



**Western Cape**

**MEDIUM TERM BUDGET**

**Policy Statement**

**2005 – 2008**

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## Foreword

**T**he 2005 – 2008 Provincial Medium Term Budget Policy Statement (MTBPS) builds on previous fiscal policies issued by the Provincial Government. Its goal is to determine and express the medium-term revenue and expenditure direction of the Province and encourage debate on these before the 2005 budget and the Medium Term Expenditure Framework (MTEF) are finalised.

The MTBPS is based on the essence of iKapa Elihlumayo, i.e. the notion of a developmental state whereby the state is not a neutral facilitator of economic activity or the passive provider of social services, but rather plays a proactive role in pursuing its socio-economic objectives.

In South Africa the ‘developmental state’ is made up of a complex compendium of national, provincial and local government. The Premier recently described the role of provinces within this complex as: *“Provincial Government is the interlocutor between the macro and micro by focusing on the meso factors in our national development effort. Provincial Governments fulfil a vital role in translating the national development agenda into contextualised provincial frameworks... Abstracted, de-contextualised blueprint development frameworks simply fail. A key role of Provinces is therefore to ensure national consistency in our development efforts but at the same time to set the frameworks for localisation and integration.”*

This reconceptualisation of the role of provinces needs to find expression at two levels. Firstly, the Provincial Equitable Share (PES) formula needs to be reconsidered in order to

give more adequate expression to the role that provinces are starting to play especially in economic development, but also in development more generally. The design of the current PES formula is based on a model of provinces as largely providers of Education and Health to the poorest of the poor.

Secondly, provincial governments themselves need to give expression to this developmental agenda in their budgets and service delivery plans. In the Western Cape this imperative resulted in the 8 iKapa Elihlumayo lead strategies that are currently under development. In order to cement the emerging developmental role of Provincial Government, it is therefore of key importance that these lead strategies be completed and implemented.

Full cognisance is taken of the national government's suggested priorities for provinces. Apart from inflation adjustments for the new MTEF, however, budget allocations largely have to take their lead from the 8 key priorities for Budget 2005.



**Lynne Brown**  
**Minister of Finance, Economic Development and Tourism**

**November 2004**



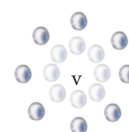
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# Abbreviations

ACSA:	Airports Company of South Africa
AG:	Auditor-General
ASB:	Accounting Standards Board
BAS:	Basic Accounting System
BEE:	Black Economic Empowerment
BER:	Bureau for Economic Research
BPO:	Business Process Outsourcing
CASIDRA:	Cape Agency for Sustainable Development in Rural Areas
CASP:	Comprehensive Agricultural Support Programme
CCT:	City of Cape Town
CFO:	Chief Financial Officer
CIDB:	Construction Industry Development Programme
CPD	Corporation for Public Deposits
CSG:	Child Support Grant
DBSA:	Development Bank of Southern Africa
DEA&DP:	Department of Environmental Affairs and Development Planning
DEDAT:	Department of Economic Development and Tourism
DG:	Disability Grant
DORA:	Division of Revenue Act
DoT:	Department of Transport (National)
DoTP:	Department of the Premier
DPW:	Department of Public Works
ECD:	Early Childhood Development
EDU:	Economic Development Unit
EHS:	Environmental Health Services
ELSEN:	Education for Learners with Special Education Needs
EMIS:	Education Management Information System
EPWP:	Expanded Public Works Programme
FAS:	Foetal Alcohol Syndrome
FDI:	Foreign Direct Investment
FET:	Further Education Training
FETC:	Further Education and Training Certificate
FMS:	Financial Management System
FSD:	Farmer Support and Development
GDPR:	Gross Domestic Product by Region
GEPF:	Government Employees Pension Fund
GET:	General Education and Training
GRAP:	Generally Recognised Accounting Practice
GSSC:	Gauteng Shared Services Centre
HEI:	Higher Education Institution
HIS:	Hospital Information system
HIV/AIDS:	Human Immune Virus/Acquired Immune Deficiency Syndrome



HRD:	Human Resource Development
HRDS:	Human Resource Development Strategy
HSRC:	Human Sciences Research Council
ICS:	Improvement in Conditions of Service
ICT:	Information Communication Technology
IDC:	Industrial Development Corporation
IDIP:	Infrastructure Delivery Improvement Programme
IDP:	Integrated Development Plans
INP:	Integrated Nutrition Programme
ISRDP:	Integrated Strategic Renewal Development Programme
IYM:	In-Year Monitoring
LCC:	Loan Co-ordinating Committee
LED:	Local Economic Development
LOGIS:	Logistical Information System
LRAD:	Land Redistribution and Agricultural Development
MEC:	Member of Executive Council
MEDS:	Micro Economic Development Strategy
MFMA:	Municipal Finance Management Act
MIG:	Municipal Infrastructure Grant
MoA:	Memorandum of Agreement
MoU:	Memorandum of Understanding
MSP:	Master Systems Plan
MTBPS:	Medium Term Budget Policy Statement
MTEF:	Medium Term Expenditure Framework
NGO:	Non-governmental Organisation
NMIR:	National Minimum Information Requirements
NQF:	National Qualification Framework
NSDF:	National Skills Development Framework
NSDP:	National Spatial Development Perspective/Plan
NTSG:	National Tertiary Services Grant
PDC:	Provincial Development Council
PERSAL:	Personnel and Salary Administration System
PER&O:	Provincial Economic Review and Outlook
PES:	Provincial Equitable share
PFMA:	Public Finance Management Act
PGDS:	Provincial Growth and Development Summit
PGWC:	Provincial Government Western Cape
PHC:	Primary Health Care
PIG:	Provincial Infrastructure Grant
PMTCT:	Prevention of Mother-to-Child Transmission
POS:	Public Ordinary Schools
PPP:	Public Private Partnerships
PSDF:	Provincial Spatial Development Framework
PSNP:	Primary School Nutrition Programme
QALYs:	Quality-Adjusted Life Years

RED:	Real Enterprise Development
SARS:	South African Revenue Services
SASSA:	South African Social Security Agency
SCF:	Social Capital Formation
SCFS:	Social Capital Formation Strategy
SETA:	Sector Education and Training Authority
SIP:	Strategic Infrastructure Plan
SITA:	State Information Technology Agency
SMME:	Small Medium and Micro Enterprise
SMS:	Senior Management Service
TB:	Tuberculosis
TCF:	Technical Committee on Finance
TIPS:	Trade and Industrial Policy Strategies
UPFS:	Uniform Patient Fee Schedule
URP:	Urban Renewal Programme
URS:	User Requirement Statement
WCNCB:	Western Cape Nature Conservation Board
WECCO:	Western Cape Clean-up Operation
WCED:	Western Cape Education Department
Wesgro:	Western Cape Investment and Trade Promotion Agency

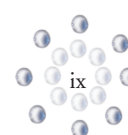


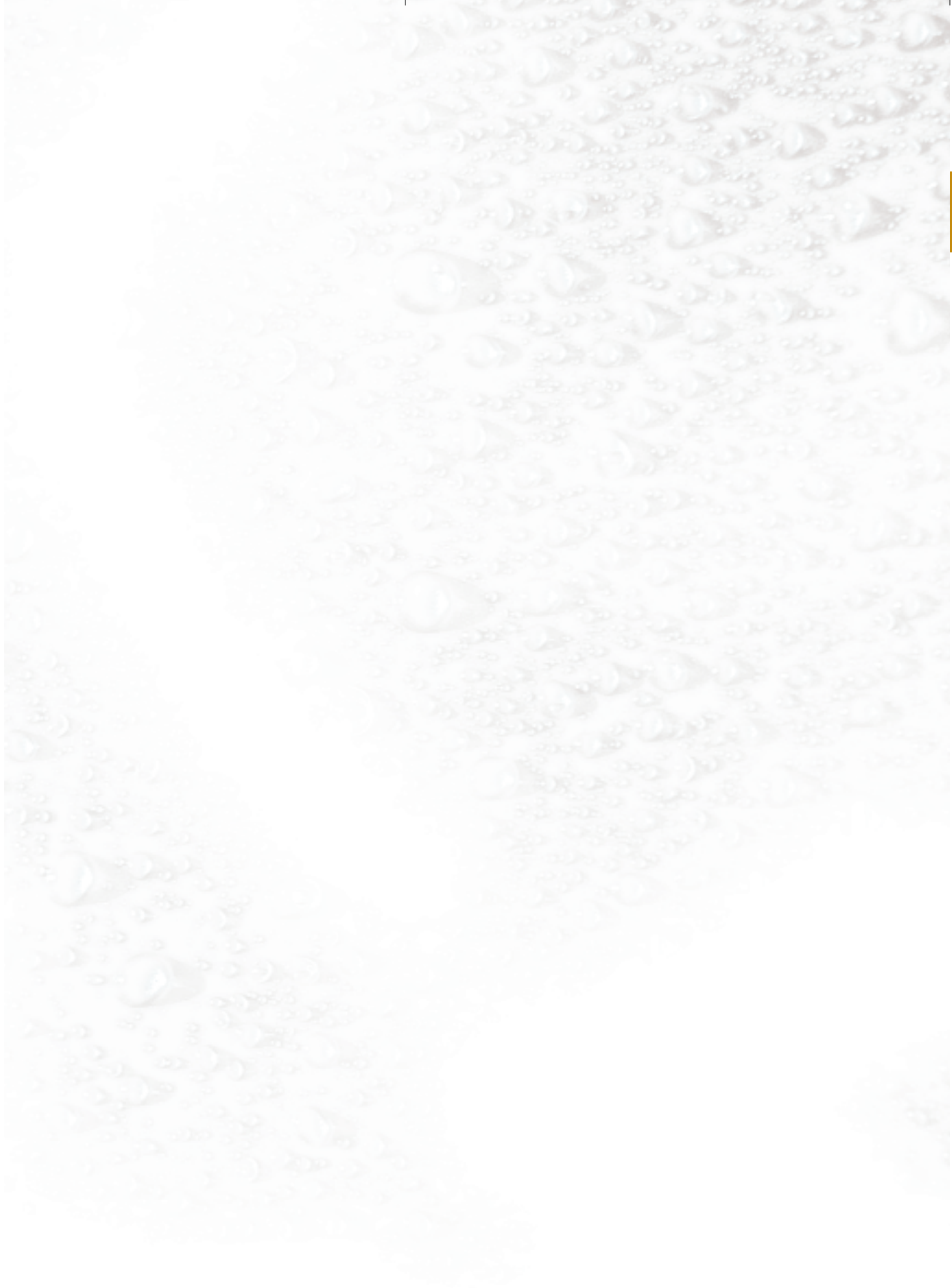
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# Executive summary

## Chapter 1: Economic analysis and framework

The Western Cape's economic fortunes are closely linked to those of the national economy. Following a decade of economic restructuring and prudent macro-economic policies, the outlook for the South African economy is the best in years. Real Gross Domestic Product (GDP) growth is forecast to accelerate to 3,9% over the next fiscal year, but to decline to 3,1% in 2007/08.

The Western Cape economy shares in the national economic revival; however, the region was comparatively harder hit by the strengthening Rand exchange rate, adverse climatic conditions and the rationalisation activities in its fast-growing financial services sector in 2003. All in all, real (Western Cape) Gross Domestic Product by Region (GDPR) is projected to accelerate to 3,2% in the fiscal year 2004/05, 4,1% in 2005/06 before declining to 3,9% in 2006/07 and 3,1% in 2007/08.

### Sectoral growth and employment prospects

Services together contribute more than two-thirds of the Western Cape's GDPR – higher than the sector's national average. Finance, insurance & business services, in particular, stand out with a combined share of 27,4% of GDPR compared to 19,3% of national GDP in 2003.

The strongest output growth in the Province (as nationally) has been recorded in finance & business services and transport & communications at average annual growth rates in the past 8 years of 4,7% and 7,7% respectively. Wholesale and retail trade has also recorded fairly continuous increases in output.

The Province has recorded higher growth than the national average in catering & accommodation, transport & storage, business services and other producers. This reflects strengths in tourism, call centres, and as a major port. However, employment has been declining in services and the disaggregated picture shows very different patterns across different sub-sectors of services.

The performance of manufacturing has been very disappointing at an average annual growth of just 0,5%, lower than the national performance of 1,8%.

In respect of employment, general government services and community & social services have overtaken manufacturing as the major employer. It is surprising, however, that there has not been net employment creation in finance & business services, transport & communication, nor in wholesale & retail trade, hotels & restaurants given the output growth of these sectors. Of perhaps greater concern is that there is little indication of increased employment resulting from tourism and other services such as telecommunications.

All manufacturing sectors in the Province had lower employment in 2003 than in 1995, except for transport equipment. The biggest proportionate declines were in other non-metallic minerals (including cement and brick-making), and the biggest absolute job losses were in the largest sector – that is, clothing, textiles & leather – closely followed by the food, beverages & tobacco sector.

In the last three years, the metals & machinery sector – linked with other important areas of potential – has shown signs of growth. Positive growth in employment in the transport equipment sector reflects capabilities in auto components and in yachts & ship-building.

At the sectoral level, growth and employment need to rest on a diverse sectoral base. The pattern of higher growth in financial & business services and tourism, with agriculture remaining very important, does not negate the need to further develop a manufacturing base.

A crucial dimension in the Western Cape is its coastal location and the opportunities that arise from it. This is not only a factor in exports, but also in deepening international links around investment, technology and production networks. The challenge is to translate the opportunities into exports, output growth and employment in relatively labour-intensive areas of manufacturing.

## Employment and remuneration prospects

Substantial in-migration to the Province is the key factor influencing the Western Cape's changing demographic and labour market profile. It is estimated that the Province gains 48 000 individuals (net of out-migration) every year, with many of these motivated by perceived brighter employment prospects and higher incomes.

Migrants of working age represent an injection of workers into the Western Cape economy. In this respect, it is important to note that the Eastern Cape is by far the largest contributor (44%) of in-migration to the Western Cape. Of interest is that the Western Cape seems to be attracting relatively less educated in-migrants from the Eastern Cape, while more educated migrants tend to move to Gauteng or to Eastern Cape cities.

In respect of employment, South Africa has witnessed notable growth in employment prior to 2000. But since then aggregate national employment seems sticky at about 11,6 million jobs.

However, while the economy may be creating jobs, it may not be creating enough given the rising number of new entrants into the labour market each year, leading to rising unemployment rates.

At the provincial level, the Western Cape's labour market performance holds brighter prospects. Since 2000, nearly 200 000 jobs were created in the Western Cape at a rate of 4,0% per year. Unfortunately, unemployment in the Province has also expanded more rapidly. This trend sees the official (narrow) unemployment rate rising from 17,1% in 2000 to 20,6% in 2003, and using the expanded definition, rising from 22,6% to 26,1%, respectively.

Reflecting the demographic profile of the Province, most jobs in 2003 were filled by Coloured individuals (58%), with Africans and Whites each constituting around one-fifth of employment. At the same time, more than one-half or 320 000 of the 612 000 Western Cape unemployed are Coloured. In contrast, at 41%, Africans' share of unemployment is twice their employment share, indicating a substantial disadvantage for Africans in the provincial labour market. Conversely, Whites' unemployment share is around 6% – less than one-third of their employment share.

Perhaps most alarming is that the Western Cape accounts for a relatively high share of the national number of unemployed 16 to 25 year olds.

As the skills bias of employment growth is central to the issue of income inequality within the Province, both across and within race groups, it is important to note that skills are highly unevenly distributed both nationally and within the Western Cape. Amongst those employed in the formal sector, Whites account for close to 54% of the highly skilled,

compared to their 22% share of total formal sector employment. In contrast, while Africans constitute slightly more than 17% of the employed in the Province, more than 28% of low skilled persons employed are African. Coloureds are over-represented in the skilled and low-skilled occupations.

Inequality in South Africa is exceptionally high, and if anything, has worsened from 1995 to 2000. Gini coefficient analysis undertaken for the 2005 Provincial Economic Review and Outlook (PER&O) shows that income inequality has increased from 0,64 in 1995 to 0,68 in 2000.

Calculating Gini coefficients by province for 1995 and 2000 shows that inequality has increased across the board. In relation to other provinces, the Western Cape, in 1995, was the third least unequal province with a Gini coefficient of 0,584, following Mpumalanga (0,582) and Gauteng (0,545), and in 2000 the least unequal with a Gini coefficient of 0,616.

A deepening of poverty at the lower end and/or upward earnings mobility of those at the top end, would serve to widen the distribution and is the likely reason for this result. Indeed, with labour market earnings being the key driver of inequality in South Africa, rising unemployment coupled with improvement in average real earnings in the Western Cape would be expected to lead to a widening of the income distribution.

Complementary poverty analysis shows that income poverty in South Africa has not improved between 1995 and 2000; it has in fact deteriorated. Taking a low poverty line of R174 per capita per month, 31% of South Africans were poor in 1995. By 2000 this had risen to 38%.

The Western Cape's performance is more satisfactory than the national picture but the aggregate view masks worrying trends in poverty pockets. However, at 28% of the population, poverty is still a pervasive problem for the Province, and given larger population numbers, this also means increased numbers of poor people despite the marginal rate improvement.

Taking a closer look at access to services, we see slight improvements at the national level, most notably in the increase in electricity for lighting purposes. Therefore, even though income poverty appears to have increased in South Africa, improvements in access to some basic services have been made.

On aggregate, the Western Cape is again well above the national average, although improvement in access is less impressive for the Province. In fact, the proportion of dwellings classified as formal has declined from 82,2% in 1996 to 80,4% in 2001, while the share of households with no toilet increased from 5,4 to 7,7%.

Considering the range of access indicators by income quintile reveals notable differences between the poorest 40% of households and the rest, indicating that it is these households that are marginalised in terms of both income and service delivery. It is these households that must be targeted in the Western Cape's development programmes and interventions over the medium term.

## Chapter 2: Provincial expenditure trends

Provincial expenditure increases in real terms from R11,513 billion in 2000/01 to R14,262 billion in 2006/07 on the previous MTEF. This increase is mainly due to additional funding made available from the national fiscus as well as increased provincial own revenue. This increase was however largely designed to cater for increases in the number of beneficiaries receiving Social Security grants and the introduction of a Provincial Infrastructure Grant. The Province has also managed to turn around over-expenditure of R0,648 billion in 1997/98 to under-expenditure of R0,409 billion in 2000/01, R0,338 billion in 2001/02, R0,308 billion in 2002/03 and R0,388 billion in 2003/04.

Despite the real growth in the budget allocation, the provincial budget is experiencing pressure, especially as a result of changes to the PES formula and the growth in grant beneficiaries. Additional pressures stem from insufficient provision for Improvement in Conditions of Service (ICS) which is likely to have a disproportional effect on personnel-intensive departments such as Education and Health as well as for the provincial budget as a whole.

The growth in Social Services and Poverty Alleviation expenditure stemming from the increased uptake of the Disability Grant and Child Support Grant has crowded out any significant increases in Education and Health, which have seen their share of the total budget decline. Education's declining share of expenditure together with the non-Social Sector has an effect of limiting the ability of the Province to play a more active role in socio-economic development and the pursuit of the iKapa Elihlumayo goals.

In recent years, the share of administrative expenditure in the provincial budget has increased largely as a result of the process of departmentalisation. Given the inflexibility of administrative costs there is a strong argument for the amalgamation of smaller departments such as Housing and Local Government. Such amalgamation could free up significant new resources. The sharing of administrative resources between especially the smaller departments will be investigated further.

The personnel expenditure share of the provincial budget has shown a gradual decline in recent years and accounted for 45,93% of the Provincial budget in 2003/04. This is largely attributable to the sharp increase on Social Security and some recovery in infrastructure spending. Despite the control of personnel expenditure, capital expenditure remains under pressure.

