Policy Brief

Provincial Fiscal Adjustment Mechanisms in Times of Protracted Fiscal Constraints – Case of the Health Sector

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EXECUTIVE SUMMARY

Provinces play a crucial role in the delivery of primary health care. Provincial health budget allocations are slowly declining in nominal terms, due to ongoing national fiscal consolidation[1]. The health sector is experiencing chronic shortages of critical medical equipment, medical consumables, and healthcare professionals, while demand for health care is increasing. Health care delivery is thus under severe fiscal pressure and provinces lack the resources to respond to the ongoing strain. Rigid intergovernmental fiscal arrangements limit the ability of provinces to make necessary adjustments to their budgets. This study examines the responsiveness of intergovernmental fiscal instruments to the ongoing fiscal strain experienced by the provincial Departments of Health (DoH) in South Africa. The results suggest that provinces need non-fiscal instruments to address their fiscal pressure. The study recommends that a framework be developed by the National Treasury and provincial treasuries that can monitor and report on fiscal strain on health care services as well as trigger fiscal adjustments to alleviate the pressure. Two further recommendations deal with the need for greater flexibility in conditional grants, and how to address the current poor state of provincial health budgets.

[1] Budget deficit and a reduction in government spending.

Background

The South African legislative framework, including the Constitution (1996), Public Finance Management Act (PFMA) (1999), Annual Division of Revenue Acts and the Appropriations Acts, provide a set of rules for provincial fiscal arrangements. The overall objective is to impose fiscal discipline and processes for promoting budget transparency and accountability. However, the institutional framework underpinning provincial fiscal adjustment is not geared for addressing fiscal pressures arising from such factors as declining revenues and rising expenditure.

Provinces play a crucial role in the delivery of primary health care. Health allocations account for 30 to 35 per cent of the total provincial budgets and are under severe pressure as a result of rapidly growing healthcare demand and the inadequate growth in fiscal transfers. The National Department of Health (DoH) estimates that the 2018 health budget is underfunded by R13 billion, and that this shortfall accumulates annually due to unresponsive transfers[2]. The ongoing pressure on the health infrastructure and the equipment budget is exacerbated by the national fiscal consolidation objectives which have resulted in budget cuts to selected health conditional grants. For example, infrastructure grants have been reduced by 14% in 2018 over a three year cycle.

A combination of rapidly rising health demands and stagnant transfers requires provinces to employ numerous fiscal adjustment measures to manage the fiscal constraint[3]. However, provinces have limited revenue raising powers; they rely almost entirely on national transfers to execute their mandates and are required to maintain strict budget balance rules. In light of this limitation, the study asks three pertinent questions with regard to provincial fiscal adjustment:

- What are the fiscal variables used by provinces to respond to protracted fiscal strain?[4]
- How responsive are the provincial fiscal transfers to actual or anticipated fiscal or delivery crises?
- What is the optimal provincial fiscal framework model required to facilitate smooth adaptation to a deteriorating fiscal situation?

A multi-pronged methodological approach including budget analysis, panel data regression analysis and cases studies has been applied to these questions.

Research Findings

Poor fiscal performance is a key driver of fiscal pressure among provincial health departments, most of which are experiencing high levels of accrued, unauthorised, irregular and fruitless and wasteful expenditure. Financial mismanagement resulted in provincial health departments in Gauteng and Limpopo being placed under national administration in 2011. The outcomes of these interventions suggest that budget pressure flows directly from weaknesses in supply chain and asset management processes, cash flow management, human resource deficiencies, and poor expenditure management and lack of budget controls.

