WESTERN CAPE
MEDIUM TERM BUDGET
POLICY STATEMENT

2004 – 2007

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FOREWORD

We present the 2003 Medium Term Budget Policy Statement at a time of great flux, but also of anticipation. The anticipation is of a 2004 Budget that will give further impetus to the transition we signalled when we introduced the concept "*iKapa elihlumayo*" into our budgetary lexicon in March 2003. *iKapa elihlumayo* is our strategy to grow and share the Cape, and it recognises both our economic potential as well as the great disparities in wealth and income among our citizens.

Our MTBPS comes in the context of much work already done. For one, a landmark publication, the Socio-Economic Review, produced by the Provincial Treasury is a definitive piece of work that tells the story of our Province and challenges us to find the right responses to that story. The MTBPS attempts this. Secondly, there is, at last, an intelligent conversation, arising out of Census 2001, about migration patterns to the Western Cape and its impact on services and budgets. And, thirdly, the MTBPS comes in the wake of a successful Provincial Growth and Development Summit which forged a consensus on the road to realising our economic potential for all our people.

So the MTBPS is a considered attempt to respond to the multiplicity of challenges with scarce resources, but to do so in a conceptually and strategically sustainable way by ensuring that all our departments and programmes are aligned to a single, shared set of objectives while maintaining their specialist role within the bigger picture of combating poverty.

The MTBPS speaks of good leadership. The Provincial Treasury has gone through rough times as it had to transform itself for the tasks ahead. Yet, at the same time, we had the honour of witnessing the Head Official of Provincial Treasury, Dr JC Stegmann, win his own battle with his health inch by inch.

This is the same steely resolve which the MTBPS calls upon as we meet the challenges of the Province.

Sincerely

Rasool

EBRAHIM RASOOL
MINISTER OF FINANCE AND ECONOMIC DEVELOPMENT

27 NOVEMBER 2003

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Introduction

This provincial medium-term budget statement (MTBPS) takes its name from its national counterpart and builds on previous fiscal policies issued by the Provincial Government. Like its national counterpart, its main aim is to elicit comment and encourage debate on proposed priorities before finalising annual budgets, projected expenditure and revenue priorities for the next three financial years, in the medium term expenditure framework (MTEF).

Because of the increasingly greater depth and wider range of topics covered, it was felt that the name "fiscal policy" was no longer applicable and was indeed becoming a subset of this MTBPS. As the name suggests, the MTBPS attempts to cover a range of topics: socio-economic analysis; the provincial response thereto (its fiscal policy); the supportive financial governance areas to further enhance efficiency; the necessity for formal provincial intergovernmental structures to deal with development and growth; the most efficient division of responsibilities given constitutional and other derived legislative imperatives; and, lastly, the possibilities relating to provincial revenues and its broad application to meet the provincial priorities.

The concept of *iKapa elihlumayo*[1] together with its goals of promoting economic growth and employment, reducing inequality and providing a sustainable safety net, was born in Fiscal Policy 2003-2006. This MTBPS aims to give content to this concept, although early results and future aims are already being given effect to in the Adjustments estimates of 2003/04. Further results from the various interactions with departments (MTEC hearings), municipalities (Summit of 7 November 2003), private sector (Western Cape Investment Council), and the November 2003 Provincial Growth and Development summit are reflected in this MTBPS.

The eight key priorities that have emerged from this process allow us to take the concept of *iKapa elihlumayo* a step further by articulating quite clearly what it is we have to concentrate on if we wish to achieve its desired outcomes:

- *Building human capital or human resource development*: The results of the various interactions and research projects point to this as the overriding imperative or major stumbling block towards realising the aims of *iKapa elihlumayo*. It goes without saying that youth have to be the main focus of this endeavour.

- *Strategic infrastructure* plan: On its heels follows the imperative to plan and spend strategically on infrastructure where its economic and social returns will be highest without sacrificing engineering standards (as the key discerning characteristic of South African infrastructural projects). Such planning should be done in close co-operation and synergy with municipalities and the construction industry.

[1] The Provincial Growth and Development Strategy that adds the dimension of (com)passion.

- *Micro-economic strategy*: The latter's partner, as the one endeavour can't be successfully executed without the other, is the development of a clear and comprehensive micro-economic strategy that draws in Agriculture and specifically its Land Redistribution for Agricultural Development programme. Such a strategy has to be based on exhaustive analysis of the different sectors to both piggyback on high potential areas and to remove impediments for all sectors to at least try and prevent further shrinkages.

- *A spatial development framework*: Allied with both infrastructure and a micro-economic strategy is the acceleration of the completion of a spatial development framework to guide their development and implementation.

- *Building social capital*: High unemployment particularly amongst the younger economically active population group, high crime rates, early school leaving, high poverty rates, slow delivery of appropriate housing and community building projects and the after-effects of the pre-1994 cultural, political and economic divide, all point to the necessity of building social capital amongst our communities. Such a strategy has to strengthen social ties and integration, give the youth special attention to find worthwhile and sustainable economic opportunities, engender self-sufficiency, and instill pride and the knowledge that obstacles are surmountable. In addition, the fight against HIV/Aids and its debilitating impact on society at large has to be escalated.

- *An effective co-ordination and communication strategy*: None of the above interventions will be effective without excellent co-ordination and communication between spheres of government and its social partners. Such unity of purpose will require an unqualified commitment to the optimum transformation of society capable of withstanding the rigours of international competition and being able to play its part on the African continent.

- *Improving financial governance*: Supporting these themes and underpinning most of them is the necessity to further improve financial governance so as to upgrade overall efficacy in resource use.

- *Provincialisation of municipal rendered functions:* An important step in bringing together under one roof and realising one of the aims of the Constitution relating to provincial functions and responsibilities, is finding a way for the Province, in co-operation with both the national and local government spheres, of taking over the responsibility for services currently rendered by municipalities on its behalf.

Economic analysis and framework

In a nutshell, the unfortunate message is that close to a decade of redistributive service delivery has not reduced levels of inequality and unemployment nor has it stimulated sufficient levels of growth in the Western Cape. In fact, inequality as measured by the Gini coefficient has increased since 1995. A labour force that is growing faster than the national equivalent, a slowdown in provincial economic growth since 1999 and stagnant real per capita growth rates from 1996 to 2001 has exacerbated this trend.

What makes this picture even more perplexing and challenging is that in spite of a stagnant real per capita income and, by implication, the non-worsening of poverty as measured on a per capita basis, is the very rapid growth in the number of people going on to welfare, with growth rates far in excess of economic growth rates. For example, the growth rate in child support grant recipients has been estimated to be in the vicinity of 16% in the current financial year, that for disability grants 7%, but rising close to 20% in 2004/05, and old age pensioners (previously the largest, but now falling to third place behind disabilities) growing at just below 3% per annum.

It is clear that thorough research has to be done to comprehend the driving forces behind social grant recipient growth as well as the dynamics underpinning poverty, its geographic distribution and its age, gender and race dimensions. Initial conclusions from the economic analysis indicates that low levels of human and social capital and a dearth of economic opportunities are the main reasons for both persistent poverty and subsequently for people accessing the social safety network at increasing rates.

Other factors influence this situation, such as stagnant international demand and a domestic economy that has not in all instances made the adjustments allowing it to compete successfully in a global economy. This reality is manifested in the declining shares of the manufacturing sector and the relatively stagnant shares of the previous mainstays of the provincial economy, agriculture and fishing. In addition, it would seem that technology and mechanisation have also played their role in declining or stagnant employment numbers in these sectors.

The characteristics then of the Western Cape economy is one of being driven by the skills-intensive tertiary sector with Transport, Communication and Finance; Real Estate and Business industries responsible for almost all growth since 1995. Secondly, the economy displays growing unemployment, particularly amongst Africans of 19 to 30 years old. Unemployment is exacerbated by a rising economically active share of the population that is double that of the country's average and a group of possibly "unemployable" workers, given their age (over 40), education and skills.

Taking all of this forward will also necessitate determining what makes a successful entrepreneur and what roles the government, the educational system and society in general must play to develop this desirable trait amongst our youth.

An imperative is therefore a full microeconomic analysis of the economy in conjunction with both the private sector and our partners in local government. This would necessitate a drill-down of data so that we can identify constraints and potential within the economy and land use and unleash them. Parallel with this the necessity to develop a long-term strategic infrastructure and transport plan together with municipal government in order to maximise job creation and economic and social growth. To a large extent this will depend on the fast-tracking of the development of a spatial development framework so that all interventions are optimally targeted and the greatest degree of return is attained.

Another clear potential obstacle is the growing rate of HIV/Aids infection and the persistent increase in crime rate and motor vehicle accidents, which require concerted action by those tasked to deal with this, although these are also responsibilities that rest with each individual as they relate to lifestyle choices.

Provincial Responses & Performance

Pressures arising from the growth in social security grants, the difficulty in obtaining predictability of future spending commitments on this and health services pose severe challenges for provincial budgeting. The necessity of beginning to provide for the provincialisation of municipal-rendered functions in 2007/08 and the possible further adjustment of revenue streams from the national fiscus in favour of poorer provinces over the new MTEF[2] will result in very tough budget choices for the Western Cape.

The requirement to provide income support ostensibly as a short-term measure for alleviating poverty unfortunately has to be traded off against other social services expenditure and spending on job-generating economic services. If it were not for the fact that part of this decreasing revenue stream was anticipated and addressed through improved cash management, allowing the build-up of a buffer to fund the continuation of infrastructure and economic generative expenditures, the Province would have been in an impossible situation. The non-social sector functions play a vital role in sustaining economic activity in provinces and have the potential of developing assets, creating jobs, eradicating poverty and addressing rural development. Great efforts have therefore to be made to maintain growth in roads budgets, to strengthen post-settlement support for the Land Redistribution for Agricultural Development programme and to facilitate the implementation of the Expanded Public Works programme.

While the goal is targeted income support while simultaneously addressing employment creation, the increasingly liberal entry criteria into the social security system makes this difficult. Because of their inability to significantly influence spending criteria for social security, most provinces are adamant that an alternative financing mechanism should be sought urgently.

Therefore to give full effect to the national interpretation of provincial priorities from the augmented equitable share for next year is patently impossible, except maybe for social security. A different approach is therefore required that concentrates on deriving full benefit from a 2004/05 budget of around R18 billion (after financing). We need to move away from the incremental augmentation syndrome and ensure that the priorities of *iKapa elihlumayo* come to the fore in determining expenditure provisions. Without that mindset we will have difficulty in finding lasting and truly innovative solutions to the socio-economic challenges facing the Province.

[2] Medium-term expenditure framework covering the next three financial years, i.e. starting 1 April 2004.

Efficacy of provincial responses

Analyses done this year indicate that although there have been shifts, significant improvements in alignment of departmental goals to the socio-economic outcomes still have to be effected. Too many departments still appear to be unaware of the true scope of the challenges facing us.

While each department has its ascribed role and key priorities[3] that emanated from the efficacy analyses, from the MTEC hearings and the different policy options proposed by each, the following broader strategic roles have emerged:

- *Education* has to drive the important human resource development strategy, inclusive of the fostering of entrepreneurship, and ensure its delivery.

- *Transport and Public Works* as the lead department in conjunction with *Housing* needs to formulate an infrastructure strategy that would guide subsequent planning and setting of priorities across both provincial and municipal spheres.

- *Economic Development and Tourism* as the lead department has to derive the required micro-economic strategy based on sound analyses and incorporating the key roles of *Agriculture* and others to ensure its successful follow-through.

- *Environmental Affairs and Development Planning* needs to drive the formulation of the spatial development framework as well as the reform of the regulatory environment for business activity in the province. The formulation of both the strategic infrastructure plan and the micro-economic strategy will eventually have to slot in with this framework.

- *Social Services and Poverty Alleviation* has to drive the build-up of social capital in the Province, involving a host of other departments, most notably *Health, Housing, Education* and *Cultural Affairs and Sport*.

- Co-ordination and communication have to be driven by *Provincial Administration* and *Local Government* respectively, the first provincially and the latter with respect to municipalities.

Efficiency of provincial responses

Although it is acknowledged that the goals of efficiency is to “do things right”, the actual assessment of efficiency in the Province is still in its infancy. Furthermore, it is clear that the silo approach amongst departments is still detracting from our efforts to maximise the impact of provincial spending. On the positive side the Province has improved in a number of ways, including achieving declining levels of under-spending, signaling closer attainment of annual departmental objectives. Ballooning social security and, to a lesser extent, Health expenditure, have, however, wreaked havoc in the attainment of other goals.

As a measure of efficiency, total personnel costs versus non-personnel have come down, but rising Social Security expenditures have also played a role in this. On a per

[3] More fully described in Chapter 2, *Provincial Responses and Performance* under the heading *Key priorities per department*.

capita basis, however, there are only 14.6 provincial officials per 1000 of the population versus the national average of 15.6.

Health's per capita expenditure has come down from a high of 21.3% above the national average in 2000/01 to 14.7% above in 2002/03 and is set to decline further to 12.8% above in 2005/06. By the same token, Health's personnel numbers have decreased from 26 576 in 1998/99 to 23 977 in 2003/04 whilst patient numbers have shown steady increases over this period. Healthcare 2010, the Department's strategy to only treat patients at the appropriate contact level, together with provincialisation of primary health care services should further improve efficiency.

Social Services has accommodated a doubling of social grant beneficiaries between April 1998 and March 2003 (248 015 to 501 126) but with only a 32% rise in personnel costs. In addition, the administrative cost per grant is the lowest in the country at R16,53 versus the national average of R24,28.

Education's above average per learner expenditure has come down from 21.74% above the country average in 1999/2000 to 14.52% in 2003/04. However, at 3.4 in 2002, their educator to administrative member ratio is a lot lower than the country average of approximately 5.7.

Much more work and benchmarking have to be done to be able to gauge whether the Province is in fact becoming more efficient or not. Work scheduled for next year includes analyses of:

- *Personnel expenditure trends*: an examination of the levels and categories of personnel groupings, hidden personnel costs in transfers and other expenditure items, driving forces behind all of this and the degree and trends in human capital information.

- *Transfer payments*: verification processes, analysis of recipients, performance, the efficiency of alternative delivery systems, sidestepping of accountability, hidden and distorted costs and results.

- *Capital expenditure*: trends and application.

- *Other efficiency analyses*: assessment of control structures and employee efficiency utilisation in Health and Education as the two biggest employers of this valuable resource. Other possibilities relate to property utilisation (movable and immovable) and a reward system to foster further innovation in this field as the future standard of services in the Western Cape will depend heavily on greater efficiency in resource use.

Consolidation of the iKapa elihlumayo strategy

With the results of the efficacy analysis in mind, Provincial administration has been tasked in putting together the full *iKapa elihlumayo* or Growth and Development Strategy for the Province in 2004 and beyond. This strategy and analysis will draw in the entire anticipated budget for next year under the banner of *Co-operative and developmental governance*, with three overall key priority categories:

- *building social capital;*
- *building human capital; and*
- *enhanced economic participation and growth.*

This Provincial *Growth and development strategy* will not only pull together all the themes outlined above, but will also assess and quantify the amount spent and type of activity contemplated by all the different spending programmes within the Province.

Improving financial governance and efficiency

Accounting

The main thrust in the interests of promoting greater transparency has to be to produce credible and full information as regards financial transactions. These have to comply at least with the prescribed standards of the Accounting Standards Board, but in addition go one step further in analysing and interpreting the results for both public consumption and internal use to further improve financial management.

Accomplishing this would entail making sure that the new standard chart of accounts and the nascent GRAP[4] standards are effectively put in place and further evolved in line with the requirements of good business and financial governance practices. In a similar vein, no unrecorded transactions with financial implications should take place unnoticed.

Another key focus area has to be to clean books of account at year-end as well as the final clearing of both the pre-1994 account balances of previous state departments that were inherited into the books of the Province and the uncleared transactions emanating from the turbulent formative years of the Province.

In the 2005/06 financial year further work will have to be done to get a proper hold on physical assets and to determine their actual worth in accounting terms, so that the full value of the Province's assets and liabilities can be calculated.

In addition, a lot of effort will have to be expended to build the necessary analytical capacity amongst current financial personnel within the Province and finding appropriate means to recruit and retain capable finance personnel to counter the high vacancy rates within the Treasury and CFO[5] offices.

Systems

The main intention is to ensure a painless and well-planned migration to BAS[6] on 1 April 2004, taking into account the simultaneous implementation of the new standard chart of accounts and the very high vacancy rates in both the Treasury and CFO offices. The switchover to a new financial management system is fraught with risks, but the addition of the other two factors makes this endeavour a highly interesting and challenging one.

[4] Generally recognised accounting practice
[5] Chief financial officer
[6] Basic accounting system

Given the greater flexibility of BAS relative to FMS, the system that it replaces, accords the opportunity to take advantage of any cost-centre innovations (at the central hospitals for example) and to capture expenditures incurred in each municipal ward, a possibility that has so far eluded us. The latter would go a long way in facilitating assessment of integrated governance performance.

In furthering preventative steps to eliminate fraud and other irregular personnel related transactions, a data verification project relating to Persal is due to be initiated in the new year, and to be repeated annually. This will strengthen other measures already in place. In the same vein, but with the accent on supply chain management, the rollout of Logis is due to be finalised within the Province by 1 April 2004, augmented by an asset management service (the latter at cost to each participating department) that would directly interface into Logis and be in line with GRAP and Auditor-General standards.

Given the higher levels of sophistication required, the interfacing into a whole host of other systems, the preparation for a new suite of financial systems, the increasingly higher standards of financial management requirements, and the unexpectedly rapidly rising SITA costs that perhaps should not have occurred, the shifting of cost management (and associated funding) for the crosscutting financial systems to Treasury from 1 April 2004 is required. In fact this approach should apply to all similar systems, appropriately vesting accountability in the principals and improving efficiency in the management thereof.

Financial asset management (Cash flow)

The Provincial treasury's efforts in maximising returns on investment and minimising liquidity requirements has by and large reached maturity and any further improvements will be limited to fine-tuning. The Province is probably one of the few government organisations (if there are others) that have converted to a full electronic payment process. The only remaining aim is to make electronic payments on scheduled actual due dates, not before and not later, taking into account any desired socio-economic nurturing goals with respect to smaller businesses and start-ups.

Cash flow management enhancement has allowed the build-up of a substantive buffer to defray declining revenues from national sources, but it is clear that this source of financing will become increasingly less relevant as this buffer is drawn down (a process that has already started in the 2002/03 financial year), interest rates fall and new cash management initiatives of the national treasury come into play.

The only other alternative, and that relates to the management of the Province's property portfolio, is to facilitate a much quicker turnover of property deals, inclusive of rezoning, so as to rebuild cash reserves to finance infrastructure projects with suitably high returns.

Normative financial management and internal audit

The overall aim is to improve performance management, efficiency of oversight bodies, particularly those of the Provincial parliament, and to give further impetus to the vesting and development of the normative financial management model throughout the Province. The desired end-result is greater efficiency, compliance and risk-reducing practices.

Amongst others, this process includes a review and assessment of the degree and method of compliance relative to the entire spectrum of the financial legal framework, including the necessity for intervention or concurrence of the Provincial Minister of Finance in other legislation.

Intrinsically related hereto is the building of a proper internal audit competency as the objective eyes and ears of accounting officers in assessing their systems, procedures and processes for adequacy and degree of risk management prevention. Putting in place adequate individual audit capacity over the new MTEF, specifically at Education, Health, Social Services and Poverty Alleviation and Transport and Public Works, would require very good management of the different initiatives currently under review and the concomitant restructuring and strengthening of the internal audit unit and the associated four audit committees as the responsible oversight and guiding bodies.

Supply chain management (SCM)

In achieving the stated goals of reducing procurement costs and servicing the Province's customers better, it would be imperative to get this new system of dealing with government's acquisitions or already owned assets, up and running as from 1 January 2004. A great deal of preparatory work has already been done but specific attention needs to be given to the unlocking of value in the government's assets and achieving the necessary efficiency and cost savings which, in large budgets (as found in Health and Transport and Public works), can run into millions every year.

In addition good advance planning and research, early identification and overcoming of risks, appropriate innovation and good contract management are areas that will have to receive the undivided attention of accounting officers, as they are now increasingly becoming masters of their own destiny in achieving the stated policy goals of their own organisations. Although they will be assisted by the Provincial Treasury, both in terms of guidelines issued or through more personal help and guidance, accounting officers must install adequately designed SCM structures and processes within their departments, staffed by skilled and competent personnel.

In putting their SCM units into operation accounting officers will further be assisted by an enhanced electronic purchasing system, interlinked with the new supplier database that is jointly being developed with the City of Cape Town.

As regards the management of fixed assets, the spotlight for the immediate future has to fall on property management, together with Transport and Public Works, as well as other departments and roleplayers, to achieve full utilisation of provincial owned property and to realise the required revenues and other returns to rejuvenate other provincially-owned property.

Another key goal is to do much more extensive socio-economic impact analysis to determine the impact of SCM practices and private-public partnerships on advancing the cause of preferential procurement and black economic advancement and entertaining new and better methods and practices to do so. Much of this work obviously has to be done in tandem with other initiatives in the offing.

Private public partnerships (PPPs)

It is quite clear that PPPs are still very much in the starting blocks, and although much has been learned from the Chapman's Peak Drive project, much has to be done before this novel concept can take its place as a more efficient service delivery option.

The provincial-municipal interface

An entirely new challenge for the Province and municipalities alike is the impending enactment of the Municipal Finance Management Act, which will in all likelihood take effect from 1 July 2004. It will pose its own financial and other management challenges at both spheres, although much more intensively within the municipal sphere, impacting within the Province on the department of local government and Treasury in a yet to be determined manner.

Proposed amendments to the MFMB[7] are being contemplated which should throw much needed light on the subject. The MFMB will pass on an unfunded mandate to Provinces (it is understood that municipalities will be assisted) and, taken together with the uncertainties on provincial roles and responsibilities and other unfunded mandates, might make provinces rather less than enthusiastic in promoting this important piece of legislation.

Another area of great uncertainty, particularly as regards funding and assuming responsibility and accountability, relate to the vexed question of shifting powers and functions that have historically been delivered by municipalities, but due to constitutional and other legislative provisions have lately become provincial responsibilities. Provincialisation is obviously the preferred option as that could immeasurably improve efficiency, integration with other services and accountability, but such an option would not be possible without either substantive restructuring and downscaling of these services on the municipal side and corresponding downscaling by the Province to create the necessary room for these services, as current revenues are totally insufficient to cater for them. The only other alternative, or perhaps complementary instrument, is via adequate funding from national revenues and thus by adjusting the vertical share between the spheres of governments in favour of provinces to fully or partially fund such functions.

Complicating this scenario are functions that are the responsibility of both spheres (provincial and municipal) and here dual co-operative management systems and practises would have to be developed with clear delineation of responsibilities.

[7] Municipal Finance Management Bill

Nonetheless, for any of these endeavours to be successful, a formalised structure of co-operative and developmental governance has to be established between the provincial and municipal spheres. This would include the provincial equivalent of the President's Co-ordinating Council at a more practical and detailed level as Province and municipalities share the same territory with a greater degree of immediacy than at national level. In addition, provision would have to be made for a provincial budget council/forum and line function Munimecs (sectoral government executive forums), all within the same overall co-operative structure and with appropriate technical support, evolving from similar structures and systems currently used by the Provincial department of local government.

On the developmental side it would be necessary for the two spheres to agree on the aims of the provincial growth and developmental effort, *iKapa elihlumayo*. In doing so their efforts will require alignment in terms of targeting, timing and synergy in budget composition: quite a challenge but without which the attainment of economic emancipation would become increasingly difficult.

Funding priorities for the new MTEF

While cognisance is taken of the national government's suggested priorities for provinces, funding priorities, apart from inflation adjustments for the new MTEF, must take their leave from the eight key priorities for Budget 2004. This must again be read with the more explicit departmental priorities as detailed in Chapter 2. There is also a close association and synergy with the national government's priority perspectives.

