CHAPTER 6

Assessing and Improving the Fiscal Performance of Provinces

6.1 Introduction

The aftermath of global economic crises continues to affect economies, which are confronted by policy dilemmas over whether to continue with stimulus interventions or budget consolidation. In the midst of this predicament, the demand for public services continues to rise because of high levels of poverty and unemployment, while growth in government revenues is decelerating.

The rising need for basic services and lower growth in government revenues can contribute to high fiscal stress. Fiscal stress may be defined as an inability to meet current and future financial obligations, to provide minimum service levels at minimum (efficient) cost and to reduce service backlogs, particularly infrastructure. When expenditure increases are not matched by corresponding increases in revenue, governments are compelled to make hard choices between mobilising additional resources, pursuing budget consolidation or improving fiscal performance, all associated with substantial economic and political costs (Digler, 2011).

Governments constantly experience revenue shortfalls relative to original budget estimates and planned outlays, leading to periodic budget imbalances or an impaired ability to deliver services. In the case of South African provinces, commentators are divided over whether such imbalances and resulting delivery deficiency exist at all. Some take the view that provinces are fully insulated against endogenous and exogenous budget pressures through national transfers. Budget imbalances and delivery deficiencies are seen mainly as the result of poor fiscal management. Others suggest that provinces are facing exogenous cost pressures (some of which are imposed by national policies) and increasing demand for services (e.g. through in-migration), which are not always matched by adequate transfers. The result is budget shortfalls, which often manifest as unauthorised expenditure, the inability to meet set delivery norms and standards, under-servicing/backlogs, delays or deferment of expenditure commitments and rationing of services (e.g. long queues at clinics or low service quality).

This chapter seeks to assess the phenomenon of provincial fiscal performance from the perspective of fiscal stress, The underlying causes of perceived poor fiscal performance, as reflected by selected fiscal stress indicators, are analysed, and various ways through which fiscal performance can be improved are explored. A fiscal stress index for provinces is constructed by first reviewing and then using (after adapting to suit South African conditions) theories of sub-national budget constraints, resource allocation management and fiscal adjustment.

6.2 Framework for Evaluating Fiscal Performance

As with many intergovernmental fiscal systems around the world, South Africa is faced with ongoing, unresolved debates around whether adequate devolution of revenue sources accompanies the devolution of spending responsibilities. Sub-national governments, particularly provinces, rely on national transfers to finance their expenditure commitments. These arrangements raise concerns over structural budget imbalance in the lower spheres (Eyrauud and Lusinyan, 2011).

Disagreement around imbalances is a feature of any decentralised system of government due to the common economic problem of scarcity. Some level of discrepancy between sub-national own revenues and spending is inevitable, and may even be desirable for the purpose of retaining national control over provinces. However, large and persistent budget shortfalls can have detrimental effects, including the partial collapse of public service, under delivery, missed delivery targets and prolonged service backlogs (Besfamille and Lockwood, 2004).

6.2.1 Definition of Fiscal Stress

Fiscal stress is a term that is interchangeable with concepts such as fiscal distress, fiscal strain, fiscal crises, fiscal squeeze, poor fiscal health, poor financial condition or budgetary pressures. The term is used to describe the predicament of government dealing with social, financial and economic difficulties (Arnett, 2012). There is no universally accepted definition of fiscal stress. A large body of the literature suggests that fiscal distress is a condition of imbalance (Muller and Rohr-Zanker, 1998; Gold, 1992; Skidmore and Scorsone, 2007). Intuitively the balance is between what the public would like and what

government can provide, given the available resources. Balance can also be viewed in the context of short to medium-term cyclical budget balance and long-term generational balance[1] attributable to a number of factors including indebtedness, structural and demographic issues.

6.2.2 Causes of Fiscal Stress

The literature reveals considerable consistency and consensus on what factors cause poor fiscal performance. There are many possible factors, some of which may be long standing, while others may be relatively recent and related to institutional, behavioural, budget practices, structural and policy-related drivers.

