CHAPTER 7

Managing the Provincial Wage Bill to Contain Fiscal Stress and Build a Capable State

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7.1 Introduction

In the past[7], the Commission has highlighted the risk to fiscal sustainability posed by the potentially negative impact on service delivery of the rapid rise in public sector wage bill relative to expenditure on complementary inputs required to deliver services effectively. The public sector wage bill has consistently constituted the largest component of Government's current expenditure. Reasons for this are varied: annual cost of living adjustments coupled with promotion and job re-grading; the increase in employee headcount; the introduction of the occupation specific dispensation (OSD[8]); poor internal controls (poor management of the antiquated personnel salary (PERSAL) system); lack of critical skills resulting in headhunting, which is often expensive; appointments made without proper planning and budgeting, and poor organisational design (strategic plans not aligned with organogram); policies initiated at national level with insufficient regard to the resulting enormous financial implications on provincial administrators; the equalisation of service conditions (salary increases for low-income earners); and the influence of trade unions, coupled with weak management, on the outcome of wage-bargaining agreements.

Provincial government functions such as education and health are particularly labour intensive, and therefore expenditure on compensation of employees is a major cost driver. On the one hand, provincial governments are responsible for remunerating their employees for conditions of service, which are centrally determined through collective bargaining and over which provinces have no control. On the other hand, in contrast to collective bargaining that is centralised within the national sphere, budgeting for personnel costs is decentralised to provincial departments, as part of their allocations received through the Provincial Equitable Share (PES).This disjuncture – between the setting of wage levels at national level and the budgeting for personnel costs at provincial level – is sometimes perceived as encouraging fiscal irresponsibility on the part of provinces. However, for provinces, the PES is also considered inadequate to cover the full carry-through cost of remuneration decisions taken at national level. Furthermore, national initiatives such as OSD may be implemented in widely varying manners across provinces, contributing to personnel spending pressures.

Public spending growth needs to be moderated as the economy recovers, in order to stabilise growth in the medium-term public debt. An important issue to consider is the composition of public expenditure. If the aim is to promote growth, development and economic activity, as is the case for most economies, the focus should be on the more productive items of the budget, such as investment in capital. Therefore, the social spending components of the budget in South African provinces need to be assessed, to ascertain their effect on economic activity. The focus on the provincial sphere is warranted when considering that provinces in South Africa are responsible for the bulk of Government's social spending.

A key determinant of progress in managing personnel expenditure is the ability to achieve an efficient mix of spending on personnel, capital, and goods and services (National Treasury, 2012). Without this balance, service delivery will be compromised – for example, there could be teachers but no learner support materials, medical personnel but no medicines, etc. Furthermore, even within personnel expenditure, an appropriate skills mix is needed – a balance between core frontline delivery staff and support staff – as well as appropriate allocation of posts between head offices, district/regional offices and delivery institutions (clinics, schools).

[7] For example, in its Submission on the 2010 Medium Term Budget Policy Statement (FFC, 2010), the Commission raised concerns about the rising personnel budgets and indicated the risk of creating perverse incentives by rewarding provinces that fail to contain their personnel expenditures through increasing their budget allocations.

[8] The OSD emanated from the resolution taken in 2007 by the Public Service Coordinating Bargaining Council, introducing a new dispensation of revised salary structures that are unique to specific skilled occupations such as educators, health professionals and certain categories of professionals. The aim of the OSD was to improve Government's ability to attract and retain skilled employees through improved remuneration.

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This chapter examines the underlying drivers of the growth of the provincial wage bill in relation to increases in staff numbers, vacancy rates versus scarce skills, value for money (commensurate with productivity), the effect of wage-bill expenditure on economic growth and, lastly, complementary inputs (such as textbooks or medicines).

7.2 Legislative, Policy and Budgeting Arrangements Influencing the Public Sector Wage Bill

7.2.1 Legislation and Policy

In line with constitutional principles, certain legislation and policies govern matters related to the public service administration. In addition to labour legislation regulating the private sector[9], legislative frameworks specific to the civil service include the Public Service Act (RSA, 1994) and the Public Service Amendment Act (RSA, 2007). The latter provides mainly for the organisation and administration of the public service and clearly states the responsibilities of the Minister of Public Service and Administration. These include establishing norms and standards related to public service functions[10], which are all subject to the Labour Relations Act and any collective agreement. The Public Service Regulations (RSA, 2001) regulate in detail persons employed and institutions governed in terms of the Public Service Act. They stipulate that, when determining a public service employee's salary, available funding, the employee's performance, recruitment and retention of appropriate skills, collective agreements and job evaluations need to be taken into account. The regulations also prescribe a timeframe for filling funded vacant posts: once advertised, funded posts must be filled within a year. The Public Service Act does not explicitly contain any consequences for non-compliance, apart from stating that if a department fails to comply with the regulations, reasons for non-compliance need to be recorded in writing.