The main revenue source for the Province is its equitable share from the national revenue fund, increasing by R1,567 billion over the new MTEF. Although there were significantly higher rises from Budget 2002 to Budget 2003, difficult global and national trading conditions have precipitated a slump in national tax revenues, necessitating a tempering in the growth rate of proposed government expenditures. In addition, although there have been calculated increases in conditional grants[8] of R444,851 million over the MTEF, notably for HIV/Aids, infrastructure and the child support extension grant, the biggest grant being the Tertiary services grant only caters for an inflation adjustment in 2006/07 whilst the Health profession training and development grant remain flat and actually decrease in real terms.

The Province has to cope with this and the after-effects of the final phase-in of the current equitable funding formula in 2003/04 against the background of an increasing client base, sharply rising social security and, to a lesser extent, personnel costs. The latter is particularly vexing, as this occurred with overall personnel numbers falling somewhat from 68 253 in April 2000 to 67 410 in April of this year.

These two trends, funding and service requirements imposed on the Province, run counter to one another resulting in continuing budget deficit funding if current service

[8] The final divisions between provinces still have to be made. The calculations made are based on current trends.

growth rates were to be funded anywhere near the demands imposed on the system. In this context room needs to be found to deal with the eight main budget priorities.

To counter the falling revenue flows, the financing methodology is essentially to maximise savings in the 2003/04 financial year and to roll these over together with other cash reserves into 2004/05 and beyond as replacement funding for Transport and Public Works. At the same time, its revenue share from the equitable source will be cut back to maintain other key services and to support the eight key priorities. Furthermore, a minimum floor has to be established for the Transport and Roads functions, leaving Public Works to maximise revenue from its property holdings to fund any shortfalls in construction needs in the key delivery areas, namely Health and Education.

Apart from the normal inflation adjustments for all departments, no funding will be given for the latest 0.5% personnel inflation increases (on salaries, bonuses and pensions), except for Education and Health. Similarly, no additional provision is made for free disability care at Health. The net result of these actions would begin to make room for functions currently still rendered by municipalities but reverting to the Province from 1 July 2007 onwards.

In addition, departments have to closely examine their current spending patterns and objectives and determine whether these are really adding value and, even if they are, which would serve the goals of *iKapa elihlumayo* best. Subsequently, to ruthlessly cease or cut those serves whose impact is dubious or of lesser value and concentrate on the remainder that will result in the greatest socio-economic returns.

Revised assessments have been made on provincial own revenue possibilities, with these changes given through to the respective individual departments as baseline adjustments. As regards additional tax income, the assumption is made that both the public and national government will give their sanction for the imposition of a fuel levy in the Province. In spite of these revised own revenue targets bringing in an extra R581,641 million over the next three years, there still exists a funding shortfall of R671,341 million for the next four years, if the proposed provincialisation of municipal delivered services are brought into account. Given certain assumptions on interest rates and cash flows, an adequate cash buffer can be put together to cover this gap.

The sum total of all of this should provide enough leeway to prioritise the goals of *iKapa elihlumayo*, without upsetting the apple cart. The success of this strategy will, however, require everyone's real co-operation and commitment to achieving success.

Provision is made in the new MTEF for, firstly, the strengthening of human resource development by continuing the *iKapa elihlumayo* catalyst funding at Education by an extra R279,875 million over the next three years and substituting for the disappearance of the Financial management and quality enhancement grant (approximately R62,3 million) over the same period. These proposed augmentations, in addition to the personnel inflation increases already referred to (R392,5 million) and conditional grants changes and shifts (R62,2 million), are subject to the same clean-up process as for all other departments alluded to above, clear unambiguous output targets from the department as a whole to complement the *iKapa elihlumayo* catalyst funding, the provision of all information necessary to outside parties to critique and assess progress, an optimal schooling configuration that takes account of opportunity costs and demographic trends and funding possibilities from excess property stock.

Infrastructure spending sees increased provision from conditional grant increases calculated to be in the vicinity of R104,8 million over the MTEF, own revenue changes of R80,5 million and on the assumption that a fuel levy of 10 cents to the litre becomes a reality, another R375 million in the two outer years of the new MTEF.

To promote microeconomic reform, including greater impetus to the Land Redistribution for Development programme, the issuing of construction or upgrading permits for old buildings and heritage sites and the development of a spatial development framework, R238,2 million is specifically proposed from anticipated revenue, of which R104,8 million, relative to the current MTEF, is actually additional. The major difference is that the current provision was funded from cash reserves but that did not allow the development of long-term strategies, which were obviously detrimental to enterprise developmental initiatives and appropriate supporting research. Given the major increases to Agriculture in both Budgets 2002 and 2003, further augmentation is not on the cards, requiring further priority shifts within the department itself to more adequately fund Land Redistribution and Development and associated small farmer settlement assistance.

Towards building social capital, substantive increases are foreseen to cater for social security: R1,466 billion additionally from the equitable share and another R183,6 million from conditional grants. Increased own revenue of R135,5 million adds further impetus to this priority with most of this going to Health. Provision is also made for scarce skills and rural allowances within Health to the value of R75,7 million over the new MTEF, something that was not possible to provide for in Budget 2003, which together with other provisions cumulatively increases expenditure on Health by R439,2 million over the next three years. It should be noted that the responsibility for primary school nutrition shifts to Education from 1 April 2004. Due to current problems country wide in the housing delivery system and accompanying substantive under-spending, further additions to the Housing subsidy grant is only foreseen in the 2006/07 financial year, amounting to R28,9 million.

In strengthening financial governance, communication and local government oversight, R44,2 million over the MTEF is provided, adding capacity to Cultural Affairs and Sport to run the inherited archives function and to Provincial administration for legal services and IT, assisting the roll-out of internal audit and building oversight and associated capacity at local government.

If all of this comes together, and assuming the effective ceilings on personnel expenditures remain in place over the MTEF, the fuel levy is realised and the cash buffer holds, with no other unforeseen circumstances cropping up, close to R166 million could be made available to take over the rightsized provincial functions from municipalities in the 2007/08 financial year.

As nothing in life is certain, and based on the experiences of the current financial year where a very small provision of R26,6 million was made for unforeseen and unavoidable expenditures and none whatsoever in either 2004/05 or beyond, provision has now been made for this in the new MTEF from revenue, totaling R50 million[9] in 2004 Rands per financial year increasing annually by inflation. An additional amount of R2,5 million has been set aside in 2004/05 to make provision for unresolved contingencies within Agriculture, rolled over from 2003/04.

In conclusion the challenges are enormous, but with good leadership, perseverance, comradeship, a good dose of humility and a bit of luck, the desired results should be attainable.

9 Excluding a small committed "roll over" from 2003/04 for Agriculture that has been provided for in 2004/05 under the Contingency reserve.

1

ECONOMIC ANALYSES AND FRAMEWORK

One of the key goals of *iKapa elihlumayo* is to make provincial service delivery more responsive to development challenges in the Province. To this end the 2003 Socio-Economic Review (SER) analysed economic growth, the labour market and inequality trends in the Western Cape. The analyses pointed to the need for provincial responses in the following areas:

- A micro-economic strategy to formulate the provincial response to the restructuring of the national and global economy;
- A strategic infrastructure plan to address the low and unstrategic infrastructure expenditure in the Province. A spatial development framework would need to underpin this plan;
- A human resource development strategy to address the low education and skills levels of the labour force; and
- A social capital formation and job creation strategy to address high levels of inequality, poverty and social disintegration in the province.

The SER revealed that a decade of redistributive service delivery has not reduced levels of inequality and unemployment nor has it stimulated sufficient levels of growth in the Western Cape. From 1996 to 2001 the Western Cape population and labour force grew much faster than the national population and labour force. The result was greater pressure on the provincial labour market than is the case nationally. After a long period of sustained growth, the Western Cape economy also started slowing down in 1999. While the causes of the slow-down are diverse, preliminary evidence suggests that the slow-down has not yet bottomed out. The mounting population pressure and slowing economic growth resulted in stagnant real per capita growth rates from 1996 to 2001.

The Western Cape economy also restructured dramatically over the last ten years with a big shift to the skill and capital-intensive tertiary sector. Significantly, the growing dependence on the tertiary sector was even more pronounced in the Western Cape than in the rest of South Africa. From 1996 to 2001 the provincial economy also lost a significant portion of its share of national jobs.

The result of these trends is that wealth creation has not kept up with population growth in the province. While the delivery of basic services to the poor has improved, their chances of participating in and benefiting from the growing Western Cape economy has deteriorated. These developments in turn result in high and increasing levels of income inequality. While these developments are not unique to the Western Cape, they hit the Province even harder than other provinces and the country as a whole. Because redistributive service delivery has not had the desired effect, the government should not only reconsider its output goals, but also give greater consideration to the potential impact on the economic environment within which the reconfigured services are delivered.

Trends in economic growth

The Western Cape economy grew by an average of 3.3% between 1995 and 2001. The Provincial economy grew faster than the national economy until 2000, but has been slowing since then (Figure 1.1). The provincial economy has also undergone major restructuring since 1995 with tertiary industries growing much faster than primary and secondary industries that virtually stagnated over this period. Transport, communication, finance, real estate and business services industries contributed almost 75% of all growth in the Province over this period. Together, agriculture, forestry, fishing and manufacturing industries, two traditionally important sectors in the provincial economy, could only contribute 8.6% of all growth in the provincial economy between 1995 and 2001. While a similar drift to the tertiary industries is visible at national level, this trend is significantly more pronounced in the Western Cape.

Figure 1.1: GDP Growth rates (1995 Rands)

Source: Statistics South Africa

Since 2001, national trends in all key Western Cape industries have shown a significant slowdown. In fact the most significant national slowdowns were recorded in three mainstays of the Western Cape economy and labour market, namely agriculture, transport, communication (from 8.4% to 4.6%) and financial services (from 6.6% to 2.3%). Slowing retail and wholesale trade figures and the recent strengthening of the Rand confirmed the continued slowdown in the provincial economy.

Apart from skills, training and a restructuring labour market, another important determinant of growth and employment is the adequacy of transport infrastructure. Public investment in *transport infrastructure* usually accounts for 2.0 to 2.5 percent of GDP, and it may rise as high as 3.5 percent in countries modernising outdated infrastructure or developing new. In comparison, preliminary estimates indicate that public investment in transport infrastructure (road and rail, excluding airports and harbours) accounts for only about 1.1 percent of the Western Cape GDP. As a result, the Western Cape transport network shows signs of stress on a number of fronts such as harbour congestion, high levels of motor vehicle accidents and unsatisfactory public transport. Many proponents favour radical or interventionist strategies (such as fundamental land use restructuring) to address these issues. Others drive an agenda aimed at improving economic competitiveness in the context of ongoing structural economic changes towards globalised production systems. The challenge is to define a strategically balanced agenda (and an associated transport investment portfolio) that yields both higher levels of growth and economic participation.

Provincial labour market trends

As salaries and wages make up most of the income in the Western Cape, the proper functioning of the labour market should be a key component of any policy of redistribution and poverty alleviation. The Western Cape labour market performed much better than nationally between 1995 and 2002 with the Western Cape economy providing jobs for 55 out of every 100 new entrants into the labour market, compared to 34 for every 100 nationally. Between 1996 and 2001 the Western Cape did however lose 1.6 percentage points of its share of total jobs in South Africa (Table 1.1). The 2001 Census indicates that the largest percentage point sectoral share losses over this period were felt in the manufacturing (-3.8), financial services (-1.4) and community sectors (-1.2). Transport (0.5), mining (0.5), construction (1.3) and agriculture (0.4) sectors have managed to increase their shares of national sectoral employment.

Within this general trend, the labour market experience of African workers in the Western Cape remains decidedly worse when compared with coloured, Asian and white workers resident in the Province. Nationally, 30 out of every 100 Africans found employment between 1995 and 2002, but in the Western Cape, only 3 out of very 100 Africans found employment over this period. It is this poor performance of the labour market for Africans that engenders higher poverty and poverty gap levels for this cohort within the Western Cape province. This phenomenon is linked to the fact that the provincial economy continues to provide decreasing opportunities for unskilled workers. Unskilled workers' share in employment declined from 34% in 1995 to 29% in 2002 while the share of skilled workers increased by 5 percentage points.

Table 1.1: Western Cape shares of total RSA employment

	1996	2001	Share lost/ gained
Agriculture	21.0%	21.5%	0.5%
Mining	0.7%	1.2%	0.5%
Manufacturing	21.0%	17.2%	-3.8%
Electricity	10.1%	10.3%	0.2%
Construction	18.4%	19.7%	1.3%
Wholesale and retail	17.4%	16.7%	-0.7%
Transport	14.1%	14.6%	0.5%
Financial etc	18.6%	17.2%	-1.4%
Community, social	15.3%	14.1%	-1.2%
Private Households	9.2%	9.9%	0.8%
Unspecified	11.7%	17.0%	5.2%
Total	**17.1%**	**15.5%**	**-1.6%**

Source: Statistics South Africa Census 1996 & 2001

The skills and education of workers remains an important indicator of their chances of finding work. The growing earnings function literature in South Africa – and internationally – also shows a close relationship between education and labour market status and earnings. To date the education system has however proven incapable of substantially reducing inequality in the Western Cape labour market because of its inability to reduce inequalities in educational output. The Western Cape's educational performance is far from ideal: producing low levels of literacy and numeracy in young learners, with only 45-52% of learners who enroll in Grade 1 reaching Grade 12 and with variable enrolment, matriculation and mathematics passes by population group.

In both South Africa and the Western Cape, unemployment has a very strong *youth* dimension with the youth cohort making up 82% of all unemployment. Youth unemployment also has different dimensions for each main population group, with very few African teenagers having found work. On the other hand, data suggest that those jobless individuals over the age of 40 with primary schooling or less, best reflect the core of individuals in the labour market who, given the economy's labour demand trajectory, are *unlikely to be employed in their lifetime*. A significant group of these workers have also not worked for over three years, have not looked for work recently and display lower levels of literacy.

The economic growth and labour market trends described above have a profound effect on the distribution of wealth in the province.

Distribution of wealth

The population of the Western Cape Province has grown from just short of 4 million in 1996 to over 4,5 million in 2001. This represents a total increase of 14.3% compared to 10.4% growth in the total national population. Even more striking is that the economically active population in the Western Cape grew almost twice as fast as in South Africa as a whole (21% versus 11%). This translates into significant additional pressure on the

Western Cape's labour market. The impact of growth in the population can clearly be seen on the per capita GDP growth that remained stagnant between 1996 and 2001 (Table 1.2).

While government services have been largely redistributive, the rest of the economy has followed a different path. The Gini coefficient for the Western Cape therefore remains significantly higher than the national figure. While these figures should be treated with some caution, preliminary indications are that the level of inequality in the Western Cape has increased between 1995 and 2000. These analyses are supported by trends in the labour market discussed above with low skilled jobs being shed.

Table 1.2: Real Per Capita GDP in RSA and Western Cape (1996 Rand terms)

	1996	**2001**
Western Cape real per capita GDP	20685	20716
RSA real per capita GDP	14087	14325
	1995	**2000**
Western Cape Gini Coefficient	0.602	0.625
RSA per capita Gini Coefficient	0.56	0.57

Source: Statistics South Africa

Further analyses required

The 2003 SER provided some baseline analyses of trends in economic growth, employment and the distribution of wealth. In order for these trends to inform provincial policy making, more micro-level analyses will be required in years to come. These would have to include:

- *Detailed analyses of economic opportunities open to the Province.* As their point of departure these analyses would have to assess the past performance of key provincial industries against domestic and global trends in demand and supply and will take the form of detailed industry level analyses. They should at least reveal blockages and explain why primary and secondary industries in the Western Cape, while facing globally adverse conditions, have done even worse than their national counterparts.
- *Skills demand at enterprise level*. While the 2003 SER used trends in employment as a proxy for skills demand, more micro-level analyses are required to determine skills shortages and employment opportunities at enterprise level.
- *Further work is also required on the levels of investment in human resource development at firm level.* Preliminary analyses indicate variable levels in this regard. Correlations between such investment and industry level skills shortages need to be investigated further.
- *While the need for additional transport infrastructure expenditure has been defined, the exact nature and location of such need still has to be determined*. Such analyses

would need to take account of at least the micro-economic strategy as well as existing infrastructure.

- *Micro analyses and case studies of the aspects of successful entrepreneurial activity*. Currently entrepreneurial activity follows socio-economic patterns in society and does not serve to change them. Entrepreneurial activity does, however, have the potential to stimulate the economy, and also increase levels of participation in it. These analyses would need to reveal how this potential can be unlocked as well as addressing the perennial problems of micro-financing.
- *Plotting the nature and extent of poverty.* With the slowing economy and shedding of unskilled jobs, all the analyses point towards greater levels of poverty and inequality. Detailed analyses need to reveal the causes and geographical spread of poverty in the Province.

2

PROVINCIAL RESPONSES AND PERFORMANCE

Introduction

Chapter 1 outlined the development challenges faced by the Western Cape. While these are daunting, the Province is well placed to respond to these challenges as the social partners have agreed[10] to a co-ordinated development strategy that can take advantage of the Province's many strengths. Through its tourism, property, ICT and financial services industries, the Province has managed to carve out a significant niche in both national and international markets. In addition, well-developed sectors like manufacturing, agriculture and tourism continue to employ large numbers of unskilled and semi-skilled workers. The Province is thus faced with a unique challenge of completing the restructuring of its economy to achieve an even better interface between its products, skills and infrastructure and international demand than is currently the case.

To do this, the government and its social partners will need to define and market its unique role in the national and global economy and ensure that its people are skilled to fulfill this role. While these trends pose unique and immediate challenges to all four social partners in the Province, government itself needs to ensure that its services are conducive to high levels of economic growth and employment.

In recognition of the above, the Western Cape provincial government has embarked on the development of a growth strategy, known as *iKapa elihlumayo (The Growing Cape)*, built on the general philosophy of maintaining and improving the social safety net while progressively reducing the number of people who rely on this safety net through increased participation in the economy. The *iKapa elihlumayo* strategy is based on three critical paradigm shifts, namely:

- to shift from welfare dependence to economic self-reliance;
- to grow the economy, increase employment and broaden ownership; and
- to fight poverty, reduce disparity and improve living standards.

More specifically, six specific pillars to such a development strategy emerge from Chapter 1, the SER[11], the Sector efficacy reviews, the MTEC[12] hearings and departmental strategic plans:

[10] At the November 2003 Provincial Growth and Development Summit.
[11] Socio-economic Review 2003
[12] Medium-term expenditure hearings between Treasury and departments.

- a human resource development strategy;
- a strategic infrastructure and Logistics plan;
- a micro-economic strategy;
- a plan for building social capital;
- an effective co-ordination and communication strategy; and
- a spatial development framework.

In the rest of this chapter, we discuss these pillars in turn and indicate how effectively and efficiently the Western Cape government has responded to these challenges. We start off by an initial discussion of how *effectively* the Province has responded.

By "efficacy" we refer to the appropriateness of provincial outputs to produce the desired outcomes. So while "efficiency" refers to the need to "do things right", efficacy refers to "doing the right things". This section is therefore an initial discussion of whether the Province is doing the right things to respond to its socio-economic challenges. In the next section we will discuss the efficiency with which these service outputs are being produced. Admittedly, the pursuit of efficacy and efficiency are often related to each other. In the current provincial context, for example, the fiscal constraints of provincial government make the allocation of additional funds to facilitate reprioritisation unlikely. Increased efficiency, and the funds that it liberates, is therefore one of the strategies that can be pursued to facilitate reprioritisation towards other desirable outcomes.

The efficacy of provincial responses

In this section we will consider the question of whether the current provincial outputs are appropriate in the first place, because, to paraphrase an old Yiddish saying, "that which is not worth doing, is not worth doing well". In this section the discussion is loosely organised by reference to the strategic interventions identified by the Province in pursuit of the goals of *iKapa elihlumayo* namely: human resource development, strategic infrastructure plan, Micro-economic strategy, a Co-ordination and communication strategy, building social capital, and a spatial development framework. In this section we discuss broad strategic intervention before we discuss the efficacy of each of the departments contributing to the relevant intervention.

Before passing onto a discussion of specific themes, we raise some transversal efficacy concerns. Firstly, one of the basic requirements of alignment of outputs with outcome goals is that the latter be clearly formulated and communicated. The sector efficacy review found that many departments fail to state clearly many of their current outputs and these outputs are also often not fully communicated and subscribed to by all employees of the relevant department.

Secondly, in order for efficacy to be pursued and assessed, departments should generate more detailed information on the linkages between departmental strategic objectives and objectives of *iKapa elihlumayo*. Major departmental initiatives that dovetail with initiatives in other departments within the same sphere of government or in other spheres of government should also be identified and reported. This would give a comprehensive view of how much money government is spending in particular areas of service delivery and allow an assessment of how appropriate such expenditure is.

Thirdly, in the case of some departments, with Health serving as example, there is an intuitive link to the goals of *iKapa elihlumayo*, but it is not clear how each of its outputs would make a particular contribution to these development goals. In these cases, additional research is required as a matter of urgency to investigate ways of establishing the impact of various scenarios of service delivery.

Fourthly, within its overall expenditure, the Western Cape directly procures goods and services of over R2 billion each year. To date the bulk of these transactions were guided by a procurement policy that targeted “previously disadvantaged individuals”. The latter was quite loosely defined to include women, small businesses, people with disabilities and locally based businesses. The recently approved Black Economic Empowerment Act regulates more specific and detailed definitions of empowerment. This Act will in due course result in corresponding changes to the Provincial procurement policy.

Apart from directly ensuring empowerment, provincial procurement can also be used as leverage for ensuring broader adherence to the development strategies of the province. Such interventions are key instruments in implementing the micro-economic and job-creation and poverty alleviation strategies referred to above. As the central guardian of procurement, the Provincial treasury should co-ordinate and guide the strategic usage of procurement. The forthcoming revised procurement policy and large procurers in the province namely Health, Education, Transport and Public works and Provincial administration will, however, also have a key role to play. The sector efficacy review came to the general conclusion that the Province does not as yet derive sufficient benefit from its procurement activities.

Human resource development

The overall goal of a human resource development strategy would be to ensure that the entire labour force has appropriate skills to enter the labour market, on the one hand, and to facilitate additional investment by supplying enterprises with appropriately skilled workers on the other hand.

The SER confirmed that human resource development remains a key development challenge in the Province. The human capital model maintains that as people receive more education they become more productive and can more easily adapt to changing circumstances and technology than those workers that did not receive any further education. As workers become more productive (e.g. by requiring additional skills) the market will be willing to pay them more. In general this means that workers with more education will receive a higher remuneration package than those with less education. Through these mechanisms, human resource development can therefore make a contribution to all the goals of *iKapa elihlumayo*.

In the SER, skills and education levels were identified as one of the primary causes of exclusion from the restructuring economy and entrepreneurship. The persistent racial patterns in this field, in particular, demand urgent attention. Even more disconcertingly, initial analyses suggest that the education system may not be making any inroads in this regard.

The challenges to the skills profile of the workforce has changed substantially as a result of the changing structure of the global, national and provincial economies. As was indicated above, the provincial economy has generally become more skills-intensive, while lower-skilled industries have grown more slowly than others. The labour force and the education system are therefore being faced with a new set of challenges.

One of the avenues open to people who do not participate in the labour market as salaried workers is entrepreneurship. The Western Cape, relative to the rest of the country, has comparatively high levels of total entrepreneurial activity but overall success in such endeavors is limited as this is also highly dependent on levels of education.

In the education chapter of the efficacy review, the importance of quality of education was highlighted as being the most important issue. All outputs measuring educational attainment are ultimately secondary to quality outputs. Historically, only two performance measures were, however, available at school level, viz. pass or promotion rates and matriculation.

The Western Cape has performed well in this examination compared to the rest of South Africa. This does not, however, mean that efficacy has been reached. When the high pass rate of the Western Cape is linked with the number of passes with mathematics, the picture becomes less rosy. For example, in 2002 only 17% of learners that passed mathematics passed it on higher grade. More broadly, numeracy and literacy test scores should also be included as departmental performance measures. Most worrying in the Western Cape, the attainment of quality education still has a distinctly racial bias, although this seems to be linked to attendance patterns at dysfunctional schools, rather than any active discrimination.