From an institutional angle, numerous factors contribute to fiscal stress, although the magnitude of their contribution is difficult to measure. For instance, when major financial decisions are made outside of the budget process, fiscal stress problems inevitably arise. Political economy explanations of fiscal stress are rooted in models of polarisation or bargaining between rival political interest groups. Unintended fiscal disorders often result from the lack of explicit procedures or provision for coordinating revenue and expenditure, as well as the linkage between the budget process and macro economic framework.

Another important institutional factor dominating the discourse on fiscal stress relates to vertical fiscal imbalance and assignment of expenditure responsibilities (Jimenez, 2009; Sutherland et al., 2005). When the balance between revenue assigned and expenditure responsibilities is disproportionate, provincial governments may find it difficult to meet minimum services requirements or expenditure commitments imposed on them by national government or statutes.

From a policy and budgeting standpoint, rapid growth in expenditure, which leads to fiscal stress, can result from the pursuit of populist policies, formulation of indefinite expenditure programmes, lack of or poor costing of policies, unaffordable delivery norms and standards, incremental budget decisions and uncontrolled borrowing to finance new programmes (Premchand, 1993; Karen Lee, 1982). Weak budget and financial controls by budget claimants (spending agencies) and budget controllers (finance ministries) can also lead to excessive fiscal stress. Actual spending levels are most likely to exceed original budget estimates when treasuries are incapable of monitoring spending by line ministries, adjusting spending downward after budget approval, and sanctioning profligate budgetary practices such as overspending. Other causes of fiscal stress are listed in Table 20. These factors are not mutually exclusive but can conveniently be grouped in three broad categories: socioeconomic decline, internal political dynamics and bureaucratic expansion.

Table 20: Various Drivers of Fiscal Stress

Demographic changes i.e. high school enrolment or failure rate disease burden i.e. high infection rate	General cost increases/inflation: National government often make aggregated inflationary adjustment to transfers without taking into account the rate of cost increase in various expenditure categories whose rate of growth far surpasses that of Consumer Price Index i.e., health care cost (Gold,1992)
Court decisions (Gold, 1992)	High personnel (including ghost employees) and capital outlay costs
Weak economic base	Economic swings
Rapid expenditure growth rate and/ high entitlement expenditure	Wasteful expenditure or tax competition Service benefit spillover
Redistributive policies	Debt obligations
Expenditure inflexibility: Factors contributing to inflexibility include obligatory programs which are structured by law as well as programs based on political agreements.	Fraud and corruption
Revenue collection inefficiency	Unfunded mandates (Jimenez 2009)

Source: Commission compilations from various sources

[1] The term long-term generational balance refers to the long-run consequences of current government policy on future generations.

6.2.3 Measuring Fiscal Stress

Finding an acceptable measure is one of the biggest hurdles when empirically determining the extent to which fiscal stress affects government structures. Like the definition itself, the concept of fiscal stress has no generally accepted measure. Several applied and theoretical frameworks have been developed and used to measure fiscal stress. Many applications draw on the work of Grove et al. (1981), which breaks down fiscal stress into three types of insolvencies. These include (a) cash solvency (concerned with government's liquidity and ability to pay its bills); (b) budgetary and long-run solvency (related mainly to fiscal sustainability); and (c) service level solvency (measures the ability of government to meet the needs of the community by providing the required minimum service levels).

6.2.4 Response to Fiscal Stress – Closing the Gap

Responses to fiscal stress are generally limited and depend on the underlying causes, severity of the situation and flexibility of fiscal rules. The most generic and common responses found in the literature are expenditure cuts, revenue enhancement and borrowing where it is permitted (Arnett, 2011; Jimenez, 2009; Kalambokidis and Reschovsky, 2005; Porteba, 1993). The budget can also be balanced through budget gimmicks (deferring expenditure such as maintenance), expenditure reviews, drawing from reserves or "rainy day funds" and much tougher fiscal stances, such as absorbing part of the fiscal pressure within existing budgets and current fiscal year. The limited number of responses mentioned conceals the wide variety of other available specific approaches within each broader category of response. Table 21 outlines some of these approaches classified by problem area or cause of fiscal stress.