Further, recognising that provincial departments are legal entities in their own right, the Public Service Act and the Public Service Amendment Act transferred the executing authority to ministers (in the case of national departments) and to Members of Executive Councils (MECs) for provincial departments. However, concerns raised when the PSA was passed were: (i) the Act gave considerable personnel powers to ministers and MECs, which could lead to circumstances where senior officials, mindful of their job security, pander to the needs of their political superiors and compromise, at the expense of rational policy decisions. (ii) the powers of the provincial director general were reduced (Cameron and Tapscott, 2000) (iii) entrusting ministers and MECs with personnel appointments may create an incentive for purging existing officials and putting in place a new management team every time a new Minister or MEC takes office; this disruption in the political–administrative interface would have a very negative impact on a department's ability to deliver services.

In addition to the arguments above, Fifield (2008) notes the functions of the Minister of Public Service Administration as stated above and those of the executive authorities (MECs, premiers, ministers), which include organisational structure, appointments and promotions. With the appropriate delegations from their executive authority, heads of departments can also establish departmental policy on human resources management.

The regulatory framework for human resource management laid out in the public service regulations should be read with the Public Finance Management Act (PFMA) of 1999 and its regulations. These require the Accounting Officer to establish a system of controls to ensure that any human resource decisions with financial implications are affordable in terms of the department's budget. Enforcing this regulatory framework is crucial for those provincial departments that spend beyond their established, approved employment structures or funded vacancies, to ensure that spending on employees' compensation is consistent with approved budget plans. This is because these expenses are mainly driven by province's own decisions. In line with the legislation currently in place (e.g. PFMA), accounting officers must be held accountable where these powers have been delegated to them.

Tensions with the PFMA are created when executing authorities have not delegated human resource functions to their accounting officers. Under the PFMA, accounting officers are held accountable for personnel spending over which they have little control. Accordingly, the National Development Plan

[9] Labour Relations Act (1995), Basic Conditions of Employment(1997) including Amended Basic Conditions of Employment (2004).

[10] Organisational structures, conditions of service, public sector reform and other related matters.

2030 has proposed that the Public Service Act be amended to locate human resource management with the Accounting Officer (departmental head), which would both resolve this tension and expedite the filling of vacant posts by streamlining the appointment process.

7.2.2 Public Sector Wage Bill and Financing

South Africa has not been immune to public sector pay and employment pressures. In fact as far back as 1995 South Africa was among the world's biggest spenders on public service salaries, the second highest of the 17 countries that fall within the World Bank's middle-income category (Cameron and Tapscott, 2000). Since then, the expenditure on personnel as a proportion of total budget has been on the increase. The challenge facing South Africa is not about the size of the public service *per se* but rather the affordability of public sector employment (Cameron and Tapscott, 2000). The Presidential Review Commission (1998) noted that the salary issue is often confusing: on the one hand departments constantly refer to the failure to attract high calibre skills due to poor salaries, while on the other hand salaries are growing constantly.

The public sector wage bill has escalated over the past 10 years, accelerating above average inflation (Pillay, 2010). If this trend continues, the wage bill may become unsustainable and potentially crowd out other expenditure items also needed to deliver public services. The introduction of the OSD is a reason cited for this trend. Higher-than-budgeted wages could have negative effects on the fiscus because of the carry-through effects over the medium term expenditure framework (MTEF) period that may become unsustainable (Pillay, 2010). This has the potential to undermine government fulfilling its mandate of service delivery provision. To address this, some of the measures that can be explored include: the need to link salary negotiations with wage growth and productivity; the impact of the rising wage bill in relation to employment policy; and the need for Government and trade unions to discuss putting in place performance management and rewards systems, which aim to improve the efficiency, effectiveness and quality of the public services (Pillay, 2010).

7.2.3 Public Sector Wage Bill and Staffing

The Organisation of Economic Cooperation and Development (OECD) considers the proportion of the labour force working for Government as one indicator of how public services are being delivered in a country and an important factor determining the costs of service delivery (OECD, 2010). A large proportion of the labour force working for Government could also crowd out private sector employment. Lindauer and Nunberg (1994) argue that most governments tend to expand employment even when in fiscal crisis, for reasons that include: employment guarantees for graduates, a rapidly growing labour force, rising urban unemployment, macroeconomic crisis effects, and political pressures that are often compounded by the election of a new administration. The latter would rely on their power of appointment to reward supporters, as a form of loyalty, which often results in excess political patronage.