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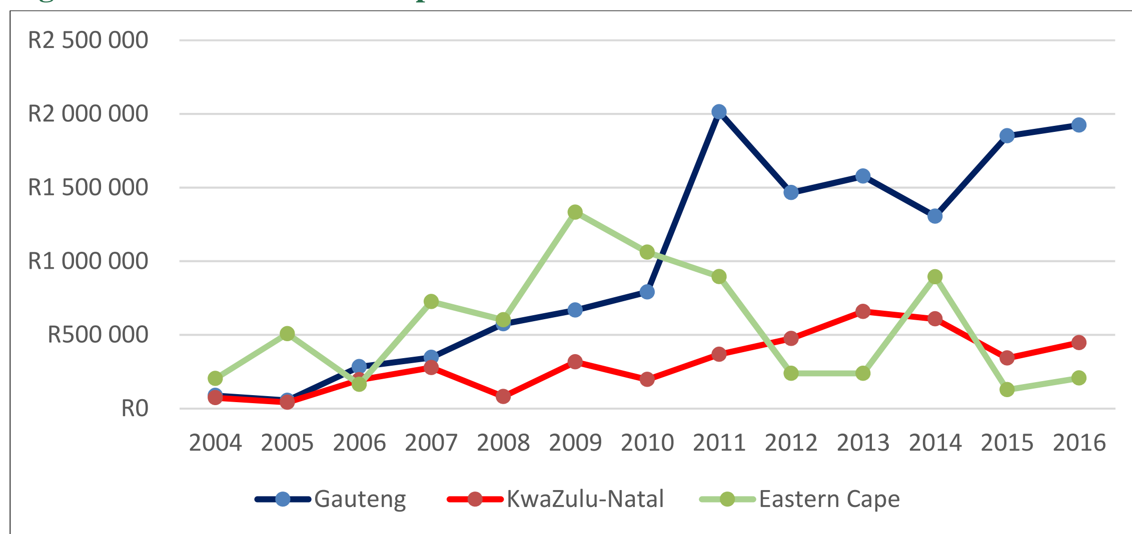
[2] Insufficient fiscal transfers or grants to meet social demands or expenditure needs.
[3] Reduce the impact of the fiscal pressure.
[4] This question is particularly pertinent as responses to budget shocks often manifest in non-fiscal variables such as hospital bed shortages, availability of medical supplies and poor healthcare services.

In the absence of effective fiscal adjustment instruments, provinces tend to use expenditure accruals[5] to effect negative budget balances or smooth temporary budget pressures. There are two possible reasons for doing so. On the one hand, accruals may be a result of financial mismanagement as provinces commit their allocations in advance without having the cash available in the current year to offset the expenditure. On the other hand, it could be a signal of pressure to address pressing delivery needs with an insufficiently allocated budget. The National Department of Health claims that accruals in the health sector are unavoidable because patients have to be treated when they present themselves at health facilities, irrespective of budget availability. At the end of 2016/17, accumulated total provincial accruals were R23.4 billion of which R13.8 billion was attributable to the health sector (R7 billion to the Gauteng Department of Health). Figure 1 shows that Gauteng Department of Health has one of the highest levels of health expenditure accruals.

Figure 1: Provincial health expenditure accruals



Source: Computed from National Treasury database

Most of the adjustments on expenditure are not discretionary[6] as they are channelled through national transfers to provinces. The national government influences provincial budget adjustment by varying the size of additions to baseline budget allocations between discretionary transfer, Provincial Equitable Share (PES) and conditional grants. For the 2018/19 financial year, the baseline allocation to the PES, which includes health allocations, has been reduced by R4.7 billion while health conditional grants have been reduced by R1.34 billion. Despite these budget cuts, total health allocations grew at an average rate of 7.3 per cent over the 2018 Medium Term Expenditure Framework (MTEF).

Research suggests that provincial fiscal pressure emanates mainly from compensation of employees spending. The results indicate that one percentage change in compensation of employees spending leads to 5.5 per cent decline in the budget balance. On the other hand, capital spending has a positive and statistically significant effect on the budget balance. This could mean that provinces are using capital spending as a primary variable to balance the budget. However the positive relationship can also be explained by the strong influence of national transfers in provincial capital budgets. Provinces have little discretion in varying the amount of funding allocated for capital projects.

[5] Accounting expense recorded in the books before it is paid for.
[6] Autonomous budget allocation decisions

The health sector has used cross-cutting fiscal and non-fiscal measures, straddling human resources, financial management, procurement and infrastructure, to respond to the ongoing budget strain and budget efficiency concerns from the treasuries (Table 1). Some of the measures are new while others have been in the pipeline and are yet to produce the desired outcome because of implementation delays. For instance, Gauteng has frozen health capital projects to the value of R7 billion in 2018. Other provinces have reduced delivery outputs to manage their respective fiscal pressure. For instance, provincial health departments have been advised to scale down on the doctor training bursary programme. Provincial own-imposed measures include that the intake of nursing bursary recipients has been reduced, coffins have been transported in inappropriate vehicles, maintenance on oncology equipment has been delayed and, food supplies have been depleted. These measures are clearly not ideal ways of managing fiscal pressure, since they impact negatively on service quality.