To ensure equity in the Western Cape educational system, educational attainment outputs, e.g. pass-through rates, should therefore be improved specifically in the poorest (normally black) school quintiles and linked to the quality of passes, e.g. number of learners passing mathematics higher grade, with appropriate incentives to encourage the attainment of these outputs. These goals can be linked to the Norms and Standards classification and it is suggested that good performances of schools in the poorer communities be rewarded on a wider scale when those goals are met. More broadly, the measurement of performance needs to be shifted from the current focus on workload statistics to the measurement of the attainment of quality education.

While key, the schooling system is only one aspect of a human resource development strategy (HRDS). While the Department of Education therefore has a key role in conceptualising and driving such a strategy, a number of parastatal and private players are also important, namely tertiary institutions, SETAs[13] and FET[14] colleges etc.

[13] Sectoral Education and Training Authorities
[14] Further Education and Training

Ultimately such a strategy should have an internal as well as an external wing. The internal dimension will target the development of at least the 70 000 civil servants in the Provincial government, but could ultimately also include local authority employees. This complexity requires that Education acts beyond its narrow mandate to marshal strategically the delivery of skills in the Province. To assist with the conceptualisation of the delivery of appropriate skills in the Province, a HRDS Task Team has been constituted and has recently submitted its report to Government.

A human resource development strategy would also be key in supporting the micro-economic strategy. Skills should be produced in at least the sectors targeted by the latter. We discuss the nature of the desired micro-economic strategy below.

Micro-economic strategy

The overall goal of a micro-economic strategy would be to guide and direct provincial involvement in private sector. In order to do this, it would need to identify and address global and national economy-wide trends as well as sector and industry specific blockages and opportunities.

Apart from pro-active support through strategic financing and information provision, such a strategy should also ensure that the regulatory environment in the Province does not function as a barrier to employment and business activity. This may include a major rationalisation of regulatory functions currently being managed by three provincial departments (Environmental Affairs and Development Planning, Economic Development and Tourism and Cultural Affairs and Sport) and across all three spheres of government.

Many of the shifts in the sectoral composition of the provincial economy were initiated by shifts in the global economy that the provincial, or the national government, do not have control over. Some economic sectors and some sectors of the population were, however, not able to adapt to this environment and were thus not able to benefit from it. The key challenge in the formulation of a micro-economic strategy is therefore to support priority sectors in the Province in order to achieve a better fit between what the provincial economy has to offer and what global and domestic markets demand.

Broadly, it seems that such support should be targeted at industries that are currently or are likely to benefit in the future from the global restructuring of economic activity that the Province has experienced over the last decade. The strategy should ultimately identify the key growth sectors in the Province on the basis of employment as well as growth considerations. To this end, more detailed analyses would be needed to determine why primary and secondary sector industries have done so badly. Such analyses will point to useful interventions of facilitation by government and should take account of trends in the global economy, technology transfer and changes in trends in trade and exports.

At least initially, it would appear that most such industries are to be found in the tertiary, rather than the primary and secondary sectors. A key challenge, however, is to ensure that any further development of the tertiary sector does not further entrench the patterns of inequality and exclusion described above. Some of the key issues that would need to be considered in this regard would include:

- The nature of support to industries that are driven by and vulnerable to external circumstances (tourism, financial services and property);
- How and whether to support industries that have not been able to derive much benefit from a more open economy (manufacturing). This could be done through enhancing competitiveness on the basis of quality, niche or price depending on the sector;
- How to support industries that have derived some, but not sufficient, benefit from the restructured economy (agriculture);
- How to support industries of which potential growth is substantially affected by limited local demand (ICT), and
- Influencing industries that are dependent on government activity in general and procurement in particular (construction, IT).

This strategy should be co-ordinated and integrated with the HRD and infrastructure interventions as well as with the job-creation and poverty alleviation aspects of the social capital strategy described below. The interface, especially with the latter, would need to ensure maximum absorption of workers into the labour market and ensuring markets for the goods and services that are produced by these interventions. The micro-economic strategy's integration with these strategies will hinge on geographical and age group targeting. As described in the previous chapter, this strategy should largely focus on people who are likely to be integrated into the economy through salaried labour and entrepreneurial activity.

Two final considerations in the design of a micro-economic strategy should be that the Western Cape has a preponderance of non-labour intensive SMMEs[15] and that the poor and unskilled are not often successful entrepreneurs in the Province. Any micro-economic strategy that hinges on increased SMME and entrepreneurial activity in the Province, would need to take account of these two facts. Within the Province, such a strategy should be the result of consensus at least between Economic Development and Tourism and Agriculture as well as the social partners – especially business and labour.

The current wide spread of interventions by Economic Development and Tourism may lack sufficient focus to have any lasting impact on economic development in the Province. The most progress has been made in the Tourism branch where a detailed strategic plan has been formulated that considers detailed analyses of demand and supply on a geographical basis. A similar approach would be a minimum requirement for the rest of the department. As was indicated above, such planning should, however, also be conducted at an economy-wide level. Such planning will identify the sectors that the Province should be focusing on in the first place. Another aspect of a fully-fledged micro-economic strategy that deserves attention in the Department is more thorough

[15] Small, medium and micro enterprises

measurement of the impact of its interventions. Lastly, the revamped Wesgro also had to take a step up in terms of improving on low levels of investment in the provincial economy and promoting greater trading opportunities with the rest of the world.

As indicated above, Agriculture would be the other department that would play a key role in designing and implementing a micro-economic strategy. Within *iKapa elihlumayo*, the agricultural sector has been identified as one of the lead sectors because it is the main economic activity in the rural areas of the Province and is a significant provider of unskilled and semi-skilled employment opportunities in rural areas. It also has the potential to be internationally competitive and provide strong forward and backward linkages with the rest of the economy.

However, the Department faced the challenge of ensuring equity in the distribution of benefits from growth in the Agriculture sector. The low wages, casualisation and poor working conditions of agriculture workers is well documented. While the large new allocations to the farmer settlement programme is a step in the right direction, Agriculture needs to re-align its support services to ensure that emerging farmers are adequately supported. More broadly, the Department also has a key role to play in rural development, especially through the new mandate of Cassidra.

Strategic infrastructure plan

The overall goal of a Strategic infrastructure plan would be to provide the physical infrastructure that supports growth, labour market participation and general well being in the Province. Given the fiscal constraints that the Province is under, such a plan would need to contain a strategy for progressive rollout according to the position of relative priorities in it. It must be explicit about the sequencing of the implementation of such a plan, and this sequencing should take account of both socio-economic priorities and technical requirements such as the lifespan of tarred roads. A key component of such strategy should also be to unlock maximum benefit from the provincial property portfolio that could result in not only improved service delivery, but also increased revenue to support other key functions.

In terms of the support that roads provide for economic development and labour market participation, the SER argued that for growth to take place in an open economy, world-class Logistics and transport networks are critical. The bulk of the provincial economy depends for its livelihood on people and goods moving into and out of and around the Province. Where this cannot be done optimally, the prospects for greater levels of growth and participation seem limited. Such interventions should be balanced with the imperative of improving access and increased economic participation of underdeveloped areas and people of the Province. We therefore argued for a strategically balanced, or "dual-logic action" agenda and an associated transport investment portfolio that takes account of the efficiency, equity and sustainability imperatives of the Province. The public transport network has a particularly central role to play in the job-creation and social capital interventions of the Province. Any effort to integrate and reintegrate disadvantaged and marginalised members of society has access to amenities as a basic precondition.

Additional expenditure on the provincial transport network should therefore be based on a "Strategic Infrastructure Plan" that targets public funding to priority areas and leverages maximal private sector contributions. As far as service delivery is concerned, such a plan would need to propose an optimal ratio in expenditure between the Public Transport, Roads and Works components of this department.

Such a plan should, in addition, also show close connections to the micro-economic strategy of the Province. Any additional expenditure on infrastructure should at least plan for and support the industries prioritised by the micro-economic strategy. This Department also plays a key role in the creation of low and unskilled employment in the Province through its extended Public Works programme. This programme should be integrated more closely with the design and targeting of the social safety net in the Province.

The Transport branch in particular should take measures to retain the necessary technical expertise in order to ensure that its traditionally high standards be maintained in the long term. Measures should also be instituted to ensure that the Transport branch, as well as the local authorities that act as agents for the Province, have the technical capability and capacity to efficiently spend the increased budget allocation over the medium term. While there is recognition that funding for the maintenance of the road network should be increased substantially in order to protect road infrastructure disrepair, such additional funding also needs to be targeted to ensure optimal economic and socio-economic returns. The branch does not, however, currently appear to have sufficient capacity to ensure such planning and targeting.

While it is appreciated that many of the department's activities result in socio-economic benefits to the community, it is suggested that the ethos of the department should develop more rapidly to include socio-economic in addition to technically related goals. It is important that all employees in the department understand and subscribe to this broader ethos. It is also important that the department has a clear and current understanding of its role vis-à-vis government policy and that it recognises its broader role in socio-economic development. To this end it should ensure that it develops and maintains strong ties with other public and private sector organisations in this field. This will allow the department to play a more strategic role in realigning the infrastructure provision of its partners.

While a certain degree of integration and co-ordination in the planning area exists between the Public Works branch and other government and non-government players, it is felt that this is insufficient if holistic socio-economic aims are to be achieved. The department as a whole needs to play a more proactive, rather than responsive, role in developing and submitting proposals on how it can contribute to the attainment of government aims. In recognition of the multi-disciplinary nature of community development, the department needs to participate more fully with other departments and branches in the planning of projects. There is already steady strategic interaction between the Transport branch and Economic Development and Tourism as part of the Public Transport vision. This exercise will be finalised by June 2004.

Another key component of such an infrastructure plan should be the provision of housing in the Province. Admittedly, service delivery in the Department of Housing is heavily regulated by national policy. The Department does, however, have significant discretion in the areas of targeting and procurement. These instruments need to be used optimally in the support of *iKapa elihlumayo*. The capacity of the Department to pursue these goals is, however, hampered by the fact that restructuring has not been completed and, as a result, key vacancies have not been filled.

The potential contribution of proper housing to the goals of *iKapa elihlumayo* is enormous. The lack of integrated planning and deliberate targeting, however, perpetuates spatial apartheid and leads to the maintenance of homogenous poor communities. This in turn reinforces the structural inequality that bedevils the South African economy at large and restrains growth and the alleviation of poverty by separating communities from job opportunities and the formal economy. Currently, the majority of housing developments are still located at the edge of urban areas, which also tends to reinforce urban sprawl. Housing analysts generally agree that this spatial pattern of development perpetuates poverty and marginalisation by cutting off poor communities from economic opportunities.

It is recommended that spatial integration be achieved through the vertical and horizontal integration of multi-year plans and funding mechanisms. A key component of such a strategy should be to engage the housing component in the IDP processes of municipalities. In this way, the largely demand-driven process of housing delivery could be more strategically managed. There may also be space for influencing the building industry through framing local procurement, but this leverage is limited by the low profit margins of these projects.

Building social capital

The goal of *iKapa elihlumayo* is not just economic and job-creation in the narrow sense, but restoring dignity to all the people of the Province. As such, a job-creation and poverty reduction intervention would have contributions from a large number of departments, but would concentrate around the provision of non-social security functions like housing, health, community safety, sport and culture.

As the design of social security provision is largely beyond the control of Provincial government, these initial recommendations refer to other aspects of the social safety net such as farmer settlement initiatives, public works programmes, poverty alleviation programmes, social assistance and social development initiatives. Currently, as many as nine of the 14 departments participate in aspects of the safety net, albeit in an apparently haphazard manner. Ultimately such a strategy should, however, also include broader interventions to restore the social fabric of society. As such, it would include youth programmes, crime prevention initiatives, cultural integration, literacy programmes and the provision of housing and primary health care.

Of the six provincial priority interventions described here, this one still needs the most work in terms of formulation and conceptualisation. The first goal of such a strategy would have to be to co-ordinate and integrate the provision of the social safety net across the Province. In addition, these interventions would need to use a single targeting framework that could be based on the socio-economic aspects of a provincial spatial development framework.

The labour market analyses in the SER yield some vital information for the structuring of the provincial social safety net. The SER argues that there are largely two groups of people within the "unemployed" category, namely, the youth who have every chance to be employed again and a group of "unemployable" workers who have been the victim of the changing structure of the economy. It seems that the only way in which income can be provided for these workers is a state-sponsored social safety net. It can therefore be argued that the parts of the safety net that Provincial Government has discretion over should be targeted at these workers and their households. While the unemployed youth and their households should also be supported, such support should have the ultimate goal of re-integrating these workers into the labour market. Such re-integration should obviously start with education and skills development that is appropriate to this re-integration.

As a key player in this intervention, the strategic objectives of Social Services and Poverty Alleviation are directly supportive of the outcome goals of *iKapa elihlumayo*. The bulk of the Social Services budget is, however, governed by national mandates and the Province has little control of the design or targeting of the bulk of the services that it delivers. While this trend puts pressure on development services provided by the Province, the latter often seems to be governed by historical patterns of expenditure and political imperatives. These programmes could play a key role in provincial efforts to restore the dignity of its people through poverty reduction and job creation. For this to happen, however, it would need to become part of a coherent and integrated larger strategy that involves the other eight Provinces that provide services that would support such an initiative.

As was the case in the Departments of Transport and Public Works and Economic Development and Tourism, the Department of Social Services and Poverty Alleviation should also give more attention to measuring the impact of its social development interventions. The wide spread of its current interventions risks having a minimal effect.

Given the tight fiscal environment, the space for reprioritisation and increased efficacy towards such a programme will most likely be created by increased efficiency, rather than additional resource allocations. Taking Health as an example, economic efficiency analyses reveal, for example, that academic hospitals could reduce on their inputs by 17% and still produce the current level of outputs. This translates to a saving of almost R16 million that could be reallocated to district hospitals.

Governance, co-ordination and communication

The country faces many challenges, but resources with which to achieve these challenges are limited. It is thus of the utmost importance that the government's resources be utilised in such a way that they provide maximum benefit. This implies that the budgets of the different spheres of government be co-ordinated and optimally integrated to ensure alignment with each other's goals and to eliminate duplication. In addition, the internal activity of Provincial government needs to be aligned, co-ordinated and integrated to produce the maximum impact for its interventions. It is thus foreseen that the President's Office, Premier's Offices and the different treasuries will become progressively more involved in ensuring maximum synergy within and between spheres. A sound working relationship with the "three social partners" is also essential to the successful implementation of *iKapa elihlumayo*.

Cabinet committees and administrative clusters have been established at national and provincial level to enhance policy development and integrated planning. Similar structures were established in the Western Cape provincial government and are co-ordinated by Provincial administration. The clusters are, however, yet to establish themselves as key instruments in Provincial government processes. While they are formally part of most budget and planning exercises, they have yet to establish a niche for adding value as a collective. Such a niche should include leveraging the budget within the entire sector to better effect and to achieve the goals the cluster has set for itself.

The co-ordination and dialogue between government and its three social partners is to be facilitated by the reconstituted provincial development council. An appropriate mechanism has been agreed to at the November 2003 Provincial growth and development summit.

Provincial departments will in turn have to work closely with the local government sphere and give their full co-operation with regard to the IDP process. While this co-operation involves the majority of provincial departments (especially Housing, Transport and Public Works and Health), the Department of Local Government has a key role to play in this process. In the tight fiscal environment, there is an even greater need than before for interaction between the provincial departments and municipalities to ensure efficiency gains. Departments are investing financial and management resources to support the nodes on an on-going basis. Some participating departments have refocused their budgets through their projects and programmes. However, provincial departments generally disregard the planning processes of municipalities to the extent that very limited consultation takes place with municipalities on local development issues. It is envisaged that provincial departments through their policy choices and priorities should plan and budget to support Local government development policies.

The priorities identified in the IDPs of Western Cape municipalities, apart from a few exceptions, are already reasonably well aligned with those of the Western Cape provincial government. It is, however, evident that municipalities are yet to shift their expenditures to these priorities as analyses of their budgets illustrate a lack of alignment between IDP priorities and expenditures. These expenditures reflect "traditional" municipal expenditure patterns and the notion of "developmental local government" is yet to affect spending priorities. Studies conducted elsewhere in South Africa have found that linkages between budgets and IDP priorities are often only drawn after the finalisation of the budget. The Systems Act, however, requires that budgets be prepared according to IDP priorities and not vice versa. The IDP must therefore be viewed as the overall strategic planning document of the municipality that guides budgeting decisions.

One of the key facilitators of such co-operation as has been discussed above, is the proper flow of communication between departments, spheres of government and the four social partners. While this is a collective responsibility, KEEG[16] has a key role to play in communicating the activities and priorities of at least provincial government to its development partners and the public at large.

Spatial framework

Given the multitude of actors involved in the development process in the Western Cape, both inside and outside the provincial government, it is of cardinal importance that the interventions of these actors be made in response to the same spatial appreciation of growth and development challenges and opportunities in the Province. Such a spatial map or framework should at least provide a map of poverty, unemployment, economic opportunity, infrastructure and environmental priorities. The tight fiscal environment within which the next few budgets will be formulated, increases the need for such a spatial framework because it will allow development actors to target limited resources at the areas that will bring the maximum return.

Within the provincial government, the formulation of such a spatial framework is the responsibility of Environmental Affairs and Development Planning. While initial planning in this regard has started, the projected 18-24 month timeframe for delivery is of some concern, given the short-term social and economic pressures on the Province. In the absence of such a framework, it may well be justified to look at shorter-term proxies for spatial need and opportunity pressures.

Once formulated, this spatial framework will form the basis for all the provincial interventions referred to above. It will, for example, guide the micro-economic strategy to areas of economic potential that also have the required infrastructure. It will also guide the job-creation and poverty alleviation strategy to areas with less economic potential and less skilled and marginalised workers and so forth.

The efficiency of provincial responses

After considering whether the Province is "doing the right things", we now move the focus to a consideration of whether the Province is "doing things right" or whether it is efficient in its delivery of services. Efficiency means achieving the maximum output from a given level of resources used to carry out an activity. Technically, efficiency can therefore be expressed as the ratio of output (goods, services or other results) to input

[16] The Knowledge Economy and E-government Programme.

(the resources used to produce inputs). The higher the ratio, the higher the efficiency. The challenge is therefore "to do more with less".

Operationalising efficiency in an institutional context means that management should strive to maintain and improve this ratio. The basic responsibility of provincial government departments is therefore, firstly, to ensure that they remain within budget, but also that funds are actually spent on the purposes for which they have been appropriated. The basic precondition for the pursuit of efficiency is that inputs be put to the appropriate use.

Ultimately the levels of input cost for every unit produced should measure efficiency. Given the complexity of government service delivery, this is no easy task. A lack of fully developed performance indicators (benchmarks) to measure performance against spending (i.e. non-financial indicators) heightens this challenge. To date the focus of the financial management system has been on producing financial information, but the emphasis is shifting to ensure that non-financial information is also made available. The availability of more regular non-financial performance information will assist a more systematic assessment of efficiency.

In the absence of the relevant indicators, we use a number of proxies for efficiency. Except for the first bullet below, these proxies refer to the need for maintaining a balance between certain kinds of expenditure:

- Overspending and underspending;
- Spending on personnel compared in relation to non-personnel expenditure;
- Capital expenditure in relation to other expenditure;
- Transfers vs. non-transfer expenditure; and
- Social sector spending (Education, Health and Social Services and Poverty Alleviation) compared to the balance of provincial spending.

Over-/Underspending

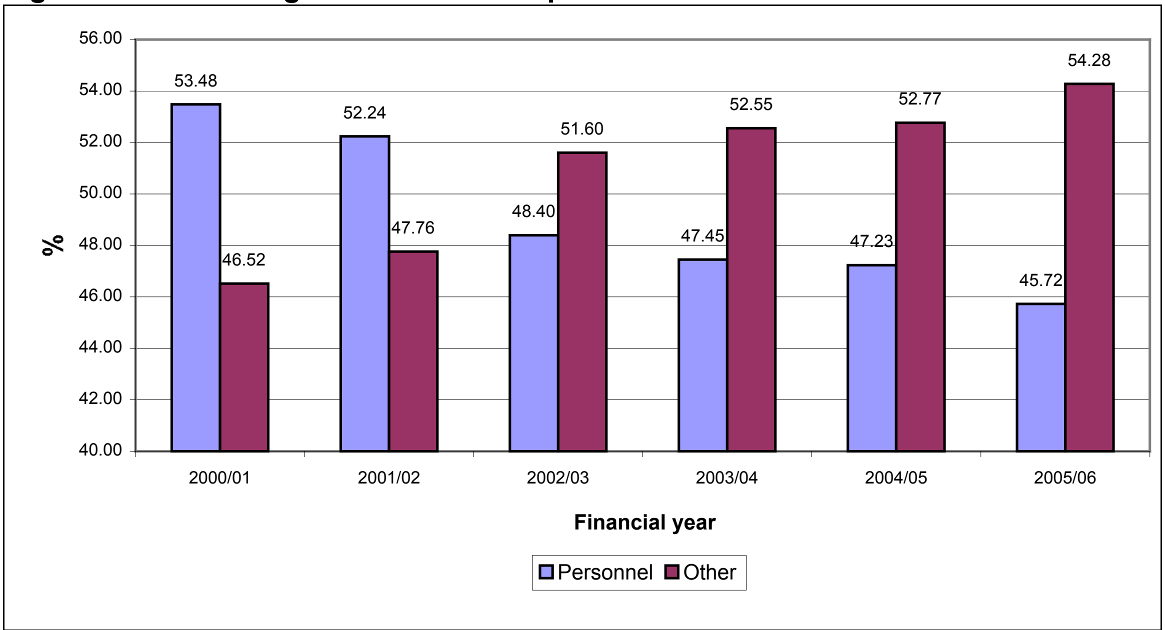
There are encouraging signs that the amount of unspent funds be rolled over to the next financial year will decrease over the medium term, provided that allowance is made to reassign funds between programmes during the financial year. Historically the departments of Transport and Public Works, Housing and Social Services and Poverty Alleviation have posed the biggest challenge in this regard. The Province has managed to turn around an 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 and R0,308 billion in 2002/03.

Despite efficiency gains, underspending translates into less service delivery than would have been possible if the full budget had been spent. To safeguard service delivery levels, R101 million of the 2002/03 underspending was declared a compulsory saving for spending in the 2003/04 financial year. In terms of over-expenditure at departmental level, the departments of Health and Social Services and Poverty Alleviation continue to pose a challenge to the provincial drive to improved efficiency.

Personnel vs. non-personnel expenditure

The sharp decrease in the portion of personnel expenditure of the total expenditure is mainly due to the sharp increase of social security and some recovery on infrastructure spending. From a provincial perspective it is difficult to manage down personnel expenditure, due to ICS (salary increases) being negotiated nationally. Even though general salary increases have been in line with inflation, rank and leg promotions, the increasing cost of medical aid, general promotions and general wage drift have resulted in rising unit labour costs.

Figure 2.1: Percentage of Personnel Expenditure vis-à-vis Other



In real terms (2000/01 Rand value) the Province spent R6,157 billion on personnel in 2000/01 compared with ± R6,032 billion in 2002/03. This was achieved by reducing the number of personnel employed from 68 253 in April 2000 to 67 410 in April 2003. The average cost in real terms per incumbent (2000/01 Rand value) in terms of total personnel expenditure increased from R90 215 to R94 837 (over the same period based on the personnel expenditure provision in 2003/04).

There are currently 14,86 provincial public servants per 1 000 of the population in the Western Cape. The average for the country as a whole is approximately 15,6 provincial public servants per 1 000 of the population. However, research still has to assess what the optimal personnel complement should be and what the composition of such a workforce has to be in order to ensure optimal service delivery within available means.

In 2002, Government and Labour unions signed a restructuring agreement (Resolution 7 of 2002) focusing on redeployment and retraining, paving the way for retrenchments where necessary. To date this resolution has not resulted in a significant number of people being redeployed or retrenched. The Resolution was to be terminated in June 2003 but extension has been granted until September 2003, with a further grace period until June 2004 for those declared in excess, to leave the public service.