Table 21: Approaches to Fiscal Stress

Problem area	Approaches
When ministry of finance lack power to adjust outlays after budget approval	Provision of emergency powers to finance ministry through legislation
Low revenue efforts, extensive regulations, indefinite spending programs	Revenue generation through user fees, reduction in regulations, introduction of sunset legislation, reallocation of task and responsibilities, postponement of policy initiatives and programs
Uncontrolled deficits, policy implications and costing analysis	Introduction of global targets, forward expenditure planning; institutionalisation of functional costing
Lack of program or project review	Expenditure review, program reconsideration, performance based budgeting, incentives
Personnel growth and expenditure rigidities	Hiring freezes and restrictions, salary reductions, staff ceilings, retrenchment, reduction in capital outlay, across the board cuts, reprioritisation of spending into core and non-core
Difficulty in implementing approved budget	Cash management, cash limits, centralisation of payments
Decision taken outside the process and no explicit efforts to coordinate revenue and expenditure	Expanded budget process, envelope or portfolio budgeting

Source: Adapted from Premchand (1993)

Fiscal stress responses must be centred on the four pillars of expenditure management: stabilisation, economy, efficiency and effectiveness (Premchand, 1993).

- Stabilisation is primarily concerned with determining and sustaining the aggregate level of expenditure, and observing the limit.
- Economy entails using fewer resources than planned (i.e. economies of scale and savings).
- Efficiency involves the ability to produce more with the allocated resources.
- Effectiveness is concerned with the extent to which the programme objectives have been fulfilled.

Thus, if the issue is one of excessive use of resources in relation to the needs, the policy response may have to emphasise economy. Alternatively, if the problem emanates from leakages and inefficient operations, policy options focus on restoration of efficiency. In practice, however, Schick (1988) found that governments tend to look for the easiest places to reduce spending rather than resort to reviewing the efficiency or effectiveness of programmes.

6.3 Fiscal Stress in the Context of Provinces in South Africa

It is empirically difficult to construct an acceptable measure of fiscal stress, and provinces agree that declaring themselves fiscally stressed (or not) is difficult without carrying out a comprehensive costing of delivery norms commensurate with all their functions. Notwithstanding the importance of costing as a critical factor, provinces do encounter numerous budgetary problems, which are consistent with the literature on causes of fiscal stress. Most notably, the issue of misaligned expenditure responsibilities (or unfunded mandates) tops the agenda of problems that affect the budget significantly and is the most prevalent provincial perception in South Africa. Misalignment cuts across different provincial departments and is often linked to national political decisions on policy, which are made without being accompanied by funding for implementation. The most compelling finding from interaction with provinces is that their positive budget balance is in effect masking a number of "budget gimmicks", which may not necessarily show up in official budget and audit reports. For example, spending agencies tend to understate their performance targets to cater for national mandates, unforeseen expenses and profligacy.[2]

The South African legislative framework describes and specifies factors which may constitute fiscal stress, and how such a condition should be addressed. First, the legislation stipulates that national government may intervene in provincial and municipal affairs if they fail to fulfil their obligations or experience material and persistent financial problems (sections 100 and 139 of the Constitution and sections 6 and 136 of the Public Finance Management Act (PFMA) and Municipal Finance Management Act (MFMA) respectively). Section 139(5) of the Constitution specifies that a province must intervene if a municipality experiences a financial crisis, whereas section 100 specifies that national government may intervene in the event of a provincial government failing to fulfil an executive obligation (which would of course include financial crises). Thus, in terms of section 100, national intervention is optional and not obligatory. The triggers for intervention in terms of section 100 are much less clear than those set out in section 139 for local government or municipalities.

The regulations pertaining to provinces are less detailed than those applicable to municipalities. The PFMA does not explicitly list criteria for determining the seriousness of financial problems, whereas the MFMA (section 138) provides a list of factors which constitute financial problems and by implication fiscal stress. These factors are fairly generic and include:

- Failure to make payments as and when due.
- Default on financial obligations for financial reasons.
- Actual current expenditure exceeding the sum of actual current revenue plus available surpluses for at least two consecutive financial years.
- Operating deficit in excess of five per cent of revenue in the most recent financial year for which financial information is available.
- Submitting annual financial statements to the Auditor-General more than 60 days late.
- The Auditor-General withholding an opinion or issuing a disclaimer due to inadequacies in the financial statements or records.