In the South African context, bargaining councils have been the pillar of collective bargaining. The rise in the number of workers covered by bargaining councils was largely driven by the introduction of public sector councils: during the first decade of democracy in South Africa, bargaining council coverage rose rapidly in the public sector, while the private sector saw an erosion of coverage (Bhorat et al., 2009).The expansion of the public sector wage bill in South Africa is closely associated with trade unionisation: about 76 per cent of the public sector and only 24 per cent of the private sector workforce belong to a trade union. Furthermore, over the past decade government employment has grown, while employment in the agriculture, mining and other primary sectors has fallen. South Africans are twice as likely to be employed in the public sector compared to 40 years ago, while more people are receiving social welfare grants than are employed (UASA, 2012).

7.2.4 Public Sector Wage Bill and Administrative Inefficiencies

The Auditor-General (2000) found some severely inadequate internal controls over the compensation of public servants:

- Payments were made to deceased staff members, and salary payments were not cancelled on time, resulting in over-payments.
- Payments were not cancelled timeously after the termination of service and so were not effected on time in the PERSAL system.

- The non-integration of the PERSAL system meant that multiple appointments could be made, allowing staff members to be appointed and paid by more than one department.
- Staff members over the age of 65 were still employed by the provincial departments.
- State guarantees of staff members who had resigned often were not covered.
- Some users could enter and approve their own transactions on the PERSAL system.
- In some instances, authorisation was not required either for the creation or cancellation of posts.
- Duplicate payment systems existed to staff members with the same identity or PERSAL number.
- Controls were not in place to ensure that service terminations were processed within a reasonable time in order to prevent double payment.
- The reliability and integrity of data on the PERSAL system was questionable because of shortcomings regarding the validation of system-generated identity numbers.

The Auditor-General made recommendations on corrective measures to be taken to remedy these shortcomings to the accounting officers, National Treasury, national and provincial departments. Subsequent reports by the Auditor-General indicate that various systems were implemented to address those shortcomings. However, the reports do not state whether actions were taken against the accounting officers and heads of departments responsible. Furthermore, an investigation into provincial departmental operations uncovered extensive administrative malpractices, poor delegation and coordination, as well as the employment of large numbers of supernumeraries and fictitious or ghost employees (Cameron and Tapscott, 2000). Another major impediment to the implementation of policies at national level is the deficiencies in policy analysis skills and practices, which are essential for improving performance. These findings clearly indicate that increases in the public sector wage bill are further intensified by inefficiencies in the administrative processes.

7.2.5 Public Sector Wage Bill and Productivity

Since the late 1990s, public sector wages in South Africa have been a point of contention between the government and trade unions. In July 2012, for the first time the government and trade unions reached an agreement, which stipulates in advance the annual increases (inflation rate plus one per cent) to be received by the public sector workers for the years 2013 – 2015, thus introducing an element of stability to public wage growth. This wage settlement was a victory for the negotiation processes. However, issues of sustainability cannot be ignored. Unless the one per cent increase is accompanied by a similar increase in productivity, the public sector wage bill to government expenditure ratio will deteriorate because of increased labour costs (Morton and Blair, 2012).

According to international literature, a number of productivity measures can be used, and their feasibility is often determined by the data available. The most common ones are (a) single factor productivity of labour or capital, based on value added or gross output and (b) multi-factor productivity based on a combination of labour and capital (OECD, 2010). Public sector productivity has generally not been extensively researched in South Africa. Recent attempts to measure productivity raised serious methodological questions regarding the measure and the approach adopted. Nevertheless, both estimations suggest that public sector productivity is significantly below private sector productivity.

Typically, a real increase in wages would be expected to be accompanied by an increase in productivity. A more productive public sector would reduce the percentage of total expenditure spent on personnel, through a slowdown in the growth of personnel numbers over time. However, over the years personnel numbers have in fact increased steadily, reaching over one million employees (National Treasury, 2012).

Despite recession in 2009 and tepid recovery in 2010, real wages in South Africa continued to increase rapidly, outpacing the growth in labour productivity. This misalignment of real wages and labour productivity reflects the outcomes of the collective bargaining framework in South Africa, which not only contributes to the weak link between pay and productivity but also reduces the responsiveness of the real wage to fluctuations in the business cycle.

Labour laws in South Africa limit the ability of government departments to scale down employment when necessary in the short term. Technological advances and streamlining business processes (such as the computerisation of certain processes in key sectors like education and health) could enable costs to drop over the medium to long term through, for example, reallocating redundant staff to existing vacant posts elsewhere.

7.2.6 Social Spending and Economic Growth

Assessing the impact of fiscal policy on the economy requires a deeper understanding of the relationship between public expenditure and economic activity (growth), specifically whether government spending is a consequence rather than a cause of economic growth. In addition, understanding which type of public expenditure affects growth can help in redirecting public spending (including which components should be limited) during fiscal consolidation. Hence the social spending components of the budget in provinces and their effects on economic activity need to be looked at.

