FINANCIAL AND FISCAL COMMISSION
POLICY BRIEF

8/2013

Assessing and Improving the Fiscal Performance of Provinces in South Africa

EXECUTIVE SUMMARY

A long-standing issue in South Africa's intergovernmental system is the fiscal condition of provinces in relation to the capacity to deliver their constitutionally mandated services. Views are divided over whether provinces are fiscally stressed, and reasons for the fiscal stress. Some say that national transfers are inadequate to cover the increasing demand for services, while others claim that provinces need to improve their fiscal performance. In an attempt to mediate these opposing views, the phenomenon of fiscal stress was analysed using a composite index of ten variables that capture the underlying drivers of fiscal stress. Fiscal stress is defined broadly as the manifestation of service delivery problems transmitted through the budget from political, institutional, structural, legislative, financial and economic factors. Under this broad definition, expenditure and financial mismanagement alone do not constitute fiscal stress. The results showed that fiscal stress appears not to be not rampant, and the degree of fiscal stress does not appear to vary substantially across provinces. Poor fiscal performance appears to be mostly attributable to internal factors, such as expenditure management, maladministration and wasteful expenditure. National and provincial treasuries should put into place measurement and assessment frameworks for fiscal performance against which provinces are evaluated, and carry out mandatory expenditure reviews. To avoid "budget creeping", the maximum allowed threshold for over and under-expenditure should be replaced with relative, inflation-adjusted figures.

BACKGROUND

The combination of rising demand for public services (because of high levels of poverty and unemployment) and decelerating growth in government revenues creates fiscal stress. Fiscal stress manifests in the form of spontaneous spending overruns (unauthorised expenditure), inability to meet set delivery norms and standards, under-servicing/backlogs, delays or deferment of expenditure commitments and rationing of services (e.g. long queues at clinics or low quality of service). A long-standing issue in South Africa's evolving intergovernmental system is the fiscal condition of provinces in relation to the capacity to deliver their constitutionally mandated services in a sustainable manner. Those who sympathise with provinces decry the narrow fiscal space in which provinces operate (transfers are inadequate to cover the increasing demand for services and additional costs imposed by national policies). Critics stress the adequacy of intergovernmental transfers to the provinces and the need for provinces to improve their fiscal performance. In an attempt to mediate the two opposing views, the Financial and Fiscal Commission examined the phenomenon of provincial fiscal stress and policy options for improving fiscal performance. [1]

FINDINGS

The South African legislative framework outlines conditions under which provinces may be regarded as fiscally stressed and how to address such a condition. However, the approach is financially biased, which tends to give the impression that fiscal stress is strictly a budget-related problem. In this policy brief, fiscal stress is viewed more broadly, as the manifestation of service delivery problems transmitted through the budget from political, institutional, structural, legislative, financial and economic factors. Ten variables capture the underlying drivers of fiscal stress and were used to compute a fiscal stress index. Evaluating each indicator separately does not give a clear picture of whether or not provinces are fiscally stressed. However, as Table 1 shows, a combination of indicators gives a better overall indication of the key drivers of fiscal stress per province.

The composite index reveals that fiscal stress, broadly defined, does not appear to be rampant, although the degree of fiscal stress varies substantially across provinces. The Eastern Cape has the highest weighted fiscal stress score, at 3.25 out of 5, followed by Gauteng at 3 and the Free State at 2.8. The Western Cape and Mpumalanga appear to be containing fiscal stress well, with a low score of 1.3 and 1.4 respectively. Surprisingly, in contrast to popular expectations, Limpopo, whose socioeconomic profile and fiscal performance are comparable to those of the Eastern Cape, has a middle fiscal stress score of

[1] For the full study, see Rakabe, E. 2013. Improving the fiscal performance of provinces in South Africa, Chapter 6 in Financial and Fiscal Commission (2013). 2014/15 Submission for the Division of Revenue Technical Report, Midrand, South Africa.