Therefore, an opportunity exists to refine how the PFMA treats provincial fiscal stress, by aligning it more closely with the MFMA in providing regulatory guidance on indicators for detecting and responding to provincial fiscal stress.

[2] Naomi Caiden (1970) says that this "padding" of the budget can often be a rational response to uncertainty in the spending. Furthermore, at provincial level, other departments often have their budgets cut when there is overspending, especially on personnel in the health and education departments. Building in unofficial "contingency" reserves could well be a rational departmental action in response to poor fiscal management in the province as a whole.

6.3.1 Measuring Fiscal Stress

As observed earlier, the literature does not contain a clear, optimal operational definition and measure of fiscal stress. The concept is highly dynamic and encapsulates numerous political, institutional, managerial, structural and cyclical elements. Existing definitions of fiscal stress are mostly country-specific and focus mainly on financial conditions. The financial bias tends to give the impression that fiscal stress is strictly a budget problem and hence the overemphasis on budget-related variables as measures or indicators.

For the purpose of this Submission, fiscal stress is viewed more broadly, as the manifestation of service delivery problems transmitted through the budget from political, institutional, structural, legislative, financial and economic factors. These factors constitute most of the variables that indicate the degree to which government is fiscally stressed. Table 22 provides a list and description of 10 indicators, which capture the underlying drivers of fiscal stress, used to compute a composite fiscal stress index.

Table 22: Selected South African Indicators of Fiscal Performance

No	Indicators	Description	Source[3]
1	Provincial annual budget balance	Two operating deficit within a five year period are viewed as financial risk by credit rating agencies and lenders. For provinces in South Africa the minimum allowed threshold for over and under spending is 8 per cent	Endogenous
2	Cash balances	A cash balance of 5 per cent or less is generally regarded as. Lower cash balances result in delays in payment of suppliers	Endogenous
3	Expenditure buoyancy	Expenditure elasticity measure whether growth in expenditure keep pace with the rate of growth in national income	Exogenous
4	Expenditure rigidity and earmarking	Measure the extent to which composition of provincial expenditure changes in response to changing economic conditions and spending priorities	Endogenous
5	Unfunded mandates/Misalignment of expenditure responsibilities	Measures the extent of service delivery responsibilities undertaken by provinces for which there is no funding from national government	Exogenous
6	Wastage & profligacy	Measures the extent of inappropriate use of resources by provinces	Endogenous
7	Budget and expenditure control	Inability to control budgets constitutes one the biggest triggers of fiscal stress. This indicator measures the ability of province to maintain fiscal discipline, allocate resources in accordance with national priorities and produce maximum output with minimum costs	Endogenous
8	Maladministration/managerial capacity	Measures the extent to which the province is able to comply with regulatory requirements pertaining to reporting, performance oversight and internal audit controls	Endogenous
9	Minimum efficient expenditure	Measures the minimum expenditure associated with the inputs required to deliver national minimum service standards which are within provincial mandates, given that certain prices are set by national government (e.g. wages)	Exogenous
10	Service needs/burden	Measures the extent of service needs and burden in relation to other provinces as well as budget allocation in response to such needs	Endogenous

Source: Commission's compilations

[3] Endogenous factors are stress indictors that emanate from internal provincial fiscal and budgetary operations, while exogenous stress indicators arise from external factors such as policy or spending decisions that have an impact on provincial budgets.

