, after informing the Financial and Fiscal Commission of the possible impact of such assignment on-
  - i) the future division of revenue between the spheres of government in terms of section 214 of the Constitution;
  - ii) the fiscal power, fiscal capacity and efficiency of municipalities or any category of municipalities; and
  - iii) the transfer, If any, of employees, assets and liabilities; and
- consult the Minister of Finance and the South African Local Government Association with regard to-
  - i) the assessment by the Financial and Fiscal Commission contemplated above;
  - ii) the policy goals to be achieved by the assignment and the reasons for utilising assignment as the preferred option;
  - iii) the financial implications of the assignment projected over at least three years;
  - iv) any possible financial liabilities or risks after the three-year period referred to in subparagraph (iii);
  - v) the manner in which additional expenditure will be funded by municipalities as a result of the assignment;
  - vi) the implications of the assignment for the capacity of municipalities;
  - vii) the assistance and support that will be provided to municipalities in respect of the assignment; and
  - viii) any other matter that may be prescribed.

Similarly, in the case of a general assignment of a function by Provincial Government, section 9(2) of the Local Government: Municipal Systems Act, 2000 (Act 32 of 2000) requires that the MEC acts in the same manner as a Minister.

Furthermore in the case of the shift of a function from national to provincial governments, besides obtaining approval of the national Treasury and Budget Council, for the Minister for the Public Service and Administration (MPSA) to make a determination regarding the function, (in terms of section 3(3)(b) of the Public Service Act), the Minister of the national department needs to be consulted. The nine Premiers also need to be approached requesting their approval that they will accept the function within their administrations. The MPSA does not have the authority to shift a function to a provincial administration without the agreement of the relevant Premier. Assigment can be asymmetric general assignment or specific assignment.

Asymmetric General Assignments

Asymmetrical general assignments, result when only certain provinces or municipalities receive an assignment. These assignments are allowed by legislation.

For example assignment may be to some local municipalities within a district area and to the district municipality for the remainder of its area because the legislation relating to general assignments in the sector concerned may set requirements producing the asymmetrical assignments. The shifting of a function may be phased in over time.

Specific Assignment

Specific assignment involves either:

a) the transfer of a statutory power in provincial or national legislation to a specific municipality by agreement as envisaged in sections 99 and 126 of the Constitution and section 10 of the Local Government: Municipal Systems Act, 2000 (Act 32 of 2000); or

b) the transfer of a function, listed in part A of Schedule 4 or Part A of Schedule 5 of the Constitution, to a specific municipality by agreement as envisaged in section 156(4) of the Constitution.

Section 10(1) of the Local Government: Municipal Systems Act obliges the organ of state assigning the function or power to: submit a memorandum to the Minister and the National Treasury giving at least a three-year projection of the financial implications of that function or power for the municipality; disclose any possible financial liabilities or risks after the three-year period, and indicate how any additional expenditure by the municipality will be funded.

If a statutory power in terms of an Act of parliament is specifically assigned to a municipal council, then the requirements in section 99 of the Constitution must be satisfied and the specific assignment must be in terms of an agreement between the relevant Cabinet member and the Municipal Council. The assignment must be consistent with the Act of Parliament according to which the relevant power or function is exercised or performed, and only takes effect upon proclamation by the President.

Similarly, if a statutory power in terms of a provincial Act is specifically assigned to a municipal council the MEC is required to act in the same manner as a Cabinet member.

If a matter listed in part A of Schedule 4 or Part A of Schedule 5 of the Constitution is specifically assigned to a municipality in terms of section 156(4) of the Constitution, then the assignment must be by agreement and the requirements in guideline 29(2) must be satisfied.

d) Preference for General Delegation or Assignment

For coherenc and co-ordination, general delegation of assignment of a function made on a provincial or national scale should be preferred to specific assignment or delegation and accordingly:

i) a national or province-wide process should be undertaken to review and define the implications of any change in the locus of management of the function as a whole before a decision is taken to transfer the function;

ii) a general delegation or assignment may shift a function to all provinces, to all municipalities, to particular categories of municipality (A, B or C), or to particular provinces or municipalities that have satisfied a particular requirement such as accreditation; and

iii) it would be appropriate only in unusual circumstances to delegate or assign a function to a specific province or municipality rather than to generally delegate or assign the function.

e) **Function Shifts Intended Permanence**

All function shifts, whether as a result of a delegation or an assignment are intended to be permanent, subject to any legislation to the contrary. The organ of state with the primary responsibility may exercise supervisory powers in terms of section 139 of the Constitution to correct non-performance by the administration to which the function is shifted. A delegation may be reversed but an assignment may not be revoked.

Furthermore, the work involved and, frequently, the disruption to staff and services is usually significant and it is therefore incumbent on the parties to ensure that the decision to shift the function is properly motivated and managed

13.5 Checklist and Manual

The principles and guidelines in this submission were converted into a "Checklist for Assessing Function Shifts" with an accompanying "Manual" to assist the FFC in how to proceed when making recommendations on the shifting of functions from one sphere of government to another. The checklist is available from the FFC if required. The checklist and manual will be available on the FFC website.

The Checklist is a tabular presentation which provides a summary 'index' to a set of documentary evidence of the responses that are obtained from the questions asked about the proposed function shift.

The Manual explains the process of function shifts and from where the authority for the execution of functions is derived; what to look for in terms of possible impact of assignment and delegation on the future division of revenue; fiscal power, fiscal capacity and efficiency of the respective organs of state; and information on the transfer of employees as well as on assets and liabilities. The legislative requirements that must also be adhered to are outlined. It is intended that the FFC with reasonable knowledge of the environment of the proposed function shift will be guided through detailed sourcing of appropriate documentation, record-keeping and formulation of opinion for drafting recommendations.

The Checklist and Manual have two parts. The first part deals with the policy and legal issues while the second half deals with the process of shifting the function. The tabular checklist is available for perusal if required.

Since there are many compliance issues required in terms of prescribed procedures, the documents are designed in a manner that the FFC may systematically compile a file that records all the relevant consultation, evaluation and approval steps of the proposed shift. It should be possible to formulate opinion on the understanding and preparedness for a shift just from the Checklist. The accompanying filed documentation is the evidence for the opinion.

The Checklist is also designed in a sequential manner where the FFC can defer to the proposing authority at a number of critical points where there is inadequate (or no) proof of the required step/s having been taken.

13.10 Relevance of the framework for the Financial and Fiscal Commission (FFC) Recommendations Research

A number of consultations were held with key stakeholders and the draft report, manual and checklist were received positively. It is possible that proper preparation for a shift may even persuade a proponent that a shift is not viable or the best solution. Such a proposal could save time and resources.

Having considered the research into the principles and guidelines for instituting function shifts the Commission agrees to:

a) Adopt the Checklist and Manual as the tools for use by the FFC in assessing function shifts

b) Accept that the framework will be updated from time to time as experience dictates

c) Distribute the documents to all organs of State to use in their own preparations for addressing proposals for a function shift

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Annex One: The CMBS Model – Theoretical Composition and Operations.

In order to gain the necessary insight into the practical functioning of the FFC CMBS grant model, the first requirement is the establishment of regional aspects of South Africa's system of public finance. In this respect, South Africa should be regarded as a decentralised economy in which 'regional' governments provide a set of public services. These regions include provinces, which comprise the provincial sphere, while the other regions are local governments, which constitute the local sphere. The implication of this arrangement is that one can refer to service j being provided in region i, thereby encompassing the possibility of a provincial service being provided by a province, or a local government service being provided by the local municipality.

Let us also assume that time can be divided into four 'periods'; τ = 0,1,2,3 where period 0 is the 'current' period, and period 1 is the period in which the CMBS grant model commences. Each period can correspond to one or more years; though for present purposes we think of a period being just one year. Thus, the three periods of the simulation, τ = 1,2,3, correspond to the three year macro forecasting cycle for South Africa – the Medium-Term Expenditure Framework (MTEF). It is assumed that the model would be applied at the start of period 1, which commences in January 2008; hence, all input data for the model is constructed for the end of period 0, that is, 2007.

Since each period consists of one year, the simulations would run from the commencement of 2008 to the end of 2010. It should also be noted that all expenditures and capital stock values used in the model would be in real terms, with a base year of 2007. The implication thereof is that all values would be represented in terms of 2007 Rands. However, different deflators would be employed to construct real values of variables, with the choice of a deflator being made on the basis of the type of expenditure or stock. For example, in the case of capital stock values, an investment deflator would be considered.