The transfer of funds out of and between spheres of government is an activity that has historically exposed both the transferring and recipient agents to significant risk. In general transfer payments still reflect an upward trend as the financial year progresses. This trend is mainly due to the growth in Social Security beneficiary numbers and, secondly, transfers to municipalities and other institutions increasing towards the end of the financial year. The spending trend, on a month-to-month basis, is very uneven, especially if it is taken into account that the bulk of the transfers are Social Security transfers to households. The projection/forecast for transfer payments seems to be inaccurate as is evident in both 2003/04 and 2004/05. Generally a more pro-active role is also needed in the monitoring of projects implemented by transfer recipients, beyond the traditional monitoring of administrative processes.

Currently the service delivery boundaries of some provincial departments do not agree with those of the district municipalities, or with each other. Departments have therefore been requested to align their services with the borders of the district municipalities by 1 July 2005 to ensure delivery of all services within these boundaries when the Provincial Treasury's roles and responsibilities in terms of the Municipal Finance Management Act (No. 56 of 2003) become effective.

### **Chapter 3: Provincial service delivery challenges**

The 8 lead strategies identified in the pursuit of the goals of iKapa Elihlumayo are at various stages of development. The strategies are however nearing completion and the linkages and interfaces between them are becoming clearer.

The implementation of lead strategies implies funding shifts within and between departments as well as changes in the way departments do things. The slow pace at which some lead strategies are being developed, however means that departments have yet to effect the challenges of realignment and reprioritisation of their budgets. Ensuring maximum return from such changes will necessitate the development of key linkages between various lead strategies for example, between the Strategic Infrastructure Plan (SIP) and Micro-Economic Development Strategy (MEDS), the Human Resource Development Strategy (HRDS) and Social Capital Formation Strategy (SCFS), etc.

#### **Human Resource Development Strategy**

The HRDS is the most developed of the 8 lead strategies. Its largest remaining challenges include:

- The harnessing of private and public sector partners in human resource development such as Sector Education and Training Authorities (SETAs) and Higher Education Institutions (HEIs);
- The need to internalise the HRDS into the Department of Education itself;
- Targeting the learners who do not find employment or placement in HEIs;

- The high drop-out rate in the Further Education and Training (FET) band as well as persistent racial disparities in educational attainment;
- Improving the Education Management Information system (EMIS) to provide better information on learner numbers and the movement of learners in the Education system; and
- Consolidating the interface between the MEDS and the HRDS to ensure the smoothest possible transition for learners from the education system to the labour market.

Budgetary shifts that could accompany the implementation of the HRDS would include:

- More detailed infrastructure planning to account for the redevelopment of provincial property, the redesign of the school transport system, etc;
- A reconsideration of funding to Education for Learners with Special Education Needs (ELSEN) schools;
- A better balance between Public Ordinary Schools (POS) and FET allocations; and
- Lower learner-educator ratios in primary education and higher ratios in secondary education.

## **Social Capital Formation Strategy**

The first draft of the SCFS has been tabled, but further work is being done on diagnosis, design and target setting of this strategy. Specific challenges include:

- The roles of especially Culture & Sport and Community Safety need to be developed further;
- The numerous community level interventions need to be supplemented with intervention in larger scale societal problems such as racial divisions and international drug networks;
- The need to spend more on social worker salaries as the front end of the SCFS; and
- The need to address remaining racial, geographic and functional imbalances in transfers to Non-Governmental Organisations (NGOs) and Community-based organisations.

The role of the Department of Health has been developed significantly, but also needs to be integrated into the rest of the SCF strategy. Other challenges to the Department of Health would include:

- The need to assess the weight of external impactors on the general health status;
- The challenge to co-ordinate with selected partners to address the causal factors of poor health in the Province such as homicide, environmental health and lifestyle diseases;
- The need to agree on appropriate indicators to assess the impact of interventions; and
- The need for improved community interaction in order to improve the reception of health care services in the Province, especially amongst the youth.

Preliminary work by the Department of Health indicates that in order to maximize its role in social capital formation and preservation, its budget should place emphasis on District Health Services and the training of health care professionals. In the short to medium term key equipment and maintenance needs should also be seen to, in order to improve services and efficiency.

## **Micro-Economic Development Strategy**

Research for the MEDS is at an advanced stage, and will be pulled together into a coherent strategy by December 2004, followed by further refinement towards the middle of 2005. Key challenges to the development of the MEDS include:

- Improved co-ordination between the 2 primary departments (Department of Economic Development and Tourism, or DEDAT, and Agriculture), public entities (Wesgro<sup>1</sup> and Casidra<sup>2</sup>), the Provincial Development Council (PDC), the private sector and local government. The current parallel planning streams in many of the bodies will be difficult to integrate after the fact:
  - One of the key issues in this regard would be the formulation of a vision for the development of both the provincial economy as a whole as well as the development of each of the different sectors within it;
  - A central part of this development path should also be to take account of the impact of water shortages on the development of key sectors such as Agriculture;
  - The role of Wesgro in the MEDS needs to be developed in much greater detail, given the importance of exports and Foreign Direct Investment (FDI) to the Western Cape economy;
  - Some of the 'advance interventions' flowing from the MEDS such as the Real Enterprise Development (RED) and the Economic Development Units (EDUs) need to be accompanied by detailed monitoring and evaluation mechanisms, given the high risk associated with such projects;
  - Numerous initiatives to bring about regulatory reform in both the local and Provincial Government need to be consolidated and developed further; and
  - The future role of emerging farmers in the likely development path of the agricultural sector needs to be expanded in much greater detail.

As far as the budgets of these two departments go, the following issues would need to be addressed in the implementation phase of the MEDS:

- The need to find the appropriate balance between expenditure on generic interventions such as regulatory reform and sector specific interventions such as expenditure on agriculture;
- Finding the correct balance between sector interventions;
- The need to address duplication and disparities between departments such as the fact that Wesgro is not involved in trade promotion on behalf of Agriculture; and
- Addressing the financial health of Casidra, its future and its integration into the strategic vision of the MEDS.

<sup>1</sup> *Western Cape Investment and Trade Promotion Agency*

<sup>2</sup> *Cape Agency for Sustainable Development in Rural Areas*



## Strategic Infrastructure Plan

In the first draft of the SIP, a number of key areas would need to be developed further, such as the assessment of the existing infrastructure network, the links of the SIP to the MEDS and SCFS, and the proposed rollout of a defined need for infrastructure in the Province. Other broad areas of further work include:

- The size and nature of the infrastructure backlog. The current paradigm of 'maintaining the provincial asset' does not take account of the possibility of deproclamation of low priority roads and the redevelopment of other provincial assets;
- The need for leveraging of private sector funding is acknowledged by the Department of Transport and Public Works, but further strategic thinking needs to be done on how to go about mobilising such funding;
- Given the challenges to which Public Works programmes are generically exposed, the design of the Saamstaan intervention would need additional work and capacity;
- The human resources needed in the Department of Transport and Public Works to design and implement the SIP; and
- The debate about the location of the Public Works budget and function will be addressed by an interdepartmental committee chaired by the Treasury.

Issues specific to the role of the Department of Housing to the SIP would include:

- The need for the Department to continue unblocking housing service delivery and to eliminate under-spending;
- The further development of an improved targeting mechanism to ensure equitable delivery;
- The filling of posts and building internal capacity in the Department;
- The further development and implementation of initiatives to support delivery capacity of municipalities;
- Defining the scale and nature of the housing backlog and exploring ways of reducing such. This may include non-government driven initiatives; and
- Economies of scale and associated savings to be obtained by the amalgamation of the Departments of Housing and Local Government and the application of such funds towards the deployment of Community Development Workers.

## Provincial Spatial Development Framework (PSDF)

The key challenge to be addressed in the development of the PSDF is the clarification of the vision for the spatial development of the Province. Specifically the role of small towns in the Province needs to be clarified. This spatial vision should be closely tied to the path of the agriculture sector to be developed as part of the MEDS. Other key issues to be addressed in the finalisation of the PSDF would include:

- The linkage between the PSDF and other spatially driven initiatives in the Province such as Project Consolidate, the Integrated Strategic Renewal Development Plan (ISRDP) and the Urban Renewal Programme (URP); the development of mechanisms to ensure the integration of the PSDF into the business of provincial, local and national government as well as the private sector – in short, all the development spenders active in the Western Cape; and
- The development of the process to manage the political and public consultation process around the introduction and acceptance of the PSDF.

### **Vote 1 Strategies (Department of the Premier)**

The development of the strategies for which Vote 1 is responsible would include further work on:

- The internal HRD and SCF strategies; transformation of the Cluster system; and improved co-ordination with other spheres of government, social partners and the private sector in particular.

Budget and implementation challenges in Vote 1 would include:

- Reprioritisation of the current budget to fund activities emerging from the internal SCF and HRD strategies in particular; employment equity along gender and demographic lines – the largest challenge lies in the Senior Management Service (SMS) that has very few women and remains largely white; improved management of sick leave across the Province; and
- Systematic spread of expenditure on training between departments. Closely related to this would be more ‘evidence-based’ provision of training. An option in this regard would be the expanded use of the Personnel and Salary Administration System (PERSAL).

Across the 8 lead strategies, the pursuit of greater efficacy and efficiency in expenditure also necessitates the identification of relevant and reasonable indicators and targets per lead strategy. It is only once these measurable performance indicators have been developed that Provincial Treasury and the relevant departments are better able to target funding at programme and sub-programme level. Chapter 3 makes specific proposals in this regard.

## **Chapter 4: Improvements in financial governance**

Good financial governance is critical in ensuring that scarce resources are used more efficiently, effectively and economically. This necessitates a structured, co-ordinated and integrated approach towards financial governance improvements.

Systems and policies have been put in place or are currently being developed to ensure improvements in efficiency and performance as well as socio-economic results. Key components of these reforms include amongst others:

- The rectification of negative audit outcomes as a matter of priority;
- Ensuring that internal audit promotes a standardised and integrated methodology and re-engineering of its organisational fit;
- Promoting standardised and integrated methodologies for risk management;
- Including risk management methodologies in training programmes of junior, middle and senior managers;
- Development of additional prescripts on the 4 functional areas of supply chain management (i.e. demand management, acquisition management, logistics management and disposal management);
- Mechanisms to assess the viability and efficiency gains from public entities;
- Improve current Black Economic Empowerment (BEE) practices through the establishment of a provincial monitoring and complaints mechanism to address concerns of the public and ensure that departments are operating within the ambit of the Public Finance Management Act, or PFMA (No. 1 of 1999);
- The adoption of the Standardised Public Private Partnership (PPP) provisions, the PPP Manual and the Code of good practice for BEE in PPPs, aligning to uniform disclosure standards and best practices. Furthermore a Provincial Treasury PPP Unit has been established to provide developmental technical assistance and support and the assessing of PPP projects; and
- The need to roll out a PERSAL data verification system, particularly in terms of the requirements of the Skills Development Act, the Employment Equity Act and the National Minimum Information Requirements.

The main thrust behind financial management reforms in the Province is to produce credible and more complete information on financial transactions, using the standards of the Accounting Standards Board (ASB) as the minimum benchmark in this regard. In addition the results will be analysed and interpreted for both public consumption and internal use to improve financial management further. Key components of these reforms are:

- The continued maintenance of the standard chart of accounts and the nascent standards of Generally Recognised Accounting Practice (GRAP);
- Ensuring that all sub-systems feed into the main financial system (Basic Accounting System – BAS) so that no unrecorded transactions with financial implications take place unnoticed;
- Ensuring clean books of account at year-end, clearing pre-1994 balances of previous state departments as well as uncleared transactions emanating from the formative years of the new constitutional dispensation for the Province;
- Further preparatory work will have to be done to obtain a complete understanding of physical assets and their actual worth in accounting terms, so that the full value of the Province's assets and liabilities can be calculated;
- The building of a proper internal audit competency as the objective eyes and ears of accounting officers in assessing the adequacy and efficiency of their internal control, risk management and governance systems, procedures and processes; and

- In achieving the stated goals of reducing procurement costs and servicing the Province's customers better, the main drive would obviously be to get this new system of dealing with government's acquisitions or already owned assets, up and running as from 1 January 2005, given all the preparatory work that has already been done.

## Chapter 5: Provincial fiscal framework

Raising debate on the developmental role of provinces is critical in the annual budget discourse. Recognised roles and functions are the key determinants of the level and the type of resource allocation and financing for each sphere.

As the intergovernmental system matures, the appropriateness of current financing mechanisms as well as the level of financing to provinces should be reconsidered. More specifically, a developmental role demands a range of more sophisticated and targeted financing mechanisms and a systematic review of the level of financing for provinces, particularly in respect of the vertical division of nationally collected revenue.

The Western Cape draws its resources from the following four key sources – the provincial equitable share transfer from national government; conditional grant transfers from national government; provincial own revenue; and accumulated financing reserves.

The PES transfer is the Western Cape's principal revenue source. Showing negative annual growth, averaging -1,4% over the next three years, the share (excluding Social Security funding) rises from a base of R10,5 billion in 2004/05 to R12,0 billion in 2005/06 and R13,7 billion in 2007/08.

The recent review of the equitable share formula undertaken for the 2005 MTEF takes account of the following changes – the removal of the welfare component given changes in the financing and administrative arrangements for social grants; removal of the backlog component; revision of data and weighting of the education component; revision of data of the health component; reduced weighting of the economic activity component; and inclusion of a new poverty component, thus continuing the redistributive thrust of the formula.

The revised formula reduces the target share for the Western Cape to 8,86% – pointing to a loss of 0,17%.

Introduced in the 1998 Budget, conditional grants are the second largest source of funding for the Western Cape. Averaging 35,7% of the Province's total revenue envelope over the next three years, conditional grants grow sharply from 13,8% of total provincial revenue in 2004/05 to 35,4% in 2005/06 due to the change in financing arrangements for the delivery of Social Security grants. In Rand terms, conditional grant allocations, inclusive of provision for the new Social Security Grant, rise from a base of R2,6 billion in 2004/05 to R7,4 billion in 2005/06 and R8,6 billion in 2007/08.

The Province's main area of concern lies with the National Tertiary Services Grant (NTSG) that funds tertiary level services in three specialised hospitals: Groote Schuur Hospital, Red Cross Children's Hospital, and Tygerberg Hospital. The NTSG channels R1,1 billion to the Western Cape fiscus in 2005/06 rising to R1,2 billion in 2007/08. Excluding the new Social Security Grant, the NTSG forms the bulk (average of 44,8% between 2005/06 and 2007/08) of conditional grant funding to the Province.

The Western Cape has been notably disadvantaged in respect of NTSG allocations, given incorrect assumptions in respect of the redistribution of tertiary services made in the allocation formula. This contributes to the severity of the fiscal pressure that the Western Cape faces over the next three years, largely borne by health services.

Apart from the NTSG debate, the most fundamental change to the conditional grant framework is the introduction of the new Social Security Grant. As discussed above, 1 April 2005 sees the second phase of centralisation of the function for administration and delivery of Social Security grants.

Under phase two, provinces will continue to administer the grants under a conditional grant agreement and Memoranda of Understanding while the new Social Security Agency is capacitated to take over the grant administration.

Given the scale of grant spending, the change in grant responsibility has a dramatic impact on the level and type of provincial financing. Provinces will therefore receive conditional grant allocations based on actual spending and grant take-up trends as well as estimated grant take-up over the 2005 MTEF. It is therefore expected that the Western Cape's allocation will amount to R4,9 billion in 2005/06, rising to R5,7 billion in 2007/08.

At about 6,1% of total provincial revenue over the 2005 MTEF, provincial own revenue remains a smaller, yet still significant, supplementary revenue source for the Western Cape fiscus.

Generated mainly from motor vehicle licenses (52%), interest received on bank balances and investments (11%), health patient fees (11%) and casino taxes (11%), provincial own revenue sources are limited, amounting to R1,259 billion in 2005/06, rising to R1,324 billion in 2007/08. Growth over the 2005 MTEF is therefore modest, averaging 0,2% per year over the next three years.

Preliminary adjustments to own revenue add additional amounts of R137,9 million in 2005/06 and R106,2 million in 2006/07 to baseline estimates. The 2005 MTEF revenue estimates therefore amount to R1,259 billion in 2005/06, R1,283 billion in 2006/07 and R1,324 billion in 2007/08.

Given moderate growth of the revenue envelope and faced with expanding expenditure pressures, particularly with regard to social service provision, the Western Cape faces a financing shortfall or 'deficit' of R213 million in 2005/06, R200 million in 2006/07 and R242 million in 2007/08.

Fortuitously, the Province is able to draw on a fourth source – financing or accumulated reserves – to fund the projected provincial fiscal deficit. Over the next three years, the fiscal framework therefore sources further amounts of R213 million in 2005/06, R200 million in 2006/07 and R242 million in 2007/08 from financing reserves for spending on infrastructure and other capital. This provision includes funds drawn in respect of, amongst others, accumulated capital reserves and departmental surrenders.

The framework also makes provision for R52,6 million in 2005/06, R55,2 million in 2006/07 and R58,0 million in 2007/08 in respect of contingency reserves or a 'financing buffer' that will serve to shield the MTEF in the event of any unforeseen and unavoidable events. The contingency reserves remain 'unallocated' in a sense, and if required, are 'drawn-down' in-year for allocation within the annual Adjustments Estimates process.

The Western Cape's financing situation is not sustainable over the medium to long term. Fiscal deficits cannot continue to be financed from accumulated financing reserves.

Over the medium to long term, the Province must therefore deepen and expand its own revenue base. This will raise the discretionary part of the Province's revenue envelope, providing greater allocation flexibility and also enhance the Western Cape's capacity to service any borrowing for large infrastructure projects to expand its economic base in the long term. It was with this dual purpose in mind that in 2002 the Western Cape initiated research into the feasibility of a provincial fuel levy tax. Led by the Bureau for Economic Research (BER) at the University of Stellenbosch, the research was completed in June 2003 and the findings presented in last year's Medium Term Budget Policy Statement.

Over the past year, we have engaged in extensive consultation and public participation processes on the proposed provincial fuel levy tax in compliance with the Provincial Tax Regulation Process Act, 2001 (Act No. 53 of 2001). The final report, submitted to the Province in September 2004 details the full proposal for a provincial fuel levy to be instituted in the Western Cape, imposed on all sales of petrol and diesel by fuel wholesalers to fuel retailers or direct to the public. The two exceptions are the sale of fuel for harbour bunkers used for shipping and fishing and aviation fuel which is internationally exempt (Chicago Convention). Rebates on such a tax will also be given to retailers in border districts according to a specified formula. The latter will mitigate any possible negative economic impact in such areas due to the imposition of the proposed provincial fuel levy tax.