Many of the key services delivered by the provincial government, such as Education and Health, are very labour intensive. Personnel expenditure in Health consumed 62% of the 2002/03 Health budget (63% in 2001/02), whereas in the case of Education this figure was 85,5% (87% in 2001/02). Overall personnel expenditure consumed 48,40% of the total Provincial budget in the 2002/03 financial year. This compares favourably with the 53,48% spent on personnel in 2000/01 and 52,24% in 2001/02.

The improved ratio of personnel expenditure compared to other expenditure and social sector expenditure is however under pressure because of the 8.5% ICS increases (effective from 01 July 2003). Added to this is the pay progression system also introduced from 01 July 2003, which amounts to approximately 1% of the wage bill. Another challenge would be to keep the expenditure on personnel within reasonable limits to allow room for spending on other categories such as learner support material, roads, etc. The challenge is also to define such a balance, as some provincial services such as Education and Health can only be delivered in a labour-intensive manner.

From a generalised human capital argument it could be argued that, because of the loss of personnel in the Western Cape Government in previous years, the capacity is not what it used to be in previous years. Some provincial departments were restructured during the current financial year as part of the Public service co-ordinating bargaining council's (PSCBC) Resolution No. 7 of 2002 (the framework agreement for transformation and restructuring of the public service).

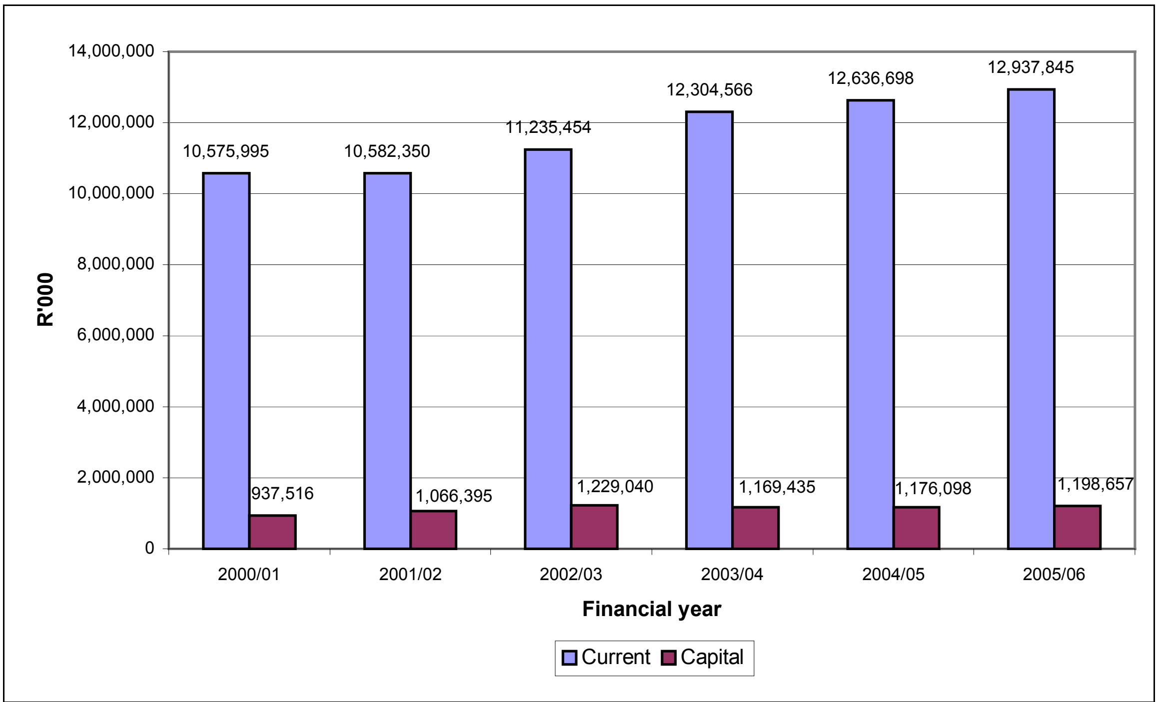
The challenge for the provincial government is to build capacity and to prevent further loss of expertise to ensure effective service delivery. The other side of the challenge is to deepen the knowledge base without significantly increasing the number of personnel. The emphasis should be to employ personnel with the required skills and competency and to build the required skills and competency within the existing staff complement who may be more amenable to transformation to enable the provincial government to cater for challenges in the public sector in the 21st century.

A further challenge facing the provincial government will be to deal effectively with the impact of HIV/Aids on its employees. Unfortunately, little information is available on the prevalence of HIV/Aids amongst provincial employees. Further research will therefore be required to properly manage the possible impact of HIV/Aids on provincial service delivery as well as the cost thereof. It is, however, generally understood that the age group most susceptible to the virus is the group aged 19-49 years. Approximately 70% of the Province's employees fall into this age interval, making it a highly vulnerable organisation. To emphasise the commitment to its employees, the Province has developed and signed a policy framework on HIV/Aids in the workplace in collaboration with organised labour. Arising from this agreement, an organisation and establishment investigation was recently conducted to ensure that the Province has a dedicated human resource capacity for the development, implementation and monitoring of a HIV/Aids workplace policy and programme for the organisation and its employees.

Capital vis-à-vis other

Capital expenditure increases from R0,94 billion in 2000/01 to R1,61 billion in 2005/06 in nominal value. However, in real terms (2000/01 Rand value) the increase is only from R0,938 billion to R1,2 billion. Given the major backlogs in buildings (classrooms, upgrading of hospitals, road infrastructure, housing, etc.), it is clear that with the current allocations the Province will not be able to address the need in infrastructure. Again the limited provision for capital is as a result of the crowding out-effect of the increases in the social security expenditure.

Figure 2.2: Capital vis-a-vis Other (real 2000/01 Rand values: R'000)

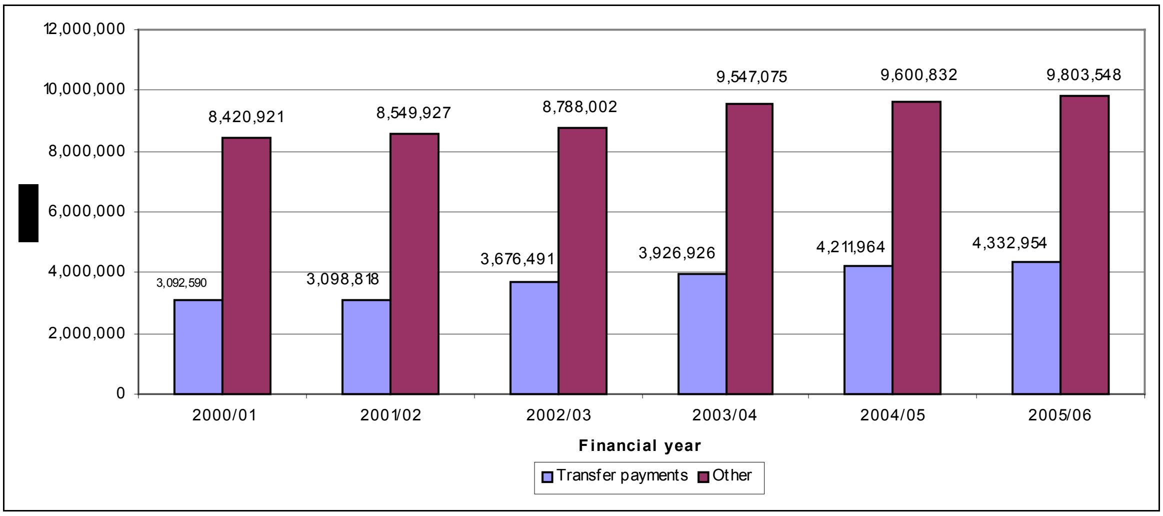


Although there has been some recovery in capital spending, the current level would appear to be inadequate either to address the backlogs that have accumulated or even to preserve the current stock. A new approach to this dilemma might lie in analysing the value of provincial property stock more innovatively. Infrastructure needs should be aligned and integrated with the provincial accommodation plan, strategic plan and budget of a department and should be based on technical, economic, socio-economic and demographic factors.

Transfer vis-à-vis other

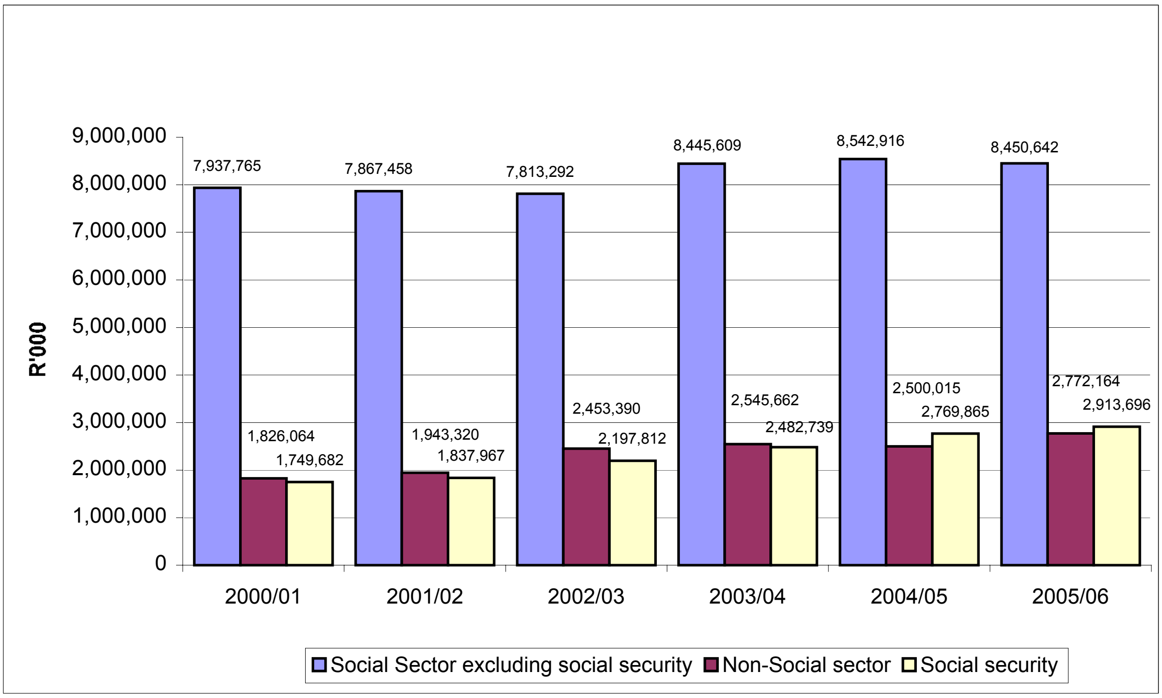
Transfer payments increases in nominal terms from R3,09 billion in 2000/01 to R5,82 billion in 2005/06, which translated into a real increase of 40.1%. This is almost exclusively due to an increase in the number of social security beneficiary numbers and the resulting increase in social security grant expenditure. The main cost drivers are the growth in disabilities and child support grant numbers.

Figure 2.3: Transfers vis-à-vis Other (real 2000/01 Rand value: R'000)



The sharp increase in transfer payments as a result of the increase in social security expenditure is crowding out expenditure on other categories of provincial expenditure to such an extent that those services are deteriorating. This challenge will heighten in future years, especially if the growth in the population in the Western Cape and the growth in the demand of its services is taken into account.

Figure 2.4: Social sector (excluding social security transfers), non-social sector and social security transfers (Real 2000/01 Rand value: R'000)



In Figure 2.4 above, Social Security is isolated from the social sector in order to get a better understanding of what the main driver in the increase expenditure is in the social services sector. From Figure 2.5 it is clear that the social sector (excluding Social Security) remains almost constant in real terms. Only increasing from R7,938 billion in 2000/01 to R8,451 billion in 2005/06, while Social Security increases from R1,750 billion to R2,914 billion over the same period. Social Security overtakes the non-social sector, as the non-social sector only increased from R1,826 billion to R2,772 billion over the same period.

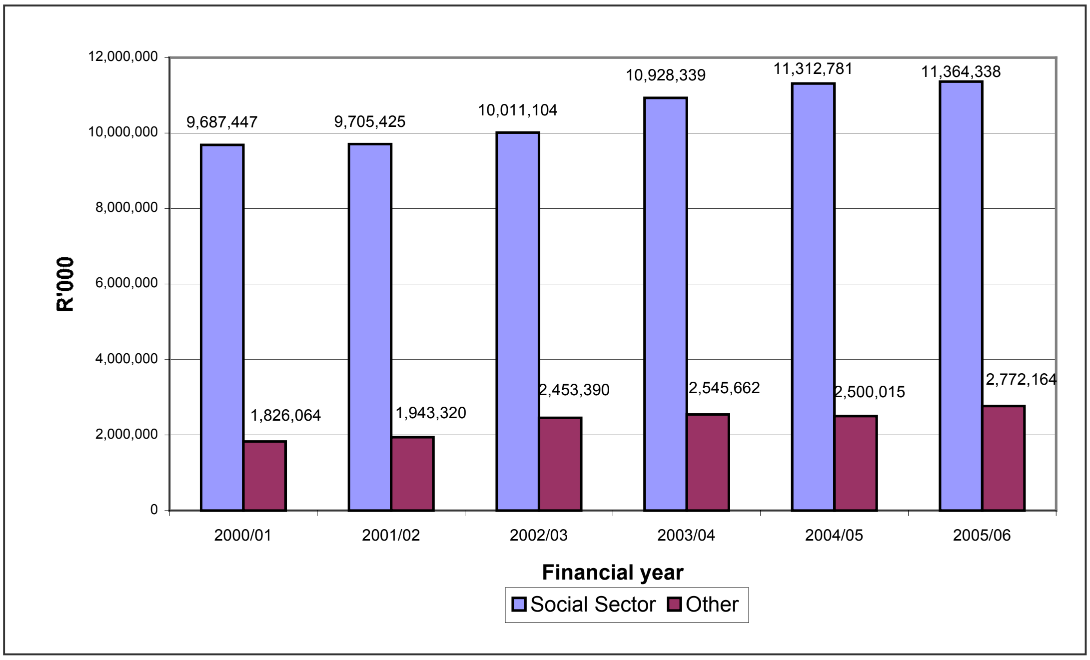
From the aforementioned, it is also clear that Social Security remains the main beneficiary from transfer payments as its share of transfer payments increased from 56,58% in 2000/01 to 67,25% by 2005/06. As the growth on Social Security remains strong, it might be required that the provision therefore be augmented which will even further increase its share of the transfer payments of the social sector and in fact the Provincial budget.

The other main beneficiaries of transfer payments, quoted in nominal values, are the housing subsidy programme R423,282 million, Local government R295,843 million, subsidies to schools R234,463 million and provincial public entities R103,800 million, as budgeted in 2003/04.

Social sector vis-à-vis other

In nominal terms, social sector expenditure over the period 2000/01 to 2005/06 has grown from R9,7 billion to R15,3 billion, which relates to real growth of 17,31%. While Health and Education salaries make up a large component of it, the biggest contributor to the growth in expenditure in this sector is the social services security grants.

Figure 2.5: Social sector vis-à-vis Other (real 2000/01 rand values: R'000)



The social sector[17] budget (excluding Information Technology and Works), as a proportion of the Provincial budget, has declined from 84.14% in 2000/01 to 80.39% in 2004/05. Consequently the expenditure on the remainder of the Provincial budget increased from 15.86% to 19.61% over the same period. The improvement in the ratio to almost 80:20 (2002/03) between the social sector compared to other expenditure is, however, under pressure from social security grant payments, and the impact of HIV/Aids on Health and Social Services.

Non-social sector expenditure will have increased in real terms from R1,826 billion in 2000/01 to R2,772 billion in 2005/06; a moderate growth over this period. Expenditure for the period 2001/02 to 2003/04 is, however, inflated by the provincial contribution of R142 million towards the Cape Town International Convention Centre.

In terms of the 1996 Census figures, per capita health expenditure, excluding conditional grants, as a percentage difference from the national average indicates that the Western Cape has moved from a high of 21.3% above the national average in 2000/01 to 14.7% above in 2002/03. This downward trend is set to continue to 12.8% by 2005/06. Calculated on 2001 Census figures, the Province's per capita spending on health is even closer to the national average. The number of personnel in the health sector also decreased from 26 576 in 1998/99 to 23 977 in 2003/04. As the patient load appears to increase, the deduction can be made that the department of Health, and in particular its personnel, are becoming more efficient quantitatively.

In addition, the average length of stay for district hospitals in the Western Cape is 2,6 days (the lowest in the country) while the average for the country as a whole is 4,2 days. The bed occupancy is at 65.0% (second highest) while the average for the country is at 57%. From the aforementioned, it appears as if the Health Department is reasonably efficient at district hospital level. However, it also indicates that there is room for improvement regarding the occupancy of district hospitals.

In *Education,* the Province's average expenditure per learner compared to the rest of the country has decreased from 21.74% above the average in 1999/00 to 14.52% in 2002/03. This realignment can be contributed to, amongst others, high transportation cost of learners, hostel accommodation cost and the larger proportion of better-qualified educators. The educator to administration personnel ratio is also very low at 3.3 (third lowest of the provinces), while the average for the country was 5.7 in 2001. The percentage of the department's total budget consisting of personnel expenditure has, however, decreased from 86.4% in 1999/00 to 83.8% in 2002/03. This is a welcome trend as it releases funding for other expenditure such as learner support material. This ratio will be under renewed pressure in the outer years (2004/05 and 2005/06) of the current budget, as the personnel share of the education budget will again increase.

Social grants as a percentage of total s*ocial services*[18] expenditure has increased from 78.8% in 1999/00 to 84.4% in 2002/03. This compares well with the national average that increased from 83.2% to 87.2 over the same period. The result is that Social Services

[17] The Social Sector refers to the departments of Health, Education and Social Security and Poverty Alleviation
[18] Departments of Health, Education and Social Services and Poverty Alleviation

has a greater percentage of its total budget available to spend on other welfare services than their provincial counterparts. The increased percentage of social grants compared to the total budget is due to the sharp growth in social grant beneficiary numbers, from 248 015 in April 1998 to 501 126 in March 2003, while at national level it grew from 2 429 653 to 5 617 151 over the same period. The personnel expenditure for the department only grew from R113 million in 1999/00 to R150 million in 2002/03, implying greater efficiency. The cost to administer the grant in the Province is also the lowest of all the provinces at R16,73 (compared to the national average of R24,28).

Conclusions and future work

Overall expenditure trends relative to budgets show declining levels of underspending, but burgeoning social security and health expenditure. The former is slowly coming under control but the latter still unstable. However, Health, Education and Social Services and Poverty Alleviation have all shown signs of improved efficiency.

As was indicated above, these analyses are still at a very basic level of refinement. In the following years more sophisticated analyses would be required on:

- *Personnel*: For instance the relative shares, levels, categories and composition, hidden personnel costs, driving forces and the degree of human capital wealth accumulation.
- *Transfer payments*: Recipients, performance, efficiency of alternative delivery systems, sidestepping of accountability, hidden and distorted costs and results. More detailed analyses of non-social security transfers particularly to local authorities would also be required to test the efficiency of this delivery mechanism.
- *Capital expenditure*: More detailed analyses.

Taking account of the above and given the limited resources over the MTEF period and the non-affordability of inefficiencies in delivery systems inclusive of human capital and asset utilisation, it is clear that efficiency within departmental activities must be enhanced and promoted – an issue which can no longer be avoided.

To this end the effectiveness of efficiency control structures within departments and their institutions need to be assessed. Due to the magnitude and complexities of provincial activities as a whole, it would be appropriate to assess institutions where expenditure pressures are the most significant. Taking this into consideration, the three central hospitals would probably be the appropriate choice to start with. Lessons learned can be shared with other hospitals and departments.

By taking only the number of personnel into account it can be deduced that the departments of Education and Health are dependent on an efficient workforce to deliver cost-effective services, that means working productively with minimum wasted effort or expense. It would thus be appropriate to do an employee efficiency assessment within these departments but limiting the assessment to a sample in selected schools in the case of Education and primary health care services in the case of Health.

A manner in which efficiency can be promoted and enhanced is through the application of proper incentive and reward systems. Although the legislative framework provides for this, the application thereof needs to be assessed to reap the benefits of the enabling provisions. An appropriate departure would be to assess the functioning of reward systems in Transport and Public Works due to the magnitude and cost of infrastructure investment, in Health due to the complexities and cost related to the health delivery system and in Education due to the magnitude of the educator workforce employed.

The outcome of these assessments with the focus on remedies and lessons learned should be shared with other departments and institutions in an appropriate manner.

Key priority areas by department

The previous two sections assessed efficacy and efficiency at a strategic, interdepartmental level. The full spending priorities of each department (Provincial parliament vote excluded) were assessed during the recent Medium-Term Expenditure hearings (MTEC) and the following key priority areas were agreed to:

Provincial administration

Firstly, a key strategic leadership and co-ordination role for this department, via the cluster system and the to be reconstituted Provincial Development Council. It also has the responsibility for the overarching formulation and consolidation of the *iKapa elihlumayo* strategy.

As regards the cluster system, the department needs to consolidate its leadership role in the cluster system and refine the strategic leadership roles ascribed to Education, Economic Development and Tourism, Transport and Public works, Environmental Affairs and Development Planning as well as Social Services and Poverty Alleviation. In furthering their efforts, each cluster should establish a clear framework for the roles of each partner, levering the budget within the entire sector to better effect in order to achieve the goals the cluster has set for itself.

Secondly, the need to efficiently incorporate the KEEG function in order to promote E-government, general greater access into government and the transfer of information to the broad public.

Thirdly, the necessity to formulate and implement an internal human resource development strategy so that provincial personnel are adequately skilled and orientated to tackle the challenges ahead.

Fourthly, the need for a credible IT budget including the introduction of processes fostering greater acceptance of responsibility for cost drivers by departments in order to prevent moral hazard, without abrogating the principles enshrouded in Budget Statement No. 1 of 2003. Examples of these would be the required shift of SITA costs for the major crosscutting financial systems (BAS, Persal and Logis) and the responsibility for the Electronic purchasing system (EPS) to Treasury as these costs have escalated without IT being able to control them.

Fifthly, the demands on legal capacity have increased as the demands by our Constitution, new legislation and the increasing needs for due diligence in contractual and administrative practice have increased considerably.

Sixthly, the clean-up of pre-1994 remnant components (such as translation and security services) in order to increase focus. These components should be shifted to the appropriate line departments in order to enhance specialisation and synergy.

Treasury

Firstly, to realise the desired fiscal aspects of the *iKapa elihlumayo* drive and to build macro-economic and analytical capacity in partnership with lead departments (Education, Social Services and Poverty Alleviation, Agriculture and others as they develop). Such partnership would allow better engagement with national and local spheres as regards both financing and optimum service delivery.

Secondly, to complete its restructuring in order to facilitate greater efficacy of resource use and build internal audit capability for the Province as a whole. These improvements would reduce risk and increase efficiency leading to better financial governance, including getting a handle on hidden liabilities in accounts that are as yet not fully resolved.

Thirdly, to ensure economic growth and transformation through procurement by better targeting, co-ordination of departmental efforts, strategic sourcing and facilitating and guiding better asset management with the immediate focus on the property portfolio and its integration with Housing's property portfolio as levers for development and revenue sourcing.

Fourthly, Treasury has to ensure better utilisation of IYM[19] processes in order to control and direct expenditures and revenue generation.

Lastly, Treasury has to play its designated role around the implementation of the MFMB[20].

Community safety

Firstly, an intensive concentration on one of the few receptive areas for crime and trauma reduction, namely motor vehicle accidents. They would also need to introduce systematic interventions after due analyses and liaison with Health in order to lower the intensity and incidence of these accidents.

[19] In-year-monitoring
[20] Municipal Finance Management Bill

Secondly, to continue to build social capital through crime preventive actions in liaison with Social Services and Poverty Alleviation, the social cluster and the Department of Local Government.

Thirdly, it should assume a strategic role in the Province as regards safety and security issues. A first step would be the transfer of security services from Provincial Administration to Community Safety.