For each provincial and local government service included in the model, one would start by listing the estimated level of output that authorities envisage for a defined future period, for example, the year 2010.[24] This per capita national service specific standard would then be applied in each province and local government sector to derive the total level of service provision needed to meet the per capita national standard. These are referred to as the 'desired outputs' for each service. The next step would be to 'adjust' the desired aggregate output levels depending on whether a province displays 'poverty and inequality cost disabilities'. Such disabilities reflect the fact that a province with a relatively high concentration of unemployed, household income inequality, poor people, or people with special heath needs, would, given the equality of other variables, face higher per capita demands for public services than other regions. Thus, cost disabilities capture differences in poverty and inequality across regions, and the design of the grant scheme recognises these variations in poverty and inequality by region in the measure of the desired output.

24. This is assumed to be exogenously derived (e.g. determined from the political and policy-making process).

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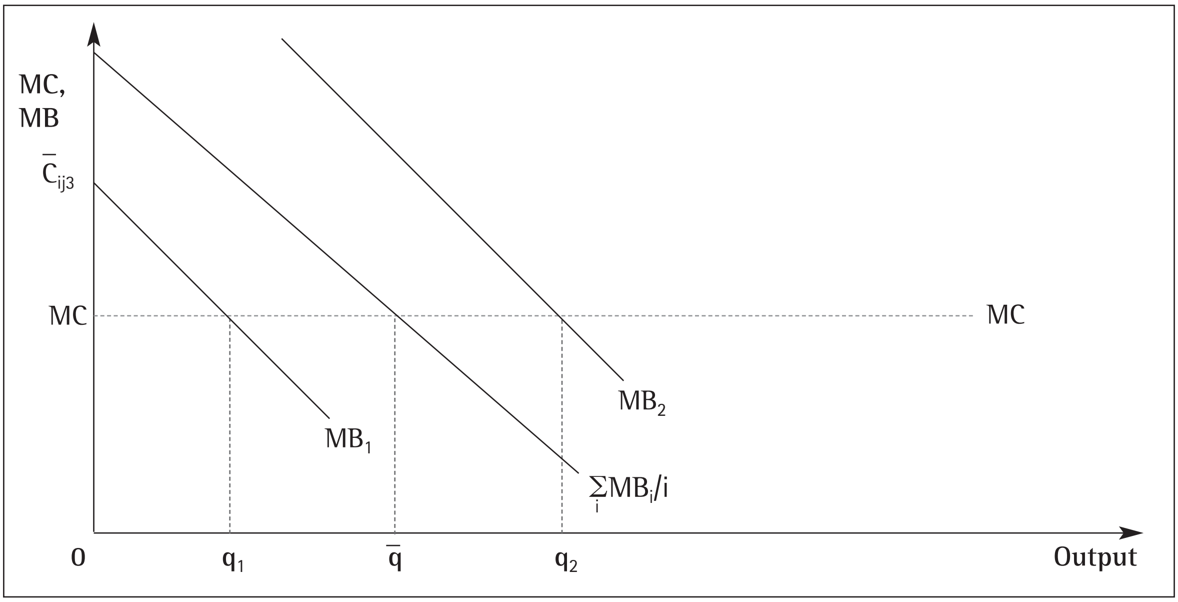
The basis of the thinking around cost disabilities is illustrated as follows. If it were assumed that just one person was living in each region and that he/she differed in terms of 'poverty and inequality characteristics' such as health, education, income, or employment status, the per capita marginal benefit for the public service in region i would be defined as MB_i. If it were not for the above-mentioned divergent characteristics, everyone in the country would have the same marginal benefit curve for public service j. It could be further assumed that the average per capita marginal benefit across all regions, would be defined as $\sum_i MB_i/i$.

Figure A.1 illustrates the average per capita marginal benefit curve, together with the marginal benefit curves for two other regions, in this instance, the examples of regions 1 and 2 are illustrated. Captured within this curve is the average effect of the individual poverty and inequality characteristics, herein after referred to as cost 'disabilities'. In the case illustrated, for a given (constant) marginal cost, the per capita demand for service j is higher than the average in region 2; this is because the single resident of region 2 possesses more of the characteristics that lead to a higher demand for given marginal costs, relative to the per capita average.

Similarly, it is assumed that for a given (constant) marginal cost, the per capita demand for service j is lower than the average in region 1; this is due to the resident of region 1 possessing fewer poverty and inequality characteristics (i.e., he/she is healthier, more educated, has a higher income, and a better employment status than the average).

Figure A.1: Poverty and Inequality Disabilities



Key

$\sum_i MB_i/i$	Average per capita marginal benefits
MB_i	Per capita marginal benefit for the public service in region i
τ = 1,2,3	Three periods of the simulation
MC	Marginal cost
MB	Marginal benefit

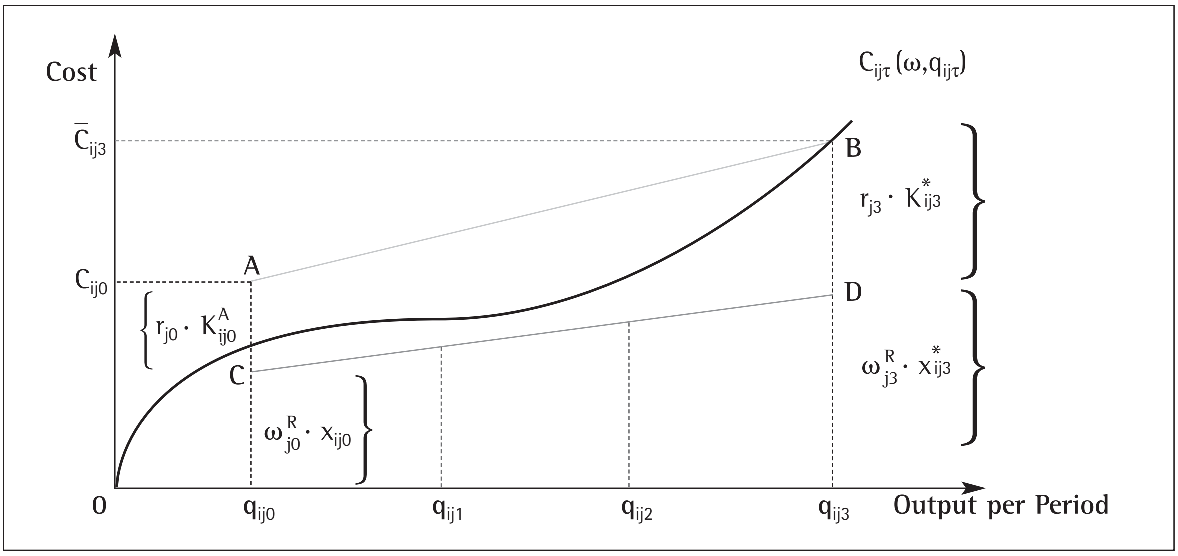
The implication of this situation is that region 2 would be required to provide more of service j, per capita, than region 1, or deliver service j well above the average per capita level across all region. In this case, the disparity would arise purely because of the poverty and inequality related disability characteristics of the region's population. This difference in per capita demand can be accounted for in the grant model by weighting the per capita outputs that must be achieved by each province, according to the magnitude of its cost disabilities. This is calculated by first constructing an index number, which is a function of the underlying cost disabilities, followed by applying this number to the service outputs.

For example, in the case above, region 2 would receive a per capita output weight greater than region 1 to reflect the fact that it must provide a higher level of service per person as a result of the cost disabilities of its single resident.[25]

It is convenient to show this working of the model for recurrent inputs and capital separately. This is because of the key difference between recurrent inputs and capital; namely, the former needs to be purchased period by period, whereas the latter is durable and provides a flow of services over time. The other distinguishing feature of capital is that it depreciates through time.

The decomposition of total actual expenditure into its recurrent and capital components for period 0 is illustrated in Figure A.2 as a breakdown of the vertical distance between the horizontal axis and point A. Point C characterises total spending on recurrent inputs, $\omega^R_{j0} \cdot x_{ij0}$, while $r_{j0} \cdot K^A_{ij0}$ is spending on capital, where K^A_{ij0} is the real value of the capital stock in period 0. Therefore, C^A_{ij0} is the total spending on all inputs in period 0.

Figure: A.2: Transition of Spending on Recurrent Inputs for Service j in Region i



Key

$\omega^R_{j0} \cdot x_{ij0}$	Point C characterises total spending on recurrent inputs
$r_{j0} \cdot K^A_{ij0}$	Spending on capital
K^A_{ij0}	Real value of the capital stock in period 0

25. Note that we do not intend, at this stage, to estimate and incorporate cost disabilities that affect the cost curves differentially across regions (as in the Australian equalisation model). This remains as a future possible extension and refinement to the analysis.