A focus on the provincial sphere is warranted, as provincial governments in South Africa are tasked with the implementation of social spending objectives and also responsible for the majority of government's social spending. Social spending is defined as the provision of benefits (and financial contributions) by public (and private) institutions to households and individuals in order to provide support during circumstances that adversely affect their welfare (OECD, 2010). The components considered here are provincial expenditure on education, health, social development and other social expenditure.

7.3 Findings

The research methodology comprises both descriptive analysis of trends and modelling. This section examines the public sector wage bill data and assesses the key drivers typically used to explain the upward spiral of total personnel costs. The assessment focuses on the interaction of the wage bill in five areas: personnel numbers, staff mix, productivity, salary notches, and social spending and economic growth. At a provincial level, the departments of education and health are looked at, as these departments have proportionately larger personnel budgets compared to other provincial departments. Health and education are labour-intensive in nature, and so any adjustments related to personnel will have a far greater effect than in other sectors.

7.3.1 Status Quo in Relation to the Public Sector Wage Bill

Over a six-year period, the total wage bill for the three spheres of government more than doubled, from R140 billion in 2003/04 to R290 billion in 2009/10. In relation to total government expenditure, the total wage bill amounted to 43 per cent in 2003/04 with a marginal decrease to 39 per cent in 2009/10. The MTEF projections show an increase to 41 per cent in 2012/13.

Table 25: Composition of the Wage Bill by Sphere (2003/04 – 2012/13) (in R'millions)

			Avge	
	2003/04	**2009/10**	**Share of Total Wage Bill**	**Real Annual Growth**
National	38.5	75.28	27%	6%
Provincial	80.85	171.21	57%	7%
Local	21.58	44.68	15%	7%
TOTAL	**140.95**	**291.17**		
Wage bill as share of Total Expenditure	**43%**	**39%**		

Source: National Treasury database, Commission's calculations

On average, the provincial sphere accounts for more than half (57 per cent) of the total wage bill, followed by national government at 27 per cent and local government at 15 per cent. Between 2003/04 and 2009/10, the real wage bill increased by an average of 6.85 per cent annually. National and the provincial government have a staff component of over a million employees under the Single Public Service initiative, with provinces employing about 73 per cent of all government employees[11] (National Treasury, 2012). Figure 16 illustrates personnel expenditure as a proportion of total expenditure by

[11] The creation of a single public service came out of a cabinet decision on 31 May 2006 and culminated in a legislative process to align and harmonise the operations of the three spheres of government. The objectives of the new model are to facilitate the mobility and deployment of public officials between spheres, standardise the work conditions, have uniform norms and standards for human resources, and create single service delivery points for citizens to access government services.

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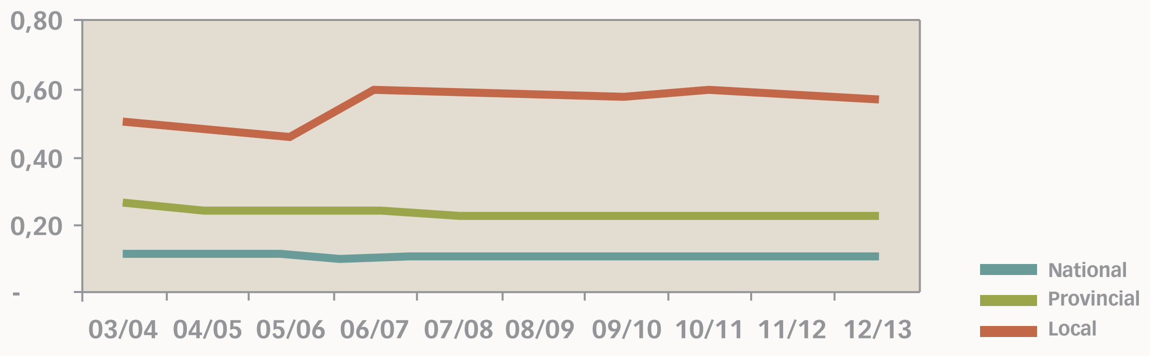
sphere between 2003/04 and 2012/13. Provincial government spent by far the most on personnel, with the proportion of total provincial expenditure increasing from 50 per cent in 2003/04 to 58 per cent in 2012/13.[12] A substantial upward adjustment for provincial government, from 46 per cent in 2005/06 to 58 per cent in 2006/07, resulted from under-spending on non-recurrent expenditure items. For national and local spheres, average marginal reduction in national and provincial ratios occurred from 2006/07 through to 2012/13.