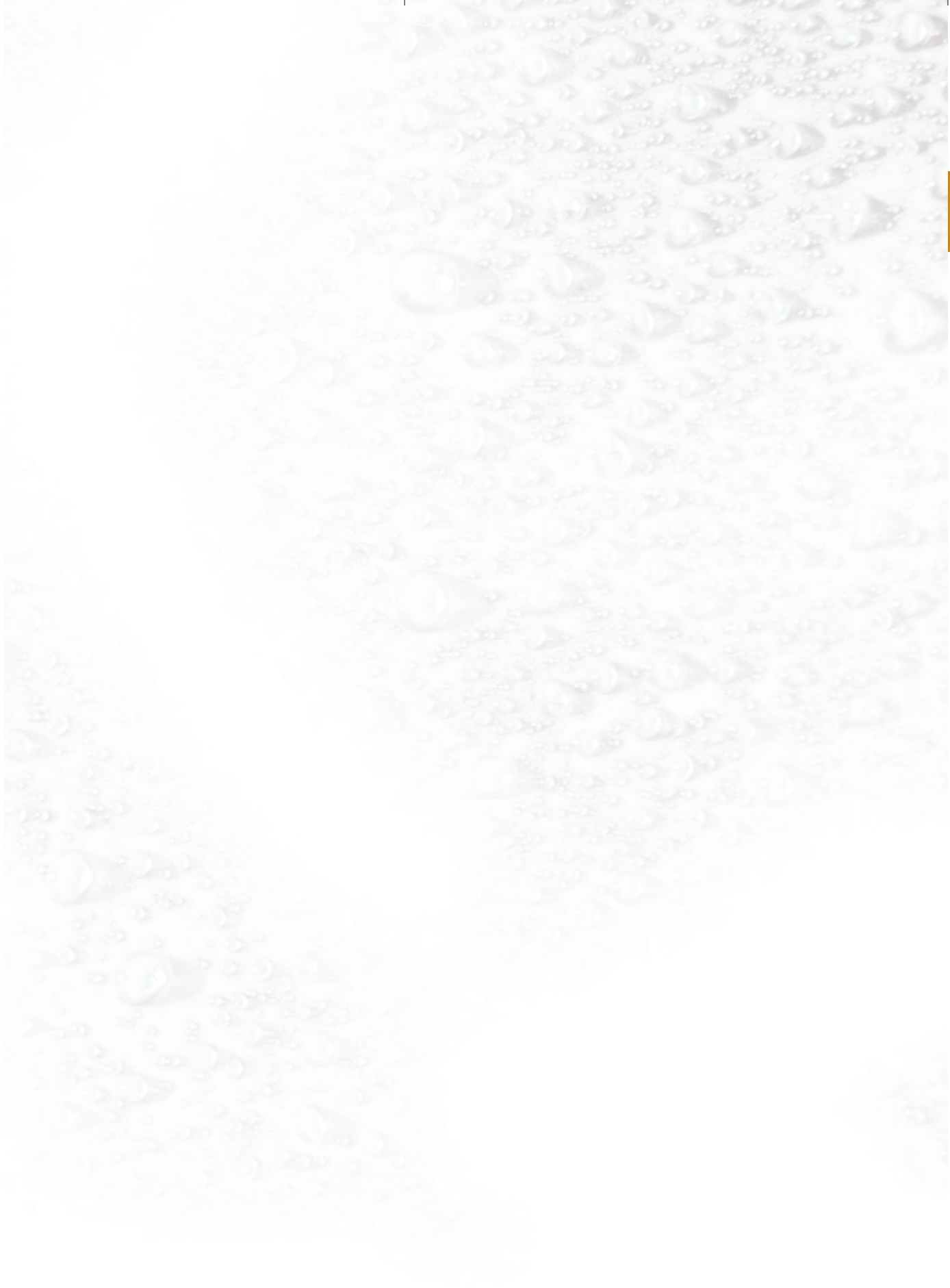
Provincial Cabinet approved the proposed fuel levy tax at the beginning of November this year. The proposal will now be submitted to the National Minister of Finance for consideration and response, following further consultation with the National Treasury, the South African Revenue Service (SARS), the Technical Committee on Finance and the Budget Council. This process is only expected to take place early in 2005, as the 2005 Budget process is now in full swing.

Recent moves have invited a re-opening of the debate on provincial borrowing, given the importance of such in financing large-scale economic infrastructure projects. The Budget Council has recommended that in the initial stages provinces be allowed to borrow for specific projects and that such borrowing may be sourced from the Development Bank of Southern Africa (DBSA) only. Given concerns in respect of raising national government's contingent liabilities, provincial borrowing will be closely linked to own revenue streams, ensuring the ability to service debt.

Developments on the provincial borrowing front are encouraging, but still at the early stages. Considerable work and consultation on a borrowing framework has to take place before any significant progress is made in respect of implementation. An initial outline of the framework suggests that it is to be broad, spanning project risk and sustainability assessment, macroeconomic impact, microeconomic impact, and institutional and financial requirements.

The Western Cape is noting these proceedings with considerable interest. While not yet ready to nominate specific projects for borrowing purposes, the Province is engaging actively in the debate so that appropriate mechanisms, regulations and procedures are put in place.







# 1

## Economic analysis and framework

### The road towards equitable growth and development

iKapa Elihlumayo is based on a vision for equitable or broad-based economic growth and development in the Province.

It is generally accepted that growth on its own will not bring benefits to the wider community. The wealthy are able to capture economic rents, while poorer communities tend to have few resources or capabilities to respond to social and economic changes. Growth for its own sake always results in higher levels of inequity and tends to exacerbate income distribution trends.

Yet growth also has the ability to make a significant contribution to reducing poverty and improving people's livelihoods and future opportunities. In this sense, 'development' may be viewed as growth through broad-based spectacles or growth that is pro-poor in its focus, presentation and rewards. Today, understanding the links between economic growth and inequity is integral to getting to grips with the process of development and the impact of different strategies and policy mixes in respect of development goals.

Globally there is renewed interest in pro-poor growth among policy-makers and development practitioners alike. The concept is attractive and holds the best prospects for enhancing development prospects in sustainable manner. Less well understood, however, are the strategies and policy mixes that governments at national and sub-national level should use for accelerating the pace of poverty reduction through economic growth.

This is the policy conundrum that each government has to face – understanding that ‘one size’ does not fit all and that, while drawing from best practice, governments must take it on themselves to design and implement policy packages that are best suited to addressing local circumstances; creating indigenous solutions to local challenges. The Western Cape has done so. In iKapa Elihlumayo, it articulates the Province’s plan of action for enhanced growth and development over the medium term.

## **South Africa’s development challenges**

iKapa Elihlumayo’s beauty and its value lie in its simultaneous connectivity and uniqueness. Positioned within the broader cooperative intergovernmental system, iKapa Elihlumayo builds on and shapes both vertical and horizontal relationships in a dynamic and fluid interaction, all whilst holding onto its distinctive appeal.

As such, iKapa Elihlumayo is embedded within national government’s stated socio-economic policy priorities set out in the Medium Term Strategic Framework (MTSF) and the National Spatial Development Perspective (NSDP). It draws together the Integrated Development Plans (IDPs) of municipalities within the Western Cape, thereby enhancing economic development at the local level. And it builds on the President’s bold approach for raising South Africa’s development prospects into the third democratic term, outlined in his State of the Nation Address earlier this year.

More specifically, the President set out a programme of action to raise investment, growth and job creation in the First Economy, seen as the ‘engine’ driving South Africa’s development prospects. The stated policy interventions reflect a strong appreciation to achieve broad-based, inclusive growth, expanding and deepening economic opportunities for all South Africans.

An equally expansive programme that responds to the challenges of the Second Economy infuses a sense of realism and practicality, ensuring a Social Security net that provides immediate poverty alleviation. Matched to the latter are interventions that improve people’s capabilities and livelihoods, drawing them to participate in basic economic activities that reduce their dependency on social grants and raise their self empowerment in their own development agenda.

As said, the approach is bold and demanding. It sets an energetic pace for delivery in all spheres of government over the next 10 years. In doing so, it challenges interaction,

cohesion, and performance within our cooperative intergovernmental system – delivery depends on the whole, rather than the sum of the parts. The scorecard is rigorous and demanding. Driven by acute reality, it measures improvements in the livelihoods and opportunities of South Africans by 2014. A tough development agenda, one may say. The stakes are high and our choices stark. Realism informs our options. Vision and passion guide our future.

*“As Africans, we can neither be pessimistic nor skeptical about our future. Necessarily, we have to be firmly confident about the certainty of a better future for all our peoples. For us to be pessimistic or skeptical is to give up the fight and resign ourselves to lives of misery.”*  
– Thabo Mbeki

## The changing intergovernmental landscape

As South Africans, our development agenda is clearly defined in many ways. In others, it is ambiguous. One that is most striking is the lack of clarity on the role and functions of the different spheres of government in effecting social and economic delivery programmes as the intergovernmental system evolves and matures over the next 10 years.

In this respect, the intergovernmental landscape is slowly changing. Like a kaleidoscope, the transition through fractal vision is often surprising yet pleasing; the end result still a distant uncertainty. For provinces, broaching a greater recognition of a provincial development role demands that provinces build robust economic capacity that provides the analytical platform that may inform and guide annual provincial budget decisions.

Provinces need a better understanding as to how to describe provincial economies as distinct regional entities within the broader South African economy. They should be able to analyse key provincial economic variables and propose credible trend forecasts. Decomposing labour market structures and trends adds to an understanding of the provincial skill base and income distribution patterns.

Finally, determining the sources, potential and constraints for enhanced provincial growth and employment is critical to ensure appropriate policy and/or co-ordination interventions that, at a meso-level, link overarching macro-economic policies and local economic development interventions.

Two years ago, in anticipation of the changing role of provinces, the Western Cape started embedding its actions in a clearer appreciation of its socio-economic environment. Such led to the tabling of the 2003 MTBPS and the 2003 Socio-Economic Review.

Building on and deepening this analytical foundation, the PER&O will be published with the Main Budget in March 2005. The remainder of the chapter previews the 2005 PER&O as a background to the 2005 MTBPS.

## Western Cape's economic outlook

### The South African economy

The Western Cape's economic fortunes are closely linked to those of the national economy. Following a decade of economic restructuring and prudent macro-economic policies, the outlook for the South African economy is the best in years.

In this respect, the South African economy has matured appreciably over the past decade and the economy is poised for higher growth. Fiscal policy has become more supportive of growth, prospects for lower and more stable inflation and interest rates are real, tariff reductions have for the most part run their course, the political climate is the most stable it has been in years, and business and consumer confidence are on historically high levels. This reflects an optimistic business mood intent on expanding production capacity. Exchange rate volatility remains a threat and currently places substantial pressure on the (higher value-added) export sectors, as well as import competing sectors.

The global economy is expected to remain supportive of domestic economic growth over the short term. The single biggest risk to the favourable global economic outlook is the high oil prices.

The South African economy is currently in the longest post-war economic upswing phase. Economic growth averaged a relatively pedestrian 2,8% over the past decade; however, this is a big improvement and there are increasing signs of structurally higher growth prospects. Last year, economic growth was adversely affected by the strength of the currency, but the affected production sectors are recovering as business adjusts to the macroeconomic forces. Real GDP growth is forecast to accelerate to 3,9% over the next fiscal year, declining over the MTEF to 3,1% in 2007/08.

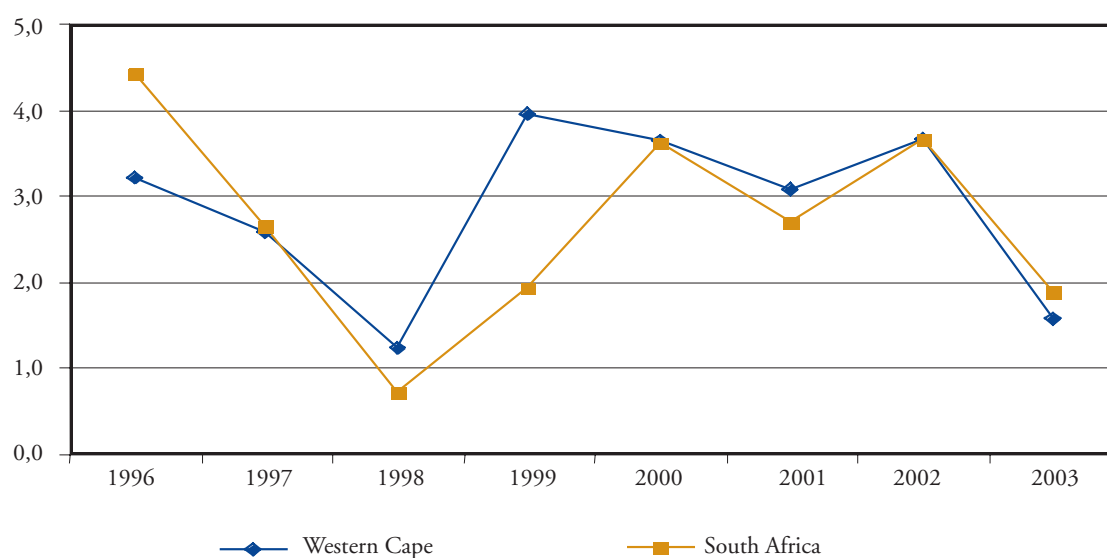
Job creation is expected to accompany robust fixed investment spending as firms contemplate expansion plans. There is already evidence of this. A more satisfactory rate of employment creation remains the single most important national economic challenge.

The financial environment should remain supportive of economic growth over the short term, with inflation and inflation expectations adjusting to lower levels in a structural sense, creating the possibility of lower real interest rates and sustainable higher real economic growth. While exchange rate volatility remains a threat, the improved balance of payments reserves and investor confidence could prevent a repeat of the 1998 and 2001 "Rand events". However, somewhat disconcerting is the composition of the capital inflows on the South African balance of payments over the past 18 months, revealing a lack of net foreign direct investment.

## The Western Cape economy

The Western Cape economy shares in the national economic revival; however, the region was comparatively harder hit by the strengthening Rand exchange rate, adverse climatic conditions and the rationalisation activities in its fast-growing financial services sector in 2003. Whereas the Western Cape economy grew at a higher rate compared to the national economy over the past five years, it is estimated that growth was lower in 2003/04 (figure 1). The Western Cape employment conditions also deteriorated in 2003, interrupting an improving tendency since 2000/01.

**Figure 1 Real GDP growth: Western Cape versus South Africa**



[Source: Quantec Research]

The regional economy is expected to catch up with South Africa's economic recovery over the short term. Prospects vary, inter alia, depending on the direction of the Rand exchange rate and/or business' adjustment to the new macro-economic parameters, as well as the regional policy support.

The Western Cape economy's strong linkages with the national economy are reflected in a closely corresponding business cycle. The economy is also relatively open, that is external trade contributes a large share of the Gross Domestic Product by Region (GDPR), which renders the economy sensitive to changes in the exchange rate and global demand.

## **Economic growth trends**

Real GDPR growth for the Western Cape economy averaged 3,1% over the period 1999 to 2003, compared to the national average of 2,7%. The appreciation of the Rand exchange rate, adverse climatic conditions and rationalisation activities in the financial services sector have had a disproportionately negative impact on the Western Cape economy in 2003. The region's real GDP growth rate decelerated to 1,6% (compared to 1,9% nationally) from 3,6% in 2002.

Western Cape business confidence is currently measured on a lower level compared to the rest of South Africa. While the financial services and manufacturing sectors are recovering, the hostile climatic conditions and the strength of the Rand persist, suggesting regional growth could also be weaker compared to the rest of the country in 2004.

Provided the sustained buoyancy in domestic demand persists together with a more robust recovery anticipated in exports, the lagging business confidence levels in the Western Cape should catch up over the short term. Generally, firms appear to be adopting a long-term view and are embarking on expansion plans.

In all, real GDPR is projected to accelerate to growth of 3,2% in fiscal 2004/05, rising to 4,1% in 2005/06, declining marginally to 3,9% in 2006/07 and further to 3,1% in 2007/08 in line with national growth trends<sup>3</sup>.

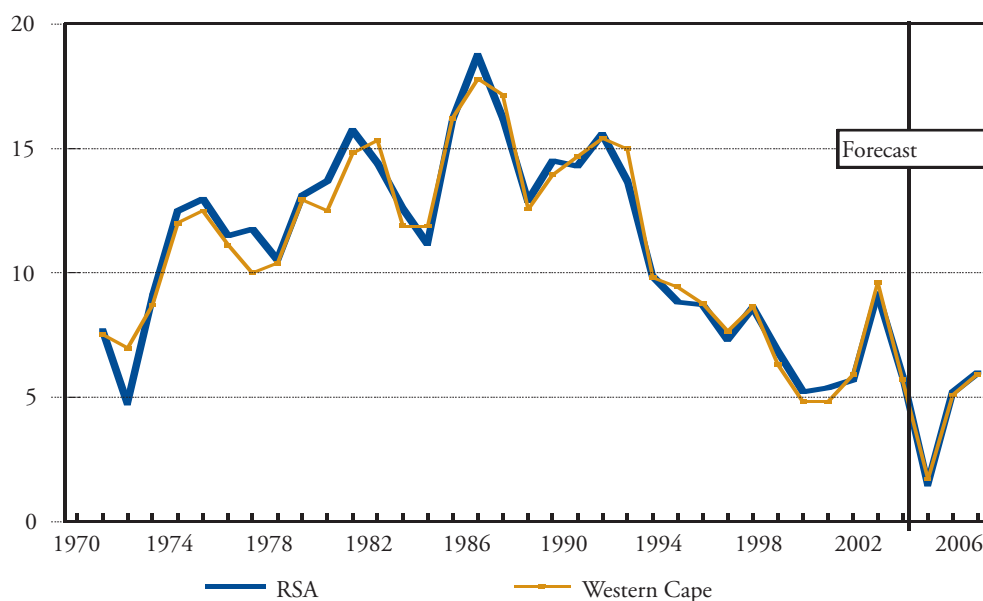
The growth in the Province's services industries is projected to equal or exceed the national performance and a more competitive exchange rate should allow for a firmer recovery in the Province's embattled manufacturing sector, as well as the agricultural sector on the assumption of normal climatic conditions.

## **Inflation**

Regional inflation is highly correlated with that of the rest of the country (figure 2). The inflation outlook is benign, apart from the crude oil price risk. Inflation is expected to accelerate to levels between 5% and 6% during 2005/06 due to cyclical pressures and some depreciation in the exchange rate. Given the maturing anti-inflation process in South Africa, wage and price setting is expected to take account of competitive forces in the local and global arena.

<sup>3</sup> GDP and GDPR forecasts for South Africa and for the Western Cape are drawn from the BER's quarterly economic model and an initial Western Cape-specific econometric modelling exercise, completed for the forthcoming 2005 PER&O. They therefore do not as yet correlate to the National Treasury's macroeconomic projections for the same period, as published within the National Treasury's 2004 Medium Term Budget Policy Statement.

**Figure 2 CPI inflation: Western Cape versus South Africa**



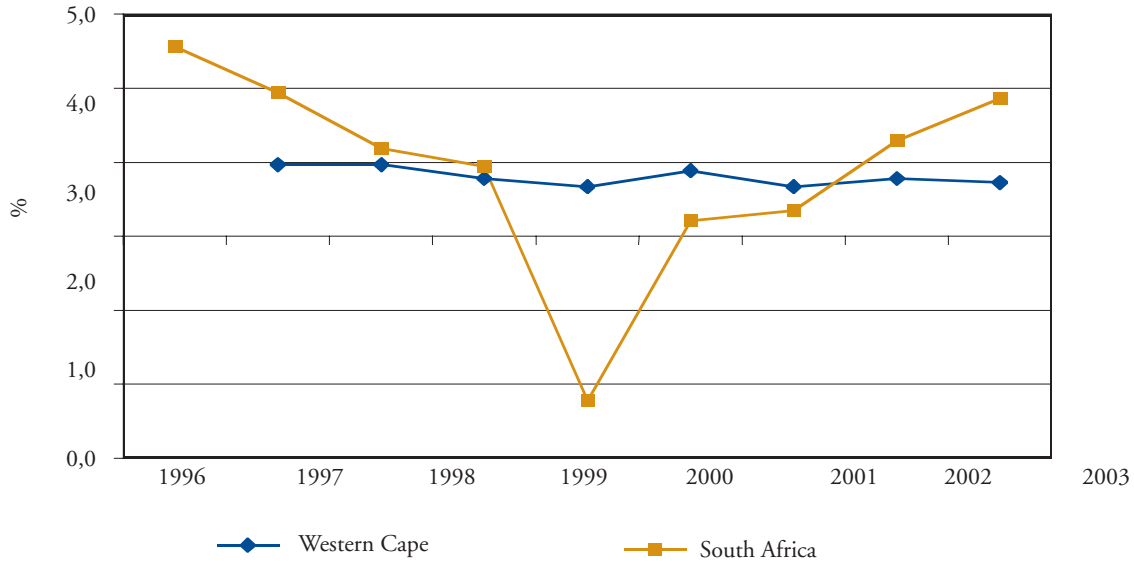
[Source: Statistics South Africa (Stats SA)]

## Fixed investment

The growth in Western Cape fixed investment spending has been very stable over the past 5 years. Due to the strong contribution by the less cyclical services industries, e.g. financial & business services (accounting for more than 45% of the cumulative growth in regional fixed investment, 1999 to 2003), transport & communication (18%) and internal trade & catering (13%), as well as autonomous mega investment projects, the Western Cape avoided the 1999 slump in general fixed investment (figure 3). Manufacturing fixed investment has been lagging behind that of the tertiary sectors, however, the situation should improve over the short term.