C^{A}_{ij0}	Total spending on all inputs in period 0
$\bar{q}_{ij3}$	Desired (disability adjusted) output for period 3
K^{*}_{ij3}	Optimal amount of capital needed to produce the end of period 3's desirable output
$\bar{C}_{ij3}$	Total least cost of producing $\bar{q}_{ij3}$
$r_{j3} \cdot K^{*}_{ij3}$	Distance between Points B and D – the least cost expenditure on capital
CD	(Linear path between Points C and D) – Transition path for spending on recurrent inputs

The desired (disability adjusted) output for period 3 is denoted as $\bar{q}_{ij3}$. Assuming that the total (least) cost curve from the underlying cost function for the service is that which is displayed in Figure A.2, with increasing and then decreasing returns to scale, the total least cost of producing $\bar{q}_{ij3}$, is $\bar{C}_{ij3}$ (see point B). From the cost share equations associated with the cost function, one can calculate estimates of the least cost expenditures on each input at point B, and from Shepherd's Lemma,[26] the least cost demand for inputs, both recurrent, and capital. The distance from the horizontal axis to point D is the sum of these least cost recurrent input expenditures. The distance between points B and D is the least cost expenditure on capital ($r_{j3} \cdot K^{*}_{ij3}$) – K^{*}_{ij3} is the optimal amount of capital needed to produce the end of period 3's desirable output.

The line between points C and D illustrates a 'transition path' for spending on recurrent inputs. Though this line is linear, this need not be the case (one can allow for the path to be non-linear through the choice of a parameter). Over the three periods of the simulation, the desired result is that actual spending on the recurrent inputs converge with the optimal spending at point D, which would be consistent with achieving the desired output at least cost. Once D is achieved, the amount given to region i for service j, for recurrent inputs, would be equal to the total minimum needed, namely, $\omega^{R}_{ij3} \cdot x^{*}_{ij3}$.

The difference between the optimal expenditure on recurrent inputs at time period 3 and the actual expenditure at period 0 is a measure of the recurrent expenditure deficiency. To close the gap between the two spending levels, spending on recurrent inputs in period 1 would need to be at the level of spending in period 0, plus a certain share – β_{ij1} – of the deficiency and so on for periods 1, 2 and 3.

One special case, where the transition is along the linear path CD in Figure A.2, implies that β_{ij1} = 1/3 and β_{ij2} = 2/3, so that spending on recurrent inputs rises by one-third (1/3) of the deficiency in period 1, and two-thirds (2/3) of the deficiency in period 2; spending in period 3 is equal to the spending in period 0 plus all of the deficiency. The simulation programme allows for the transition to be non-linear to suit the needs of the policy-maker; for example, depending on budgetary conditions, one might wish to raise recurrent spending by more than a third of the deficiency in period 1, and less than two-thirds in period 2, or vice versa. In the absence of any clear preference, a linear path is more reasonable.

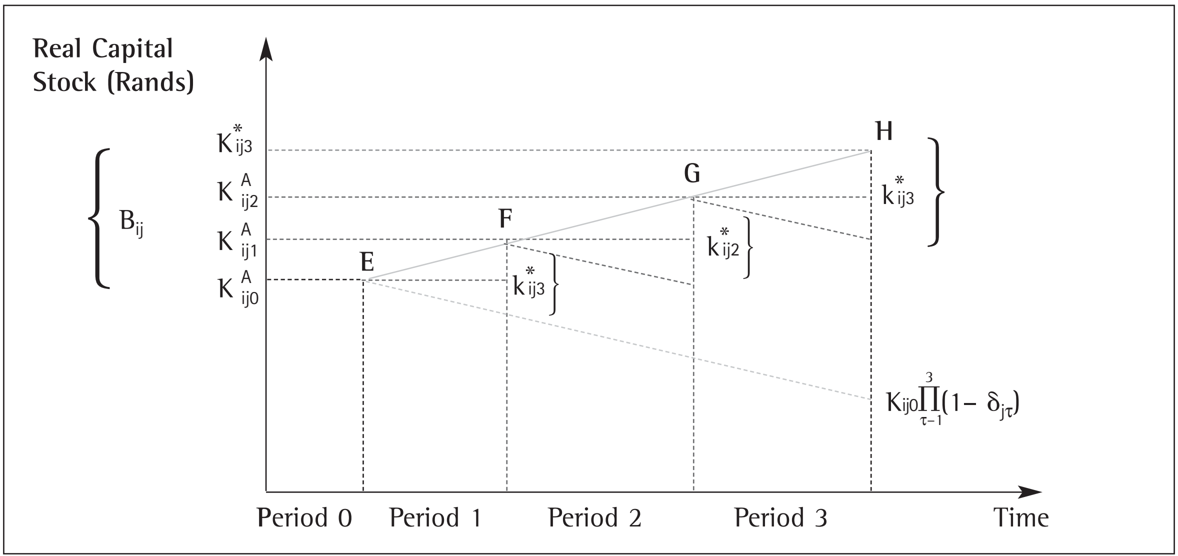
The above defines the recurrent input grant model, which should be allocated to each region (local and provincial) of the country, for each service, in each of the three periods, 1, 2 and 3. This grant would ensure that spending on recurrent inputs converges to that which is required by the end of

26. Shephard's Lemma is a major result in micro economics having applications in the economic theory of the firm. The idea is that a firm will buy a unique and ideal amount of each item to minimize the price for obtaining a certain level of profit given the price of goods in the market. This lemma was named after Ronald Shephard following his paper published in 1953.

period 3; recurrent input spending would be consistent with the least cost expenditure needed to produce the desired output.

The conditional capital grant made during the transition phase is illustrated in Figure A.3, where K^{A}_{ij0} is the real value in Rand of the capital stock in existence at the end of period 0 (which is 2007), and K^{*}_{ij3} is the real value in Rand of the optimal capital stock associated with the desired output at the end of period 3. The line EH is a linear path which describes how K^{A}_{ij0} would converge with K^{*}_{ij3} by the end of period 3. Again, this path need not be linear and it is at the discretion of the policy-maker to choose its shape in using a parameter within the model (as with recurrent inputs).

Figure A.3: Transition of the Real Value of the Capital Stock for Service j In Region i



Key

K^{A}_{ij0}	Real value in Rand of the capital stock in existence at the end of period 0 (2007)
K^{*}_{ij3}	Real value in Rand of the optimal capital stock associated with the desired output at the end of period 3
EH	Linear path to describe how K^{A}_{ij0} would converge with K^{*}_{ij3} by the end of period 3
K^{A}_{ij1}	Real value of the capital stock at the end of period 1 (point F)
K^{A}_{ij2}	Real value of the capital stock at the end of period 2 (point G)
H	Real value of the capital stock at the end of period 3

However, for the purposes of illustration in Figure A.3, one should assume the path to be linear. Point F corresponds with the real value of the capital stock at the end of period 1 – K^{A}_{ij1} – and point G is the real value of the capital stock at the end of period 2, namely, K^{A}_{ij2}. Point H is the real value of the capital stock at the end of period 3. Of these values, K^{A}_{ij0} would be constructed from a data set of services and region-specific real capital stock estimates. Furthermore, K^{*}_{ij3} would also be known. Applying Shepherd's Lemma to the cost function in Figure A.2 one is able to derive the optimal amount of capital needed to provide the desired level of output ($\bar{q}_{ij3}$).

Hence, the endpoints of the transition path for the real capital stock are known: one is derived as input data, while the other is calculated once the cost function for service j in region i is determined. Shepherd's Lemma is thereafter employed to reveal the optimal real value of the capital stock needed to support the desired output level.

The levels of capital expenditure for service j in region i, at the end of periods 1, 2 and 3, to achieve the optimal capital stock associated with the desired output at the end of period 3 is calculated using the Perpetual Inventory Methodology (PIM). This is an accumulative approach which starts at K^{A}_{ij0} and builds the capital stock through time by adding net real capital expenditures, whilst taking account of annual depreciation. These real capital expenditures are clearly illustrated in Figure A.3 for the end of each period, as follows:

- Functions of the capital stock in period 0 (the initial stock);
- Optimal capital stock (what the region envisages to spend);
- Rates of depreciation; and
- Capital stock levels in the interim periods (points F and G).

These capital expenditures are the conditional capital grants which need to be allocated for the successful delivery of service j in region i, in each period of the simulation. The grant in each period is sufficient to cover that period's depreciation of the existing capital stock, including capital formation, which occurs in previous periods as a result of the grant scheme, thereafter the grant creates new capital formation to ensure convergence with the optimal capital stock value at period 3. The division of each period's service- and region-specific capital spending into its depreciation and new capital formation parts would provide information as to how regions should realistically allocate their capital spending grant between maintenance (to compensate for depreciation of the existing stock) and new capital formation.