2.5. Yet in 2012/13, national government took over the provincial administration in Limpopo due to poor financial and expenditure management. This difference can be explained by the triggers that informed national government intervention and the indicators used to compute the index. Under the broader definition of fiscal stress used in this analysis, expenditure and financial mismanagement alone do not constitute fiscal stress. As Table 1 illustrates, most provinces score 5 on wastage and irregular expenditure, budget and expenditure control, and maladministration, indicating that such problems are not limited to Limpopo when assessed over a long period.

Table 1: Composite Provincial Fiscal Stress Index

	Weight[2]	Eastern Cape	Free State	Gauteng	KwaZulu-Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape
Budget balance	5	1	1	1	1	1	1	1	1	1
Cash balance[3]	10	0	0	0	0	0	0	0	0	0
Expenditure buoyancy/ growth	5	5	4	2	1	3	1	1	5	2
Expenditure regidity	5	4	4	1	4	5	4	2	2	2
Unfunded mandates[4]	10	0	0	0	0	0	0	0	0	0
Wastage and irregular expenditure	15	4	3	5	3	3	2	2	2	1
Budget and expenditure control	15	5	5	5	4	4	2	4	3	1
Maladministration / management capacity	15	5	5	2	2	3	1	4	3	1
Minimum efficient expenditure	10	3	1	5	5	3	1	2	1	3
Service needs/ burden	10	3	3	5	4	3	2	2	1	3
Overall Fiscal stress score (Weighted)	100	3.2	2.8	3	2.55	2.55	1.35	2.1	1.8	1.3
Overall Fiscal stress score (unweighted)		3	2.6	2.6	2.4	2.5	1.4	1.8	1.8	1.4

[2] It should be noted that weights are based on author's judgement
[3] Information outstanding
[4] No adequate indicator

CONCLUSION

Based on the broader definition, fiscal stress is not rampant, and the degree of fiscal stress does not vary substantially across provinces. Poor fiscal performance appears to be mostly attributable to internal factors, such as expenditure management, maladministration and wasteful expenditure. These findings are consistent with national government's perceptions of the efficiency and effectiveness of provincial budgets. However, more research is required to understand and measure the underlying drivers in provinces where fiscal stress has manifested and the good practices of provinces that contain their fiscal stress.

With respect to **improving provincial fiscal performance**, the Commission recommends that:

- National and provincial treasuries put in place an agreed-upon measurement and assessment framework for fiscal performance against which provinces are evaluated. The assessment framework must:
  - Take into account various factors that capture fiscal performance holistically, including services burden, expenditure efficiency and funding and delivery norms;
  - Incorporate information from internal audit reports and serve as an early warning system to complement section 32 reports and National Treasury benchmarking exercises;
  - Provide for monitoring and disclosure of key fiscal performance indicators of provincial departments, particularly when deviation (as defined by the PFMA) from a healthy fiscal trajectory is prolonged;
  - Provide for monitoring of expenditure benchmarks against which key provincial expenditure items are regularly evaluated and reported by provincial Accounting Officers.
- Government considers reducing or replacing the maximum allowed threshold for over and under-expenditure with relative inflation-adjusted figures, to avoid "budget creeping" – a situation where the budget's annual rate of growth makes large amounts of over and under-expenditure acceptable because they are below threshold.
- National and provincial Accounting Officers rigorously enforce section 86 of the PFMA, which provides for the initiation of criminal and disciplinary proceedings for persistent contravention, especially for wasteful and unauthorised expenditure. Where individuals are found guilty, consistent sanctions should be applied commensurate with the seriousness of the offence.
- Provincial treasuries must carry out mandatory expenditure reviews (overseen by National Treasury and the Department of Performance Monitoring and Evaluation in the Presidency) after every Medium Term Expenditure Framework (MTEF) cycle, specifically focusing on composition, efficiency, economy and effectiveness of expenditure, as well as access to services and realignment of spending with programme objectives and delivery targets.

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