Figure 16: Personnel Share by Sphere



Source: National Treasury, Commission's calculations

The functions assigned to each sphere are an important determinant of the magnitude of the personnel to total expenditure ratio. For example, national government typically sets policy and is typically not directly involved in service delivery (except for defence, justice cluster and home affairs etc.), and therefore would not be expected to spend the same proportion on salaries compared to provincial and local government.

Nevertheless, despite being assigned the labour-intensive education and health functions, the point to consider is whether provincial government is spending more of its total budget on personnel expenditure than it should be. In 2011/12 health and education combined accounted for 86 per cent of the provincial wage bill. The results from the status quo assessment show that, in the current economic environment, the growth in the real wage bill may be difficult to sustain. If the real wage bill continues to increase at the same pace, the share of spending allocated to social and economic priorities such as infrastructure and social security may be affected. The growth of the wage bill also coincided with the significant increase in the net loan debt, which climbed from R474 billion (36.8 per cent of GDP) in 2003/04 to R1.2 trillion (38.6 per cent of GDP) in 2012/13. Of concern is the possibility that failure to contain the wage bill could lead to increased inflation.

7.3.2 Factors Driving Rising Wage Bill

As mentioned, in a six-year period the total wage bill for the three spheres of government more than doubled. This section provides an overview of possible cost drivers of this wage bill increase.

Employment headcount

Government plays an important labour absorptive role in the economy, especially during economic downturns, when employment remains relatively stable in the public sector but generally declines in the private sector. The stabilising effect of Government in the labour market can moderate the recessionary effect on the economy through maintaining consumption levels.

As Table 26 shows, between 2004/05 and 2011/12, the total number of posts increased by an annual average of five per cent for education and six per cent for health. In 2011, the total headcount was nearly half a million for education and 329 253 for health. While permanent staff comprised almost 90 per cent of the total staff complement in 2011/12, since 2004/05 both departments substantially

[12] Table 2 shows the contribution of the sector wage bill to total expenditure for the main sectors for 1995/06–2011/12.

increased the number of contract and abnormal appointments[13]. Contract employees increased, on average, by 50 per cent per annum for education and 38 per cent for health. A similarly dramatic increase was seen in abnormal appointments for education (96.5 per cent average annual growth) and to a lesser extent health (23 per cent average annual growth).

Table 26: Total Posts Filled by Main Provincial Sector (2004/05–2011/12)

	May-04		Dec-11		Age Annual Growth	
	Education	Health	Education	Health	Education	Health
Headcount						
Permanent	340 544	215 533	440 467	284 867	4.19%	5%
Contract	2 843	7 864	13 021	28 794	51.14%	38%
Abnormal	3 873	5 063	30 053	13 288	96.57%	23%
Other	21 280	3 223	14 266	2 304	-4.71%	-4%
Total	368 540	231 683	497 807	329 253	5.01%	6%
Percent of Total						
Permanent	92%	93%	88%	87%		
Contract	1%	3%	3%	9%		
Abnormal	1%	2%	6%	4%		
Other	6%	1%	3%	1%		

Source: DPSA (2012), Commission's calculations

The substantial increase in contract and abnormal staff suggests education and health departments are adopting a strategy to expand the skill-set of its workforce in the short to medium term by using the flexibility and less onerous labour provisions that govern these positions.

Between 2003/04 and 2011/12 posts filled in addition to the staff establishment increased significantly, with the growth for health being more pronounced, at an annual average of 38 per cent. In absolute terms, education employed almost three times more permanent staff (19 519) than health (7 882). However, of concern is the number of temporary posts created in education, which amounted to roughly 54 000 in 2011/12, having increased by about 12 000 over the seven years.

Table 27: Posts Filled Additional to Approved Staff Establishment

	Apr-03		Dec-11		Avg Annual Growth	
	Permanent	Temporary	Permanent	Temporary	Permanent	Temporary
Education	11422	41995	19519	53954	9%	4%
Health	1954	1192	7882	1321	38%	1%
Total	13376	43187	27401	55275	13%	3%

Source: DPSA (2012), Commission's calculations

These unfunded additional posts are a drain on the fiscal resources of departments because resources have not been allocated as part of established organogram structures. Departments establish these posts for operational reasons, when additional functions or support are needed, but the organogram does not align with the new strategy.

[13] Abnormal appointments are positions that are filled but are not part of the approved organisational organogram.

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Staff mix

As yet, no agreed way exists of clearly demarcating administrative versus frontline staff in Government. Typically frontline staff are directly involved in activities or processes related to beneficiaries of public goods or services, whereas administrative staff support services that help frontline staff and ensure the organisation operate seamlessly. The combination of frontline and administrative (or back office) employees may vary from sector to sector. Although many managers are not directly involved in service delivery, they are supposed to play a strategic function and so are not considered back office staff.