6.3.2 Evaluating Provincial Fiscal Performance

Before proceeding with calculating a composite fiscal stress measure, each indicator is evaluated separately to establish historical provincial fiscal performance. The results suggest that, when assessed individually, provincial fiscal performance variables do not give an unambiguous, clear and discernible picture of whether provinces are fiscally stressed or not. For instance, Table 23 shows that on the basis of a nine-year provincial review of fiscal balances, an inconsistent (or volatile) pattern of surpluses or deficits emerges, which makes a particular fiscal trajectory difficult to discern. As pointed out in Chapter 7, episodes of under-spending are driven in part by rising personnel spending and service delivery pressures. Over the long term, all provinces seem to gravitate to near a zero budget balance shown by the average budget balance. However, zero budget balance is not sufficient as a measure of fiscal stress. Similarly, surpluses are not indicative of perfect service delivery.

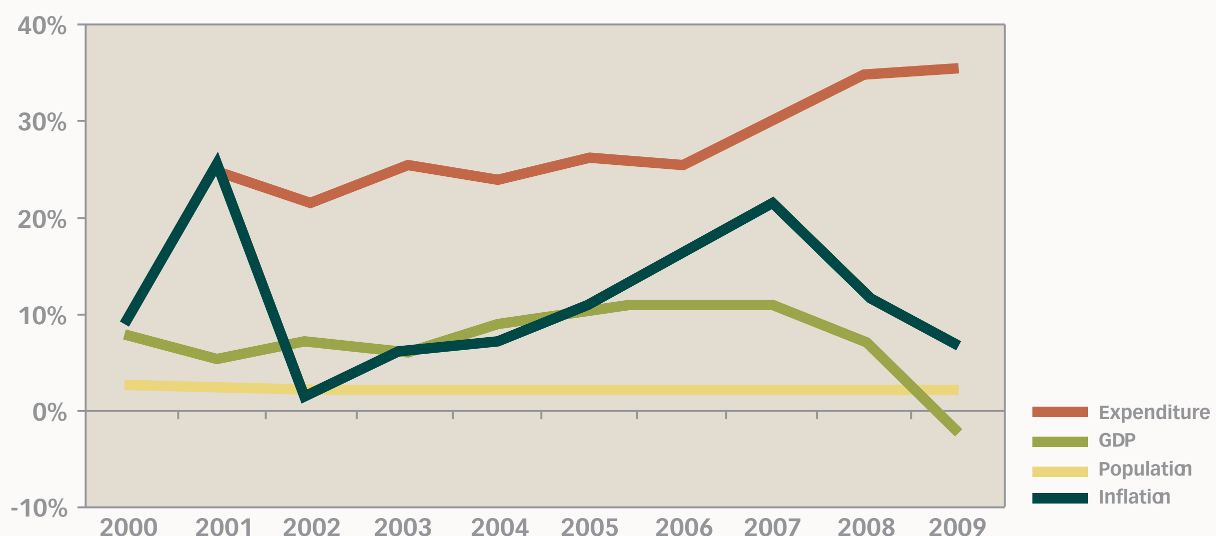
Table 23: Provincial Annual Budget Balance

R' Million	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	Average
Eastern Cape	-275	-2252	225	1333	1101	583	402	-2198	-2428	-390
Free State	2028	2950	3824	4022	51	101	149	410	-56	1498
Gauteng	150	-35	1037	-555	-636	275	1276	-2228	-1089	-201
KwaZulu Natal	534	155	158	-247	598	-380	-2308	-1126	1423	-133
Limpopo	-555	262	-69	-1036	110	220	330	273	-1885	-261
Mpumalanga	2065	2914	3370	-9561	-47	151	536	196	-10	-43
Northern Cape	733	901	1428	1427	103	146	167	237	37	575
North West	213	167	1298	-683	65	130	195	245	-280	150
Western Cape	-80	476	533	-402	-604	-318	-294	-104	208	-65

Source: National Treasury and Commission's calculations

Fiscal performance can be assessed from the perspective of expenditure growth rate in relation to the economy's capacity to sustain such growth, as well as the alignment of the rate of increase with the general price level, and population growth as proxy for expenditure needs. In general, total provincial expenditure growth appears to consistently outpace growth in real GDP and inflation. For Mitchell (2010), the expenditure growth path shown in Figure 14 is unsustainable because it outpaces the wealth-creating sectors of the economy and therefore indicates possible fiscal stress. While rapid