The fixed investment outlook is positive. Following a period of strenuous macro-economic policies and restructuring in the domestic economy, South Africa is entering a new era of more supportive fiscal policy, gradually lower real interest rates and firms generally having adjusted to the lower level of import tariffs. Under these conditions, fixed investment spending can increasingly become of the capital-widening kind; that is, being accompanied by expanding employment rather than of the capital-deepening kind of the 1990s when formal employment contracted. There is already evidence that this is actually starting to happen.

**Figure 3 Fixed investment: Western Cape versus the rest of South Africa**



[Source: Quantec Research]

## Exports

The Western Cape’s exports have performed well over the past 6 to 7 years, growing by 8% to 9% per annum in real terms. The region’s established exports (ranging from fruit and processed foods & beverages, iron & steel and fish to clothing & textile products and electrical machinery) have performed well, even in the face of the stronger Rand.

However, in a number of the smaller and fast growing (“non-core”) export categories over the past five years, volumes have declined sharply in 2003 and probably in 2004. It is possible that the weakening trend in the Rand exchange rate over the period 1996 to 2002 assisted many of these exporters entering the world markets and the latter are currently finding the going tough.

While the outlook for the Province’s agro-industrial and base metal exports is favourable, a broader recovery in manufacturing exports could be strongly influenced by the direction in the Rand exchange rate, apart from the business response.



## Outlook 2005/06 – 2007/08

In all, the Western Cape economy is expected to recover from the headwinds experienced in 2003/04 and business is adjusting to the strong Rand. The outlook for fixed investment and employment creation is positive following years of capital-deepening investment and formal sector retrenchment of workers. The challenge is to develop downstream and niche manufacturing and services industries, which have more potential to create jobs.

The positive employment trend in the retail, tourism and business services sectors is likely to persist and this needs to be supported. With improved formal sector job growth, the chances are maximised to alleviate poverty in the Province beyond the social welfare and infrastructure development spending of the government.

Table 1 below therefore presents the Western Cape's macroeconomic outlook for the 2005 MTEF period.

**Table 1 Western Cape macro-economic outlook, 2005/06 – 2007/08**

	2002/3 Outcome	2003/4 Estimate	2004/5 Estimate	2005/6	2006/7 Medium-term forecast	2007/08
<b>GDPR (Rbn, current market prices)</b>	<b>163,3</b>	<b>176,5</b>	<b>191,7</b>	<b>209,7</b>	<b>229,7</b>	<b>249,2</b>
Real GDPR growth (%)	2,9	1,7	3,2	4,1	3,9	3,1
GDPR inflation (%)	9,0	6,3	5,2	5,1	5,4	5,1
WC CPI inflation (%)	8,6	4,4	2,3	5,5	5,9	5,4

[Source: BER, in forthcoming 2005 PER&O]

## Sectoral growth and employment prospects

Formulating realistic, forward-looking economic scenarios requires robust insight into the key factors driving economic performance, how these factors are likely to change and how they may be influenced by government action.

An important dimension of the development path is its sectoral nature. The Western Cape presents a mixed picture in this regard. While overall performance in the Province has been poor, it has outperformed South Africa as a whole in recent years in value added – largely due to services sectors. But these sectors have not been creating jobs. Workers, and hence families and communities, have not benefited from the higher growth of the Province in recent years.

While tourism is undoubtedly an 'engine' for the provincial economy and there are opportunities in areas such as call centres, the Province has important strengths that should be developed in industry and agriculture with broad-based employment potential, which in turn will stimulate activity in transport, communications, finance and construction.

Building productive capabilities across economic sectors is a key theme for enhanced sector performance over the medium term. This requires upgrading of skills through the Province's HRDS and the National Skills Development Framework; improving technological capabilities of firms through the national technology and research and development (R&D) strategies; and drawing on the Province's strengths in tertiary education institutions, applying such to the practical tasks of upgrading firms' capabilities and expanding economic activity.

As mentioned earlier, the Western Cape economy is open in respect of its marked integration into the international economy. This presents both opportunities and challenges. Trade flows reveal that many industries are taking advantage of new possibilities through increased exports. Riding the globalisation wave requires that we preen our competitive advantage in international markets by developing strategic relations in areas such as design, R&D, technology and production operations.

This is the high road that will place the Western Cape's firms and industries in a stronger position to compete in the global marketplace. But it also means that the Province should move away from competing on labour costs. Low-wage economies such as India and China are able to export products, such as low value-added clothing, at low prices, undercutting domestic producers as their main input cost – wages – is much lower.

The Province does not then advocate large-scale wage reductions to match the input costs of such competitors. Instead, a strategic repositioning of the Western Cape economy requires that Province's firms compete rather on value-added output that firms and workers produce.

Lessons from developing countries and regions indicate that government plays a crucial role in strategic repositioning by anticipating future developments together with local economic stakeholders, and co-ordinating the actions of local institutions to meet the dynamic needs of the global customer. In this respect, the MEDS is expected to package a key role for the Western Cape Provincial Government aimed at enhancing the Province's sector growth and employment prospects over the medium term.

## Sectoral development

Services together contribute more than two-thirds to the Western Cape's GDP – higher than the sector's national average. Finance, insurance & business services, in particular, stand out with a combined share of 27,4% of GDP compared to 19,6% of national GDP in 2003. Table 2 provides the sectoral composition of regional GDP shares over the period 1999 to 2003.

**Table 2 Western Cape GDP: sectoral composition, 1999 – 2003**

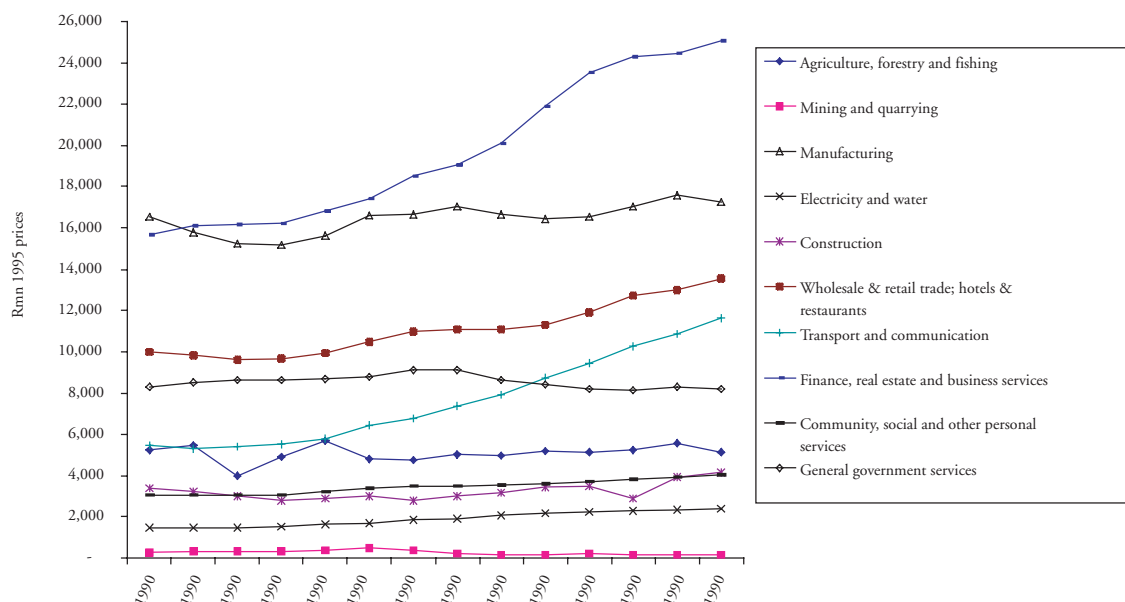
Sector	1999	2000	2001	2002	2003	Average 1999-03
	(%)	(%)	(%)	(%)	(%)	(%)
<b>Primary sector</b>	<b>6,6</b>	<b>6,3</b>	<b>6,2</b>	<b>6,4</b>	<b>5,8</b>	<b>6,3</b>
Agriculture	6,4	6,1	6,0	6,2	5,6	6,1
Mining	0,2	0,2	0,2	0,2	0,2	0,2
<b>Secondary sector</b>	<b>27,1</b>	<b>26,4</b>	<b>25,6</b>	<b>26,4</b>	<b>26,0</b>	<b>26,3</b>
Manufacturing	20,2	19,6	19,6	19,5	18,8	19,5
Electricity & water	2,7	2,6	2,6	2,6	2,6	2,6
Construction	4,2	4,2	3,4	4,3	4,5	4,1
<b>Tertiary sector</b>	<b>66,3</b>	<b>67,2</b>	<b>68,2</b>	<b>67,2</b>	<b>68,2</b>	<b>67,4</b>
Internal trade & catering	13,9	14,1	14,7	14,4	14,8	14,4
Transport & communication	10,7	11,2	11,8	12,1	12,7	11,7
Financial & business services	26,9	27,9	28,0	27,1	27,4	27,5
CSP services*	4,4	4,4	4,4	4,4	4,4	4,4
Government	10,3	9,7	9,4	9,2	8,9	9,5
<b>Total GDP (basic prices)</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

\* Including "Other producers" (mainly domestic servants).

[Source: Quantec Research]

As seen in figure 4, the strongest output growth in the Province (as nationally) has been recorded in finance & business services and transport & communications at average annual growth rates in the past eight years of 4,7% and 7,7% respectively. Wholesale & retail trade has also recorded fairly continuous increases in output. This suggests the increased importance of services, as might be expected from a relatively developed economy. The Province has recorded higher growth than the national average in catering & accommodation, transport & storage, business services and other producers. This reflects strengths in tourism, call centres, and as a major port. However, employment has been declining in services and the disaggregated picture shows very different patterns across different sub-sectors of services.

**Figure 4 Sectoral performance in respect of contribution to Western Cape GDP**



[Source: Quantec Research]

The performance of manufacturing has been very disappointing at an average annual growth of just 0,5%, lower than the national performance of 1,8%. Trade liberalisation and increased integration into the international economy would be expected to favour coastal locations such as the Western Cape. But the Province has not realised the potential gains from these developments, suggesting the need for an evaluation of constraints to firms' performance and competitiveness across a range of sectors.

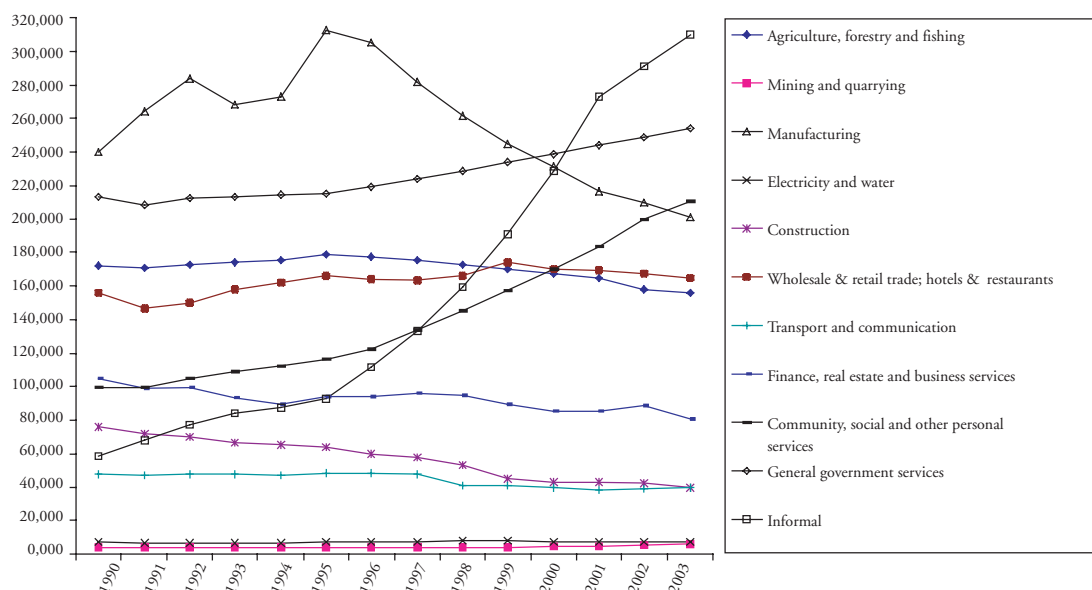
Similar to the national economy, industry in the Province is oriented towards food & beverages, textiles & clothing, and wood, paper & publishing, which together account for 41% of output (measured as value-added). Metals & machinery and transport equipment are much less important in the Province than nationally. However, the sectors in which the Province is relatively under-represented have been performing better. Relatively strong growth of output has been recorded for both metals & machinery and transport equipment over the past 8 years, with average annual increases of 4,1% and 6,9% respectively, while transport equipment in the Province has far out-performed the national economy. But, food & beverages, textiles & clothing, and wood, paper & publishing have either stagnated or recorded contractions in output, and performed more poorly than the national economy over the period.

The performance of agriculture, forestry & fishing in the Western Cape, with an average annual growth rate of 0,8% since 1995, is also much poorer than the national growth rate of 3,1%. However, concerns in respect of data raise queries as to whether there is in fact increased activity across a diverse range of agricultural activity.

## Employment patterns

As seen in figure 5, the most dramatic development has been a decline in manufacturing employment from 1995, and an increase in informal employment.

**Figure 5 Employment patterns in the Western Cape**



[Source: Quantec]

From being the largest employer, manufacturing has been overtaken by general government services and community & social services – in particular the major generator of formal sector employment, with employment almost doubling in a decade. It is surprising, however, that there has not been net employment creation in finance & business services, transport & communication, nor in wholesale & retail trade, hotels & restaurants given the output growth of these sectors. Of perhaps greater concern is that there is little indication of increased employment resulting from tourism and other services such as telecommunications.

All manufacturing sectors in the Province had lower employment in 2003 than in 1995, except for transport equipment. The biggest proportionate declines were in other non-metallic minerals (including cement and brick-making), and the biggest absolute job losses were in the largest sector – that is, clothing, textiles, & leather – closely followed by the food, beverages & tobacco sector.

In the last three years, the metals & machinery sector – linked with important areas of potential – has shown signs of growth. Positive growth in employment in transport equipment reflects capabilities in auto components and in yachts & ship-building.

Of more concern is that while the wood, paper & publishing and the petroleum & chemicals sectors have recorded employment growth (albeit small) nationally, employment in the Province has contracted. Plastic product manufacture is both labour-intensive and has experienced higher than average growth over the medium to long term, as plastic products increasingly replace other materials. The Western Cape needs to ensure that it benefits from these developments.

While manufacturing firms have not increased employment, they have increased investment. Particularly strong increases in investment have occurred in petroleum, chemicals, rubber & plastic products, as well as in transport equipment. For firms to be able to compete internationally, and to expand and grow employment, it is important to increase their productive capacity and to upgrade equipment. This is especially the case for employment growth in more labour-intensive sectors.

A major concern is that the strong growth in services value-added is not reflected in employment patterns. Indeed, there have been contractions in employment in most service sectors. Only business services (reflecting employment creation in call centres), wholesale & retail trade and other producers have recorded net increases in formal employment. Given the substantial growth in tourism, it is surprising not to see this reflected in employment in catering & accommodation and transport. The communications sector shed almost 5 000 jobs between 1997 and 1998, probably reflecting major retrenchments by Telkom following its commercialisation and move to privatisation. More than 3 000 jobs were also shed in transport between 1997 and 1998.

The loss of jobs in finance and insurance reflects retrenchments in insurance, while the value-added growth reflects developments such as the expansion of international banks such as Citibank and Barclays, as well as niche financial services aimed at the wealthy. These types of operations have not had significant employment creation effects.

### **Main drivers of provincial economic performance**

At the sectoral level, growth and employment need to rest on a diverse sectoral base. The pattern of higher growth in financial & business services and tourism, with agriculture remaining very important, does not negate the need to further develop a manufacturing base.

A crucial dimension in the Western Cape is its coastal location and the opportunities that arise from it. This is not only in exports, but also in deepening international links around investment, technology and production networks. The challenge is to translate the opportunities into exports, output growth and employment in relatively labour-intensive areas of manufacturing.

Repositioning to build and focus on the Province's dynamic competitive advantage calls for:

- Ongoing upgrading of the agriculture sector, with emphasis on a broader base of higher value-added products, that take account of climatic patterns and water usage in particular, and support for the research and standards necessary for exporting, complemented by support for smaller and historically disadvantaged farmers;
- Addressing cost competitiveness issues in industry (including steel prices), which impede the performance of labour-intensive, relatively basic products;
- Ensuring that appropriate skills and training are implemented;
- Monitoring the various technology initiatives and identifying where provincial and local government facilitation can ensure the potential gains are realised. The Province needs to identify areas to develop local technological competency in tertiary education and other research institutions;
- Facilitating ongoing growth in industries already performing well, such as yachts and film-making, with particular emphasis on quality and quantity of employment;
- Selecting a small number of target areas where government action can facilitate significant expansion, including ship-building in medium and small vessels, herbal and natural products such as essential oils, furniture and Business Process Outsourcing (BPO); and
- Implementing mechanisms to build inter-firm communication and co-operation, such as benchmarking (specifically proposed for foundries and clothing).

The above are critical in respect of enhancing provincial growth and employment prospects over the medium term.

## Employment and remuneration prospects

Turning to employment and remuneration prospects, many South Africans contend that economic restructuring has left many without work and many more are convinced that our economic revival is about jobs, jobs and more jobs. A “meso-cosm” of the national debate, the Western Cape picture is no different, and the debate on provincial labour market performance no less contentious.

That said, it is important to get a better understanding of the Western Cape labour market, as it is the key mechanism through which individuals engage with the provincial economy. As other markets, the labour market functions through supply and demand interaction. Individuals supply or offer their labour to the market. Firms and other potential employers source or demand labour from the market. Through the labour market, individuals sell their labour, earning incomes that enable them to purchase those goods and services they require. Labour market performance is therefore a key determinant of income distribution and equity profiles nationally and at the provincial level.

## **Demographic profile and migration trends**

Substantial in-migration to the Province is the key factor influencing the Western Cape's changing demographic and labour market profile. It is estimated that the Province gains 48 000 individuals (net of out-migration) every year, with many of these motivated by perceived brighter employment prospects and higher incomes.

These estimates are likely to undercount the true extent of in-migration, as migration information in the census relates to the individual's last move if the individual moved more than once in the five-year inter-census period.

Migrants of working age represent an injection of workers into the Western Cape economy. This means that it is important to examine in-migrant skill levels and potential employability given the present labour force dynamics.

The Eastern Cape is by far the largest contributor to in-migration to the Western Cape. About 44% of migrants entering the Province are moving from the Eastern Cape. On average, migrants from the Eastern Cape tend to be less educated than those who have moved within the Western Cape. In turn, both groups are less educated than in-migrants from the rest of the country. Of interest here is that the Western Cape seems to be attracting less educated in-migrants from the Eastern Cape, while more educated migrants tend to move to Gauteng or to Eastern Cape cities (Port Elizabeth in particular).