Annex Two: Using the FFC Social Accounting Matrix to Generate Some Economic Impacts of the 2010 World Cup

The impact of the 2010 World Cup on aggregate demand can be understood by computing a relevant aggregate multiplier such as:

$$\frac{1}{mps + mpm}$$

Where mps is the marginal propensity to save and mpm is marginal propensity to import. The impact on demand (ΔY) following a demand injection (ΔD) is then given by:

$$\Delta Y = \frac{1}{mps + mpm} \Delta D$$

A similar approach is Input Output (IO)/Social Accounting Matrix (SAM) multiplier disaggregation. SAM-based multiplier models belong to the class of fixed-price general equilibrium models, used to assess the economic effects of exogenous changes in income and demand. The common distinguishing features of these models include two basic sets of assumptions. First, there is an assumption that the coefficients matrix is parametric which is equivalent to the 'fixed coefficients' assumption in Leontief IO analysis. Also, there is an assumption that total activity can passively accommodate a change in final demand. This relies on the assumption that factor supplies are perfectly elastic. Both of these assumptions are based on the long run assumption that all prices (and wages) ultimately remain the same. Other-wise, a change in relative prices could mean that coefficients change – or, an increase in factor demand may simply drive up factor prices rather than expand output. Since prices are fixed, conclusions can be drawn about quantities on the basis of value shares. Second, multiplier models are demand-driven. Accordingly, there are no supply-side constraints on economic activity, and price effects are not captured as in a computable general equilibrium (CGE) model.

Because the SAM represents the idea that an economy is characterised by a circular flow of income and expenditure, a change in the demand for the product of one industry will not only affect that industry but all other activities will be affected indirectly through intermediate demand, factor demand, household demand, and government demand changes. Starting with the vector of final demands, successive rounds of gross outputs necessary to achieve that demand can be worked out. As further and further rounds are included, this converges into an 'equilibrium'.

Thus, the effects eventually die out. A multiplier is the cumulative sum of the endogenous effects. It is inversely related to the exogenous portion of economic activity.

To illustrate, let matrix X denote a vector of activity levels (in value terms) in an economy and matrix A denote the amounts of each activity used by each other activity, at rates which are assumed to be independent of the levels of activity in X (constant returns to scale). Furthermore, let a vector D denote a column of exogenous uses of each activity. Total activity X satisfies endogenous (AX) and exogenous (D) uses:

$$X = AX + D$$

Assuming A is parametric, any change in D must be accommodated by a corresponding change in X. Solving for X, the relationship between D and activity vector X is easily shown to be:

$$X = (I - A)^{-1}D$$

where the term $(I - A)^{-1}$ is known as the multiplier matrix. The multiplier matrix shows the cumulative effect on all activities of a given change in exogenous accounts (under the assumptions noted). The elements in a specific column account of the multiplier matrix show the effects on the row sectors and institutions of a 1Rand change in exogenous activity (extra-regional demand or government expenditure) in the column account.

Thus, the column coefficients show the backward linkages of a sector (purchases from sectors upstream). A specific account row shows how that account is affected by 1Rand changes in the column accounts, or, the forward linkages of the sector (sales to sectors downstream). This is the hallmark of 'Linkage' analysis. Whether the impacts of an exogenous demand injection lead to sustained real effects will ultimately depend on the shape of the Aggregate Supply function.

If one believes it to be vertical, then there will be no lasting real impact and all that is observed is higher levels of inflation. If the Aggregate Supply function is upward sloping, then there will be some sustained real effects following the demand injection.

A final modeling issue is that of the choice of closure rules. In the South African SAM-multiplier application, activities, commodities, factors, enterprises, and households are specified as endogenous accounts, whereas government recurrent expenditure, indirect taxes, government investment, capital, and the rest of the world are kept exogenous. Thus, only two kinds of shocks are possible, working through respectively the commodities and the household accounts.

In order to obtain quantitative magnitudes, the FFC study uses a recently constructed Social Accounting Matrix (SAM) for the Financial and Fiscal Commission. A major innovation and distinguishing feature of the FFC SAM is the finer disaggregation of the government into its sub-regional components.

Annex Three: Spending Performance of Selected Provincial Programmes. The results below are based on the use of the FFC Budget analysis model using data from Government departments.

Intoduction

This annexure presents a partial analysis of provincial social sector departments of education, health, welfare and economics. Also covered are the infrastructure programs for housing, transport and agricultre. For completeness the provincial governance programmes the Premier's Offices and Provincial Legislatures are also analysed. Spending programmes are analysed according to policy priorities at the time of reporting. The analysis is restricted to the aggregate performance of provinces.

Education

Provincial Education departments are responsible for providing the constitutionally mandated basic education services listed in the Bill of Rights, namely public education, adult basic education and training as well as further education and training. Education departments constitute approximately 45% of provincial budgets.

Policy Prioritization in Budgetary Allocations

Over the recent past (i.e. FY 2003 to FY 2005), the growth of provincial Education department budgets has, more or less, matched (and driven) the provincial government average growth rate of 5 percent p.a.

Table A.3.1: Policy and Spending Performance Indicators of Provincial Education Departments – FY 2003 to FY 2009

Item	Policy Performance			Spending Performance
Department / Category / Program / Grant	Real Growth of Budgets between FY 2003 and FY 2005	Real Growth of Budgets between FY 2007 and FY 2009	% of Total Departmental Spend FY 2006	Under- or (Over-) Spending FY 2003 to FY 2005
All Provincial Departments	5.02%	4.13%		2.25%
Education	4.54%	2.81%	100.00%	0.85%
Personnel	–0.52%	1.76%	79.06%	0.03%
Training*	3.30%	2.24%	0.49%	15.99%
Capital	2.96%	8.56%	4.77%	12.57%
Public Ordinary Schools	4.97%	2.80%	83.96%	0.52%
Early Childhood Development	–3.98%	7.02%	0.86%	10.18%
Adult Basic Education & Traning	6.59%	3.54%	0.97%	4.95%
Further Education & Traning	7.02%	1.64%	2.58%	2.66%
Primary School Nutrition Grant	19.24%	1.77%	1.04%	5.32%

Source: Annual Financial Statements (2004, 2005) and Budget Statements (2007) of Provinces

Note: Training data is incomplete in terms of time series and cross-provincial coverage.

However, provincial government priorities have shifted to infrastructure service departments (such as Housing and Agriculture) for the 2007 medium-term budget cycle. Over this period, budget growth is projected to slow down to 2.81 percent p.a., well below the projected growth of provincial government budgets of 4.13 percent p.a. In part, this reflects national policy needs and priorities as expressed in the Accelerated and Shared Growth Initiative of South Africa (AsgiSA) emphasizing infrastructure development. However, in respect of the Joint Initiative on Priority Skills Acquisition (JIPSA), the reduced emphasis on, at least certain educational programs, appears contradictory.

In particular, whilst budgets for Adult Basic Education (ABET) and Further Education and Training (FET) grew well above the provincial averages over the past 3 years (6.59 percent and 7.02 percent p.a. respectively); projected growth rates decelerate to below the provincial average over the FY 2007 to FY 2009 period. Implementation challenges in the ABET program were noted in President Mbeki's State of the Nation address for 2007 and projected budget growth (at 3.54 percent p.a.) is higher than the Education departments' average. Slow growth in the FET program (1.64 percent p.a.) may reflect the transition in funding sources from national department conditional grants to provincial own sources.

A similar slowdown in budget growth was experienced by Early Childhood Development (ECD) programs over the recent past when conditional grant funding was phased out and insufficiently replaced by provincial own sources (i.e. the Provincial Equitable Share or PES). Budgetary declines of (3.98 percent) p.a. between FY 2003 and FY 2005 have since been compensated for by high projected growth rates of 7.02 percent p.a. over the 2007 medium-term budget cycle. This is in line with the specific mention of ECD in the Finance Minister's Budget Speech of 2007. This seems to be informed by the policy target for universal access to Grade R by 2010.

The national Education department places little reliance on conditional grants as a policy instrument. The major conditional grant implemented by the department and inherited from Health is the Primary School Nutrition Program. This grant grew rapidly (from a low base) by 19.24 percent p.a. between FY 2003 and FY 2005 and was driven by increased target numbers. In respect of the 2007 medium-term budget, there is a clear disjuncture between an approximately 20 percent annual increase in numbers of learners targeted and a rapidly decelerated budget growth of 1.77: p.a. for the next 3 years.