Table 28 shows the staff mix for provincial education departments. Employees falling into employment levels 1–5 are defined as lower level staff, levels 6 – 12 as middle and 13 – 16 as senior.

Table 28: Staff Mix of Provincial Education Departments (2003/04– 11/12)[14]

EDUCATION	2003/'04			2011/12		
Provinces	Low: Middle	Low: Senior	Middle: Senior	Low: Middle	Low: Senior	Middle: Senior
Eastern Cape	0.16	161.48	995.0	0.20	242.95	1237.13
Free State	0.27	231.04	851.3	0.27	155.34	573.50
Gauteng	0.20	187.47	921.0	0.29	176.84	618.09
KZN	0.22	184.17	828.4	0.26	300.45	1163.68
Limpopo	0.08	124.62	1529.1	0.07	56.66	854.44
Mpumalanga	0.16	206.10	1257.2	no info.	no info.	no info
Northern Cape	0.34	155.27	454.7	0.28	79.79	285.03
North West	0.20	209.71	1053.9	0.14	88.88	657.27
Western Cape	0.19	140.49	734.5	0.2	150.73	630.73
Average	0.20	177.82	958.3	0.2	156.45	752.48

Source: DPSA (2012), Commission's calculations

The most significant movement over time is the ratio of middle to senior management, which declined from 958 middle employees for one senior manager in 2003/04 to 752 middle employees to one senior manager in 2011/12. This implies senior management is growing faster than middle employees at an aggregate level. Limpopo had the most significant decline, going from 1 529 in 2003/04 to 854 in 2011/12. Compared to the average, Eastern Cape is not employing enough senior managers, whereas the Northern Cape has relatively too many senior managers for the number of middle level staff employed. Until a benchmark for these ratios is established, definite conclusions are difficult to draw. Furthermore, comparing averages is a crude indicator, since the appropriate managerial numbers would depend on a number of other factors such as the specific delivery model being employed by the respective provincial departments among others. Table 29 shows the staff mix for the provincial departments of health for 2003/04 and 2011/12.

(See Table 29 on page 96)

[14] Information on staff mix in 2011/12 was requested but not received from the Mpumalanga Department of Education.

Table 29: Staff Mix of Provincial Health Departments (2003/04 – 11/12)

HEALTH	2003/'04			2011/12		
Provinces	Low: Middle	Low: Senior	Middle: Senior	Low: Middle	Low: Senior	Middle: Senior
Eastern Cape	1.23	156.08	126.88	1.12	69.36	61.72
Free State	1.21	80.21	66.09	1.20	41.64	34.56
Gauteng	1.41	97.46	68.88	1.35	28.57	21.16
KZN	1.63	232.54	142.62	1.89	77.28	40.83
Limpopo	1.41	215.07	152.87	1.49	72.48	48.48
Mpumalanga	1.49	294.70	198.22	1.43	88.50	62.07
Northern Cape	1.29	132.42	102.84	1.18	37.69	31.98
North West	1.63	291.53	179.18	1.41	78.29	55.45
Western Cape	1.11	120.75	108.38	0.97	21.88	22.59
Average	1.38	180.08	127.33	1.34	57.30	42.09

Source: DPSA (2012), Commission's Calculations

Between 2003/04 and 2011/12, the ratio of lower level staff to senior management and middle level staff saw major shifts. The rapid increase in the number of senior management is driving down both ratios in all provinces. Gauteng (21) and Western Cape (22.6) have the lowest ratio of middle employees to senior management, suggesting senior managers have fewer middle employees to supervise compared to other provinces, and these provinces have significantly expanded senior management personnel for health services. KwaZulu-Natal is also noteworthy, where in 2003/04 one senior manager was overseeing 142 middle level employees, compared to only 40 in 2011/12.

For health and education, the ratio of low level to middle level employees has remained relatively stable over time. This suggests lower and middle level staff operate in a proportional way. If the mix between lower and middle level staff is optimal, any change to lower level staff numbers will require a proportional adjustment to middle level staff to keep the staff mix unchanged. Although comparing staff mix between education and health is problematic, the number of senior management employed in education does appear to be less than desirable. It is also likely that reduced effort at control and supervision increases the probability of lower quality of services and staff productivity. Further work in these areas is required to determine appropriate normative benchmarks, differentiated according the specific sector, delivery model employed, service mix, quality and access norms.

Salary notch upgrades and promotions

Typically, when posts are upgraded, the skill-set required to function optimally in that position is increased, and hence the requisite salary associated with that post is also increased to a higher salary band or notch. The converse is true when posts are downgraded. In 2004/05 net upgrades in education amounted to 7 500[15], and thereafter remained negligible, apart from in 2009/10. For health, net upgrade of posts started off at 1 200 in 2003/04, then remained steady at around 750, until declining to 154 in 2011/12. Net upgrades imply that additional resources are put aside to fund the higher levels of pay associated with these upgraded posts. Both sectors have managed to keep the number of upgraded posts under control in the past few years.