These results have significant implications for the future skill base of the Western Cape economy, as enhancing the skill base is perhaps the most important factor in raising the Western Cape's economic growth and development prospects over the medium term.

## **Employment and job creation**

At the national level, South Africa has witnessed notable growth in employment prior to 2000. But since then aggregate national employment seems sticky at about 11,6 million jobs.

The net result masks dynamic movement within and between economic sectors and occupational classes or skill levels. As noted above, sunset or stressed sectors will shed employment, while rising or booming sectors will create employment, given capital-widening investment.

While the economy may be creating jobs, it may not be creating enough jobs given the rising number of new entrants into the labour market each year. If the annual job growth rate does not exceed or at least equal that of the labour force, we will continue to see rising unemployment rates in South Africa.



This is the story that represents a more realistic and factual account of South African labour market performance over the last decade. The numbers of unemployed and the rates have risen dramatically since 1995. By 2003, nearly 8,3 million South Africans were unable to find work, up by more than four million individuals, with nearly 1,8 million of these becoming unemployed since 2000. This reflects a rise in the official (narrow) rate of unemployment from 25,9% in 2000 to 28,2% in 2003, and on the broad/expanded definition from 35,9% to 41,7%.

**Table 3 Labour force change in South Africa and the Western Cape, 2000 – 2003**

	2000 (‘000s)	2003 (‘000s)	Change (‘000s)	Change %	% p.a.	Target Growth Rate (%)	Emp. Absorp. Rate (%)
<b>Western Cape</b>							
Employment	1 537	1 730	194	12,6	4,0		
Expanded Unemployment	449	612	163	36,3	10,9	23,2	54,3
Expanded Labour Force	1 986	2 342	356	17,9	5,7		
Official Unemployment	317	448	131	41,5	12,3	21,1	59,6
Official Labour Force	1 853	2 178	325	17,5	5,5		
<b>South Africa</b>							
Employment	11 675	11 612	-63	-0,5	-0,2		
Expanded Unemployment	6 538	8 302	1 763	27,0	8,3	14,6	-3,7
Expanded Labour Force	18 214	19 914	1 700	9,3	3,0		
Official Unemployment	4 074	4 562	487	12,0	3,8	3,6	-14,9
Official Labour Force	15 750	16 174	424	2,7	0,9		

[Source: Statistics South Africa Labour Force Surveys, September 2000 and September 2003]

At the provincial level, the Western Cape’s labour market performance holds brighter prospects when compared to its national counterpart. Since 2000, nearly 200 000 jobs were created in the Western Cape at a rate of 4,0% per year. This has seen the Province raise its share of national employment from 13% to 15%. Table 3 provides a comparative picture between the Province and South Africa as a whole.

Unfortunately, although employment growth has been above the national average, unemployment in the Province, irrespective of definition, has also expanded more rapidly. This trend sees the official (narrow) unemployment rate rising from 17,1% in 2000 to 20,6% in 2003, and that measured more broadly rising from 22,6% to 26,1%.

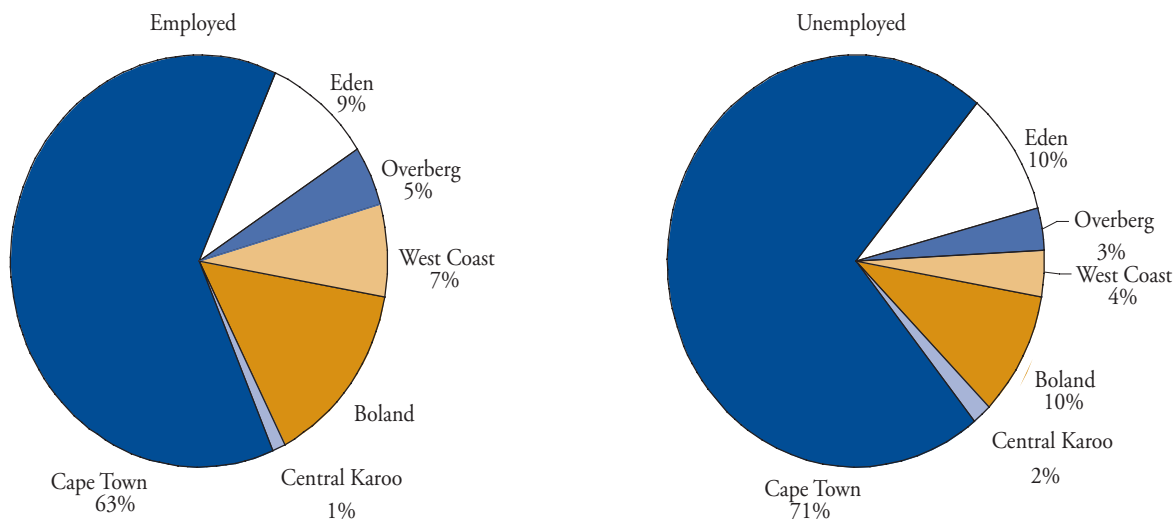
These unemployment aggregate measures hide important trends common to particular population and age groups. Reflecting the demographic profile of the Province, most jobs in 2003 were filled by Coloured individuals (58%), with Africans and Whites each constituting around one-fifth of employment. At the same time, more than one-half or 320 000 of the 612 000 Western Cape unemployed are Coloured. In contrast, at 41%,

Africans' share of unemployment is twice their employment share, indicating a substantial disadvantage for Africans in the provincial labour market. Conversely, Whites' unemployment share is around 6% – less than one-third of their employment share.

Perhaps most alarming, though, is the highly unequal age composition of employment and unemployment. In particular, the age group 16 and 25 years accounts for a mere 17% of employment but 46% of unemployment. Based on these figures, the problem of youth unemployment in the Province appears, structurally, to be relatively more acute than it is in the rest of South Africa, where this group's share of unemployment was just under 40% in 2003. Consequently, the Western Cape accounts for a relatively high share of the national number of unemployed 16-to-25 year olds, raising the importance of the youth focus of the iKapa Elihlumayo Social Capital and Human Resource Development strategies.

If we add a spatial perspective, we see that unemployment is concentrated in the City of Cape Town (unsurprisingly, given its dominance in economic and population terms) and the Boland and Eden regions, although the Central Karoo suffers from the highest unemployment rate.

**Figure 6 Spatial distribution of employment and unemployment, 2001**



[Source: Statistics South Africa Census 2001]

Key provincial challenges are therefore youth unemployment and the spatial dispersment of economic activity and hence employment patterns in the Province. A central political question is whether effort and hence resources should be concentrated on interventions that focus on the greater numbers of unemployed or on areas with higher rates (but lower aggregated numbers) of unemployed. Policy decisions in this respect have clear spatial consequences and pertain to the sustainability of development patterns in the Province.

## Remuneration trends and the skills bias

Apartheid's legacy – decades of discrimination and unequal access to educational and employment opportunities – has left an indelible mark on the Western Cape's remuneration structure of formal sector employment across race groups.

Irrespective of what income level is used as reference, White formal sector workers are significantly better off than their Coloured counterparts, who in turn are better off than their African counterparts. At the top end of the income distribution, only 3,4% of African formal sector workers earned more than R6 000 per month in 2003, compared to 9,5% of Coloureds and almost half of White formal sector workers. In 2003, therefore, the inequalities in the Western Cape in terms of formal sector remuneration were considerable, with White individuals accounting for 57% of all workers earning over R6 000 per month and 64% of those earning over R8 000.

An individual's income is closely related to his or her occupation or skill level, it is important to analyse skill distribution in a study of remuneration and inequality. Skills are highly unevenly distributed, both nationally and within the Western Cape. Amongst those employed in the formal sector, Whites account for close to 54% of the highly skilled, compared to their 22% share of total formal sector employment. In contrast, while Africans constitute slightly more than 17% of the employed in the Province, more than 28% of low skilled persons employed are African. Coloureds are over-represented in the skilled and low-skilled occupations. Table 4 provides a breakdown of the skills categories per major race group.

**Table 4 Skills composition of Western Cape formal employment by race, 2003**

	African (%)	Coloured (%)	White (%)
High Skilled	6,4	38,3	53,7
Skilled	15,2	64,4	19,7
Low Skilled	28,4	69,4	2,2
<b>Total</b>	<b>17,3</b>	<b>59,9</b>	<b>22,1</b>

*[Source: Statistics South Africa Labour Force Surveys, September 2003]*

The skills bias of employment growth is central to the issue of income inequality within the Province, both across and within race groups. The current racial composition of formal employment by skills category indicates substantial educational inequalities and racial stratification of occupations. While a key focus of the Human Resource Development Strategy, this trend is not an easy one to address and one that takes time.

For the foreseeable future, then, the supply of skills is likely to reflect these racial imbalances, though less harshly as time elapses. As skill compositions begin to reflect a more desirable demographic representation, we are likely to see a transition in demographic representations in occupational classes. This will have a definite impact on income inequality in the Western Cape, although employment growth is required across the skills spectrum and particularly amongst less skilled occupations if inequality levels are to be reduced via the labour market.

## **Equity and income distribution scenarios**

From the above, it is clear that, unless the Province makes a bold intervention, the present economic trajectory, demographic and labour force performance, and sectoral growth and employment prospects do not hold a favourable outlook for improved equity and income distribution in the Western Cape.

Similar trends in respect of demographic profile, labour force performance, mismatch in skills profile and the skills requirements of growing economic sectors may be seen at the broader national level, and in fact, in many countries across the developing world. Such trends epitomise the development challenge that many governments face. In the Western Cape, understanding these trends is critical to formulating the most appropriate policy responses to meet improved equity and income distribution goals under iKapa Elihlumayo.

Striving for equity is not only laudable from a social justice view, it also makes good economic sense. Understanding how inequality is measured, the factors that drive inequality and those that reduce such are critical for policy- and decision-makers as they formulate the most appropriate policy interventions and set attainable targets with a medium-term budgeting approach.

Moreover, lower levels of inequality have a marked impact on the level and spread of economic growth, and therefore the benefits of growth in terms of reduced poverty. That is, improved income distributions and enhanced growth tend to reinforce each other and translate into greater inroads into poverty reduction.

## Measuring inequality

The Gini coefficient is the most commonly reported measure of inequality, and is often used to compare income inequality across regions, countries and over time. Measured between the value of zero (depicting a perfectly equal society) and one (complete inequality), Gini coefficients in the range of 0,40 to 0,45 are generally seen to represent intermediate levels of inequality and those exceeding 0,45 regarded as high. Table 5 provides a representation sample of comparable countries to South Africa.

**Table 5 Comparison of selected middle income countries**

	Thailand	South Africa	Brazil	Malaysia	Venezuela	Poland
Gross National Income						
per capita US\$ (2002)	1 980	2 600	2 850	3 540	4 090	4 570
Gini coefficient	0,412	+0,602	0,603	0,492	0,493	0,313
% Share of income of poorest 20%	62,1	2,8*	22,2	42,4	3	72,8

*[Source: 2003 World Development Report and \*from Borat et al (2001):22]*

Gini coefficients move extremely slowly over time. Even fairly rapid change in the income ranking of certain individuals or households can coincide with surprisingly little change in the overall income distribution if these changes occur at both ends of the income distribution and hence cancel each other out. For instance, income distribution patterns will widen if those at the higher end of the income spectrum improve their prospects more than those at the lower end of the income scale.

## Inequality in South Africa and the Western Cape

Inequality in South Africa is exceptionally high, and if anything, has worsened from 1995 to 2000<sup>4</sup>. Use of Gini coefficient analysis in this respect, however, should be interpreted with care.

Gini coefficients may be calculated according to different definitions using income or expenditure, at the household level or the individual level. It is essential that comparisons of inequality are undertaken in respect of the identical definition, particularly if comparisons are to be made over time.

Table 6 shows the range of Gini coefficients calculated using the income and expenditure surveys of 1995 and 2000. The disparities between the different measures highlight the need for consistency in methodology. They also serve to emphasize that it is the general level and direction of change that should be interpreted, rather than the absolute values.

<sup>4</sup> The data used for the poverty and inequality analysis in this review comes from the Income and Expenditure Surveys of 1995 and 2000 (IES 1995 and IES 2000), carried out by Statistics South Africa.

**Table 6 Gini coefficients calculated according to different parameters using the income and expenditure surveys, 1995 and 2000**

Study	Total Household Income or Expenditure			
	1995		2000	
Household level	Income	Expenditure	Income	Expenditure
Fedderke, Manga & Pirouz (2003)	0,58	0,59	0,62	0,59
Statistics South Africa (2002)	0,56	-	0,57	-
Household level	Per Capita household Income and Expenditure			
Lam & Leibbrandt (2003)*	0,64	-	0,67	-
Individual Level	Per Capita household Income and Expenditure			
	1995		2000	
	Income	Expenditure	Income	Expenditure
Fedderke, Manga & Pirouz (2003)	0,66	0,660	0,69	0,670
Poswell (2004)	-	0,639	-	0,682
Hoogeveen & Özler (2004) – “Core Consumption”	-	0,565	-	0,577

*Note: \* Household income per capita with one observation included per household*

The 2005 PER&O analysis considers individuals and uses disposable household per capita as the unit of analysis in computing Gini coefficients. In such analysis, income inequality shows a large increase from 0,64 in 1995 to 0,68 in 2000 (calculated in respect of research commissioned for the forthcoming 2005 PER&O). Irrespective of data concerns in such analysis, the trend (rather than the absolute value of the measure) is consistent with the majority of studies examining inequality in South Africa over the same time period.

Calculating Gini coefficients by province for 1995 and 2000 (table 7) shows that inequality has increased across the board. In relation to other provinces, the Western Cape in 1995 was the third least unequal province with a Gini coefficient of 0,584, following Mpumalanga (0,582) and Gauteng (0,545), and in 2000 the least unequal with a Gini coefficient of 0,616 (calculated in respect of research commissioned for the forthcoming 2005 PER&O).

**Table 7 Gini coefficients by province, 1995 and 2000**

<b>Province</b>	<b>Gini 1995</b>	<b>Gini 2000</b>
Western Cape	0,584	0,616
Eastern Cape	0,648	0,663
Northern Cape	0,647	0,658
Free State	0,659	0,696
Kwazulu-Natal	0,625	0,684
North West	0,629	0,658
Gauteng	0,545	0,629
Mpumalanga	0,582	0,626
Limpopo	0,625	0,624
<b>National</b>	<b>0,639</b>	<b>0,682</b>

*[Source: Income and Expenditure Surveys 1995 and 2000, Author's own calculations in forthcoming PER&O]*

When considering within race inequality, the same pattern holds for the Province as for the nation as a whole, once again being one of rising inequality from 1995 to 2000. Inequality appears to have increased for all races, with Africans (a Gini coefficient of 0,515 in 1995 and 0,541 in 2000) and then Coloureds (0,439 in 1995 and 0,494 in 2000) experiencing the highest levels within race (calculated in respect of research commissioned for the forthcoming 2005 PER&O).

Complementary inequality measurement tools show an increase in the 'within race' contribution over the period for the Western Cape (the latter reading 52,9% in 1995, compared to 58,8% in 2000, calculated in respect of research commissioned for the forthcoming 2005 PER&O).

These results infer that it is 'within race group' rather than 'between race group' inequality that is boosting inequality measurements, also at the provincial level.

A deepening of poverty at the lower end and/or upward earnings mobility of those at the top end would serve to widen the distribution and is the likely reason for this result. Indeed, with labour market earnings being the key driver of inequality in South Africa, rising unemployment coupled with improvement in average real earnings in the Western Cape would be expected to lead to a widening of the income distribution. This means that Gini coefficient and/or complementary inequality analysis should be carefully interpreted as there are many causal factors to rising inequality that may or may not have to do with increased poverty levels.

## Measuring income poverty

That said, one of the most intractable ways to measure income poverty for a country is the use of a national poverty line – constructed to indicate the minimum amount of money required to meet the cost of an individual's basic needs or that of a household. The monetary amount includes a food and non-food component. If an individual (or household) earns or spends less than the poverty line amount, s(he) (or the household) is deemed to be poor.

The extent of absolute poverty, or the poverty rate, is then measured as the proportion of the population that falls below the national poverty line. The measure is also referred to as the poverty headcount. The depth of poverty may also be measured by summing the distance from the poverty line of all those who are poor, known as the poverty gap.

South Africa does not yet have an official national poverty line, although recent events suggest that Statistics South Africa is moving towards developing such in the near future. Despite the lack of an official national poverty line, recent academic efforts calculate a lower bound poverty line of R322 per capita per month and an upper bound of R593 per capita in 2000 prices. A further addition is the value of R174 per capita per month as equivalent to the internationally used 'Two (US) Dollar a day' poverty line.

## Poverty in South Africa and the Western Cape

Measured in any way, income poverty in South Africa has not improved between 1995 and 2000<sup>5</sup>; it has in fact deteriorated. Taking a low poverty line of R174 per capita per month, 31% of South Africans were poor in 1995. By 2000 this had risen to 38%.

Poverty gap measurement shows a similar picture. In 1995 the spending of the poor fell on average 12% below the poverty line of R174 per capita per month. In 2000, this situation had further exacerbated, with spending of the poor falling on average 16% below the poverty line. This message is a clear indictment for South Africa. Not only have the numbers of poor people risen, but the poor are faring worse in 2000 than they were in 1995!

<sup>5</sup>The data used for the poverty and inequality analysis in this review comes from the Income and Expenditure Surveys of 1995 and 2000 (IES 1995 and IES 2000), carried out by Statistics South Africa.



**Table 8 National and Western Cape poverty levels, 1995 and 2000 (%)**

	1995	2000		
	Headcount (Poverty Rate)	Poverty Gap	Headcount (Poverty Rate)	Poverty Gap
<b>National</b>				
R174 per month	31	12	38	16
R322 per month	52	26	58	3
<b>Western Cape</b>				
R174 per month	09	02	08	03
R322 per month	29	10	28	10

[Source: *Income and Expenditure Surveys 1995 and 2000, Author's calculations in upcoming 2005 PER&O*]

*Note: The poverty line of R322 per capita per month in 2000 prices is the lower bound national poverty line calculated by Hoogeveen & Özler (2004). The R174 per month in 2000 prices is the value they compute as equivalent to the Two Dollar a day poverty line generally used for international comparisons.*

The Western Cape's performance is pleasingly different, although the aggregate view masks worrying trends in poverty pockets. For example, if we take an extremely low poverty line of R100 per capita per month, poverty in the Province increased marginally from 1995 to 2000. Taking a poverty line of R174 per capita per month, we see an improvement in the poverty rate from 9% to 8%, although the poverty gap deteriorated from 2% to 3%. At the upper bound of R322 per capita per month, there also seems to be a slight decline in the Western Cape's poverty rate from 29% to 28%.

Notwithstanding the Western Cape's positive performance relative to the national picture, at 28% of the population, poverty is still a pervasive problem for the Province, and given larger population numbers, this also means increased numbers of poor people despite the marginal rate improvement.

In terms of racial groupings, at the national level, Africans and Asians at the lower end of the income distribution are doing worse than in 1995, while the performance of Whites is stable. There has been little change in the welfare of the poorest Coloureds, who fare similarly in both periods at the low expenditure levels, but perform noticeable better above the R300 per capita per month level.

The racial pattern of dominance holds in the Western Cape, with Whites faring far better than Asians, who do better than Coloureds, who in turn outperform Africans. Looking at each group in turn, we see that Whites appear to be doing better in 2000 at nearly all levels of income, with their performance in the Western Cape surpassing the national trend. Interestingly, Africans in the Western Cape fare similarly in both periods – they are not

experiencing increased poverty at the lower end, but are also not enjoying greater gains at the top end.