Education

Firstly, a concerted and highly publicised shift towards outcome-directed education as the main driver for raising the levels of human capital in the Province. The first priority should be the learners currently in its care. Subsequent to that, it should address the skills levels of the broader community in conjunction with the Departments of Economic Development and Tourism and Health. The latter would involve the broad co-ordination and integration of human capital formation in the province.

Secondly, systematically contribute towards building social capital in conjunction with the Department of Social Services and Poverty Alleviation and its other social sector partners.

Thirdly, optimise learner needs (teachers, classrooms, material) given changes in demographic trends and policy developments.

Health

Firstly, the active and systematic implementation of Healthcare 2010. These efforts would include finding appropriate ways of sustainably running the central hospitals and ensuring predictability in expenditures within the budget framework for Health.

Secondly, innovative management of new health policies and policy changes, including the new Health Bill, to manage budget pressures adequately and appropriately redirect services.

Thirdly, finding solutions for taking over primary health care services currently rendered by municipalities, although as with libraries and museums, part of this load will have to be borne by the Province as a whole.

Fourthly, dealing with anti-retroviral therapy and other issues related to HIV/Aids. The national 2004-budget framework provides for the equipping of the Health sector to handle the pressures of HIV/Aids in line with the policy framework as approved by the National Cabinet.

Fifthly, scarce skills, rural allowances and free care for disabled patients.

Lastly, the scaling up of spending on physical infrastructure partly through the Hospital Revitalisation Grant and partly through the Provincial Infrastructure Grant. Additional resources should be mobilised through the provincial property portfolio.

The above commitment gives Health a key responsibility in building social capital in the province.

Social Services and Poverty Alleviation

Firstly, to be the prime driver behind building social capital in association with other partners. The department should co-ordinate and direct the nine provincial departments currently involved in providing a safety net, job creation and poverty alleviation services of some kind. More broadly, there is a necessity for a joint research programme with the Provincial treasury to obtain a better understanding of the nature and location of poverty in the Province.

Secondly, finding ways of managing an appropriate and sustainable level of social security grants that takes account of the drivers behind it and the linkages to economic generative and other development efforts. Current trends in beneficiary numbers for social security grants (especially the Disability Grant, which is currently growing at an annualised national rate of 41%) will cause significant budgetary pressures if not managed appropriately.

Housing

Firstly, Housing has to find ways to overcome present obstacles in the housing delivery system as the build-up in unspent housing funds will further add to social miseries. In pursuance of this effort, the department has to properly define the role of municipalities in achieving an efficient housing delivery system that is also optimally targeted and conducive to spatial integration. As such, Housing has a key role in implementing the Strategic Infrastructure Plan.

Secondly, to examine and exploit the gearing possibilities locked away in housing property portfolio together with Transport and Public Works.

Thirdly, the speedy clearing up and closing down of the Housing fund and transferring assets and liabilities into the department's books.

Environmental Affairs and Development Planning

Firstly, the development of a spatial development framework for the Province within shorter timeframes than initially planned in order to guide both the micro-economic and infrastructure strategies to be developed.

Secondly, the improvement of approval processes for developmental planning applications. Also to create an environment conducive to business and development endeavours in conjunction with Cultural Affairs and Sport as well as Economic Development and Tourism.

Transport and Public Works

Firstly, the development of a provincial infrastructure strategy that includes municipalities and maximises economic growth and development. This endeavour would have to include the five-year Accommodation plan that is nearing completion, but would have to differentiate construction and maintenance priorities between Education and Health, and again between them and the balance of the departments, in such a way that it meets the overall aims of the infrastructure strategy. This would entail careful demographic and economic analyses incorporating the ideals of sustainable job creation, optimal growth results within a spatial plan, co-operative governance, improved access and the maintenance of technical standards.

Secondly, the development of the provincial property portfolio as an important funding source for infrastructure investment, particularly those associated with building construction and revitalisation and maintenance. Also finding a quid pro quo on service charges with municipalities and making sure that the funding for municipal property taxes, currently locked up in the national public works department, is transferred equitably to the Province. Alternatively, to ensure that the national department picks up the tab for municipal property taxes. All this points to a more pro-active role for this department.

Agriculture

Firstly, in collaboration with Economic Development and Tourism, to find the best balance in the provincial agricultural economy that will maximise economic growth, development and employment. This would include finding alternatives to labour agencies that tend not to be conducive to human capital growth and the skilling of farm labour.

Secondly, better alignment of its budget with that of Land Affairs in order to further promote sustainable land reform.

Local Government

Firstly, driving the concept of developmental municipal governance with special emphasis on the designated nodal areas, and integrating these efforts with those of the Province under the ambit of *iKapa elihlumayo* as well as assisting municipalities in obtaining the alignment of IDPs with their budgets.

Secondly, finding the best way, inclusive of further restructuring, of dealing with the co-ordination issues between municipalities and between the latter and the Province so that the ideal of integrated government can be realised.

Thirdly, to build the tools and structures of the provincial/local government interface to promote governance, co-ordination, development and communication between the two spheres. This would also include the fulfilling of the department's designated role around existing and future local government acts.

Fourthly, finding alternatives to community workers, as they appear not to be fundable.

Economic Development and Tourism

Firstly, it has to be responsible for developing and implementing a micro-economic strategy for the Province as a whole. As such, it should be the main driver behind the development and implementation of economic interventions within the economic cluster.

Secondly, it has to transform the *iKapa elihlumayo* provision on its budget to achieve real progress at the micro-economic level as regards film studio, tourism, job creation, HRD, increased economic participation, easier ingress into the economy, sustainable entrepreneurship, opening up of market opportunities, etc.

Thirdly, the creation of a regulatory environment together with municipalities that would be conducive to sector growth particularly in small and medium businesses.

Fourthly, restructuring Wesgro to facilitate all of these aims with specific reference to trade and export promotion.

Cultural Affairs and Sport

Firstly, building social capital and integrating society in liaison with Social Services and Poverty Alleviation.

Secondly, finding solutions for taking over municipal rendered library and museum services in 2007 after suitable reduction (roughly 50%) in these services and reductions within its own environment with the balance spread throughout the Province.

Thirdly, its heritage responsibilities will have to be developed, because of its stated impact on development.

Fourthly, to sustainably and fully take over the responsibility from its national counterpart for archive services from 1 April 2004.

3

FINANCIAL GOVERNANCE ISSUES

Apart from the socio-economic and delivery issues, cognisance needs to be taken of the contributions that better financial governance can make towards greater efficiency, apart from creating an environment that is conducive to both better service delivery and appropriate targeting of the latter.

The contribution of financial governance will be discussed under two headings, those that contribute mainly to efficiency and those that can also contribute to socio-economic growth. On an overall anticipated budget for the new financial year of around R18 billion, any improvement in efficiency would result in real money that could be released for a greater quantum of service delivery.

Facets of financial governance that have as main emphasis improvement in greater efficiency and performance

Accounting

Good accounting is a prerequisite for providing credible information, proper performance of the management function and improving accountability. New challenges have arisen in the form of developing interpretative accounting skills, successfully incorporating the development of Generally recognised accounting practice (GRAP) by the Accounting Standards Board in day-to-day business operations and consolidating all financial transactions into one report. The implementation of the new standard chart of accounts (SCOA) offers a reflection on the broad strategic shifts that have to be accommodated within the new MTEF period starting on 1 April 2004.

Specific goals include actively developing the analytical capacity of officials in the Provincial treasury, identifying and recording unfinished business emanating from previous government dispensations and organisational restructuring in the Province. In addition, much better links have to be established with other disciplines in financial management, such as budgeting, cash management and financial systems.

To improve accounting standards, efforts will be expanded to enhance the exposure and quality of training and information sessions of financial and other personnel to ensure quality financial statements, as well as the future consolidated Provincial version. This is to be augmented by a number of other steps such as providing on-line assistance via the website of the provincial treasury, actively participating in the task teams of national treasury, expressing viewpoints in the provincial interest and to gain first hand information on new developments and building capacity.

Other actions in strengthening accounting standards would be to continuously identify, develop, implement and monitor accounting best practices in provincial departments in order to ensure sound financial management, to arrange proper training and prepare to successfully implement the new SCOA on 1 April 2004, as well as the maintenance and further development thereof in conjunction with the switch-over to the Basic Accounting System (BAS) as from the same date.

A renewed focus on accounting systems is required to ensure that provincial departments clear all suspense and control accounts of unwarranted balances prior to migrating from FMS to BAS on 1 April 2004. It would also further develop the monitoring of the state of accounts of provincial departments and the IYM reports, including the building of a proper database of IYM information for analytical and further reporting purposes. Another issue is the effective closure of the Western Cape Housing Development Fund (WCHDF) and the transfer of assets and liabilities into the Provincial Revenue Fund configuration.

A neglected facet of financial management has been the management of assets. From an accounting perspective, new efforts are necessary to monitor and ensure that the compilation of departmental asset registers progresses in accordance with requirements and timelines to achieve the full recognition of all assets in the annual financial statements by the 2004/05 financial year.

Another goal would be to assess the effectiveness of the roads maintenance management system (costing system) against the criteria of system accuracy, the reliability of the system, interfacing of financial transactions with BAS and to gauge the effect of the new SCOA thereupon.

Given the intention to replace the current legacy systems within the public sector (national and provincial spheres) with a new integrated financial system, particular attention would have to be given to incorporate the initiatives on the accounting front and meaningful inputs would have to be developed to ensure this.

Another challenge is to provincially initiate and manage the change from so-called trade accounts to trading entities as envisaged by the PFMA[21] and in so doing consult and participate in the development of national accounting frameworks related to this migration. As precursor to this, the management of current trade accounts have to be enhanced to achieve an annual break-even point, to develop and implement monitoring mechanisms and a database to analyse the financial performance of the current trading accounts and appropriately report on results and design and put in place a monitoring mechanism and a database for analytical purposes to ensure that all accounting transactions from subsystems interface with BAS timeously and accurately.

[21] Public Finance Management Act (Act 1 of 1999)

On the reporting side, more attention needs to be given to building a proper database of financial information on provincial public entities in order to monitor and analyse financial performance, accounting policies and practices against the PFMA and NTR[22] requirements and possible accumulation of surpluses or deficits.

In a similar vein, the Provincial treasury should also ensure that an accounting officer who transfers funds to public entities obtains written assurance from that specific entity that it implements effective, efficient and transparent financial management and internal control systems.

In general, reporting needs to be enhanced by further developing the formats of and information presented in annual financial statements by all spending agencies, including the Provincial Revenue Fund, to improve the analyses and interpretation thereof for performance management and future planning. For this to succeed, books of account of departments have to be in a healthy state and the information provided has to be consistent, on time, accurate and relevant.

To be able to close the chapter on longstanding uncleared accounts that date back prior to the advent of the new constitutional democracy in April 1994, as well as transactions that relate to the formative years of this and other provinces, further intensive energy has to be spent to resolve the balances of the FMS[23] Departments 15 (Education) and 70 (the remnant of the balance of departments reflecting their accounting transactional history) prior to the final closure of the FMS accounting system on 31 December 2004.

A major stumbling block to the successful execution of all of these goals is the building and retention of sufficient accounting capacity. Both within the Provincial treasury and departments there are accounting capacity constraints. The Treasury guidelines pertaining to the organisational structure of the CFO[24] function in departments are aimed at addressing many of the constraints experienced by departments. However, indications are that it could take some time before departments employ the appropriate staff members, since vacancy rates are currently very high, ranging at a 35% average for all departments.

[22] National Treasury Regulations
[23] Financial management system
[24] Chief financial officer, generically incorporating management and financial accounting, supply chain management and internal control/risk management.

Table 3.1 reflects the vacancy rates within CFO structures as reported and serves as an indication of areas of anticipated instability.

Table 3.1: Vacancy rates within CFO components

Vote	Department	Approximate % vacancy rate within CFO components
1	Provincial administration	39
2	Provincial parliament	Not available
3	Provincial treasury	22
4	Community safety	6
5	Education	25
6	Health	4
7	Social Services and Poverty Alleviation	13
8	Housing	40
9	Environmental Affairs and Development Planning	15
10	Transport and Public Works	48
11	Agriculture	30
12	Local Government	*95
13	Economic Development and Tourism	75
14	Cultural Affairs and Sport	50

* Chief financial officer support services provided by the department of Housing to the department of Local Government on an agency basis.

In order to develop basic accounting capacity and most necessarily the more advanced interpretive accounting skills within Treasury and departments would require more innovative recruitment, development and maintenance of appropriate accounting skills than has been accomplished so far. In turn this will place greater demands on a human resource management system which has to be able to deal with the challenges of a modern public service system, capable of adapting to the increasing frequency of changes and able to compete with the best in the global marketplace.

Systems

The overall strategic approach would be to improve on the functioning of the current legacy of systems until such time as national treasury finalises its design and development work on the replacement of these systems with an integrated one. Thus one of the main drawbacks, the inherently stand-alone nature of the present systems, in spite of many interfaces between them and other systems, is overcome.

On account of the high cost of maintaining two financial systems and the non-compliance of FMS with current requirements, the national treasury has taken a policy decision to migrate all FMS departments/provinces to BAS by no later than 1 April 2004. This would put an end to the role of FMS as the main financial system for government (national and provincial in their various constitutional guises over time) for nearly 30 years. A very stable system, this was first introduced into government in 1975, commencing with the then national department of Agriculture. The sun is finally due to set on FMS on 31 December 2004 to allow finalisation of the 2003/04 financial statements and to resolve any other uncleared transactions, such as FMS Departments 15 and 70 before that date.

The immediate successor, BAS, is a more modern (circa 1992) and on-line system (as opposed to the mainly batch-driven FMS). In preparation for its implementation, key financial personnel have to be trained, the system set for each main user and the coding structure prepared to take account of the new SCOA and the associated programme and item structures of the various departments and the Provincial parliament.

Unfortunately, BAS is still a cash accounting type system and will require modification to convert to an accrual system as that is where the evolvement of GRAP is taking the country. Whether this will occur, as well as the extent thereof, will depend on the speed of the development of the anticipated integrated financial system. When in operation, as with FMS, daily monitoring by the Treasury will still be imperative to ensure that electronic transfers, online enquiries, debtors and other facilities are utilised to their maximum potential; also that interfacing between the various systems (Logis, Persal, Telkom, MEDSAS and the official banker) occurs properly five days a week, and that code files, access control and profiles are maintained.

As for the main accounting systems, the Personnel and Salary System (Persal) dates back many years (1990), and shares the same operational stability. Its main drawback is that has been designed and changed from time to time from a legislative perspective and not from a human resource management one. Amongst others, Persal does not cater for the latest advanced recruiting requirements, skills development and other personnel facilities. Neither does it have an on-line interaction with other systems, such as BAS, Home Affairs, Pensions, etc, to double-check and highlight irregular activities. It lacks an easy interface with scanning facilities, making the capturing of bulk information, e.g. leave forms and returned control pay sheets, a laborious process, raising the risk of errors.

Nevertheless, Persal forms the mainstay of personnel management and accommodates a vast number of daily transactions. To keep it running smoothly, it is the responsibility of the Treasury to continue and sharpen where necessary the daily monitoring of the system to ensure that exception reports and ACB[25] limits are addressed; that computer-generated personnel identification numbers are allocated only in exceptional cases and then replaced with a valid Home Affairs identification number within 90 days; that access control and profiles are checked regularly; and that computer-generated and unique reports are made available for management, budget, cash flow and monitoring purposes.

[25] Automated clearing bureau

Furthermore, a project is to be registered for the verification of Persal data in all provincial departments and repeated annually.

The other partner of the new trilogy of financial systems, the Logistical Information System (Logis) is much newer, dating from 1996, but was also mainly written to comply with the requirements of the then National and Provincial Exchequer Acts. The PFMA, although continuing with many of the standard requirements for procurement, stock and inventory controls, brought a whole new financial management paradigm to the fore. It was no longer sufficient, albeit still necessary, to be adequate in control procedures, but accounting officers are now expected to take into account full cycle costing, appropriateness and timing of goods and services ordered and obtained and the socio-economic implications of their decisions.

In order to assist accounting officers to at least comply with the more basic stipulations of the PFMA, the implementation of Logis in provincial departments was promoted and from 1998 has resulted in being rolled out to 50 institutions with over R1 billion of stock (moveable assets) under its control. The current plan is to finalise the rollout within the Health Department (central hospitals excepted), and which will add another 14 provincial institutions by the end of 2004/05.

The decision by the national treasury to stop all new enhancements on Logis resulted in Logis not being able to accommodate the Auditor-General's reporting requirements regarding an asset management system. To overcome this and departmental capacity problems, the Provincial administration has piloted the acquisition of an asset management service on a tender basis. This may well overcome some of the key drawbacks of Logis as the service includes bar-coding (ironically this facility has been developed for Logis but not put in use), inventory control, stock take, depreciation, age analysis and quarterly updates of the inventories, with the department retaining the ownership of all of the data. Provincial treasury is investigating the possibility to expand this service to all departments as well as introducing an interface with Logis to facilitate automatic update of its inventory/stock database.

Financial asset management (cash flow)

Treating cash flow as an important financial asset has resulted in an important change in approach to this asset. It is no longer deemed sufficient merely to ensure adequate balances in mainly departmental banking accounts to effect payments due that day, with investment as a side effort. The shift has been to extract the most return from the pattern of cash flows through the Province's banking account configuration with each year seeing further refinement. This change in approach has seen growing returns from investment operations and without which the Province would have been in dire straits from the constant downscaling of both its equitable and conditional grant shares from the national fiscus. Over the current MTEF, proceeds from this source will contribute close to R1 billion to the bottom line, making continued infrastructure spending possible as well as introducing catalyst funding to foster the inculcation of *iKapa elihlumayo*.

The recent move to full electronic banking and the total abolishment of cheque payments has further improved upon this trend. Further challenges entail refining this process to make payments only on the exact due dates and not before, improvements in cash flow projections and cash flow utilisation by departments and better management of transfer payments. The objective is to achieve a more even and predictable expenditure spread over the financial year, gaining both better price and interest earned advantages.

The following considerations, once achieved, will significantly contribute to the refining of cash flow procedures but remain as current challenges:

- The training of the relevant officials within the provincial departments in order that they provide the Treasury with accurate cash flow information on a daily basis is a high priority. Increased accuracy equates to a significant increase in the efficiency levels of the overall provincial cash management process.
- The ultimate challenge however is to ensure that the various banking accounts within the Provincial revenue fund remain minimally cash positive and that no overdrawn situation occurs at any time.

In spite of these initiatives, including the development of a specific provincial investment policy that balances return against risk, national actions could in future impact negatively on the quantum of interest earnings, the first being the lowering of interest rates by the Reserve Bank and the second, moves by the national treasury to reduce the amount of cash available for investment. The national treasury has initiated a plan where the equitable share and conditional grants earmarked for provinces has to be credited directly to an account held at the Corporation for Public Deposits (CPD).

This mechanism has not been finalised but, if fully implemented, provinces will be requested to keep their excess cash that is not immediately required in the CPD accounts, which will then investing excess cash on behalf of provinces. With this process there is a real risk that the interest earnings will be substantially less than is currently generated.

A further initiative proposed by the national treasury is to limit the equitable and conditional grant transfers to provinces in accordance with provincial expenditure. This will result in provinces not having access to excess funds and therefore not having the means for investment purposes, negatively affecting interest revenue generation for the Province and removing an important cushioning tool to deal with diminishing revenues from the national fiscus.

Table 3.2: Annual and projected interest earned on investments

	2000/01 Actual R'000	2001/02 Actual R'000	% Change	2002/03 Actual R'000	% Change	2003/04 Projected R'000	% Change	2004/05 Projected R'000	% Change	2005/06 Projected R'000	% Change	2006/07 Projected R'000	% Change
Interest on investments	147 709	182 206	23.4	244 717	34.3	211 577	-13.5	60 372	-49.8	29 200	-33.3	10 000	-72.0
Interest on current account	2 013	2 620	30.2	5 377	105.2	1 500	-72.1	1 200	-20.0	1 200	0.0	1 200	0.0
Total interest earned	149 722	184 826	23.4	250 094	35.3	213 077	-14.8	61 572	-49.4	30 400	-32.5	11 200	-69.6

Table 3.2 already shows the diminishing effect of lower interest rates and the running down of the quantum of financial assets applied (and to be used) to negate the reducing effect from the equitable and conditional grant shares to the Province on infrastructure spending. If the other national initiatives come to fruition, it is more than likely that cash flow operations will further decrease in importance as a financing source, and other alternatives will have to be sought to replace it.

Normative financial management

Normative financial management seeks to ensure that norms and standards within the legislative framework are developed, implemented and complied with in provincial departments and public entities. This also includes a review and assessment of the application of the entire range of financial legislation, to measure compliance thereto, the degree of overlap or any other inconsistencies.

The PFMA introduced the concept of statutory performance management and subsequent performance budgeting at all levels in a manner, which is transparent and accountable. The latter means actually achieving strategic goals and objectives in an effective, efficient and economic manner and to be held accountable for such achievements. This requires that the management effort is continuously monitored and measured, both internally by departments and externally through the various oversight bodies of which the Provincial parliament is the most important.

Other roleplayers that are meant to assist both the Executive and Parliament in the monitoring and measurement of the expansion of the latter's powers and responsibilities are, internally, the Provincial treasury (through its normative financial management and other units and independently, via its Internal Audit unit and the respective audit committees housed in Treasury, Health, Education and Social Services and Poverty Alleviation) and, finally, externally through the Auditor-General and SCOPA[26].

To ensure an equal distribution of responsibilities, accounting officers have to issue well-documented delegations and instructions in writing at appropriate levels and ensure that these are revised on a regular basis. There are currently inconsistencies in the different levels of accounting officer delegations, generally none indicate which delegation is

[26] The Standing Committee on Public Accounts of the Provincial parliament.

utilised when a function or power is exercised; and where a discretionary delegation is utilised, there appears to be uncertainty of what should be considered.

The implementation of the PFMA has now progressed from mere nominal compliance to trying to achieve actual improvements in financial management, howsoever measured. To assist departments in this regard, and with key inputs from this Province, the national treasury has, as a first phase, developed the normative measures for financial management or better known as the Normative Financial Management Manual. In essence this is a management tool to perfect the basics of PFMA implementation, taking cognisance of the King II Report, other legislation and various guideline documents.

These normative measures allow benchmarking to assist accounting officers with the evaluation of the quality of financial management, and to report meaningfully thereon in their annual reports. In addition, they assist supervisory bodies like the respective treasuries and the Auditor-General to improve on their respective feedbacks to the executive and legislatures.

Critical areas for financial management performance in the public sector that are being addressed are management arrangements, planning and budgeting, revenue and expenditure management, asset and liability management, and accounting and reporting requirements. The achievement of each of these critical areas was evaluated internally within departments, showing clear room for further improvement.

To foster communication and support to departments, a forum of CFOs of provincial departments has been established to share experiences and best practices in financial management and implementing the PFMA and DORA[27], build capacity, act as a technical forum to address common issues such as the role and operation of Internal Audit and audit committees, and strengthen and inform policy processes. In addition, together with IT, the internal treasury website (Intranet) is being rebuilt to electronically provide all reference material for fostering of better financial management. Similar effort together with KEEG[28] is being directed towards building the Treasury component of the eventual Cape Gateway website, a portal of access via the internet to the government's activities and information resources.

Reality suggests that it may be too soon to expect qualitative improvements in financial management and that it remains necessary to expend considerable amounts of effort and energy to achieve sound financial management and thereby ensuring good corporate governance through efficacy and efficiency in public spending and revenue generation.

Internal audit

The general responsibilities of the accounting officer in the PFMA requires that a department must have and maintain effective, efficient and transparent systems of

[27] Annual Division Revenue Act
[28] Knowledge Economy and e-Government currently still housed in the department of Economic Development and Tourism, but to be transferred to Provincial Administration on 1 April 2004.

financial and risk management and internal control, and a system of internal audit under the control and direction of an audit committee. Internal Audit is thus an independent service function assisting management in the achievement of its strategic goals and objectives.