Education is a particularly personnel-intensive public service with approximately 80 percent of the budget devoted to personnel remuneration. This proportion though has dropped from 89 percent in FY 2003 to 79 percent in FY 2006 and is reflected in budget declines of (0.52 percent) p.a. over the recent past. This decline was driven by national Education department policy which sought to restore an 80:15:5 percent ratio between personnel, learner support material and capital spends. More recent concerns about staff retention and attraction particularly of professional educators and especially of Mathematics and Science (and as expressed in the 2007 State of the Nation and Budget Speeches) appear to have induced an acceleration of the personnel budget's growth to 1.76 percent p.a. over the next 3 year budget cycle. The extent to which this is targeted at the identified skills gaps can not be deduced without disaggregating the personnel budget into skills categories.

The proportion of Education departments' personnel budgets devoted to training is less than the 1 percent stipulated by the Department of Labour. Whilst this would be a matter of concern in most government departments, it should be noted that teacher training is a national department competency.

Capital budgets, which grew at below departmental and provincial averages over the period FY 2003 to FY 2005 have since been accelerated to 8.56 percent p.a. over the forthcoming medium-term budget cycle, in line with national policy emphases on infrastructure development and possibly in response to rising learner: institution ratios as more schools are decommissioned than built. Institutional disconnects between the budgeting of provincial Education and the infrastructure planning of Public Works departments appears to be a matter of concern for the delivery of classrooms and schools in several provinces.

Spending and Budgeting Performance

On average, provincial Education departments have exhibited fairly stable and predictable budget growth paths and small mismatches between budgets and spending. Over the past 3 years, a low |0.85 percent of budgets have been unspent. This is below the provincial average of 2.25 percent and the Auditor-General's benchmark of a 5 percent under-spend.

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Averages though can mask wide variations in the spending or budgeting performance of components and programs within the department. Thus, while personnel spending patterns are stable and well-matched to budgets; training and capital budgets are both volatile and highly under-spent (at 16 percent and 12.5 percent respectively for the past 3 years).

Similarly, smaller and especially newer programs and sub-programs within provincial Education departments exhibit volatile funding and spending paths. This is especially true of Early Childhood Development and the Primary School Nutrition Program (though this may reflect the teething problems of relatively new programs) and Adult Basic Education and Training. All these programs exhibit persistent under-spending rates close to or in excess of the 5 percent benchmark set by the Auditor General.

Delivery Performance

Between 2003 and 2005, learner enrolment in public ordinary schools increased by 0.74 percent p.a. With real budgetary growth of 4.97 percent p.a. over this period; per learner spending has increased by 3.88 percent p.a. This is reflected through both declining learner: educator ratios and higher per capita allocations of learner support materials.

Data on the number of schools is available in the Provincial Budget and Expenditure Reviews (PBER) but this is not further disaggregated into number of classrooms. The number of learners per institution has increased over the past 3 years but the learner: classroom ratio could not be ascertained.

The extent to which such service level improvements impact on educational outcomes such as improved literacy and numeracy is yet to be recorded by the Educational authorities.

Similar time series data have not been recorded in the PBER for other education programs such as ECD, ABET and FET Target populations and timelines have been established for ECD and the PSNP.

Health

Provincial Health departments are responsible for providing the basic (primary and secondary) health services mentioned in the Bill of Rights. Health departments constitute approximately 29 percent of provincial budgets.

Policy Prioritization in Budgetary Allocations

The health sector receives little emphasis in national growth and development strategies. Over the past 3 years, provincial health sectors have grown below the provincial average at 2.96 percent p.a. Over the 2007 medium-term cycle, budget growth accelerates to 4.01 percent p.a., slightly below the provincial average.

The State of the Nation and Budget Speeches make reference to health specific priorities. These cover primary health care, the response to the HIV-AIDS epidemic, rehabilitation of secondary hospitals, modernization of tertiary / academic hospitals and, of prime importance, addressing the sector's skilled personnel shortages. These identified priorities however constitute over three-quarters of provincial health budgets.

Table A.3.2: Policy and Spending Performance Indicators of Provincial Health Departments – FY 2003 to FY 2009

Item	Policy Performance			Spending Performance
Department / Category / Program / Grant	Real Growth of Budgets between FY 2003 and FY 2005	Real Growth of Budgets between FY 2007 and FY 2009	% of Total Departmental Spend FY 2006	Under- or (Over-) Spending FY 2003 to FY 2005
All Provincial Departments	5.02%	4.13%		2.25%
Health	2.96%	4.01%	100.00%	0.53%
Personnel	3.47%	3.41%	54.80%	0.51%
Training*	4.94%	0.61%	1.56%	Not known
Capital	18.00%	4.74%	9.42%	12.43%
Clinics & Community Health	7.71%	5.77%	15.40%	0.41%
District & Provincial Hospitals	0.26%	2.11%	38.26%	(1.54)%
Tertiary Hospitals	9.46%	4.06%	16.09%	(0.95)%
HIV-AIDS, TB & STI	50.79%	9.76%	4.73%	5.29%
Training & Development Grant	0.66%	-0.28%	2.55%	3.04%
Tertiary Hospital Grant	18.09%	16.51%	2.02%	16.56%
Hospital Grant	2.44%	3.22% 1	8.75%	(1.34%)
HIV-AIDS	63.11%	11.38%	1.95%	(1.39%)

Source: Annual Financial Statements (2004, 2005) and Budget Statements (2007) of Provinces

Note: Training data is incomplete in terms of time series and cross-provincial coverage.

Between FY 2003 and FY 2005, the fastest growing program within provincial health departments was the academic hospitals, whose primary function is to train health professionals. The high budget growth of 9.46 percent p.a. has decelerated to a average budget growth of 4.06 percent p.a. for the period FY 2007 to FY 2009. Approximately 54 percent of this program's budget is derived from a conditional grant from the national Department of Health (DoH). The growth of this conditional grant has been well below average.

Personnel training makes up nearly 3 percent of provincial health departments' personnel budgets and this is higher than the average 1 to 1.5 percent devoted to this function by other departments. The national department's Training and Development Grant is over 60 percent greater than the provincial training budget implying that the difference is possibly used to compensate academic hospitals for the operational costs of training health professionals. The Training and Development Grant was increased very slowly over the past 3 years and is projected to decline in real terms over the forthcoming medium-term budget by (0.28 percent) p.a. Further, this may be driving a low rate of training budget growth of 0.61 percent p.a. between FY 2007 and FY 2009.

Although not as personnel intensive as education, nearly 55 percent of provincial health budgets are made up of personnel remuneration. Budget growth has been steady at 3.47 percent p.a. over the previous 3 years and 3.41 percent projected over the next 3 years. These growth rates are below average and, as with provincial education, have contributed to keeping provincial spending below the growth in national revenue. The number of health professionals employed by the provincial health authorities has increased by 3.79 percent p.a. between 2003 and 2005 whilst the total staff compliment increased by a lower 1.91 percent p.a. This implies that provincial health departments have focused on the employment of skilled professionals.

Primary health care services (operationalized through clinics and community health centres) have witnessed budget growth of 7.71 percent over the past 3 years and continue to be prioritized over the forthcoming medium-term with budget growth projected at 5.77 percent p.a. Some of this growth may be attributed to the transfer of municipal clinics to the provincial health authorities.

There are no national department conditional grants co-funding primary health care facilities. However, the HIV-AIDS grant is largely operationalized through clinics and community health centres. This grant has been growing very rapidly over the past 3 years (63.11 percent p.a.) but from a low base. It continues to be prioritized over the 2007 medium-term cycle but budget growth is stabilized at a lower 11.38 percent p.a. The national department grant provides just more than 40 percent of the budget of provincial sub-programs for HIV-AIDS, TB & sexually transmitted infection (STI) control.

Whilst the Hospital Revitalization Grant has been growing very rapidly over the recent past (18.09 percent p.a.) and is projected to continue doing so (at 16.51 percent p.a.); it comprises just over 5 percent of the budgets for secondary health care services (delivered from district and provincial hospitals). Secondary health care budgets have been growing at a very low rate of 0.26 percent p.a. over the past 3 years whilst projected growth for the forthcoming medium-term increases but to a below-average 2.11 percent p.a.

Capital spending at 4.74 percent p.a. budget growth continues to be prioritized over the forthcoming medium-term cycle but this is a sharp deceleration from the 18.00 percent growth recorded between FY 2003 and FY 2005. This deceleration is probably a response to persistent high levels of under-spending on capital budgets.

Spending and Budgeting Performance

In general and across most of the major programs, there are few mismatches between budgets and spending. On average, provincial health departments registered a low 0.53 percent under-spend between FY 2003 and FY 2005 with the majority personnel component recording 0.51 percent. Slight under-spending is recorded for primary health care services and low over-spends on secondary and tertiary hospital services.