Figure 14: Provincial Expenditure Growth Moderation



Source: National Treasury, StatsSA, Reserve Bank

expenditure growth in itself does not indicate poor fiscal performance, a growth pattern that is inconsistent with inflation and the population growth rate can induce fiscal stress, which may have been avoidable if an inflation-linked spending path had been adhered to. Many of the factors explaining high expenditure growth rates play out within South Africa's intergovernmental system. These factors are typically not amenable to clear-cut measurements. Every year Government introduces spending priorities, which require significant budget commitments and add to the rate of spending increase. In the 2011/12 financial year alone, more than 34 spending priorities were identified and funded.

Rigidities in expenditure line items can also cause irreversible fiscal damage. Generally personnel costs are considered to be most invasive and damaging because they are a first charge against expenditure and tend to encroach on other important expenditure line items. Figure 15 compares expenditure composition across time within and among provinces. A trend of rigidity or drag is apparent, given the insignificant change in the proportion of funds allocated to goods and services relative to personnel.

Figure 15: Expenditure Rigidities/Flexibility

Source: National Treasury

6.3.3 Provincial Fiscal Stress

Table 24 shows a composite fiscal stress index, or a combination of indicators that provide a better picture of the overall provincial fiscal situation. Each indicator is scored from 1 to 5 (where 1 is good and 5 is worse) to measure the severity and weight accounting for relative contribution to total stress. Scores are assigned to each quintile on the basis of variation from a set norm or national average over a given period.

The results suggest that fiscal stress within South Africa's provinces may not be as severe as often reported. Eastern Cape has the highest weighted fiscal stress score at 3.25, followed by Gauteng at 3 and Free State at 2.8. Western Cape and Mpumalanga provinces have the lowest fiscal stress scores of 1.3 and 1.4 respectively. Surprisingly, Limpopo, which is often compared to the Eastern Cape in terms of poor socioeconomic profile and fiscal performance, has a middle fiscal score of 2.5. Yet in 2012/13, national government took over the provincial administration in Limpopo because of poor financial and expenditure management.

This difference can be explained by the triggers that inform national government intervention and the indicators used to compute the index. Interventions are mainly driven by internal expenditure and financial control weaknesses, whereas the fiscal stress index comprises indicators or variables beyond mere expenditure and financial control. Under the broader definition of fiscal stress used in this chapter, expenditure and financial mismanagement alone do not constitute fiscal stress. As seen from Table 24, most provinces score 5 on wastage and irregular expenditure, budget and expenditure control, and maladministration, indicating that such problems are not limited to Limpopo when assessed over a long period.

Table 24: Composite Provincial Fiscal Stress Index

	Weight[4]	Eastern Cape	Free State	Gauteng	Kwazulu-Natal	Limpopo	Mpuma-langa	Northern Cape	North West	Western Cape
Budget balance	5	1	1	1	1	1	1	1	1	1
Cash balance[5]	10	0	0	0	0	0	0	0	0	0
Expenditure bouyancy/ growth	5	5	4	2	1	3	1	1	5	2
Expenditure regidity	5	4	4	1	4	5	4	2	2	2
Unfunded mandates[6]	10	0	0	0	0	0	0	0	0	0
Wastage and irregular expenditure	15	4	3	5	3	3	2	2	2	1
Budget and expenditure control	15	5	5	5	4	4	2	4	3	1
Maladmin-istration / management capacity	15	5	5	2	2	3	1	4	3	1
Minimum efficient expenditure	10	3	1	5	5	3	1	2	1	3
Service needs/ burden	10	3	3	5	4	3	2	2	1	3
Overall Fiscal stress score (Weighted)	**100**	**3.2**	**2.8**	**3**	**2.55**	**2.55**	**1.35**	**2.1**	**1.8**	**1.3**
Overall Fiscal stress score (unweighted)		**3**	**2.6**	**2.6**	**2.4**	**2.5**	**1.4**	**1.8**	**1.8**	**1.4**

6.3.4 Case Study of KZN and Limpopo

Description of the fiscal situation

Towards the end of 2011, National Treasury declared Limpopo technically bankrupt. At the time the province was experiencing serious financial problems, which later manifested in some hospitals running out of medical supplies and food, and schools not being fully funded and/or not receiving textbooks. In 2009/10, KwaZulu-Natal (KZN) was expected to overshoot its budget by over R5.6 billion. Apart from the projected overspending, the province was still expected to meet the majority of its financial and service delivery obligations.