To improve financial management the Internal Audit function, excluding the forensic investigation unit, has been transferred to the Provincial treasury from 1 August 2003 as part of the newly established financial governance component. Its function is to perform risk based internal audits for all departments by:

- assessing/auditing the adequacy and effectiveness of internal managerial and operational controls or governance in a dynamic risk management environment;
- auditing compliance with policies, procedures, laws and regulations, and
- evaluating the effectiveness and efficiency of internal control or risk management processes as well as the economic utilisation of resources.

In order to achieve effective risk management, an accounting officer has to:

- first determine his/her strategic goals and objectives in liaison with the respective executing authority;
- link each objective to processes required to achieve such;
- link risks to such processes and determine the likelihood and impact of such risks;
- attach control measures thereto, and
- evaluate the control measures and then effect improvements to such control measures.

There is obviously a very close relationship between departmental risk management and Internal Audit, as risk management is a departmental responsibility and the assessment of the adequacy and effectiveness of risk management is an internal audit responsibility.

In short, the risk management or internal control unit in a department, has to identify risks attached to operational and managerial processes and implement control measures to minimise the occurrence of such risks. Internal Audit, on the other hand, will assess the adequacy and effectiveness of the control measures identified as well as the systems used to identify such risks and give an independent assurance to the departmental management of its findings.

This whole process has to be monitored by the relevant audit committee and where applicable or if so required, it will report to the relevant accounting officer(s), Provincial treasury or Cabinet.

Considering that the current shared Internal Audit unit has only been 38% capacitated for the past two years and taking cognisance of the risks attached to an organisation with an annual budget of almost R18 billion, shared by 13 different departments and the Provincial parliament as well as approximately 69 000 officials, it cannot be disputed that urgent action is required to ensure that a fully fledged and functional Internal Audit unit/service is established as soon as practically possible and departmental CFO offices strengthened by effective risk management units.

In achieving the above, short, medium and long-term objectives have been established. Over the immediate term macro-risk assessments for nine provincial departments, excluding Health, Social Services and Poverty Alleviation, Education, Provincial Administration and Provincial Parliament, have been compiled covering the areas of budgets, spending areas, previous Auditor-General reports, previous internal audit reports, departmental strategic plans, internal control reports, fraud registers, legislative frameworks and inputs by CFOs.

Each accounting officer has been presented with a synoptic summary of the above and the high-risk processes identified, together with an indication of possible internal audits still to be conducted. Agreement now has to be reached on the number, scope and objective of the identified audits. Subsequent to the above, the shared audit committee will be approached to approve an interim audit plan.

The shared audit committee has been fully established and so too the audit committees for Health, Social Services and Poverty Alleviation and Education are in the process of finalisation. In January 2004 an internal audit charter and an audit committee charter, inclusive of terms of reference, will be considered for adoption by the respective audit committees during a combined induction session. Biannual sessions will also be arranged between the separate audit committees to consider and discuss transversal issues.

Over the medium term (the next three years) the capacity gap is due to be met by an out-sourced/co-sourced tender for an all-inclusive internal audit service to deliver, amongst others, inherent risk assessments for all provincial departments, inclusive of Provincial parliament and internal audits conducted for the most critical risk processes initially identified in the Departments of Health, Social Services and Poverty Alleviation and Education and later for the remaining departments. Over this period a fourth audit committee is contemplated to serve the interests of the Transport and Public Works.

Over the long term fully established and functional internal audit units at Health, Social Services and Poverty Alleviation, Education and Transport and Public Works are envisaged as well as a shared internal service for the remaining provincial departments, which will be housed within the Provincial treasury.

Auditor-General

The Auditor-General fulfils the role of an external auditor to the government and performs a snapshot overview of the financial management performance of the different provincial departments with relation to its annual financial statements and its compliance with laws and regulations.

Although only one provincial department received a qualified audit report from the Auditor-General on its annual financial statements for the financial year 2002/03, a survey was conducted on the emphasis of matter reflected by the Auditor-General on all provincial departments and provincial public entities for the 2002/03 financial year.

The main transversal risks identified by the Auditor-General are poor asset management and asset management systems, ineffective internal audit service and non-functioning of audit committee(s), and non-existence or ineffective risk assessment, risk management or fraud prevention strategies. The biggest risks identified at the three large departments, being Health, Education and Social Services and Poverty Alleviation, are poor internal controls, poor contract management and administration of major contracts.

A risk that needs to be managed, however, or rather monitored, from a Provincial treasury perspective, is the seriousness with which departments consider the emphasis of matter raised by the Auditor-General and their attempts to address such matters. In minimising this risk, financial governance will monitor departmental progress in addressing the emphasis of matter raised by the Auditor-General on a monthly basis as part of the in-year-monitoring narrative report.

Facets of financial governance that have as main emphasis improvement in both greater efficiency and socio-economic results

Supply-chain management

The current systems of procurement and provisioning are fragmented owing to the fact that tender boards are at present responsible for procurement whilst provisioning is largely underwritten by norms and standards within the Logis system driven by the national treasury. The division causes the current systems to be inefficient as far as the method of procurement; logistics management and obsolescence planning are concerned.

Since the advent of the PFMA it has become increasingly important to reassess the aforementioned situation and to develop an integrated approach that largely places the responsibility with the accounting officers of departments.

In addition, more emphasis has been placed on integrated infrastructure development and the unlocking of government property to contribute to the optimising of resources.

Over the last year a vigorous reform initiative was embarked upon together with the national treasury to introduce best procurement and asset management practices to ensure the efficient and effective utilisation of provincial assets. To this end a new and strategically more powerful concept was pursued, namely supply-chain management (SCM).

Supply-chain management can be defined as the collaborative strategy that aims to integrate procurement and provisioning processes, in order to eliminate non-value added cost, infrastructure, time and activities to competitively serve end customers better. The essence being integrated planning of operations, tactics and strategies.

Central to this is the abolishment of tender boards, the elevation of the traditional functions of procurement and provisioning and the placing of the accountability thereof with accounting officers of departments together with the establishment of departmental SCM units in departments, and the pursuance of public-private partnerships as a means to unlocking the property management portfolio.

A major dilemma of the current system of procurement is that it is rule-driven and limits procurement personnel in coming up with innovative procurement practices. The rule-driven approach historically stems from the fear of unlawful practices and the introduction of punitive measures where such rules have been broken. As such it has created a procurement environment in which emphasis is placed on the adherence to rules and minimising possible irregularities instead of encouraging smarter and better procuring and having a more entrepreneurial approach to buying.

The current system of procurement also has the following inherent risks/deficiencies:

- The different markets and their specific requirements are not fully understood;
- Needs/requirements of departments are not properly addressed and therefore not clearly defined and specified, bid/tender documents are not prepared and proper costs and benefit analyses are not implemented;
- The knowledge base of procurement personnel is mainly confined to legislation issued by the Western Cape provincial tender board. Limited contract management skills exist, creating unnecessary budgetary pressures due to the inability to deal adequately with contract price adjustments and rates of exchange claims, and
- Limited knowledge of the legality of contracts increases the Province's risk of possible litigations arising from the incorrect conclusion of contracts.

Taking account of the lamentations connected with the current procurement system, after a year-long preparatory phase, including training and increased exposure of departments to their own decision making, they will henceforth be responsible for the execution of all procurement related functions as from 1 January 2004. In this endeavour they will be supported by the provincial treasury which, in conjunction with departments, has to develop sourcing and procurement strategies which are in line with provincial developmental objectives. Accurate and valid market research methodologies aimed at reducing procurement costs and exploiting economies of scale by arranging of transversal contracts to provide for crosscutting procurement of goods and services would be further Treasury responsibilities. So too, in conjunction with departments, to initiate, co-ordinate and provide technical assistance and training for BEE[29] companies and departments.

The advent of supply-chain management is the culmination of a series of reforms, beginning with the introduction of the Western Cape Preferential procurement policy from

[29] Black economic empowerment.

1 January 2002 and the subsequent compilation of departmental preferential procurement plans to achieve the target set by the Minister of Finance and Economic Development that 40% of contracts be awarded to historically disadvantaged companies for the 2002/03 financial year. Statistics tell us that R345m or 48% of provincial contracts were awarded in this manner.

The second phase was the devolving of greater procurement powers from 1 October 2002 to departments to foster greater accountability. The aim was to create a culture of responsibility and accountability for procurement that would ultimately vest in accounting officers, CFOs and their designated staff. Simultaneously, this phase was used to elevate procurement and provisioning to its rightful place in the financial management environment.

The third phase of procurement reform now entails the full-blown introduction of the concept of SCM to give effect to the letter and spirit of the PFMA by the abolishment of the Western Cape Provincial Tender Board on 31 December 2003.

Concurrently with the introduction of SCM, departments have to be provided with all the mechanisms necessary to enable effective, efficient and proper service delivery, whilst at the same time complying with their socio-economic obligations. Provincial treasury embarked upon a joint initiative with the City of Cape Town to develop a Western Cape Supplier database that enables departments to register and actively manage suppliers and also to monitor the preferential procurement objectives. Features inherent to this database are:

- An accurate, up-to-date source of information on suppliers;
- Validation of supplier information and particulars;
- Updating and maintenance of the database for evaluation of suppliers;
- Electronic assistance with tender adjudication;
- Linkages with the Source Link electronic purchasing system and generating reports tracking the awarding of contracts to HDIs, and
- Keeping record of contracts and official tender documents.

In terms of using government resources to its optimum, the Provincial treasury also employed an electronic purchasing system (EPS), enabling departments to electronically source quotations and send enquiries to a broad base of suppliers. The web-based EPS integrates with the supplier database to automatically calculate preferences based on the quotes received through the EPS. It further provides detailed information on suppliers with a strong focus on reporting preferential percentages. This electronic system has a database of 1 896 suppliers/companies and six non-governmental organisations (NGOs) in the Western Cape linked thereto.

In an ongoing effort to make information accessible to the public, a tender website at *www.westerncape.gov.za/tenders* was launched on 31 March 2003. Apart from having all provincial tenders advertised on this website, it hosts the following information: procurement legislation, departmental contact details, enquiries, e-mail address, information on how to tender and where to get assistance when tendering and successful tenderers and their status.

The introduction of SCM now requires that departments introduce much more innovative and planned ways of acquiring goods and services. This approach will also enable suppliers, manufacturers and service providers operating in a specific sector to economically grow and develop to be more efficient and competitive.

Procurement expenditure forms a substantial part of the provincial budget. It is also one of the few areas of considerable discretion whether to spend and on what. As such it is a high-focus area for sustainable development for the participation and growth of BEE companies.

Another subset of supply chain management is that of physical assets, by and large a very neglected area. Although numerous mechanisms have been put in place to address inefficiencies pertaining to the management of physical assets, these mechanisms have proved to be insufficient and not meeting the requirements of the Auditor-General and more specifically international best practice.

Particular challenges that have to be met include the development of efficient systems for inventory and stock control and management, likewise for asset management and control, the development of transparent and economic practices to deal with asset disposals, and the implementation of economic life cycle and value for money assessment mechanisms.

The effective and efficient utilisation of assets requires the establishment of systems and processes to support the preparation of forward asset strategies and it further involves guiding the acquisition, use and disposal of assets and managing the related risks and costs over all phases of the asset life cycle. To be effective, asset management needs to be considered as a comprehensive and multi-disciplinary activity.

A proper asset strategy provides the basis for the acquisition, operation, maintenance, refurbishment, and disposal of assets and enables an entity to provide quantity, type and standard of assets needed to deliver its outputs. Effective planning also assesses alternatives to the acquisition of new assets, including "non-asset solutions" and the enhanced performance of existing assets. Concerning non-asset solutions one can distinguish between three types namely:

- Redesigning the service to reduce the need for assets (e.g. home-based medical care);
- Increasing the utilisation of existing assets (the conducting of evening courses in school buildings) so that acquisition of a new asset can be avoided; and
- Using private sector contractors to provide parts or all of the services.

Property management is concerned with the management and administration of the immovable property portfolio with Transport and Public Works fulfilling the role as custodian, having to ensure that the accommodation needs of all provincial departments are integrated and provided for and that properties are not dealt with independently of such requirements. The provincial property portfolio needs to be unlocked and optimised. The usage of provincial properties (land and buildings) needs reviewing in order to ascertain whether the properties are in fact being optimally utilised.

Activities relating to the management and administration of the immovable property portfolio (acquisition, development, maintenance, utilisation and disposal of properties) should make a contribution in the response to the massive challenges facing the government. This must be done, not only by providing and maintaining the required accommodation for provincial services but, especially in the particular business of property services, by creating opportunities for socio-economic development through employment, by redefining and redesigning public space and by promoting black economic empowerment in this endeavour.

Transport and Public Works is in the process of drafting a White Paper on the management of properties. This strategy document will include policies regarding the management, acquisition, development, maintenance, utilisation and disposal of the said properties. The responsibilities revolve around the qualitative performance of property, ensuring the most efficient, effective and economic utilisation of space, and the timely and effective reporting and accounting of income and expenditure. As immovable properties are valuable assets that were divisively utilised in the past, these assets should be optimally utilised to undo the negative legacies and create an integrated society within which every individual is empowered to live and participate on an equal footing.

In order to widen the activities to fully address asset poverty, or infrastructure backlogs, funding is needed. The Province, however, is facing severe budgetary constrains and alternative ways need to be explored to provide for backlogs and new accommodation needs. These needs can partially be addressed by reallocation of properties within the portfolio, leasing or buying property or buying and developing new property. The appropriate option should be determined by the duration requirement, the location, price, supply, functionality and procurement policy.

The optimal utilisation of the provincial property portfolio could potentially make a significant contribution to economic growth, through the release of redundant provincial property for development. The release of surplus property will be for purposes ranging from revenue generation, land restitution, creation of dignified public spaces and other social programmes.

Revenue generation could occur by determining the highest and best usage of properties, ensuring a balance between financial return and socio-economic potential of a property. The revenue generating from this source has to be utilised to accelerate the delivery and maintenance of infrastructure for educational, health and other social services.

Public-private partnerships

Public-private partnerships (PPPs) are a new way for government to deliver efficient yet cost-effective service to the public and through which the public sector could improve value for money in partnership with the private sector. It is defined as "*a contractual arrangement whereby a private party performs part of a Government organisation's service delivery or administrative functions, and assumes the associated risks. In return the private party receives a fee according to predefined performance criteria*".

There are three essential drivers for the use of PPPs, namely affordability, value for money and appropriate risks transfer. The PPP service delivery option was launched in 2000 with the aim to improve infrastructure and service delivery efficiency and to promote economic growth and regeneration.

Challenges in moving forward with PPPs are to:

- Elicit and ensure the effective and efficient implementation of public-private partnership projects in the province;
- Promote and support projects, which generate significant private sector capital investment to replace/enhance existing assets, as well as projects, which are, to a large extent, contracts for services;
- Assess new public-private partnership projects from a budgetary perspective;
- Monitor public-private partnership; and
- Enforce compliance with measures/regulations imposed.

Although a number of smaller PPP options are being pursued, only one deal within the Provincial government has been concluded under the PPP umbrella, namely Chapman's Peak Drive. This project took the form of a 30-year design, finance, build, operate and transfer of assets back to the Western Cape government type of agreement, involving R450 million in the form of capital works and operation expenditures.

It is intended to extend this partnership approach to an ever-widening range of public sector activities, as government is keen to foster new types of relationships with the private sector under its PPP programme. This is a new process in need of development and refinement that only comes with experience. To successfully create this new partnership approach we need a fundamental shift in thinking – putting focus on outcomes rather than inputs.

As stated by the Minister of Finance, Trevor Manuel, at the private sector launch of the Standardised PPP provisions, Pretoria, 6 May 2003, "*We want our PPPs to produce high standards at affordable cost; we want to see impetus given to black economic empowerment; we want to see local economic development spin-offs for small and medium businesses; we want to see skills transfer; and we want to see job creation.*"

Although public private partnerships can provide the public sector with better value for money in procuring modern, high quality services and infrastructure from the private sector, a great deal of work requires to be done to effectively roll out this initiative and to fully exploit its economic potential. Nonetheless, it does offer policymakers a framework for developing a cost-effective and timely means of financing services and infrastructure.

4

LOCAL GOVERNMENT ISSUES

This review on local government does not intend to provide an analysis of municipal finances or their activities, nor does it intend to express an opinion on municipalities per sé, although we remain conscious of the fact that many municipalities are financially stressed. What it does attempt to do, is to raise points of concern about the impact that new legislation might have on them and the Province respectively, as well as raising further points of debate resulting from the possible shifts of powers and functions between the two spheres that would have organisational, social and financial implications for both.

Changing legislative environment

The Municipal Finance Management bill (MFMB) will give effect to financial management reforms in local government, as the current management of local government financial and fiscal matters is still contained in section 10G of the Local government Transition Act 1993 (Act 209 of 1993). This section, which was intended to regulate municipal finances during the transitional phase, will soon be repealed by the enactment of the MFMB, which seeks to establish an entirely new approach to municipal financial management. The MFMB covers similar issues for the local sphere of government than the Public Finance Management Act, 1999 (PFMA) does for the national and provincial spheres and likewise places onerous responsibilities and the necessity for performance related outcomes on councils, mayors and municipal managers (as the accounting officer of that municipality) alike.

The enactment of the MFMB has been preceded by two significant amendments to the 1996 Constitution. The first amendment was passed in 2001, amending Section 230 of the Constitution, which deals with municipal borrowing, by adding a new Section 230A to permit municipal borrowing and long-term contracts. A second amendment was effected early this year to Section 139 of the Constitution on provincial intervention in municipalities, by allowing for the process of mandatory intervention in the event of a serious financial crisis in a municipality where the ability to provide basic services is impaired. The thrust of this constitutional amendment is to regulate provincial supervision of and intervention in local government and, where this fails, national intervention.

At the time of writing, both the MFMB and its accompanying Systems Amendment Bill were currently before the National Council on Provinces (NCOP) for consideration. As both are Section 75 (of the Constitution) Bills, it does not require any provincial mandate, as members of the NCOP vote as individual or party members rather than as provinces.

There are concerns as to how the supervisory and capacity building powers and responsibilities that relate to primary financial and fiscal matters have been assigned and allocated between the relevant treasuries and provincial and national Local Government departments. Chapter 2 of the MFMB is very clear on the responsibilities of the national treasury, which is in line with Chapter 13 of the Constitution, particularly Sections 215 and 216. Given the number of municipalities, the national treasury is, however, contemplating fulfilling its responsibilities contained in Chapter 2 of the Bill and other sections through provincial treasuries.

Consequently, the national treasury has suggested that the national Minister of Finance delegates appropriate powers and responsibilities to provincial treasuries which, in terms of the latest thinking by the national treasury, see provincial treasuries as the primary implementers of the MFMB. However, in the remaining chapters of the MFMB, the MECs[30] for local government have by and large been designated as the main players in a provincial context. It should, however, be recorded that a number of provincial treasuries have stated their concerns with respect to the vagueness of their role in terms of the Bill and the use of delegations, to resolve this, rather preferring clarity by having original powers and responsibilities assigned to them in the Bill.

Going forward in implementing the MFMB, clarity must therefore be obtained as to who will do what and when, in order to prevent unnecessary bureaucracy or conflicts, crossed lines of communication to municipalities or weakening of supervisory accountability by the different role players listed in the MFMB. Another factor in going forward with the MFMB is that its implementation has apparently not been costed.

In practice, the level of readiness of both provincial governments and municipalities to deal with the requirements of the Bill, in a constructive and coherent manner, is an area requiring a considerable amount of additional work and co-operative sharing of experiences and on formulation of financial resources, human resources, guidance, training and institutional infrastructure between the key players, notably provincial treasuries, provincial departments of local government and municipalities.

Other provincial departments, in the execution of their line functions, are also affected and need to incorporate the implementation of the envisaged MFMB into their strategic planning to position themselves for this. It is likely that structured interaction would be required with municipalities, as the main “beneficiaries” of the MFMB, and who are more specifically preparing themselves for the implementation of this legislation.

Although some municipalities have been identified as pilot sites, and benefiting from the experiences of putting the PFMA to work, an implementation framework and detailed plans need to be developed of which provincial treasuries should ideally form an integral part. However, in many cases provincial treasuries and provincial departments of local

[30] Member of the Executive Council in a province.

government should jointly be part of any processes that relates to the MFMB from here on.

The municipalities that have been identified as pilot municipalities[31] have begun implementing the budget and financial reforms including the general accepted municipal accounting practices (GAMAP) and the completion of new budget formats. The focus of the reforms are to provide more transparent and timely information to enhance accountability and lend further support to policy decisions taken by municipal councils. This will be achieved through standardising budget formats according to uniform norms and standards and linking multi-year budgets to integrated development plans.

By the end of April 2003, R221 million has already been transferred to 39 pilots countrywide. A further 23 pilots nationally were scheduled to commence in August 2003. Furthermore, non-pilot municipalities are due to receive a once off allocation from the national sphere between 2003/04 and 2005/06 to assist with the implementation of the new municipal finance management legislation. Over the medium term, the 62 pilot municipalities receiving multiple year allocations, have committed themselves through council resolutions to assist the non-pilot municipalities in their region. This roll-out to the latter is planned to begin once the reforms are sufficiently advanced in pilot municipalities.

Transfer of powers and functions from either the provincial or local government sphere or to each other

The full implementation of Chapter 7 of the Constitution towards the establishment of a new local government dispensation in December 2000 fundamentally affected and still affects the provincial government's relationship with the local sphere of government regarding powers and functions.

Schedule 4 of the Constitution lists the functional areas of concurrent national and provincial legislative competence, whilst Schedule 5 lists the functional areas of exclusive provincial legislative competence. Both schedules 4 and 5 are divided into two, Parts A and B, of which Part B relates to local government matters. Notwithstanding the Constitutional provisions, certain functions listed in Part A of Schedules 4 and 5, which are concurrent and exclusive functional areas of national and provincial legislative competence, have historically been performed and are currently still being performed by municipalities, with an element of compensation or financial assistance by the Province. These functions include:

- maintenance and upkeep of provincial roads;
- administration and management of libraries;
- administration and management of museums; and
- rendering of primary and environmental healthcare services.

[31] Two groups in succession with five Western Cape municipalities in the first group and six in the second, and which includes the City of Cape Town.

What further complicates this relationship is that most of these services are being rendered by or from municipal owned assets and from locally sourced revenue to make up for shortfalls from the Province or to achieve standards set by the respective municipality itself. Furthermore, the level of capacity and the current limited (in practice shrinking relative to the rising cost of service provision) resource envelope (financial, human and capital) on provincial level is making it practically impossible for the Provincial government to fulfill its constitutionally mandated functions. The resource envelope and institutional capacity of municipalities are equally limited.

Therefore, consideration should be given to transfer affected powers and functions to local government through various mechanisms for which provision is made in the Constitution or, alternatively, provincialise those functions that are clearly a provincial responsibility. On balance, the latter option is the preferred one as that pulls all services that Province is constitutionally responsible for under one roof, improving both accountability and efficiency. The balance of functions/services at issue would require a different arrangement to be governed within a co-operative and developmental paradigm.

Against the above-mentioned complexities, a practical and sustainable framework within which the transfer of powers and functions between provincial and local spheres of government should be managed still needs to be developed. The Provincial treasury's position on this was that for provincial designated functions, the usual funds follow function principle should apply, but because a major part of these functions were funded from municipal rates and taxes, suggested an adjustment to the vertical share at the beginning of a new MTEF period, which would have left municipalities unscathed and assured the continued funding of these services from provincial coffers without having to cut back on these or other functions. For other functions, mostly of a dual responsibility nature, appropriate funding and management arrangements would have to be made in line with each sphere's responsibilities, but without jeopardising service delivery.

With this in mind, the national government was petitioned as long ago as three years ago to find an amicable and workable solution to be applied countrywide. Indeed the Technical Committee on Finance, a team of treasury officials supporting the Budget Council, did become involved and resulted in a sub-committee on local government, under the leadership of the national treasury, to be established to deal with intergovernmental fiscal relations regarding the transfer of functions between the respective spheres of government.