The national Department of Health makes extensive use of conditional grants. The Tertiary Hospital and HIV-AIDS grants have been slightly over-spent (at 1.34 percent and 1.39 percent respectively) over the past 3 years. The Hospital Revitalization Grant has been consistently under-spent at a high level of 16.56 percent during the same period. Both this and the HIV-AIDS grant exhibit unstable budget growth paths.

Sub-optimal spending and budgeting performance also characterizes the capital budgets of provincial health departments. Erratic budget growth paths may have contributed to persistently high under-spending rates of 12.43 percent during the recent past.

Delivery Performance and Impact

Patient visits rather than numbers are recorded in the Provincial Budget and Expenditure Reviews. These have been rising at a rate of 2.78 percent p.a. between 2003 and 2005. Patient visits have not been recorded for district and provincial hospitals but appear to be declining at academic hospitals at a rate of (0.08 percent) p.a.

Similarly, the PBER does not record the number of beds in secondary and tertiary hospitals, nor bed utilization rates. No time series data is available to estimate the growth in the number of public health institutions (i.e. clinics and hospitals).

The impact of provincial public health services is indicated through measures such as the mortality rate (rising), the proportion of adult deaths due to HIV-AIDS (declining between 2005 and 2006 as HIV-AIDS prevention and treatment campaigns become effective), TB cure rates (declining) and child immunization rates (rising at 5.46 percent p.a.) over the past 3 years.

Welfare

Provincial Social Development departments are responsible for providing social welfare services as indicated in the Bill of Rights. Until this year (FY 2006), provincial departments also operated the social assistance grant schemes. These have now been passed onto a national agency (the South African Social Security Agency or SASSA). Welfare program currently constitute a mere 1.5 percent of provincial budgets.

Table A.3.3: Policy and Spending Performance Indicators of Provincial Welfare Departments – FY 2003 to FY 2009

Item	Policy Performance			Spending Performance
Department / Category / Program / Grant	Real Growth of Budgets between FY 2003 and FY 2005	Real Growth of Budgets between FY 2007 and FY 2009	% of Total Departmental Spend FY 2006	Under- or (Over-) Spending FY 2003 to FY 2005
All Provincial Departments	5.02%	4.13%		2.25%
Welfare Program	**7.22%**	**11.24%**	**100.00%**	**2.75%**
Personnel	5.60%	9.54%	27.26%	2.71%
Training*	Not known	-7.65%	0.47%	Not known
Capital	64.28%	-16.72%	1.83%	50.25%
Child Care & Protection	8.51%	14.77%	34.75%	1.95%
Services for Older Persons	0.09%	9.98%	15.38%	1.15%
Services to Disabled Persons	1.08%	4.47%	6.02%	5.80%

Source: Annual Financial Statements (2004, 2005) and Budget Statements (2007) of Provinces

Note: Training data is incomplete in terms of time series and cross-provincial coverage.

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Policy Performance

Welfare services receive no emphasis in the over-arching national growth and economic development policies. Nevertheless, welfare service budgets have grown by an above average 7.22 percent p.a. over the past 3 years and are projected to accelerate even further to 11.24 percent p.a. over the 2007 medium-term budget. In part, this can be attributed to compensatory increases after years of being crowded out by expansion of the social assistance grant scheme implemented by provincial departments of Social Development.

The largest and fastest growing component of welfare services is Child Care and Protection. Budget growth of 8.51 percent p.a. over the recent past accelerating to a rather high 14.77 percent over the forthcoming medium-term period is probably in anticipation of the passing of the Child Justice Bill and the financial implications of implementation thereof. Budgets funding services to older and disabled persons hardly grew between FY 2003 and FY 2005 but have since been accelerated to above average rates of 9.98% and 4.47% p.a. respectively for the period FY 2007 to FY 2009.

During the past 3 years, personnel budget growth of 5.60 percent has funded a 9.15 percent annual increase in staff numbers, implying a (4.91 percent) p.a. decline in spending per staff. This probably suggests a composition shift towards newly graduated and relatively inexperienced professional and/or administrative staff. Personnel budgets have since accelerated to 9.54 percent p.a. for the forthcoming medium-term and may help to attract and retain social workers. Social work has been listed as a scarce skill and remuneration improvements were identified as priorities in the Finance Minister's Budget Speech of 2007.

Approximately 1.7 percent of welfare personnel budgets are devoted to training. This lies above the Department of Labour requirements for the funding the SETAs. Whether this higher than required allocation justifies a (7.65 percent) decline over the forthcoming medium-term is a moot point given the scarce skill status of social workers.

Capital spending is very erratic with a 64.28 percent annual increase recorded for the previous 3 years and a projected annual decline of (16.72 percent) projected for FY 2007 to FY 2009. This decline is probably driven by very high rates of under-spending. Capital constitutes less than 2 percent of welfare budgets and some practitioners argue that such facilities as children's and retirement homes can be easily substituted with home-based care recorded as personnel spending.

Spending and Budgeting Performance

In general, the social welfare program exhibits a relatively stable budget growth path and average rates of under-spending (at 2.75 percent) over the recent past. Erratic budgeting and a higher than average and prescribed rate of under-spending (5.80 percent) over the past 3 years characterize services to disabled persons and, to a lesser extent, services to older persons. Child care and protection services exhibit stability and low under-spending rates.

Personnel budgets have been volatile over the recent past but under-spending rates have remained low. By contrast, half the capital budget had not been spent.

Delivery Performance

In 2005, approximately 640 000 children, 104 000 older persons and 30 000 disabled persons were indicated as beneficiaries of provincial welfare services. Time series data is not yet collated into the PBER; hence beneficiary growth rates and coverage of target populations can not be estimated.

The number of institutions such as children's and retirement homes and persons in care thereof has not been recorded.

Housing

Provincial housing departments are essentially responsible for disbursing capital subsidies for housing construction to developers and municipalities. As such, they are a link in the chain of low income housing delivery as required in the Bill of Rights. Housing budgets currently constitute 4 percent of provincial government budgets.

Table A.3.4: Policy and Spending Performance Indicators of Provincial Housing Departments – FY 2003 to FY 2009

Item	Policy Performance			Spending Performance
Department / Category / Program / Grant	Real Growth of Budgets between FY 2003 and FY 2005	Real Growth of Budgets between FY 2007 and FY 2009	% of Total Departmental Spend FY 2006	Under- or (Over-) Spending FY 2003 to FY 2005
All Provincial Departments	5.02%	4.13%		2.25%
Housing	-0.53%	9.34%	100.00%	8.38%
Personnel	4.63%	0.23%	5.14%	4.62%
Training *	Not known	-10.36%	0.14%	Not known
Capital	16.87%	-7.16%	1.00%	25.44%
Integrated Housing & Settlement Grant	-6.15%	12.36%	86.25%	11.18%
– Project Linked	Not known	Not known	Not known	Not known
– People's Housing Process	Not known	Not known	Not known	Not known

Source: Annual Financial Statements (2004, 2005) and Budget Statements (2007) of Provinces

Note: Training data is incomplete in terms of time series and cross-provincial coverage.

Policy Performance

The provision of low income housing is the primary means of reducing asset poverty and in respect of the policy prescripts of both ASGISA and the EPWP, is included in the definition of infrastructure.

The primary component, at 86.25 percent, of provincial housing department spending is derived from the Integrated Housing and Human Settlement Grant, which is transferred to households as capital subsidies. Between FY 2003 and FY 2005, this grant declined in real terms by (6.15 percent) p.a.

In turn, this drove a 0.53 percent p.a. decline in the departmental budgets. For the forthcoming 2007 medium-term budget, this adverse trend has been countered with a 12.36 percent p.a. growth of the conditional grant driving a 9.34 percent p.a. growth in departmental budgets.

Against a backdrop of declining budgets and delivery, personnel budgets grew at 4.63 percent p.a. over the past 3 years and accommodated a 5.03 percent annual growth in staff numbers. This had the effect of reducing vacancy rates from 43 percent to 36 percent. Against a projected acceleration of overall budgets over the period FY 2007 to FY 2009, personnel budgets are projected to grow at a low rate of 0.23 percent p.a. Training budgets are budgeted to decline at (10.36 percent) p.a. over the next 3 years but, at 2.7 percent of the personnel budget in 2006, this decline can be weighed against the higher than required or normal proportion of 1 percent of personnel budgets devoted to this purpose.

Spending and Budgeting Performance

It is probable that between FY 2003 and FY 2005, declining budgets have been driven by persistent, high and rising rates of under-spending on the Integrated Housing and Human Settlement grant. During this period, under spending on the grant averaged 11.18 percent and this pushed the departmental average to 8.38 percent.