Groups of concern are Coloureds and Africans. Even at the extremely low poverty line of R174 per capita per month, 17% of Africans in the Western Cape were poor in 2000. At the same level, 8% of the Coloured population was said to be poor. At the R322 per capita per month mark, an alarmingly high 48% of Africans were poor in 1995, rising to 53% in 2000. At this level, one in three Coloured people in the Province was classified as poor in 1995. This ratio drops impressively over the five-year period to 2000, although at one in four, still remains of concern.

### **Access poverty**

Poverty is not only experienced in monetary terms. It is also experienced in terms of lack of capabilities, such as education, health status, to name a few, that allow individuals to engage meaningfully in socio-economic activity.

Many government interventions therefore focus on improving poor people's capabilities, in respect of enhancing access to schooling and skill development, health care services, clean and safe water, sanitation facilities, and housing. These types of public service provision are often termed the 'social wage' or 'social wage goods'.

Capability poverty may therefore also be termed as 'access poverty' as the poor tend to have less than satisfactory access to services that would raise their capabilities, enhancing their livelihoods and future opportunities.

Taking a closer look at access to services (table 9), we see slight improvements at the national level, most notably in the increase in electricity for lighting purposes. Therefore, even though income poverty appears to have increased in South Africa, improvements in access to some basic services have been made.

On aggregate, the Western Cape is again well above the national average, although improvement in access is less impressive for the Province. In fact, the proportion of dwellings classified as formal has declined from 82,2% in 1996 to 80,4% in 2001, while the share of households with no toilet increased from 5,4% to 7,7%.

Analysing Western Cape household services access by income quintile in 2000 and so linking income poverty to services shows, not surprisingly, that access rates improve as we move up the income quintiles – households with higher income are more likely to have better access to better quality services.

Of note are the very high levels of informal dwellings for the poorest 20% – more than one in three of these households live in a 'vulnerable' structure. In fact, on average, 23%

of the poorest 60% of households lived in informal dwellings in 2001. In terms of water access, only 44% of the poorest quintile had access to piped water in the dwelling in 2001, with 32,5% having water piped on site and a further 21% making use of a public tap as their primary source. Less than half of the poorest quintile use electricity for cooking, with paraffin the main fuel for one in three. The differences in sanitation access is particularly stark across quintiles, with one in five of the poorest 20% of households having only off-site access or indicating they make use of no toilet at all.

**Table 9 Access to services for South African and the Western Cape households, 1996 and 2001 (%)**

	1996	2001	1996	2001
	National		Western Cape	
<b>Dwelling types</b>				
Formal	65,2	67,6	82,2	80,4
Informal	16,2	16,3	16,7	16,1
Traditional	18,3	14,6	0,9	2,1
<b>Water access</b>				
Piped	80,0	82,2	97,0	94,9
Borehole/tank/vendor	6,1	3,7	1,2	0,3
Spring/river/dam/pool	12,4	9,2	0,6	0,4
<b>Energy Source: Lighting</b>				
Electricity	57,7	69,5	85,4	87,5
Paraffin	12,7	6,7	8,2	7,0
Candles	28,5	22,6	5,8	4,4
<b>Energy Source: Cooking</b>				
Electricity	47,2	50,7	76,8	77,6
Paraffin	21,5	21,3	13,3	13,9
Wood	22,9	20,3	4,5	2,9
<b>Sanitation</b>				
Flush/ chemical toilet	50,3	53,4	85,8	85,8
Pit latrine	32,3	28,3	4,8	2,1
Bucket latrine	4,6	4,1	3,8	3,7
None	12,4	13,6	5,4	7,7
<b>Refuse Removal</b>				
Removed by local authority	53,5	55,7	84,9	87,2
Own refuse dump	32,2	32,0	7,7	7,2
Communal	3,2	1,7	3,7	2,1
No rubbish disposal	9,5	8,4	2,0	1,4

[Source: Census 1996 and Census 2001, 10% Samples]

Considering the range of access indicators by income quintile reveals notable differences between the poorest 40% of households and the rest, indicating that it is these households that are marginalised in terms of both income and service delivery and it is these households that must be targeted in the Western Cape's development programmes and interventions over the medium term.

## **A backdrop to the 2005 MTBPS**

An overview of the economic environment in the Province gives us much to digest. We considered the economic outlook for the Western Cape over the next three years, examined the Province's sectoral growth and employment trends and prospects, reviewed provincial labour market and remuneration performance, and highlighted the Province's challenges in respect of equity and income distribution trends and prospects.

Given the analytical economic expanse covered above, much of the forthcoming 2005 PER&O analysis is drawn from analytical inputs that the Province commissioned earlier in the year, supported by research work being completed in respect of the iKapa Elihlumayo lead strategies.

Given limited resources, the 2005 Medium Term Budget Policy Statement does not try to match resource allocations to all solutions posed in the above analyses. Rather, it offers an allocation mix that aligns to the social and economic goals of iKapa Elihlumayo, thereby planting the seeds for enhanced provincial growth and development prospects in the Western Cape over time. Chapter 2 analyses expenditure trends in the Province before turning to a description of how the Province has responded to these development challenges in chapter 3.

# 2

## Provincial budget trend analysis

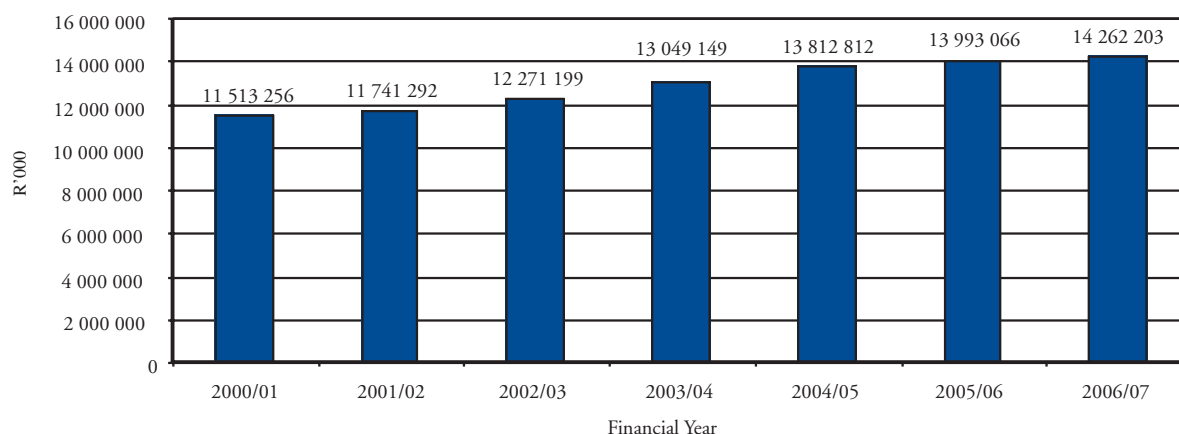
### Budget trends and funding shifts needed to realise iKapa Elihlumayo

In this chapter we discuss current trends in the budget of the Western Cape.

#### Overall expenditure and budget trends

As can be seen from figure 7 below, the provincial expenditure envelope increased in real terms from R11,513 billion in 2000/01 to R14,262 billion in 2006/07. This is mainly due to additional funding made available to the Province from the national fiscus and increased provincial own revenue (chiefly gambling and motor licence fees). The increase in the funding made available from the national fiscus is largely to cater for increases in the number of beneficiaries receiving Social Security grants and the introduction of a Provincial Infrastructure Grant.

**Figure 7 Expenditure level (up to 2003/04) and budget 2004 allocations (2004/05 to 2006/07)<sup>6</sup>**



Furthermore, capital accumulation (including compulsory savings and surrenders) totalling R602,083 million (nominal terms) allocated from reserves over the 2004/05 to 2006/07 period, also contributed to this increase. In addition, amounts were set aside for the Department of Transport and Public Works to increase infrastructure spending, financed from accumulated cash reserves to the value of R348,092 million in 2004/05, R122,681 million in 2005/06 and R113,233 million in 2006/07 (in nominal terms).

The combination of the final phasing-in of the equitable share formula in 2003/04 and the sharp rise in Social Security expenditures (substantially overshooting the nationally set targets), left the Provincial Government with no choice but to reduce the provision for growth in allocations to other services/functions.

Changes in the equitable share formula for 2005/06 include the introduction of a 'poverty component' which has a potentially negative impact on the Western Cape's future equitable share transfers (more on this in chapter 5). In addition, the current equitable share formula makes no provision for the non-ICS (improvement in conditions of service) component of personnel costs (medical aid contributions, housing allowance, etc.), which adds further pressure in the more personnel-intensive departments such as Education and to the provincial budget as a whole. The Province therefore needs to be conservative in budgeting, despite the increasing demand for services, especially in the social sector (e.g. learners, patients, etc.).

Although it might appear from the numbers in table 10 and figure 7 that the Province is in a favourable position to increase its level of services, it needs to be taken into account

<sup>6</sup>To facilitate comparison across financial years, the inflation figures provided below have been utilised to convert current (nominal) to constant (real) prices. All amounts are in real terms unless otherwise indicated. The values are as at 2004/05-budget compilation stage, i.e. February 2004.

Financial year	01/02	02/03	03/04	04/05	05/06	06/07
CPI-X%	6,61	10,91	6,07	5,10	5,30	5,40

that some of the funding (R602,083 million) comes from reserves, which is not a sustainable source. Furthermore, the population growth of the Province averaged about 3% between 1996 and 2001, according the 2001 Census. If this trend continues, the result will be a decline in per capita spending from 2004/05 to 2006/07.

## Expenditure by Department

For Social Services and Poverty Alleviation there is a 13,39% real growth from 2003/04 to 2004/05 to accommodate the beneficiary number increase in Disability Grant (DG) and Child Support Grant (CSG) recipients. This growth exerts pressure on other Social Sector departments, namely Education and Health, as well as the non-Social Sector. This is evident from the 6,36% real growth on total provincial expenditure depicted below as compared to Education (0,61%) and Health (3,13%) from the previous year<sup>7</sup>.

<sup>7</sup> Source: IYM Report July 2004.

**Table 10 The Province's expenditure for 2000/01 to 2003/04 financial years and budgeted allocations for 2004/05 to 2006/07 as reflected per vote in nominal terms**

Votes	Audited				Budget	Real Growth	MTEF	
	2000/01 R'000	2001/02 R'000	2002/03 R'000	2003/04 R'000	2004/05 R'000	03/04- 4/05 %	2005/06 R'000	2006/07 R'000
Provincial Administration	199 427	279 089	335 724	312 936	308 932	(6,07)	302 192	311 913
Provincial Parliament (inclusive of Statutory)	33 034	30 557	35 227	41 004	46 861	8,74	51 210	54 786
Provincial Treasury	39 956	51 276	60 533	65 421	113 686	65,34	115 008	117 442
Community Safety	50 949	97 130	118 751	141 187	151 436	2,05	156 256	160 296
Education	3 997 125	4 296 360	4 657 445	5 145 380	5 466 585	0,61	5 812 887	6 081 268
Health	3 342 173	3 557 870	3 850 228	4 351 127	4 738 744	3,13	4 958 141	5 236 051
Social Services and Poverty Alleviation	2 206 184	2 384 809	3 138 474	3 770 627	4 493 426	13,39	4 987 443	5 625 731
Housing	389 861	380 446	433 516	368 740	551 885	42,41	555 039	585 130
Environmental Affairs & Development Planning	79 313	92 660	120 470	120 622	135 035	6,52	140 033	144 771
Transport & Public Works	946 692	1 060 589	1 327 326	1 571 811	1 712 260	3,65	1 949 106	2 242 736
Agriculture	93 642	114 357	131 168	160 591	223 481	32,41	240 168	250 101
Local Government	21 458	31 179	49 038	57 952	76 374	25,39	54 247	55 770
Economic Development & Tourism	30 369	50 815	142 622	122 756	118 328	(8,28)	122 492	128 206
Cultural Affairs and Sport	83 073	89 859	108 478	134 477	155 339	9,91	161 664	167 773
<b>Total</b>	<b>11 513 256</b>	<b>12 516 996</b>	<b>14 509 000</b>	<b>16 364 631</b>	<b>18 292 372</b>	<b>6,36</b>	<b>19 605 886</b>	<b>21 161 974</b>
Difference		1 003 740	1 992 004	1 855 631	1 927 741		1 313 514	1 556 088
Nominal Growth%		8,72	15,91	12,79	11,78		7,18	7,94
Real Growth%		1,98	4,51	6,34	6,36		1,79	2,41
Average annual nominal growth% (2000/01 - 2004/05)					12,27			
Average annual nominal growth% (2004/05 - 2006/07)								7,56
Average annual real growth% (2000/01 - 2004/05)					4,66			
Average annual real growth% (2004/05 - 2006/07)								1,62

For Economic Development & Tourism, the equitable share increased at a sound average annual rate of 63,22% between 2000/01 and 2003/04, compared to 12,27% for the Province in nominal terms. One reason for this growth is the funds the Department received for the Cape Town International Convention Centre (R15 million in 2001/2002, R105 million in 2002/2003 and R22 million in 2003/04). However, over the MTEF, the average annual growth rate of the Department comes to only 4,09% compared to 7,56% in nominal terms for the Province.

For Agriculture there is real growth of 32,41% from 2003/04 to 2004/05 that is due to the 2 most prominent expenditure programmes, Farmer Support and Development and



Sustainable Resource Management Programmes, having increased due to substantial increases in conditional grant allocations. In the case of the former, a new national conditional grant was introduced i.e. Comprehensive Agriculture Support Programme (CASP) of R13,765 million for 2004/05, while in the case of the latter, there has been a nominal increase of 94% in the Land Care Grant for 2004/05. The Provincial Infrastructure Grant has increased by 254,74% from 2003/04 to 2004/05, to *inter alia*, give much-needed support to the construction and maintenance of agricultural infrastructure. The demand for infrastructure projects has escalated due to an increase in land redistribution and agricultural development (LRAD) beneficiaries.

For Housing there is a real growth of 42,41% from 2003/04 to 2004/05 due to the under-expenditure of 2003/04 which caused the Department's spending responsibility for 2004/05 to increase drastically. However, when comparing expenditure to the 2003/04 adjusted budget of R538,733 million, there is no increase. This trend is also due to an amount of R6,8 million that was allocated in 2004/05 to allow the Department to improve housing delivery capacity by restructuring and supplementing its staff component with further amounts of R7,160 million and R7,547 million for 2005/06 and 2006/07, respectively.

For Provincial Administration (Department of the Premier) there is a 6,07% decrease in real terms and for Provincial Treasury a 65,34% increase in real terms from 2003/04 to 2004/05 due to the shift to the Provincial Treasury of the State Information Technology Agency (SITA) payments for transversal systems.

For Local Government there is a real growth of 25,39% from 2003/04 to 2004/05 due to the establishment of the Department's own support services in Programme 1: Administration and the filling of vacant posts as a result of the newly created Administration establishment. We discuss this issue in greater detail towards the end of this chapter.

The percentage shares per vote only change marginally. The exceptions are Education and Health that decrease dramatically while Social Services & Poverty Alleviation increases because of the crowding out effect of Social Security spending over the period. Transport and Public Works increases gradually from 8,22% in 2000/01 to 10,60% in 2006/07 because of the increasing provision being made for infrastructure spending for the backlog on roads. Provision was also made for Public Works, specifically for the backlog in maintenance and classrooms and health facilities that will aid the step-down facilities for Health Care 2010.

**Table 11 The Province's percentage share for expenditure for 2000/01 to 2003/04 financial years and budgeted allocations for 2004/05 to 2006/07 as reflected per vote in nominal terms**

Vote	Actual	Budget	MTEF				
	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
	%	%	%	%	%	%	%
Provincial Administration	1,73	2,23	2,31	1,91	1,69	1,54	1,47
Provincial Parliament	0,29	0,24	0,24	0,25	0,25	0,26	0,26
Provincial Treasury	0,35	0,41	0,42	0,40	0,62	0,59	0,55
Community Safety	0,44	0,78	0,82	0,86	0,83	0,80	0,76
Education	34,72	34,32	32,10	31,44	29,88	29,65	28,74
Health	29,03	28,42	26,54	26,59	25,91	25,29%	24,74
Social Services & Poverty Alleviation	19,16	19,05	21,63	23,04	24,56	25,44	26,58
Housing	3,40	3,05	3,00	2,25	3,02	2,83	2,77
Environmental Affairs & Development Planning	0,69	0,74	0,83	0,74	0,74	0,71	0,68
Transport & Public Works	8,22	8,47	9,15	9,60	9,36	9,94	10,60
Agriculture	0,81	0,91	0,90	0,98	1,22	1,22	1,18
Local Government	0,17	0,24	0,33	0,35	0,42	0,28	0,26
Economic Development & Tourism	0,26	0,41	0,98	0,75	0,65	0,62	0,61
Cultural Affairs & Sport	0,72	0,72	0,75	0,82	0,85	0,82	0,79
<b>Total</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>

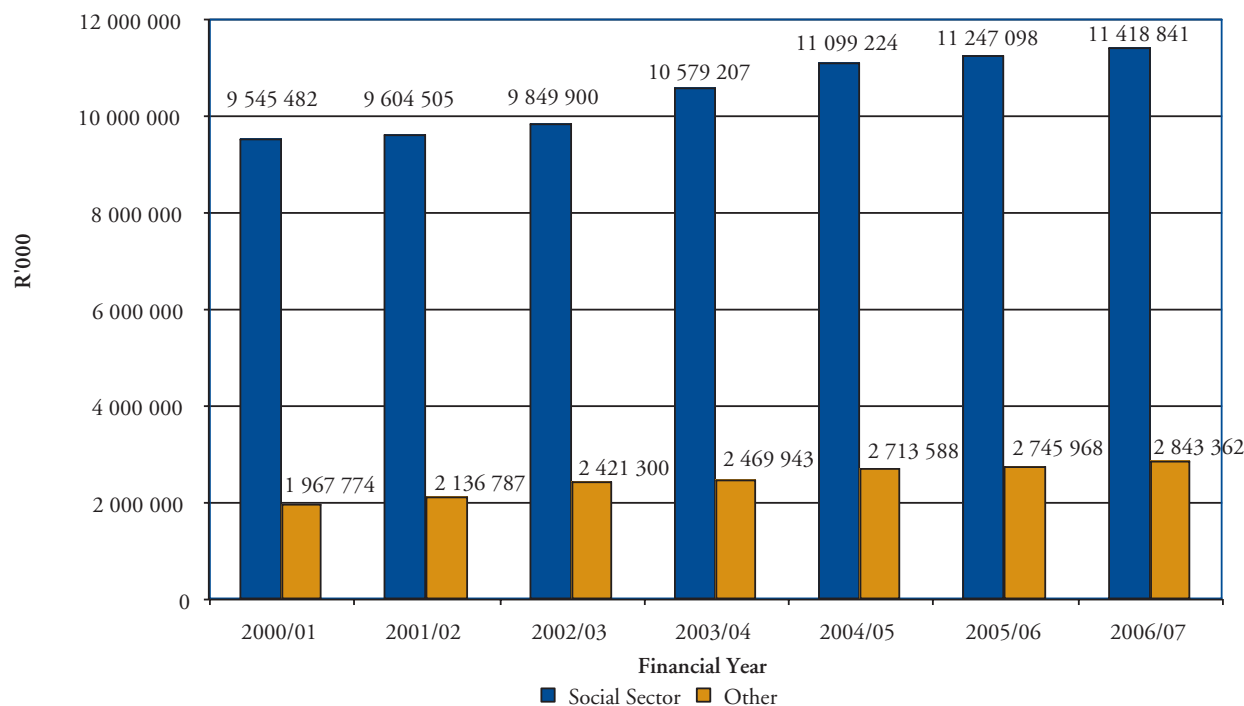
## Social Sector expenditures<sup>8</sup>

In nominal terms Social Sector expenditure has grown from R9,545 billion to R16,943 billion over the period 2000/01 to 2006/07. This translates into real growth from R9,545 billion to R11,419 billion (19,63%) over the same period, as seen in figure 8 below. The biggest contributor to the growth in expenditure in this sector is that of Social Security grants.