[15] Net upgrade of posts is defined as the difference between the number of posts upgraded and the number of posts downgraded in a particular financial year.

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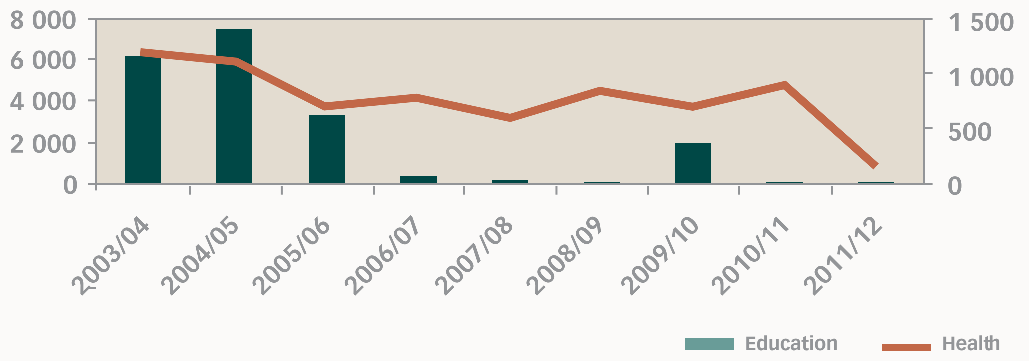
Figure 17: Net Upgrades of Posts – Provincial



Source: DPSA (2012), Commission's calculations

What is important is to monitor closely the low levels of net upgrades to avoid the costly effect of unsustainable net upgrades. Until 2008/09, the number of employees promoted to another salary notch declined significantly for education and health, and then increased in 2009/10, after the conclusion of the OSD agreement. The dispensation guaranteed a three per cent increment between notches and grade promotion every two years, subject to meeting performance targets.

Table 30: Promotions

	Apr-03		Oct-09	
	Education	Health	Education	Health
Promotion to Another Salary Level	16155	2554	469329	27766
Promotion to Another Salary Notch	286968	145779	353561	100088

Source: DPSA (2012), Commission's calculations

While promotions to another salary level rose steeply, especially for education, the figures should be interpreted with caution given the quality of data provided by provinces. Nevertheless, pay progression through salary and notch increases have contributed significantly to the increase in the salary bill in education and health.

7.3.3 Social Spending and Economic Growth

Table 31 presents the average shares of expenditure on compensation, goods and services, transfers and capital expenditure for the categories education, health, social development and other, by province. What is evident is that education and health departments spend very little on capital, and the major proportion of their budgets goes on compensation of employees. For social development, the bulk of the budget is spent on transfers, whereas the budget for "other" is spread fairly evenly between the different categories. The category "other" also has the largest share of capital expenditure (an average of about 20 per cent for the nine provinces) compared to education, health and social development. What is noticeable is that provinces show no stark differences in expenditures and their components.

(See Table 31 on page 98)

Table 31: Average Expenditure Shares in Total Provincial Expenditure on Education, Health, Social Development and Other (1995/96-2011/12)

	EC	FS	GT	KZN	LIM	MP	NC	NW	WC	Average
Education										
Compensation	88%	84%	80%	85%	87%	82%	81%	86%	82%	84%
Goods and Services	7%	7%	8%	7%	8%	12%	9%	8%	8%	8%
Transfers	2%	6%	7%	3%	2%	2%	8%	3%	8%	5%
Capital	2%	3%	4%	4%	3%	3%	2%	3%	3%	3%
Health										
Compensation	59%	62%	51%	60%	63%	57%	55%	63%	57%	59%
Goods and Services	23%	28%	34%	29%	24%	35%	33%	27%	29%	29%
Transfers	11%	4%	8%	4%	3%	3%	3%	3%	9%	5%
Capital	7%	5%	7%	8%	9%	6%	9%	7%	5%	7%
Social Development										
Compensation	25%	29%	20%	23%	25%	20%	29%	31%	19%	25%
Goods and Services	15%	12%	13%	16%	17%	21%	23%	17%	12%	16%
Transfers	58%	56%	65%	56%	49%	56%	46%	49%	68%	56%
Capital	2%	3%	2%	4%	9%	3%	3%	3%	1%	3%
Other										
Compensation	36%	39%	18%	26%	43%	32%	28%	35%	20%	31%
Goods and Services	22%	23%	23%	25%	21%	25%	31%	23%	31%	25%
Transfers	24%	20%	36%	23%	24%	20%	20%	27%	24%	24%
Capital	18%	18%	24%	26%	12%	23%	21%	16%	26%	20%

Source: Commission's calculations.