Under-spending on personnel budgets is relatively high (at 4.62 percent) but lies below the Auditor General's 5 percent cautionary benchmark. Under-spending on the department's capital budget is very high. However, capital budgets are intended for office accommodation and equipment and limited to only 1 percent of departmental budgets.

Delivery Performance

The high and rising rates of under-spending have been accompanied by a decline in the delivery rate of completed housing. Indeed, over the past 10 years, delivery rates have halved (to 80 890 dwellings completed during FY 2005). In part, this can be attributed to a failure to index the per household dwelling subsidy amount to inflation.

National norms set a minimum standard of a 30 square metre house connected to the basic municipal services of water, electricity, access and sanitation. The cost of constructing such a dwelling even on low cost land on the urban periphery has generally exceeded the per household subsidy amount. Since municipalities are often expected to provide for both the capital and ongoing operational costs of connecting and supplying basic municipal services to these low income households, many regard the top-up as an unfunded mandate. Consequently, many municipalities are resistant to being accredited with the housing function, although it would enable better integration with infrastructure provision of municipal basic services.

The Breaking New Ground policy of the national housing department was initiated in 2005. This policy endeavored to break the logjam of incomplete projects, partially constructed dwellings and resistance to municipal accreditation. It also hoped to leverage financial resources by raising the average capital subsidy amount to R 36 000 and the qualifying household income from R 3 500 to R 7 500 per month.

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New developments in the field of municipal infrastructure funding may also help to ease the low income housing logjam. In effect, the Municipal Infrastructure Grant (MIG) is being split into separate bulk and reticulated infrastructure grants with the latter being used for connections to state-subsidized low income housing. This may free up the housing grant for shelter provision rather than municipal service connections.

The eradication of informal housing has been set as a target for 2014. It has been estimated that this will require an annual delivery rate of half a million houses per annum. Current delivery rates of 80 thousand per annum are clearly inadequate to reach this target.

Transport

Transport departments are indirectly referred to in the Bill of Rights as enabling access to the other basic services. Provincial transport authorities construct and maintain roads and public transport facilities (such as bus and taxi termini) as well as policing traffic safety regulations. Transport departments constitute approximately 6 percent of provincial budgets.

The exact delineations between national, provincial and municipal competencies in transport service provision are currently under review for its potential to foster diffusion of responsibility, under-funded mandates and late year fiscal dumping. Currently, approximately 45 percent of road length in South Africa falls under provincial government road authorities.

Table A.3.5: Policy and Spending Performance Indicators of Provincial Transport Departments – FY 2003 to FY 2009

Item	Policy Performance			Spending Performance
Department / Category / Program / Grant	Real Growth of Budgets between FY 2003 and FY 2005	Real Growth of Budgets between FY 2007 and FY 2009	% of Total Departmental Spend FY 2006	Under- or (Over-) Spending FY 2003 to FY 2005
All Provincial Departments	5.02%	4.13%		2.25%
Transport	**10.95%**	**2.14%**	**100.00%**	**1.69%**
Road Infrastructure	8.69%	6.92%	54.33%	1.34%
– Construction	-4.48%	8.37%	22.87%	2.37%
– Maintenance	14.67%	8.77%	23.24%	-0.50%
Public Transport	3.97%	-0.33%	8.59%	5.06%
Personnel – Roads	0.33%	1.25%	11.51%	(1.24%)
Training* – Roads	Not known	5.11%	0.40%	Not known
Capital – Roads	8.14%	6.71%	39.46%	1.25%

Source: Annual Financial Statements (2004, 2005) and Budget Statements (2007) of Provinces

Note: Training data is incomplete in terms of time series and cross-provincial coverage.

Policy Prioritization in Budgetary Allocations

In terms of the precepts of ASGISA, an emphasis on infrastructure services is appropriate. Road construction and maintenance, in particular, are well-suited to the low skill employment generation sought after by the Extended Public Works Program (EPWP). Although it is primarily a municipal responsibility, public transport services are an important focus of preparations for the 2010 Soccer World Cup.

Between FY 2003 and FY 2005, budget growth of provincial transport department averaged a high 10.95 percent p.a. However, projected growth over the 2007 medium-term budget cycle decelerates to a below average 2.14 percent. This volatility appears to relate to shifting responsibilities for Gautrain and World Cup related responsibilities for public transport. For example, budgets for public transport facilities grew at 3.97 percent p.a. over the past 3 years but are projected to decline by 0.33 percent p.a. over the forthcoming 3 years.

Closer analysis reveals a more stable growth path for roads infrastructure budgets with a strong 8.69 percent p.a. recorded over the recent past and a 6.92 percent p.a. growth projected for the 2007 medium-term budget. In light of the policy imperatives outlined above, these allocations are appropriate. Further dis-aggregation reveals that budgets for road construction declined by (4.48 percent) p.a. between FY 2003 and FY 2005 whilst those for maintenance increased very rapidly at 14.67 percent. In light of the noticeable depreciation of many South African roads, this emphasis was probably appropriate. Over the medium-term, budget growth is projected at a healthy 8.37 percent and 8.77 percent p.a. respectively.

Further dis-aggregation reveals that personnel budgets for roads grew by a very low 0.33 percent p.a. over the recent past and are projected to grow by only 1.25 percent p.a. between FY 2007 and FY 2009. Over the past 3 years, staff numbers grew at 12.85 percent p.a. This suggests extensive hiring of low skilled staff in line with the precepts of the EPWP.

Professional skills shortages however remain a problem for delivery. Budgets for personnel training are projected to grow by slightly above average at 5.11 percent p.a. and constitute over 3 percent of the personnel budget, well above the Department of Labour stipulations.

Spending and Budget Performance

In general, provincial transport departments and its dominant program of roads infrastructure provision exhibit closer matches between spending and budgets and more stable budget growth paths than the provincial average. Under- and over-spending rates have averaged less than 2.5 percent over the past 3 years for all categories and sub-programs of road infrastructure spend.

By contrast, under-spending of public transport budgets has exceeded the AG benchmark of 5 percent over the past 3 years whilst erratic budgeting has yielded wild swings between high over- and under-expenditure on both personnel and capital budgets.

Delivery Performance and Impact

The (4.48 percent) p.a. decline in provincial road construction budgets over the recent past is reflected in a (13.58 percent) decline in the kilometers of road delivered over this period. The higher rate of decline in delivery relative to budgets is reflected in an annual 10.53 percent increase in road construction costs between FY 2003 and FY 2005. In part, this may reflect higher than average building cost inflation.

Strong budget growth in road maintenance (14.67 percent p.a.) over the previous 3 years is indicated by an average annual increase of 5.16 percent in the length of roads maintained. Per kilometer maintenance costs have increased by 9.04 percent per annum during this period.

Delivery data for the public transport programs and road utilization data is not currently collected in the Provincial Budget and Expenditure Review.

Some provincial departments endeavor to measure their economic impact, particularly in respect of temporary employment opportunities generated on public works projects. During 2004, 164 094 job opportunities were generated by provincial transport authorities.

Agriculture

Provincial Agriculture departments can play a role in ensuring food security as indicated in the Bill of Rights. Agriculture departments constituted 2.6 percent of provincial budgets in FY 2006.

Table A.3.6: Policy and Spending Performance Indicators of Provincial Agriculture Departments – FY 2003 to FY 2009

Item	Policy Performance			Spending Performance
Department / Category / Program / Grant	Real Growth of Budgets between FY 2003 and FY 2005	Real Growth of Budgets between FY 2007 and FY 2009	% of Total Departmental Spend FY 2006	Under- or (Over-) Spending FY 2003 to FY 2005
All Provincial Departments	5.02%	4.13%		2.25%
Agriculture	**9.84%**	**4.22%**	**100.00%**	**5.03%**
Personnel	-4.37%	1.00%	46.03%	1.68%
Training*	6.70%	0.55%	0.69%	Not known
Capital	16.04%	5.59%	7.03%	26.18%
Sustainable Resource Management	24.69%	4.61%	9.30%	10.49%
Farmer Support Services	9.22%	4.89%	40.30%	3.80%
Land Care Grant	12.41%	-0.38%	0.62%	20.56%
Comprehensive Agriculture Support	639.09%	1.96%	3.32%	15.08%

Source: Annual Financial Statements (2004, 2005) and Budget Statements (2007) of Provinces

Note: Training data is incomplete in terms of time series and cross-provincial coverage.

Policy Prioritization in Budgetary Allocations

As an economic sector worth promoting, agriculture is relatively export and employment intensive. Over the period FY 2003 to FY 2005, provincial agricultural departments witnessed budget growth of 9.84 percent p.a., well above the provincial average. Over the forthcoming medium-term, budget growth decelerates to a provincial average of 4.22 percent p.a.