Table 1: Health sector measures to enhance budget efficiency

Focus area	Proposed measures				
Human resource interventions	Strict management of committed overtime for clinical staff	Transfer head office staff to facilities	Create lean management structures	Halt the Cuba doctor training programme	
Financial management interventions	Establish medico legal units to promote mediation on legal claims	Improve audit outcomes and reduce accruals	Undertake comprehensive health budget review	Reduce variation orders	
Procurement/ supply chain interventions	Central health strategic sourcing on selected supplies - with price ceilings	Adoption of transversal contracts	Electronic gate keeping for laboratory services	Expansion of the Centralised Chronic Medication Dispensing and Distribution (CCMDD)	
Infrastructure interventions	Freezing capital projects	Introduce a 2-year equipment and facilities maintenance plan	Introduce a Home Affairs integrated patient and records management information system	Strengthen project monitoring and evaluation through service delivery district visits	Standardise infrastructure designs

Source: Department of Health, 2017

Government departments often adjust their outputs in response to budget pressure. However, reducing health delivery outcomes is a violation of human rights and could carry a risk of litigation. While health outcomes such as life expectancy, infant mortality and HIV/AIDS treatment are improving, two incidents stand out as cases where budget strain may have been the cause of damaging reductions in service delivery. The first involved supplies of HIV/AIDS medication in three provinces – Mpumalanga, Limpopo and Free State – which ran short in 2009 and 2013, resulting in interrupted treatment for patients. The Department of Health, however, found that the stock shortage was caused by poor inventory control and communication. The second incident, the Life Esidimeni tragedy, was attributed by the

Gauteng Department of Health to budget pressure. In this case, over 140 mental health patients died after having been transferred from a contracted private hospital to various unlicensed and unqualified non-governmental organisations. The resulting tragedy, which had a massively negative impact on the health sector's reputation, is a clear indication of the need to develop effective and efficient means of budget strain management and adjustment.

It is useful to consider whether the proposals for nationalising health funding through the National Health Insurance (NHI) fund could minimise health budget strains. While many details about the delivery model of NHI are not yet available, it can be assumed that provinces will be cushioned from external budget pressures, because funding or payments will be directly allocated to the units of delivery (i.e. clinics and hospitals). The fiscal strain that is currently being experienced by provinces will thus be transferred mostly as accruals to contracted providers. Under the NHI, national government will become aware of fiscal strain and will direct resources to where health demands are the greatest. At this stage, it is unclear whether health delivery will be most efficient when paid for by national government and delivered by contracted units of delivery, or when delivered by provinces through national transfers.

Conclusion

Health care delivery is undergoing serious strain as a result of a mismatch between resource allocations and growing expenditure needs. The situation is exacerbated by poor fiscal management characterised by spending inefficiencies across the entire healthcare delivery system. However, the study finds little evidence of the impaired provincial fiscal position that could necessitate fiscal adjustment, except in the case of higher expenditure accruals[7]. This is a result of strict enforcement of budget rules to prevent provinces from overshooting their budget. Provincial fiscal adjustments are mainly channelled through the national cuts or additions made to the provincial fiscal transfers. Provinces attribute the source of their fiscal strain to inadequate transfers and therefore propose additional resources as an adjustment factor. The national government is of the view that revenue adjustment measures should be preceded by efforts to improve management and spending efficiencies (personnel and procurement) within the health department. There is therefore no consensus between the national government and provincial health departments on the interventions required to address the pressure.

Recommendations

In the context of a constrained fiscal environment and the current fiscal pressure, this study concludes that non-fiscal adjustments, in the main, must out of necessity be utilised to drive budget efficiency. The following recommendations are made:

1) *National and provincial treasuries should develop a framework or criteria for determining serious financial strain with clear measurable financial and non-financial factors that can be monitored, reported and used to trigger automatic fiscal adjustment. Such adjustments should be overseen by the provincial legislature.*

2) *The National Treasury and the Department of Health should allocate part of the 2018/19 MTEF health infrastructure allocations to gradually set-off expenditure accruals which have arisen because of unavoidable demand for which allocated budgets were depleted and if efficiency in managing the problem can be identified.*

[7] The fiscal strain is hidden in the provision of health care services – which may include comprising the quality of services.

3) *The National Treasury should ensure that the framework for health infrastructure conditional grants (Health Facility Revitalisation Grant and National Health Insurance (non-personnel component)) accommodate flexibility during periods of protracted fiscal constraint so that provinces can be allowed to re-orientate their package of available capital allocations towards maintenance.*

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