Extra funds a fleeting balm for provinces

National government is grappling with the thorny problem of the provinces' financial crisis. **Murphy Morobe**, the chairman of the Financial and Fiscal Commission, looks at the challenges facing provincial government budgeting

IN January this year, Finance Minister Trevor Manuel identified a cash flow crisis as one of the causes for provinces being cash-strapped.

On February 13, he tabled the Adjustments Appropriation Bill in Parliament, which would provide relief for some provinces' budgets.

The matters raised by the minister and the provision of some financial respite for the provinces are seen as interrelated issues.

While the Financial and Fiscal Commission agrees with the minister's sentiments, there are additional factors causing provincial budgeting problems, and there needs to be clarity as to what these are so effective and sustainable solutions can be found.

As the intergovernmental fiscal relations system is beginning to reach a critical stage in its development, there are apparent strains and problems arising. These are manifest in such matters as those highlighted by Manuel: "provincial overspending", a lack of provincial funds for social security pay-outs and the laying off of teachers.

The commission supports much of what the minister has stated, including that one of the causes for the overspending problem is the lack of "cash-flow management". It is important that the intergovernmental fiscal relations system is not seen as the cause of the problems.

It is clear the developing system is infinitely superior to the approach of the former government. What we are seeing are issues arising from the transition between the former and new governmental system and the process of devolving expenditure responsibilities to provincial governments.

On the problem of effective cash flow management, for the 1997/98 fiscal year provinces were given block grants, based on the commission's formula which recognised that provinces were accountable political entities and should budget accordingly, determining priorities within a national policy framework.

Thus, provinces were aware in advance what their equitable allocations would be for 1997/98 and

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should have planned their cash flows accordingly. However, if provinces were inherently underfunded then the best cash flow management would not prevent this happening.

Another factor affecting provincial budgets is the macroeconomic framework. A tighter fiscal policy effectively decreases the level of government spending. This can be a cause of provincial budgeting problems, especially if managed poorly, since it requires reprioritising, restructuring and efficiency improvements to provide the same services with decreasing resources.

The commission has consistently said that the relationship between the macroprogramme and the public finance system requires careful consideration if certain key delivery objectives are to be met. The alternative is of course to make it clear that the delivery objectives have been revised downwards, and thus deepen the integrity of the new system.

A third cause of the "overspend" relates to the "base" from which the initial amount was determined. The formula had to start from a particular point, largely using historical spending patterns for estimating what provinces were receiving.

There was not much clarity in this regard in 1995 and 1996 due to the lack of data and historical expenditure patterns. The commission's formula then determined what provinces should receive if funds were allocated in an equitable manner, rather than the way they were in the past.

What has persistently occurred during the past three fiscal years is that the budgeted spending patterns have been different to actual expenditures, thus ensuring that the dynamics of the 1997/98 provincial budgets are no different to previous years.

Share of revenue

Province	1997/98	2002/03	% change
Western Cape	10,0%	9,6%	-3,8
Eastern Cape	17,9%	16,9%	-5,7
Northern Cape	2,6%	2,3%	-11,8
KwaZulu-Natal	19,2%	20,3%	5,9
Free State	6,9%	6,6%	-4,9
North West	8,9%	8,2%	-7,3
Gauteng	14,6%	16,2%	10,4
Mpumalanga	6,3%	7,6%	20,0
Northern Province	13,7%	12,5%	-8,9

Graphic: KAREN MOOLMAN Source: MEDIUM TERM BUDGET POLICY STATEMENT

The solution to this is that the base has to be sorted out more accurately by assessing what provinces' real expenditure responsibilities are. Thus, where the original base did not include all social security beneficiaries and the "ghost" claimants in the system, this would be reviewed.

The correct base issue, in a way, leads to a fourth cause for the "overspends", namely, budgeting games played by the provinces.

Although budget gaming is a universal phenomenon, SA has a history of "regional" governments being part of a system of incentives, where "blowing" budgets was "rewarded" with central government bale outs. The leverage of provincial governments is particularly powerful if either or all three key social sector functions — education, health or welfare — are allowed to be underbudgeted by provinces, in the hope that national government will not allow such key functions to be crippled.

One way of dealing with this is to change the incentives so poor budgeting is not rewarded. This implies hard political decisions have to be taken about not bailing out provinces.

Clearly, the base issue has to be sorted out so such "friction" cannot be used as the rationale for not meeting budgets.

The fifth reason why provinces are not functioning within their budgets is that they have little recourse to raising substantive own revenues in response to budgeting problems during the transition.

The commission has recommended that provinces be allowed to impose a provincial surcharge on the national base of personal income tax. This would be imposed in such a way that the current aggregate tax burden would not be violated in any material way. Such a surcharge would not only provide provinces with a tool

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to manage their budgets better, it should increase their accountability to their electorate.

For example, if the Western Cape government wanted to deliver a higher quality education service to its electorate, then it would be able to do so. Providing provinces with own revenue sources as a complement to the already devolved expenditure responsibilities they have, would ensure greater symmetry in the developing fiscal system.

The sixth factor contributing to the problem is the much discussed lack of capacity in the provincial governments. This problem is particularly acute in the areas of financial control and management and has the potential to undermine all attempts to solve the aforementioned factors. It is imperative that solutions to all of these are found in parallel: sorting out the base, improvements in cash flow management, developing disincentives to budget gaming, assigning own revenues, revisiting macrotargets and lastly, building capacity, especially financial management capacity.

Building capacity is a long term process and needs to get under way immediately if the other solutions are to be effective. It is obvious that national government should take greater responsibility in this and team of financial experts need to be sent into the worst provinces to manage the crisis and develop systems.

It is clear that the financial relief offered to provinces in the Adjustments Appropriation Bill does not fully address the six abovementioned factors, nor is it perhaps intended to do so. Firstly, cash flow management problems are not addressed by simply allocating additional funds to provinces. This problem would continue to exist even if the provinces had access to more revenue. The budgeting problems caused by parameters and goals of the macroeconomic framework are also not necessarily addressed. Providing additional revenue can change some of the targets if it is not a zero-sum game of shifting funds among existing votes. If the macroeconomic framework results in provinces not being allocated sufficient revenues for proper delivery, the nature and role of provinces would have to be re-examined.

The "base problem" is of course also not addressed in the finance ministry's approach. The commission is involved in discussions with stakeholders about how this problem can be addressed for the 1999/2000 fiscal year.

The problem of "budget gaming" is addressed to an extent, as provinces are not being given additional revenues equivalent to what they have overspent. Even if they are not being explicitly bailed out, there is still the danger of reinforcing the incentives for budget gaming and overspending. However, some provinces, especially those which have tried to stay within their budgets, are likely to feel hard done by as there is an implicit bailout benefiting those who have significantly exceeded their budgets.

The second component of the finance department's offering to the provinces, namely making R1,5bn available through a bridging finance mechanism, does ensure that provinces who have played budget games pay a cost for this. Provinces which make use of this scheme will be required to pay national government's borrowing costs for the R1,5bn. However, this is unsustainable. It seems that one of the key sustainable solutions to the provincial budgeting problems is providing provinces with access to some significant own revenues.

Lastly, to deal with the inherent capacity problems in provinces would require a specific nationally designed programme to ensure that sooner, rather than later, provinces have the human resource capacity to prepare proper budgets, manage such budgets and control their expenditures to ensure effective use of resources.