The dominant program, constituting 40 percent of provincial agricultural department spending, is Farmer Support Services, which provide a range of training, extension and marketing services to emerging farmers. In parallel with the departmental totals, this program grew at a rapid 9.22 percent p.a. between FY 2003 and FY 2005 and is projected to decelerate to a slightly above average growth of 4.89 percent p.a. between FY 2007 and FY 2009.

The Sustainable Resource Management program focuses on land rehabilitation and both on- and off-farm infrastructure. As with capital spending in the department (which grew at 16.04 percent p.a. over the past 3 years), this infrastructure services program grew very rapidly at 24.69 percent p.a. Over the 2007 medium term budget, growth is projected to decelerate to 5.59 percent p.a. (for capital spend) and 4.61 percent p.a. (for Sustainable Resource Management).

The national Department of Agriculture operates 2 conditional grants. The most recently initiated is the Comprehensive Agricultural Support Program (CASP), which provides infrastructure and training to recipients of land redistribution and tenure reform schemes. Very high annual growth rates of 639 percent p.a. over the past 3 years reflect growth from a very low base in FY 2003. Projected budget growth over the medium-term though indicates rapid deceleration, probably due to high rates of under-spending. The more established Land Care grant provides land rehabilitation and engineering services to farmers in ecologically degraded areas. This grant grew at a healthy 12.41percent over the previous 3 years but is anticipated to decline by (0.38 percent) p.a. over the forthcoming medium-term.

Between FY 2003 and FY 2005, personnel trends in provincial agricultural departments indicate budgets declining by (4.37 percent) p.a., staff numbers declining by (10.15 percent) p.a. and vacancies rising from 18.8 percent in 2003 to 26.4 percent in 2005. Projected increases to the personnel budget between FY 2007 and FY 2009 are a slow 1 percent p.a.

Training budgets constitute almost 1.5 percent of departmental personnel budgets, above the 1 percent norm established by the Department of Labour. Healthy growth rates of expenditure on personnel training of 6.70 percent p.a. over the past 3 years decelerate sharply over the forthcoming medium-term to a very low 0.55 percent p.a.

Spending and Budgeting Performance

Average under-spending over the past 3 years is recorded as 5.03 percent for all provincial agriculture departments. This is more than double the provincial government average of 2.25 percent and is over the Auditor General's 5 percent benchmark.

Problems of over-budgeting, under-spending and erratic growth paths are least prevalent in the dominant Farmer Support Services program with an average 3.80 percent under-spend between FY 2003 and FY 2005. The 3-year average under-spend on the Sustainable Resource Management program stood at a high 10.49 percent. Furthermore, the budget growth path has been decidedly unstable over this period.

Mismatches between budgets and spending are particularly noticeable for both national department conditional grants. 3 year average under-spend on the Land Care grant is recorded as 20.56 percent, whilst that of CASP is indicated as 15.08 percent. Volatile growth paths characterize the Land Care grant whilst budget growth rates have been high on CASP.

Capital budgeting and spending is both volatile and erratic recording an average 26.18 percent under-spend over the past 3 years. By contrast, personnel spending have been well-matched to budgets.

Delivery Performance and Impact

The Provincial Budget and Expenditure Review records that 54 028 emerging farmers were receiving training, mentoring or advisory services, 2 259 were assisted with infrastructure and 1 077 settled on land in 2005. Time series data are unavailable for these beneficiary indicators; hence trends in respect of progressive realisation can not be estimated.

The P.B.E.R. also notes that 4 152 hectares have been settled whilst 208 hectares have been readied for farming purposes. 600 community gardens have been established.

Governance

Provincial governance departments analyzed here include Premiers' Offices and Provincial Legislatures. These 2 governance departments constitute approximately 1.5 percent of provincial budgets.

Table A.7: Policy and Spending Performance Indicators of Provincial Governance Departments – FY 2003 to FY 2009

Item	Policy Performance			Spending Performance
Department / Category / Program / Grant	Real Growth of Budgets between FY 2003 and FY 2005	Real Growth of Budgets between FY 2007 and FY 2009	% of Total Departmental Spend FY 2006	Under- or (Over-) Spending FY 2003 to FY 2005
All Provincial Departments	4.94%	4.13%		2.25%
Premiers' Offices	**6.95%**	**0.86%**	**100.00%**	**4.98%**
Personnel	10.91%	1.34%	40.16%	2.87%
Training*	6.80%	10.52%	0.41%	Not known
Capital	-14.07%	0.97%	10.35%	15.48%
Administration	5.29%	2.04%	27.30%	Not known
Corporate Support	3.59%	0.71%	37.11%	Not known
Policy & Governance	14.07%	0.44%	35.59%	Not known
Provincial Legislatures	**8.63%**	**0.79%**	**100.00%**	**5.87%**
Personnel	3.46%	1.65%	53.96%	(1.88%)
Training*	-33.98%	-4.84%	0.38%	Not known
Capital	35.99%	-7.80%	9.09%	36.51%
Administration	8.96%	1.35%	46.20%	Not known
Facilities for MPLs	5.75%	0.99%	29.26%	Not known
Parliamentary Services	12.47%	-0.38%	24.54%	Not known

Source: Annual Financial Statements (2004, 2005) and Budget Statements (2007) of Provinces

Note: Training data is incomplete in terms of time series and cross-provincial coverage.

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Policy Prioritization in Budgetary Allocations

Between FY 2003 and FY 2005, budget and spending growth of Premiers' Offices and Provincial Legislatures grew well above the provincial government average at 6.95 percent and 13.66 percent respectively.

Within Premiers' Offices, just over one third of the budget is devoted to its core function of Policy and Governance and the remainder to Administration and Corporate Support. The Policy and Governance programs grew fastest over the recent past at 14.07 percent p.a. However projected increases over the medium-term are low at 0.44 percent and below the growth rates of the support programs.

Personnel budget growth in Premiers' Offices between FY 2003 and FY 2005 stood at a hefty 10.91 percent p.a. whilst capital budget growth declined at (14.07 percent) p.a. This mismatch has been balanced out over the 2007 medium-term budget with low growth rates of 1.34 percent and 0.97 percent respectively. Premiers' Offices appear, appropriately, to have prioritized personnel training with healthy growth of 6.80 percent over the recent past accelerating to 10.52 percent over the forthcoming three years. Just over 1 percent of the personnel budget is devoted to training in line with Department of Labour requirements.

Within Provincial Legislatures, facilities and benefits for Members of Provincial Legislatures (MPL) constitute just nearly 30 percent of the budget whilst the Parliamentary Services program makes up approximately one quarter. Just less than half the budget is therefore devoted to administration and support services. Over the past 3 years, the Parliamentary Services program grew at a hefty 12.47 percent p.a. but is anticipated to decline by (0.38 percent) p.a. over the 2007 medium-term budget period. Facilities and benefits for M.P.L.s grew slower than other programs within Provincial Legislatures at 5.75 percent p.a. over the recent past and decelerate to a low 0.99 percent p.a. between FY 2007 and FY 2009.

The growth of personnel budgets in Provincial Legislatures was more measured exhibiting a 3.46 percent p.a. growth rate over the previous 2 years whilst a 1.65 percent p.a. growth is planned for the forthcoming medium-term budget. By contrast, training and capital budgets have been much more volatile registering significant decline and growth respectively over the recent past and projected declines over the forthcoming medium-term cycle. In 2006, Provincial Legislatures spent less than the 1 percent of personnel budget specified for training.

Spending and Budgeting Performance

Both governance departments exhibit relatively volatile budget growth paths as indicated by the above average growth over the recent past and the below average growth over the forthcoming medium-term. Whilst personnel budgets are relatively stable, capital and training budgets have been and remain extremely erratic.

Over the past 3 years, under-spending rates have averaged 4.98 percent for Premiers' Offices and 5.87 percent for Provincial Legislatures. This is close or in excess of the 5 percent benchmark adopted by the AG as indicating poor performance. Typical of many other provincial departments, mismatches between budgets and spending for personnel are far less noticeable than for capital (where under-spending rates of 15.48 percent and 36.51 percent respectively are recorded). This is likely indicative of the secondary and flexible status attached to capital spending in these governance departments. Insufficient data is available to estimate spending to budget matches for the training component.

Delivery Performance

The Provincial Budget and Expenditure Review does not report any delivery or impact statistics for Premiers' Offices and Provincial Legislatures. Appropriate measures might cover the objectives of public participation such as number of hearings, size of audience, number of queries and answers etc.