The effect on economic growth of the provincial public sector wage bill in the social sector was considered.[16,17] Disaggregated expenditure is important in the South African context, particularly given the government's commitment to moderate the growth in public sector wage bill and to redirect this expenditure to more productive uses. Therefore, total education, health, social development and other expenditure are divided into expenditure on compensation (i.e. the public sector wage bill) and expenditure on all other items excluding compensation (i.e. sum of expenditure on goods and services, transfers and subsidies and capital assets). Private capital formation and employment were used as control variables. The results reveal the following:

- Together with private capital expenditure, non-compensation expenditure for the social development and "other" categories has positive effects on provincial economic growth in the long run. The largest contributor to provincial economic growth (gauged by the coefficient magnitude) is non-compensation expenditure on the "other" category, followed by employment and non-compensation expenditure on social development.

- Compensation expenditure for the social development and "other" categories result in negative effects on provincial economic growth in the long run.

- Other variables were found to be statistically insignificant and hence have no effect on long-run provincial economic growth.

[16] Log(GDPi,t-1) = 1.818 + 0.025*Log(Education_all_otheri,t-1) – 0.309*Log(Education_compi,t-1)+ 0.377*Log(Health_all_otheri,t-1) + 0.196 *Log(Health_comp,t-1) + 0.272*Log(SocDev_all_otheri,t-1) – 0.728 *Log(SocDev_comp,t-1) + 0.940*Log(Other_all_otheri,t-1) – 0.407*Log(Other_compi,t-1) + 0.701*Log(Capitali,t-1) + 0.071*Log(Employmenti,t-1)+ ei,t-1

[17] The Technical Report (Chapter 2) contains a more detailed discussion of the research methodology and results discussed in this section.

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7.4 Conclusion

The rising provincial public sector wage bill in South Africa is a complex issue. Reasons for the increase range from annual cost of living adjustments coupled by promotion and job re-grading, increasing Government employee population, the introduction of OSD, vacancies for critical skills not filled (leading to appointment of contract workers and appointments being made without proper planning and budgeting) and poor organisational design. The analysis suggests that, in South Africa, increases in the wage bill do not necessarily translate into an increase in productivity, which is inconsistent with the international literature. This implies that other factors could play an important role in moderating the effects of personnel spending on productivity, such as the collective bargaining process that often results in higher salary increases than were assumed in the budget process negotiations, poor supervision and management of frontline staff, and lack of complementary equipment, supplies and infrastructure. Given that the South African government has committed to moderating the growth in the public sector wage bill, the effect of provincial personnel expenditure on economic growth becomes an important consideration. Based on the econometric analysis carried out by the Commission, expenditure on employee compensation at provincial level has no statistically significant effect on economic growth in the short run. The implication of the finding is that personnel expenditure could be reduced as part of fiscal consolidation without necessarily compromising economic growth.

This has to be balanced against the fact that provinces typically spend in areas such as health and education, which contribute both to long-run growth and broader social development. As a result, productivity increases within the existing quantum of personnel expenditure is also critical (e.g. by achieving a more appropriate skills mix), as well as the possible need to redirect funds from personnel expenditure to complementary inputs such as equipment and infrastructure to raise overall productivity. This implies policy adjustments should not only be restricted to personnel management and performance-based measures, but should also include exercising effective accountability, financial management, organisation reform and adherence to monitoring mechanisms.

7.5 Recommendations

With respect to the **provincial public sector wage bill**, the Commission recommends that:

- A transition over the medium to long term is required, towards a more appropriate balance between the wage and non-wage components of provincial budgets for social spending (starting with education and health). This should be in the form of national sector departments setting a norm or ratio of frontline versus administrative staff to total expenditure per sector and/or by specific occupational categories, and developing accurate and up-to-date management information systems to monitor employee compensation expenditure against those norms

- When human resources functions have been delegated to them, accounting officers are required to adhere to agreed staff establishment norms when filling posts. This requirement must be enforced through existing regulations and performance agreements. Furthermore, each accounting officer must be held accountable for establishing effective personnel spending controls, ensuring up-to-date and credible personnel information to act as an early warning, and for taking prompt corrective action when necessary.

- The capability of human resource functions within provincial line departments – to cost and budget for staff establishments, establish the necessary control systems, respond to Auditor-General queries, and manage financial and non-financial information – is enhanced. Provincial treasuries and Offices of the Premier should enhance their capacity to monitor, support and supervise management of employee compensation.

- Methods to improve productivity of health and education sectors are considered, such as computerisation of certain processes, reorganising and streamlining workflow, and organisational design. The non-wage components of provincial budgets should include adequate provision for health technologies and technologies for e-education (ICT) and supporting organisational innovations in order to enhance productivity in the social sector.