[4] It should be noted that weights are based on authors' judgement.

[5] Information outstanding

[6] No adequate indicator

Causes of the situation

The causes of fiscal stress in Limpopo appear to have been mostly self-inflicted and consistent with the factors that constitute financial problems as listed in the MFMA. These include a poor cash-management system, ineffective expenditure management, non-compliance with supply chain regulations and a weak provincial treasury. For KZN, the reasons given for overspending were: extra medication needed to treat AIDS opportunistic infections and extreme drug-resistant tuberculosis, the new occupation-specific dispensation (OSD), skills retention incentives and nursing that resulted in many patients (especially in Durban) being "farmed out" to the private sector, costing the fiscus several additional millions.

Adjustment mechanism

The severity of the situation in Limpopo led to the national government responding swiftly by invoking section 100 of the Constitution, which provides for the temporary takeover of a provincial administration. The intervention resulted in recovery plans being developed for five provincial departments. The recovery plans focused mainly on cash management, cost containment, reduction of personnel costs, organisational realignment, financial accountability, restoration of legal procurement practices and service delivery monitoring. In each remedial area, specific activities were undertaken and reported over the period of intervention. In Limpopo, national government drove the interventions, whereas in KZN the provincial treasury (supported by the provincial legislature) instituted an internally driven fiscal restraint. The provincial executive committee approved a number of far-reaching cost-cutting measures, which were strictly enforced and monitored by the Premier and MEC of Finance. Key among the measures were the freezing of all posts and capital projects for which tenders had not been issued, a moratorium on the purchase of furniture and equipment, travel and accommodation controls (pool travelling, no overnight accommodation for distances below 500 kilometres), and no payment of performance bonuses or leave day conversions. In both cases, financial progress followed the respective externally and internally driven interventions, but the cost to service delivery remains unclear.
Despite the good effects associated with remedial action, controversies remain about when and who should institute fiscal adjustment. Nationally driven interventions often displace accountability, while internally driven adjustments may prolong cost to service delivery, especially in the absence of provincial executive will and well-defined fiscal parameters to trigger adjustment.

6.4 Conclusion

This chapter sought to answer one of the long-standing issues in South Africa's gradually evolving intergovernmental system: the fiscal condition of provinces in relation to the capacity to deliver their constitutionally mandated services in a sustainable manner. Those who sympathise with provinces decry the narrow fiscal space within which provinces operate, while critics stress the adequacy of intergovernmental transfers to the provinces and the need for provinces to improve fiscal performance. The balance between these opposing views is resolved through empirically testing whether provinces are fiscally stressed or not.

In an attempt to mediate the two opposing views, the chapter has applied an objective method to measure fiscal stress. The method combined existing legislative prescripts and practical experiences borrowed from the literature with assessing various elements that are considered unfavourable to service delivery. A fiscal stress index was then compiled that contains 10 indicators to capture the underlying drivers of fiscal stress.

The index reveals that (based on the broad definition) fiscal stress is not rampant, and the degree of fiscal stress does not vary substantially across provinces. The Eastern Cape has the highest weighted fiscal stress score (3.25/5) followed by Gauteng at 3 and Free State at 2.8. The Western Cape and Mpumalanga have the lowest fiscal stress scores of 1.3 and 1.4 respectively. Poor fiscal performance appears to be mostly attributable to internal factors, such as expenditure management, maladministration and wasteful expenditure. These findings are consistent with national government's perceptions of the efficiency and effectiveness of provincial budgets. However, more research is required to understand and measure the underlying drivers in provinces where fiscal stress has manifested and the good practices of provinces that contain their fiscal stress.

6.5 Recommendations

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

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