Added to this is the effect of the health sector's new framework for tertiary services and training constituting a major reconfiguration of the conditional grants: National Tertiary Services and Professional Training and Development, to address equity amongst provinces. The new framework entails a redistribution of the tertiary health care funds away from the Western Cape and Gauteng in favour of the more rural provinces to be phased in over a period of 5 years, starting in 2002/03. In the Western Cape the resulting shortfall is funded from either departmental receipts and/or from the equitable share allocations meant for other departments.

<sup>8</sup> The Social Sector refers to the departments of Health, Education and Social Security & Poverty Alleviation

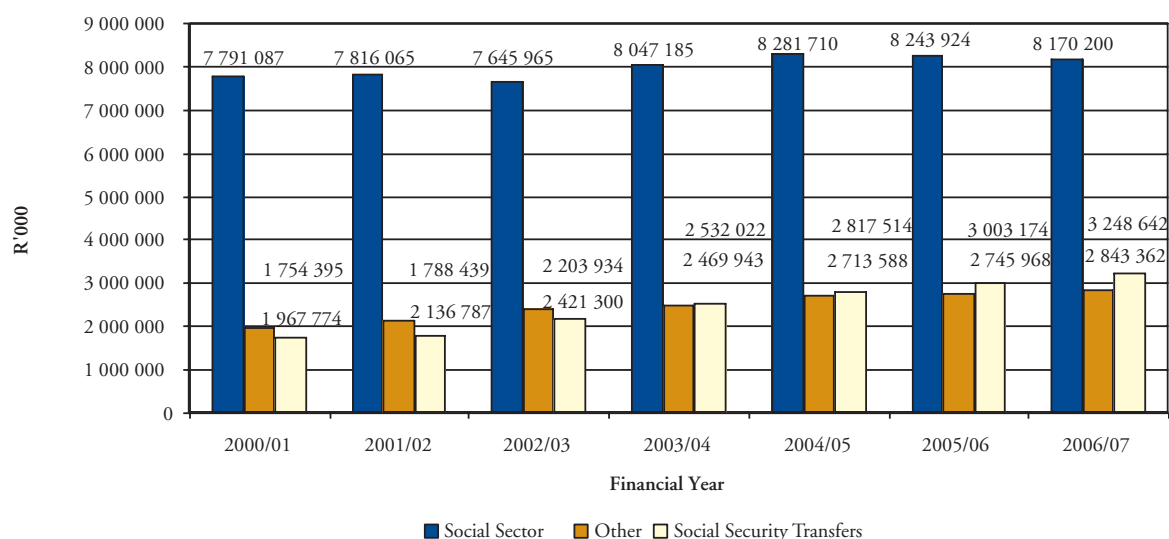
**Figure 8 Social services expenditure versus other expenditure, 2000/01 to 2006/07**



Nonetheless, the Social Sector budget, as a proportion of the provincial budget, has declined from 82,91% in 2000/01 to 80,06% in 2004/05. Consequently, the expenditure on the remainder of the Provincial budget increased from 17,09% to 19,94% over the same period. It should, however, be borne in mind that part of the increase in the non-Social Sector is funded from accumulated cash reserves. In reality the non-Social Sector share of the budget is therefore smaller than these numbers indicate. The improvement in the ratio of social:non-social expenditure to almost 80:20 (2006/07) is therefore under pressure.

In figure 9, Social Security is isolated from the Social Sector in order to get a better understanding of what the main driver is in the increase in spending in the Social Sector. From figure 9 it is clear that the Social Sector (excluding Social Security) remains almost constant in real terms. It only increases from R7,791 billion in 2000/01 to R8,170 billion in 2006/07, while Social Security increases from R1,754 billion to R3,249 billion over the same period. Social Security also overtakes the non-Social Sector from 2003/04 onwards, as the non-Social Sector only increased from R1,968 billion to R2,843 billion over the same period.

**Figure 9 Social Sector (excluding Social Security transfers), non-Social Sector and Social Security transfers, 2000/01 – 2006/07**



As indicated above, ‘other expenditure’ (excluding the Social Sector) increased in real terms from R1,968 billion in 2000/01 to R2,843 billion in 2005/06, which relates to an increase of 44,46% over this period. The expenditure in the period 2001/02 to 2003/04 includes a contribution from the Province of R142 million towards the Cape Town International Convention Centre. These amounts were R15 million, R105 million and R22 million in 2001/02, 2002/03 and 2003/04 respectively (nominal terms).

### Expenditure by economic classification

The tables and paragraphs below analyse provincial expenditure by economic classification. Not surprisingly, the bulk of provincial expenditure goes to the Compensation of employees, followed by Transfers and subsidies. Each of these categories are discussed in greater detail below.

**Table 12 The Province's expenditure for 2000/01 to 2003/04 financial years and budgeted allocations for 2004/05 to 2006/07 as reflected per economic classification**

Economic Classification			Audited		Budget	Growth	MTEF	
	2000/01 R'000	2001/02 R'000	2002/03 R'000	2003/04 R'000	2004/05 R'000	03/04 -04/05 %	2005/06 R'000	2006/07 R'000
<b>Current payments:</b>	7 829 132	8 395 094	9 349 844	10 488 913	11 788 277	6,95	12 440 828	13 037 657
Compensation of employees	6 140 592	6 503 940	6 987 603	7 516 575	8 543 267	8,14	8 900 303	9 272 422
Goods and services	1 681 240	1 883 358	2 355 015	2 890 345	3 240 760	6,74	3 536 110	3 760 599
Interest and rent on land	4 057	2 752	1 922	78 216	2 503	(96,96)	2 671	2 807
Financial transactions in assets and liabilities	3 243	5 044	5 304	3 091	1 747	(46,22)	1 744	1 829
Unauthorised expenditure				686		(100,00)		
<b>Transfers and subsidies to:</b>	3 129 465	3 390 709	4 336 129	4 967 778	5 498 650	5,31	6 032 765	6 736 667
Provinces and municipalities	320 356	298 625	310 042	374 901	306 592	(22,19)	318 763	331 986
Departmental agencies and accounts	75 196	94 079	85 041	117 124	119 532	(2,90)	124 610	128 544
Universities and technikons	31 292	34 291	41 075	42 723	51 090	13,78	53 646	56 765
Public corporations and private enterprises	5 696	14 460	7 954	4 941	2 585	(50,22)	2 000	2 100
Foreign governments and international organisations	61	113	100	67	100	42,01	105	110
Non-profit institutions	560 943	661 367	831 446	907 252	763 125	(19,97)	791 880	831 482
Households	2 135 921	2 287 774	3 060 471	3 520 770	4 255 626	15,01	4 741 761	5 385 680
<b>Payments for capital assets:</b>	554 659	731 193	823 027	907 940	1 005 445	5,22	1 132 293	1 387 650
Buildings and other fixed structures	435 334	491 144	587 648	619 714	772 501	18,61	930 705	1 178 829
Machinery and equipment	118 491	231 150	233 524	219 019	226 713	(2,07)	195 354	202 278
Cultivated assets								
Software and other intangible assets	1			5 818	4 131	(32,44)	4 034	4 243
Land and subsoil assets	833	8 899	1 855	63 389	2 100	(96,85)	2 200	2 300
<b>Total</b>	<b>11 513 256</b>	<b>12 516 996</b>	<b>14 509 000</b>	<b>16 364 631</b>	<b>18 292 372</b>	<b>6,36</b>	<b>19 605 886</b>	<b>21 161 974</b>

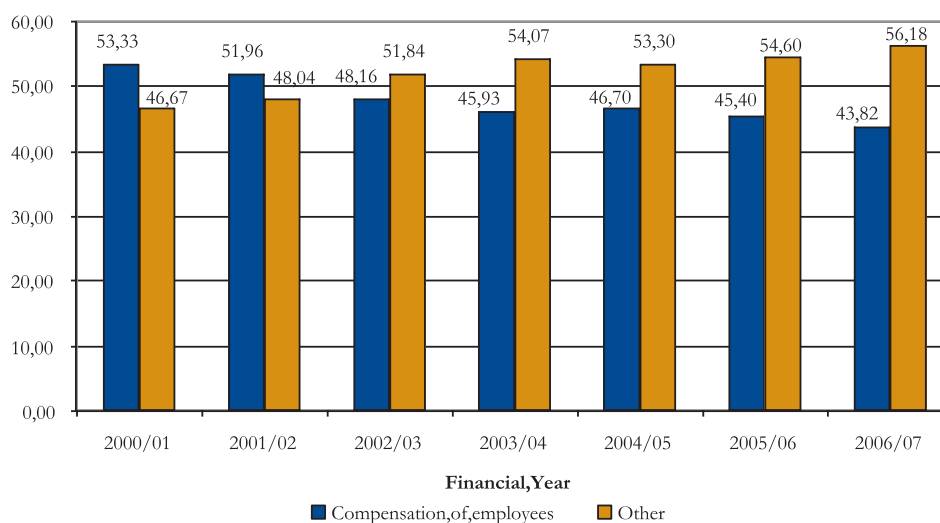
## Compensation of employees

From a provincial perspective it is difficult to manage down personnel expenditure, due to the fact that salary increases are negotiated nationally. General salary increases have been above inflation while rank and leg promotions, the increasing cost of medical aid, general promotions and general wage drift have resulted in rising unit labour costs<sup>9</sup>. There are currently 14,86 provincial public servants per 1 000 of the population in the Western Cape compared to the country average of 15,6. However, the average cost per incumbent in real terms decreased from R91 262 to R 88 749 between March 2001 and 2004. In real terms the Province spent R6,141 billion on Compensation of employees in 2000/01 compared to R5,994 billion in 2003/04. This stability was achieved by keeping the number of personnel more or less the same from 67 285 in April 2001 to 67 501 in April 2004 (table 13).

Overall the Compensation of employees expenditure consumed 45,93% of the total Provincial budget in the 2003/04 financial year. This compares favourably to the 53,33% spent on Compensation of employees in 2000/01, 50,96% in 2001/02 and 48,16% in 2002/03. The sharp decrease in the portion of expenditure on Compensation of employees is mainly due to the sharp increase on Social Security and some recovery of infrastructure spending.

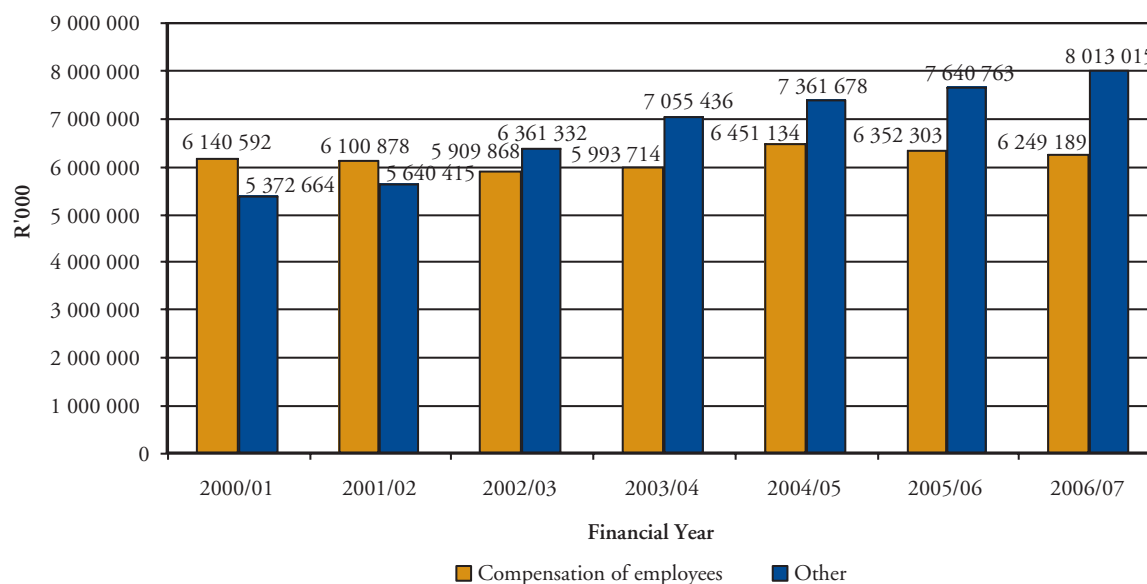
Many of the key services delivered by Provincial Government, such as Education and Health, are highly labour intensive. Compensation of employees expenditure in Health therefore consumed 56,19% of the 2003/04 Health budget (61,56% in 2002/03), whereas in the case of Education this figure was 83,89% (85,02% in 2001/02).

**Figure 10 Percentage of Compensation of employees versus other, 2000/01 – 2006/07**



<sup>9</sup> *Intergovernmental Fiscal Review (IGFR) 2003, page 188*

**Figure 11 Compensation of employees versus other, 2000/01 – 2006/07**



**Table 13 Personnel numbers and unit costs (nominal terms) at year-end 2001/02 – 2004/05**

Programme	As at 31 March 2001	As at 31 March 2002	As at 31 March 2003	As at 31 March 2004	As at 31 March 2005
Provincial Administration	587	582	527	573	800
Provincial Parliament	47	53	59	61	72
Provincial Treasury	211	202	170	202	218
Community Safety	291	446	570	610	713
Education	37 703	37 847	37 847	37 866	37 466
Health	24 123	24 885	23 965	23 384	23 384
Social Services & Poverty Alleviation	1 468	1 371	1 357	1 496	1 496
Housing	276	268	271	293	362
Environmental Affairs & Development Planning	162	218	218	206	285
Transport & Public Works	1 301	1 325	1 370	1 290	1 791
Agriculture	612	614	685	731	795
Local Government	59	68	75	130	155
Economic Development & Tourism	45	56	56	124	124
Cultural Affairs and Sport	400	425	430	535	593
<b>Total head count</b>	<b>67 285</b>	<b>68 360</b>	<b>67 600</b>	<b>67 501</b>	<b>68 254</b>
Total personnel cost (R'000)	6 140 592	6 503 940	6 987 603	7 516 575	8 543 267
Unit cost (R'000)	91 262	95 142	103 367	111 355	125 169
Total personnel cost in real terms (R'000)	6 140 592	6 100 878	5 909 868	5 993 714	6 451 134
Unit cost in real terms (R'000)	91 262	89 246	87 424	88 794	94 517

## Payments for capital assets

Payment for capital assets expenditure increases by 68,61% or from R554,659 million in 2000/01 to R935,213 million in 2006/07. This translates to a real average annual increase of 11,4%. This increase was largely driven by conditional grant allocations that are limited in their sphere of application. Given the major backlogs in buildings (classrooms, upgrading of hospitals, road infrastructure, etc.), it is clear that with the current allocations the Province will not be able to address its need for infrastructure. Again the limited provision for capital is the result of the crowding-out effect of the increases in the Social Security expenditure.

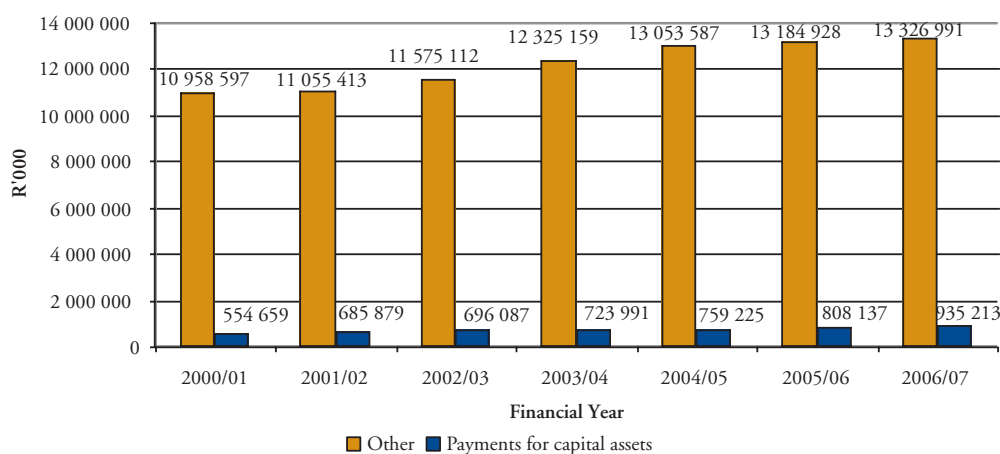
The increase in Payments of capital assets over the period 2000/01 to 2006/07 is due to the following factors:

- The increase in the conditional grant: Hospital Revitalisation from R28,294 million to R115,626 million over the period for the construction and/or upgrading of regional hospitals at George, Worcester, Vredenburg and Paarl;
- The introduction of the conditional grant: Provincial Infrastructure in 2001/02 amounting to R49,524 million and increasing to R223,215 million in 2006/07. The Province also provided extra funds through financing from accumulated cash reserves. This is mainly spent on facilities for education and health as well as on roads infrastructure;
- Earmarked allocations will be used for the acquisition of health equipment, which should bring needed improvements to the quality and quantity of service delivery, were introduced in 2003/04, starting at R40 million; and
- The roll-out of the Hospital Information System (HIS) project for Health and the Khanya project (computer “laboratories”) for Education since 2001/02.

The increase of 18,61% in Buildings and other fixed structures is due to Transport and Public Works expenditure for the relocation of Conradie Hospital on the Lentegeur Hospital site at an estimated cost of R60 million and the construction of the Clanwilliam secure care facility.



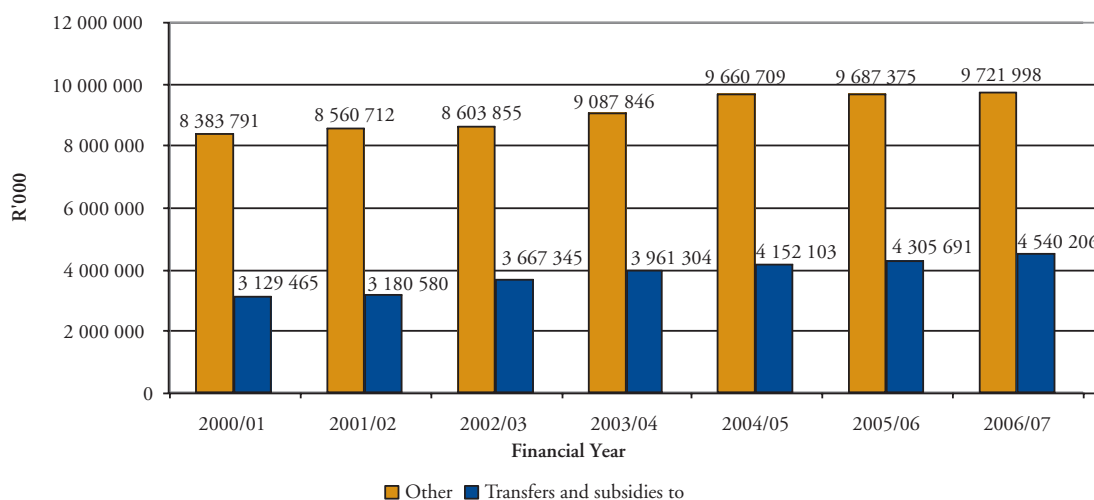
**Figure 12 Payment for capital assets (R'000), 2000/01 – 2006/07**



## Transfers and subsidies (including Social Security)

Transfers and subsidies increases in real terms from R3,129 billion in 2000/01 to R4,540 billion in 2006/07, or 45,09%. This is almost exclusively due to the increase in the number of Social Security beneficiary numbers and the resultant increase in Social Security Grant expenditure. The main cost driver for this item is the growth in Disability and Child Support Grant numbers.