Another national initiative by the national Department of Provincial and Local Government (DPLG) saw the release of a draft "Policy Framework for the Assignment of Powers and Functions". The purpose of this draft framework was to lay down a solid foundation for making assignments and, where appropriate, delegations. Its intention was to create clarity regarding legislative arrangements, processes for taking decisions and financial arrangements in this context. However, a number of concerns were raised regarding the interpretation and practical application of the relevant primary and peripheral legislation, both during the workshop held by DPLG in March 2003 and subsequent discussions with them. Similar provincial political inputs have since ameliorated the initial stance of DPLG.

The latest development on DPLG's policy framework is that the minister for provincial and local government indicated that the investigation into a single public service needs to make additional progress and the impact thereof determined before the national policy framework dealing with the transfer of powers and functions can be finalised.

However, on 13 June 2003, the Minister for DPLG published authorisations in terms of Section 84(3) of the Local Government Municipal Structures Act, 1998 (Act No. 117 of 1998). In terms of these, municipal health services will, with effect from 1 July 2004, be exercised and performed by district (C) municipalities.

Furthermore, the National Health Bill defines municipal health services as environmental health services. The practical consequence of the authorisation by the Minister for DPLG and the definition as contained in the Health Bill is that from 1 July 2004 municipalities will effectively only be responsible for environmental health services and all other health services currently performed by municipalities can be construed to be a provincial responsibility. Mindful of the possible impact on primary healthcare services, municipalities have been requested to maintain the current level of services and funding, but given all their other responsibilities it remains dubious whether they would be able and indeed willing to do so. Nationally, it is estimated that municipalities contribute R1 billion from own revenue to primary healthcare services (PHC).

To try to deal with this dilemma, a national PHC financing task team made up of national, provincial and local government representatives, was established to determine alternative ways to fill the R1 billion gap and to work out timeframes, links with the budgeting processes, proposed primary healthcare norm costs and provincial implementation plans from July 2004. Unfortunately, the activities of the team has so far come to naught in respect of funding and implementation with no provision been made in the new MTEF framework put forward by the national treasury.

Similarly, a Provincial trilateral task team (Local Government, Provincial Treasury and Legal Services) has been trying to obtain a full picture of the true scope of governing mechanisms underpinning these services. As information was not always readily available from departments, this has resulted in a rather protracted exercise. The revised timeframe for completing this analysis has been set for end November 2003 and the suggested transferring framework for 31 March 2004. The purpose of this exercise is to have a full documented survey of all functions being contested to serve both as a firm basis on which negotiations can be entered into with municipalities and to inform further strategic planning as regards the future scope and most appropriate delivery mechanisms.

Although the primary and peripheral legislation governing the various mechanisms by which functions and powers can be transferred from the national and provincial spheres to the municipal sphere are relatively explicit and detailed, the reverse is conspicuous in its absence. Similarly, the prescriptions dealing with the accompanying financial and human resource arrangements and fiscal adjustments are equally vague. The key inhibiting factor in transferring functions and powers is not the legislation, but the financial arrangements and fiscal adjustments, although transferring staff from the local to the provincial sphere is a problematical and tedious process. It is therefore critical to develop an appropriate fiscal, financial and human resource framework to ensure, not only fiscal and human resource stability, but also continued service delivery to inhabitants of urban and rural towns. Other matters relating to the transfer of a function or power are infrastructure, assets and liabilities. These issues require vigorous investigation as well as consultation and negotiation with affected parties and key roleplayers.

It has become critical to formally agree with municipalities on a way forward, particularly as nothing much has emanated from the national processes to date and secondly, as the cost pressures of these services jeopardise their survival in their current format.

In this context, three options present themselves, one, the status quo, two, further petitioning of the national government, and three, to find a pragmatic solution between the Province and municipalities with due consultation with the national government as necessary. Given the lack of progress to date, the only viable option appears to be option three, but that would imply fairly drastic rightsizing of these functions to make them affordable (at current estimates of close to R400 million per annum, costs of providing these services, at least a 50% reduction in the hands of the municipalities and a corresponding reduction in provincial services). Option one is obviously not viable and option two immediately postpones any solution to the 2005/06 financial year as no provision has been made over the new MTEF via the vertical adjustment process.

Co-operative governance

All spheres of government are obliged to observe the principles of co-operative governance put forward in the Constitution and also in the Constitution of the Western Cape and the Systems Act. All these different and compelling sets of legislation provide for co-operative governance between the three spheres of government and the legislative obligation on each sphere to participate in structures and institutions to promote and facilitate intergovernmental relations.

Although a number of intergovernmental structures have become institutionalised at national level, similar developments at provincial level have not achieved the same formality and maturity. It should be obvious that provincial and local government spheres cannot function effectively without co-operation with one another. Co-operative governance is therefore required because of increasing complexity of governmental activities, the increase in the number of concurrent and exclusive legislative matters, the interdependency and interrelatedness of some government functions, spillovers in services, limited resources and relatively stagnant or even worsening socio-economic conditions.

In addition, co-operative governance would allow for integrated policy development, prioritisation, planning, execution and evaluation of government programmes and projects.

The principles of co-operative governance require a fundamental commitment from both spheres of government to play a significant role in the creation of co-operation and mutual trust. To effect this arrangement, a number of additional instruments are suggested to give both politicians and administrators the necessary forums to discuss, agree, drive and monitor relevant issues to move towards integrated (wall-to-wall) governance in the Western Cape. It is thus suggested that the two spheres agree to the utilisation of the current Western Cape local government forum as a departure point to create the equivalent of the President's co-ordinating council at provincial "level" to achieve three integrated structures.

First, a forum inclusive of the Premier, all his/her Cabinet members and all mayors supported by all heads of provincial departments and municipal managers, to conduct annual strategic planning *lekgotlas* early in each year under the guidance of the Premier so as to agree on the key goals to be strived for by both spheres over the next three year period, to assess the obstacles in achieving these and deliberate on ways and means to overcome them. In addition, to also meet periodically to deal with key governance issues and to co-ordinate the activities of the two spheres. This forum thus must have the effect of committing both spheres to a particular set of strategic and operational executive objectives

Second, to create sectoral government executive forums (Munimecs) to meet on an ad hoc basis to politically guide the evolvement of integrated governance, development and co-ordination of functions to be rendered individually by the two spheres.

Third, to create a provincial budget forum under the guidance of the Provincial Minister of Finance to deal with the ongoing fiscal and budget management issues, specific budget priorities to be strived for and subsequent budget performance assessment to ensure attainment of the agreed to strategic goals for the Province as a whole.

Fourth, to create supporting technical committees to assist the Executive at both spheres in their deliberations and to do all the advance preparatory work for the different forums to efficiently and fully process the relevant discussion points.

Developmental governance *(iKapa elihlumayo)*

The very term implies that government is acquainted with the socio-economic realities of society, that it knows that interventions have to be sustainable over the long term so as to best apply limited resources, and that it has to co-ordinate its efforts with other roleplayers to achieve maximum and targeted impact and that the necessity to evolve rational plans is very much a part of its budgetary and operational activities.

Chapter 1 clearly demonstrates that redistributive service delivery has so far not significantly reduced levels of inequality with rising levels of unemployment and stagnant real per capita growth rates. Both the municipal and provincial spheres are not exactly awash with financial and other resources, and both are in the process of refining their development plans and better integrating those into their budget processes. The timing is thus opportune to begin to work together on these matters, with particular emphasis on the development of a micro-economic strategy that will frame local economic development and begin to identify those factors that will promote or hinder increased economic participation.

Another issue that requires agreement (sufficient consensus) on action to take, is a co-ordinated and integrated job creation and poverty alleviation strategy with specific focus on two key deliverables. Firstly, a province-wide infrastructure planning strategy that brings together all projects and ranks them with respect to their synergy and effect on economic growth and job creation (their social impact). Secondly, a study to understand the dynamics behind poverty and the high growth in welfare dependency as well as the desired sustainable levels of the latter in different communities.

Integral to the development of a micro-economic and infrastructure strategy, is a dynamic spatial development framework that unambiguously indicates areas of the greatest growth potential in addition to a map of poverty, unemployment, infra-structure and environmental priorities. As important, if not more so, given the close correlation between unemployment and lack of education and training, is a concerted effort to right this persistent form of inequality, which by itself probably contributes more than any other factor to poverty, perpetuating historical inequity in society.

To put all these in place requires the structures for co-ordinated governance referred to above, the annual *lekgotla* to agree on development strategies and the provincial budget forum to integrate planning into budgets and align the two. For more detailed discussions on line functions, the Munimec type structures must play their role and all of these with the requisite technical support by officials and other experts as deemed appropriate.

5

RESOURCE ENVELOPE AND TAXATION

Overview and context

The Constitution of South Africa, 1996[32], establishes the three spheres of government i.e. national, provincial and Local government as autonomous spheres that are "distinctive, interdependent and interrelated" and requires them to work co-operatively for the promotion of economic and social progress for all. South Africa is a unitary state with a fiscal system[33] which is based on a revenue-sharing model or intergovernmental fiscal transfers to address, among others, the "vertical imbalances" across the different spheres of government and further aims to ensure that the responsibilities of each sphere are carried out in the spirit of co-operation, fairness and efficiency. The intergovernmental fiscal system in South Africa is based on fiscal uniformity, harmony and efficiency with lower fiscal autonomy to provincial and local governments. Section 214(1) of the Constitution requires that all revenue raised nationally should be divided equitably between the three spheres of government (vertical division of revenue); that the provincial share must be divided equitably between the nine provinces (horizontal division of revenue); and that the other allocations may be made from the national share, with or without conditions. Section 214(2)(a) – (j) of the Constitution sets out the ten factors that must be considered, including fiscal capacity of recipients, disparities between provinces and obligations in terms of national policy (functional competencies), before allocations are made to the different spheres.

The equitable division of revenue aims to provide each sphere of government with the necessary funds to provide the services and perform the functions assigned to it under the Constitution. Provincial expenditure responsibilities are set out in Schedules 4 and 5 of the Constitution and primarily funded from the national fiscus as provinces have limited sources of own revenue to augment the funding of services. Overall, transfers from the national budget to provinces provide approximately 96% of provincial budgets. National transfers take two forms, i.e. the provincial equitable share (without any conditions) to fund the bulk of public services to be rendered and conditional grants (a supplement) which are used to ensure that national priorities are adequately provided for

[32] The Constitution of the Republic of South Africa, 1996 (Act 108 of 1996). It establishes rules for revenue and expenditure assignment, but with concurrent jurisdictional powers of national and provincial governments in many areas such as education, health and welfare. It is also distinctive in that it provides for many areas of concurrent legislative competencies shared by national, provincial and local governments.

[33] The Intergovernmental Fiscal Relations Act (IGFRA), 1997 (Act 97 of 1997) formalises the intergovernmental fiscal system and it establishes a framework for considering the recommendations from the FFC with regard to intergovernmental transfers. It also requires consultation with the provinces and organised local government prior to any final decisions on these allocations. The Act further requires that a Division of Revenue Bill be tabled with the annual budget, indicating all intergovernmental transfers, including the equitable shares and any conditional grants or agency payments. Conditions associated with any of these transfers are included in the Bill.

in provincial budgets, to support compliance with national norms and standards, and to compensate provinces for providing services that may extend beyond provincial boundaries.

Transfers from the national budget will continue to dominate provincial budgets as a result of the current intergovernmental system which is based on a revenue sharing model, complemented by limited taxation and borrowing powers to provincial governments. In respect of the 2003/04 financial year, the total Western Cape revenue envelope is constituted by an equitable share of 78%, conditional grants of 14% and own revenue of 8%.

This chapter focuses on the Province's total resource envelope (equitable share, conditional grants and own revenue) available for 2004/05 and over the MTEF, developments within the intergovernmental system affecting provinces, initiatives to increase provincial own revenue (tax policy issues) and expenditure priorities that underlie the Provincial government's budget proposals for the 2004 MTEF.

The provincial equitable share

The equitable share is the largest of the provincial allocations from the national government. Over the course of the MTEF the equitable share allocation will rise from an adjusted estimate of R12,902 billion in 2003/04 to respectively R14,189 billion, R15,431 billion and R16,550 billion in 2004/05, 2005/06 and 2006/07, representing an annual growth rate of 10% from 2003/04 to 2004/05 and an average annual growth of 8.7% from 2003/04 to 2006/07.

The equitable share is allocated "horizontally" among the nine provinces according to a redistributive formula currently comprising seven components/weights i.e education (41%), health (19%), social security (18%), basic (7%) economic activity (7%), backlog (3%) and institutional (5%).

Funds from the equitable share are fully fungible and provinces (Provincial Executive Councils) retain discretion for choosing their own budget mixes, and the "share allocations" are intended merely as broad indications of relative needs and are not intended as indicative budgets or guidelines as to how much should be spent on a specific function.

The equitable share formula was designed to be phased in over a five-year period achieving ultimate target shares in 2003/04, with the Western Cape's share declining annually over the four-year period from 9.8% in 1999/2000 to 8.9% in 2003/04. Although apparently a small percentage, this implies a shift of almost R1,428 billion away from the Western Cape in 2004/05 Rands.

Review of the provincial equitable share formula for Budget 2005 and the Impact of the Census 2001 data

In formulating the 2003 national budget, the government committed itself to a major review of the equitable share formula subsequent to the release of the 2001 Census data. The review has commenced but a range of issues have surfaced during the initial consultations with sector stakeholders, some of which required more in-depth research and analysis, made a full review implausible for the 2004 Budget. As a consequence, it was agreed at a recent Budget Council[34] that the structure and components of formula principally be kept the same, but that some of the individual components of the formula be updated with the Census 2001 data for the education and basic components as well as the economic component with the GDPR data to begin taking account of the significant shift/movements in population between provinces.

The outcome of the Census 2001 data saw significant population movements primarily from predominantly rural to urban provinces, resulting in shifts in relative demand for public services and resources and thus on the equitable share. In the case of the Western Cape the percentage share of population increased from 9.7% to 10.1% between 1996 and 2001, reflecting a five-year change in population growth of 14.34% or annually at an average of 2.72%, with a population attraction rate of 0.35% chiefly from the Eastern and Northern Cape provinces.

Table 5.1 summarises the impact of the changes that are proposed for the 2004 Budget, for each of the three components. The table shows the weighted shares applied in determining the 2003 baseline allocations and the new target shares after updating the formula with data for selected components.

Table 5.1: Changes in share distributions

	Old share	Changes			New Share	Change in share
		Education	Basic	Tax		
Western Cape	8.9%	0.2%	0.3%	-0.6%	9.0%	0.1%

It was furthermore agreed that to smooth the impact of the Census 2001 updates and to further ensure that the impact of the changes does not lead to reductions in the baseline allocations of some provinces, a three-year phasing period be adopted. This impacts on the equitable share that would have been allocated to the Western Cape if an immediate adjustment were to be made to take account of the Census 2001 data without any phasing-in. With the phasing-in, the equitable share allocations grow slightly slower than what they would otherwise have, had the formula not been revised. In global (country-wide) terms however, the phasing over three years allows for all provinces to receive increases over their baseline allocations.

[34] The Budget Council of 16 October 2003. The Budget Council consists of the national Minister of Finance, Members of the Executive councils responsible for financial matters in the various provinces and the FFC. It is a body established in terms of the IGFRA that consult on any fiscal, budgetary or financial matters, proposed legislation or policy with financial implications or any other matter concerning financial management which effect provinces.

Table 5.2 shows the current weighted share of the Western Cape and the impact of the phasing over the next three years in reaching its target shares.

Table 5.2: Phasing of updates for data

R million	2003/04	2004/05	2005/06	2006/07
	Budget	Weighted shares		
Western Cape	8.9%	8.9%	9.0%	9.0%

It was agreed in principle that the review of the other components would be central to the full review that is to be conducted in 2004 for implementation in the 2005 Budget. One major issue that remains a challenge is how to accommodate/adjust the equitable share to take account of mid-term population projections as the Census 2001 data is already two years old and further in-migration is likely to have a major effect on the services to be rendered by this province.

Table 5.3 shows the revised equitable share allocation to the Western Cape for the 2004/05 MTEF when the formula is phased in over a period of three years. It shows the revised budget for 2003/04 as per the adjusted estimate, and the additional resources (equitable share) available over the new MTEF. The budget framework provides for additional equitable share allocations of R1,567 billion over the 2004 MTEF. These adjustments are intended to cater for:

- Personnel adjustments for the anticipated revisions to salary adjustments and the carry through effect of these;
- Policy adjustments for (a) the carry-through effect of projected spending in social security grants and further take up of beneficiaries, (b) further increases in the school-based non-personnel non-capital expenditure; (c) adjustments to remuneration packages of personnel with scare skills in health; and (d) the stepping up of provincial economic services functions, such as support for emerging farmers, including beneficiaries of Land Redistribution for Agricultural Development and programmes with high labour intensity such as maintenance of buildings.

Table 5.3: Equitable share for the Western Cape and Growth rates

R million	2003/04	2004/05	2005/06	2006/07	*% Growth rates*	
	Budget (revised)	Medium-term estimates			*2003/04-2004/05*	*2003/04-2006/07*
Revised MTEF estimates						
Western Cape	12,904	14,189	15,431	16,550	*10.0%*	*8.6%*
Total (all provinces)	**144,743**	**158,670**	**172,000**	**183,890**	***9.6%***	***8.3%***
Changes to baseline						
Western Cape	212	345	495	727		
Total (all provinces)	**2,358**	**3,357**	**4,444**	**6,280**		

A more comprehensive (full) review of the formula is to be being undertaken in early 2004 for consideration in the 2005 MTEF. This review will mainly deal with the following issues:

- The extent to which the current equitable share formula has supported the government's objective of effecting redistribution of resources among provinces;
- The modalities of shifting funding of social security grants to the national sphere;
- Whether the formula should continue to have explicit components for social services functions such as education and health, and
- How the formula can be used or complemented by other mechanisms so that it addresses broader policy challenges such as economic development, poverty and so on.

The review is to be conducted under the political guidance of the Budget Council, and it is expected that it will be submitted to the national Cabinet for consideration and approval in the second half of 2004.

Conditional grants

Conditional grants are national transfers to provinces earmarked for specific purposes, mostly introduced in 1998/99. They are specifically used to:

- provide for national priorities in provincial and Local government budgets;
- promote national norms and standards;
- compensate provinces for cross-boundary flows;
- effect transition by supporting capacity building and organisational reforms, and
- address backlogs and regional disparities in social infrastructure.

The current grants system has been shaped by major reforms that have been introduced to enhance accountability, monitoring, reporting and administration responsibility of these grants.

With the exception of major additions in grant funding for HIV/Aids, Provincial infrastructure and the extension of the child support grant, the level of funding for programmes already funded through conditional grants will remain broadly stable. The only major change in grant funding pertains to the phasing out of the financial management and quality enhancement grant in education and the school-based portion of the integrated nutrition programme grant administered by Health, now shifts to Education. In total, the revised provincial budget framework adds about R25,540 million, R66,559 million and R352,752 million respectively to conditional grants over the next three years in line with the government's broader policy priorities. National departments have not as yet determined provincial breakdowns for the major additions in grant funding, but the preliminary calculations are premised on this Province's share of the individual conditional grants in previous years.

Table 5.4 sets out conditional grants to this Province (new and changes to existing grants) for the 2004 MTEF, the key features of which are described below.

(a) Additional amounts of R18 million, R36 million and R62,151 million over the baseline for the *HIV/Aids Grant* to fund the further roll-out of an anti-retroviral programme. The main elements of the programme are the cost of co-ordinating the programme, treatment, training and nutrition.

(b) The shift in the *Integrated Nutrition Programme (INP)* is a result of national Cabinet approval for the shift of the administration of the primary school nutrition programme (PSNP) component of the INP from Health to Education, as the beneficiaries of the programme are school pupils. Only those funds available for purposes of primary schools (i.e. the PSNP) will be transferred to Education. It is envisaged that the relocation of the programme will improve planning, enhance co-ordination and further contribute to more efficient feeding in schools. Based on recent expenditure trends, R35,727 million, R39,632 million, and R47,425 million will shift to Education for PSNP over the next three years. The Department of Health will retain R5 million per annum in 2004/05 and 2005/06 as a conditional grant to continue with part of the INP (integrated nutrition outside the school system) for another two years.

(c) Baseline allocations to the *Provincial Infrastructure Grant* increases by R14,670 million; R26,367 million and R50,367 million over the 2004 MTEF to enable provinces to prioritise labour-based extended public works programme with the caveat that at least 10, 20 and 30 per cent respectively of the share of the infrastructure grant for 2004/05, 2005/06 and 2006/07 must be spent on labour-based and employment intensive projects.

(d) A baseline adjustment of R13,375 million will be added to *the Hospital Revitalisation Grant* in 2006/07 bringing it to R102 million to create some scope to broaden the programme to additional hospitals.

(e) Further strengthening of the *Child Support Extension Grant* as the current take-up rate indicates that additional funding may be required for its full implementation. Additional allocations of R12,5 million, R25 million and R144,670 million are proposed for the 2004 MTEF. The steep jump in 2006/07 caters for completion of the phasing of the grant.

(f) The *Financial Management and Quality Enhancement grant* administered by Education since 1998/99 will be absorbed into the equitable share from 2004/05.

Table 5.4: Adjustments to conditional grants: 2004/05 to 2006/07

SUMMARY : CONDITIONAL GRANTS : 2004/05 TO 2006/07						
SOURCE	2004/05 R'000		2005/06 R'000		2006/07 R'000	
	Revised MTEF estimate	**Changes to baseline**	**Revised MTEF estimate**	**Changes to baseline**	**Revised MTEF estimate**	**Changes to baseline**
Health: National tertiary services	1 104 087	0	1 121 380	0	1 188 663	67 283
Health: Professions training and development	327 210	0	323 278	0	323 278	0
Health: HIV/Aids	52 661	18 000	71 849	36 000	98 000	62 151
Health: Integrated nutrition programme	5 000	- 35 727	5 000	- 39 632	0	- 44 632
Health: Hospital management & quality improvement	16 983	0	17 608	0	18 664	1 056
Transport & Public Works: Hospital revitalisation	85 217	0	88 625	0	102 000	13 375
Transport & Public Works: Provincial infrastructure grant	176 215	14 670	199 215	26 367	223 215	50 367
Agriculture: Provincial infrastructure grant	17 785	0	17 785	0	17 785	0
Education: Financial management and quality enhancement	0	- 19 630	0	- 20 808	0	- 20 808
Education: HIV/AIDS	10 158	0	10 767	0	11 413	646
Education: National School Nutrition programme	35 727	35 727	39 632	39 632	47 425	47 425
Housing: Housing subsidy	446 035	0	473 136	0	502 000	28 864
Housing: Human resettlement & redevelopment	14 310	0	12 211	0	12 944	733
Local Government: Local government capacity building fund	19 302	0	0	0	0	0
Local Government: CMIP	3 508	0	3 738	0	3 962	224
Social: HIV/Aids	3 088	0	3 273	0	3 469	196
Social: Food security	20 034	0	20 034	0	21 236	1 202
Social: Child support grant extension	186 961	12 500	353 330	25 000	473 000	144 670
Total conditional grants	**2 524 281**	**25 540**	**2 760 861**	**66 559**	**3 047 054**	**352 752**

Source: Amended from the National Treasury's Medium-Term Budget Policy Statement 2003.

Caveats/Assumptions: Primarily own calculations. Baseline adjustments i.r.o. Health HIV/Aids = 6% of total additional to the WC whilst Social Development: Extension of the CSG = 5% of total additional grants to the WC representing the relative percentage shares of the 2003 total. Other adjustments in line with adjustments in the national Treasury MTBPS being mainly for inflation.

As part of the full review of the current fiscal transfer system (in particular the equitable share) the Budget Council resolved that a full assessment of all conditional grants and their formulae should be done as well. In addition the extent to which conditional grant formulae complement the equitable formula to facilitate attainment of policy objectives will be assessed as well. In particular, it will entail a careful examination of the large conditional grants with the view of determining whether they are still appropriate in their current form and funding levels. This will require early initiatives from the Province to do its own research in order to be able to intellectually interact with the national treasury and respective national departments on this issue.