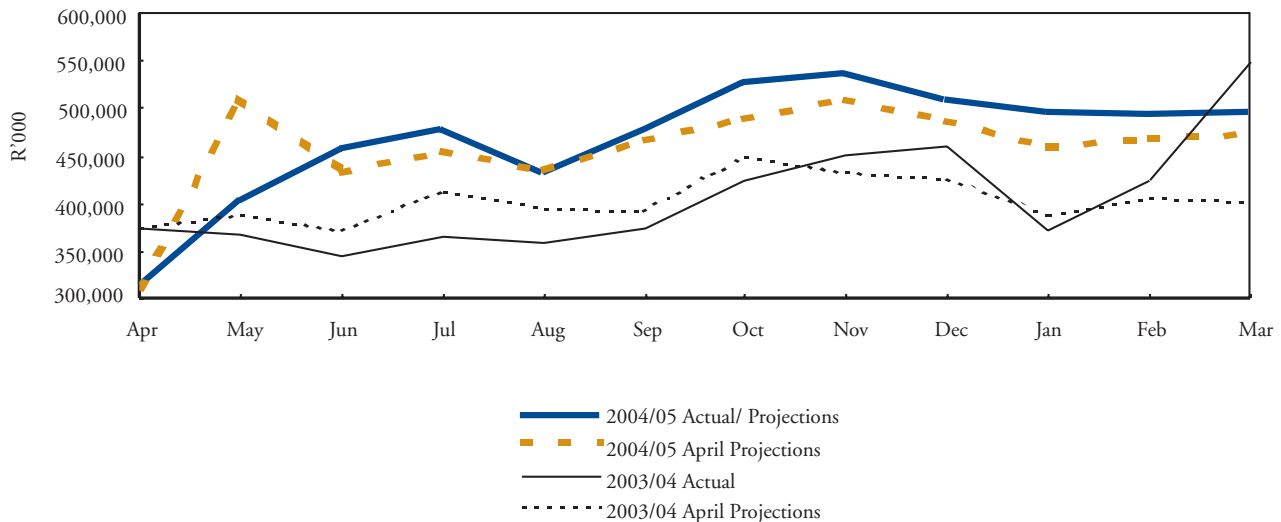
**Figure 13 Transfers and subsidies (real 2000/01 Rand value), 2000/01 – 2006/07**



The other main beneficiaries of Transfers and subsidies, in nominal terms, are the Housing subsidy programme (R446,035 million), local government (R306,592 million), subsidies to schools (R254,412 million<sup>10</sup>) and provincial public entities (R119,532 million), as budgeted in 2004/05. Including Social Security, the aforementioned amounts total R4,858 billion or 88,38% of the total budgeted amount (R5,497 billion) for Transfers and subsidies in 2004/05.

The decrease of 22,19% in Transfers and subsidies to municipalities is due to the shift of funds in Health for the provincialisation of emergency medical services amounting to ± R30 million to Compensation of employees.

**Figure 14 Transfers and subsidies**



<sup>10</sup> The amount is based on 75% of the norms and standards funding.

**Table 14 Transfer and subsidies as at 30 June 2004: National benchmark percentage 25%**

R million	2004/05					Projected (over) under expenditure
	Budget	1st Quarter spending	% Spent of Budget	Revised estimate	% Revised estimate vs Budget	
Prov. Admin.	4,941	941	19.0%	4,941	<b>100.0</b>	
Prov. Parliament	5,646	1,522	27.0%	8,463	<b>149.9</b>	-2,817
Prov. Treasury	3,317	39	1.2%	3,287	<b>99.1</b>	30
Community Safety	19,998	10,604	53.0%	19,998	<b>100.0</b>	
Education	371,522	57,908	15.6%	373,800	<b>100.6</b>	-2,278
Health	381,330	91,208	23.9%	384,792	<b>100.9</b>	-3,462
Soc. Serv & P.A.	4,003,669	903,200	22.6%	4,008,311	<b>100.1</b>	-4,642
Housing	461,845	75,148	16.3%	564,642	<b>122.3</b>	-102,797
Env. Aff. & D. Plan.	71,489	17,573	24.6%	71,493	<b>100.0</b>	-4
Transport & P.W.	62,596	2,614	4.2%	62,604	<b>100.0</b>	-8
Agriculture	20,885	2,387	11.4%	20,885	<b>100.0</b>	
Local Government	17,167	5,028	29.3%	17,226	<b>100.3</b>	-59
Econ. Dev. & Tourism	49,072	5,044	10.3%	64,067	<b>130.6</b>	-14,995
Cult. Aff. & Sport	25,173	1,716	6.8%	25,196	<b>100.1</b>	-23
Direct charge	Included in Prov Parliament					
<b>Total</b>	<b>5,498,650</b>	<b>1,174,932</b>	<b>21.4%</b>	<b>5,629,705</b>	<b>102.4</b>	<b>-131,055</b>

Transfers mainly comprise of the following components:

- Social Security payments to households, which start off at about R285 million for April 2004 and are projected to increase to about R336 million by March 2005;
- Capital transfers to households, which is almost R460 million for 2004/05, in essence the Housing Subsidy Grant;
- Transfers to municipalities amounting to R306,592 million over the year (capital and current) for various functions (libraries, primary health care, public transport infrastructure, etc.); and
- Departmental agencies and accounts (public entities such as Cape Routes Unlimited, Cape Nature Conservation Board, etc.), which amounted to R132,461 million for 2004/05.

The transfer of funds out of and between spheres of government is an activity that has historically exposed both the transferring and recipient agents to significant risk. Figure 14 compares the April cash flow with the actual expenditure for both the 2003/04 and 2004/05 financial years for transfer payments. The following is evident from figure 14:

- That, in general, transfer payments reflect an upward trend as the financial year progresses. This is mainly due to firstly, the growth in Social Security beneficiary numbers and secondly, transfers to municipalities and other institutions increasing towards the end of the financial year;
- The spending trend, on a month-to-month basis, is very uneven, especially if it is taken into account that the bulk of the transfers (on average R300 million per month) consists of Social Security transfers to households; and
- The projection/forecast for transfer payments seems to be inaccurate, as is evident in both 2003/04 and 2004/05.

From figure 14 above, a negative variance can already be seen for the first quarter of 2004/05 when comparing the 2004/05 actual with the April projections (actual up to June 2004, with the remainder a projection as at 30 June 2004). When one considers the 2003/04 actual with the April projections, one notices the spike in the actual transfers towards the end of the financial year. This is a trend that has occurred in previous years as well. Since this phenomenon was not reflected in either of the April projections for 2003 and 2004, the deduction could be made that this trend is the result of unplanned expenditure towards the end of the financial year and may even border on fiscal dumping, especially by the smaller departments.

Regarding the control and monitoring of service providers who receive transfer payments, an investigation in the Department of Economic Development and Tourism revealed that the following checks and balances have been instituted:

- Service providers are required to supply the Department with audited financial statements before funds are transferred. This measure aims to ensure that service providers implement effective and transparent financial control;
- Memoranda of Agreement (MOAs) as signed by service providers have a clause that compels them to supply the Department with detailed quarterly reports on spending and the progress of the project;
- Regular meetings are convened with service providers for updated progress reports;
- Site visits are also conducted to gain first hand information on the progress of projects; and
- In cases where service providers are not performing, their transfers are withheld.

Generally a more pro-active role is needed in the implementation of projects, beyond the traditional monitoring of administrative processes. However, the required frequency of site visits to ensure improved monitoring, cannot currently be attained due to insufficient staff.

To determine the extent to which key controls are functional on the receiving institutions' side relating to the transfer payment process, the Auditor-General (AG) conducted an investigation into the utilisation of transfer payments made by the Western Cape Department of Health to 14 municipalities for the municipal financial years ending 30 June 2002 and 30 June 2004<sup>11</sup>. The main findings were:

- The records of Kannaland, Theewaterskloof and the City of Cape Town were difficult to verify;
- The funds transferred to the municipalities seem, in the majority of the instances, to be used for the purpose the transfer was intended;
- The Department (Health) must conclude service level agreements with the municipalities;
- Health's regional offices must be trained in the management of the transfer payments (some even authorised the municipalities to apply virement on the funds transferred); and

<sup>11</sup> Report dated 26 July 2004 submitted to the Head Official: Provincial Treasury.

- Only 64% of the back payments were audited as the other 36% relates to financial years prior to 2002 (which the AG was not instructed to audit). Of this 64%, there were no significant or material findings, so it is assumed that the remaining 36% will reflect the same.

## Over and underspending

The Province has managed to turn around over-expenditure of R0,648 billion in 1997/98 to under-expenditure of R0,409 billion in 2000/01, R0,338 billion in 2001/02, R0,308 billion in 2002/03 and R0,388 billion in 2003/04. Included in the under-spending of 2003/04 is an amount of R141 million that was not spent on housing due to the policy changes and project-specific reasons. To ensure optimal service delivery R10,4 million of the 2003/04 under-spending was declared a compulsory saving and budgeted in the 2004 Budget for spending in the 2004/05 financial year.

## Administration costs

Resulting from the Provincial Government's departmentalisation initiative that took effect in 2002/03, most of the non-social services sector departments underwent substantial internal organisational and programme restructuring and refocusing to improve their efficiency, cohesion, direction and service delivery. The following departments were affected: Department of the Premier (Provincial Administration), Provincial Treasury, Community Safety, Housing, Environmental Affairs & Development Planning, Agriculture, Local Government, Economic Development & Tourism, Cultural Affairs & Sport and Transport & Public Works.

Ample provision was made for the support structures underpinning departmentalisation to assist these departments in creating the capacity to perform their newly assigned roles and responsibilities. Departmentalisation has resulted in the creation of 13 departments and the Provincial Parliament, each with administrative, human resources and financial structures. Especially in the smaller departments this is arguably not always the most efficient way in which to deliver these services. It is, however, understandable that each department, due to the generic structure and functions to be performed in terms of the Public Finance Management Act and the Public Service Act, needs to carry out a certain level of administrative functions notwithstanding its size.

Table 15 below compares expenditure on administration programmes<sup>12</sup> of the Western Cape departments on a year-on-year basis from the 2001/02 actual expenditure up to the 2006/07 budget<sup>13</sup>.

**Table 15 Summary administrative expenditure per vote, 2001/02 – 2006/07**

R'000	2001/02 Actual	2002/03 Actual	2003/04 Actual	% growth 2002/03 to 2003/04	2004/05 Budget	% growth 2003/04 to 2004/05	2005/6 Budget	2006/07 Budget
Prov. Admin	18 050	25 596	30 205	18,01	38 998	29,11	36 364	38 603
Prov. Parliament	7 332	8 436	10 764	27,60	13 390	24,40	15 107	15 985
Prov. Treasury	17 685	20 806	20 276	-2,55	22 519	11,06	24 035	24 807
Community Safety	9 766	12 822	16 744	30,59	20 808	24,27	21 737	22 389
Education	152 742	161 379	208 037	28,91	226 220	8,74	209 855	228 202
Health	122 813	121 273	232 710	91,89	217 549	-6,51	225 204	236 192
Soc. Serv. & P.A.	115 496	135 072	168 994	25,11	246 570	45,90	253 361	267 615
Housing	17 374	16 631	16 929	1,79	22 913	35,35	25 176	27 478
Env., Aff. & Planning	10 503	16 541	14 801	-10,52	16 439	11,07	18 002	17 887
Transport & P.W.	19 397	21 742	27 608	26,98	39 203	42,00	39 481	41 985
Agriculture	16 067	17 134	31 359	83,02	29 794	-4,99	30 607	31 405
Local Govnt,	2 829	4 997	14 234	184,85	20 411	43,40	21 181	21 533
Econ, Dev. & Tour.	2 909	3 614	11 026	205,09	11 297	2,46	11 964	14 278
Cult. Aff. & Sport	2 046	2 964	19 239	549,09	21 930	13,99	23 499	24 624
<b>Total</b>	<b>515 009</b>	<b>569 007</b>	<b>822 926</b>	<b>44,62</b>	<b>948 041</b>	<b>15,20</b>	<b>955 573</b>	<b>1 012 983</b>
Real growth rate %		-0,37	35,60		9,61		-4,28	0,58

As can be seen in the above table, most of the departments had quite a dramatic growth in their administration budgets from 2002/03 to 2003/04, the year in which the departmentalisation referred to above took place. This is especially visible in some of the smaller departments, where nominal growth rates of 83% (Agriculture), 185% (Local Government), 205% (Economic Development & Tourism) and 549% (Cultural Affairs & Sport) were experienced. In some departments, these extraordinary nominal increases are repeated from 2003/04 to 2004/05, with 42% in Transport & Public Works, 46% in Social Services & Poverty Alleviation and 43% in Local Government.

In real terms the overall growth rate for administration peaked in 2003/04 at 35,6%. The real growth rates slow down considerably in 2004/05 (9,61%) and remain constant over the MTEF years, although still at a high level. This can mainly be attributed to the increase from 2002/03 to 2003/04 in Health (from R121,273 million to R232,710 million) due to the inclusion of deferred payments (R48 million) and earmarked allocations, health

<sup>12</sup> It is not always easy to classify and isolate administrative functions in a department. In the Department of the Premier (Provincial Administration), for example, the expenditure for the Office of the Premier, the Office of the Director-General (accounting officer), Financial Management and Personnel Management and Administration were added together to determine the total administration cost. This however is, still not an accurate reflection, as the components of the Department do not only deliver an internal administrative function to the Department itself, but also provide strategic direction and management support to line departments.

<sup>13</sup> Information as per the IYM reports.

equipment and exchange rate fluctuations (R46 million) under this programme. From 2003/04 to 2004/05 the largest increase (from R168,994 million to R246,750 million) was in Social Services and Poverty Alleviation due to an internal organisational restructuring process in the Department's head office in terms of Resolution 7 of 2002. The Department aligned itself to a cost centre approach at district office level. They also made provision for the increase of social workers salaries. Table 16 indicates the share of each vote's administration budget to the total allocation per vote:

**Table 16 Administrative expenditure as share of total allocation per vote, 2001/02 – 2006/07**

	2001/02 Actual %	2002/03 Actual %	2003/04 Actual %	2004/05 Budget %	2005/6 Budget %	2006/07 Budget %
Prov. Admin	6,47	7,62	9,34	12,62	12,03	12,38
Prov. Parliament	36,65	35,32	36,96	40,21	41,63	41,65
Prov. Treasury	34,49	34,37	26,45	19,81	20,90	21,12
Community Safety	10,05	10,80	11,85	13,74	13,91	13,97
Education	3,56	3,46	40,58	4,14	3,61	3,75
Health	3,45	3,15	5,32	4,59	4,54	4,51
Soc. Serv. & P. A.	4,84	4,30	4,42	5,49	5,08	4,76
Housing	4,57	3,84	4,57	4,15	4,54	4,70
Env. Aff. & Planning	11,33	13,73	12,27	12,17	12,86	12,36
Transport & P.W.	1,83	1,64	1,73	2,29	2,03	1,87
Agriculture	14,05	13,06	18,26	13,33	12,74	12,56
Local Govnt.	9,07	10,19	20,37	26,73	39,05	38,61
Econ. Dev. & Tour.	5,72	2,53	9,02	14,62	9,77	11,14
Cult. Aff. & Sport	2,28	2,73	14,04	14,12	14,54	14,68
<b>Total</b>	<b>4,12</b>	<b>3,92</b>	<b>5,00</b>	<b>5,19</b>	<b>4,88</b>	<b>4,79</b>

From table 16 it is clear that the department with the largest growth in administration as a share of total budget is Local Government, from 9,07% in 2001/02 to 38,61% in 2006/07. This is largely due to the phasing out of the Local Government Capacity Building Fund conditional grant, which resulted in a decrease in the total allocation to the vote, but without a concomitant downscaling in the administration component.

Another vote with extraordinary growth in the share of administration to total allocation is Cultural Affairs & Sport, which grew from a lowest level of 2,28% in 2002/03 to 14,68% in 2006/07. This is also due to the departmentalisation process and the resultant creation of an own administration component.

The three social sector departments have reasonably constant administration allocations and, comparing 2001/02 with 2006/07, the largest increase in share was in Health, from 3,45% in 2001/02, to 4,51% in 2006/07 after experiencing a decrease to 3,15% in 2002/03. As mentioned before, the inclusion of the deferred payments and the earmarked allocations for health equipment played a role in this growth. On aggregate the administration allocation grew from a low of 3,92% in 2002/03 to 5,19% in 2004/05, then declining slightly to 4,79% in 2006/07.

Especially with regard to the 8 smaller departments, some of these services could possibly be shared to enable departments to rationalise the so-called back office services and reduce the overall remuneration to employees, thus releasing resources to be used in the so-called frontline services. An example of such a shared services concept is the Gauteng Shared Services Centre (GSSC)<sup>14</sup>. The GSSC is an innovative concept in the country, pioneered by the Gauteng Provincial Government. Its main purpose is to provide consolidated operational support services to all the Gauteng Provincial Government departments in the areas of internal audit, information technology, human resources, procurement and finance. The Gauteng Provincial Government's vision in establishing the GSSC was to develop a customer-centric, fully operational service organisation that specialises in superior transversal services with a view to achieving optimum benefit and return on investment.

For the Western Cape to go the route of the United Kingdom government<sup>15</sup> and achieve reductions in administration budgets and release more resources to the front line, will require serious revisiting of especially the way in which the smaller departments' administrative functions are budgeted for, as well as the need for large human resource and finance establishments in these departments.

## **Regions/borders, boundaries (alignment between departments/local governments)**

Three different categories of municipalities were established in terms of the Constitution, 1996 (Act No. 108 of 1996) and the Local Government: Municipal Structures Act, 1998 (Act No. 117 of 1998):

- Category A: A metropolitan municipality that has exclusive executive and legislative authority in its area.
- Category B: A local municipality that shares municipal executive and legislative authority in its area with a district municipality within whose area it falls.
- Category C: A district municipality that has municipal executive and legislative authority in an area that includes more than one municipality.

<sup>14</sup> Address by former Gauteng Finance and Economic Affairs MEC, Jabu Moleketi, on tabling of the Gauteng Shared Service Centre Budget vote, 12 June 2003.

<sup>15</sup> *Releasing resources to the front line, Independent Review of Public Sector Efficiency by Sir Peter Gershon, CBE – July 2004* (© Crown copyright 2004), document can be accessed from the UK Treasury Internet site.



The Western Cape Province is subdivided into one metro (Category A), 24 local municipalities (Category B) and five district municipalities (Category C) – a total of 30 municipalities.

The service delivery boundaries of some provincial departments, however, do not agree with those of the district municipalities, or with each other, for a variety of reasons. In some departments the various services delivered by the department itself (e.g. Development Planning & Environmental Affairs) are even delivered in different regions. Departments have been requested to align their services with the borders of the district municipalities by 1 July 2005 to ensure delivery of all services within these boundaries when the Provincial Treasury's roles and responsibilities in terms of the Municipal Finance Management Act become effective.

## Conclusion

The crowding out of Education, Health and non-Social Service expenditure has limited the Province's ability to play an active role in the socio-economic development of the Province. This limitation shows in low spending on the functions of the Department of Economic Development & Tourism, limited infrastructure spending (propped up by cash reserves), low spending on FET Colleges, etc. The net result is that the Province could only give limited effect to iKapa Elihlumayo, its programme of socio-economic development.

This chapter described the above trends as well as indicated potential areas for improved efficiency, such as the delivery of administrative services across departments. Such savings could release funds that could be applied in pursuit of the goals of iKapa Elihlumayo.