Own revenue

Currently, own revenue sources of the Province remain fairly limited, consisting mainly of motor vehicle licence fees, hospital fees, interest revenue and gambling and betting taxes. Although own revenue formed a mere 7.5% of the total provincial revenue envelope in adjusted 2003/04 budget, they do remain an important source of funding. As the current sources have upper limits, it is projected that own revenue, as a percentage of total provincial revenue, will fluctuate at more or less 6% over the MTEF mainly as a result of provincially biased and buoyant growth in national transfers. The baseline changes in own revenue over the MTEF are captured in more detail in table 5.5.

Table 5.5: Own Revenue: 2004/05 to 2006/07

VOTE		2004/05 R'000		2005/06 R'000		2006/07 R'000	
		Revised MTEF estimate	**Changes to baseline**	**Revised MTEF estimate**	**Changes to baseline**	**Revised MTEF estimate**	**Changes to baseline**
3:	Provincial treasury	177 558	4 893	155 453	(481)	142 253	(13 681)
6:	Health	156 112	37 000	162 125	37 000	176 633	51 508
10:	Transport and Public works	706 591	28 089	873 986	128 750	1 043 925	298 689
	Other	62 937	3 000	62 954	3 000	63 828	3 874
	TOTAL	**1 103 198**	**72 982**	**1 254 518**	**168 269**	**1 426 639**	**340 390**

The preliminary baseline adjustments to own revenue adds R72,982 million, R168,269 million and R340,390 million bringing the own revenue allocations to R1,103 billion in 2004/05, R1,255 billion in 2005/06 and R1,427 billion in 2006/07. Main changes and challenges involves the following departments:

a) *Department of Transport and Public works*: an adjustment in 2004/05 of R28,1 million for increased motor vehicle licence fees and property income. The steep adjustment of R128,8 million and R298,7 million in 2005/06 and 2006/07 is mainly due to the proposed introduction of a provincial fuel levy at 10 cents per litre from 1 September 2005, assuming that the necessary sanctions are obtained both from the public and the National treasury and the passing of the required regulation both nationally and provincially.

   A key concern is the fact that the licence fees structure in the Western Cape is the highest in comparison with the rest of country, mainly as a result of systematic annual increases in licence fees whilst most of the other provinces have failed to revise their fees annually. The higher fee structure may result in the migration of vehicle licencing (particularly heavy vehicles and fleet operators) to other provinces where fees are much lower and consequently threatening this revenue source. In this regard the Treasury has requested Transport and Public Works to do an economic analysis and impact assessment of the annual increases on the tax payers (tax incidence analysis) together with an analysis of whether the impact of the tax had an effect on motor vehicle migration. This assessment should be completed prior to any further major adjustments to the motor vehicle licence fee structure. Ideally, annual increases in motor vehicle licence fees over the MTEF should be coupled to the rate of infrastructure building cost inflation. Therefore, it has been projected that motor vehicle licence fees will increase by at least the usual projected annual inflation rate over the 2004 MTEF, i.e. 6%. The outcome of the economic impact/tax incidence analysis should guide future policy decisions in this regard.

b) *The Department of Health*: an annual baseline adjustment of R37 million in 2004/05 and 2005/06 and R51,508 million in 2006/07 to bring the revenue estimate in line with the estimated total in 2003/04. This shift can mainly be attributed to a combination of improved administration of the billing system, a renewed focus on debt collection and the implementation of revenue generation initiatives. Hospital fees, as a share of provincial revenue appear to be stabilising an average of around 13% of overall own revenue over the MTEF.

c) *The Provincial treasury*: a net adjustment of R4,9 million, -R0,49 million and -R13,7 million in 2004/05, 2005/06 and 2006/07 respectively, mainly as a result of falling investment interest due to the lowering of liquidity levels of the Provincial revenue fund, the reduction in gambling taxes and revenue inflows from the introduction of the limited payout machine industry. Although casino turnover appears to have settled, tax revenue will drop over the MTEF, in comparisons with 2003 projections, as a result of the amendments to the current tax structure to compensate for fiscal drag[35]/bracket creep and to allow greater return to investors in the gambling industry, particularly to empowerment groups. The introduction of 2000 limited payout machines will result in approximately R35 million in additional tax receipts over the new MTEF.

Introduction of new provincial taxes

The Provincial Tax Regulation Process Act, 2001 ("PTRPA") strives to improve the fiscal capacity of provinces. The act gives effect to Section 228 of the Constitution by laying out a procedure for provinces to introduce new taxes. The effectively declining trend in nationally sourced revenue, as projected in the MTEF, has renewed the Treasury's efforts on improving provincial tax and revenue administration and at the same time to systematically explore the possibilities of supplementing provincial discretionary funds.

In this regard, the Minister of Finance and Economic Development indicated in his main Budget Speech in 2003 that a particular avenue of current focus identified by the Treasury will be the exploration of the viability of introducing a provincial fuel levy in the

[35] Fiscal drag is caused where inflation erodes the value of the income that falls within each of the tax brackets, thereby increasing the average rates of tax and automatically pushing taxpayers, whose real income does not concomitantly increase from year to year, into higher limits and marginal rates, because their nominal income have increased owing to inflation resulting in the real tax liability being affected.

MTEF for the augmentation of funding for transport (including roads) infrastructure. The business sector has generally come out in support of this initiative. The initiation of this endeavour has led Treasury to appoint a team of research consultants and economic advisors lead by the Bureau for Economic Research (University of Stellenbosch) to undertake research in concert with the Treasury on the feasibility of implementing a fuel levy in the Western Cape. The amount of the fuel levy, its base, relief measures, constitutional and legal issues, economic feasibility, tax administration alternatives, inter-provincial implications and other requirements of the PTRPA were similarly researched and investigated by the analysts. The only remaining process is to consult with industry and taxpayers through a public hearing process prior to any final recommendations being put to the provincial Cabinet and the national Minister of Finance. This levy, if implemented, will enhance the Province's fiscal capacity and expertise and also promote provincial fiscal accountability.

The findings of the research include the following:

- International tax literature is supportive of the use of a fuel tax to fund subnational government. A rate band of 10 cents to 50 cents per litre for such a tax is suggested, allowing a large enough revenue to make a substantial contribution to provincial own revenue, without impacting negatively on the economy. It also allows the province to address some of the unmet needs for infrastructure, particularly spending on roads and transport. However, the Treasury's inclination is to introduce the levy at 10 cents per litre.
- The constitutional issues were investigated in detail and the team found no legal or constitutional impediments to such a tax.
- With regard to the economic impact of the tax, it was found that it does not prejudice national economic policies, as there are already similar taxes at the national level and that the magnitude of the envisaged tax does not require national government to reduce its own revenues significantly to create tax room in order to maintain a stable national tax to GDP ratio.
- The impact of such a tax on the macro-economy, even if applied in all provinces, would be very small and the imposition of a fuel levy in the Western Cape would not compromise macro-economic activity in South Africa.
- The impact of the fuel levy on the population would be modest. As most of the population and economic activities are far removed from the border, cross-border shopping is not a real concern as only 5½% of the population lives in border districts, with retail sales of diesel being disproportionately located in border districts.
- A reversal of the slope of the current cost differentials between adjacent magisterial districts should not greatly affect factor location.
- A fuel levy in the Western Cape would have little impact on overall factor mobility, given that fuel plays such a small role in most production processes. Capital is unlikely to relocate on the basis of these cost differentials and labour is not directly affected.
- Revenue forecast from a fuel tax at 10 cents per litre will annually amount to approximately R290 million in 2004 Rands.

What remains to be finalised before the report can be submitted to the national treasury is the public participation and consultation process to disseminate information and understanding about the principles of the proposed fuel levy for the Western Cape and obtain feedback from the different interest groups. In particular, the information to be disseminated will deal with:

- the rate band under consideration and initial rate applicable to all fuel used with the exclusion of aviation fuel;
- the comprehensiveness of the tax, especially the fact that no exemptions or compensation (rebates) will be given to specific sectors; and
- the fact that the tax will be used primarily for the creation and improvement of infrastructure.

A summary of the main body of the report will be placed in the public arena, including the Provincial treasury website. The Provincial treasury will arrange further discussions with its national counterpart and other national government stakeholders. Presentations will be made to the relevant sectoral interest groups, in particular the lobby organisations for the fuel, taxi, transport, fishing, shipping and agricultural industries, community and civic organisations that may have an interest in the introduction of the fuel levy or the use of the funds so raised, heads of departments and the political stakeholders in the Provincial government, including the Provincial parliament.

It is anticipated that the process will be completed by the end of January 2004 with a report that will summarise all the submissions and responses to the various submissions. The final report will then be submitted to the national treasury by the beginning of April 2004.

Key challenges for 2004 and beyond

a) The review of the intergovernmental system: the provincial equitable share formula and conditional grants may lend further support to the increasing tendency to promote funding to pro-poor geographical regions. Examples are the national resource targeting framework in education, removal of the double weighting within the equitable share formula for education, in primary health care services, in welfare services and overall to move to a norms based funding formula. Many of these initiatives are sectoral initiatives meant to correct crowding out by social security. Underlying these, however, are the principles of per capita income augmentation (after transfers) and geographic re-distribution (within and between provinces).

   The implementation of all of these could result in downward adjustments of the equitable share formula for the Western Cape, as the formula is essentially equity driven. The problem is that equity targets were supposed to have been reached in 2003/04, but is now being pursued further via the pro-poor inclination. The further problem with the formula is that it is retrospective and does not reward efficiency. In addition the major conditional grants are all equity based in a geographical sense but does not factor in the time lags necessary for changes to take root or the requirements for the country as a whole.

b) The evaluation of provincial taxing and borrowing powers and the feasibility of adopting some form of asymmetric decentralisation, especially in the light of possible capacity constraints in respect of borrowing and taking account of skewed distribution of economic activity. In this regard the Treasury will focus on finalising the process in respect of the feasibility analysis of implementing a fuel levy on 1 September 2005. Furthermore, the analysis of the feasibility for the possible implementation of a bed/tourism levy from 1 April 2006 will be completed.

   In respect of provincial borrowing, the required capacity has to be developed to effectively manage and accept full liability for provincial borrowing, to be able to gainfully access the various borrowing instruments available in the capital market.

c) To promote and enforce transparent and effective management of own revenue, the Treasury in concert with departments will, *inter alia*, pursue the following challenges to increase the efficacy of own revenue collection:
   - Maximisation of provincial own revenue through the implementation of new provincial taxes, with specific focus on introducing a provincial fuel levy and a bed/tourism levy already referred to;
   - Perfecting the basics on departmental level in respect of revenue and specifically debtor management and to rigorously explore initiatives and concerted efforts to collect outstanding debt as well as to step up the level of reporting to the Provincial parliament;
   - Stability in revenue collection through improved forecasting and the tabling of sustainable and credible revenue estimates, and
   - Finalise the economic investigation into the current motor licence fee structure.

Conclusion

The additional allocations over the MTEF are in the main intended to boost government expenditure in line with its priorities and aims and further to provide for some relief in spending pressures. This chapter shows, however, that overall the Western Cape is facing a very difficult new MTEF from a financing perspective given the changes to *inter alia* the equitable share formula, further moves afoot to review the formula for the 2005 Budget, the diminishing liquidity in the Province's bank accounts and the concomitant reduction in investment revenue, as well as from declining interest rates.

The additional allocations over the MTEF are much lower than last year and it appears as if national government's largesse is at an end for the time being. All indications are that this trend will persist over the next MTEF. As a result the 2004 MTEF is going to be very tight with effective cutbacks seemingly inevitable given the growth of social security numbers and less augmentation from the national fiscus due to low performance of the economy, unsettled global economic and political conditions and the appreciation of the

Rand. All of these have contributed to lower than expected inflows into government coffers (tax receipts).

On the positive side, this situation has forced the government to carefully prioritise and reprioritise selected components of spending, and retain only those that explicitly support the *iKapa elihlumayo* concept to improve socio-economic conditions in the Province. The 2004 budget will build on the policy priorities laid down in the 2003 budget, but with a further consolidation and deepening of these priorities.

Within this tight fiscal framework, the government has responded and identified the following eight key priority areas in addressing the key policy areas to reach the desired outcomes of *iKapa elihlumayo*, i.e.:

- *Building human capital or human resource development*: The results of the various interactions and research projects point to this as the overriding imperative or major stumbling block towards realising the aims of *iKapa elihlumayo*. It goes without saying that the youth has to be the main focus of this endeavour.
- *Strategic infrastructure* plan: On its heels follow the imperative to plan and spend strategically on infrastructure where its economic and social returns will be highest without sacrificing engineering standards (as the key discerning characteristic of South African infrastructural projects). Such planning should be done in close co-operation and synergy with municipalities and the construction industry.
- *Micro-economic strategy*: The latter's partner, as the one endeavour can't be successfully executed without the other, is the development of a clear and comprehensive micro-economic strategy that draws in Agriculture and specifically the Land Redistribution for Agricultural Development programme. Such a strategy has to be based on exhaustive analysis of the different sectors to both piggyback on high potential areas and to remove impediments for all sectors to at least try and prevent further shrinkages.
- *A spatial development framework*: Allied with both infrastructure and a micro-economic strategy is the acceleration of the completion of a spatial development framework to guide their development and implementation.
- *Building social capital*: High unemployment, particularly amongst the younger economically active population group, high crime rates, early school leaving, high poverty rates, slow delivery of appropriate housing and community building projects and the after-effects of the pre-1994 cultural, political and economic divide, all point to the necessity of building social capital amongst our communities. Such a strategy has to strengthen social ties and integration, give the youth special attention to find worthwhile and sustainable economic opportunities, engender self-sufficiency, and instill pride and the knowledge that obstacles are surmountable. In addition, to the fight against HIV/Aids and its debilitating impact on society has to be escalated.
- *An effective co-ordination and communication strategy*: None of the above interventions will be effective without excellent co-ordination and communication between spheres of government and its social partners. Such unity of purpose will require an unqualified commitment to the optimum transformation of society capable

of withstanding the rigours of international competition and able to play its part on the African continent.

- *Improving financial governance*: Supporting these themes and underpinning most of them is the necessity to further improve financial governance so as to upgrade overall efficacy in resource use.
- *Provincialisation of municipal rendered* functions: An important step in bringing together under one roof and so also realising one of the aims of the Constitution relating to provincial functions and responsibilities, is finding a way for the Province in conjunction with both the national and local government spheres, to take over the responsibility for services currently rendered by municipalities on its behalf.

Given the revenues referred to previously in this chapter and the eight priority areas, the proposed allocations for the new MTEF can be framed. Before discussing these, the overall position is depicted in summary in table 5.6 below.

The table illustrates the various components, i.e. national transfers via the equitable share and conditional grants, provincial own revenue proposed expenditure level, contingency provision and financing, making up the total proposed budget for the Province over the MTEF 2004/05 to 2006/07:

Table 5.6: Total anticipated revenue vs total expenditure

SOURCE	2004/05 R'000		2005/06 R'000		2006/07 R'000	
	Revised MTEF estimate	**Changes to baseline**	**Revised MTEF estimate**	**Changes to baseline**	**Revised MTEF estimate**	**Changes to baseline**
TOTAL REVENUE	**17 816 665**	**443 458**	**19 446 173**	**730 029**	**21 024 178**	**2 308 034**
National equitable share	14 189 186	344 936	15 430 794	495 201	16 550 485	1 614 892
Conditional grants	2 524 281	25 540	2 760 861	66 559	3 047 054	352 752
Provincial own revenue	1 103 198	72 982	1 254 518	168 269	1 426 639	340 390
TOTAL EXPENDITURE	**18 013 126**	**454 552**	**19 499 928**	**941 625**	**21 119 269**	**2 560 966**
CONTINGENCIES	**52 500**	**52 500**	**52 550**	**52 550**	**55 230**	**55 230**
SURPLUS/(DEFICIT)	**(248 961)**	**(63 594)**	**(106 305)**	**(264 146)**	**(150 321)**	**(308 162)**

Next we discuss how this revenue can be divided to reflect the eight provincial priority areas.

Breakdown per priority area

(a) *Maintaining the basics*: providing for general inflation adjustments (excluding the 0,5% personnel inflation adjustment) to all votes, amounting to R1,472 million in 2004/05, R34,022 million in 2005/06 and R264,5 million in 2006/07 based on the following:

i. 2004/05: Unchanged inflation rate projections already in the baseline of 5,1%.
ii. 2005/06: Projections on the non-personnel inflation rate changed from a provision already in the baseline of 4,4% to 5,1% together with an estimated personnel inflation adjustment of 5%.
iii. 2006/07: New inflation rate for non-personnel items of 5,1%.

(b) *Micro-economic strategy, including Land Redistribution for Agricultural Development (LRAD) programme and Heritage Services*: Additional allocations will focus on strengthening the development of a comprehensive microeconomic strategy across all spheres, the removal of impediments for growth and building enhanced institutional capacity for the LRAD programme and ensuring that adequate agricultural support services follow the transfer of land. Additional baseline allocations for this goal, excluding baseline amounts already allocated to land reform initiatives, amounts to R75,123 million in 2004/05, R79,3 million in 2005/06 and R83,792 million in 2006/07. Already in the baseline allocations is an amount of R118,050 million allocated to land redistribution and small farmer settlement from 2001/02 to 2005/06, with a further opportunity of R19,9 million becoming available for this purpose.

(c) *Building human capital or human resource development (HRD) with a focus on the youth*: The adjustments to baseline caters for:

i) The continuance of the *iKapa elihlumayo* catalyst provision for education over the MTEF of R23,5 million in 2004/05, R125 million in 2005/06 and R131,375 million in 2006/07 for infrastructure, learning materials and other support services in schools to improve the quality and output in the schools system. These allocations are subject to (a) clear output targets for the balance of the Vote; (b) provision of all information necessary for outside performance assessment; (c) optimal schooling configuration and revisiting of school building programme; and (d) a construction financing shift to property.

ii) Personnel inflation adjustments (ICS) to take account of the latest revisions and the carry-through effect thereof of R48,906 million in 2004/05, R65,079 million in 2005/06 and R278,483 million in 2006/07.

iii) The net result of conditional grants to Education amounting to R16,097 million in 2004/05, R18,824 million in 2005/06 and R27,263 million in 2006/07. This is for the shift of the administration of the primary school nutrition programme (PSNP) component of the Integrated nutrition programme (INP) from Health to Education together with an adjustment for the phasing out of the Financial management and Quality enhancement grant in Education.

iv) A baseline adjustment from the equitable share of R19,630 million, R20,808 million and R21,869 million in respectively 2004/05, 2005/06 and 2006/07 to compensate for the cessation of the financial management and quality enhancement grants in Education.

(d) *Building social capital, focussing on the youth*: Specifically in Health, Social Services and Poverty Alleviation and Housing. This policy objective will experience the largest increases in spending over the next three years. This reflects the continued emphasis to continue building social capital, but with a specific focus on the youth, in the form of assistance to households and public health services. In this context, Social Services and Poverty Alleviation has to take up this responsibility as lead department in building social capital. The adjustments provide for:

(i) Strong growth in social security projections of R150 million, R340 million and R976,488 million extra from the equitable share and respectively R12,5 million, R25 million and R144,670 million as a conditional grant adjustment in 2004/05, 2005/06 and 2006/07, to deal with the pressure arising from the growth in social security grants, the unpredictability of future expenditure and future spending commitments relating to this function. The adjustments cater for the further strengthening of the *Child Support Extension Grant* as the current take-up rate indicates that additional funding may be required for its full implementation in 2006/07;

(ii) Personnel inflation adjustments (ICS) in respect of Health to take account of the revisions to salaries and the carry-through effect thereof of R4,292 million in 2004/05, R2,220 million in 2005/06 and R114,736 million in 2006/07;

(iii) Own revenue baseline adjustments of R135,7 million over the MTEF primarily in Health due to robust revenue collection;

(iv) A net baseline reduction for conditional grants in Health totaling R3,840 million over the MTEF relate to strengthened funding of the HIV/Aids grant to fund the roll-out of an anti-retroviral programme and the shift of the administration of the PSNP component of the INP from Health to Education;

(v) An inflation adjustment of R32,051 million in 2006/07 to the housing subsidy, housing human resettlement and development, food security, hospital management and quality improvement and social HIV/Aids conditional grants, and

(vi) Provision for scarce skills and rural allowances in Health amounting to R24 million in 2004/05, R25,224 million in 2005/06 and R26,510 million in 2006/07 to provide for the improvement in remuneration of scarce health professionals and upgrading of rural allowances.

(e) *Improving financial governance, co-ordination and communication*: To improve good financial governance chiefly to improve efficiency, additional baseline allocations amounting to R14 million, R14,663 million and R15,584 million are proposed to cater for policy proposals to *inter alia* address the strengthening of the oversight role in respect of the local government sphere, promoting effective coordination and communication strategy (intra and inter), information technology restructuring, legal services strengthening, the roll-out of the provincial internal audit function, implementation of the Municipal Finance Management Bill within the Provincial treasury and to provide for the archives function.

(f) *Strategic infrastructure plan*: Spending on infrastructure services continues to be robust over the 2004 MTEF as this underpins the *iKapa elihlumayo* strategy to spur economic growth. Primarily financed through own revenue, adjustments to conditional grants and financing initiatives such as accumulated reserves, additional baseline allocations amounting to R42,759 million in 2004/05, R155,117 million in 2005/06 and R362,431 million are proposed to support this. Included in this amount is a provision of R249,147 million in 2004/05, R106,099 million in 2005/06 and R316,095 million in 2006/07 as financing and R125 million in 2005/06 and R250 million in 2006/07 for the implementation of the provincial fuel levy, scheduled for 1 September 2005, to chiefly address the maintenance and rehabilitation backlogs on the provincial roads network.

(g) *Contingency Reserve*: As in the previous years, a contingency reserve, amounting to R50m in 2004/05 increasing annually by inflation, is set aside for each year of the 2004 MTEF. The purpose of this allocation is to respond to adverse natural or economic occurrences that have the potential to threaten the budget framework. An additional amount of R2,5 million has been set aside in 2004/05 to make provision for unresolved contingencies within Agriculture, rolled over from 2003/04.

Table 5.7 demonstrates the recommended allocations per priority area as discussed above.

Table 5.7: Recommended allocations per priority area:

Priorities	2004/05 R'000	2005/06 R'000	2006/07 R'000	Per-centage
	Changes to baseline	**Changes to baseline**	**Changes to baseline**	
Maintaining the basics	1 472	34 022	264 500	7.58
Human resource development	108 133	229 711	458 990	20.14
MES (including LRAD, Heritage and spacial development)	75 123	79 300	83 792	6.02
Building social capital (Health, Social services)	213 065	428 812	1 375 670	50.98
Financial governance	14 000	14 663	15 584	1.12
Infrastructure	42 759	155 117	362 431	14.16
TOTAL	454 552	941 625	2 560 966	100.00

(h) *Provincialisation of municipal rendered functions*: These proposed allocations reflected above and in table 5.8 do not take account of the uncontested provincial functions historically rendered by municipalities. These are primary health care services (non-municipal variety as from 1 April 2004), library and museum services, all in all amounting to some R340 million per annum based on the two line function departments' latest estimates. The basic proposal is that each sphere cuts back in its services[36] (each equivalent to 50% of its current costs of the disputed service) to allow the Province to take these over on 1 July 2007. To this end approximately R165 million through the process described earlier in this chapter should be available to ease the transition of these services to the Province. However, there is also a whole range of other contested services currently performed by municipalities not catered for in the above, but it is foreseen that most of these will be of a joint nature.

When looking at the total fiscal position, it clearly signals that the budget is not without risk and is with very limited manoeuvrability. The position depicted in the table above constitutes a position where the liquidity has been reduced to zero to respond to the magnitude of challenges and policy objectives of Chapter 2 and various contingencies. This budget statement is strongly premised on the assumptions that a provincial fuel tax will have been approved by the National Treasury and implemented on 1 September 2005. Further, that the current national investment framework with regards to money management operations remain and that interest rates remain stable at current levels.

Attaining these objectives through successful implementation of this budget to achieve the provincial government's desired outputs and outcomes, firstly, rely on good leadership and, secondly, on appropriate fiscal discipline by executive authorities and accounting officers and excellent co-ordination and communication between all affected roleplayers.

[36] Municipalities with reference to primary health care services, libraries and museums.